Methodology and Findings of Evaluations of Non-project Financial Aid

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1 Introduction[1]

This article traces the historical evolution of BOP (balance of payments) support from Norway, and discusses policy and other guidelines for such aid, the importance of BOP support in total Norwegian aid and the main recipients of this aid. It is partly based on an analysis of the evaluation methodology adopted by six evaluations and project reviews, and assesses what can be learnt from those studies about the economic impact of BOP support.

The familiar argument in favour of foreign aid is that it comes in addition to the recipient country's domestic saving and its own foreign exchange earnings, and thus allows that country to increase its level of investment, without being hindered by foreign exchange shortages, and consequently boost its growth rate and economic and social development. However, empirical studies have revealed that in many developing countries the impact has not been as expected, *inter alia* because foreign aid in many cases has led to reduced domestic savings. Such studies are controversial, e.g. White's criticism of them (White 1992 and 1994). Attempts to evaluate the macroeconomic impact of parts of the foreign aid, viz. in this case of commodity import support (CIS), will necessarily be as difficult to undertake in a convincing way as are studies of the impact of total aid, not least because CIS basically is the most fungible part of foreign aid.

2 Norwegian Balance of Payments Support

Norwegian balance of payments support has traditionally taken the form of commodity import support, broken down in two components: commodity assistance which was administered by NORAD, and import support which was handled by the recipient country. Goods under commodity assistance were purchased and paid for by the Norwegian aid administration, and in practice most were bought in Norway, on the condition that the unit price should not exceed the price at which the commodity could be procured elsewhere by more than 10 per cent. Much of the commodity

[1] This study was commissioned by the Norwegian Ministry of Foreign Affairs, and is in the main based on documentation provided by the Ministry.

assistance consisted of traditional, presumably internationally competitive, Norwegian export products such as fertilisers and non-ferrous metals, but there were exceptions. Import support was handled by the recipient countries themselves and could, in general, only be used for purchases in other developing countries, or Norway.

Both forms of commodity import support involved negotiations between the two governments on which goods should be imported under the programmes. This arrangement often led to delays in disbursements as some parts of the agreed allocations remained unutilized, and new negotiations had to be undertaken to select other types of goods. On the other hand, because of slow disbursement of other aid, at the end of a financial year Norway would sometimes offer the recipient country additional commodity aid or import support in order to better reach planned disbursements.

As many recipient countries introduced more liberal import regimes, the operation of the 'traditional' or 'old' commodity import support became even more difficult to implement. Many donors started to supply funds to the foreign exchange market, and Norwegian commodity import support has also been following this example.

It is difficult to trace any particular policy behind Norwegian commodity import support programmes. As for all other aid, the motivation for providing it is to promote self-sustained growth and development with particular emphasis on improving the living conditions of the poorest part of the population in recipient countries. In some cases commodity aid was used directly to reach particular targets. One example is the supply of papers for school books to India which did not have the intended effect of supporting the Indian objective of expanding free education in primary schools. An evaluation in 1991 (IMTEC 1991) observed that the Norwegian supply of paper is a straight grant to the Government of India, without any educational consequences. Similar observations were made on other commodity import support programmes. In a review of Norwegian evaluation studies covering the period 1986-92 (Norbye 1994) it was stated:

> Commodity aid is also shown to be a sector in which most activities which we have looked at, on balance have been performing negatively in terms of effectiveness (achievement of objectives). But the conclusion is based on the way the analysis has been undertaken. If we look at commodity aid merely as a quick way of disbursing balance of payments and budget support to the recipient governments, it has done so..... Our assessment does not imply that commodity aid is an ineffective way of assisting a country with balance of payments and/or budgetary problems, nor that Norwegian deliveries have not taken place as planned, but it stresses that the way in which it had been implemented, was a poor instrument in order to achieve more specific targets, in line with the main objectives of Norwegian development cooperation.

