



INSTITUTE OF ECONOMIC POLICY STUDIES AFRICAN OUTREACH PROGRAMME

INNOVATIVE WAYS OF MAKING AID EFFECTIVE IN GHANA: Tied Aid Versus Direct Budgetary Support

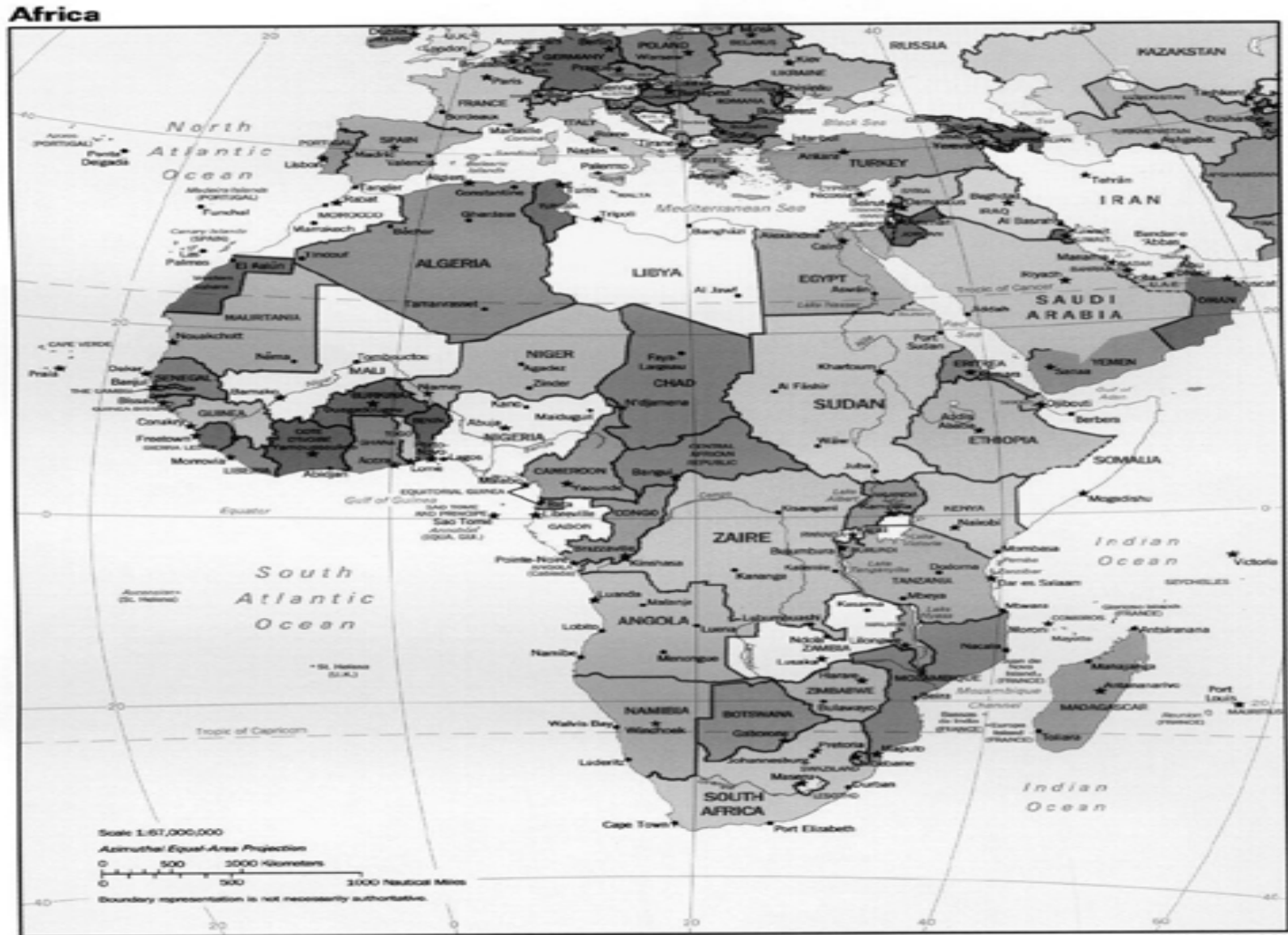
By

Peter Quartey (PhD),
ISSER, Univ. of Ghana

OUTLINE

1. Introduction
2. Aid Flows
3. Improving Aid Effectiveness: MDBS & Tied Aid
4. MDBS
5. Current Status of MDBS
6. Conclusion & Policy Implications

