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Can New Aid Modalities Handle Politics?

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Abstract

Are recent donor approaches compatible with a political understanding of policy processes in partner or recipient countries? This question is given increased urgency with the recent calls for and commitment to increasing financial flows, scaling-up of aid, and promoting donor coordination. Do these commitments sharpen the potential dilemma between increased aid and the political processes, and the changes that inevitably accompany this? This paper discusses the nature of the partnership enshrined in the Monterrey consensus, budget support and poverty reduction strategy papers (PRSP) approaches, and assistance directly targeted to the poor, as one way of increasing aid flows to poorest countries. It also discusses approaches to the role of aid in economic growth, and argues for better understanding of the politics of growth. The papers questions whether the current 'institutions' or governance paradigm brings sufficient political context to aid delivery, and discusses the relationship between domestic revenue generation and foreign aid. A concluding section draws out implications for aid delivery, and for a potential role of socio-political analysis in new aid modalities.

Keywords: aid, donors, governance

JEL classification: F35, F59, F33

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Note from authors

The opinions expressed are those of the authors, and do not necessarily express the views of DFID.

Acronyms

DFID	Department for International Development of the United Kingdom
IFIs	international financial institutions
IGRs	institutional governance reviews
MDGs	Millennium Development Goals
PRSPs	poverty reduction strategy papers
SIDA	Swedish International Development Cooperation Agency

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Introduction

This paper looks at a range of recent developments in the ways in which aid is provided, or 'aid modalities'. In particular, we consider whether donor approaches around budget support, poverty reduction strategy papers (PRSPs), and direct transfers to the poor are compatible with a political understanding of policy processes in partner or recipient countries, an understanding that is typically not captured in quantitative analyses of aid effectiveness. The theme is given increased urgency with recent calls for—and commitment to—increasing financial flows, scaling-up of aid (Monterrey consensus, Gleneagles, the 2005 MDG project, the Millennium Challenge Corporation), and for increased donor coordination. The question we raise is whether these commitments sharpen what we believe to be a potential dilemma between increased aid and the political processes and changes that inevitably accompany this.

The paper is structured as follows. The first section discusses the nature of the partnership enshrined in the Monterrey consensus, and some questions around the realization of this consensus, particularly the debate whether scaling up is possible or desirable. Section 2 discusses budget support and PRSP approaches, and the lessons learnt around increasing aid and the political processes that accompany this. Section 3 focuses on assistance directly targeted to the poor, as one way of increasing aid flows to poorest countries, and asks the question how this way of providing assistance may impact politics. Section 4 looks at old and new approaches to the role of aid in economic growth, a major subject of debate during the 2006 WIDER Aid conference, and discusses the need to strengthen an understanding of the politics of growth. Section 5 then focuses on the increasingly important work on governance and institutions, and questions whether the current 'institutions' or governance paradigm brings sufficient political context to aid delivery, followed by a discussion of the relationship between domestic revenue generation and foreign aid, and how this is understood in donor literature. The concluding Section draws out implications of these concerns for new aid delivery, and discusses the potential role of socio-political analysis in new aid modalities, and ways in which a better understanding of political context and changes can inform the post-Monterrey consensus.

1 Monterrey: the political partnership?

Following the period of structural adjustment that largely ignored questions of governance and micro- and macro-institutions, the 1990s increasingly identified governance as crucial to development outcomes. Aid modalities sought governance with 'quick fix technical solutions', but experience showed reforms implemented without respect for local conditions proved disastrous. As governance became the centre for development activity, the list of allegedly necessary reforms grew exponentially across all its dimensions, from 'rule of law' to 'capacity building'. But, after the initial euphoria of the collapse of the cold war and its client dictatorships in the developing world, it became apparent that these supply-driven generic governance solutions were not working.

This dissatisfaction with the proliferation of these technocratic solutions led away from the early 1990s ideas of 'good governance' to a more focused and realistic '*good enough* governance' (the term coined by Merilee Grindle 2004) that tried to target fewer

but more prioritized and feasible interventions. To match demand, a new mantra developed: context specificity, addressing local needs. Legitimacy of reforms and their general principles (such as the macroeconomic principles of the Washington consensus) required adaptation to local political and social context. Soon it became apparent that reform feasibility required better understanding of local politics. The few universal principles that did emerge from the 1990s showed 'political will' and 'political context' needed to be understood much better: for example, legal reforms, while actively encouraged by the teams of highly paid lawyers and consultants, should not be seen as 'solutions' without understanding whether new laws were really needed or would be implemented, rather than reformist governments and activist judges applying existing laws to changing contexts (Kaufmann 2003).

So by the beginning of the new millennium the international community had arrived at a broad agreement: not only did governance matter, but the problems underlying the technocratic challenges in governance were inherently political. The Monterrey consensus in 2002 consolidated politics at the heart of development, and thus also potentially at the centre of its meaning of governance: both domestic and international politics were integral to the governance problem and also to its solution. The Monterrey final report[1] cautioned that 'governments must build within their countries—both developed and developing—the public support necessary to translate their collective vision into action. That would require political leadership in the developing countries to overcome the many difficulties in undertaking institutional and policy reform, and in the developed countries to develop engagement and solidarity with the developing countries in their efforts to reduce poverty'. It warned that 'to translate the draft Consensus into action will involve a process of arriving at politically acceptable decisions at the national and international levels. There is a need for strong political will'. The consensus admitted that non-developmental considerations still strongly influenced aid allocation models: 'ODA resources have not always been targeted at the poorer countries but have often been driven by geopolitical considerations'.[2]

