



IDA13

**HIGHLIGHTS FROM WORKSHOP ON THE FUTURE OF
CONCESSIONAL FINANCE**

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Highlights from Workshop on the Future of Concessional Finance

Introduction

1. In advance of the IDA13 replenishment discussions, the IDA team sponsored a 2-day brainstorming session with international development experts to stimulate debate on a number of critical issues now facing IDA and the development community at large. The workshop was part of a larger effort being made by the Bank to reach out to members of the academic and research community to gather intellectual input for the IDA13 process.

2. The workshop was held on November 6-7, 2000 at the Carnegie Endowment for Peace in Washington. The first day covered broad ODA issues relating to multilateral and bilateral aid in general and served as an input to the preparatory work for the United Nations' upcoming, high-level event on Financing for Development for which the Bank is leading the working group on ODA. These sessions provided a backdrop for the following day in which IDA-specific topics were discussed, and some of the recommendations that emerged might be usefully applied to IDA. This note provides highlights from the presentations made by the guest speakers and attempts to paraphrase their perspectives and the ensuing discussions, and not the views of IDA management (for a list of external speakers, see Attachment).

3. As a follow-up activity to the workshop, and to incorporate perspectives from research and NGO communities in borrowing countries, the IDA team is co-sponsoring a conference with the African Economic Research Council (AERC) and the Research Department of the Bank (DEC) on April 3-4 in Dar Es Salaam¹. The conference, "Aid in the New Millennium", will bring together African researchers, civil society members, and policy makers from throughout the region to discuss a number of topics relevant to the IDA13 policy discussions including: the role of aid in meeting the International Development Goals, keys to growth in the African context, addressing the needs of poor performers, and aid dependency. In addition, the Operations and Evaluation Department (OED) held a workshop in November which brought together international external experts and Bank staff to discuss the background studies of the IDA Review as well as IDA's policies and products, its performance in partnership with borrowers and other development agencies, and the IDA replenishment process. Proceedings from the OED workshop will be provided to the Deputies in advance of the first IDA13 meeting in Paris², and a summary of the discussions at the AERC conference will be shared with the Deputies before the second replenishment meeting.

¹ Financing for this workshop has also been provided by the Government of Norway.

² Once finalized, the Proceedings Note from the IDA Review Workshop will be sent to members of the Committee on Development Effectiveness (CODE) for information and will be posted on the IDANet for Deputies' information (by February 16, 2000). Two other background papers (Review of Performance-Based Allocations, and Report on Country Consultations) will also be posted at this time. All of the background papers for OED's IDA Review will be made public within two weeks of their distribution to Deputies and CODE members.

4. This summary therefore represents a first installment in what is planned as a series of informal background reports for Deputies about various strands of “informed opinion” on IDA’s role.

Trends in ODA Flows and the Changing Motivations for Development Assistance

5. In her opening remarks for this session, Carol Lancaster claimed that we are at a crossroads in terms of the motivation behind concessional assistance in major donor countries, due mainly to the end of the cold war and to ambivalence with regard to the effectiveness of aid in difficult country contexts. She began the session by presenting the facts on ODA trends over the past several years: after a decline in ODA flows between 1994 and 1997, ODA has been on the rise over the last two years. While the trend in ODA contributions has been mixed in Europe (with contributions from the smaller countries increasing and the contributions from the larger countries decreasing), the U.S., Japan and Canada have remained steady. In addition, she pointed to the need to recognize that a considerable amount of assistance is not officially counted as ODA, such as the “foreign aid” line item in every US agency’s budget, which is unlikely to diminish. She also noted that between 1992 and 1999, there has been a slight shift towards using multilateral institutions as a conduit for aid as well as a concentration of aid to the “top ten” recipient countries.

6. Ms. Lancaster pointed out that despite the rise in ODA flows over the last two years, there has clearly been a loss of urgency around the development cause per se in some of the major donor countries, and the case for aid is much more subtle, complex and difficult to make today than it was before. While the lack of motivation could be attributed in part to fiscal deficits in the early to mid-1990s, it is also related to the end of the cold war -- especially in the US which, as the major international player, must always think globally and strategically. She stressed that the US will continue to make demands on the foreign aid budget for strategic concerns, and that this should come as no surprise to the development community.

7. In addition to a shift away from the cold war era’s strategic justification for development assistance, the loss of urgency could be due in part to the perceived intractability of the development problem, especially in Africa. This can be attributed both to the political environment in recipient countries and to the mismanagement of resources by both donors and recipients. As a result, some donor constituencies are moving their support towards global public goods (especially AIDS and infectious diseases) and humane concerns such as street children, AIDS orphans, and amputees. These are discrete activities for which people can see results, and they fit more in the domain of charitable giving than long-term development.