AFRICA MAP



1. Introduction

- Developing countries, including Ghana, have been burdened with severe resource problems. A number of these countries are aid-dependent (Table 1)
- Their fiscal and current account deficits are unsustainable in the face of severe debt problems

1. Introduction

Years	% of Govt Central Govt Expenditure	% of GNI	% Gross Capital Formation	% of Imports	Aid Per Capita (US\$)	ODA & OA (Current US\$ Mil)
1982	11.3	3.5	103.3	15.6	12.4	140.8
1983	5.2	2.7	71.9	15.1	9.3	109.4
1985	23.2	4.4	45.4	20.5	15.5	195.5
1987	62.1	8.4	77.9	31.1	30.4	412.6
1989	98.6	13.9	103.4	50.9	49.1	717.2
1991	95.3	13.6	84.1	49.5	56.4	881.5
1993	49.8	10.7	47.1	27.2	37.7	623.9
1995	Na	10.3	50.3	28.8	37.6	650.8
1997	Na	7.3	28.9	17.7	27.4	494.0
1999	Na	8.1	37.6	14.9	31.6	609.5
2000	Na	12.4	50.3	17.3	30.6	600.4
2001	Na	12.4	45.7	17.4	32.3	643.6
2002	Na	10.8	53.5	18.5	32.0	649.8
2003	Na	12.2	51.3	20.8	43.9	906.7

1. Introduction

DONOR	YEARS					
	1998 (%)	1999 (%)	2000 (%)	2001 (%)	2002 (%)	2003 (%)
Denmark	5.5	7.0	6.7	7.1	9.2	7.4
France	0.7	0.7	0.6	0.8	1.8	2.4
Germany	5.0	6.9	5.7	4.3	6.1	6.1
Netherlands	3.4	2.2	4.9	20.5	10.6	8.6
Norway	0.2	0.1	0.6	0.1	0.1	0.1
Sweden	0.1	0.1	1.1	0.4	0.2	0.1
Switzerland	0.1	0.1	0.1	0.1	1.3	1.0
United Kingdom	10.2	16.9	14.3	17.6	22.1	17.1
United States	5.4	7.5	11.4	9.6	12.3	10.9
Japan	23.4	18.7	18.4	6.2	4.2	3.9
UNDP	0.9	0.9	0.6	0.6	-	-
IFAD	0.5	0.6	0.9	0.5	1.0	0.8
IDA	38.5	36.5	32.1	28.6	13.7	25.6
EC	5.1	4.7	2.9	3.3	7.6	9.3

1. Introduction

- In an attempt to rescue the situation, donors have often used tied aid not just for self commercial interests but sometimes to facilitate aid effectiveness, but without the hoped for results
- Aid Effectiveness is defined in terms of Aid's contribution to poverty alleviation or sustained poverty reduction

1. Introduction

- Tied aid is defined in this study as project aid contracted by source to private firms in the donor country. It refers to aid tied to goods and services supplied exclusively by donor country businesses or agencies. Aid can also be tied to conditions such as policy or institutional reforms but the paper defines tied aid narrowly to exclude aid tied to conditions

1. Introduction

- In view of the resource constraint in many developing countries and the fall in ODA flows to these countries (Bulir and Lane 2002; Alesina and Dollar 2000), donors are faced with two complementary options:
 - (i) develop new or innovative sources of financing for developing countries, and
 - (ii) find new ways of making aid more effective.