The consensus declared that 'the international community has created the political space for unprecedented dialogue among all relevant stakeholders on financing for development'. But 'implementation will require major national and international efforts, and … substantial technical efforts should be accompanied by a strong and persistent political will … Political will and leadership—in both the developed and the developing countries—will be key factors determining its ultimate success'. It asked, 'Who will provide the political leadership for listening to new ideas and changing institutions?' It noted the importance of strengthening coherence between United Nations, the Bretton Woods institutions and the World Trade Organization, as well as regional financial institutions, and argued to place development at the centre of the global political agenda. The then president of the General Assembly of the UN declared, 'Something must be done to galvanize the global political will for an accelerated drive to meet the Millennium Declaration targets'. Only the head of the IMF added a note of caution to

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1 Report of the International Conference on Financing for Development Monterrey, Mexico, 18-22 March 2002: http://www.un.org/esa/ffd/aconf198-11.pdf

2 The then head of the World Bank, James Wolfensohn, declared that 'too much money has been squandered in the past by decisions determined by politics instead of development'. Alesina and Dollar (2000) analyse the political and historical motives behind aid patterns.

the focus on politics, observing that 'slow progress in the reforms needed to fight poverty often reflects lack of institutional capacity rather than lack of political will'.

So Monterrey created a 'Faustian' bargain between rich and poor. The developed world would give more money in return for political elites in poor countries delivering the better politics and governance essential for delivering the MDGs. Now these vested interests in the developing world would have to adjust not just the governance structures, but also apparently the political processes of their countries if they want to benefit from surging aid flows and debt relief.

The rest of this paper focuses primarily on the whether and how this new aid modality can incorporate such politics. However, from the outset it is important to highlight the genuine doubts about whether such increases in aid will and should materialize. First, the consensus needs to be seen against the background of the renewed emphasis particularly by USAid—returning from a decade of holiday from history, and criticizing a 'European consensus'—to ensure that aid is aligned with donor country foreign interest (Natsios 2006). Second, while there has indeed been a significant reversal since 2000 of the downward aid trend of the 1990s, the commitment of 0.7 per cent of GNI is, of course, no different from the consensus since 1969 drafted under the Pearson committee. It is important to note that these commitment have had little sustained impact on total aid flows (except for short periods, in particular countries, but indeed the fluctuations in aid flows have been highlighted as a major concern). Recent trends also suggest that the trends are not always more favourable for the 'like-minded' donors, and that they can reflect rather different interpretations of priorities for the development agenda, and of course follows shifts in national politics.

The commitment for increasing aid is made in the face of clearly documented doubts about 'the capacity for absorption of aid' (as well as increased scrutiny of the 'outcomes' of aid). Well-known and often populist concerns about the failure of aid have recently been given a loud voice by Easterly (2006), who suspects that the increased commitments to aid will be subject to a dominance of 'planners' (including those who think they can plan a market, as opposed to 'searchers') and failure to learn from past mistakes. Easterly's book is in direct critique of the Millennium Project, the Commission for Africa, and Sachs (2005), probably the best-known proponent of increasing aid. Sachs has been a fervent supporter of increased aid to Kenya or Ethiopia, for example, and during a DFID presentation in 2005 strongly opposed ideas that increased aid should be subject to improvement in governance, arguing (as he does in his book) that it is impossible to run a health system on current per capita health allocations like in Kenya.

The fact that this debate is very much alive is further illustrated in the recent *IDS Bulletin* (2005) on increased aid: minimizing problems, maximizing gains. Very diverse views are illustrated, for example, by Howard White, on the one hand, who concludes there is a serious shortfall in aid disbursements, while on the other hand Tony Killick who argues additional aid will divert attention from attention to quality and effectiveness of aid (as in Easterly, disagreements regarding conclusions and reliability of quantitative analysis feature strongly). Views differ around questions of absorptive capacity, possibilities for governance reform, likelihood that aid will be delivered in coordinated manner, donors 'unhelpful habits', and continued questions around aid dependency (Manor 2005).

Hence, the nature of the new political partnership, and technical views regarding its feasibility, remain hotly contested. The point here is the fact that doubts about desirability of increasing aid exist, not to prove one or the other side in the debate right or wrong. The push for increased aid is occurring in the face of well-documented doubts around the desirability of additional aid (possibly suffering from the 'confirmation bias' identified by Easterly 2006: 48), and against very clear evidence that new aid modalities engage only in a very limited way with local politics. Later in the paper we come back to how work on 'governance' has changed alongside the emergence of the new consensus, and we next look at how a number of aid modalities incorporate notions of the political nature of development.

2 Budget support, sector-wide approaches and PRSPs

During the late 1990s two forces came together, leading, at least temporarily, to quite radical changes in the way aid was delivered: the pressure for debt relief, and the critique notably within the World Bank around aid effectiveness. The concept of poverty reduction strategy papers (PRSP) was the clearest outcome of these changes, and central to the international public debate, but was preceded by related changes in aid modalities.

Both sector-wide approaches and budget support arose out of concerns around uncoordinated donor programmes, and lack of sustained impacts. Sector-wide approaches have been defined as an aid modality, in which all significant funding for the sector supports a single sector policy, under government leadership, adopting common approaches across the sector, and relying on government procedures. The modality emerged as a response to three issues (Foster 2000: 7-8). First, donors found that conditionality, in general, did not work, and sector approaches became a way of providing support against government commitment and track record in providing services for poverty reduction. Second, the emergence of sector approaches was an attempt to focus support on creating a sound policy environment. Rather than donors directly funding services, sector-approach funding is geared towards changes in policies and institutions. A third set of issues revolves around public expenditure frameworks and management: a key question in which sector approaches was thought to help provide a solution was the fragmentation in the budgeting process, with much spending being outside the government budget, and with reliance on donor rather than government financial management.

