



Shifting away from financial aid responsibly and sustainably

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Question

What is the global evidence on strategies/approaches that have worked in ensuring a responsible and sustainable shift from provision of financial aid support to governments to technical assistance or alternatives?

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1. Executive summary

Many donors are rethinking aid delivery away from the provision of direct financial aid through modalities like General Budget Support (GBS). Several trends are contributing to this reassessment. The world has become more complex and more diverse in the last decade, with a wave of countries graduating from aid, and several countries once considered developing countries now becoming donors themselves. Financial aid is now only one of many mechanisms for poverty reduction, among regional development banks, trust funds, non-profit organisations, and the private sector (Ocampo, 2016; Rudolph, 2017). Some donors are fading out aid because of changing political priorities or for fear of corruption, which might cause funding to be misused (Orth, Schmitt, Krisch, & Oltsch, 2017), or with the objective of focusing strategically on fewer countries. In many cases, withdrawal of budget support is driven by political and strategic considerations that go beyond issues of aid effectiveness (Orth et al. 2017).

This report is not concerned with establishing whether interrupting financial aid is appropriate. Instead, based on an awareness that there is a trend towards reducing or ending financial aid, or substituting financial aid for other forms of cooperation, the report reflects on the potential risks and issues around aid exit, transition, or transformation and presents some of the lessons learned to support appropriate and responsible shifts.

Any decision to end foreign aid needs to be carefully thought through and planned in coordination with local partners. Phasing out financial aid to a partner country implies several risks, especially when recipient countries are still aid dependent, and when aid exit/transition strategies are executed over short timelines. Decisions to fade out financial aid should consider several risk factors which could hinder the success of a transition process:

- Exclusion of government actors from the transition planning and implementation;
- Insufficient regard for the consequences of the shift for civil society partners;
- Inadequate human capacity on the part of donors and/or partner countries;
- Basing exit/transition decisions solely on quantitative indicators without assessment of the local partner's ability and context;
- Lack of coordination with other bilateral donors;
- Lack of consideration of the implications of alternative aid modalities.

To be considerate towards the sustainability of development achievements in the partner country, as well as to the health of bilateral relations, donor countries might consider the following lessons learned from previous aid transitions:

- Inform the transition through a broad consultation process with state and non-state stakeholders;
- Implement aid transformation gradually and with flexibility;
- Fulfil previously established commitments (the legal as well as non-legally binding ones);
- Invest in knowledge exchange;
- Include long-term exit planning in aid strategies;

- Consider continued investments in sectors that might not be prioritised by the local partners but promote the public good.

Definitions

In this report, we take the phrase '**responsible and sustainable shift**' to mean a shift that minimises disruption in the recipient country and avoids corroding the bilateral relationships between donor and recipient country.

Aid exit is a term used to refer to the closure of a bilateral programme and country offices (ICAI, 2016). According to the evaluation authored by Kerapeletswe, Isaksen, Slob, and Jerve (2008), aid exits are "processes of phasing out and terminating ODA-funded government-to-government bilateral aid relationships" (p. 8).

Aid transition refers to a relationship where aid might stop, but the relationship continues: "These transitions may last several years, during which aid flows decrease, new instruments for development cooperation are introduced, and a new partnership is forged" (ICAI, 2016, p. 5).

Aid transformation is used by Nordic countries as a term applicable when aid exits include (Slob & Jerve, 2008):

- phase-in of other types of development assistance such as regional cooperation or private sector investments; and
- phase-in of new forms of cooperation (not necessarily development-related) and including non-ODA funding - also referred to as broader cooperation.

2. Historical trends in aid modalities

Development aid as we currently know it was first seen as a tool to rebuild European economies after World War II. With the Cold War, aid became a political tool, intended to ensure security and promote donors' economic and strategic interests. By the 1980s, the ineffectiveness of aid to ensure growth and poverty reduction was associated with the inability of developing countries to manage stable institutions: corruption, institutional inefficiency, and the distortion of the economy because of state-led development were singled out as causes preventing development.

Throughout most of the 1980s and 1990s, international aid mechanisms were guided by the agenda of the Washington Consensus. The World Bank and the International Monetary Fund (IMF) adopted Structural Adjustment Programmes (SAPs), conditional loans intended to encourage a reduction in the role of government and a more dynamic economy. The World Bank promoted liberalisation, called for a reduction of state-led development, and aimed at stimulating market mechanisms.

