

# **The institutional impact of aid dependence on recipients in Africa**

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**WP 1999: 1**

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## Contents

Introduction	1
Definitions and Methodology	2
Sources of Aid Dependence	4
Sources of Effective Governance	7
The Institutional Impact of Aid Dependence	10
Project and Program Implementation	11
Finance, Budgeting and Planning	15
Tax Effort	18
Democratic Governance and Accountability	20
Managing a Transition From Aid Dependence	23
Mauritius, Botswana, and Eritrea	23
A Strategy for Reducing Aid Dependence	25
Conclusion	32
Appendix A	33
References	35

*Public institutions in Africa have run on imported energy  
rather than on domestically available resources.*

*Goran Hyden, 1990, 44*

Effective governance rests on a tripod base of good political leadership, capable public institutions, and societal expectations. The political leadership provides the vision and developmental goals. Capable public institutions translate vision and goals into plans, programs, and policies. Societal groups reinforce the vision and help ensure accountability. Aid dependency can affect all three of these. When a country is heavily dependent on aid, donor goals and vision can come to substitute for those of a country's leadership. Foreign experts and technical assistants substitute for public institutions, providing plans, programs and policies. The deep involvement of aid donors in the affairs of the government mean that accountability can become something between government and external actors, rather than between a government and its people. None of these outcomes is inevitable, but the experience of aid dependence suggests that these outcomes may be the rule, rather than the exception.

Aid was originally conceptualized as a gap-filling mechanism, enabling countries to access additional funding to supplement shortfalls in savings and foreign exchange (Chenery and Strout 1966). Over time, aid has expanded far beyond its original gap-filling role, becoming a large-scale and multi-faceted business, benefiting both developed and developing countries alike. In more than twenty African countries today, aid accounts for 10 percent or more of GDP. All of these countries are low income, and the effects of aid dependence are perhaps difficult to separate out from a constellation of problems -- including skill shortages, economic instability, and wrenching inequality -- facing many low income countries. At the same time, some countries with low incomes per capita are less dependent on aid than others, suggesting aid dependence is not simply a function of poverty. Outside of Sub-Saharan Africa, China, Vietnam, Pakistan and India are all examples of countries poor in income, but not generally considered aid 'dependent'.<sup>1</sup>

This paper addresses the possible impact of aid dependence on institutions in Africa. We focus primarily on the public sector, but also briefly address the impact of aid dependence on institutions in the private sector (firms and NGOs). The next section wrestles with the issue of defining aid dependence, and the methodological problems raised in trying to determine its institutional impact. We then briefly discuss sources of aid dependence in Africa. The fourth section considers the possible impact of aid dependence on the critical functions of the central government: raising revenues and budgeting; making and implementing policies, programs, and plans, as well as its impact on indigenous private sector and civil society

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<sup>1</sup>These countries all receive less than 4 percent of GNP in aid, and the experiences of aid agencies working in those countries suggests that they use aid as a relatively minor input into established government programs. They all have large economies, however, and high levels of aid as a proportion of GNP may also reflect the fixed costs of aid programs against small GNPs.

organizations.<sup>2</sup> The fifth section offers a strategy for reducing the deleterious impact of aid dependence on economic and political institutions in Africa.

On the positive side, high levels of aid (one measure of aid dependence) are associated with more extensive political liberalization in Africa in the 1990s, although, surprisingly, this relationship does not hold when political conditionality is applied. In some countries, aid dependence allowed governments to fund for a time a vision that led to increases in education and living standards for the majority of their people. Tanzania in the first post-independence years is such a case. In others, high levels of aid were accompanied by donor leverage that resulted in better policies in the short term, although there is no evidence that aid itself enabled these policies to be sustained in the absence of political commitment. In yet other countries, such as Mauritius and Botswana, initially high levels of aid helped build the development of local capacity, enabling them to 'graduate' from most bilateral aid programs.

But for other countries, and for Tanzania after the mid-1970s, the costs of aid dependence may have been unacceptably high. We argue that in the absence of effective, committed leadership, long-term dependence on aid can serve to neutralize internal pressures for more effective governance and to thwart the critical process of learning how to manage the complexities of governing. It also creates a specific set of institutional problems for governments.

The costs of aid dependence can include (1) institutional overload and capacity weakening; (2) loss of sovereignty and weakened ownership of policies and plans, with consequent sustainability problems; (3) revenue instability, repetitive budgeting, budget fragmentation, wage distortions, and lower tax effort, with serious implications for the management of monetary and fiscal policy; and (4) the undermining of accountability and democratic decision-making. The private sector in an aid dependent country is primarily affected by the 'crowding out' effect. Large amounts of aid enable a government to enlarge itself beyond the boundaries set by domestic revenues and to subsidize monopolistic state-owned enterprises (through the fungibility of aid funds). Through their tendency to appreciate domestic currencies ('Dutch disease'), large amounts of aid may lead governments to tighten credit policies and consequently squeeze private sector investment. Large amounts of external aid reduce incentives for indigenous NGOs to develop a dues-paying membership or local fundraising base, and by amplifying the 'voice' of external donors over that of other possible constituents, aid dependence affects accountability for NGOs just as it does for governments. We have to emphasize, however, that these effects are not inevitable, and much depends on the pre-existing quality of governance and the degree of 'developmentalism' in the leadership of an aid dependent country.

## **Definitions and Methodology**

This paper aims to examine the impact of aid dependence on economic and political institutions in Sub-Saharan Africa. We use the standard definition of aid used by the

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<sup>2</sup>We do not consider the impact of aid dependence on the judiciary in this paper, although this is an area that would benefit from research.

OECD's Development Assistance Committee.<sup>3</sup> Our own working definition defines aid dependence as a state where the level of aid becomes a *decisive* factor in the overall performance of the national economy. Aid dependence can be a function of the size and duration of aid, the type of aid, and the way aid is managed. In 1995, African countries raised about 16 percent of GDP in taxes and other revenues, but spending was about 25 percent higher on average (Stotsky and WoldeMariam 1997: 7), suggesting that for most countries, a sharp drop in aid would have serious repercussions. But aid dependence can also be 'a state of mind', as a Bangladeshi critic charges, 'where aid recipients lose their capacity to think for themselves and thereby relinquish control' (Sobhan 1996: 122). Finally, *aid dependence* was defined for this AERC/ODC project as 'a situation in which a significant diminution or elimination of aid flows over a short period of time would produce serious negative economic, political and organizational consequences for the recipient of that aid' (Lancaster and Wangwe 1998).<sup>4</sup>

*Institutions* can refer to organizations, or they can refer to the 'rules of the game' (North 1990) in a social system: the norms, codes of conduct, laws, and patterns of behavior that enable human interactions to have some degree of predictability. In our view, institutions are based on organizations, but are broader, encompassing laws, patterns of behavior and cultural values. For example, organizations such as political parties can become 'institutionalized', as they become embedded in and supported by laws, values, and social norms.<sup>5</sup> We are interested in the impact of aid dependence on organizations that construct budgets, manage economic policy, make decisions about program priorities, and carry out development initiatives. But we are also interested in the impact of aid dependence on the 'rules of the game', the processes and norms, codes of conduct, and patterns of behavior.

How can the impact of aid dependence on African institutions be measured? To start with again, isolating aid 'dependence' from a more general assessment of the impact of aid itself presents considerable problems.<sup>6</sup> But in addition to this, we lack precise measures of institutional quality, and there is no easy way to measure changes in institutions, for better or for worse.<sup>7</sup> Finally, there are intervening variables in the political environment that complicate any assessment of the direct relationship between aid dependence and

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<sup>3</sup> 'To qualify as ODA, a transaction must meet the following tests: it is administered with the promotion of the economic development and welfare of developing countries as its main objective, and it is concessional in character and conveys a grant element of at least 25 percent.' (World Bank 1997: 253).

<sup>4</sup> In another context, Wangwe has defined aid dependence as a condition where increases in aid reduce an economy's ability to generate self-sustaining growth (Wangwe and Lyakura 1998: 6).

<sup>5</sup> There is a long history of confusion and multiple use of these terms in the literature on Africa. See, for example, Arnold Rivkin's *Nations by Design: Institution Building in Africa*, Colloquium on Institution Building and the African Development Process, University of California at Los Angeles (New York: Anchor Books, 1968), which states "institution' and 'structure' are used interchangeably. Both are taken to mean *organizations, arrangements, relationships and practices*, of an established nature, having political, economic or social purposes, and accepted as legitimate by the preponderant number of people affected or concerned' (x). For a useful discussion of this issue, see Johnston (1998): 44-47.

<sup>6</sup> For a very useful recent analysis of the effectiveness of aid in Africa, see the case studies in Carlsson, Somolekae, and van de Walle (1997). See also Gwin and Nelson (1997).

<sup>7</sup> Some researchers have attempted to measure institutional development directly. For two examples, see Johnston (1998) and Andersson and Winai (1998). Both of these efforts are quite preliminary, and indeed Johnston notes that 'There remains a lot to be done before we have easily applicable methods for measuring institutional development ready to hand' (59).

institutions.

The only quantitative data we have on institutions is the by now well-known database that rests on measures compiled by political risk consulting firms. One version of this database was put together by The IRIS Center at the University of Maryland, and includes brief measures of institutional variables for 31 Sub-Saharan African countries, mainly for 1990.<sup>8</sup> The data are subjective and give businesspeople's ratings of the level of corruption, rule of law, and bureaucratic quality in each country, measures that might reasonably reflect a broad range of institutional variables. Only one African country had 'high' quality institutions (Botswana; Mauritius was not ranked). Twenty countries had 'medium' quality institutions, and the institutional quality of ten countries was ranked 'low'. The correlation between level of aid dependence (measured by aid as a percentage of GNP) and institutional quality is negative: -0.12. The correlation between aid dependence and per capita income is also negative: -0.45. But the correlation between institutional quality and per capita income is positive, at 0.408, suggesting that poverty and wealth may be more significant factors in determining the quality of institutions than aid dependence.

This relationship between institutional quality and income level presents one of the two major problems in any attempt to tease out the separate impact of aid dependence on institutions; the second is determining the intervening effect of political leadership. The impact of economic crisis and its accompanying institutional deterioration complicates analysis even further.<sup>9</sup> With the limited utility of the IRIS data, the scarcity of any other cross-country work on institutional quality, and the absence of survey data on attitudes (to measure psychological aspects of dependence) it is difficult for research on this topic to avoid relying heavily on anecdotes.

One way for the case studies to address this problem will be for researchers to ask standardized questions in all the case study countries. Interviews and archival work can be used to paint a picture of changes in these institutional relationships over the past several decades. Respondants can be asked to reflect on the impact *high levels of aid*, not simply aid itself, have had on institutional practices and the 'quality' of local institutions, and if possible to compare that impact with the situation in place before aid became such a large component of governmental activity. Questions that could be used in the case studies are included in an appendix to this paper.

### **Sources of Aid Dependence**

Why do countries become dependent on aid? Aid dependence has its source both in supply and demand. Aid dependence may be temporary. Countries recovering from civil war or other disasters may have a high percentage of public expenditures covered by aid for a period of time. But for too many countries in Africa, aid dependence has become a long-term fact of life, with roots in Africa's initially low skill levels, poor political leadership and patterns

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<sup>8</sup> The scale was composed from survey data collected by a political risk consulting firm: International Country Risk Guide. It is not clear if this was a random sample survey. Institutional quality involved three elements: corruption, rule of law, and bureaucratic quality which together provide a scale with a total of 18 points. High countries were ranked 13-18, and so forth.

<sup>9</sup> Thanks to Nicolas van de Walle who pointed this out, personal communication, June 30, 1998.



of neopatrimonial politics, the economic and debt crises since the 1970s, war and political instability, and the institutional inertia of international aid agencies.

