



Making Aid Work for Africa

The Issue

Recent research suggests that African countries require high, inclusive and sustained economic growth in order to make significant progress in creating employment and reducing poverty. Experiences of advanced and emerging economies indicate that massive public and private investments are needed to achieve high, inclusive and sustained economic growth. In this context, one of the challenges facing African countries is how to mobilize sufficient resources to finance domestic investment in priority sectors. Given the current low domestic savings rates of African countries, Official Development Assistance (ODA) and other sources of external capital flows are needed to narrow the region's financing gaps in the short to medium term.

Historically, ODA has been an important source of development finance for Africa, and since 2000, aid flows to Africa have increased significantly, largely due to the adoption of the Millennium Development Goals (MDGs) and the focus of the international community on Africa's development needs (table 1). Despite the increasing trend in ODA flows to Africa, preliminary figures for 2011 suggest that bilateral aid to developing countries from the Development Assistance Committee of the Organisation for Economic Co-operation and Development (DAC/OECD) declined by 2.7 per cent in real terms compared to 2010.

Africa has not been spared this decline in ODA, attributed largely to the impact of the global recession and fiscal constraints in donor countries.

Africa's relatively high dependence on ODA has stimulated debate on the impact of aid in the region. Aid skeptics argue that it perpetuates bad governments and creates a disincentive for African policymakers to take proactive measures to boost domestic resource mobilization. Proponents of aid on the other hand argue that it complements domestic savings in the region and contributes to growth and poverty reduction. Recently, ECA conducted empirical studies on the impact and effectiveness of ODA to Africa. The studies show that ODA has a positive and statistically significant impact on the growth of per capita income, investment in physical capital, primary school completion rates, and health outcomes such as increasing life expectancy and reducing infant mortality. The studies also show a greater contribution of ODA to improvements in social indicators than to growth.

Furthermore, the studies find that the positive impact of ODA on development increases with better governance and a good policy environment. The research findings suggest that the focus of the aid debate should be on how to maximize its impact rather than on whether or not aid is useful. Against this background, this policy brief highlights some policy actions necessary to make aid work for Africa.

Table 1: Trends in aid flows (million US\$)

	1970	1980	1990	2000	2010
All Recipients	8,129.32	43,857.64	74,658.98	68,285.38	169,564.20
Africa	1,681.40	10,821.66	26,187.13	15,466.17	47,842.47

Source: OECD

Policy Options

The dialogue on aid should focus on development rather than aid effectiveness

In the discourse on aid, there has been a tendency to focus on aid effectiveness as if it is an end in itself. For example, in the Paris Declaration there is an emphasis

on process-related issues, such as strengthening the use of country systems and harmonization of donor support deemed necessary to improve the quality of aid. While aid effectiveness is a useful concept, there is growing acknowledgement that the ultimate impact or usefulness of aid depends largely on whether or not it enables recipient countries to meet broad national development objectives such as poverty reduction. In this regard, there is the need

for African Governments and their development partners to pay more attention to how aid can be used to further broader national development goals rather than continue with the current approach which places emphasis on process-related issues and enhanced aid effectiveness.

African Governments have recognized the need to refocus attention from aid to development effectiveness. In the run-up to the Fourth High Level Conference on Aid Effectiveness, African countries adopted the African Consensus and Position on Development Effectiveness. The key priorities identified in the document as critical to development effectiveness included: (a) donors fulfilling outstanding commitments on aid; (b) building human and institutional capacity; (c) strengthening regional integration; (d) harnessing the potential of south-south cooperation; (e) reducing aid dependence; and (f) establishing a new development-cooperation architecture that is inclusive and that captures Africa's development needs and realities. Interestingly, the Busan Partnership Agreement highlighted most of these important issues identified by African countries.

Aid to Africa should be geared towards promoting structural transformation

Structural transformation is crucial for sustained economic growth and poverty reduction in Africa. History and econometric evidence show that countries that have been successful in creating significant employment and reducing poverty are those that have gone through the process of structural transformation involving an increase in agricultural productivity accompanied by an increase in the share of manufacturing and modern services in output. Unfortunately, most African countries have not gone through the normal process of structural transformation. In 2008, the share of manufacturing in output was about 11 per cent and there is evidence of de-industrialization in the region.

In this context, one of the challenges facing African countries is how to promote structural transformation. Aid can play an important role in addressing this challenge if donors make an effort to direct more support towards promoting technological progress, capital accumulation and development of agriculture and manufacturing.

African countries should have a strategy to exit aid dependence

ODA has contributed to Africa's economic development through, for example, complementing domestic savings. However, it cannot be the basis for financing long-term development because it is highly volatile and unpredictable. Furthermore, dependence on ODA makes it challenging for recipient countries to have complete national ownership of their development programmes, policies and outcomes. Consequently, African countries need to design strategies to make better use of aid in the short to medium term and enhance the likelihood of reducing aid dependence in the long term. Recent research at ECA suggests that one way

ODA could contribute to reducing aid dependence in the long term is to use it to boost capacity to mobilize domestic resources in the short to medium term.

ECA research also provides reasons why aid has not played this crucial role of boosting domestic resource mobilization in the past. First, current aid allocation mechanisms rely on identifying a financing gap and then seeing how aid could close this gap. This approach can undermine incentives for savings and tax collection and needs to be re-examined. Second, as a result of emphasis on the MDGs, there has been a shift in aid allocation from economic infrastructure and production to the social sectors. This shift has negative consequences for the development of productive capacity crucial for dynamic and sustained growth. By stimulating growth, Governments create the necessary condition for enhancing domestic revenue and private savings. In this regard, it is important that financing of social sectors is not achieved at the expense of financing of the economic infrastructure and production sectors. These sectors should not be in competition with each other because financing for economic infrastructure can make a positive contribution to growth and generate more revenue for finance of social sectors. Third, ODA flows to Africa often finance domestic consumption rather than investment which is an engine of growth and is necessary to generate revenue.

The need for African countries to boost domestic resource mobilization is particularly important in light of the slowdown in economic growth in advanced countries and the fiscal constraints facing traditional donors which have had a negative impact on their ODA budgets. Fortunately, African countries are aware that ODA is not the magic bullet that will propel the region onto a path of sustained economic growth and are beginning to scale-up efforts to strengthen domestic resource mobilization.

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