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EDITORIAL

Development aid is a major issue for countries benefiting from it, but also for those providing it, as well as for the balance of globalisation. The persistent gap over many years between the goals put forward and reality is therefore disconcerting.

The main benefit of the report is that it discusses, in a resolutely constructive way, the main issues on development aid, namely its legitimacy, effectiveness and preferred selectivity. The contributions presented at the end of the report are both complementary and convergent on several points.

Several recommendations are presented, involving for some improved global governance and, for others, an improved conception and management of French ODA (official development assistance). Reforms appear necessary regarding the relationships between the relevant institutions, the improvement of procedures, the conditions associated with the aid, the preferred balance between loans and donations, the desired regional dimension with a call for a more coherent European policy on the subject...

Christian de Boissieu
Executive Chairman of the CAE

France and Official Development Assistance

Report by Daniel Cohen, Sylviane Guillaumont Jeanneney and Pierre Jacquet

With Patrick Guillaumont, Jean-Davis Naudet and Helmut Reisen

This report makes an assessment of the French official development assistance (ODA) policy in light of the recent changes of international context (collapse of the Soviet bloc, 11 September terrorist attacks and debt crises, etc) and the last academic and empirical debates.

The report notes that ODA is no longer a weapon in geopolitical confrontation. Conversely, current preoccupations focus on poverty reduction (millennium goals), the production of global public goods and globalisation management. Likewise, emerging countries have been hit by financial crises over the last twenty years and the debate is now focused on the loans/donations dilemma (illustrated in the Metzler report).

After having reviewed the foundations of official development assistance and its transformations over the past few years, our 'France and Official Development Assistance' report leads a critical discussion of the French aid, its effectiveness and selectivity.

This analysis enables the authors to recommend some improvements for the French system.

The report was presented to the plenary session of the CEA on 17 January 2006, and to the Prime Minister on 8 June 2006. This letter, released by the Permanent Committee, reviews the author's main conclusions.

Development aid: double paradigmatic discomfort

In the first chapter, Pierre Jacquet and Jean David Naudet examine the foundations of aid and its historical origins. For the authors, official development assistance (ODA) has always been characterised by a double 'paradigmatic' tension between the interests of the donors and the interests of aid recipients on the one hand and development goals and redistribution goals on the other hand.

The historical overview shows that ODA has a long history (going back to the 19th century). However, the authors, provide a brief overview of previous debates on the role of

foreign savings in development and conclude that in fact, there is no true ODA theory. Conversely, the multitude of debates that have arisen from foreign capital contributions to development is striking: from the 'big push' to 'absorption capacity', the question of effectiveness and the sectors in which aid should be invested (human capital, technological progress, aid to institutions or projects, appropriation or supervision, etc.). The post-war period marked by the reconstruction of Europe (therefore by the Marshall Plan managed by an institution leading to the creation of the OECD), the East-West confrontation and the establishment of the Bretton Woods institutions, was obviously a

milestone in the history of aid and determined the course of future events. This period was characterised by the duality between multilateral institutions, built on the paradigm of cooperation, and bilateral aid policies designed as diplomatic instruments (*vis-à-vis* former colonial empires or as stabilisation vectors of coalitions engaged in the Cold War). Against this backdrop, the creation of the Development Cooperation Directorate (DAC) at the OECD was a major step reflecting the need to coordinate the policies of the main donors (and to record the aid on the basis of precise definitions approved by all parties).

In the 1960s, after the era marked by the requirements of reconstruction, the Pearson report (1968) – named after the Pearson Commission which was set up by the World Bank to stimulate development aid – highlighted the twofold moral (based on the duty of the rich to help the poor) and strategic necessity (aid is based on the mutual interest of the parties involved). A goal was set (0.7% of GDP in ODA), and development was recognised as being a complex interaction between internal and external factors. The importance of multilateral institutions was strengthened.

The third step was taken in the 1980s against a backdrop marked by the first ‘debt crisis’ affecting both the debtor countries in relation to the private banking sector (Mexico’s case) and those with ODA debt. One then becomes aware of the fact that aid, which is supposed to help development, may, on the contrary, actually heighten the financial dependency of aid recipients. Given that prevalent analysis insists that macroeconomic and structural policies are inappropriate, aid is therefore directed towards financing the adjustment aimed at restoring financial sustainability for the country. In fact, this often involves refinancing debt in order to avoid insolvency that would put international financial

stability in jeopardy (*‘too big to fail’*). The debate on conditionality will take shape on the basis of this new order, since these refinancing policies will systematically be based on the countries’ commitment to undertake policies aimed at restoring their financial credibility.