The newly independent nations of Africa were not well-prepared for self-governance, and many faced ethnic tensions that had been exacerbated by colonial rule. Local skill bases were weak. Only six universities had been established in all of Sub-Saharan Africa, and in 1960, post-secondary enrollment levels were about one-sixtieth of those in Asia and Latin America. During their occupation of India, the British had established the Indian Civil Service, providing a dense network of several generations of well-trained civil servants with a growing tradition of meritocracy. Few countries in Africa had any comparable experience. In Nigeria, for example, only fifteen percent of the upper level civil service positions were filled by Nigerians as independence drew close (Mutahaba, Baguma and Halfani 1993: 82). In other countries, the percentage was even lower (Moore 1997). After independence, the move toward one-party states did little to strengthen local institutions. As Arthur Rivkin pointed out in 1968, 'the history of universities, courts, civil services, parliaments -- to say nothing of private or theretofore private voluntary groups -- in Africa has been one of subordination, take-over, and destruction by the one party. . . [this] has made it all but impossible for truly national institutions representative of and responsive to the total nation to develop and grow' (17).

With these multiple weaknesses, it was not surprising that many countries relied on aid funding for technical assistance and expertise. The extent to which this was the case is underscored by the experience of Côte d'Ivoire. In 1980, staff from the World Bank and the International Monetary Fund arrived in Abidjan to meet with the Ministry of Economy and Finance to negotiate the country's access to the IMF's Extended Fund Facility, and its first World Bank Structural Adjustment Program. At the Ministry in the meeting room where the all important negotiations were held, the IFI representatives found themselves on one side of the table; on the other side sat French advisers. There were no Ivorians at the table (Mule, 29).<sup>10</sup>

Perhaps understandably, many Africans and others labelled these aid relationships 'neo-colonialism.' But foreign aid also provided enormous political opportunities for some African leaders. Advisers and their projects and programs came with funding, vehicles and other expensive equipment, frequently constructed new housing for expatriates that would later be occupied by government officials, and fit usefully into patronage systems. Projects could be established in various regions of the country to reward followers (Bates 1981; Migdal 1988). Aid funding meant that governments did not need to make the politically difficult choice of raising tax revenues to pay for their growth, and because of the fungibility of aid, they had more flexibility to maintain economically costly but politically important subsidies, such as those to state-owned enterprises.<sup>11</sup>

The economic crisis that began in the late 1970s with a combination of oil price hikes,

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<sup>10</sup>Mule points out that by 1985, this situation had changed dramatically, and the Bank and Fund were by then negotiating with well-trained Ivoirian counterparts.

<sup>11</sup> In Tanzania, for example, subsidies to the country's state-owned enterprises and parastatals were the equivalent of 150 percent of government spending on health, or 72 percent of the education budget (World Bank 1995: 1).

commodity price drops, the accumulated impact of poor policies, and a slowing of world growth and demand proved a major watershed in Africa's experience of aid. Squeezed between their lower revenues (particularly from commodity exports, whose prices plunged) and higher costs (including debt finance), African countries became ever more dependent on aid. Frequent devaluations also made it difficult to capture the true impact of aid levels as a percentage of GDP, as the value of GDP expressed in dollars was constantly shrinking. In one of the more extreme examples, as Table 1 indicates, aid to Tanzania ballooned from 3 to 56 percent of GDP (measured in \$US) between 1970 and 1990. The stabilization and structural adjustment programs put in place to try and address the crisis contributed to a vicious circle of aid dependence and eroding capacity.

**Table 1: Indicators of Aid Dependency for Tanzania**

Year	ODA as a % of GDP	ODA as % of Exports	ODA as % of Govt. Expend.
1970	3	20	14
1975	8	79	37
1980	15	132	37
1985	8	170	26
1990	56	293	113
1995	23	80	N/A

Source: Bagachwa, et al, *A Study on Aid Effectiveness in Tanzania: The Case of Danish Aid*. Dar es Salaam, 1997 (for 1970-1990), cited in Catterson and Lindahl (1998: 19), and, for the 1995 figures, World Bank, *Global Development Finance* (Washington, DC: World Bank, 1998).

Note: These two sources may not use the same data.

As donors and lending agencies provided budget and balance of payments support, one of their first concerns was to stem the hemorrhage on the fiscal side. Dictating budget priorities and expenditure parameters externally cut away at one of the critical governance functions of African states. Budget and balance of payments support came with conditions that by their nature were choices governments would not otherwise have made, reducing their autonomy. Additionally, the severe restraints on the central budget and donor reluctance to support recurrent costs meant in practice that salaries for African officials plummeted in real terms even before any structural adjustment programs were put in place. In 1983, Nigerian salaries for permanent secretaries, the highest civil service post, were only 30 percent of their 1975 level, in real terms, while in Ghana, permanent secretaries saw their salaries fall to 11 percent of the 1975 level (Lindauer, Meesook and Suebsaeng 1988). Corruption increased, fueling donor demands for additional paring down of the state. In many countries, the combined impact of corruption and donor pressure to prune the state (trade liberalization, the elimination of marketing boards, etc.) weakened the state's critical capacity to generate revenues, adding to aid dependence.

A fourth factor promoting aid dependence is the high degree of political instability in Africa. More than half of the countries in Sub-Saharan Africa have had significant political

instability since independence, including civil war and violent coups (Collier and Gunning 1994). Political instability disrupts domestic revenue generation both because investment, production, and trade generally drop during the period of instability, and because tax collection becomes much more difficult. This, in turn, increases the dependence of countries on aid receipts.

Finally, aid dependence is also related to institutional imperatives and inertia in the international agencies established to assist developing countries. The present foreign aid regime has its origin in the vacuum left by the decline of colonialism, which meant that new institutions were needed to govern the relations between the developed and less developed world. The establishment of the United Nations, the Bretton Woods institutions, and a host of bilateral aid agencies marked a major shift in the patterns of interaction between the high-income 'north' and the low-income 'south.' At present, there are more than six multilateral agencies, more than 17 UN agencies that address development, more than 25 bilateral donors, and countless numbers of international NGOs, some of which rival bilateral donors in their funding transfers and programs. The poorest countries might attract representatives of *all* of these institutions. In many aid agencies, careers are made on the basis of loans and grants committed and disbursed. Yet even when their presence is clearly not leading to 'development' by any measure, it is rare that aid agencies leave a country. In this regard, perhaps the issue is not so much aid dependence, but aid 'interdependence'. Both donors and recipients are locked into a system that seems unable to produce development with consistency or predictability.

### **Sources of Effective Governance**

We will go out on a limb and claim that it is not really possible to have effective governance in the absence of any one of the three bases of good leadership, public institutions with technical and managerial abilities, and societies that provide the pressure for and expectation of a reasonably well-working state. How do countries reach this point? What are the sources of effective governance?

Good leadership can be serendipitous, where exceptional people are in the right place at the right time, but, particularly in the 'second generation' (or more) after independence, good leadership is also likely a function of having a broad base of well-educated, skilled people to draw from, a system of accountability that creates incentives to govern reasonably well, and the happy coincidence of a developmental vision that is technically workable. One can have a charismatic (and well-educated) leader like Tanzania's Julius Nyerere, whose vision of *Ujamaa* ultimately created such difficulties for his people. But one can also have a less charismatic figure like Mauritius's Anerood Jugnauth, who piloted his island nation through an economic crisis and into a prosperous period of broad-based economic growth, supported by a capable public administration and societal expectations for the continuation of growth in the context of a modified social democracy.

A capable public administration is also critical for the translation of good leadership into effective programs and policies. At the highest levels of economic management, it is critical to have a team of technocrats who understand the complicated interactions between policy choice and economy response. The line ministries need to be staffed by people who are skilled in their technical functions, and who are overseen by administrators skilled in public

management. Regulations and standard operating procedures governing the public sector need to be clearly promulgated and to offer incentives for behavior that supports effective planning and implementation. Statistical services need to provide the information required for monitoring and policy adjustment. Tax collection agencies need to be efficient and fair in their collection of the revenues necessary to fuel governmental programs. Transparency, regularized auditing and more broadly, a rule of law, are important for enforcing expectations of probity.

Society provides the incubator both for effective leadership and for a capable public service. Political scientist Robert Putnam's 1993 research on the sources of effective and responsive governance in North-Central Italy found that civil society -- the relative density of associational life and the concurrent social capital and trust created by membership in voluntary and social organizations -- accounted for a great deal of the positive variance in the quality of governance on the state (as opposed to the central) level in Italy. It is not surprising that this might be so, for after all, the state can be seen as a societal institution, and all its members and personnel are at the same time members of a society and affected by the norms, values, and institutions present in society.

It is important to emphasize the synergy among these three bases of effective governance. Although leadership matters, even the finest leaders can do little without the proper tools and resources, information, managerial and technical expertise, appropriate policy instruments, and revenues. The capacity of the public institutions that carry out developmental policies and programs depends on a societal base: policy networks that draw on the expertise of interest groups and non-state institutes, a broad base of skills which underpin effective government service, and an intolerance for abuse of the public trust. Organized social forces provide the incubator for effective leadership and good governance. Good leaders are themselves drawn from society, and hold a mandate to rule, as the ancient Chinese believed, only insofar as they govern both wisely and well.

Do high levels of aid dependence always undermine the development of good leadership, effective public administration, and social capital? Not necessarily. A combination of good leadership and policies that boost self-reliance can ensure that high levels of aid are well-used to promote a national development strategy. The experience of East Asia is instructive in this regard.<sup>12</sup> Both South Korea and Taiwan received high levels of aid from the United States government during the 1950-1965 period when they were most under threat from their Communist other halves.<sup>13</sup> In Taiwan, economic aid as a percentage of GNP between 1953 and 1963 amounted to about 7 percent of GNP, 38 percent of gross investment, and 40 percent of government expenditures. In Korea, economic aid over the same period averaged 13 percent of GNP, 96 percent of gross investment and 76 percent of government expenditure. Military aid in both countries was additional to these figures and was even greater than economic aid.<sup>14</sup>

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<sup>12</sup> Examples of African countries that have avoided aid dependence include Botswana, Mauritius, and possibly Eritrea, discussed below.

<sup>13</sup> Figures for aid cited in this paragraph are drawn from Jacoby (1967: 156).

<sup>14</sup> U.S. economic aid to Korea totalled about \$6 billion, and military assistance was \$7 billion (Bahl, Kim and Park 1986: vi); economic aid to Taiwan totalled about \$1.5 billion, and military assistance about \$2.5 billion (Jacoby 1967: 40, 118)

These high levels of aid differ from the high levels received by African countries in several respects. First, the U.S. was the only significant bilateral donor. This meant that neither country experienced the problems that occur when a country is highly dependent on aid, but that aid comes from numerous sources: difficulty in coordinating donors, conflicting messages and conditions, and the much higher transaction costs associated with multiple funding sources. Second, the 'aid ideology' and thus the content of U.S. aid in the 1950s and 1960s was different from that currently in vogue. And third, this aid did not create long term dependency.

In East Asia, the U.S. emphasized the building of institutions and productive infrastructure. In Korea, for example, U.S. aid financed the establishment of the joint U.S.-Korean Economic Cooperation Committee (ECC), and in Taiwan, the semi-autonomous Council on U.S. Aid, (later reorganized as the Council on International Economic Cooperation and Development, CIECD), and the Joint Commission on Rural Reconstruction. The ECC in Korea and the CIECD in Taiwan became centers for development planning, foreign investment coordination, and economic policy reform strategy and were maintained and strengthened after the termination of U.S. aid. The U.S. also used aid as leverage to implement extensive land reforms, particularly in Taiwan. Large amounts of aid in the 1950s were clearly helpful in Taiwan and Korea in repairing the infrastructure damaged during the war and the large commodity import program helped feed and cloth more than a million refugees. The early emphasis on infrastructure was modelled after the successful Marshall Plan used to help rebuilt war-torn Europe, and the electricity production, roads, and harbors financed by aid were critical for the competitiveness of exports, later.