By the early 2000s, the SAPs were heavily criticised for reducing governments' ability to invest in local markets and for undermining their capacity to sustain and direct development efforts (Niyonkuru, 2016). It was recognised that SAPs undermined local governance and weakened economies that were not prepared to engage with free trade. The failure of SAPs prepared the ground for a recognition of the importance of local government in development.

The Paris Declaration in 2005 signalled a critical paradigm shift (Dabelstein, 2013). The Declaration reflected a growing awareness of the state as an essential development actor, and responded to the criticism that aid had been too donor-driven and not well coordinated. More than 150 countries

agreed on the Paris principles of ownership, alignment, harmonisation, results, and mutual accountability.

The 2000s were a decade of growing aid, driven by the momentum of the Millennium Development Goals (MDGs) and by the intention to promote country ownership and more harmonious aid mechanisms (Dabelstein, 2013). Conditional loans were replaced by the World Bank's Poverty Reduction Strategy Papers (PRSP), underpinned by the idea that poverty reduction strategies should be locally-owned instead of being externally imposed. Programme-based approaches (PBAs) replaced fragmented project approaches, aiming to reduce transaction costs and strengthen local governance.

General Budget Support (GBS) was introduced as a mechanism to coordinate aid by enabling donors to pool resources and directly support partner governments' budgets, improving state ownership of development efforts and reducing the costs of managing fragmented projects (Lister & Carter, 2007). GBS was designed to respect recipient government's own distribution, procurement, and accounting systems. Similarly, Sector Budget Support (SBS) earmarked funds to specific sectors that were considered priorities. Budget support also included non-financial elements such as policy dialogue, conditionality, and technical assistance / capacity development (TA/CD) to encourage reform processes in partner countries.

Throughout the 2000s, and especially in the second half of the decade, GBS was the preferred modality for implementing the principles of effective aid articulated in the Paris Declaration. GBS and SBS were expected to ensure alignment with national structures, harmonise donors' work, and complement local efforts towards the achievement of Poverty Reduction and Development Strategies. Budget support was expected to stabilise aid levels, making aid more predictable, and to significantly lower transaction costs by leveraging national systems. Official Development Assistance (ODA) increased during the 2000s, going from \$84 billion in 2000 to \$137 billion in 2013 (constant 2011 prices) (Ocampo, 2016). An extensive independent evaluation of the effectiveness of GBS carried out by Deval (Orth, Schmitt, Krisch and Oltsch 2017) concludes that the evidence in favour of GBS is robust. The authors concluded that there is evidence for the effectiveness of budget support especially towards:

- Ensuring a greater orientation to medium-term results;
- Greater predictability of aid flows;
- Increased allocative efficiency in public spending;
- Reduced transaction costs;
- Stronger domestic accountability.

However, in recent years, budget aid as a share of overall aid has decreased (Hynes & Scott, 2013) and donors have been increasingly interested in strategies to exit from financial aid and/or transition to other forms of development assistance. In some cases, donors might decide to pull out aid from a country as an attempt to focus their efforts on fewer countries, which are identified as having more need and geopolitical significance. In recent years, there have also been many 'graduations' from aid (Sedemund, 2014) as countries once considered developing have crossed the income threshold and are now considered middle-income countries (MICs). Financial aid is now only one of many mechanisms for poverty reduction in a development field that is becoming increasingly pluralised and complex, with a growing number of emerging development actors (such as India and China), regional development banks, trust funds, 'bottom of the pyramid' (BoP) businesses which target low-income people in developing regions with an intention to address social problem, international non-profits, and the increasing prominence of the private sector (Ocampo, 2016; Rudolph, 2017).

However, DEval concludes that the decisions to pull out of GBS are driven by political and strategic considerations that go beyond issues of aid effectiveness (Orth et al. 2017).

3. Issues, challenges, and risks of managing shifts away from financial aid

Exclusion of government actors from the transition process

Aid exit or transitions require complex layers of coordination and stakeholder engagement. However, Slog and Jerve (2008) conclude that, despite the principles set by the Paris Declaration calling for mutuality and partnership, decisions to transition or exit from aid tend to be donor-induced and one-sided. Poor communication with national governments risks jeopardising bilateral relationships. Donors should pay close attention to the local context by engaging early with the national government. This engagement can go a long way towards mitigating the possible disruption caused by the exit (Slob & Jerve, 2008).