More recently, with persistent financial crisis, development failures, the weakening of geopolitical considerations linked to the collapse of the Soviet bloc, aid has been redirected towards poverty reduction, as reflected in the Millennium Development Goals (2000), a common framework for the international development community. More recently, the attacks of 11 September put security matters on the development agenda again.

The second tension, development or redistribution, refers to the two Aristotelian concepts of law: corrective justice (aimed at making up for injustice identified previously and that must lead either to compensation, or the implementation of a ‘make-up’ procedure) or distributive justice (aimed at correcting a situation deemed inequitable in terms of resources based on needs, actions or merit). The development paradigm naturally relates to a corrective justice concept since it involves correcting ‘accidents of history’ that have led to separate development processes. Aid, as redistribution, is obviously justified by a distributive justice concept, making it imperative to help the poor solely on justification of their poverty.

Consequently, we can see how these two concepts, which in principle reject any form of compromise, refer to rather different visions of the world, in terms of the approach to responsibility, aid and the assessment thereof. The corrective approach is associated with a dynamic vision (poor countries should develop) of society, whereas the distributive approach accepts that interdependencies systematically produce ‘winners’ or ‘losers’, which

ODA will be required to constantly correct. The gradualist position will emphasise the contract binding the aid recipient with the donor and the responsibility of both parties, while the distributive concept of aid tends to more naturally emphasise the limitations of the recipients’ responsibility. Aid is therefore contractual (based on reciprocity) and contingent (the implementation of verifiable policies, goals, etc.) in some cases whereas it is based on the situation of a State (land locked, poverty, sanitary conditions, etc.) in other cases and therefore not conditioned by the ‘performances’ of the aid recipient.

Millennium goals and global public goods production: going beyond?

The traditional concept of ODA has remained restricted to the fields of bilateral or multilateral relations between States, although alternative concepts are emerging. The first approach considers that the aid is fundamentally aimed at individuals (the poor, those suffering from discrimination, with no access to basic resources, etc.) and that in this respect the interests of States may diverge from those of all or part of their population. As a result, governments tend to become representatives acting on behalf of their populations, and aid becomes ‘selective support’: this involves supporting a certain number of beneficiaries in implementing projects according to methods chosen by themselves. The emergence of this form of aid is presented as an example of crossing the traditional divide between distribution and development. By recognising that the ‘human being is the central subject of development’ (1986) and by setting universal objectives based on this awareness (MDGs, Millennium Development Goals) in 2000 the international community points the way to ODA contractualisation.

The other approach is that of joint production, by rich countries and poor countries, of global public goods (GPG). Given the increase in interdependencies and externalities, the concept on which the aid was based has gradually become obsolete (i.e. the interaction between Sovereign States). If globalisation implies the participation of poor States in GPG production (fight against pandemics, preservation of biodiversity, security and fight against terrorism, fight against global warming), aid can be seen as ‘remuneration’ that rich countries grant for the participation of poor countries in the production of goods to the benefit of all.

Effectiveness, selectivity and conditionality: an analysis of French aid

The second part (Sylviane Guillaumont Jeanneney and Patrick Guillaumont) is devoted to the issues of the effectiveness, selectivity and conditionality of aid, and the way in which French ODA may be judged in light of these three criteria. These debates, that are predominant in the field of ODA, highlight that aid effectiveness is optimised when directed towards countries that have a certain type of governance. This theory, highlighted in a major article by Burnside and Dollar (2000), suggests that aid is effective in countries with a good economic policy or good institutions. The authors review a few remarks of a technical nature (concerning ‘good economic policy’ indicators, the quality of estimated regression, effectiveness examined solely by measuring product growth per capita, etc.) before more significant criticisms:

- The first is that a key analysis of the effectiveness of aid depends on cultural ties (notably linguistic) that exist between donors and aid recipients. These ties, that are generally not taken into account in studies, focus on aid effectiveness, yet prove one of the most significant explanations of ODA flows;

• Moreover, Burnside's and Dollar's theory overlooks two much debated issues on links between aid levels and effectiveness. The first is the 'big push' issue, raised by Roseinstein-Rodan in the 1940s. It highlights the existence of a threshold effect below which effectiveness will remain limited. Conversely, physical constraints (geographical isolation, limited infrastructures, etc.) or administrative ones may work against an efficient mobilisation of aid without calling into question the governance of countries receiving aid. Likewise, aid that is too significant can cause certain types of macroeconomic imbalance, such as the 'Dutch disease', which reflect an increase in effective exchange rates detrimental to growth.