In contrast, African aid programs in the first two decades after independence were influenced by new ideas emphasizing a more experimental (and ultimately unsuccessful) approach intended to meet the needs of the poor more directly, particularly through integrated rural development programs. By the late 1970s, one critic charged that 'projects intended to build the institutions or infrastructure of developing countries are now undertaken surreptitiously, if at all' (Cotter 1979: 107). Between 1960-69 and 1970-79, World Bank lending for infrastructure (transportation, telecommunication, electricity) in Africa shrank from 69 percent of loans to 39 percent (Kapur, Lewis and Webb, 1997: 696). Much of the difference was made up by a doubling of funding to rural development and agriculture, which might have been a good idea, except that the area development programs were highly experimental and in Africa, they were widely recognized to have largely failed (Hazlewood 1991: 137).<sup>15</sup> Donor-funded 'by-pass' organizations were established to more efficiently administer aid monies, but they were focused on particular projects, existed in multiple forms, and were generally divorced from regular government operations, rather than overseeing them.

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<sup>15</sup> The 1997 Kapur, Lewis, and Webb history of the World Bank's first fifty years notes that world-wide, 'The pace of the area-projects expansion was explosive. . . [lending for these projects] (in constant 1984 dollars) rose from \$14.4 million a year to \$556.4 million annually, which translates to an annual growth rate of 50 percent! . . . the *relative* concentration in Africa was striking; area projects altogether dominated the Bank's ARD portfolio for that continent. Further, the problems in the area projects category were typical of the difficulties that, during the McNamara years, beset the Bank's ARD work throughout most of Africa (415). . . In Africa... the Bank's interventions may have delayed the development of effective, self-reliant cadres and institutions' (421). The recent history of the World Bank's first fifty years notes that between 1976 and 1980, almost 60 percent of the Bank's agriculture operations in Africa were considered unsatisfactory (Kapur *et al*, 1997: 422).

Finally, U.S. aid did not create long-term dependency in East Asia. High levels of aid helped to finance an environment that enabled Korea and Taiwan to 'graduate' from dependence, while giving them the means to do so.<sup>16</sup> In Taiwan, economic aid from the U.S. terminated in 1965 after only 15 years, and Taiwan's membership in the World Bank, the IMF, and the United Nations ended in 1971 upon the UN's recognition of the People's Republic of China in Beijing as the official government of China. U.S. economic aid to Korea lasted a little longer, but that country also received a deadline and the same stimulus to diversify its sources of foreign exchange and investment capital. The knowledge that aid would be terminated helped push a leadership interested in legitimacy and survival to put more performance-oriented, export-directed policies in place, policies that assisted both Korea and Taiwan to fill their savings and foreign exchange gaps largely through domestically generated resources.<sup>17</sup>

### **The Institutional Impact of Aid Dependence**

The impact of large amounts of foreign aid can be either positive or negative for institutions and organizations in Africa. Many of the programs financed through foreign aid achieve positive results, and can strengthen agencies in and outside of the state through training, reorganization, and the provision of new technologies for data collection and analysis. Some countries such as Botswana and Mauritius have, like Korea and Taiwan, managed large quantities of aid with noticeably positive impact. We suggest below that the reasons for these countries' greater success with aid have to do with the quality of their leadership, as expressed in better policy choices and better management of the aid system from the early stages of aid.

In other countries, in the short term, the influence of aid donors and the aid they provide may even have prevented the breakdown of the state itself. James Fearon cites the case of Sierra Leone where aid dependency by many measures has traditionally been high (in 1994 aid amounted to 36 percent of GNP), giving the World Bank and the IMF enormous short-term leverage. Fearon argues that the 'international norms and institutions' that accompanied the aid reinforced those in the government who were opposed to the efforts by some politicians to let the state collapse into a series of 'private agreement(s)' with gem and mineral traders (128). This is clearly one possible institutional impact of aid dependence, to maintain the state itself as the primary institution of governance, in the face of internal and external pressures pushing for its collapse.

Yet aid dependence has the potential to have considerably more insidious institutional impacts. Aid dependence can exacerbate the problems of an underdeveloped administration. Long term technical assistance without skill transfer, and the external design of policies, programs, and projects, undercut the learning processes that new nations inevitably undergo, and when extended over time, are bound to promote apathy, resentment, and low levels of

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<sup>16</sup> One impact of the recent economic crisis in Korea is that the country has again become eligible for World Bank funding, after 'graduating' in 1994.

<sup>17</sup> The actual impact of the 'deadline' for a termination of aid in Korea is discussed in Bahl, Kim and Park (1986), Haggard (1989); and Woo (1991).

confidence among African civil servants. These can affect the norms, values, and patterns of behavior -- the institutional framework -- within which governments must operate.

Countries highly dependent on aid lack the leverage they require to manage their donors and reduce the 'tiedness' of their aid. Differences between the timing of different donor funding cycles and host government budget requirements, and failure of donors to report changes in project funding commitments and disbursements can lead to budget fragmentation, make a mockery of budget cycles, and undercut government efforts to gain control of expenditures. Perhaps most importantly, aid dependence can undermine the legitimacy of government leadership, the accountability that should exist between a government and its people, and the budding role of democratic decision-making. We discuss these potential institutional problems below as they arise in the context of specific institutions and practices: (1) project and program implementation, (2) finance, budgeting and planning, (3) tax effort, and (4) democratic governance and accountability.

### *(1) Project and Program Implementation*

Countries that are heavily aid dependent may find that large numbers of donors and projects make it much more difficult to manage national development. Multiple donors can lead to duplication of efforts and high transaction costs. Donor goals and vision often substitute for the goals and vision of the political leadership, reducing local ownership. Rather than being 'built', the institutions of a weak and aid dependent state may simply be by-passed. Finally, heavy doses of technical assistance can be hazardous for local capacity.

High Transaction Costs. High levels of aid dependence are generally associated with multiple aid donors and greatly increased transaction costs for government officials. Nearly 15 years ago an article by Elliot Morss (1984) commented on the 'institutional destruction' experienced by Malawi as it attempted to manage 188 projects funded by 50 different agencies, its development efforts reduced to trying to follow up on the continuous and different demands of this myriad of donors. Yet compare this with Zimbabwe in 1996 (91 aid agencies), Kenya in 1996 (2000 donor-funded projects), Tanzania in 1997 (1800 donor-funded projects) or Mozambique, with 405 donor-funded projects in the health sector alone!

Each donor has its own procedures, monitoring and evaluation requirements, procurement systems, commercial interests, and oversight missions. Merely servicing these multiple stakeholders requires enormous amounts of government time, often at the highest levels. In Ghana, senior officials were estimated to each spend as much as 44 weeks a year facilitating or participating in donor supervision missions (Sawyer 1997: 7). These high transaction costs of governing in an aid dependent context help explain why so many low income countries are unable to maintain control over aid.

During the 1980s, this problem worsened. Through a period that witnessed the partial collapse of the state in many countries, and the shifting by the World Bank of some of its funding to structural adjustment loans, donor projects continued.<sup>18</sup> World Bank adjustment

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<sup>18</sup> Except for one year (1990), adjustment disbursements at the World Bank never exceeded 28 percent of total disbursements (Kapur, Lewis and Webb, 1997: 536). The rest was disbursed to projects. The same source notes that the 'IBRD drastically cut lending [in Africa, at the beginning of the 1980s] for creditworthiness reasons' (747). The number of projects also declined by the late 1970s and early 1980s.

lending in 1985 came to only \$230 million, while program and project lending amounted to \$1800 million. In 1990, adjustment lending had risen to \$1260 million, but nonadjustment lending was \$2600 million (Lancaster, 1997: 165). As economic crisis lowered government's effectiveness in general and as the flow of aid funding exceeded the absorptive capacity of the country, donors faced a choice between reducing project aid flows until they reached a level that would be manageable by the government, or stepping outside of the government. They chose the latter course.

By-Passing Government. Instead of the slower route of working within existing institutions to build their capacity, donors frequently implemented their projects through temporary, semi-autonomous project management units that 'by-passed' weak government offices and civil service regulations.<sup>19</sup> The series of integrated area development projects in the 1970s and 1980s were particularly notorious for doing just this, but the practice is widespread even today. The rise of NGOs in the 1980s also contributed to the bypassing of dependent governments. By the early 1990s in The Gambia, more than 100 international and local NGOs were managing projects, and NGOs were responsible for more than 10 percent of external aid funding. (Bräutigam 1994b). In the short term, the use of NGOs allowed some communities to receive services, but NGOs clearly cannot substitute over the long term for an effective and capable government.

Semi-autonomous project management units (PMUs) allowed donors to supplement low government salaries and add benefits for officials seconded to the PMU. Managing development in this way is not doomed to ultimate failure. In fact, the highly successful U.S. aid program in Taiwan also funded a 'bypass' organization, the interministerial Council on International Economic Cooperation and Development, which also was able to pay higher salaries and recruit skilled staff (Jacoby 1967: 58-63). A critical difference, however, was that this bypass organization was valued by the government in Taiwan, and it did not take over the functions of the existing line ministries, but rather performed a coordination and planning role. The government continued to fund and maintain the CIECD after aid funding ceased. It became a key feature of the government, not something imposed from outside, and there was consequently no need to fold its functions back into the regular civil service. The government clearly 'owned' this strategy, which has often not been the case with similar bypassing in Africa.<sup>20</sup>

Ownership. Although 'ownership' is widely assumed to be a critical factor in development interventions, it is rarely defined in any rigorous way. The single exception appears to be research by Johnson and Wasty at the World Bank, who measured 'borrower ownership' using four independent variables: (1) locus of initiative, (2) level of intellectual conviction among key policymakers, (3) expression of political will by top leadership, and (4) efforts toward consensus-building among various constituencies (1993:4-5).<sup>21</sup> Their study

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<sup>19</sup> Some donors, such as Germany's GTZ, were early to recognize these problems and established their integrated rural development projects within the existing governmental ministry operations. See Bräutigam (1988).

<sup>20</sup> As a possible exception, it will be useful to follow the progress of the Free Compulsory and Universal Basic Education Program in Ghana, as described in Sawyerr (1997). It will be some time before it is possible to see if this effort at collapsing 16 donor bypass project implementation units into a single bypass Projects Management Unit bears sustainable fruit.

<sup>21</sup> Each dimension of ownership was rated according to four-level scale intended to capture the intensity of



determined statistically that ownership of reforms was strongly associated with the success of adjustment programs. In a similar vein, Brunetti and Weder (1994) found that a government's lack of political credibility strongly affects growth. If reforms are negotiated within a government, and between a government and its society, rather than imposed from outside, the process is likely to take longer, but affected groups are more likely to have had a chance to voice their concerns. This makes it more likely that a significant sector of the government (and the governed) will 'own' the reforms and also see them as more sustainable, and therefore more credible.

The rise of adjustment lending gradually legitimized an unprecedented degree of external ownership of policy decisions normally made by the political leadership of a country. In many ways, structural adjustment programs and the budgetary support they provided might have been a capacity-building and institutional-strengthening initiative. Indeed, African leaders had been calling for a shift from project to more flexible program aid. However, the sense that these were crises that needed to be addressed urgently, as well as the well known ideological differences between African policy elites and the International Financial Institutions (IFIs) in Washington meant that the IFIs frequently wrote African governments' adjustment programs and brought them to Africa.<sup>22</sup> Although African participation in structural adjustment program design has been improved in the 1990s, many governments experienced a loss of sovereignty and consequently weakened commitment to programs imposed from outside.

