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Is it time for Mali to plan an exit strategy from aid?

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1. Introduction

First of all I would like to thank you very much for inviting me to speak with you today. I hope that some of the things I have to say will help this group to continue to reflect on the role aid can play in encouraging growth, development and poverty reduction in Mali.

What do I mean by an exit strategy? Well it is not necessarily as radical as it sounds.

When "The Trouble with Aid" first came out, suggesting that African countries should set out plans to reduce aid over time, rather than increase it, most of my colleagues in the aid business were shocked.

Even my friends told me I might not get a job in the aid industry again! After all, the whole direction of the development sector at the time was about doubling aid, with a special focus on Africa.

Since then, however, I have been surprised by how many people are keen for a debate about an exit strategy to begin more earnestly. Speaking at the European Development Days event in Stockholm in 2009, at the heart of the European donor agency world, I was applauded when I argued that developing countries should set out plans to reduce aid over time, rather than increase it.

At ODI I am managing the production of the Country Chapters for the OECD's 2011 Paris Agenda Monitoring Survey, so I am in touch with the OECD a fair bit. According to my latest

meeting, South Korea wants "exit strategies from aid" to be an item of discussion in Busan, and is supported by a number of developing countries.

Clearly, some countries will "graduate" from aid in the usual way. When they grow to a certain size they no longer need aid to fill a savings gap, and will gradually see aid decline. Why suggest an aid exit strategy apart from this traditional exit?

There are two reasons:

Firstly, when we do an analysis of all of aid's impacts, it is possible to conclude that after decades of high levels of dependence on aid, aid itself has become the problem, more than the solution. Efforts to reform aid are welcome, but the fundamental problems of aid dependency are stubborn and probably intractable.

Secondly, there is a fast-changing international context that requires a new understanding of the role of aid.

Let me define a little what I mean by an exit strategy from aid. I am not suggesting an end to aid. A limited level of aid is welcome, even in fairly rich countries. I am suggesting an end to aid dependency.

It is not a course that can be implemented swiftly. It is, however, a change of course. A recognition that rather than setting out a medium term future in which Mali is as dependent or more dependent on aid, it is time to start to work out how to bring down the level of aid.

For some it is perhaps only articulating what is in any case implicit, that aid will end. But this articulation is important, as it energises certain parts of the sector into action, and encourages donors and donor publics to engage.

2. Analysing all of aid's impacts

All along I have been encouraged by colleagues in Africa who encouraged me to publish what, in any case, was what many of them had been saying for a long time – that aid dependency was a serious issue and one that requires redress.

Studies of aid's impacts have been generally weak. They have not given a comprehensive picture of the overall impact aid has had in a given country. Almost always they focus on one particular set of impacts, without looking at the others.

In "The Trouble with Aid" I identify four categories of impact:

<u>Direct impacts</u> are the easiest to measure and are the ones we hear about most in the media – how many people have been vaccinated, how many schools have been built, and so on. But also in this category, and perhaps not publicised quite so much, are the harmful side-effects of aid such as when people are displaced by large projects like dams and mines.

Even more controversial are the <u>policy conditions</u> attached to aid, which have arguably had greater consequences in the lives of Africans than the direct consequences of the way the money has actually been spent. The whole economic direction of a continent has changed in two short decades largely as a consequence of aid, and while some people have gained, many more have suffered as a result.

It is generally agreed that shortcomings in the accountability and effectiveness of African governments in recent decades have been a major part of the problem of low or negative growth and insignificant poverty reduction. What is less discussed, but is becoming increasingly clear, is that dependency on aid from foreign donors has undermined the development of the basic institutions needed to govern, and the vital link of accountability between state and citizen. This has retarded African development in fundamental and long-lasting ways.

Finally, receiving large amounts of aid also has macroeconomic consequences because large inflows of foreign money affect prices and incentives. If they aren't managed well these effects can be very damaging to poor people.

For the sake of time, let us assume that the direct impacts of aid are positive, and that the macreoeconomic impacts are manageable. I also need to skip over a debate about the pros and cons of the Washington Consensus, because what I want to focus on today are the institutional impacts of aid giving.

