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An 'Aid Exit' Strategy for African Countries

This policy brief argues that African governments need to take explicit steps to formulate and implement "aid exit" strategies. After well over three decades of the misapplication of massive amounts of resources by African governments and donor agencies, foreign aid cannot be "made" effective while African governments remain so highly dependent on international assistance. Restructuring the mechanisms by which foreign aid is provided and used across Africa will require explicit action to fundamentally change what has proven to be a seriously flawed and counter-productive relationship. We argue that for African countries to grow and development, aid dependence "as we know it" has to end.

This brief does not argue that foreign aid to Africa should be eliminated. As a practical matter, the forces allied against such an outcome, both inside and outside the continent are too well organized and too formidable for that to happen. Nevertheless, there is a strong case for substantially reducing aid to African governments so that economic performance can be enhanced. Indeed, we contend that lower levels of aid would improve economic performance. The latter, in turn, would make the extraordinary flows of aid to Africa unnecessary.

The need for an end to aid dependence in Africa rests on two premises. First, as foreign assistance across Africa is currently administered, most (if not all) aid agencies and their NGO satellites have lost sight of what aid is meant to achieve. Second, African governments have become so "hooked" on foreign assistance that efforts to ensure aid continues flowing have distorted their whole approach to economic management.

Three points need emphasis. First, there is nothing fundamentally wrong with the principle of foreign assistance. The experience of Europe and Asia has demonstrated that foreign aid can make a major difference when it is constructively used for limited periods. Problems arise, however, when aid become the open-ended, game-inducing, growth-dissipating transfers that have been so liberally dispensed to African countries. Second, in practice, foreign aid has been neither necessary nor sufficient for achieving rapid economic growth and development. All of the currently industrialized countries progressed without

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foreign aid of the type and in the amounts that poor countries have received since 1960. Third, there is nothing new about the argument that aid should be reduced. Some critics have argued that aid should be cut completely. Both ultra-conservatives and radicals have made this point. Our focus in this brief is not the quantity of aid. Rather, it is how to end "aid dependence."

What is aid dependence? According to the World Bank's *World Development Indicators* it is the ratio of net official aid flows to gross national product (GNP). This, of course, is only one dimension of what in fact is a highly complex relationship. Other (partial) measures include the:

- time over which a country has been receiving aid;
- size of aid flows relative to resources mobilized for local public capital formation;
- proportion of external debt service covered by foreign aid;
- import coverage provided by foreign assistance;
- trends in the budget and balance of payments deficits relative to aid flows;
- reduction in the debt stock resulting from foreign aid;
- proportion of the health, education, and infrastructure budgets that are donor-funded;
- expected results of aid and penalties (if any) for under-achievement of the results; and
- processes used to increase aid flows by the government and the donor agencies.

By these criteria, African countries have been and remain highly aid dependent. Most African countries have received some form of foreign assistance since the early 1960s. During the initial period, foreign aid was low relative to national income. It was primarily provided for public capital formation. The oil and food shocks in the early 1970s led to a major increase and a marked broadening of the scope of foreign assistance. Since that time, foreign aid has been supporting an incredibly diverse range of public and private expenditures. For some categories of public expenditure, foreign assistance is the dominant source of funding.

While trends in the budget and balance of payments deficits do not directly reflect the amount of aid provided, African governments have only been able to sustain these deficits *because* of foreign aid. By conventional criteria, most African countries have been completely unbankable for the last two decades. In the absence of foreign aid both budget and balance of payments deficits would have been constrained to levels close to zero. Indeed, the type of compression that would have occurred has been evident in countries that went "off-track" with the donors (Zambia in the late 1980s is an example). Due to the lack of foreign aid and their heavy debt burdens, these countries could not obtain credit forcing them to provide cash-in-advance to cover their foreign transactions.

For most African governments, there has been no fundamental reduction in their debt stocks due to their own efforts at mobilizing resources. All net reductions in external debt have occurred because of donor-sponsored efforts. For example, most bilateral donors have forgiven outstanding principal and interest. The Paris Club has rescheduled large amounts of trade credit and government-guaranteed debt. The World Bank has refinanced large amounts of debt owed to the IMF. Selected bilateral donors have provided "fifth dimension" support to repay the World Bank. And, other bilateral donors have provided resources for the commercial debt buy-back. Finally, the budgets of most African governments reflect the fact that donor agencies continue to fund crucial parts of their programs, particularly in the social sectors and infrastructure.

