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Aid and the “New” Conditionality

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Aid and the “New” Conditionality

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ABSTRACT:

Aid conditionality is described in the literature as an exchange of policy reforms for external resources. Based on the premise that financial aid works best in a sound policy environment, foreign assistance has become increasingly subject to conditionality. Since the 1980s, policy- and process-based conditional lending has obligated recipient nations to take specific actions relating to policy or process reforms, as well as meet predetermined performance measures, benchmarks and indicators. Over the past several decades, there has been a shift from shorter-term policy- to longer-term process-oriented conditionality.

Much debate exists on the effectiveness of this traditional aid conditionality. Recent studies indicate that such an approach to conditionality has *not* proven effective in spurring policy reforms, economic growth, and social change. Rather, many in the development community believe a “new” conditionality is warranted. Increasingly, donor agencies are modifying their approach to include analytical frameworks that support greater host government ownership, as well as adapting conditionality based on a host country’s situation; focusing more on outcomes; and increasing transparency and accountability within a coordinated framework.

The Monterrey Consensus, a commitment signed in 2002 by officials from 160+ countries, was created on the shared vision that successful development must be based on mutual commitment and dialogue, transparency, and accountability. The Consensus has determined that traditional aid conditionality does not have an appropriate disciplining effect. Instead, a more pragmatic form of financing for development through partnership is needed. This approach is similar to the Doha Declaration, which was adopted in 2008 at the follow-up conference on Financing for Development to Review the Implementation of the Monterrey Consensus.

In the context of insecure environments, a parallel strategy is warranted. This comprises a flexible, gradual approach to conditionality in which recipient participation is emphasized and responsibilities are clearly defined. Focus is on a broader review of progress, in which objectives and outcomes are viewed as more important than the achievement of specific reforms. As country performance improves, emphasis on reforms deepens.

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Aid Conditionality Defined

The traditional concept of aid conditionality is described in the literature as an exchange of policy reforms for external resources. Based on the premise that financial aid works best in a sound policy environment, foreign assistance has become increasingly subject to conditionality. Beginning with IMF and World Bank loans in the 1980s, policy- and process-based conditional lending has obligated recipient nations to take actions specific to policy or process reforms, as well as meet predetermined performance measures, benchmarks, and indicators. Non-compliance, in theory, jeopardizes donor support; however, failure to comply does not always culminate in a loss of donor funding. Aid conditionality does not comprise a single approach, but rather a set of strategies used to induce broad-based and sustainable economic and political changes. Cross-conditionality exists when bilateral donors provide funding conditional on recipients meeting specified agreements with multilateral institutions.

Do Policy Conditions Work?

There has been much debate on the concept and application of aid conditionality. One argument is that it has served as a positive external influence for a weak but willing democratic government in which reform will have unambiguous impact on growth and poverty reduction. Another asserts that traditional conditionality has not been successful, because it subordinates the needs of the poor and is not enforced, which discredits the entire process. Recent studies indicate that conditionality has *not* proven effective in policy reform, economic growth and social change. A 2009 OECD brief, for instance, reports that stringent conditionality does not work, because a government becomes more accountable to donors than to preferences of its citizens. This weakens recipient ownership of the reform process and suppresses national debate.

Shifts in Conditional Financing

Due to the progressive nature of development assistance, the focus of aid conditionality has changed over time. In the 1980s, donors made assistance dependent on short-term economic policy reforms, with market liberalization as the goal. In the 1990s, with the Cold War's end, political conditionality became a key mechanism in advancing medium-term institutional changes, such as good governance, democratization, and human rights. A third "generation" of conditionality has gained prominence this past decade in the form of longer-term social revisions (i.e., poverty reduction). These trends reflect a shift from policy-based to more process-oriented conditionality that is based on incentive-driven reform and aid selectivity – this is the core principle behind the Millennium Challenge Account (MCA).

Aid and the "New Conditionality"

Recommendations for a "new conditionality" revolve around greater flexibility, which includes granting recipient governments and civil society control of the reform process, as well as monitoring enforcement. Adoption of the 'Monterrey Consensus' in 2002, as well as the creation of the MCA are, in effect, an acknowledgement that traditional aid

conditionality has not had an appropriate disciplining effect. The Consensus was founded on the shared vision that successful development must be based on mutual commitment and dialogue, transparency, and accountability. In effect, it calls for a more pragmatic form of financing for development that emphasizes partnership … the mirror image of conditionality. In 2008, the Doha Declaration was adopted in order to reaffirm the Consensus and its commitment to a global partnership for sustainable development.

As a result of Monterrey, the World Bank developed Good Practice Principles on Conditionality in 2005, which guide recipient government ownership of Bank-supported programs. The United Kingdom's Department for International Development (DfID) also established benchmarks that focus on impacts of recipient governments' overall programs, rather than on specific policies. Similarly, in 2009, the IMF streamlined its conditionality framework and revamped its concessional lending facilities. To operationalize conditionality, analytical frameworks are being developed, which primarily support the following: 1) strengthening host government ownership; 2) adapting conditionality to the host country's situation; 3) focusing more on outcomes; 4) improving coordination and harmonization; 5) ensuring predictability of resource flows; 6) promoting transparency and accountability within a coordinated framework; and 7) developing a sufficient response to inadequate performance.

Conditionality in Insecure Environments

A growing awareness centers on the need to consider political realities when delivering development assistance, particularly during conflict. Consequently, supporting conventional conditionality in fragile or insecure states, where leaders may be either insufficiently committed to reform or lack capacity, may be inadequate. This pragmatic approach to aid conditionality focuses on the issue of using aid to foster security versus aid for traditional development goals. Despite views that both can be mutually reinforcing, there is concern that a strategic use of foreign aid will undermine donors' ability to address the needs of the poorest, in addition to detracting from local ownership. A parallel strategy for assistance that addresses both – security and development goals – is critical.

The World Bank's approach in uncertain settings has changed in recent years; its Good Practice Principles call for a multi-year agenda that incorporates a flexible, gradual approach, in addition to greater recipient participation in which responsibilities are clearly defined. Focus is on a broader review of progress, in which preset objectives and outcomes are viewed as more important than the achievement of specific reforms. As country performance improves, emphasis on reforms deepens. There are cases, however, when policy-based financing is warranted, such as in post-conflict settings.

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