1. Introduction

- DFID and a few other donors have considered the latter option. The donor community and the government of Ghana have agreed on an aid package dubbed the *multi-donor budgetary support* (MDBS)
- Issues: will this reduce transactions cost of aid? Not all donors have signed on to the MDBS, other forms of aid continues to exist? How will aid policies be harmonized under MDBS

2. Profile of Aid Flows

- Ghana currently receives aid in various forms, including general budgetary support, sector budget support (mainly health and education), and project aid using parallel systems.
- Until the mid-1960s, aid flows were relatively unimportant in Ghana (Harrigan and Younger 2000) because the Nkrumah government was highly suspicious of the major donors

2. Profile of Aid Flows

- Ghana's economy had inherited substantial foreign exchange reserves, little debt, and a small public sector. Very little foreign exchange and budgetary support were needed until the 1961 balance-of-payments crisis
- In the mid 1960s, the situation began to improve and aid inflows as a share of GDP increased from 0.002 per cent in 1960 to 0.22 per cent in 1965 because the new government after Nkrumah favoured foreign interests (Quartey 2002)

2. Profile of Aid Flows

- The economic policies of the 1970s were not impressive either and aid inflows declined during the first half of the 1970s, but the second half recorded more than a compensating increase

2. Profile of Aid Flows

- According to Harrigan and Younger (2000), there were three reasons for this increase.
 1. Competition by East and Western allies for Africa's loyalty in the post-independence period
 2. Most donors realized the severity of poverty in Africa relative to other developing countries and responded with more foreign assistance.
 3. The development community shifted away from the emphasis of growth being the engine for poverty reduction towards direct intervention to satisfy basic human needs.

2. Profile of Aid Flows

- This shift weakened the link between aid flows and good economic policies
- Repudiated 35 million pounds of Nkrumah's debt and this brought a sharp response from commercial donors in 1973 and 1974

2. Profile of Aid Flows

- Ghana's foreign debt increased substantially from US\$ 895 million in 1975 to US\$1407 million in 1980 (Harrigan and Younger 2000).
- To make matters worse, the source of Ghana's external financing contracted to a small number of donors, with the World Bank being the major donor