3. Institutions

Accountable and well-run institutions, while never considered *un*important to growth and development, are increasingly considered to be the most important prerequisites for development and poverty reduction in the long term.

Although the topic has been discussed for decades, it is sometimes presented today as the latest big idea in development. Everyone is talking about institutions. How do you build them? What kinds are needed?

In the 1980s and 1990s, at the height of the neoliberal hegemony, the emphasis was very much on the importance of the private sector and limiting the role played by public institutions and the state in the economy. Now, years of ignoring or attempting to bypass the state have been replaced by efforts to make the state more accountable and more effective.

To quote from the Africa Commission, 'Africa's history over the last fifty years has been blighted by two areas of weakness. These have been capacity – the ability to design and deliver policies; and accountability – how well a state answers to its people.'[1] It goes on to call for aid to focus on putting that right.

What it doesn't say, is that aid itself has undermined democracy, institutions and the capacity to govern in Africa. This could turn out to be the most serious and long term impact of aid.

Harmful or helpful, the impacts of aid conditionalities have been far greater than the direct impacts of aid. Many African analysts and civil society leaders have campaigned *against* some aid and debt relief initiatives – not because they are unaware that African governments are in desperate need of cash, but because they are aware of the other side of the coin.

And it goes even deeper. The sense of powerlessness that has been instilled in governments, the civil service, parliaments and civil society in almost all African countries to varying degrees has led to what might be called the psychological malaise of aid dependence.

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1 Commission for Africa 2005, p. 14.

Aid dependence is not just measurable in terms of aid per GDP. It is apparent in the way governments and other sectors of society go about their business and is characterized by a lack of initiative in developing strategies and policies and, in general, a reactive rather than proactive form of government.

Richard Dowden, the director of the Royal Africa Society, suggests that 'in the long term foreign intervention will undermine Africa's self-respect'.[2]

Donors are using traditional methods in their push to improve governance in Africa, drastically increasing the governance content of the conditions attached to aid. About 50 per cent of World Bank aid conditions now relate to public sector governance, compared with 17 per cent at the end of the 1990s, and this ratio is particularly high in Africa compared with other regions.

It is possible that some of these governance conditionalities will have positive results in the short term and lend weight to the progressive sectors of government and civil society who want to see more accountability. Donor pressure to involve civil society more in decision-making has had important results in some countries, where civil society has grown stronger, although in others, such as Kenya, civil society remains unengaged in these processes.

The fundamental contradiction that few donors appear prepared squarely to face is that the more they involve themselves in governance issues in Africa, however well intentioned, the more harm they may be doing to the strengthening of institutions.

In a literature review, Moses Isooba of Uganda's Community Development Resource Network found that, 'A majority of civil society actors in Africa see aid as a fundamental cause of Africa's deepening poverty.'

He goes on to acknowledge that aid can make 'a lasting difference in helping people to lift themselves out of poverty', but calls for a radical rethink about the purpose and nature of aid giving.[3]

Charles Lwanga-Ntale of Development Research and Training (DRT), a Ugandan NGO, describes what he perceives as 'almost unanimous pessimism among African civil society and academia about the unworkable nature of aid, given the way in which it is structured and delivered.'[4]

According to Siapha Kamara of the Social Enterprise Development (SEND) Foundation of West Africa, 'mainstream African civil society, especially the emerging independent grassroots based development agencies, think tanks, research and policy advocacy organizations are justifiably asking what is different in the present day international aid architecture. Official Africa tends to be more enthusiastic about the anticipated increase in international aid than civil society... the more African governments are dependent on

2 Dowden 2004

3 Isooba 2005

4 Lwanga-Ntale 2005

international aid the less ordinary citizens such as farmers, workers, teachers or nurses have a meaningful say in politics and economic policies.'[5]

Studies in other countries have drawn similar conclusions. Ghana's budget has been described as a 'façade' and a 'deceptive mirage' directed towards satisfying donors rather than being a genuine and thought-through spending plan.[6]

A 2007 analysis of aid's impacts in Mali talks of 'a mentality of aid dependency' in the country, restricting the 'world of the possible' and leading to the loss of the 'habit, capacity, and incentives to set up and implement their own policies'.