The question of aid effectiveness includes a 'selectivity' analysis of this aid, i.e. the quality of its geographical allocation. The authors point out that the selectivity of French aid is poorly considered by the DAC, which accuses it of donating too much to Africa, of a high concentration in a few countries (37% of French aid goes to the five first recipients) and, conversely, too dispersed across many other countries (27% of French aid is spread over more than 120 countries). This criticism is subsequently discussed at length in the report. Firstly, and as in the previous case, one should examine the criteria used to assess selectivity. For example, the authors state that the vulnerability of countries, which are sometimes in a post-war situation, is often not included in studies evaluating the quality of the geographical allocation of aid. Moreover, France's allocation criteria are considered rather inefficient in light of significant historical ties –former French colonies often turn out to be countries with low revenues and with poor governance.

But above all, given that the optimal aid is that which responds best to the goals pursued, the objectives of the aid will have to be

explored for all selectivity analyses. The most common approach (see Collier and Dollar, 2001 and 2002) consists in stating that aid is aimed at durable poverty reduction while favouring economic growth. The legitimacy of aid would therefore be based on one objective: poverty reduction obtained through growth, with effectiveness depending on the quality of governance. The ethical grounds of such an approach are to reduce the likelihood that inhabitants of developing countries to remain poor. This likelihood, depending on policies followed locally by aid recipients, varies significantly from one country to another; and the desire to help the highest number of people out of poverty therefore leads to a concentration of aid in countries that are governed best or those with the highest poverty rate. In other terms, it would lead to a deliberate choice to deprive part of the world's poor population of aid.

An alternative may be the 'equal opportunity for all' principle. One considers that individual differences in terms of well-being should only be due to efforts by the individual, rather than differences in allowances to the latter. Thus, the principle would be to allocate aid to areas where obstacles to growth minimize most the results of a given effort. Contrary to views mentioned above, human rights violations and the poor governance of countries could arguably be assimilated with obstacles to citizens of these countries and should thereof receive more aid than those of well governed countries! The most vulnerable countries (e.g., because they are subject to the instability of commodity prices), but also countries with low human capital, may therefore legitimately receive more aid than others.

The authors' debate leads to a few recommendations.

The first prompts France to take action aimed at developing the international community's posi-

tions as regards the diversity of criteria taken into account to examine the selectivity of aid. The international community could easily agree on the following four criteria: two poverty criteria (per capita revenue and average level of human capital) and two effectiveness criteria (governance and economic vulnerability).

In return, our country should be a lot more explicit and transparent on the criteria it uses to select the countries it decides to help (the authors argue that the French speaking world is an explicit component of French aid). As such, once the global allocation of development aid is determined for each recipient, each donating country could indicate the portion of bilateral aid that it would like to be responsible for depending on its own selectivity criteria. This procedure would provide great visibility, apart from reconciling global and national preferences, on aid for recipients.

Nonetheless, the inertia of the geographical allocation of the aid should be noted with regard to compliance with a reformed procedure. In particular, the cancellation of debt, partly booked as ODA, results from prior decisions or international commitments. Likewise, money directed to foreign students en France, refugees, or even committed to research organisations working in developing countries (IRD, CIRAD, etc.) cannot be transferred rapidly. Note that aid expenditure corresponding to bilateral flows directly allocated to countries represents just over 10% of French ODA.

The final part of the chapter on French aid for developing countries is devoted to the conditionality issue. This implies that financing is subject to a commitment from the recipient to pursue a specific economic policy, whether on macroeconomic terms (for example, adjustment policies negotiated with the IMF) or microeconomic ones (one may decide, for example, that aid for an agri-

cultural project may be subject to the reform of a product's distribution channels). This is also referred to as 'instrument-based conditionality'. Macroeconomic conditionality was mainly developed in the 1980s during the first debt crises in the context of adjustment policies driven by international financial institutions. In fact, macroeconomic conditionality is now dominated by that of the Bretton Woods institutions (for example the restructuring of bilateral public debt is subject to an agreement with the IMF). This logic, aimed at securing the reimbursement of loans, is based on the doubt that the international community has as regards developing countries' capacity to define an economic policy that is both efficient (i.e. will lead them to development) and likely to guarantee the reimbursement of loans ('credibility' effect that the countries 'buys' by obtaining approval from multilateral institutions). In light of this, specific difficulties have emerged:

- countries are asked to make rapid decisions before the payment of an additional tranche, thereby leading to rushed and short-term decisions;
- it leads to a game between negotiators who are leading the concerned states to accept reforms that they know they cannot implement or that they believe they can obviate;
- reforms lose their credibility when lenders are reluctant to apply sanctions. Conversely, applying sanctions strictly or discontinuing payments may lead to losing the benefit of what has already been accomplished;
- conditionality often involves putting under strict supervision the country where development is inseparable from an appropriation process of reforms.