None of these measures is a decisive indicator of aid dependence. But, taken together they represent a pattern of reliance on foreign aid by African governments with three features. Current flows of foreign assistance cannot be stopped without major economic disruptions. There is no formal program for phasing out or substantively modifying the level of foreign assistance. And, both the donor agencies and African governments expect the flows of aid to continue for the foreseeable future.

Nonetheless, these (and other) quantitative indicators are seriously deficient in that they do not measure the games, strategies, and tactics associated with the way that aid is generated, distributed, and used. At its most basic level, aid dependence is reflected in the behavior of the relevant decision-makers. A feature common to most African governments is that aid is seen as the first rather than the last resort. When senior African policymakers are confronted with a shortage of resources, they do not as a matter of principle exhaust every local opportunity to raise revenue or economize on expenditure *before* turning to the donor community. Similarly, members of the donor community do not as a matter of principle insist that every local effort be made to raise resources *before* they agree to assist. Aid relationships have become so institutionalized and predictable that each donor has its own well-known "strategic objectives" (to use a USAID code word) and senior African policy makers are fully aware which donor can be "tapped" for each type of support.

Gamesmanship enters at other levels. An example is the IMF's "financial programming framework." The inevitable "financing gap" emerging from this exercise is meant to incorporate the country's best efforts at adjustment. The IMF staff establishes performance criteria that will pass muster with the IMF Board and will induce other donors to provide support. African governments, typically, treat these performance criteria as the maximum requirements for adjustment. They are not generally seen as performance markers that should be exceeded by as much as feasible. Thus, an IMF financial program represents a "grand compromise" consisting of the minimum amount of adjustment that African governments are likely to achieve consistent with the ability of IMF staff to move the program past their Board and the best guess of the amounts of resources that donor agencies (comforted by the IMF 'seal of approval') will provide.

Lost in this bureaucratic posturing is the fundamental objective that was once the centerpiece of aid relationships. This is the idea of "self-help." This principle, fundamental to the success of Marshall Plan, was seen as being vital to the promotion of growth and development. As President John F. Kennedy noted in his foreign aid message to Congress in 1961:

> … At the center of the new effort must be national development programs. It is essential that the developing nations set for themselves sensible targets; that these targets be based on balanced programs for their own economic, educational and social growth, programs which use their own

resources to the maximum ... Thus, the first requirement is that each recipient government seriously undertake to the best of its ability on its own those efforts of resource mobilization, self-help and internal reform, ..., which its own development requires and which would increase its capacity to absorb external capital productively ...

Over time, the idea of "self-help" was dropped and aid to Africa degenerated into an open-ended quasi-entitlement that largely substituted for rather than supplemented the efforts of African governments. In the process, African countries have become and remain, in Paul Krugman's phrase, "wards of the international community."

How do African countries, most of which have regressed for two decades despite massive foreign assistance, break out of the aid trap? Since none of the major aid agencies is planning to end its aid to Africa, any substantive restructuring of the aid relationship will need to emerge as an African initiative. The "aid exit" strategy suggested in this brief is one such initiative.

The Dimensions of an Aid Exit Strategy: What might foreign aid achieve if African governments purposefully reduce their dependence on the donor community and the games now being played by both sides are re-directed to achieving growth and development? What, in effect, would an "aid exit" strategy entail?

For a start, an "aid exit" strategy has to be initiated by Africans governments. Donors cannot be part of the fundamental process by which African leaders decide that their nations would grow and develop if their countries became less reliant on foreign aid. Once Africa's leaders have taken that decision and have begun to formulate an aid exit strategy, external agents willing to support the effort can be invited to contribute. They could provide immediate help by determining the complementary actions — debt relief, disaster relief, and foreign investment — that would enable African countries to move beyond aid. An "aid exit" strategy will not necessarily "end" all aid to Africa. But, such a strategy will encourage Africans to take full responsibility for promoting growth and development thereby providing the potential for ending aid dependence.

One approach African governments might adopt to formulating an aid exit strategy is to appoint a technical working group that draws on a broad cross-section from the public sector, private business, and civil society. Its members would be instructed to derive a 10 to 15 year growth and development program that explicitly phases down foreign assistance over time. The technical working group would be empowered to draw on local and foreign expertise to help clarify issues that were seen as relevant to the strategy. Discipline would be imposed by giving the working group a specific (short) deadline.

The group would need to make realistic assessments of the following:

- The flows of aid from all sources and their contribution to growth and development.
- The capacity of the government in particular and public sector more broadly to provide the services which are truly of a social nature — basic health, education, law and order, food security, and infrastructure.
- Areas of opportunity within the private sector for the rapid growth of output, exports, and employment and the public support (if any) required to promote these activities.