It describes the Malian government as having 'adopted a strategy of compliance aimed at maximizing aid flows coming into the country', and argues that 'aid is not a mere financial and technical tool to support national initiatives: it has replaced any national political reflection on development in the country.'[7]

In Mozambique the first Action Plan to Reduce Absolute Poverty (PARPA 2001–2005), which is the country's key policy document, was unashamedly guided by donor strategies. The second PARPA (2006–2010) was heavily influenced by foreign consultants and was not even shown to the parliament, although donors, of course, were invited to comment.[8]

In an analysis of aid to Sierra Leone, not one expert interviewed could think of an example of the government refusing aid because it was opposed to the terms on offer.[9]

All of which is disappointing, but hardly surprising. We have seen how often policies developed nationally have simply been rejected by donors. While on the one hand donors emphasize the need to listen to country governments and civil society, which is acknowledged as vital for policies to work, on the other they make clear that certain policy options are out of bounds.

Over time recipient governments have learnt to play the role cut out for them. The problem of self-censorship now pervades African government policymaking. When countries know they will not have a chance of passing a particular law, or will have to spend immense political capital trying to get it past donors, they may not bother to think about it, let alone suggest it.

In Mozambique an attempt by the government to take the policy initiative with the launch of a development bank met flat rejection from donors (despite the usual rhetoric encouraging policy autonomy and ownership).[10]

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5 Kamara 2005

6 Killick 2004 and Campos and Pradhan 1996 respectively

7 Bergamaschi 2007

8 De Renzio and Hanlon 2007

9 Eurodad 2008b

10 Derenzio and Hanlon 2007.

When even flagship government projects like this are blocked by donors, how many projects do countries simply not bother to develop into proposals? In a context of donor pressure to liberalize and privatize, what recipient country would put forward a plan for increased subsidies and nationalisation, even if it considered such measures to be in the best interests of the country?

According to Isaline Bergamaschi's study of aid to Mali, 'As aid-donors' influence over policy has increased, [Mali's] capacity and will to take the lead in managing aid and the aid relationship have decreased. Indeed, if the current political situation seems characterized by a certain degree of inertia, a lack of development strategy, weak capacities and compliance with donors, it can only be understood as the result of the weakening of the state and donor entanglement in national institutions and politics, and several decades of aid dependence.'[11]

In their analysis of the impact of aid on Malian democracy, Magassa and Meyer (2008) conclude that:

"Regarding national sovereignty and the consolidation of Malian leadership, civil society commentators argue that the complete opening of the budget elaboration process and allocation of government expenditure to donor influence poses serious problems in the fields of national priority definition, concepts of development, and political vision...

"The second PRSP was elaborated before the first was evaluated. Moreover, it took place right before presidential elections in 2007, thus impeding a synchronisation of the technical substance with the political leadership."[12]

In the words of one civil society leader from Niger, 'We have become aid economies; we no longer know how to reflect on the solutions we need to put in place in our countries.'[13]

The fact that governments feel more accountable to donors than to their own parliaments and people dominates attempts by civil society to stand up for its interests. African civil society has responded in many instances by linking up with international NGOs to try to get a foot in the door at donor capitals like Washington, Geneva and London, not without success, especially on single issues like HIV/AIDS.

But this does little to support the development of national level decision-making processes. Moreover, there are fewer and fewer political options available to the citizenry – all parties have to adhere to donor thinking to obtain funding. So where is the choice at the ballot box?

Magassa and Meyer (2008) argue that:

"It seems undisputed that donors lead in formulation, with little initiative on the definition of policies emerging from government... The lack of a strategic vision of global development,

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11 Bergamaschi 2007

12 Magassa and Meyer 2008

13 Mamane Sani Adamou of the Nigerien civil society organisation Alternative Espaces Citoyens, quoted in Eurodad 2008a

which characterises the entirety of the Malian political class, reduces the democratisation process to political representation for profits."[14]

There have been some encouraging signs in Africa since 2002, with domestic revenue climbing as a percentage of GDP for the first time in a long while, especially for those countries that are predominantly oil exporters, but also for oil importers.[15] If other revenues increase faster than aid, dependency on aid will decrease, taking African governments one step closer to resolving some of the problems of capacity and accountability outlined so far.