The lack of ownership was not limited to adjustment programs. The increased use of project management units reduced government officials' sense of ownership of projects. When the World Bank began to encourage member countries to produce National Environmental Action Plans (NEAPs) in 1987, many low income countries were slow to take advantage of the assistance offered by the Bank. Frustrated with the slowness, and eager to show progress in environmental matters to forestall its critics, the Bank then 'compelled IDA governments to complete their NEAPs by June 1993', a decision that effectively led to the hurried preparation of NEAPs by NGOs and outside consultants, with little government ownership (Dorm-Adzobu 1995: 29). Countries eligible for IDA funds are, of course, generally those that are most heavily aid-dependent.

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Although the World Bank was at the forefront of those emphasizing local ownership as a critical component of effective lending, the Bank has been slow to act to change its own practices. Within the Africa Region of the Bank, for example, recently revised guidelines take it for granted that Bank staff will be writing concept papers for projects themselves, rather than reacting to needs identified and proposed by African governments. 'No set measures are prescribed for making sure that borrower nationals are involved and committed

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ownership. For example, at the highest ownership level for 'locus of initiative', 'the initiative for formulating and implementing the adjustment program was clearly the borrower's.' At the lowest level, 'the program was prepared by the Bank and funding extended, despite governmental disagreement and reluctance to implement some aspects of the program' (4). Surprisingly, this study appears to be the only cross-country empirical research testing the actual impact of ownership on development outcomes.

<sup>22</sup> There were certainly exceptions to this. Ghana's adjustment program was clearly written by Ghanaian government economists, for example. Outside analysts who wrote the recent history of the World Bank since 1945 called it 'an outstanding example of recipient ownership of macro reforms' (Kapur, Lewis and Webb 1997: 587).

at every stage of the project process' (Mule, 17). These low levels of ownership are likely also associated with low levels of state capacity.

State Capacity. African government's low capacity levels have multiple sources, and aid dependence is but one possible contributing factor (Bräutigam 1996). Particularly important is the impact of two or more decades of economic crisis and retrenchment. Staff layoffs and severance packages often induced the most capable staff to leave government, while working conditions for those left behind sank to appalling levels. But aid dependence also directly affected local capacity: through the erosion of state capacity by aid agencies who often hired the most qualified staff away from their government positions, and through ready provision of technical assistance (often without charge), undermining the incentives to develop capacity locally.

In many countries, salaries and benefits for local employees of aid agencies and NGOs are generally vastly better than anything the government can offer, and the working conditions approximate those available in Europe or North America. Some studies have pointed out that the leadership and staff of new development NGOs funded by donors were often formerly high level staff in related ministries (Meyer 1992). In Kenya, even though donors were complaining bitterly about the ineffectiveness of their counterpart training and education programs for Kenyan government economists, who refused to stay in the government once trained, John Cohen pointed out that 'it is primarily the donors who are poaching economists' trained under these programs (Cohen 1992: 500). Donors offered Kenyan economists staff positions at up to five times the starting salaries (plus benefits) they would have received in the public sector. For its part, the government failed to enforce a bond system it had instituted to avoid this problem. Cohen notes that aid agencies 'must come to recognize that it is pure sophistry to argue that even if Kenyans leave the positions they were trained for there is still a net increase in national capacity. Ending the dependence on advisors requires that those trained to replace them stay in their positions' (506). Efforts under the Special Program of Assistance to Africa (SPA) and the OECD's Development Assistance Committee (DAC) to develop guidelines that would halt these practices have apparently been ineffective (Engberg-Pedersen 1998: 218).<sup>23</sup>

On the other hand, the provision of technical assistance, often on a grant basis, reduces the incentives that governments like Kenya have to keep their skilled staff, either through enforcing a bond system, or through improving working conditions and salaries.<sup>24</sup> Not long ago the World Bank's former Vice President for Africa blasted technical assistance in a speech delivered at an African-American Institute conference: Technical assistance, he charged, 'is a systematic destructive force which is undermining the development of capacity in Africa. And most of this technical assistance is imposed, it is not welcome and there is no demand for it really, except on the donor side.'<sup>25</sup>

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<sup>23</sup> Apparently there has been some success in these efforts in parts of Southern Africa. Personal communication, Tor Halverston, Bergen, Norway, October 1, 1998.

<sup>24</sup> Given spending limits, the latter would have to be done through a deliberate, and politically challenging reallocation of existing resources.

<sup>25</sup> Edward V. K. Jaycox, 'Capacity Building: the Missing Link in African Development,' address delivered at the African-American Institute Conference on African Capacity Building: Effective and Enduring Partnerships, Reston, Virginia, 1993.

The more aid dependent a country is, the more it is likely to have this technical assistance imposed on it. For example, in 1993, technical assistance made up 42.6 percent of all aid going into Tanzania (Sobhan 1996: 119). When technical assistance is sought by a government to fulfil a clear 'felt need' – as, in the 19<sup>th</sup> century, the Japanese sought out British, Prussian, and American experts, and the Thai monarch sought out British advisers to supervise his revenue and expenditure restructuring – they are far more likely to retain the knowledge. Capacity building, like other development tasks, needs to be handed back to governments, to be planned, budgeted and financed locally.

## *(2) Finance, Budgeting, and Planning*

Relying on external sources for a large proportion of the government's budget can create a cluster of institutional problems for African governments heavily dependent on aid. Maintaining budget discipline becomes much more difficult when budget cycles of donors and their partners differ and when donors lack transparency. Budget fragmentation and repetitive budgeting become common. Budgets that are essentially aggregates of donor projects can easily become divorced from coherent planning and make it difficult for governments to adhere to their own priorities, particularly when they need to adjust the public expenditure program. Donor provision of counterpart funds may exacerbate rather than ease local funding problems. Donor imposed remedies such as cash budgets may worsen capacity weaknesses. Large and unpredictable aid flows can complicate macroeconomic management and may promote Dutch disease. In countries highly dependent on aid, where the budgetary apparatus has broken down, the policy framework and planning process may shift entirely to Washington, with targets, sectoral spending criteria, and benchmarks developed by the IFIs. Yet there is little recognition that one cause of the budget being in such disarray is the system of foreign aid itself.

Repetitive Budgeting. Repetitive budgeting occurs when the budget is continually made and remade over the course of the fiscal year. Investment budgets are less likely to be subject to repetitive budgeting, but many governments in Africa fund recurrent budgets this way, by default. Aid dependence exacerbates these tendencies. With up to a hundred donors, and hundreds if not thousands of projects requiring government cost contributions throughout the year, it is difficult for all recurrent expenses to be included in the budget. Donors' and governments' fiscal years rarely coincide. Donors may announce new projects at any point in the government's fiscal year, and new commitments by donors to projects and programs mean new expenses for the government budget. Supplementary budgets are routinely approved. This reduces the ability of planners to produce realistic estimates and weakens the incentives for staff to control spending. In Zambia's Second Republic, for example, officials gave up even trying to fit the budget to a plan, and the recurrent budget was funded entirely incrementally (Cromwell 1994).

Budget Fragmentation. High degrees of aid dependence may also exacerbate budget fragmentation. In an idealized budgetary process, the central planning and finance ministry prepares estimates of revenues, based on taxes and local revenues. Timely inputs from the line ministries help create the capital and the recurrent budget. With budget fragmentation, centralized budgetary control erodes, and portions of the budget are prepared at multiple levels, by different government units (Sekwat 1997). Ministries of finance and planning in

aid dependent countries are frequently already overburdened trying to negotiate pressing matters of debt rescheduling and macroeconomic balance. They lack the capacity to review and incorporate hundreds of donor projects into their plans. Donors then often negotiate directly with line ministries or even with regional or local governments, and disburse funds directly at those levels, even when budgetary centralization is formally required for aid projects. Projects are often implemented outside of any public investment program; the government may not even know of their existence (Nordås 1998: 24; Healy 1994: 253). Donors may report disbursements on their projects to their own governments, but not their host; the Chinese aid program has been particularly closed regarding the reporting of actual disbursements (Bräutigam 1998).

Aid dependence is never the only factor operating in these situations. The nature of a country's political institutions probably also makes a difference. There is some evidence that the experience of more socialist countries in Africa has led to stronger states, and greater control over the budget. Ethiopia and Tanzania reportedly suffer less from budgetary fragmentation and loss of centralized control (Klase and Mengitsu 1995).

Public Expenditure Control. Aid dependence can exacerbate problems of public expenditure control. There is some econometric evidence that expectations of aid themselves may induce weaker fiscal discipline in recipients (Svensson 1995). But large amounts of aid also affect budgets and fiscal stability directly. At times, unplanned projects announced midway through the fiscal year have forced increases of up to 50 percent in government investment budgets (Cromwell 1995:196). Commitments may not translate into disbursements. In these circumstances, budget exercises become more akin to exercises in magical realism than grounded in facts.

Foreign aid was originally designed as support for government investment or capital expenditures (substituting for savings) or as balance of payments support (substituting for foreign exchange earnings). But in heavily aid dependent countries, donor funds are programmed into both the investment and recurrent budgets. In 1993, Mozambique depended on donor funding for 61 percent of the recurrent budget (Wuyts 1995: 33). Almost all of these funds are tied up in projects, which require some level of local contribution. Countries in this position are then squeezed between the IMF's demands for fiscal rectitude, and government spending largely dictated by donors' demands for local cost contributions to donor-controlled projects.

In Mozambique, for example, the requirements for local cost contributions to several World Bank projects were projected to absorb the agriculture ministry's entire local funds budget allocation. The ministry tried to scale back these loan projects in order to free funds for local contributions to several grant-funded projects. But the World Bank threatened to give control over the projects directly to the ministry of finance and planning, while still charging the local costs to the agriculture ministry's budget (Wuyts 1995: 35). The ministry backed down. Dependence in this case created rigidities that made it more difficult for a government institution to establish its own priorities and to have the flexibility to adjust its spending. In other cases, governments don't even attempt to scale projects back. Projects create strong vested interests. They bring in vehicles, equipment, and sometimes salary supplements. On their side, donors naturally want their projects to continue, and it is likely that these projects are making net positive contributions for the moment, and so *even though the government*

*cannot possibly afford to sustain the project's benefits*, the investment continues, and the ministry again overspends.

Part of the donor response to local governments' inability to support the local costs of projects has been to supply funds via the import and local sale of goods from their home countries.<sup>26</sup> Proceeds from the sale of these goods ('counterpart funds') go to support the donor's projects. When the government experiences difficulties in supplying any of its committed contribution, counterpart funds often substitute. In these cases, although the government clearly cannot absorb this aid or sustain the investment afterwards, donors have arranged to also supply the government's contribution rather than terminate their projects. While in the short term counterpart funds used in this way allow a project to go forward, they have several adverse consequences. First, aid is tied twice, first to the particular imports, and second to the use of the proceeds.<sup>27</sup> Tying counterpart funds is costly, since tied aid is generally reckoned to add some 10 to 30 percent to costs (Jepma 1991). In addition, this entire procedure often takes place outside of the country's budget, causing difficulties for the management of expenditures.

Ultimately, funding the local resource gap through counterpart funds aggravates the problem it was intended to solve. Once completed, the new investment will continue to require funds for operation and maintenance, funds that the government almost certainly will have difficulty providing, due in part to the pressure from other donors for local funds for *their* new projects. The local financing gap thus widens. Only by providing counterpart funds through program aid, or direct budget transfers, can this problem be avoided (Agbonyitor 1997: 13).