8. Another participant pointed to the possibility that increasing private capital flows to developing countries may also be a factor in the changing motivation behind aid in donor countries. The influx of private capital to developing and transition countries during the 1980s and 1990s may have created a sense that continued expansion of these flows would provide the resources needed for developing countries to achieve accelerated

investment and growth. However, since 1997, private capital flows have declined, and their prospects now seem less certain. More importantly for IDA countries, even at the peak of private capital flows in 1996, low-income countries received very little of these flows, and now private flows make up only 4% of GDP in good performers and 1.5% in poor performers. In fact, private capital flows are concentrated in only five low-income countries, some of which are resource-based. As such, ODA flows continue to represent the bulk of external financing in virtually all IDA countries.

9. A number of participants agreed that while the diminishing motivation behind concessional assistance among some key constituencies deserves further consideration, it is not clear that there is a need to increase the level of concessional resources to developing countries across the board. In many instances, the problem is not one of lack of resources, but rather lack of sound public institutions. In many cases, it is possible that increasing the levels of ODA would actually increase the mismanagement of resources. This predicament should lead us to consider more seriously the role that NGOs and the private sector might play in furthering development, especially in those countries where governance is a problem.

Reducing the Transaction Costs of Aid

10. Aid effectiveness is the result of two types of factors. The first relates to the policy and institutional preconditions in recipient countries, including targeting public expenditures to priority areas in line with the goal of poverty reduction. The second relates to the level and nature of transaction costs in the aid delivery system. Within this second category, there are transaction costs borne by the donors and multilateral agencies as well as costs borne by the recipient countries. It is worth examining more closely the nature of the costs to recipients in order to find a way to make the flow of resources to good performers more efficient. Tony Killick, in his introductory remarks for this session, defined these costs as follows:

- **The cost of negotiations.** By nature, the costs of debt renegotiations and aid agreements tend to be highest in the countries least able to handle them. Now the cost of HIPC negotiations has been added on top of this. The HIPC negotiation process produces huge costs (e.g., 7000 meetings for 39 countries) which would never be justified if a debt reduction program were to be designed de novo.
- **The cost of fragmentation.** The multiplicity of aid agencies that operate simultaneously in each IDA country results in a heavy administrative burden for the recipient government as well as a loss of strategic cohesion. An average of 25-30 aid agencies operate at one time in a single African country (in Zambia there are 69 donors and 614 projects under implementation). This situation could be alleviated somewhat by switching from a project-driven approach to program support.

- **The cost of protection.** Tying aid to donor country supplies and consultants can result in prices that are 15-30 percent higher for the recipients.
- **The cost of foregone development of local institutions.** Excess supply of external technical advice and donor country supplies has a swamping effect on local institutions and industries. In this vein, Paul Collier's work points to the diminishing returns to aid.
- **The political costs of aid.** Excessive conditionalities limit governments' freedom of action. There is also some doubt about the effectiveness of conditions in achieving reform. Even though conditionality has become less fashionable among the multilateral and bilateral agencies, it is still overused and misused.
- **The cost of donor reporting and compliance requirements.** All bilateral and multilateral development agencies have operational policies and procedural requirements that guide their engagement with developing countries. Most define such policies for environmental and social areas, procurement, financial management and analysis, and country and sector strategy formulation. A major problem is that even when agencies have similar objectives, their specific requirements can be different. Also, the number of such requirements has grown as the number of donors has increased. As a result, scarce human resources are diverted away from policy work towards meeting these donors' demands.
- **A loss of coherence in the budget.** Aid distorts the composition of the budget in the direction of donors' strategic priorities rather than of the priorities that have emerged from the domestic system. The resulting priorities may not in fact foster the best route to development.
- **The loss of self-reliance.** The dominant role played by external agencies in many of the poorest countries can have a negative effect on the local mindset in terms of what is considered to be appropriate for national authorities to handle vs. what is appropriate for external agents to handle. This problem points to the relative failure of technical assistance in building up local institutional capacity.

11. Mr. Killick suggested that in order to tackle these challenges and help reduce the transaction costs associated with aid delivery, there are a number of steps that could be taken on both the recipient and the donor side.

12. First, with regard to recipients, transaction costs could be reduced if governments were more informed about the costs associated with some offers and could refuse assistance that did not fit into their own development agenda. A good example of this behavior is Zimbabwe where the government accepted assistance only when it fit into what they were already doing. Relatedly, coordination of the many donor influences should be the responsibility of the borrowing government. Effective aid coordination can happen only if government takes control of the process. Because of the political dynamics behind aid and the natural competition among aid agencies, coordination will

never happen if left to the donor community. Assuming control of the aid coordination process may be the most difficult step for borrowers to take, but it is a necessary one.