So these gains are important. But, unfortunately, they are fragile. Today's higher tax revenues are largely a result of sharp increases in commodity prices, especially oil and minerals. With the prospect of a global slowdown, it is far from assured that high prices will last, and revenue gains in many countries could be reversed.

If aid rises at the rate campaigners are demanding and governments are promising it will almost certainly outpace revenue collection efforts in most African countries.

Ravi Kanbur, a former chief economist for Africa at the World Bank, is one respected analyst who argues that 'a reduced volume of conventional development aid to Africa [is] a price worth paying for reduced aid dependence.'[16]

4. Will problems of aid dependency improve in the coming years?

What about the possibility that things are improving, most notably in the Paris agenda for aid effectiveness? And, given that aid dependence is fundamentally correlated to aid/GDP, what about the quantity of aid in the future?

The Paris Declaration focuses most of its attention on some of the technical aspects of aid giving: how money could be transferred more efficiently; how its (direct) impacts should be monitored; how best to get value for money; how known bottlenecks can be eliminated.

These are not unimportant issues. Tying aid to the purchase of goods and services from the donor country makes it between 15–40 per cent less efficient.[17] Progress on value-for-money would be beneficial for Africa.

In their study of the impact of aid on environmental issues in Mali, Lawson and Bouaré (2008) argue that:

"... in relation to the basic problem of establishing and sustaining an adequate institutional framework to protect the environment and promote sustainable natural resource management, it seems clear to us that the Development Partners are inadvertently undermining the institutions which need to be protected and developed. They are part of the problem rather than part of the solution.

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14 Magassa and Meyer 2008

15 Manning 2006.

16 Kanbur 2005

17 ActionAid 2005

"Why is this? Simply because there are too many projects, which are poorly coordinated and generate strong incentives for the Malian environmental institutions and agencies to neglect their core roles. We have described above the negative effect this has had on the institutional framework."[18]

But even if technicalities such as these improve, the fundamental problems of aid will remain. The Paris Declaration does not take the accountability of aid downwards from governments to citizens seriously into account.

Let's take donor coordination. While it may seem obvious that donors should sit down and coordinate their aid giving, as I know you will be doing later today, such coordination might be entrenching and continuing the system of consolidated donor pressure that has done such damage to Africa's chances of development. Harmonization and coordination can be a double-edged sword in the aid business.

While less bureaucracy means more time available to do more important things, variety among donors can sometimes be a good thing if it allows innovation and even competition, whereby recipients might refuse some offers of aid and accept others, depending on the modalities. Harmonization of conditions is quite different from harmonizing procedures.

Donors are working in coalitions to draw up complex agreements with recipient countries that include a large number of conditions covering policies, processes and outcomes. For instance, Tanzania's Performance Assessment Framework (PAF), which is attached to its Budget Support Agreement, has a twelve-page matrix of conditions, and forty-nine pages recounting the government's progress or lack thereof on the conditions.[19] Because the PAF brings together the conditions of all the donors, it is hard to change it once it is prepared.

The fundamental problems remain. In donor countries the push for increased value for money of aid is clearly meant to reassure their own publics and is a reminder, if one were needed, that donors are ultimately accountable to their parliaments and their people – no amount of technical fixes in Mali can change that fact. So as long large quantities of money arrive from abroad ownership will be a chimera.

Unfortunately, concerns about these issues <u>will worsen</u> as aid increases. Large-scale aid to Europe after the Second World War lasted only a few years and never exceeded 3 per cent of GDP for any one country.[20] Korea and Taiwan received substantial aid but only for a decade or so.[21]

In contrast, aid to Africa has become the defining element of a number of African economies, including Mali. Africa receives over 9 per cent of its GDP in aid and many countries receive

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18 Lawson and Bouaré 2008

19 Alexander 2007.

20 De Long and Eichengreen 1991.

21 World Development Indicators.

much more than that. Most, including Mali, are now in their third or even fourth decade of large-scale aid receipts.[22]

According to economists Todd Moss and Arvind Subramanian, if aid is doubled from 2005 as promised, twenty-seven of Africa's thirty-eight low income countries will receive aid inflows equivalent to over 50 per cent of total public expenditure by 2015, while for twelve that figure will be 75 per cent. That compares with seventeen and nine at present. In this expected scenario, Mali will see ODA grow from less than 50 per cent of the budget to more than 65 per cent.[23]

This means almost total dependence. The fundamental problem that the Malian government will be more accountable to donors than their own citizens is set to worsen, despite the best efforts of the aid community.