The experience of Denmark exiting Vietnam illustrates that informing high-level government officials is not enough (Lattanzio, 2017). In Vietnam, regional governments were mostly unaware of the process of aid transformation, but since regional governments were the primary recipients of aid, this was particularly disruptive. The evaluation report regards the lack of direct involvement of sub-national stakeholders as a missed opportunity in supporting the transformation process (Lattanzio, 2017).

Transition could negatively affect civil society partners

Civil society organizations (CSOs) appear in the literature as crucial stakeholders to keep in mind during a transition process, as they might experience sharp reductions in funding as a consequence of the withdrawal of foreign aid. This was the case in India, in which the shrinking space available to civil society was associated with DFID's aid transition (ICAI, 2016).

Troubles for civil society were also noted in the evaluation of the Netherlands' exit from Bolivia, Burkina Faso, Guatemala, Nicaragua, Tanzania, and Zambia. In those cases, it was tough for civil society to find alternative funders. This was particularly because the Dutch had been providing core funding for civil society actors, which was uncommon amongst donors (de Kemp & Lobbrecht, 2016). Civil society actors were effectively dependent on such funding and, since the exit happened over a short period, it was impossible to find other donors to compensate. The evaluation reports that CSOs had to dismiss personnel and saw operating budgets shrink dramatically.

Lack of skills and human capacity could hinder the transition process

Human resources will be pivotal in times of transition. A policy brief discussing USAID's early wave of aid exit in the late 1990s reflects on the skills and capacity required for aid transition and exit. The skill set required to manage aid, as Rose, Collinson, and Kalow (2017) point out, might not be appropriate to manage the transition. It might be fitting to develop expertise in managing transitions or exit, and build the capacities of donor officials operating at the local level. The authors argue that staffing needs to be strengthened, not weakened, during transitions. For example, following the decision to transition out of financial aid in South Africa, Swedish Sida withdrew staff and the limited

capacity at the embassy level hindered the transition process (Tjønneland, Pillay, Slob, Willemsen, & Jerve, 2008).

The capacity of local staff is also pivotal to the transition's effectiveness. A joint evaluation by the Nordic countries reports that the lack of capacity at the country level in South Africa, coupled with a high level of staff turnover, contributed to making aid transition slower and more tumultuous (Tjønneland, Pillay, Slob, Willemsen, & Jerve, 2008). In Botswana, Sweden's aid exit was considered successful, but the government of Botswana argued technical assistance should have faded out more slowly to support the strategy (Slob & Jerve, 2008).

Basing an exit/transition decision solely on quantitative indicators such as poverty lines is risky

The decision to embark on an exit or transition process should be carefully considered. The literature points out that exit decisions tend to be based on political considerations, rather than considerations of aid effectiveness. In countries where transitions are based on a claim of aid graduation, decisions should be made on both qualitative and quantitative considerations. Discussing USAID's strategy, Rose, Collinson, and Kalow (2017) explain that quantitative indicators are used to show evidence of transparency and accountability in the aid decision. However, the authors argue that the insights provided by quantitative indicators offer a limited picture: they do not provide insights on the readiness for transition, the internal dynamics of inequalities, or of a country's likely future performance. Rose, Collinson, and Kalow (2017) recommend that USAID avoid using quantitative insights prescriptively.

Some authors suggest that achieving a particular level of per capita income does not mean that a country has resolved issues of poverty (Alonso, Glennie, & Sumner, 2014). The new geometry of global poverty sees two-thirds of the global poor in middle-income countries (MICs), whereas in 1990, 94.5 per cent of poor people lived in low-income countries (LICs) (Ocampo, 2016). Ocampo (2016) argues that "if the amount of people living in poverty is our paramount concern, then MICs should become the main aid recipients" (p.25). MICs should not be underestimated and might require international support (Rahman & Baranyi, 2018).