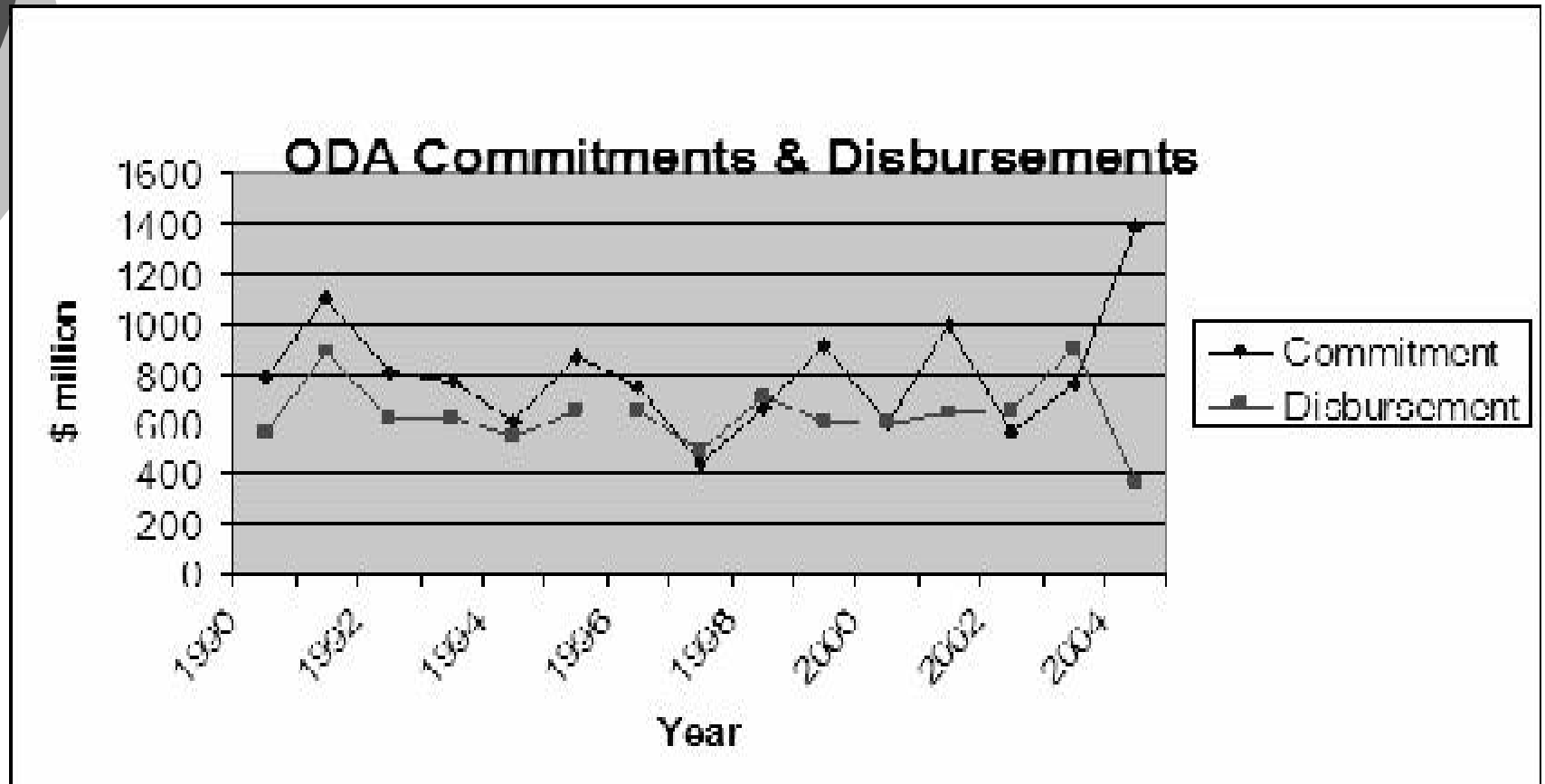
2. Profile of Aid Flows

- The early part of the 1980s witnessed a gradual reduction in aid flows to developing countries and Ghana was no exception
- Aid flows had increased substantially by the end of the 1980s and Ghana was receiving more foreign aid per capita than the average for Africa and other developing countries.

2. Profile of Aid Flows

- The added inflows coincided with increases in growth but it is not clear whether the increase means causation.
- It can be argued that the increased inflow had a positive impact on growth at least during the early part of the ERP (Aryeetey and Cox 1997).

2. Profile of Aid Flows



2. Profile of Aid Flows

- Despite the increases in aid flows to the various sectors, there is no indication that the increased aid flow matched adequately the improvements in policy (Tsikata, 2001)
- Devarajan et.al (2001) argued that some bad policy countries also remained major aid recipients.
- It is possible that aid allocations went to countries with high population, more aid to strengthen countries with weak democratic institutions.

3. Improving Aid Effectiveness: MDBS & Tied Aid

- In a WB study on the fifty most aid-dependent countries, it was observed that the mean value of aid as a share of central government expenditure for the period 1975-95 was 53.8 per cent (van de Walle 1998)

-

3. Improving Aid Effectiveness: MDBS & Tied Aid

- Have these huge flows been applied effectively? In other words, have these inflows resulted in significant poverty alleviation in recipient countries? If not, we need to consider how to make aid more effective?
- Should aid be tied to specific projects or conditionality, or should governments be allowed to determine how aid can be effectively utilized within their countries without influence from donors' commercial self-interests?