While budget support modalities follow many of the ideas of sector-wide approaches, but are applied to cross-sectoral frameworks and typically in the context of fiscal reforms or adjustment, the PRSP approach incorporated much civil society critique, linked debt relief to a strengthened poverty focus, and emphasized (recipient) country ownership and in-country consultative processes.

As indicated, two forces brought about this new approach. First, the PRSP came about partly as a result of the successful NGO pressure on the international financial institutions (IFIs), particularly through Jubilee 2000, and helped by the changes in European governments in the late 1990s. This broad movement argued for increasing debt relief, particularly but not only by the IFIs. It increased pressure to make this debt relief pro-poor, and to address the negative consequences of structural adjustment. The

international financial crisis in East Asia also increased the pressure on the IFIs, to review their policies, and their effects on poverty.

Second, the changes happened against the background of an intensive debate about the effectiveness of aid. The World Bank in 1998 produced the influential *Assessing Aid* report, which emphasized the need for good economic management as precondition for aid to be effective. The report also acknowledged problems with traditional lending conditionalities, the need for (recipient) government ownership, and problems of fungibility. Changes in the IMF included a response to the critique of the inflexibility in its macroeconomic and fiscal options, of the way conditionality had evolved over time and the need for better prioritization of policy measures, and division of labour between international institutions.

The PRSP approach has been based on the following (interrelated) principles: an emphasis on country ownership and partnership between donors and recipients, formulation of a PRSP through broad national-level participation, a result-oriented approach including establishing a link between debt relief and impact on poverty, and comprehensive and long term. The empirical material generated by reviewing the experience leaves little doubt that at least the debate has brought in a much stronger focus on poverty reduction. It was acknowledged that time pressure greatly influenced early experiences, that the design of the approach had focused too much on the strategy *paper* (and hence it became common to refer to PRS), and reviews indicated much diversity of country experiences (IMF and World Bank 2005).

What do we know about modes of aid delivery through poverty reduction strategies (PRSPs)? Debt relief has delivered large amounts of additional aid—yet the lessons from PRSPs are as yet unclear, even though there is little doubt that spending has a more 'pro-poor' direction. The IMF appears to pull out from discussions on PRSPs: is this a sign that the modality has become mainstream, or that it is not working for the IMF? Booth's (2005) assessment that the PRSP is still an 'experiment' can be read as an important warning against the aid modalities that received most attention since the late 1990s. The question of donor alignment and coordination is still very important, though much work has been done by the Development Assistance Committee (DAC) in this area. Much of the literature (internal and independent alike) ask questions whether donors can really leave countries in the driver's seat, or whether they continue to push them, often in uncoordinated manner producing 'Christmas trees' PRSPs.

The critiques of PRSPs have been manifold, and only some of these are pertinent here. Booth and Lucas' early emphasis on the missing middle of politics in PRSPs seems particularly important (2001), as is Craig and Porter's (2003) assessment of the technocratic nature of PRSPs. Monitoring of progress is very much and increasingly outcome focused, with little analysis of the why, the causes and political-economy of change. The anti-political nature of PRSPs is confirmed by reports of a neglect of the legislature in the consultations leading up to PRSPs (while civil society often has seen its space increased). In the paper presented at the 2006 WIDER Aid conference, Booth, Grigsby and Toranzo emphasize that, rather than a *neglect* of political constituencies, PRSP modalities in Latin America are *unrealistic* in their expectations of political constituencies' commitments to the comprehensive plan encapsulated in the PRSPs (instead, they call for a focus on specific actions, to which governments in power can reasonably be expected to commit themselves to.

A recent World Bank paper also highlights the issue in relation to budget support:

> The provision of funds to a partner country's treasury should provide an incentive to strengthen both internal and external accountability. Finance ministries should demand that sector ministries deliver sustainable development results, line ministries have an interest in receiving adequate funds on a regular basis, supreme audit authorities monitor the proper use of public funds, and parliaments can hold governments accountable for delivering on their promises. Ultimately, however, the quality of this process is dominated by *domestic political dynamics* that can either support or block whatever modest contributions may be made by the policy dialogue underpinning budget support (Koeberle, Stavreski and Walliser 2006: 21; emphasis added).

Budget support, PRSPs, and sector-wide approaches have been very important reactions to concerns about perceived failures of aid modalities, at least since the successful debt-relief (and more recently rapidly increasing private aid flows, including through 'vertical initiatives') also motivated by the increased spending pressure. A very different recent response among the development community has been a focus on cash transfers which we discuss next.

3 Direct assistance to the poor: solving poverty, or the aid delivery problem

This section looks at the role of social protection and cash transfers in donor practices. Since the critique of structural adjustment, and revived by the Commission for Africa, cash and other forms of direct transfers to the poor have obtained increased significance. What does this imply for the political dynamics of aid relationships? We focus here on social protection, but the argument could be extended to, and would be strengthened by, a consideration of the politics around decisions on social sector spending, including the global debates on ceilings that some NGOs argue are being imposed by the IFIs.