Lack of coordination with other bilateral donors could jeopardise the sustainability of local development

Countries might struggle with sustainable development when multiple donors decide to transition simultaneously. This was the recent case in Bolivia, Nicaragua and Guatemala. In Bolivia, the effect of several donors pulling out in the same years meant that Bolivia's total ODA in 2014 was 45% lower than in 2010 (de Kemp & Lobbrecht, 2016). The phasing out processes of Denmark, the Netherlands and Spain negatively impacted Bolivia's education sector, for example (de Kemp & Lobbrecht, 2016).

Donors should coordinate exit strategies to prevent the sudden withdrawal of multiple budgets. The 2008 evaluation of aid transformation by the Nordic countries stressed the responsibility of donors to find alternative funding to substitute theirs. However, this has proven hard to implement in practice.

Donors tend to have their own agendas and priorities, and coordination is unusual. The Danish evaluation of aid transformation in Vietnam states that:

“As more and more of Vietnam’s former development partners transform their relations into new approaches based first and foremost on economic interests, former like-minded donors have become competitors.” (Lattanzio, 2017, p.11)

Alternatives to financial aid may be less broadly developmental

One of the considerations leading to a decline in the popularity of financial aid is that new finance modalities, including private financial flows, are regarded by policy makers as making up a greater proportion of contributions towards development (ICAI, 2016). However, the literature points out that post-aid agendas are driven by robust pro-market approaches, and alternatives to financial aid might have a growth bias. Financial aid has been important for incentivising change and promoting access to additional resources for poverty reduction (Orth et al., 2017; Thomas, Viciani, Tench, Sharpe, & Hall, 2011). The dynamics of competition between donors that Lattanzio (2017) highlights might be risky for poverty reduction strategies, considering that cooperation is particularly important in the 2030 sustainability agenda (Rudolph, 2017).

4. Ensuring sustainable shifts: lessons learned

Inform aid exit/transition through a broad consultation process

The process of exit or transformation needs to consider the quality of relationships with local stakeholders to ensure the strategy won’t harm bilateral relations. Slob and Jerve (2008) highlight that exit/transition strategies should consider process indicators and found participation of stakeholders in the planning and implementation of exit processes to be a good indicator for strategy success. An extensive consultation with local stakeholders is regarded as an essential step to frame exit and transformation decisions. In particular, engaging early with high-level government officials has become a best practice in managing exit and transformation strategies.

The way emerging strategies are communicated matters. Communication should be “early, clear, and ongoing” (Rose et al., 2017). For example, the success of the Danish transition in Vietnam was associated with the fact that the strategy was approved early on, rooted in high-level policy consultations, and grounded in good diplomatic ties. This made it well-received on the Vietnamese side. On the other hand, Sweden’s exit from Botswana was regarded by local government officials as an ‘abrupt and unceremonious’ way to terminate a 30+ year relationship (Slob & Jerve, 2008).

The literature stresses that a responsible aid transition should consider the capacity for the achievements supported by ODA to be sustainable post-transition. It should also involve efforts by the donor to define the direction the aid exit/transition. For example, to create a regular forum between partner countries, South Africa and Sweden established a bi-national Commission coordinated by high-level officials, which was intended as a political forum to explore ways of

broadening cooperation between the two counties (Tjønneland, Pillay, Slob, Willemsen, & Jerve, 2008).

Successful shifts happen gradually and with flexibility

Fast transitions tend to be irresponsible transitions. In Malawi, a country with high aid dependency, the Danish terminated aid on six months' notice. This led to "a 40 per cent shortfall in the agriculture sector budget, a major setback in agriculture sector programme development, and affected long-term agricultural research negatively" (Slob and Jerve, 2008, p.12). An assessment of USAID's previous aid exit also recognises that timelines affect the success of the transition – Rose, Collinson, and Kalow (2017) recommend a gradual transition process of at least three to five years.

In general, successful transitions happen once a country is no longer dependent on aid (Slob and Jerve, 2008). In 2010, the Netherlands decided to drastically cut back general budget support, and cuts were deepened in 2012 when a new government reduced ODA from 0.7% to 0.55% of GNI (de Kemp & Lobbrecht, 2016). Such decisions were political in nature and motivated by concerns of budget cuts, and not necessarily consideration of aid effectiveness. The recent Dutch wave of aid exit lacked flexibility and included no in-depth assessment of the potential consequences. In Burkina Faso, Zambia and Nicaragua, the Dutch exit contributed to budget cuts in the health and education sector, deepening the countries' financing gaps and reducing spending (de Kemp & Lobbrecht, 2016).