In general, however, Norwegian commodity import support was introduced in order to assist countries in balance of payments difficulties with a form of aid that was quicker to disburse, and which also acted as direct balance of payments and budget support. This certainly was the case in Bangladesh in the late 1970s and in Tanzania around 1980. On Tanzania Skarstein *et al* write (Skarstein 1988): 'By 1981, it had become meaningless to maintain traditional project aid at its attained level, because the forex (foreign exchange) costs of operating new projects could obviously not be covered by Tanzania's export earnings. In this situation there were two options; either to reduce foreign aid, or to switch some part of total aid to balance of payments support, budgetary support or CIS (commodity import support) as *ad hoc* measures to provide some relief in an untenable situation.'

The purchase by NORAD of goods to be delivered under commodity assistance clearly favoured Norwegian suppliers which eventually could establish markets in the recipient countries. This objective does not seem to have been met to any considerable extent, as Norwegian enterprises have not always been interested in doing so.

However, as Norway wanted to reach its poverty oriented objectives, and commodity import support clearly was not a satisfactory instrument to achieve this goal, Norway has since the middle of the 1980s sharply reduced its commodity aid and import support, as shown in Table 1 in which balance of payments support (and for 1994 also debt relief) are expressed as percentage of total bilateral aid. Thus in the course of 10 years the proportion of com-

Table 1 **Norwegian balance of payments support (as a per cent of total bilateral aid)**

1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
24.9	23.4	17.3	18.2	9.4	16.7	12.0	8.0	5.6	8.2*

Note: * includes debt relief.
Source: Ministry of Foreign Affairs.

modity import support has fallen dramatically; in fact, in 1994 it corresponded only to 2 per cent of the bilateral aid; the rest was debt relief.

In 1994 only two of the programme countries received commodity import support: Zambia and Zimbabwe. Zambia received a slightly higher amount in debt relief, and two other programme countries, Bangladesh and Nicaragua, also received debt relief. 60 per cent of the debt relief went to five non-programme countries or unspecified recipients.

3 Analysis of Evaluation Methodology Adopted by Some Evaluations and Project Reviews

Four evaluation reports and two projects reviews of, mainly, Norwegian commodity import support have been reviewed for the purpose of this paper (Norbye 1986; Skarstein *et al.* 1988; Ofstad 1990; Bhaduri *et al.* 1993; Hekland 1990; and Schreiner 1995). This section aims at a systematic analysis of these reports.

Only one of the studies (Bhaduri *et al.* 1993) contains a systematic attempt of macroeconomic analysis; and as White points out (White 1994: 44), that particular study was concerned with all aid, rather than balance of payments support. In my opinion this would not matter much, as significant changes in the volume of aid in recent years have been through changes in the volume of balance of payments support. This being said, most of the theoretical analysis is not supported by any econometric analysis and hence is somewhat speculative in nature. The only results of regression analysis which are presented in the, report show very strong links between aid flows and investment; and between increases in counterpart funds receipts to the government and the government budget deficit. The theoretical analysis shows *inter alia* that the aid inflow has depressed demand for domestically produced goods. On that point I will make the observation that this development (which is supported by empirical data) primarily is caused by the 'aid supported policy programme' which has led to a much more liberal import regime. Hence the analysis stops short of taking all relevant factors into account.

All studies deal with management of the commodity import support programmes, and have various recommendations as regards changes in procedures, both on the part of the Norwegian donor and also other donors, and by the recipient country authorities. The management problem for the donors becomes much simpler when the support is channelled through the recipient's foreign exchange market, and the remaining key problem is whether the market is operated in a way which gives the most efficient users of foreign exchange full access to buy such exchange, *inter alia* by having equal admission to credit facilities.