3. Improving Aid Effectiveness: MDBS & Tied Aid

- Tying aid to donor-country products is common sense; it is a strategic use of aid to promote the donor country's business or exports. It is further argued that tied aid, if well designed and effectively managed, would not necessarily compromise the quality or the effectiveness of aid (Aryeetey 1995; Sowa and White 1997).
- Valid in the case of programme aid, which ties aid to a specific project or policy, and where there is little or no commercial interest. But it must be emphasized that commercial interest and aid effectiveness are two different things and it would be difficult to pursue commercial interest without compromising aid effectiveness

3. Improving Aid Effectiveness: MDDBS & Tied Aid

- Recently, tied aid has not been well received by aid recipients or within the international community
- Twenty-two developed countries reached an agreement in May 2003 to eliminate tied aid for certain categories of development assistance to the world's poorest countries

3. Improving Aid Effectiveness: MDDBS & Tied Aid

- Budget support is a form of programme aid. Programme aid is an umbrella term covering budget support, debt relief, and balance-of-payments support
- May take two forms (i) general budget support, and (ii) specific budget support such as health and education

4. Multi-donor Budgetary Support

- Its main goal is to ensure a continuous flow of aid to enable the government to finance its poverty related expenditures.
- Unlike direct budget support, MDBS aims to harmonize policies and procedures of the development partners (DPs) in order to minimize transaction costs for the recipient country

4. Multi-donor Budgetary Support

- The framework memorandum (FM) was signed in March 2003 between the government of Ghana (GoG) and the DPs.
- Minimize transaction costs for the government by: (i) agreeing on a common benchmark against which performance is assessed, (ii) improving dialogue between government and the development partners, (iii) conditioning funding commitments and disbursements on the achievements of the agreed targets.

4. Multi-donor Budgetary Support

- Framework to be based on Ghana Poverty Reduction Strategy Document and Medium Term Expenditure Framework
- Given that the conditions have been set for the MDBS and it has become operational since June 2003, has the MDBS made any significant in-roads towards poverty alleviation?

4.1 Possible Gains from MDBS

- o The multi-donor budgetary support system—if properly planned, coordinated and well implemented—is likely to offer considerable benefits.
- o Possible benefits include: off-budget spending, using local capacity systems, reducing transactions cost, country ownership, donor influence and policy change, predictability of aid flows, pro-poor spending

4.1 Possible Gains from MDBS

Reduce Off-Budget Spending

- o Defined as, 'below the line' expenditures of donor funds given to sector ministries of a country. These expenditures are not incorporated in the national budget and audited reports are not sent to the Ministry of Finance
- o Off-budget spending is common in aid-dependent countries, where a number of specific projects, especially within the health and education sectors are financed by donors through sector ministries. MDBS synchronizes aid flows and private flows - coordination

4.1 Possible Gains from MDBS

Use Local Capacity Systems

- o The MDBS is gaining popularity because it utilizes local systems and capacity, helping to build local potential. More often than not, governments are faced with an absorptive capacity constraint for project aid
- o MDBS, offers the opportunity to utilize the accounting systems of partner governments, encouraging staff to remain at their posts and strengthening local skills

4.1 Possible Gains from MDDBS

Reducing Transactions Cost

- o Projects aid is often hindered by high transaction costs because submitting separate reports on a range of donor-funded projects is costly.
- o Also, the numerous meetings between government officials and donors can be time-consuming and significantly add to the cost of aid
- o MDDBS – common reporting format, a single periodic report per project is sufficient to meet the requirements of all partners

4.1 Possible Gains from MDDBS

Country Ownership

- o Project aid is generally made up of different projects funded by different donors. This often comes with very little country ownership and may not support the government's priorities
- o Johnson and Wasty (1993), 81 adjustment credit cases
- o MDDBS operates with Ghana Poverty Reduction Strategy document as framework. Note – ownership is not the same as authorship

4.1 Possible Gains from MDBS

Donor Influence & Policy Change

- o Donors want to influence the targeting of public expenditure towards the poor and at times towards more general economic and social reforms. Donors, therefore, use conditionality to influence policy change
- o there is little that donor conditionality can achieve if the willingness to take action is missing; conditionality then is superfluous and counter-productive because it undermines local ownership
- o Would donors be able to use their financial power to influence policy? Could MDBS minimize the occurrence of policy reversals