Direct assistance to the poor became an increasingly important instrument during the period of adjustment. Social funds were one of the key instruments in the 'human face of adjustment' that the World Bank, regional banks, and supporting bilaterals tried to show from the 1980s onwards, and was one of the fastest growing sectors in the World Bank during the 1990s (Fumo et al. 2000). One of the first social funds was conceived explicitly as a compensating measure for laid-off mine workers in Bolivia. PAMSCAD in Ghana had a fairly open objective of reducing social unrest. And the social fund in Thailand after the East Asia crisis was very explicit about social integration as a key element. The basic idea of social funds, which have shown large variety, has been to provide funds for development activities (across sectors) to poor communities. Indeed, over time, the emphasis of social funds shifting towards community-driven development has been strengthened.

The literature on social funds is voluminous, with excellent studies about the extent to which money reaches the poor (like the World Bank's own evaluation study by Rawlings, Sherburne-Benz and Van Domelen 2004), and whether they are demand- or supply-driven. One of the important critiques in this context has been the effect of social funds on 'mainstream' institutions; in many cases, though not all, social fund agencies

operate as semi-autonomous institutions. It has been argued that social funds bypass line ministries. In a way they are, indeed, a response to the failure of the regular government institutions. Thus, they can even have a negative impact on these regular institutions, by attracting personnel for line ministries to work in better-paid jobs in social fund agencies, for example. Social funds as an instrument for delivery of assistance to poor communities may thus have been a way of avoiding the task of addressing problems of inefficiency in mainstream institutions.

Of late, the instrument of direct assistance to the poor (under the title social protection, or cash transfers) has been gaining popularity. The Commission for Africa argued for predictable streams to (pre-emptive) national social protection strategies. The ILO has provided estimates around the cost of social protection, trying to convince the international development community that such systems are less expensive than often assumed, and Ravallion's (2003) work has provided support to arguments about the importance and feasibility of direct transfers. Interestingly, much of the evidence on these new instruments to reach the poor directly derive from Latin America, where programmes like PROGRESA in Mexico are explicitly political, and new and more progressive forms of pensions in Brazil are based on a 'new social contract' (Graham 2002). While such programmes in Latin America are country-led, in Africa donors play an enormously important role in new programmes in Zambia and Ethiopia, for example.

The argument is that while these are important modalities in many countries, particularly those with weak commitment to poverty reduction or weak governance structures, they can also be a means of circumventing a central problem, of increasing aid without acknowledging the political nature of aid delivery. These aid modalities are not neutral. Addressing poverty as a question of social security runs the risk of neglecting structural, and in particular political dimensions or causes of poverty.[3] At micro level, such transfers impinge on community and power relations.[4] And at macro level, we can illustrate this point with reference to Orissa (Jayal 1999, in de Haan 2004): while outside the donor context, the key points seem pertinent to the way new social protection programmes particularly in Africa are conceptualized. In the state of Orissa, where starvation deaths are a perennial occurrence but usually denied by the state government, claims for increased central assistance are made with reference to 'droughts', and are relief-oriented, arguably in a way that denies the structural nature of problems like land alienation, corruption in access to forest resources, and failure of extensive development programmes over years, if not decades.

The key message here is not whether social protection schemes are a good or a bad thing. The point in this paper is that the assessment in the international donor community remains limited to a very narrow and technocratic framework, with too little understanding of the political dynamics in which such policies are inevitably embedded,

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3 Poverty analysis has played an important role in this emphasis on targeting the poor, leading to the well-established critique of a 'residual' nature of the dominant social policy paradigm (Mkandawire 2004; de Haan 2007).

4 Gaspart and Platteau (2006) criticize the practice of providing cheap aid money for poor communities, as this leads to corruption and may strengthen or create unequal power relations. Capacity differentials among communities impact disbursement. The requirement of community contributions can favour projects where contributions can be more easily quantified and projects approved (such as school-building), but disadvantage poorer communities, and those for whom the opportunity costs of in-kind contributions is too high.

and the way the global debate (for example, on social sector spending) influences these dynamics.

4 Economic growth

Promoting economic growth, of course, or more recently pro-poor growth, has been a key objective of aid, and the 2006 WIDER Aid conference had many papers that looked at the conditions under which economic growth can be promoted. The question we address here is whether the multilateral and bilateral development agencies are becoming smarter at understanding the political conditions necessary for achieving the economic growth needed for poverty reduction.

The proliferation of supposedly necessary technocratic reforms for growth and investment in the 1990s were impossibly demanding for many poor countries. At the same time, the policy prescription on the broad governance reforms needed for investment and growth is evidently incomplete or misleading: growth spurts or sustained economic development have occurred where the institutional environment appeared 'poor' (notably in China since 1978 and, to a lesser extent, in India since 1980). Vice versa, the adoption of the 'right' institutions often fails to generate growth, notably Latin America, just as structural adjustment failed to generate a 'supply response'.

Moreover, substantial intra-national growth differences exist that cannot be explained by broad generalizations about institutional factors. There are significant examples of rapid growth and investment in some sectors within countries that are otherwise regarded as having poor growth and investment climates (Haber, Razo and Maurer 2003). Growth differs widely by locality within countries, with local governance factors often explaining the marked regional variations in growth performance (e.g., across the Indian states of Gujarat, West Bengal and Tamil Nadu that were at a comparable level of development at the time of independence (Sinha 2005);[5] and across China (World Bank 2006a).