Rushed strategies limit the ability of the donor to consult local stakeholders, but a policy brief for USAID reports that if the strategy for exit is well thought out and gradual, it is possible to build capacity to ensure sustainability. Rose, Collinson, and Kalow (2017) report a successful case study by USAID in Kenya. Food for Peace funding withdrew gradually with an intention to support community-based organisations to manage programs autonomously. Before ending financial aid, USAID built the capacity of micro-savings and loans organisations and certified their readiness to operate independently.

Because aid exit and transition should be tailored to the local context, long-term planning and flexibility are requirements of successful shifts. Rapid exits are irresponsible also because closing down aid programs is costly. A USAID evaluation reflects that:

"Breaking leases, paying for severance packages, and selling and shipping furniture are just a few of the direct costs that may be associated with mission closure. It is wasteful and a disservice to both the partner country and American taxpayers to incur such high costs without planning for longer-term sustainability and partnership management." (ibid, p.16)

The 2008 joint evaluation by Nordic donors recognised the exit of Denmark from India as a responsible one: it was defined in 1998 with a 10-year timeline and a strategy which included sector/programme specific action plans. The strategy was designed with sustainability in mind and involved Indian stakeholders. Budgets were relatively stable over the years and accounted for a couple of years of increased volume of aid before slowly decreasing.

Some of the experiences around aid exit/transition stress that aid remains a valuable tool to strengthen bilateral relations. While there is a trend towards concentrating aid to LDCs, some donors might consider providing ODA to MICs as a strategy to continue maintaining influence (this is the case of Germany, for example) (Rahman & Baranyi, 2018). Slob and Jerve (2008) points out that, after terminating aid to India, Norway decided to invest in another large health program as a tool to strengthen relationships. In South Africa, Nordic countries planned to fade out aid but ended up

postponing the decision, probably due to the strategic role South Africa plays in the region (Tjønneland et al., 2008).

Trust is sustained when donors fulfil both legal and non-legally-binding commitments

As part of an exit strategy, donors should ensure the fulfilment of ongoing commitments. Walking away from previously planned processes negatively affects the institutional capacity of the recipient, as well as the success of the aid transition (Heldgaar, 2008). Honouring commitments as part of exit strategies sustains trust, an essential ingredient in healthy bilateral relations.

This is true even when commitments are not yet legally binding. Van der Meer, Tostensen, Slob, and Jerve (2008), compare the Danish and Dutch exit from Malawi. The Netherlands faded out aid to Malawi over five years, taking a gentle rather than legalistic approach. For example, they moved into the second phase of a health programme even though it had not yet been agreed in a legally binding contract. In contrast, the Danish exit from Malawi – which unfolded in a rushed four-month process – complied only with legally-binding commitments (van der Meer, Tostensen, Slob, & Jerve, 2008). While they technically fulfilled their duties, their exit caused a loss of trust on the Malawian side because of the withdrawal from programmes that had been planned.

Beyond legality, there are ethical requirements to keep in mind in aid transitions, especially when the power of the donor is considerably higher than an aid-dependent recipient. Action Aid stresses that aid should be “accountable, transparent and predictable” (Thomas, Viciani, Tench, Sharpe, & Hall, 2011).

Invest in knowledge exchange

In aid transitions, especially in graduating MICs, investing in knowledge exchange might be especially valuable. MICs might lack capacity and expertise in specific sectors, and knowledge exchange can promote partnership between countries, strengthening bilateral relationships. The literature emphasises that knowledge exchange and capacity-building efforts should ensure local ownership. The Real Aid report by Action Aid (2011), however, warns that when technical assistance is not aligned with local needs, it could “distort country priorities and spend valuable money without doing any good” (Thomas et al., 2011). A strategy paper by Belgium Development Cooperation stresses that knowledge should be exchanged in both directions, promoting a sense of mutual respect and collaboration between countries (Achten, 2013). As countries step out of providing aid, they should ensure the transfer of knowledge in specific sectors in which the donors have gathered useful expertise. With the intention of encouraging local ownership, ensuring low transaction costs, and increasing funding predictability, Belgium Technical Cooperation suggests creating basket funds with other donors.