Cash Budgeting. In recognition of their difficulties in managing expenditures, several countries have been persuaded to adopt cash budgeting, where the government spends only what is collected in revenues each month. However, this may only provide an additional incentive for donors to cover local costs for their projects outside of the budget, if they want the project to continue. Cash budgeting also means that governments still operate on credit, they simply force credit from their suppliers and from their employees, as there is often not enough cash to pay invoices and salaries at the end of the month. This creates morale and capacity problems in the civil service, as moonlighting increases. Another strategy donors have used to address the local financing gap has been to adopt a matching funds system, which supplies aid only on the basis of matching funds from the government. In Tanzania, this has 'created a strong incentive for revenue collection' (Catterson and Lindhal 1998: 20). In countries with low tax effort, this may be a viable strategy. However, the alternative of cutting back on donor funded projects and allowing the private sector to invest more of its profits may be a more sustainable strategy for low income countries.

Managing Monetary Policy. Aid dependence can affect the management of monetary policy in several ways. When the amounts of aid entering an economy are quite large, the unpredictability of concessional flows can affect an economy just like external 'shocks' due to a sudden drop or rise in commodity prices. Pressure to supply local funds for donor

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<sup>26</sup> These are generally excess commodities, such as United States PL-480 agricultural surpluses, although other donors, like the Chinese, have used these opportunities to establish markets for inexpensive consumer goods.

<sup>27</sup> Personal communication, Arve Ofstad, Bergen, Norway, October 8, 1998.

projects may lead to inflationary domestic credit expansion. Large aid flows can also create pressure on the exchange rate, in the manner of the well-known 'Dutch disease'. The experience of Ghana illustrates these problems.

Based on donor commitments, Ghana's 1992 medium term budget was built on expectations of a certain amount of external assistance. In 1994, shortfalls in disbursements amounted to 3.6 percent of GDP, creating a fiscal shock that reverberated for several years, since they had to be financed through domestic bank borrowing (Botchwey 1997: 24). Large inflows of aid also created symptoms of Dutch disease in Ghana. Stephen Younger (1992) has analyzed how the 'boom' of aid sharply expanded the foreign exchange available in Ghana, forcing the exchange rate to appreciate. Converting aid money into local cedis expanded the money supply. The government's major tool to counteract money supply growth has been to shrink domestic credit, primarily through tight credit policies for commercial banks. Younger argues that this tight credit helps explain the poor private sector supply response to Ghana's economic reforms. In this way, large amounts of aid can actually crowd out the private sector.<sup>28</sup>

Dependence on aid can also create upward pressure on public and private sector wages. In Ghana, and elsewhere where minimum wage rates are set by tripartite bodies made up of government, private sector representatives and trade unions, the high salary levels paid in donor-funded Project Management Units were cited as benchmarks for wage negotiations, as were the improved wage rates paid in the name of better incentives in the parastatal Revenue Authorities that often accompanied tax reform in adjustment programs. This upward pressure can make it tremendously difficult for governments to restrain expenditures.

### (3) *Tax Effort*

Without aid, governments in Africa would have to cut spending, raise taxes, or borrow from other sources. Chronically high levels of aid may diminish a government's incentive to make full use of its domestic resources for revenue generation.<sup>29</sup> Governments are likely to view the benefits gained from negotiating aid agreements as higher and the costs lower than domestic revenue collection, 'the latter task being both administratively more demanding and politically hazardous' (Sobhan 1996: 128). At the same time, the higher the proportion of aid in an economy, the lower the probable tax base. Imports for aid projects are usually exempt from import duties. Foreigners working for NGOs, aid projects, and aid agencies do not have to pay local income taxes. In Tanzania, a UNDP study estimated that the total for government wages and salaries (which are taxed) was \$100 million, while the salary bill for technical assistants supplied under aid programs (and not taxed) was \$200 million! (Berg 1993).<sup>30</sup> The relationship between taxation and aid dependency has implications not only for the institutionalization of a fair and efficient tax regime, but for fiscal policy and for the development of democratic institutions (Bräutigam 1991, 1996; Moore 1997).

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<sup>28</sup> Younger proposes that governments in this situation could manage their policies differently by tightening fiscal policy still further, and loosening monetary policy to foster private sector investment (1595).

<sup>29</sup> For an excellent analysis of these issues, see Moore (1997).

<sup>30</sup> The actual cost of the technical assistants (including benefits, transport, etc.) was \$300 million, or triple the government's wage costs.

A debate currently underway pits one group arguing that African countries need to reform their tax systems and ultimately increase their tax receipts, and another that argues that increasing tax effort would be 'both ludicrous and self-defeating' (Collier 1997: 54). The IMF, concerned with chronic revenue shortfalls, argues that African countries 'have significant potential for raising tax receipts by broadening the tax base, improving tax administration, and rationalizing the tax system' (Hadjimichael, et al, 1995: 44). Paul Collier, now research director at the World Bank, argues instead that tax levels in Africa are already high. '[R]etarding the growth process and inducing evasion, high taxation is delaying the buildup of the taxable base of the economy and so is delaying the time at which fiscal sustainability can be achieved' (56). He argues that aid should be used to substitute for taxation in countries with policies that support private sector development, enabling the growth of investment and building a base for more sustainable revenue generation after a time.

The empirical evidence is fairly contradictory on the actual impact of aid (and aid dependence) on tax effort. A 1994 study by Howard White showed that aid in general reduces tax effort, to the extent of reducing overall government spending. Conversely, research conducted with a sample of 18 African countries (Devarajan et al 1998) suggests that aid *increased* overall government spending and did not reduce tax effort significantly (although with a sample that includes just over a third of the countries in Sub-Saharan Africa, it is difficult to extrapolate these findings to the entire subcontinent). The tax effort implications of aid may vary depending on whether the aid is from loans or grants. A study examining these issues in the context of South and Southeast Asia found that loans increased tax effort (because they need to be repaid), while grants reduced it (Khan and Hoshino 1992:1486).

Do African countries make full use of their taxable capacity? A common estimate is that government revenues in developing countries probably need to be somewhere around 20 percent of GDP, although as Angus Maddison (1995: 65) has shown, this is quite a bit higher than government expenditures in Europe in the 19<sup>th</sup> century, which averaged 10 percent of GDP.<sup>31</sup> On average, the revenue raised by low and middle income countries in 1995 came to about 19 percent of GDP. The World Bank's *World Development Indicators* for 1998 has data on revenue for only 14 Sub-Saharan African countries. In this small sample, seven raised more than 20 percent, and seven raised less. The average for low income countries alone, however, was 10 percent (as in low-income, 19<sup>th</sup> century Europe), yet all but three African countries raised more than 10 percent of GDP in revenue. Another set of data collected by Peter Heller (1997) from unpublished IMF documents and staff estimates gives revenue levels for 29 African countries. In the most recent year, only 8 of these raised more than 20 percent of GDP in revenues. Heller called the tax effort in most of Africa 'disappointingly low' (39). Finally, Stotsky and WoldeMariam add an ambiguous note to the debate in their 1997 study on tax effort in Africa. This study measured tax effort as a ratio of tax revenues to a measure of taxable capacity calculated indirectly through the use of various proxies for the existing tax base of a country and 'other factors that might affect a country's ability to raise tax revenues' (1997: 10). Countries with a tax effort ratio above 1.0 (nineteen Sub-Saharan African countries) were thought to be making good use of their taxable capacity, those between 0.8 and 1.0 (eight countries) moderate use, and those below

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<sup>31</sup> Thanks to Hildegunn Nordås for pointing this out.

0.8 (sixteen countries) low use.

Does aid dependence affect tax effort? Table 2 suggests that the index of tax effort in countries for which aid makes up a smaller percentage of GDP is in fact likely to be above 1.0. Thirty-seven percent of the countries receiving less than 15 percent of GDP in aid had a tax effort index above 1.0, while only 10 percent of the countries with aid making up more than 15 percent of GDP were making good use of their available tax base. However, the correlation between the index of tax effort, and aid dependence (aid as a percentage of GNP) is  $-0.30$ .

Whether one agrees with Collier or with the IMF, it is clear that countries in Africa need a long term strategy for replacing the significant contribution aid makes to their public finances. Neglecting the development of domestic taxation may also have longer term implications for democracy building, as well as making fiscal sustainability an ever elusive goal. Throughout history, the imperative of raising revenues has generated pressures to build capacity in a number of institutions, from offices of the budget, to revenue bureaus, to legislatures. Aid dependence softens or removes those pressures, and reverses the direction of accountability.

**Table 2: Tax Effort and Aid Dependence**

Tax Effort (1995) <sup>32</sup>	Aid as % of GDP (1996)	
	0-15 %	Above 15%
Above 1.0	37 %	10%
Between 0.8 and 1.0	10%	7%
Below 0.8	20%	17%

Source: Stotsky and WoldeMiriam (1997).

Note: Only thirty SSA countries have measures both for tax effort, and aid as % of GDP.

#### (4) *Democratic Governance and Accountability*

The impact of aid dependence on democratic governance and accountability cuts to the heart of the relationship between state and society in Africa. Aid dependence can affect transparency and accountability, and it may contribute to the continuation of a 'strong

<sup>32</sup> Countries with a tax effort index above 1 in 1994-95, meaning that they were making better use of their tax base, were: Botswana, Lesotho, Namibia, South Africa, Swaziland, Zimbabwe, Angola, Burundi, the Comoros, Côte d'Ivoire, Djibouti, Ethiopia, Ghana, Kenya, Malawi, Seychelles, Tanzania and Uganda (35). Countries with a tax effort index below 0.8 during that period were Burkina Faso, Central African Republic, Chad, Equatorial Guinea, Guinea-Bissau, Madagascar, Niger, Nigeria, Rwanda, São Tomé and Príncipe, Sudan, Congo-Brazzaville, and Guinea (Stotsky and WoldeMiriam).



presidency, weak parliament' syndrome common in Africa. Finally, aid dependence may indirectly help forestall the development of national institutions that can speed adjustment to fiscal shocks. On the other hand, there is some evidence that aid dependence may be associated with greater political liberalization and democratic transitions in Africa (Bratton and van de Walle 1997: 219-220), although its impact on democratic consolidation remains to be tested.

Transparency and Accountability. Accountability ought to be primarily a matter between governments and their citizens, or NGOs and their members. Although the recent wave of democratic transitions may change this, aid dependence means that many African governments currently face more organized and effective pressures for accountability and transparency from the IFIs than from their own citizens and parliaments.

Accountability for the use of the public's tax money is one of the primary levers a society has for enforcing probity and for supporting consistency or change in the goals and vision formulated by their leaders. In Europe over the past century or so, taxation and disputes over the use of revenues stimulated the development of greater citizen rights and privileges, with democratic institutions enforcing accountability and greater transparency in expenditures. In many cases, aid dependence may thwart these processes in Africa.

In order to hold their governments accountable, citizens need information. In particular, they need published budgets and regular audits by qualified accountants. Off-budget expenditures (include off-budget aid funding) reduce transparency and make it harder for both the IMF *and* domestic groups to monitor government spending (Healey 1995: 253). In addition, countries that are heavily aid dependent have large sections of their public expenditure tied up in projects whose funds are controlled, monitored, and audited by the donor. Perhaps this in part accounts for the fact that many African countries have not developed the capacity to carry out extensive audits. Out of 20 African countries in a recent study, half had 25 or fewer fully qualified accountants in the entire public sector (Makanda 1995: 27).