13. On the donors' side, Mr. Killick outlined a number of actions that could be taken by multilateral and bilateral agencies to reduce the transactions costs of aid delivery:

- First and foremost, donors should be more rational about which countries receive assistance and should direct their assistance to countries with good policy performance. As it stands, the correlation between good policy performance and aid flows could be improved substantially.
- Donors and multilateral agencies should continue to move away from project aid towards programmatic aid in good policy environments. If aid is fungible, then moving from projects to programmatic lending is an easy way to remove transactions costs and eliminate dead weight loss. In addition, donors must accept the duty to simplify their aid delivery systems and must abandon procurement tying. Finally, donors should feed more aid through lead agencies rather than allow each individual agency to insist on having its own leadership in a country.
- Multilateral agencies and donors have to show real commitment to borrower ownership and to the reduction of conditionalities. The PRSP process has a great deal of potential for transferring ownership to countries and is the best attempt so far at changing systematic relationships. The PRSP is a vehicle for more programmatic lending and less onerous conditions. Nevertheless, donors and multilateral agencies will need to relinquish control in order for true country ownership to materialize. The attitude taken by the Bank and Fund boards with regard to "sub-standard" PRSPs will play a major role in determining the degree of ownership possible.

14. One participant noted that it is important to acknowledge that there are significant constraints on the ability of donor and multilateral agencies to change the way they do business. He questioned whether or not the necessary incentives exist for bilateral and multilateral agencies to simplify their procedures and to pursue real coordination which could lead to the rationalization of their operations and attendant downsizing. Nevertheless, it was recognized that if the donor community is serious about reducing the transaction costs of concessional assistance and about delivering resources to good performers in an efficient and timely manner, then shareholders will insist on the institutional changes that will bring about the required simplification and harmonization of procedures.

What is IDA's Role in Post-Conflict/Poorly Performing Countries?

15. In order to increase the effectiveness of concessional assistance, IDA, other multilaterals, and individual donors have increasingly emphasized the need to link lending to good policy performance. However, this presents a conundrum in terms of

how to deal with the poor performers, many of which are in Africa, and many of which are post-conflict countries. What should IDA's role be in these countries? How can IDA best help advance development and poverty reduction in countries with weak governments and institutions? What should IDA do in countries that lack the necessary policies and governance to carry out PRSPs and to receive IDA within the current framework? How should the donor community deal with situations where government is not part of the solution, especially given the legal constraints of the development institutions? This discussion session generated more questions than answers, but some of the main points are outlined below.

16. Professor William Zartman introduced this session by pointing to the fact that many poorly performing countries are also countries that are in conflict or that have recently emerged from conflict and that it is important to keep in mind the following things when dealing with post-conflict situations: the people who come into power tend to continue the war, at least in terms of fueling the "we vs. they" dynamic; the situations are usually "winners take all"; and, most importantly, conflict tends to weaken and fractionate the fabric of civil society.

17. He asserted that it is necessary to examine conflicted countries on a case-by-case basis before designing an approach for the delivery of development assistance. The most important task at hand is to help build a "we-we" society by rebuilding civil society. Concessional assistance might be used to support this endeavor in the following ways:

- **Rehabilitation:** It is crucial to employ the unemployed, the people who have been dedicated to the fight and no longer have any livelihood. Congo cannot be considered a post-conflict society because the militias have not been given jobs (after having laid down their arms).
- **Targeting assistance:** Concessional assistance should be used to support activities in certain sectors where government and civil society can cooperate and where there is little controversy, such as education. Regional or public goods activities could also help prevent future conflict.
- **Protect the sources of wealth:** In order to reduce the likelihood that a resource-driven conflict will rekindle, the donor community could find ways to ringfence the country's productive assets (although this raises some legal issues regarding interfering in countries' internal affairs).
- **Build accountability:** Building accountability into the system in conflicted states is a major challenge, but technical assistance is likely to be more effective than conditionality to achieve this end.

18. Some of the participants in this session felt that the Bank and IDA are not the appropriate vehicles with which to deal with post-conflict situations because grants are necessary, and the Bank is a lending organization. Some argued on a moral ground that it is not right to ask post-conflict countries to borrow, especially when the new government

has inherited debt from an opposing aggressive party. Others argued on a pragmatic ground that the Bank could risk fueling conflict through lending. Finally, some noted that the complexities of post-conflict situations are social and political, and that it is not clear that Bank staff have the right skill mix to handle these kinds of challenges. One participant pointed to the Bank's operations in post-apartheid South Africa as a good example of how the Bank could effectively engage in a post-conflict situation: there was no lending, but the Bank kept an office there that maintained a policy dialogue and provided technical assistance and periodic grants.