Successful growth economies have all witnessed the state playing an important but varying role: attracting investment; improving productivity, technology, and competitiveness. Delivering economic and political stability would seem critical, yet research finds instances when increasing political instability has been correlated with *increase* in investment (Londregan and Poole 1990, Campos and Nugent 1999). So what matters is how political arrangements have underpinned the competence of key institutions: legal systems, regulation and competition, the public sector, and the flexibility of fiscal and monetary policies. Causality, however, is unclear between governance, investment and growth. Governance may be critical to the investment climate, which in turn may—or may not—lead to growth. But governance will also

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5 Gujarat has consistently attracted a higher share of investment, West Bengal failed to capitalize on its initial conditions, and Tamil Nadu has a fluctuating performance (investment per capita in Gujarat was two and half times the all-India average by 1994, while in Tamil Nadu such investment stood at 0.85 of all-India levels, and in West Bengal at 0.47). Local politics in Gujarat developed 'strategic capacities' that consistently attracted private capital, while in West Bengal and Tamil Nadu local politics have tended (at least until recently) to have the opposite effect.

influence how the investment climate can lead to growth. For example, India and Brazil, with similar rates of investment (21 per cent of GDP), grew at rates as different as 5.7 per cent and 2.1 per cent between 1980 and 2004. Even the evidence for institutional reform impacts on growth is surprisingly patchy (Hausmann, Pritchett and Rodrik 2005; Hausmann, Rodrik and Valesco 2005; Jones and Olken 2005). Governance reforms supposedly crucial for growth have had no effect on economic performance of African countries (Sachs et al. 2004). China has enjoyed significantly higher growth rates than India, yet does not perform better along the supposedly critical dimensions of growth/investment climate factors like stability of property rights, corruption or the rule of law, but rather has other governance capacities that seem to matter.[6] Increasingly the attention is on what really matters: identifying the key binding constraints to growth, 'good enough governance' (Grindle 2004), and better insight on how governments may have used non-market mechanisms to improve economic performance, such as not initially creating secure property rights but reshaping property rights to put assets into productive hands (Khan 2005).

Such innovative approaches require a much better understanding of the politics of growth, as is described in a recent briefing paper for DFID by Williams et al. (2007). Political coalitions for growth are shaped by how political parties, government bureaucracy, and the private sector develop and maintain the state's support for longer-term growth objectives, while balancing concerns for other key priorities: equity, human development and poverty reduction (White and Anderson 2001; World Bank 2006b: chapter on political equity; Alesina and Rodrik 1994). It necessitates a good grasp of history to appreciate how the construction of the political settlement for growth, the 'sense of national purpose' develops, including modern economic systems developed in parallel with the rise of nation-states and nationalism (Greenfeld 2001). Even central banks, often portrayed as the archetypal technocratic economic structure, have strong political dimensions (Epstein 2006). State legitimacy matters for economic growth. The most economically successful African states, such as Botswana, are also the continent's most legitimate, so their political leaders do not need to maintain political power at the expense of development. This historical legitimacy in Africa is estimated to be worth over 2 per cent annual growth. (Engelbert 2002)

Thus, politics lies at the heart of economic growth, and to the relationship between aid and growth, just as it has been for budget support and direct transfers to the poor. In the following sections we look the role of governance in donor frameworks, and discuss whether this sufficiently captures politics.

5 Governance as institutions—but as politics?

The post-Washington consensus has put institutions at the centre of attention of aid delivery, as have the new aid modalities of sector-wide approaches and PRSPs. 'Lack of political will' over the last decade has steadily moved out from the 'risk assumption' of development into the spotlight as the problem. The most important development of recent years has been the recognition that 'good governance is about good politics'

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6 E.g., for accelerating resource allocation to growth sectors, prioritizing infrastructure for these sectors, and in making credible and attractive terms available to investors bringing in advanced technologies (Qian and Weingast 1997).

(DFID 2006: 23). However, we argue here that work on governance remains, by and large, too technocratic, and institutional approaches can reinforce this.

Political scientists have found little entry into donor agencies (unlike economists and sociologists/anthropologists; and with exception of the World Bank president, as the joke in the World Bank goes). Development economists have been overly content with the new institutional economics concept of *institutions* as *rules of the game* structuring transaction costs, an approach that sidesteps the real challenge of getting traction on how politics delivers development outcomes, now recognized to be essential, for example, in budget support (as the quote from Koeberle, Stavreski and Walliser 2006 above shows). It results in shaping the debate around technical reform to establish a supposedly critical institution like secure property rights, rather than on understanding property rights as a complex and constantly politically contested concept generating complex political incentives around achieving sustainable reform (Rochefort and Cobb 1994).

Where does this leave donor ambitions for a policy dialogue to shape and influence the domestic political debate, if donors (particularly the World Bank) are not to be accused of interfering in the domestic affairs of partner countries? Broad generalizations about *political will*, *corruption* or *elite capture*—common in project documentation—add little understanding of the underlying causes and motives of the individuals and groups involved. Current political governance analysis frequently notes 'the lack of incentives' for individuals or groups to change, while few suggestions are on offer for finding and applying the potential and practical levers of change, or the need to better understand how behavioural change could be brought about. Political leadership or support is often mentioned, but little evidence is offered as to whether the problem is lack of knowledge, structural disincentives for tackling long-term developmental challenges, or inherent contradictions and vested interests.

Leaders face incentives to use aid for patronage purposes—for example, by subsidizing employment in the public sector and in state-operated enterprises (and even cash transfers to the poor, as we discussed earlier)—to tighten their grip on power. As rents available to those controlling the government increase when aid levels are higher, resources devoted to obtaining political influence increase (and this applies at least as much in social sectors). In fact, corruption and aid can be mutually reinforcing (Degnbol-Martinussen and Engberg-Pedersen 2003: 273). By making control of the government a more valuable prize, aid may even increase political instability (Grossman 1992).