- The main constraints — skills, finance, international competition, managerial limitations — that prevent expansion in the private sector. Particular attention would be given to the ways that changes in government regulations and policy could alleviate these constraints.

The objective of these assessments is to understand, within the context of each country's available resources, the possibilities for:

- Cutting government expenditure;
- Running a "large" public sector surplus;
- Stimulating local private sector investment;
- Enhancing production in the key growth sectors, especially agriculture, mining, tourism, and energy;
- Reducing the nation's external and internal debt to genuinely "sustainable" levels;
- Creating the institutions to ensure that the public sector remains "restrained" so that deficit financing, rising levels of debt, and aid dependence do not re-emerge.

The Donor's Role: While donors cannot decide for African governments that they should get off aid, they might help in other ways. For example, donor agencies could honestly and openly admit that their activities have undermined the effectiveness of aid to Africa. (The World Bank report *Assessing Aid* was quick to point to the policy failings of African governments but slow to acknowledge that donors, including the Bank itself, has contributed to Africa's poor economic performance. The more recent publication of ten case studies has made some concessions in this direction.)

Given the debt burdens of most African countries, it is unrealistic to believe that they could immediately "get off aid" even if they wanted to. An "aid exit" strategy would not be designed to do that. However, what the effort of formulating and implementing the strategy will do is focus attention of public officials, the local private sector, and donor agency staff on the types of changes that have to be made *and sustained* if African countries are to move beyond debt and aid.

African countries cannot exit from aid unless they can exit from debt as well. Properly conceived, an "aid exit" strategy also embraces a "debt exit" strategy. A simple approach to this issue would be for the donor community to agree that as African countries formulate and coherently and consistently begin implementing an aid exit strategy, all debt service obligations outstanding prior to an agreed cut-off date would be suspended. This would effectively remove a major part of the foreign debt of all participating African countries. (Whether donors write off the debt or agree to fifth dimension funding if it cannot be written off would be left to them to decide.) In return for this commitment from the donor community, African governments would agree to refrain from new external borrowing. This would be reinforced in the aid exit strategy by ensuring that the government (and public sector) run a "large" surplus. The reason is simple: African countries can never escape from debt and no one will ever believe they can escape unless they stop borrowing.

The donor community would also be asked to continue supporting sector programs for which governments provide more than 50 percent of the funding. The latter is a crucial condition. An exit from aid is not possible unless the government fully accepts the principle of "self-help." A schedule of declining contributions from donors can be worked out as African governments scale back their activities and re-direct their resources away from value-subtracting and non-productive activities.

During a pre-arranged transition period (e.g., three years), the donor community should continue its direct support for projects in social sectors and infrastructure. There are many examples and well-established procedures for support to health, education, water and sanitation, infrastructure (roads, bridges, rural grain stores), legal reform, and so on. The aim would be to continue to strengthen the relevant institutions and directly enhance welfare. Whether the donors work through existing government organizations or undertake the support directly should not be pre-determined. The basic principle for this type of support should be to ensure that the donors and the government only maintain the mechanisms of cooperation that are efficient and effective.

Three issues affecting donor roles are funding for NGOs, disaster relief, and special assistance to deal with the HIV/AIDS pandemic. NGOs are a powerful, persistent lobby for a host of activities, many of which are unrelated to growth and development. Donors cannot be prevented from financing whomever they please but they should not act as though the support they provide to NGOs is "official aid." Moreover, donors should not agree to scale back their assistance to the government only to redirect the resources through other channels such as NGOs. That does nothing to help African countries wean themselves off aid.

Disaster relief will be required from time to time. If appropriately provided, disaster relief will be irregular, specific, and close-ended. It should not be continued once the disaster has passed, a practice common to Africa. For purposes of transparency, the government should separately account for any disaster relief that it receives. Since disasters of some form always occur, the "aid exit" strategy should also include some government funding for disaster relief. This is fully consistent with the idea of "self-help."

The HIV/AIDS pandemic raises the question of additional donor support (technical assistance and special training) to help stabilize institutions that are crucial to the promotion of growth and development. Progress will be impossible across Africa if organizations such as the central bank, ministry of finance, budget office, and revenue departments become dysfunctional due to the morbidity and loss of large numbers of skilled personnel.

Moving Beyond Aid: Formulating a strategy to reduce the dependence of African countries on foreign aid is one thing. Having an idea of where the economy can go is another. An essential feature of any "aid exit" strategy will be to restructure the economic system so that the government can be sustained by the country's resource base allowing it to perform the (public) functions that raise economic output and enhance welfare.