All four evaluations deal with what we may refer to as microeconomic issues, viz. the impact of commodity import support on the firms or sectors which have benefited from the use of this access to foreign exchange. This was a major part of the earlier evaluation of Tanzania (Skarstein *et al.* 1988), and the survey material collected by that evaluation team shows clearly that this microeconomic impact had negative macroeconomic consequences through the way in which manufacturing enterprises which did not save any foreign exchange benefited from aid supplied foreign exchange. The methodology applied was certainly appropriate under the conditions which prevailed in Tanzania at the time of the evaluation. This form of enquiry was not followed up in the second evaluation of experience in Tanzania, but the team does point out that even under the new foreign exchange market regime, less efficient enterprises appeared to have easier access to import finance. The Bangladesh study (Norbye 1986) did not study the performance of enterprises that used inputs imported under Norwegian commodity import support, but was only concerned with whether the manufactured products were of importance to the economy, and concluded that this was the case. The study of Mozambique (Ofstad 1990), however, also analyzed the potential viability of some of the industrial sectors that used Norwegian financed inputs, and found a mixed picture. Neither of the two projects reviews (Hekland 1990; and Schreiner 1995) dealt with the microeconomic impact.

None of the evaluations and project reviews deal directly or even implicitly with debt relief, and as regards ongoing structural adjustment programmes they are only dealt with marginally, except in Bhaduri *et al.*

What can be learnt from these evaluations about the economic impact of balance of payments support?

The way in which these evaluations and project reviews have dealt with the commodity assistance and import support programmes in Bangladesh, Mozambique, Nicaragua and Tanzania implies that not much systematic, if any, emphasis has been put on the economic impact of commodity import support itself. The macroeconomic analysis in Bhaduri *et al* (Bhaduri 1993) is the only exception, and its treatment of the impact of counterpart fund flows to the government budget is of particular value. Their conclusion is that this flow of funds has permitted the Tanzanian government to follow a soft approach to mobilization of domestic resources through aiming at higher tax revenues, etc. However, if we accept that the intention of foreign aid is to create gaps, not to fill them, and that this might also apply to government budgets, the conclusion is not quite so evident. What is most important: to increase expenditure in priority areas, and to plan realistic ways in which later to increase government revenues could be taken; or to aim at lessening the dependence on foreign financing of government expenditure in the short run? The evaluation may be right in assuming that inflows of foreign funds have dampened the need for immediate mobilization of domestic resources, but without a further study of what has been done and what has been aimed at, the conclusion may be too severe.

The second most important conclusion which can be drawn from the evaluations, is to be found in the earlier evaluation of the experience in Tanzania (Skarstein 1988). It points out that firms that had received Norwegian commodity import support, were not net foreign exchange earners or savers, and what is remarkable is that a sample of firms which had not benefited from Norwegian aid on the contrary saved foreign exchange for the country. It should be added that provision of aid must have had other, positive effects, notably by keeping the firms going and thus saving jobs and improving the firms' financial position. However, the long term effects of keeping economically inefficient firms going are necessarily negative, unless the performance will improve over time. Also in the Mozambique study (Ofstad 1990) reference was made to the possible misallocation of funds between individual potential commodity import support recipients. The study does not make any specific suggestion as to which other enterprises might be more support worthy. In the case of many of the least developed countries it might indeed be difficult to single out many well qualified enterprises.

The change which has occurred recently in the distribution of commodity import support funds to potential importers through a relatively free exchange market should in principle mean that the firms which are able to buy the foreign currency at the prevailing rate and then either sell the imported goods or process them and manage to sell their products should be economically viable firms. Thus many of the problems which earlier faced donors providing commodity import support should disappear or at least become less serious. This is the conclusion drawn by Carlsson *et al.* (1994). But this depends on the overall policy of the recipient countries.

Several of the studies indicate, at least implicitly, that the fungibility of commodity aid necessarily undermines efforts by individual donors to assure that their commodity import support will allow increased imports of precisely the goods which donor and recipient government have agreed to use the funds for. In the case of high priority goods, the recipient country would have imported them in any case, and the financing of the import of them, releases foreign exchange to be used for imports of other goods. Only when commodity import support is used to pay for imports of what the recipient consider to be low priority goods, the donor can be reasonably sure that its support in reality is used for those specific goods. But in general donors do not want to support low priority import.