Governance indicators have become a key component of aid delivery (also for the Millennium Challenge Corporation). But significant problems remain, inherent in adapting to governance as political process rather than as technocratic fix, and often with superficial generalities, based in theory rather than actual experience. Any political understanding of governance needs to ask how indicators are constructed, what they really measure (e.g., rule of law), hidden assumptions (e.g., preference in favour of rules associated with liberal-democratic societies), and how they are being used and why. Governance indicators produce assessments on a narrow set of issues and leave out some important governance dimensions (e.g., informal political *voice* or influence,

inequality).[7] A key test might be: could the current governance evaluations have been able to predict in the 1960s and 1970s that a repressive authoritarian regime in South Korea was the political vehicle for creating an extraordinary successful economic, political and social transformation in terms of speed and impact of growth on poverty reduction?[8] Would existing governance indicators have predicted the similar economic success of China or Vietnam? Governance indicators remain in their infancy, and certainly do not yet provide a way for tracking how the formal and informal methods that delivered this transformation. Donors are struggling with the potential dangers of normative approach to governance, and the use and abuse of governance indicators to justify aid allocations and aid modalities that will doubtless remain much more political.

Forms of political analysis have been introduced in a number of agencies, for example SIDA's power analysis, World Bank's institutional governance reviews (IGRs); and DFID's drivers of change (now synthesized by the DAC). While much good quality analysis has resulted, some fundamental questions remain, for example, who does the analysis and from what perspective. To justify political approaches, the term *political economy* is widely used by donors and the World Bank (e.g., Keefer 2004). But this convenient portmanteau term does as much to obscure as to clarify or facilitate a more political approach to economic growth. Often it seems to mean no more than an attempt to recognize that the linkage of politics and power cannot be separated from economic policy or asset distribution. The ambiguity may be useful where it enables economists to start to recognize that markets and incentives are politically constructed. But as economists attempt to use their theories to explain politics, social scientists (or 'non-economist social scientists') have largely failed to develop alternative analyses to challenge the dominant economics paradigm in universities and development agencies.

So political economy is often used by economists as a neo-determinist assertion that political power and the (economic and other) policies and institutions of states reflect economic structures and the interests of the dominant economic interests. The 'institutions and growth' literature that has blossomed in recent years has empowered economists, using a limited application of the complexity of history, to construct simple models of institutional change. The findings of various influential papers such as those by Acemoglu, Johnson and Robinson (2001), asserting that the structure of economies and the distribution of economic power within them have a profound effect on the historical development of political power, would hardly surprise Marxists. What is surprising is the degree to which the poor history underlying many of these sweeping assertions goes unchallenged, perhaps because in the post-cold war intellectual climate determinist approaches are no longer of wider or ideological concern. But the real challenge, of genuine inter-disciplinary understanding of the linkage between the political and economic spheres in development, remains poorly addressed in

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7 To overcome the dangers of such governance determinism, Hyden , Court and Mease (2004) suggest that, in addition to the usual categories of participation, efficiency, accountability, and transparency, the more intriguing categories of fairness and decency be applied. These imply a qualitative approach, suspicious of quantification of econometrics and the stylization of game theory. See Assessing Governance Programme Website www.odi.orguk/wga_governance .

8 The World Bank Institute's 'Governance Matters' indicators seek to track *political stability* (perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means) and *government effectiveness* (the quality of the civil service and the degree of its independence from political pressures), overly normative concepts for analysing long-term development trends.

development agencies. In the World Bank, for instance, institutional and governance reviews have regrettably faded in prominence and have not become obligatory for country programme managers.

The development agencies and IFIs are very good at producing long lists of the *what*—what usually others need to do for reform; the *how* and the *why* partner governments would undertake these things are usually addressed rarely. Much political analysis explains past history and current trajectories, but provides very little, if any, real guidance as to how to create the social cohesion and common interests between elites and the population needed to turn to replicate the development success of the East Asian tigers or Botswana and Mauritius. What, one might wonder, is the operational lesson from insights like this:

> pro-development policies are comparatively rare in the developing world less because of the moral fibre of politicians (though that surely matters) than because good politicians typically lack the room for manoeuvre needed to make desired reforms. This lack of manoeuvrability is a product of insufficient social cohesion and weak institutions (Woolcock, Easterly and Ritzen 2000: 4)

Although it has been belatedly been recognized that economies with strong growth usually lack the institutional structures traditionally recommended by the World Bank and others, even the World Bank has concluded that 'what works' matters more than economic theories (World Bank 2006c).

The process of political analysis also has to be of concern. Local experts may have inside knowledge but at the risk of local bias vis-à-vis donors; whereas external specialists may possess greater objectivity, they may also be less well-informed about the informal processes of power. A historical institutionalism approach may over-emphasize static fatalism and path dependence; others may focus on forms of new institutional economics or political economy that highlights incentives but without recognizing deeper social forces. Academic consultants may stress theoretical risks and weaknesses, rather than practical policy implications and possible improvements, or commercial consultants may be creating jobs for themselves. The aim and focus of analysis is often ambivalent about how confidential information is used, how inclusive or transparent the process can be, who is the audience and how will the report be disseminated. Foreign ministries' political analytical processes remain confidential to allow for the necessary freedom to express and internally debate candid views about governments, their policies and the quirks of their leading personalities. It can be debated whether development agencies will really be able to find a complementary match of skills in political analysis and country level knowledge, and then value and reward them, especially when top management in development agencies and the World Bank are staffed by economists or administrators under short-term expenditure performance measures. Will political analysis be compressed into simplified governance indicators that permit a new generation of overambitious claims for aid effectiveness?