Yet ultimately, accountability and other institutional strengths and failures are probably more affected by domestic political leadership decisions and the culture of politics than by aid dependence and capacity shortages. Only governments can institutionalize accountability. Tanzania has had an Audit Corporation (TAC) since 1968, supported by the Swedish aid agency Sida between 1978 and 1993. Yet despite 40-50 person years of technical assistance and a significant increase in Tanzania's auditing capacity, the Sida project was unable to improve public sector accountability in Tanzania, primarily because the Auditor General's office (considered 'extremely weak') has never used TAC, or indeed any outside firm, to audit Tanzania's government accounts (Catterson and Lindhal 1998: 76). The most meaningful reviews of Tanzania's accounts are done quite privately, through Public Expenditure Reviews conducted by the World Bank. On the other hand, Nigeria receives a very small amount of foreign aid as a proportion of GDP, and the country also has a large number of qualified public sector accountants (more than 800). Yet Nigeria's government produced its last audited public accounts in 1982 (Makanda, 1995: 31), suggesting again that other factors are probably more critical for explaining accountability than aid dependence.

NGOs and Accountability. Donor funding of NGOs, particularly membership-based associations, also risks breaking the links of accountability between members and officials.

A Zambian official in the Zambia Chambers of Commerce and Industry (ZACCI) interviewed by Lise Rakner (1998: 215) sketched this problem quite graphically:

Donor funding of ZACCI is wrong. It kills the organisation when we are forced to lick the boots of someone who is financing you. We should diversify and ZACCI must live within its means, organise seminars, get in subscriptions, hold conferences, simply we must make money. We are compromising ourselves by receiving donor funding... This is the dependency syndrome and it must be stopped as we are shooting ourselves in the arm.

Rakner charges that the level of donor dependency among NGOs in Zambia has created a 'precarious weakness' in civil society and exacerbated a 'patronage culture', creating 'limited attachment and commitment to the local membership' (253-54). If aid dependence has this impact on NGOs across Africa, the celebrated associational revolution may be in trouble.

Democratic Transitions. Aid dependence may have a positive effect on democratization. Bratton and van de Walle (1997) found in statistical analysis of 29 cases of democratic transition in Africa that 'the higher a country's relative level of aid flows, the more extensive were its democratization reforms' (219). Curiously, this effect was reversed if donors explicitly applied political conditionality. Bratton and van de Walle suggest instead that high levels of aid dependence interact with high levels of social protest. Governments more dependent on aid are also more vulnerable to citizen protests. Perhaps both vulnerabilities reflect other underlying weaknesses.

Strong Presidency, Weak Parliament. Across Sub-Saharan Africa, political cultures have produced 'presidentialism', political systems that overprivilege the formal and informal power of the chief executive.<sup>33</sup> Up until 1989, large amounts of aid (including balance of payments financing from the IMF) helped maintain presidentialism in single party systems like Zambia's 'longer than it would otherwise have survived' (Cromwell, 1995: 195). Despite requirements that often existed on paper that parliaments should approve budgets and projects, in practice donor funding frequently bypassed parliament's scrutiny. Parliamentary approval takes time, and donors joined with ministers in not taking the parliamentary role seriously, except in a very few cases (Botswana, for example, where the government required donors to take the rules seriously). Finance ministers presented their budget and plans not to parliament, but to consultative group meetings in Paris (Sobhan 1996: 197).

With the transition to democracy in many parts of Africa, presidentialism now faces a challenge from parliament. But the deeply engrained practices of presidential centralism and weak parliaments have proven difficult to change.<sup>34</sup> Aid dependence contributes to these

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<sup>33</sup> See the discussion in Bratton and van de Walle (1997): 63-65.

<sup>34</sup> Lise Rakner's 1998 study of democratization and economic reform in Zambia provides a compelling case study of the continuation of presidentialism in Zambia under democratic rule. See also the case of Ghana, where the 1992 Constitution stipulated that 'The Government of Ghana cannot contract a foreign loan without the approval of parliament.' Later the govt. amended this to allow for 'small foreign loans' which then allowed a number of agreements to be signed outside of parliamentary scrutiny (p. 367). George Ayittey, *Africa in Chaos* 1998. [Did gov. amend this, or parliament?]

difficulties through a distinctive political dynamic that revolves around the issues of accountability, the corrosive effect of dependence on the development of democratic institutions, and the resources aid provides for patronage. Bargaining over the budget and over tax policy is one of the primary ways in which different state and societal goals are reconciled in a democracy. One of the critical roles of a legislature is to address budget issues. This clearly requires that all actual and projected government spending, whether funded by donors or not, be included in the budget, so that legislatures can master its intricacies, and provide needed balance to presidential and ministerial. But aid dependent countries in which large amounts of project funding continue to be off-budget present a challenge to this aspect of democratic consolidation.

Democratic Institutions and Fiscal Adjustment. In more developed countries, research suggests that constitutions with tighter expenditure rules may promote more rapid adjustment to fiscal shocks (Porterba 1994: 799). This seems to be the case as well in Latin America (Alesina *et al* 1996). Institutions that promote fiscal probity can include rules that limit the size of the deficit, or the ability of governments to carry the deficit into the next budget. They may limit deficit financing to short-term debt, or require referendum before a government can issue bonds or undertake other long-term debt. In aid dependent countries, expectations that deficits will be met by foreign aid may stop these kinds of institutions from developing.

### **Managing a Transition From Aid Dependence**

Aid was never intended to be a permanent feature of the international political economy. Yet over the past fifty years, very few developing countries have ever graduated from the aid system.<sup>35</sup> In Africa, most countries have seen aid become a significant share of their GDPs, and 'all too often, African governments have found cozy accommodation with dependency, despite adopting the rhetoric of self-reliance' (Mule *et al* 1996: 7). Yet the rise in aid dependence and the loss of sovereignty and ownership are uneven across African countries. Decisions made at independence in some African nations paved the way for greater capacity and may have created a path dependence that enforced sovereignty and ownership. This happened in different ways in Mauritius and Botswana (Goldsmith 1998; Carroll and Carroll 1997).

#### *(1) Mauritius, Botswana, and Eritrea*

In Mauritius, even the World Bank (1992: 1) has commented on the high degree of local ownership of reform plans. This local ownership may have its roots in the experience of colonialism and independence, as well as in the institutions of Mauritian political practice. As Carroll and Joypaul point out, in Mauritius 'the process of 'nativization' had begun well

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<sup>35</sup> Different donors use different criteria for 'graduation'. For example, a number of countries including Korea, Belize, Botswana, and Mauritius have 'graduated' and no longer receive economic aid from the U.S. Agency for International Development. At least 20 low income countries have seen their incomes rise enough so that they no longer qualify for concessional funds from the The World Bank's IDA window. However, Barbados appears to be the only developing country to have truly graduated from the World Bank. Korea graduated in 1994, but is now again receiving World Bank funds. Taiwan's membership was revoked in 1971.

before independence' (430, 435). Only four British senior civil servants remained by 1971, just after independence. The rules of politics in democratic Mauritius support a high degree of continuity in the professional bureaucracy. Generally only cabinet-level offices are shuffled in political turnovers. Capacity levels are high in the bureaucracy, and the country supports a vigorous and lively democracy (Bräutigam 1997). In 1990, aid amounted to about 15 percent of central government expenditures, but by 1994, that figure had dropped to 2 percent.

Botswana followed a very different strategy, but with equally successful results.<sup>36</sup> Botswana and Mauritius gained independence within a few years of each other, but capacity levels in Botswana were far weaker. The country had only 22 college graduates, for example. The Botswana leadership made several decisions that have also reinforced the government's ability to manage aid resources. First, the government decided to make use of expatriate personnel in line positions in the ministries, replacing them only when local people were adequately trained to take over those specific posts. Expatriates generally occupy mid-level advisory and analytical positions, but not the high level decision-making posts. Technical assistance is assessed and used not on a project-by-project basis, but according to manpower development plans prepared sector-by-sector for the economy as a whole. If the technical assistance required for the plan is not available locally, or provided by donors or volunteer services (on request), the government advertises and hires international staff itself. Second, the government established a very strong Ministry of Finance and Development Planning, which constructs the country's six year development plans, prepares projects as needed (together with the appropriate line ministry), and *only then* matches projects with appropriate donors.<sup>37</sup> Line ministries do not negotiate directly with donors. All projects and programs must be approved by parliament. All aid money and local revenues are integrated together into the budget. The government is quite willing to reject offers of aid that do not fit within the plan.

Although Mauritius and Botswana are now relatively wealthy compared with other African countries, they did not start out that way.<sup>38</sup> Wealth does not appear to be highly correlated with ownership and effective aid management, at least not at the start. The new leadership of Eritrea, independent in 1993 after a decades long civil war, has stressed local ownership of projects and programs.<sup>39</sup> The country has refused to delegate responsibility for social welfare programs and village level development to NGOs, few of which have been invited in. Because Eritrea became independent without any debt, the World Bank has little leverage and along with bilateral donors, has been forced to fall in line with the plans and programs of

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<sup>36</sup> This discussion of Botswana draws on Maipose, Somolekae and Johnston (1997), Nordås (1998), Rakner (1996) and Nordås, Sekgoma, and Somolekae (1998).

<sup>37</sup> Despite very different cultures and histories, Botswana's institutional management of its aid relationships echoes the early experiences of Korea and Taiwan, which both established centralized economic planning boards. For example, the Economic Stabilization Board (ESB) in Taiwan, established in 1951, was chaired by the minister of finance, and was the only entity empowered to approve foreign and domestic loans to the government (Haggard, 86). The ESB was later replaced by the Joint Commission on Rural Reconstruction, and the Council on International Economic Cooperation and Development.

<sup>38</sup> Data from Africa Development Indicators on relative wealth in 1968 or so to be added.

<sup>39</sup> The discussion of Eritrea is based on personal communication from David Hirschmann, Washington, DC, February 1998, and on Norwegian Agency for Development (NORAD) *Annual Report for 1997*, Oslo: NORAD, pp. 16-18.

the government. The country's leaders are clearly affected by their analysis of aid dependence in other African countries, and have announced a goal of phasing out all foreign aid over time. As part of their effort to maintain self-reliance, Eritrea plans to eliminate all grant funding and accept only carefully selected loans for investments that fit into their development plans. One of these loans has already been concluded, for capacity strengthening of the central government. This experiment is well worth watching for its potential impact on sovereignty, local ownership, and self-reliant development.

These cases suggest that political leadership is a necessary, if not sufficient, factor in making effective use of aid and avoiding the possibly debilitating effect of high levels of aid. Yet given that most other countries in Africa have suffered instead from a combination of poor leadership and inappropriate and often self-serving donor responses, what can now be done to remedy the situation? What will promote changes in the norms, values, patterns of behavior – in local *and* international institutions – that have been so deeply affected by the incentives build into the current aid system?

## (2) *A Strategy for Reducing Aid Dependence*

A strategy for reducing aid dependence in Africa needs to proceed from several basic principles. (1) Aid *can* be helpful for development, supplementing domestic savings and foreign exchange earnings, as Chenery and Strout hypothesized long ago. (2) But aid is only as effective as the environment in which it is used. Research suggests quite strongly that aid given to governments with poor macroeconomic policies and political instability neither promotes growth nor human development (Burnside and Dollar 1997; Madavo and Sarbib, 1998). (3) The ambitions of donors in very poor countries have overshot local capacities by a large margin, creating unsustainable 'enclaves of development' divorced from local realities. At the same time, the lack of attention to the *collective* medium and long-term impact of premature and unsustainable expansion of government programs has created some of the fiscal problems that plague African countries. The role and reach of the state has to be proportional to the strength of the local revenue (tax) base, which suggests that only by building up the private sector will governments be able to sustainably build up the social sectors.