The most interesting macroeconomic conclusion drawn from these studies is the idea put forward in the Bhaduri *et al* study of Tanzania (Bhaduri 1993) that commodity aid (above the level of 'absorptive capacity' of the recipient country) actually can have a negative impact on the gross domestic product by squeezing out domestic production by imports. White (White 1994) is sceptical to this hypothesis which only will only be valid 'if consumption and investment (in the recipient country) remain unchanged,' and in his opinion this will not be so. Bhaduri *et al* refer to the strong fall in market shares of the domestic manufacturing industry and the subsequent fall in manufacturing output as an indication of the validity of their hypothesis, but they do not provide any data on the overall impact on the economy. For example, what has been the impact of the counterpart funds generated by such imports on government expenditure? The idea expressed in the second Tanzania evaluation is fascinating, but much more research must be done to test its validity.

The four countries in which Norwegian evaluations and project reviews considered in this report have been conducted, were all countries that suffered from very serious balance of payments difficulties, although these now are much less critical in Bangladesh. But all of them depend clearly on commodity import support as an important part of balance of payments and budgetary support. All studies point out more or less directly that the functioning of the economies in these countries depend on continued foreign aid of this type. Such aid cannot be replaced by project aid in the short run. Commodity import support can be disbursed sufficiently quickly, and it is also so fungible that it allows the recipient country to undertake essential imports and through counterpart funds finance crucial government expenditure. I will add that whether it creates unnecessary aid dependence or not, both as regards financing of imports and of government expenditure, will depend on future developments. None of the four countries could function properly without foreign aid for many years ahead, but unless the dependence on aid in relation to gross domestic product, imports and government expenditure will start to fall, the hopes for sustainable development may appear to be grim.

5 Conclusions

To evaluate the actual impact of total foreign aid on the recipient's economy is in itself a complex task, and the results of the studies that have been undertaken, are controversial. The assignment and its results become even more arguable if the intent is to assess its consequences for specific economic sectors or population groups. Non-project financial aid or commodity import support or programme aid is mostly as fungible as total aid, and therefore it is as difficult to measure its effects on the economy as a whole or on specific parts of the economy and the society as it is to evaluate the consequences of total aid.

On the other hand aid donor countries and international organizations will frequently aim at reaching specific objectives when they grant non-project financial aid to a recipient country. Consequently evaluations of such aid have had to address the question as to whether such specific objectives have been met.

Initially most non-financial aid took the form of commodity import support (CIS) which was controlled in considerable detail by the donor organization. It was therefore possible, at least in principle, to assess the impact of aid financed imports on certain economic sectors, on individual enterprises, on the availability of individual commodities etc., and it is therefore not surprising that early evaluations of CIS paid much attention to the microeconomic results. In addition, since allocation and purchase procedures were so important, evaluations also dealt extensively with administrative problems. However, even when the use of CIS was subject to serious constraints, it was nevertheless still a fungible form for aid because it released foreign exchange for use on other imports. Hence the macroeconomic results of the CIS were important, but very seldom addressed seriously in evaluations of the 'traditional' CIS.

In more recent years CIS has been offered as an inflow of foreign exchange which recipient countries can use for imports of a wide range of goods from very different sources. This has made it increasingly meaningless to try to measure its relations to very specific objectives, and therefore an evaluation of its macroeconomic impact has become essential. However, the most important consequence of such basically untied CIS is linked to the conditionality attached to it by many important donors. Such conditionality is not concerned with the use of the money for imports of certain types of goods, but with changes in policies and institutional arrangements in the recipient countries. Thus the evaluation has become increasingly complex: it must also find out to what extent conditions have been met, and if so which consequences this has had on the economy and the society as a whole.

This article is based on the study of six Norwegian evaluations and project reviews of mostly Norwegian commodity import support. Five of those studies do not deal systematically with macroeconomic consequences of CIS, and this is understandably as they dealt with the 'traditional' form of CIS. The sixth report does, however, try to analyse the macroeconomic impact, and in my opinion it has not clearly distinguished between the impact of the flow of foreign exchange supplied by foreign donors as CIS or other forms of non-project financial aid, and the consequences of the policy changes that had been undertaken. This remains an important and interesting challenge for future evaluations.

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