Thus, while the donor community agrees that *institutions matter*, a discrepancy remains between an instrumental version of a governance-indicators approach that tends to focus on development as a technical fix, and the political realities of the messy development process (reflected in messy political science debates) in recipient countries and the way

the (equally messy) politics of donor agencies interact with these. The next two sections describe some of the challenges that this poses for aid delivery.

6 Aid and the politics of the fiscal contract

With respect to strengthening institutions and enhancing accountability, there is perhaps no more intractable problem than the question of taxation and revenue generation. Yet, the development literature and practice have paid remarkably little attention to this, and recent studies suggest that the politics are very complex and contradictory findings regarding the impact of aid have emerged.

Strengthening tax collection (UN Millennium Project 2005: 245) is at the heart of donor expectations from partner governments; but in many low-income countries with a narrow domestic taxbase or large informal economy and agricultural sector, significant operational challenges include national tax administrations tempted to focus on a relatively small number of medium and large formal sector businesses, and largely ignore the others, including large and growing urban informal business activities.[9] Tax administration staff may have few incentives to address the problems;[10] politically influential business and major investors obtain generous tax exemptions. The introduction of a VAT has failed in poor countries to compensate for the revenue effects of trade liberalization (Baunsgaard and Keen 2005). Ross (2004) finds that higher taxes relative to government services tend to make states more democratic. WIDER papers on poverty reduction and tax (e.g., Di John 2006), and Mick Moore's work on tax and accountability at IDS Centre for the Future State have been highly influential in the development community in suggesting that taxation matters for the link between governance and development outcomes.[11] Jim Mahon (2006) suggests a more complex relationship between the political process and taxation, while Gloppen and Rakner case studies on Sub-Saharan Africa find reciprocity in the relationship between state and society and accountability mechanisms have not been strengthened to the degree predicted in the literature (Gloppen and Rakner 2002).

State legitimacy is, in part, constructed by the fiscal social contract—the political process by which a responsive and accountable government delivers services to its population while building quasi-voluntary compliance from its population to pay the taxes needed to fund those services.[12] And in turn, state legitimacy is itself an important underpinning for enabling the sustainable economic growth on which ending aid dependency will depend (Engelbert 2002; Moore 2004a). The key plank of governance—accountability—has therefore emerged only when governments need to raise revenue, requiring those in authority to bargain with its citizenry (no taxation

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9 In Tanzania, with a population of over 35 million people, 286 large taxpayers pay almost 70 per cent of the domestic taxes. Fewer than 1 per cent of the taxpayers pay more than 85 per cent of the direct taxes levied in Peru (Mostajo 2004).

10 Tax agency staff do not like to be given posts that take them away from working in lucrative positions and require them to make a great deal of effort to raise small amounts of money from very reluctant taxpayers: see research in Ghana tax system at IDS Future States Programme phase 1 on taxation.

11 See www.ids.ac.uk/futurestate/drc-pubs/index.html.

12 On Africa's fiscal contracts see, e.g., Hoffman and Gibson (2005) and Schneider (2004).

without representation) (Moore 2004b). To make a significant impact on poverty reduction aid effectiveness needs to incorporate better the importance of taxation for improving governance.

Conflicting arguments and supporting evidence exist on the effects of scaling up aid on government political efforts for revenue mobilization. IMF has argued in contradictory fashion: suggesting in 2003 that scaling up was a threat to revenue mobilization (Gupta et al. 2004a, 2004b); but suggesting in 2006 that this was less significant a concern:

> In some cases, to the extent that a weaker tax effort reduces domestic distortions, it might spur economic activity. In other cases, where weaker revenue collection reflects poor compliance or unnecessary tax exemptions, it would be more likely to breed aid dependency. Furthermore, a weaker tax effort can have an adverse effect on domestic institutions because citizens are less likely to hold the government accountable when they pay lower taxes (Bevan 2005). An argument can be made that reducing tax rates can be an optimal response to permanently higher aid flows, but this argument has less weight for countries that are currently below their potential for raising tax revenues and for which scaled-up aid inflows will be temporary. This latter group of countries must establish a strategy for coping with an inevitable drop in aid flows (IMF-World Bank 2006a).

The IMF also argues that policymakers in developing countries seeking to deliver the MDGs face a problem of inadequate 'fiscal space' in balancing unutilized borrowing capacity, an increase in aid flows, with reducing unproductive expenditure (IMF-World Bank 2006a: Section 3.9). But in countries with weak institutional capacity, aid may reduce incentives for institutional reform, locking donor and recipient into a permanent situation of high aid and low governance capacity (Azam, Devarajan and O'Connell 1999). A case study on Indonesia finds aid a disincentive to expand domestic revenue through a more efficient and effective taxation system (Chowdhury and Suegma 2005). Additional grants, whether from an overall increase in foreign aid or from a conversion of loans into grants, may be completely offset by a reduction in domestic revenues in countries where institutions are weakest. This risk is perceived to be lower in the case of loan financing (Clements et al. 2004).

The temptation from the above might be to promote conditionality on aid flows and the efficient mobilization of domestic revenue. The IMF suggests 15 per cent tax take of GDP as a general indicator of government determination to meet the Monterrey consensus;[13] and some donors (e.g., Belgium) may be using this as a governance benchmark for conditionality of aid. Conditionality, however, would not necessarily address the real political issues for partner governments to tackle the practical and political challenges of efficient, effective and equitable revenue mobilization, and DFID, for example, is concerned for a more nuanced approach to track 'direction of travel' rather than specific targets.

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[13] Adam and Bevan (2004) suggest the tax ratio for post-stabilization countries should be in the order of 15–20 per cent, and IMF (2005) offer a ratio of at least 15 per cent as a reasonable target for most low-income countries.