When should this aid eventually be reduced? It is surprising how few people have an answer to that question! According to current thinking we can expect aid to rise until 2015 and presumable fall only gradually over time, perhaps reaching today's levels again by, say, 2030.

That means another twenty years or so of today's levels of dependency before Mali even *begins* to recover its autonomy.

A note on climate finance

A quick note on climate finance. It is noticeable that in a very comprehensive look at the future of the aid system written in 2004 by eminent colleague Andrew Rogerson the only climate mentioned is the political one.[24] The Make Poverty History campaign in 2005 didn't give climate finance a second thought. That shows how fast it has risen to the top of the aid agenda. Experts are saying at least an additional US$100bn a year for mitigation and adaptation is needed by 2020. That more or less doubles the current US$140bn DAC aid budget, although it is supposed to be private as well as public.

The climate finance debate needs to be at the top of the aid effectiveness agenda. It is still surrounded by generalities and top-level direction setting. If you are concerned, as I am, about high levels of aid dependency in the poorest countries, this does nothing to soothe those worries. The issue of conditionality, and other old aid problems, looms large.

5. What to do: towards an exit strategy

If Mali is short of cash at the moment, reducing aid quickly would make the shortfall even more drastic. What is required is not a sudden break, but a deliberate change of direction, moving away from aid dependence. This will not be easy and will require brave leadership focused on longer time horizons than the next general election. But it is the first step in the right direction.

Homi Kharas of the Brookings Institute sites an example of well used aid in Aceh, Indonesia, after the tsunami. By adding a "sunset clause" of 4 years, minds were focused on achieving

22 World Development Indicators. Average since 2000, excluding Nigeria and South Africa.

23 Moss and Subramanian 2005

24 Rogerson 2004

change and planning for a post-aid scenario. A very different context, but perhaps a lesson to be learnt.

The mindset of aid dependency leads people frequently to adopt the following non sequitur: there is a financing gap, therefore we need more aid. This is not the case. There are other sources of finance that need to be investigated better.

Complementary policies

Development finance means finding the money needed to pay for development. Resources already in a country can be supplemented with money and resources from abroad (aid, loans, foreign investment and, increasingly, remittances). But it is important to remember that billions of dollars flow out of Africa every year as well, destined for rich countries.

Other sources of development finance

If aid is to be reduced over time, where on earth would Mali find money to grow and develop. Leaving aside trade and private investment which are obviously crucial, the main areas for research and public policy influencing are:

1. Capital flight
2. Better mobilisation of domestic resources (resource revenue, other taxation, financial instruments like insurance and bank accounts)
3. Use of reserves (various ideas to reduce the need for large reserves)
4. Debt sustainability and fair workout mechanisms
5. So called “innovative forms of financing” (such as the currency transaction tax, reallocation of subsidies for fossil fuels)
6. The use of SDRs to create quick money
7. Support remittance transfers (reduce fees to 5%)

Realistic short-medium term policy actions might be:

- Look at the introduction of capital controls
- International charters to bind the way businesses operate (Natural Resource Charter)
- Reform IFI governance
- Tackle tax havens and address tax evasion
- Reform accounting standards
- Stop debt servicing for countries in difficulties

Realistic longer term policies might be:

- Reform the international monetary system (i.e. dependency on dollar)
- Institute fair and transparent debt workout mechanisms

These issues are far from new. The UN’s FFD process, from Monterrey to Doha, has led the work on them. But in some cases they are little known, and in nearly all cases they lack political momentum and evidence.

Without a clear change in rich country policies, it is difficult to envisage how African governments will be able to stem flows or maximise other opportunities. Rich countries need to shut down tax havens – they serve no useful purpose and their only real use is to help businesses and individuals hide money and avoid paying tax.