Donors are limited in what they can do with aid. There are no magic keys to unlock the door to development from outside; it only opens from within. Donors can train accountants, reorganize ministries, hold action-planning workshops with stakeholders, and use conditionality to try and force change, but when local norms and practices – local institutions – do not support accountability, rational bureaucracy, or participation, these will have little lasting impact. Institutions matter, and they matter more than donor-provided savings and foreign exchange.

The question then becomes: can aid be used to promote good leadership, good policies, and good institutions? And the answer to this is, probably not, at least not directly. To the extent that it can, this will depend on the strength of internal democratic forces. Conditionality has clearly failed either to produce lasting economic reforms, or to produce consolidated democracies.<sup>40</sup> The best foreign aid can probably do is to reinforce a leadership that is

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<sup>40</sup> For the impact of conditionality on economic reform in Africa, see the discussions in Johnson and Wasty

already committed. At the worst, because it is highly fungible, aid can maintain uncommitted governments in power longer than they would otherwise be able to stay.

We believe the aid system as it presently exists needs fundamental reform. Only then can the ownership of development initiatives be shifted back to African governments and their societies, where it belongs. Even though all involved recognize the problems multiple donors and NGOs are creating for countries dependent on aid, the existing incentives and demands make it difficult for countries to turn down offers of funding, or for donors to voluntarily concentrate on a single sector, align their procurement requirements with other donors, abandon 'tied' aid, or to simply wind down their programs and leave.

Below we outline several elements of a medium and long-term strategy for reducing the deleterious impact of aid dependence on African institutions. We advocate (1) *increased debt relief*, but at the same time, (2) greater *ex post selectivity*; and for countries that meet the selectivity criteria, we recommend (3) a *shift from project to program funding*. For countries that do not meet these criteria, we suggest, first, humanitarian assistance where this is called for; second, aid targeted at identifiable vulnerable groups and disbursed through domestic non-governmental organizations (NGO's) with a track record of democratic governance and accountability; and third, aid disbursed through regional demand driven foundations for regional projects and programs and basic capacity building. (4) Finally, we believe that African governments should themselves develop, in consultation with donors, *a timetable for an orderly termination of aid*.

(1) **Increased Debt Relief.** The bilateral donors have provided extensive debt relief to African countries over the past ten years or so, often across the board, but sometimes tied to performance. Recently the multilaterals have begun a lengthy process that may lead to relief for multilateral debt in the most highly indebted countries (HIPC), a process that will take up to six years in each eligible country, and depend on strict adherence to IMF policy guidelines. While the HIPC is at least a step forward, it still operates under the assumption that the IFIs, and the World Bank in particular, bear no responsibility, and therefore should bear no burden, for all the 'bad' loans they made, particularly the loans for multiple projects that were in retrospect, clearly not well-designed for the environment in which they were to operate or with budgetary sustainability in mind.<sup>41</sup> Take for example the Gorgol irrigation project funded for Mauritania (Kapur, Lewis and Webb, 1997: 706). Approved despite an appraisal giving a rate of return of 5.5 percent (later re-worked to 7 percent), and projections that the recurrent costs would exceed the total annual income of the project's beneficiaries,

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(1993), Collier (1997), Collier, Guillaumont, Guillaumont, and Gunning (1997). On conditionality and democracy, see Bratton and van de Walle (1997).

<sup>41</sup> The argument is made that writing off some of these bad loans across the board would lower the Bank's credit rating, raising the interest it must pay for the funds it raises, and punish its more credit-worthy members who have been servicing their debts. Conversely, some argue that loan write-offs might increase problems of moral hazard, where countries will apply their loans to riskier investments than they normally would, in the belief that these loans will eventually be forgiven. But we believe these arguments miss the point. All lending is subject to these problems; should the Bank be insulated from the results of its decisions? It is important to introduce some aspects of a real bank environment into the World Bank. First, staff need to consider each loan in the context of the projected future income of the entire country, and the projected future debt burden, in order to judge whether the country will be able to afford the payments on the loan. Clearly, if this information is not even available, no loan should be made. Second, staff need to face pressure *not* to make 'bad loans' to at least the same degree as they currently face pressure to move money now.

the project was ultimately an expensive failure for a very poor country, but still added \$100 million to Mauritania's debt. Loan write-offs that are clearly linked to the failure or poor performance of the specific projects they funded might stimulate some kind of sanctions (even if informal) within the IFIs for those responsible for projects like that in Mauritania that had such poor outcomes. A dollar of debt relief also avoids almost all of the institutional problems that can be associated with a dollar of program or project aid, including exchange rate appreciation, and seems a better use of funds.

(2) Greater Ex Post Selectivity. It has long been the case that, as Jacoby noted in 1967, 'aid for development *must* be conditioned upon the pursuit of developmental policies by the aided country if it is to be effective' (131). Donors have in the past given aid in furtherance of their own political and strategic interests that had little to do with good policies in the recipient countries (Burnside and Dollar 1997). It is time to practice more principled selectivity by channelling more funds toward countries that can make good use of them; by rewarding commitment (Collier *et al* 1997). Research strongly suggests, and the experience of Botswana, Mauritius, Taiwan, and South Korea confirm, that aid delivered to countries with developmental policies, and a clear idea of their own specific needs, can be quite effective in promoting growth and human development, whereas aid delivered to countries with poor policies has no noticeable impact.

What should be the criteria used for ex post selectivity? Political stability and macroeconomic stability appear to be baselines for a developmental state. The importance of keeping fiscal and current account deficits modest now enjoys a very wide consensus, as does the need to keep the exchange rate from becoming overvalued, and the importance of promoting diversified exports. In the final analysis, export-led growth in manufacturers and services is what enabled East Asia to graduate from aid. But many of the other elements of the neoliberal prescription, in particular the timing and sequence of the liberalization of trade, the financial sector, and the capital account, are still hotly debated. These debates will probably increase as a result of the East Asian crisis. Given the fact that no organization or region has a monopoly on a guaranteed path to development, it seems that the benefits of African governments being able to set their own liberalization goals and learning, even if more slowly and with mistakes, what it takes to get there, might ultimately build more lasting capacity and contribute to an end to aid dependence.

Donors are likely, and with good reason, to want to also base selectivity on evidence of improvements in state capacity and governance, particularly accountability and budget management, public expenditure transparency, and a plausible medium-term plan for increasing domestic resource mobilization and foreign exchange earnings in order to gradually boost self-reliance. The noted economist Sir Arthur Lewis remarked in 1969 that 'those who give aid are entitled to ask whether the recipients are using the opportunity of foreign aid to increase steadily the share of taxes and savings in national income' (52). The same can surely be said for foreign exchange earnings. Even if aid to Africa continues to decline overall (a realistic projection) but is then channelled more narrowly toward countries that can usefully absorb it, foreign aid in Africa may finally start to show evidence of more wide-spread growth and development. Research suggests that the large amounts of aid channelled to Taiwan in the 1950s and 1960s 'quadrupled the annual growth of per capita GNP, and cut thirty years from the time needed to attain 1964 living standards. . . Actual per capita GNP of 1964 would not have been produced until 1995' (Jacoby 1967: 152).

Africa has as yet no local model the way Chile served as a model in Latin America, and Japan in East Asia. But in the right environment, a concentration of aid may produce quite visible results, which could produce a model or models that would help convince other governments of the virtues of better economic policies and governance (Collier 1997: 66). But ultimately, the goal of selectivity is to return the initiative for development back to African governments and people. Two additional changes should support this: a shift to program support (for selected countries) and a shift to demand-driven funds and basic capacity support, for countries not yet able to receive program aid.

(3) Abandon the Project Mode of Aid Delivery and Switch to Program Support. Funding agencies were originally created to supply funds for countries whose own savings and foreign exchange earnings fell short of their needs. If developmental policies are in place, there is then no reason for donors to be designing or implementing projects on behalf of the country, or for providing 'tied' aid or technical assistance. This implies more than 'mov[ing] toward empowering our clients to take the leadership and share ownership of operations' as a 1994 World Bank directive urged. Rather, it implies that once a country meets the criteria for selectivity, funding should be integrated into the budget and managed by the country itself.

For a clearly delimited interim period, funding agencies might help establish in selected African countries the kind of centralized parastatal economic co-operation councils set up in Taiwan and Korea, or the foreign aid management units in Botswana's Ministry of Planning and Economic Development. These councils would have responsibility for managing the winding down of aid already committed to projects, and the move to program funding, possibly on a sector basis, as the UNDP and the World Bank have recently been promoting (Harrold 1995; Jones 1997).<sup>42</sup> One way to do this might be to establish a review board for economic co-operation activities, external to the council, but with joint representation from donor agencies and council staff. Participation could be encouraged through the democratic process: the submission of these recommendations for parliamentary debate and approval, which would involve the people's elected representatives.

With funds no longer tied to the projects of particular funding agencies, developing countries would be free to fill their manpower gaps and obtain their technical assistance from a variety of sources, much as did the European late developers and Japan. Many will likely look to Asia: to India and China, both of which have extensive numbers of well-qualified advisers

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<sup>42</sup> See UN General Assembly Resolution 44/211 of 1989. See also UNDP's manual on 'Guidelines for Programme Support Document (PSD),' November 1993, and Harrold (1995) and Jones (1997). Jones notes that 'There is tension between the ideal of local ownership of both the content and process and what was termed by one donor representative a 'massive and rapid' initiative from the World Bank to promote the SIP [Sector Investment Program] model.' (5). Harrold notes the tension in the Sector approach 'between *requiring* good capacity to exist as the basis for the SIP, and using the SIP process to *develop* this capacity.' (22) He recommends that before a SIP can work, governments need to have good leadership capacity, and be 'willing and able to take the lead and to tell donors what is and is not acceptable.' There also has to be well developed capacity 'in project management, especially in terms of financial management and procurement. This means a good record in timeliness of project audits, the absence of serious financial scandals, and preferably an ability to handle large volumes of procurement, ideally with standard procurement documents' (22). These would all be important preconditions before a shift to program aid is implemented.



and technicians who are undoubtedly much less expensive than those from the West. The competition that will result from the untying of aid should stimulate the transformation of aid agencies into sources of skills and knowledge, and help them to make a transition away from the career incentives and disbursement imperatives that currently exist.

The move to program aid should only happen where the underlying policy and governance fundamentals are in place, as outlined above in the section on selectivity. In particular, countries need to be able to develop and implement their own sectoral plans and projects, make their own determinations of manpower gaps, and decide themselves how those will be filled. Only in this way can aid relationships become true rather than fictional partnerships. For countries moving toward greater local ownership of development initiatives, the transition period to program aid might take five or ten years. For those not yet ready, councils could serve as a way to wind down project aid over the same five or ten years, with the goal of limiting funds in these countries to humanitarian aid, demand-driven funds disbursed by regional foundations and basic capacity strengthening.

(4) Establish Demand-Driven Foundations, and Basic Capacity Strengthening. For the foreseeable future, the majority of African countries will not meet the criteria for selectivity outlined above. If it is true that aid delivered to countries lacking developmental policies has no measurable impact on growth or development, then it is clear that the existing system of aid, in those countries, needs to be changed. We propose a shift in two directions: toward demand-driven foundations established on a regional basis and funded by multiple donors, and basic capacity strengthening, through long-term commitments that build human resource capacity and maintain commitments to basic and applied research, or that address regional issues, such as conflict resolution, malaria and AIDs.