7 Politics and aid delivery

> Tensions are emerging between corporate objectives and the implications of power and DOC (drivers of change) analysis, which emphasize the prime importance of local political process and incremental change, in the face of pressures on donors to meet short term spending targets, and to be accountable to their own taxpayers.

This quote from the OECD-DAC's Network on Governance 2005 paper sums up a large part of our expectations around the Monterrey consensus—a 'consensus' that has been forged in the face of knowledge that PRSPs are depoliticized documents, that governance is conceptualized in technical not political terms, and new channels for aid like cash transfers are delinked from political projects in which such provisions are inevitable embedded.

Are donors in a position to develop the necessary understanding of, for example, likely political winners and losers from proposed reforms in a way which will really enable them to be effective in pushing realistic solutions to existing development challenges in local contexts? Can a political understanding of aid delivery be squared with other donor-country interests, and are ambitions of better political understanding inevitably thwarted by aims to increase aid flows?

To begin to answer these questions, apart from understanding the politics of development in recipient countries, it is essential to see donors as political agents. Aid agencies consist of bureaucrats and political leaders, with interests and incentives in success, claiming success, and controlling the process such that success seems to be justified by the results. Donors are part of government bureaucracies and as such are content with their established developing country counterparts (even though political analysis often suggests that informal power may lie with non-traditional partners). Donor agencies are part of wider government bureaucracies without the remove from the mainstream civil service usually accorded to foreign ministries: donor agencies struggle to value and retain detailed country expertise, including language learning, and are preoccupied with 'corporate' issues. Donors like to perceive themselves as the friends of the poor; but donors are (also) political actors—without adequate political checks and balances and transparency.

At the domestic level, the Monterrey challenge is to explain how the partnership and the resulting aid instruments interact with domestic politics on two levels: first the sources, distribution, control and conflicts over the use of power in relation to the policies and institutions influencing MDG outcomes; and second, the origins and nature of the political demand for delivering the MDGs. How can development agencies answer in general and in every specific national context the key question: How is a sense of national purpose first created; then maintained in the medium/long term; and what can aid modalities do to influence the process?[14] Scaling up aid will increase the importance of political analysis for development, and it matters whether politics is understood to be a process (institutions), a set of structures (organizations), or a range of policies

14 In Tanzania, for instance, the World Bank recently noted that the lack of critical scrutiny of budget proposals and budget execution reports by parliament means that there have been few political incentives to improve the efficiency of public spending (Koeberle, Stavreski, and Walliser 2006: 131).

amenable to potentially subtle nuances of overt and covert conditionalities.[15] Political analysis has many different approaches: on the immediate concerns on the individual—the 'big man', *caudillo* (development agencies do increasingly recognize leadership as often key to successful reform); the organization or institutional level on medium-term reform given the right conditions and with the right incentives; and at the deep structural level of informal institutions, culture and tradition that may require an inter-generational change period. Political analysis tracks power and incentives shaped by the institutional environment, and political governance challenges donors' aid effectiveness agenda, to ensure that increasing spending is balanced by adequate attention to political and institutional structures.

The challenge is how to experiment according to experience and local realities, not to roll out the *best practice* but to try to find a *good practice that actually works*. This requires:

- disaggregating the broad governance objectives such as secure property rights into its component parts,
- understanding the inherent theoretical and practical challenges posed by the need to shape effective organizations and practices; laws that are actually implemented because they reflect but also help shape individual, group, and organizational behaviour.

Reforms differ in complexity to put into practice and depend on windows of opportunity to challenge vested interests, or take time to embed if they require behavioural and attitudinal change, or are simply administratively complex. Analysis is needed to match the development need.

This agenda and the concerns it generates imply clear priorities for donors: for example, to focus on key areas around building domestic accountability and voice; to work better with other donors on political analysis to understand informal political spheres, and to recognize that there are as yet no adequate quantitative indicators for much of the political governance agenda. Improving indicators on governance will remain a priority for the foreseeable future, as donors will need to be able to handle the question of attribution of donor efforts to progress, and maintain long-term engagement (and be flexible to grasps political windows of opportunity, and seeing impact while accepting that there will be setbacks). Finally, political accountability extends to donors, not just partner governments: there will be increasing focus on whether donors are really delivering on their promises.

All this represents a major challenge and potential long-term threat for the governance agenda. As yet, little is known about the real formal and informal processes that contribute to success or failure, but perhaps even less about asking the right questions about the underlying conditions necessary for delivering the MDGs. Perhaps ironically this is exactly the same context that donor agencies face internally. It is often the informal incentive environment of 'office politics', norms, practices and culture that shape development agency responses, which are then justified and externally evaluated by the formal rule environment: human resource guidance, knowledge management

15 For a summary of IMF views on conditionality and how this interacts with domestic politics, see Mourmouras (2002).

systems and specific policy directives. For this reason, Tendler (1975) and Berg (2000) suggest that aid organizations are poor learners because the incentives to spend cut across the flexible, adaptive structures and procedures that would be needed to encourage institutional learning (also Eyben 2005). If development organizations tend to be characterized by internal staff turnover, weak horizontal information flows and an excessive reliance on blueprint approaches to project design and implementation, handling the issues of development politics may revert increasingly to foreign ministries. Donors do increasingly recognize publicly that poverty reduction is an inherently political agenda which will require the bilaterals and also the IFIs to rethink their skills and capacities and aid modalities, and have clearer ideas about policy conditionality. The question is whether there will be enough consensus to grapple with political judgement of complex development trade-offs, at a time of a focus on scaling up aid

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