These remarks enable the authors to make other recommendations regarding conditionality: this involves shifting from 'instrument-based conditionality' to 'results-based conditionality'. Aid will no longer be subject to actual

implementation of specific action, but to achieving the goals of policies, defined by the countries themselves. The challenge is that countries assisted adopt the policies for which they receive aid. This conditionality should be based on impact indicators measuring the results of policies under-taken thanks to the aid, implementing assessments that are not too frequent (policies take some time to produce results) and based on standard indicator developments defined internationally (in order to avoid the double pitfall of countries which set goals too ambitious to entitle them to aid, or, on the contrary, goals that are too restrictive that enable to minimise the risk of failure).

Loans or grants: the issue of volatility of southern economies

The third chapter, written by Daniel Cohen and Helmut Reisen, refers to the loans/grants dichotomy and the debate that followed the publication of the Metzler report, which argued in favour of cancelling loans and providing aid through grants. The logic was based on the idea that the institutional capacity of some of the poor countries was too weak to assume the repayment burden, therefore there was no point (for development) or it was dangerous (for the economic stability of these countries) to continue to lend. In this case, it would be best to note that it is im-

possible for them to access capital markets, cancel their public debt and substitute a grants policy (potentially results-based) for a loans policy.

Nonetheless, the authors highlight reasons other than institutional weakness that force these countries out of global capital markets:

- low capital return, due to increased economies of scale. This argument, well known by theorists of 'endogenous growth', argues in favour of massive transfers which would enable breakeven to be reached. A loans policy is therefore perfectly legitimate, but the question is: which lender has to bear the 'waiting cost' (the time needed for this accumulation to bear fruit in terms of profitability);
- excessive economic volatility of these countries (notably commodity producers) means they bear risk premiums and, as such, are excluded de facto from capital markets.

As a result, the authors argue in favour of the implementation of a policy of original aid which ensures that these countries retain access to capital markets. Loan repayments would be explicitly contingent on the debtors' economic cycle. The proposed modification would be to subsidise the establishment of reserves by aid agencies who grant loans, which would enable them to deal with repayment incapacity if the debtors are confronted with a downturn. The reserves thus built up could be used in the event of external circumstances (natural catastrophe, sharp fall in the price of an export product, etc.) and recorded as development aid.

The benefit of this method is that it is virtuous: the more risky is the

country, the higher should be the provisions (scaled to the risk associated with a country), then the lower the leverage effect. As such, a loan to a 'totally risky' country should be fully covered by a provision (100%), which *de facto* transforms this loan into a grant. Conversely, a country where a provision is set aside for, let say, around 10% of the loan, would have access to a loan ten times higher than the provision. This recommendation would prompt countries to reduce their exposure to risk (since in this case, they benefit from a higher leverage effect on the provision booked), and to redistribute wealth to countries which have been unfortunate (economic shock) and to the detriment of poorly managed countries (who end up rescheduling their debt).

Comments

In his comment, *Jacques Delpla*, notices that some of the countries that perform better (India, Vietnam) are also those which have benefited least from development aid. He also stresses that although no one knows what are 'good policies', bad ones are easily identifiable. He concludes that a negative conditionality in ODA could be envisaged. He regrets that the question of the Central African Franc (associated with an overvaluation of foreign exchange in these countries) was not discussed in the report and wonders why one cannot go beyond what the report recommends (the centralisation of aid at AFD –the French Development Aid Agency) by merging different aid agencies of European countries. He states that the

analyses of Daniel Cohen on the volatility of economies are of great importance and should be developed further.

Jean-Paul Fitoussi stresses that he agrees on the main points of the report: the intractable ambivalence of aid, the lack of absolute criteria to define a 'good policy', and the difficulty of basing aid on effectiveness criteria only (one would end up only helping those that do not need it, and this fails to take into account the debate on objectives and aid's influence on policies). As far as French aid is concerned, he underlines that his main criticism is that it is difficult to define it due to lack of clarity on objectives and the lack of independence of the institutions responsible for the management of this aid.