Evidence from the last three decades suggests that for all African countries this would require a major reduction in the size of government (as measured by revenue and expenditure) combined with drastic simplification of its agenda. The principal focus of the agenda would be rapid growth and development. It is not possible to determine in advance how each country will be structured as it moves beyond aid but those that succeed will have several common features. There will be no budget deficit. Government savings will be positive. Foreign debt will be declining.

Gross domestic savings will be at "Asian" levels (i.e., 30 percent of GDP or more). Gross national investment will be high and supplemented by modest inflows of official support (1-2% of GDP) and significant inflows of private capital. Labor and capital productivity will be rising even if the levels do not match "comparable" international figures. The real exchange rate will be at a level that discourages imports and encourages exports. Reflecting the lack of deficit financing and money creation, inflation will be at or near average world rates. Interest rates will reflect the opportunity cost of local capital and risks peculiar to each country. In effect, the economy will be in macroeconomic balance (or approaching it).

Merits and Demerits of an Aid Exit Strategy: Why should African governments bother? Is it worth the effort to formulate and implement an aid exit strategy? There are several advantages. First, it would represent an explicit attempt by African governments to move beyond the experience of the last three decades during which massive foreign assistance was associated with rising poverty. Second, it would focus attention on the main issues — growth and development — that African governments have to emphasize if their countries are to become viable members of the global economy. Third, the strategy provides a framework for Africans to collectively take the initiative in promoting sustained economic recovery.

There are, however, some drawbacks to such a strategy. First, since most African governments lack credibility, a program to exit from aid (initially at least) would be seen as wishful thinking. Indeed, many members of the donor community are likely to see the interest by African governments in an aid exit strategy as yet another tactic to divert attention from economic reform. Second, the formulation of an aid exit strategy would be an official acknowledgement of the extreme mutual dependence that has emerged between African governments and donor agencies. Few aid agencies, particularly the World Bank, have yet been willing to admit that large parts of their support to Africa have been counter-productive.

A third disadvantage is that an "aid exit" strategy will force African governments to simplify and reduce their development agendas. To do this, the privileged access by many interest groups will have to end. It will require African leaders, many for the first time, to begin acting in ways consistent with the broad "national interest."

Overview: Is There An Easier Way Out? Do the disadvantages of an "aid exit" strategy so completely outweigh the advantages that such an approach should be dismissed out of hand? Can't policy makers in Africa regain the initiative by "taking charge" of the current formulation of their "country development programs" and use them to promote and sustain rapid growth and development? The historical record is not encouraging. Moreover, since aid dependency is a mutual problem, it will take time for donor agencies to reorient their priorities away from "moving money."

Where does this leave African governments? As noted earlier, international experience has shown that economic aid, if effectively used, can stimulate growth and development. For that to happen, four requirements need to be met.

First, African governments should only accept donor support that is specifically designed to accelerate the rate of economic growth and development.

Second, African governments should formulate and begin implementing without reservation or diversion their own adjustment programs.

Third, once such programs are underway, the donor community should agree to remove from the current budget (through debt write-offs or a structured program of annual payments) the burden of all past external debts.

Fourth, both the donors and government should agree to a mutually binding set of conditions for monitoring and judging their performance. These conditions should relate directly to the goals of rapid growth and development.

Such a program would be a time-bound, structured effort by both the donors and the government to "end aid [to Africa] as we know it." The program would transform aid from its current status of an "entitlement." It would also break out of the cycle of IMF/World Bank supported adjustment programs, debt rescheduling, debt reduction, and "extraordinary finance."

In one of his first speeches to the United Nations General Assembly, President Mbeki of South Africa argued that the "begging bowl" mentality in Africa has to end. Breaking out of the cycle of "aid dependence" which has kept development from being the responsibility of African governments would be a useful place to start.

None of the measures needed to reform African economies requires more government interference in the economy. None of them requires any deepening of Africa's dependence on the donor community. All of them require an improvement in *quality* of the government's economic management. All of them can be sustained only if donor assistance supplements rather than supplants government action.

This policy brief is based on EAGER Discussion Paper Number 52, *Restarting and Sustaining Growth and Development in Africa: The Macroeconomic Dimension,* 2001, by James S. Duesenberry [jduesenberry@harvard.edu] and Malcolm F. McPherson [Malcolm_McPherson@harvard.edu], and on EAGER Discussion Paper Number 49, *An 'Aid Exit' Strategy for African Countries: A Debate,* 2000, by Malcolm F. McPherson [Malcolm_McPherson@harvard.edu] and Clive Gray [Clive_Gray@harvard.edu], Belfer Center for Science & International Affairs, John F. Kennedy School of Government, Harvard University.

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