Demand-driven foundations would be modeled after private foundations, or the social investment funds operating in many countries, which respond to requests formulated by individuals and groups for locally identified needs.<sup>43</sup> These funds could be used to build capacity in and outside of weak states. They would be able to respond to specific project proposals submitted by central and local government units, and non-governmental groups. Successful proposals will be those that enhance capacity without requiring unsustainable recurrent costs. There might be an initial step in which proposals are reviewed by a joint governmental/non-governmental committee in each country, before being forwarded to the regional foundation. In this way, even when the political leadership is not developmentally minded, developmental initiatives of those at lower levels can still be reinforced, and might prove to be role models and exemplars.<sup>44</sup> It would be important that these foundations be truly demand-driven, responding to proposals submitted by a variety of entities, on a

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<sup>43</sup> See the insightful and detailed discussion by Göran Hydén (1995) on autonomous development funds in the special issue of *Development Dialogue* published by the Dag Hammarskjöld Foundation. It is worth noting that when the AID program phased out in Taiwan in 1965, the U.S. established a Sino-American Fund for Economic and Social Development which took control of the local currencies generated by the remaining commodity imports, and the debt service owed to the U.S. (Jacoby 1967: 231). The U.S. specified that 15 percent of funds should go to agriculture, annually, and that 'all projects were to conform to developmental criteria, meet technical and economic feasibility tests, and emphasize research and innovation' (232). Decisions on funding of projects were to be made solely by the government in Taiwan.

<sup>44</sup> For examples of how local government officials can make a difference even when the central government cannot, see Leonard (1991) and Tandler (1998).

competitive basis.<sup>45</sup> Having funds on a regional basis would eliminate country programming as a framework for disbursements in countries that did not qualify for program aid, and break the 'disbursement imperatives' that currently characterize aid and have led to some of the institutional problems outlined above.

A second initiative could focus on capacity strengthening over the longer term by targetting funds to support some of Africa's formerly excellent universities, regional agricultural research centers (along the lines of the CGIAR agricultural centers), schools of public administration, training in higher level science and technology expertise required by a global economy, or programs that combat threats like malaria or AIDs, on a regional basis. These institutions would not be expected to be sustainable without external support, and funding agencies could usefully 'adopt' these centers, programs, and universities, making long-term commitments.<sup>46</sup>

(5) Establish a Credible Timetable for the Eventual Termination of Program Aid. Aid is likely to continue as long as poverty levels and income disparities remain so acute in the developing world. However, bilateral aid programs in many countries are already being wound down or reconsidered, and the political geography of aid is likely to look quite different in another decade. How should decisions be made about aid termination? The issue is difficult if aid is given solely on the basis of need (without regard to how well it will be used), because clearly a Samaritan's dilemma exists where it might be to a government's advantage to project greater needs, so that it can obtain greater aid. But if aid is directed only toward governments that are already on the right track toward self-sustaining development, this is less likely to be a problem.

In these cases, the timetable for aid termination should involve a series of steps and plateaus, keeping in mind that the primary purpose of aid is to supplement gaps in domestic savings and foreign exchange. Aid should be quite concessional and generous for the first big push, financing imports and providing a large share of investment. With these resources, countries should be able to purchase expertise on the international market, as Prussia, Russia, and Japan did at the end of the 19th century. Part of the aid mission should be to facilitate this, by serving as a source of knowledge, linking the country's officials to information networks about development policies, technologies, and promising innovations, and organizing study trips and internships for lower level but full-of-promise officials. This should promote learning from 'successful' upper middle-income developing countries whose recent history is relevant for low-income countries seeking to move up several steps.

At the same time, aid missions can help to promote the country as a destination for foreign investment, and as a source of export goods, both of which should help build foreign exchange reserves. Over time, as formal sector employment and production grow, and savings rates rise, the revenue base should improve, and the fiscal gap should narrow. When per capita income levels, the savings rate, and foreign exchange reserves reach some agreed

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<sup>45</sup> They would also need frameworks of rules that would allow funds that were unused to be rolled over to the following year.

<sup>46</sup> Many bilateral aid agencies are required to operate on year to year budgets, which would make these kinds of commitments difficult without changes in legislation governing the aid program. USAID recently was able to obtain a revision of the Foreign Assistance Act which enabled it to use grant money to create local currency endowments (Hydén 1995: 48).

upon level, the terms of aid should harden from grants and highly concessional loans to terms more closely approximating market levels. This could happen in several steps before aid funding is terminated completely, and even then, an endowed fund should remain behind to support projects for an additional specified period.<sup>47</sup>

It is useful again to return to the East Asian experience, upon which this strategy is loosely based. Both Korea and Taiwan were dependent on U.S. aid at levels that resemble many African countries. In 1959, before the government in Taiwan had adopted the momentous 19-Point Program of Economic and Financial Reform, 'the Director of the AID Mission [to Taiwan] proposed that the [Taiwanese] government should adopt a comprehensive set of public policies to foster private investment and expand exports, looking toward the phasing-out of U.S. aid' (Jacoby 1967: 35). U.S. government officials made aid termination to Taiwan a firm policy goal in 1960 once the 19-Point Program had been adopted and they felt that the island was on the right track to self-sustaining growth. The official announcement in May 1964 of a June 1965 date for aid termination further stiffened the government's reformist zeal. 'Confronted with the reality of economic self-support in another year, the government acted in many ways to further improve the climate for private investment, to promote exports, and to seek capital and credit from the World Bank, the Export-Import Bank, and other countries. It dispatched trade missions to Latin America and Africa, and eased controls of foreign exchange and payments (ibid, 230).'<sup>48</sup>

In Korea, on the other hand, the first significant fiscal and monetary reforms were undertaken in 1958, 'in response to reduced aid levels' (Krueger and Ruttan 1989: 229). Relations between the U.S. and Korea cooled for several years after a 1960 coup removed the corrupt but democratic President Syngman Rhee and established a military government. During this time, the new government attempted to free the country from its heavy dependence on the U.S. in order to have a freer rein in its domestic politics. It was also reacting to the U.S. announcement that the level of its aid would 'gradually decline' (ibid: 234). The Korean government then sought loans from the World Bank (1962) and from other bilateral donors. Bilateral aid from the U.S. ended in 1974.<sup>49</sup> Korea graduated from most other bilateral programs in the early 1980s.

It is important to keep in mind that the U.S. terminated aid to both countries only when they looked to be firmly situated on a self-sustaining growth path. But part of the incentive for getting on that path appears to have been the knowledge that the aid program was temporary. Because so many donors currently operate aid programs in Africa, a consensus on a coordinated program for phasing out aid may be difficult to reach. Yet the new reconsideration of foreign aid in light of the end of the Cold War and the long-term objective interest of the African countries themselves may force such a shift, in fact if not in announced intention. It would be better for Africa to plan for an orderly transition, rather than have it happen as the end result of an accumulation of ad hoc bilateral and

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<sup>47</sup> USAID appears to be setting a funds like this up in Zimbabwe, as it phases out the aid program there. Personal communication, David Hirschmann, October 1998.

<sup>48</sup> Although new commitments to the U.S. aid program in Taiwan ended on June 30, 1965, the U.S. continued to disburse funds that were already committed, and continued to provide surplus agricultural commodities for use in generating local counterpart funds, for several more years (Jacoby 1967).

<sup>49</sup> Except (as in the case of Taiwan) for several more years of concessional PL-480 commodity loans (Krueger and Ruttan 1989: 233).

multilateral actions.

## **Conclusion**

The challenge of aid in the 21<sup>st</sup> century may very well be how to do more with less. Levels of aid have been falling since 1989, but this may not be as problematic as it seems for many African countries. Many highly aid dependent countries are clearly not able to absorb all of the funds that are presently on offer, and high flows of aid in many of these countries have had some pernicious institutional effects. At the same time, aid flows are not high enough in African countries with good policies and greater absorptive capacity.

In countries where the political leadership is not committed to maintaining developmental policies, high levels of aid can have institutional costs, including organizational overload, capacity weakening, loss of ownership, revenue instability and budget fragmentation, lower tax effort, and the undermining of accountability and democratic decision-making. None of these costs are inevitable, and countries like Botswana, Mauritius, Korea and Taiwan have all been able to absorb large amounts of aid without ill effect. Over time, these countries have moved significantly closer toward, or even succeeded in, graduating from the international aid system. The difference seems to be related to domestic politics, and policies.

These experiences suggest that aid needs to reinforce norms and rules – institutions – that provide incentives for good policies and good governance. Our recommendations involve a shift toward an aid system that rewards countries that are already making clear moves toward political stability and macroeconomic balance, encouraging diversified exports, and creating an environment where their private sectors will grow, building a sustainable tax base that can support government programs. To encourage the leadership of more countries to pursue these goals, we argue for significant changes in the international aid system, including greater debt relief and greater selectivity. Countries that meet selectivity criteria are much more likely to use aid funds wisely, and we recommend a shift toward program support in these cases. For countries that do not meet selectivity criteria, we recommend that aid be scaled down, and limited to basic capacity building, through demand-based funds and support on a regional level for basic and applied research and university level science and technology education, and programs that combat AIDs and other problems that are regional in scope. Finally, we argue that aid programs need to be seen as temporary, and primarily as supplements to a country's own efforts to fill the significant savings and foreign exchange gaps typical at low income levels, or as responses to emergency situations. The eventual termination of aid needs to be anticipated and planned for in a thoughtful manner. If these changes are implemented, high levels of aid dependence should become an enabling factor in the efforts of African countries to become truly self-reliant.

## **Appendix A: Case Study Questions for Evaluating the Institutional Impact of Aid Dependence**

### **General**

- What are the total aid disbursements over the past ten years, and how does this break down into project, program, and other aid? What percentage of GDP/GNP is made up of aid, and how has this changed? What is the ratio between aid inflows and actual debt service outflows?
- How many multilateral, UN, and bilateral agencies operate in the country? How many international NGOs?
- Have any donors terminated their aid programs or made plans for terminating their programs in the near future? Were any of these programs terminated because (a) the country was unable to manage the volume and type of aid provided; or (b) the country was considered able to raise its own funding, either on the capital market or through own resources?
- Does the leadership have a clear vision for the goals and objectives of policy and programs? What measurable progress has the country made toward those goals?

### **Project and Program Implementation**

- Does the government have a single unit that has responsibility for signing loan and grant documents and coordinating donor aid? If so, do donors respect these requirements?
- Does the government have a single unit that coordinates with NGOs?
- What percentage of government line positions are unfilled? What percentage are filled by expatriates? Does the government have clear plans as to how it will eventually fill these positions with nationals?

### **Ownership**

- For major projects and programs undertaken by the government, where was the locus of initiative?
- How deep was the level of intellectual conviction among key policymakers?
- Were there expressions of political will by top leadership?
- What were the efforts made by the top leadership toward consensus-building among various constituencies?

### **Finance, Planning, and Budgeting**

- To what extent are all donor project costs included in the country's development and recurrent cost budgets?
- What is the gap between domestic investment needs, and amount filled by domestic resources?

Foreign exchange needs? How have these gaps changed over the past two decades?

- How competitive are local government salaries compared with the private sector? What is donor practice in 'topping up' local salaries?
- Have donor salary scales created upward pressure on public and private sector wages? Is this pressure sustainable?
- Has the government's budget undergone many significant changes over the year as a result of new donor commitments and projects?
- How much of the government's budget is devoted to servicing donor projects?

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# Summary

Heavy aid dependence can have significant effects on institutions and governance. In Botswana, Mauritius, Korea and Taiwan, high levels of aid reinforced local capacity, enabling them to 'graduate' from most aid. But in many countries, the costs of aid dependence have been high. Aid dependence can overload institutions and weaken capacity and ownership, create revenue instability and fragment budgets, lower tax effort, and undermine accountability and democratic decision-making. These pernicious effects of aid dependence suggest that countries differ strongly in their *institutional* absorptive capacity, and that economic cooperation needs to be designed quite differently for countries with 'good' institutions and those without.

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