Examples of knowledge exchange modalities which emerged in the literature include:

- **Twinning:** a European Union instrument used for institutional cooperation between partner countries. It supports peer-to-peer technical assistance and learning by doing through ongoing workshops, training, and other knowledge exchange activities (Janus, Klingebiel, & Paulo, 2015).
- **Contract-financed technical co-operation (KTS):** KTS is used within Swedish development co-operation for technical assistance in MICs. KTS includes demand-driven

projects for knowledge transfer and technical assistance; it emphasises cost sharing and is delivered through consultancies (Slob and Jerve, 2008).

- **Sector-specific Knowledge Dissemination Facilities:** Denmark had developed a specific expertise in the Fisheries Sector Programme (FSPS) which supported Vietnamese seafood and aquaculture exports, creating employment for many people in poverty. The evaluation of the Danish partnership transformation efforts in Vietnam recommends the creation of a 'Sector-specific Knowledge Dissemination Facility', a cloud-based knowledge hub to gather sector-specific information (Lattanzio, 2017).

Include long-term planning for phasing out aid in aid strategies

As part of aid transitions, it is vital to create a long-term exit and/or transition plan. Slob and Jerve (2008) explains that:

“When a realistic timeframe was set, and the exit was allowed to take time, attention was given to sustainability and mitigation of adverse consequences. This involved long-term planning, careful consultation of all stakeholders and good monitoring of results.” (p.11)

Long-term exit/transition strategies allow for a more thoughtful assessment and for preparing the country for the transition. This can be facilitated by including in the strategy a timeline which should be realistic and flexible, yet establish some benchmarks (de Groot, Slob, Willemsen, & Jerve, 2008).

In an extensive study on aid exit strategies, Engels (2010) concludes that as donors have a broader awareness that aid will need to fade out, project cycles should account for exit strategies, which are currently missing from the project cycle framework. He suggests that planning should include the phase-over, capacity-building, and institution-building stages necessary to the program's sustainability (Engels, 2010).

Accounting for phasing out and the sustainability of programs in initial budgets should secure adequate funding for transition processes. In any case, exit and transition strategies should secure financing before proceeding with implementation, and adjust planning strategies accordingly (Engels, 2010).

Consider continued investment in public goods that might not be prioritised by future aid partners

As part of transition strategies, donors seem mainly focused on strengthening pro-growth and pro-market environments to promote business opportunities in the partner country. For example, Denmark's transition out of Vietnam focused on expanding economic relationships between the partner countries. The evaluation reports that between 2005 and 2015 Danish investments in Vietnam tripled, and bilateral trade quadrupled (Lattanzio, 2017). This was sustained by various tools such as the Private Sector Development Programme (PSD, 1993-2006) and the Business-to-Business Programme (B2B, 2006-2011) which provided incentives for Danish companies to open in Vietnam (Lattanzio, 2017).

This strategy created direct and indirect employment in the country. Lattanzio (2017) reports that:

“Denmark was able to establish itself as the largest EU exporter of goods to Vietnam per capita, with over 130 companies doing business in the country, primarily in wooden furniture,

garments, clean energy, information and communications technology, electronics and software, maritime transport and logistics, and the food industry.” (p.12)

In this strategy, there is an assumption that economic growth will lead to poverty reduction. However, it is worth considering that economic growth might also lead to more inequity and does not necessarily target poor people. Moreover, as the agenda of the SDGs stresses, an attention to the preservation of public goods is essential in the current understanding of development (Rudolph, 2017).

Economic growth could also lead to environmental degradation. In Vietnam for example, environmental sustainability has not been prioritised, and environmental governance has been weak. Through foreign aid, the Danish helped Vietnam increase fisheries and aquaculture production, but Lattanzio’s (2017) evaluation reports that there are concerns about the sustainability of such programs: unsustainable capture fishery harvests and water resource management might have led to a decline of the industry due to environmental degradation and overfishing. Currently, the Comprehensive Partnership Agreement between the two countries is focused on creative incentives for green growth, food safety, and environmental management programmes by facilitating knowledge transfer. Moreover, the evaluation recommends the creation of a pool of local green-growth sector experts to inform Danish investors (Lattanzio 2017). Environmental concerns should be prioritised in the post-ODA era, especially when the local government might not have the capacity or political will to promote environmental goals.

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