4.1 Possible Gains from MDBS

Predictability of Aid

- o Aid flows to developing countries are unpredictable and very volatile. There are diverse views on the effects of aid volatility on government's fiscal behaviour and growth
- o In Ghana, delays and shortfalls in donor inflows have forced the government to cut back on development expenditures.
- o At times, shortfalls have resulted in unplanned domestic financing or in non-concessional external borrowing, with serious repercussions on future budgeting

4.1 Possible Gains from MDDBS

Predictability of Aid

Years	Actual inflows	Projected inflows	Shortfall (%)
1999	1275.0	1498.1	17.5
2000	2385.5	2978.9	19.9
2001	3739.4	3784.6	1.2
2002	2868.6	4706.3	39.1

4.1 Possible Gains from MDDBS

Pro-poor Budget Spending

- o Projects aimed at poverty alleviation often have limited impact outside the project area and target group.
- o Budget support, which works hand in hand with dialogue, aims to re-shape the budget setting process in favour of the poor with better planned budgets, and ensuring that expenditures are related to resource availability and outputs

o

5. Current Status of MDBS

Actual Disbursements Projected Disbursements	2003 - 2005 2006 - 2009 (US\$m)	Actual Disbursements			
		2003	2004	2005	2003-2005
Total Disbursements: Actual and Projected		883.06	987.00	1,096.30	2,966.37
IMF Support					
PRGF Arrangement (BOP support to BOG)		73.83	39.03	78.02	190.88
Budget Support (MDBS)					
Credits		129.57	105.59	171.22	406.38
Grants		134.73	205.32	119.37	459.42
Sector and Investment Support					
Credits		172.82	224.33	240.85	638.00
Grants		372.12	412.74	486.84	1,271.69

5. Current Status of MDBS

	2003	2004	2005
Total Disbursement (\$ million)	883.06	987.00	1096.3
Share of MDBS (%)	29.93	31.50	26.51

5. Current Status of MDBS

- Increase in aid disbursements (flows) to Ghana between 2003-2005
- Significant proportion of aid is outside the MDBS basket – transaction costs have not been reduced significantly
- The decline in the share of aid through MDBS between 2004 and 2005

5. Current Status of MDBS

- Decline in MDBS contributions between 2004 and 2005 from the World Bank, EU, Netherlands, UK. Most significant decline from the UK (66.6%)
- If MDBS is key to ensuring aid effectiveness, why are donors delivering aid outside the MDBS framework?

6. Conclusion

- The paper examines whether the multi-donor budgetary support in Ghana is a better alternative to tied aid in influencing aid effectiveness
- The *multi-donor budgetary support* (MDBS), as it is called, might reduce transaction costs, take advantage of donor accounting systems to build local capacity, promote country ownership of policies and programmes, ensure pro-poor spending and above all make aid inflows more predictable

6. Conclusion

- Commendable as the idea may seem, there are a number of issues that need to be solved to make the programme effective
- MDBS operates in tandem with other forms of project aid. The problem with this arrangement is that the mix between the MDBS and other forms of project aid would not reduce transaction costs significantly

6. Conclusion

- There may be some gains but the benefit would be much greater if aid policies were synchronized so that other forms of project support were to operate similarly to the MDBS.
- Not all donors have signed the agreement, including Japan, one of the biggest donors. Japan may wish to continue providing food aid and other forms of project support, which often have high transaction costs.

6. Conclusion

- Aid predictability has improved under MDBS
- Study recommends that more aid be channelled through MDBS Framework while other sector supports are designed to have a unified reporting and accounting framework

ISSUES

- How do we promote aid effectiveness in Developing Countries
- Should donors attach conditionality to aid?
- Aid Dependency reduces economic and political freedom
- Should aid go to countries with good policies or governance structures?



END OF PRESENTATION

THANK YOU