Governments around the world lose over $250 billion a year in lost tax revenues because of this dubious system – so rich governments are losing too.[25]

But the biggest losers, as usual, are the poor, as they see money that could have been invested in development spirited abroad. International accounting standards need to be tightened to reduce the amount of fake and mispriced transactions – by far the biggest tool for moving money out of Africa.

Let's look briefly at capital flight. Illicit financial flows out of developing countries are estimated by some at $850 billion to $1 trillion a year, increasing year on year. Estimates are particular hard for this kind of flow, especially in Africa where data is weak, but we are talking $30-35bn as a conservative estimate, according to Global Financial Integrity.[26]

Uganda loses around $450m a year in illegal capital flight, the same ball park figure as the amount it receives in aid. The African Union wrote a paper claiming that $148bn leaves the continent each year through corruption, which seems unlikely, but demonstrates the ball park we are in.[27] Mali needs to look at this issue, if it is not already doing so.

Investing money in Mali

As always the role of African governments is paramount in dealing with this crisis. They need to persuade Africans to invest their money (whether corruptly gained or not) in Africa. Leading economist Dani Rodrik has argued that 'often the key [to economic growth] is a set of targeted policy interventions that kindle the animal spirits of domestic investors.'[28]

Taxation

Fundamentally, African governments need to raise domestic revenues, currently about 14% of GDP in Mali. If they grow faster than in the past, after adopting more economically viable policies, and if they reintroduce trade taxes where appropriate and impose ambitious but achievable taxes on big companies, especially foreign multinationals, their overall tax intake will rise.

But serious efforts to increase individual taxation are needed as well, not only to increase government revenue but also to improve the crucial state–citizen relationship. In an ideal world, everyone would pay something, so that everyone has the right to demand accountable government.

Donors should support such efforts and foster a progressive international tax system rather than encouraging developing countries to compete for foreign investment by lowering taxes.

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25 Christensen and Guindja 2005

26 Baker 2005

27 Africa APPG 2006

28 Rodrik 2001, p. 16.

According to South Africa's finance minister, Trevor Manuel, 'It is a contradiction to support increased development assistance, yet turn a blind eye to actions by multinationals and others that undermine the tax base of a developing country.'[29]

Savings

Raising revenue is only a part of the equation. Better use of savings is also key. UNCTAD focused its 2007 annual report on Africa on domestic resource mobilization. Its findings will surprise many.

Far from being short of cash, African banks are actually too liquid. But they are not using the money they have productively. African businesses cite lack of credit as their most important constraint, along with lack of infrastructure, institutions and skills.[30] The lack of good information systems on potential borrowers and systems to enforce repayment inhibit moneylending, which is the way savings are turned into productive investments.

Additionally, most banks in Africa are now in foreign hands, following financial liberalization as part of the structural adjustment reforms package. In Botswana, Guinea–Bissau and Lesotho all banking assets, worryingly, are owned by foreign banks.

According to UNCTAD, 'These banks lend to larger borrowers such as the public sector, large enterprises and wealthy households. They do not have mechanisms well suited to catering to the needs of small, low-income and mostly agricultural and rural-based economic agents, despite the fact that these agents constitute the backbone of African economies.'[31] I don't know what the situation is in Mali, but it is something to be looked at.

Reforms in the African banking sector have improved management in some cases, but banking services for rural households and the informal sector (by far the largest part of Africa's private sector) have suffered. Most of Africa's wealth never reaches the formal banking sector.

Developing more informal and semi-formal saving and investment mechanisms needs to be a top priority for Africa, with the goal of eventually making better links with the formal sector. Changes in these areas are feasible if governments prioritize them.

Conclusion – Leadership is the key

When countries arrive at the negotiating table with clear ideological preferences and viable policy suggestions, and when they demonstrate democratic legitimacy, it becomes harder for donors to take control of the process. There are some examples of African governments standing up to donors in this way, especially when they form a negotiating bloc. It becomes even harder for donors to impose their will when recipients are prepared to refuse aid if they are not content with the overall package.

What we need is a differentiated approach, taking into account the complexities of aid giving and the risks to development that might occur if ratios of aid to government revenue

29 Manuel 2008

30 African Development Indicators

31 UNCTAD 2007

deteriorate further in Africa. But what we have are generalized calls for aid increases across the board which do not take these concerns seriously.

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