19. One participant stressed that in order for IDA to deal effectively with conflicted states, it will be necessary to separate the post-conflict states that are plausible clients from those that are not. IDA needs to go either below the state or above it. The African Economic Research Council (AERC) and the Consultative Group on International Agricultural Research (CGIAR) are examples of organizations that work above the state; in these instances, the Bank should serve as the organizer of these efforts rather than the financier. Below the state are churches and mosques; they are the organizations that keep the hospitals going and maintain the morale during difficult circumstances.

20. Another participant suggested that IDA should also become more involved in pre-conflict work and should learn more about conflict prevention. He noted that the Bank often avoids involvement in conflict issues until the situation becomes dire. A number of participants agreed that conflict arises from poor governance and skewed distribution of resources, not simply as a result of poverty per se. It was noted that many conflicts center on issues of land (lack of clarity regarding land ownership and legal arrangements) and that IDA may well be able to play a role in modifying the system of land ownership and property rights before conflict erupts.

Debt and HIPC

21. Tony Killick introduced this topic with the assertion that the current unsustainable debt levels in HIPC countries are not a result of lending terms that have been too high, but rather they stem from poor macro-economic performance. Over the 1980s and 1990s, developing countries have borrowed on increasingly soft terms for public investment:

	1980	1990	1997
Interest Rate	6.5	3.3	1.5
Maturation (years)	18.5	28	38
Grant/Loan (ratio)	35	124	168

22. He argued that since the terms of lending have not created the problem, the problem cannot be solved by providing grants. IDA needs to look more deeply at the reasons behind poor macro-economic performance in these countries and needs to find a way to address the lack of success of critical reforms as well as the perceived riskiness by the private sector. He cautioned that since these fundamental questions are difficult to grapple with, there is a danger that HIPCII may divert attention away from these issues

and focus simply on “what do we do about the poor?” We will never reduce poverty in a country if we cannot fix domestic economic conditions so that the government can sustain an interest rate of zero percent with a maturity period of 30 years. He also warned that by tying HIPC debt relief to poverty reduction through the PRSP, IDA is creating very high expectations that are sure to result in disappointment down the road.

23. One participant argued that the real challenge is to better understand the factors that affect the growth process in each country, especially in Africa where structural adjustment has not seemed to work. In many African countries we see examples where the government has been taken out of the market, but the market still does not function properly. Despite the need to more closely examine the sources of and impediments to growth, the interim PRSPs have so far focused primarily on the social sectors, and the Bank is going along with this. This social sector emphasis is largely a result of the fact that the NGOs that are most active in the PRSP process are promoting these areas. IDA should make sure that the private sector is also involved in the PRSP process in order to counterbalance the social sector bias and to try to get to some of the issues affecting growth.

IDA’s Role and Comparative Advantage

24. Throughout the workshop many discussions turned to the need to focus IDA’s role and comparative advantage. Many of the participants agreed on the importance of realizing that IDA cannot be the best at everything. One participant suggested that certain initiatives such as community-driven development and direct interventions for poverty reduction may not make the best use of IDA’s expertise. He recommended that the Bank group cede control over some of these areas in order to focus on its core competencies and, after recognizing something as a key issue, let other agencies take over (e.g., the WHO on AIDS). The notion that in order to address poverty, one needs to deal directly with the poor may be mistaken. The Bank may be better equipped to address poverty through other mechanisms such as policy advice on economic and structural reforms. The Bank needs to think about the division of labor among NGOs, UN agencies, and the private sector and should consider supporting (with grants) institutions that work outside those governments that aren’t doing the right things.

25. Other participants questioned whether IDA should simply concentrate on the traditional business of development (e.g., projects) in every country or should follow a two-pronged strategy: in good performers, encouraging country ownership and pooling resources with other donors and multilaterals to provide programmatic lending; and in poor performers, working through projects and technical assistance. Many agreed on the need to examine more closely IDA’s comparative advantage in poor environments. For example, should IDA focus on targeted interventions in health and education, the areas in which the institution has the most experience and on which rivalrous groups are more likely to reach agreement? One participant noted that a clear advantage of IDA over other sources of development finance is that it provides a more liquid, more fungible mechanism through which to funnel resources to poor countries. As such, IDA should

make the best use of its instruments and financial flexibility by approaching the varied and challenging situations of the developing world with creativity and by responding quickly to the needs of the poorest countries.

List of Invited Speakers

Augustin Fosu, Director of Research, African Economic Research Council (AERC)

Chandra Hardy, Consultant to the UN Development Group on Financing for
Development

Tony Killick, Senior Research Associate, Overseas Development Institute

Carol Lancaster, Professor and Director, Master of Science in Foreign Service,
Georgetown University

Brian van Arkadie, Advisor to the Government of Vietnam, Independent Consultant to
UN and donor agencies

William Zartman, Fellow, Woodrow Wilson Center; Professor and Director, Conflict
Management Program and African Studies Program, School of Advanced
International Studies (SAIS), Johns Hopkins University