Vietnam is transitioning out from foreign aid (Credit: Flickr CC-BY 2.0)

Managing the transition from aid: lessons for donors and recipients

By Annalisa Prizzon
29 May 2019

The past 15 years have seen 35 low-income countries (LICs) achieving middle-income country (MIC) status. While income per capita is only one measure of a country's economic and social development, the move to MIC status can shape its mix of financing resources and often triggers donor discussion on whether to reduce or even phase out financial assistance.

Several authors have mapped how development assistance overall has been allocated to MICs and how it should be delivered. However, graduation and reclassification policies based largely on income per capita do not capture a country's complex development challenges or its vulnerability to setbacks.

So how do donors decide to phase out their programs and how do they manage that process? How do recipient countries manage the transition away from aid? And what can we learn from their experiences?

To our great surprise, we found very little research that tried to answer these questions systematically across countries and donors. There are only a handful of outdated reviews of development partners' approaches to transition and exit, including a joint evaluation of support from Denmark, the Netherlands, Norway and Sweden, and a separate evaluation of the phasing out of support from the Netherlands. Less surprisingly, the few analyses available on recipient countries focus on individual Asian economies (Laos, Vietnam, Indonesia).

So we decided to take a first step and analyse how selected bilateral donors approach transition (beyond aid allocation) (including Australia, the EU, and Korea). Second, we reviewed how recipient countries are affected by – and plan for – transition, including countries moving away from their classification as low-income countries (LICs) and eight country case studies in lower middle-income countries (LMICs), spanning countries in Africa

(Egypt, Ghana and Nigeria), South Asia (Pakistan and Sri Lanka), South East Asia (Laos and Vietnam), and the Pacific (Papua New Guinea).

We identified seven patterns that were surprising and that challenged our initial hypotheses.

1. **Few donors have criteria for either transition or exit from development programs.** The exceptions are found in specific agencies within a development cooperation system (SDC and SECO in the Swiss Development Cooperation System) or in specific instruments, such as the EU's Development Cooperation Instrument (DCI). Most agencies that we analysed make country-by-country decisions or take an indirect or informal approach to exit and program driven by aid allocation criteria.

2. **Income per capita has only a marginal influence on decisions about aid allocation and, therefore, transition.** Most indicators for allocation, transition and exit focus on needs and impact of development cooperation. However, income per capita becomes the dominant factor in aid allocation when a country is reclassified as high-income, which determines its eligibility – as a country – for official development assistance (ODA).

3. **Transition to LMIC status does not automatically mean less international public finance.** Official development finance rose in several of the countries reviewed following their transition to LMIC status and increased, on average, for all countries making that transition. Donors often reprioritise their programs when a country becomes an MIC, so we expected the opposite result. It seems that development assistance is driven by motives well beyond the income per capita of the recipient country.

4. **In general, the terms and conditions for financing got tougher for recipient countries, with a gradual shift to loans.** Countries that are becoming MICs gradually rely more on loans and less on grants. Most of our case study countries also saw an increase in their share of loans versus grants following their transition to LMIC status. Egypt and Papua New Guinea were two exceptions: they continued to receive most of their assistance in the form of grants because this was the main approach of their largest development partners (the United States and Australia, respectively).

5. **Resource allocation in most countries shifts towards infrastructure**

development. With MICs expected to rely more on loans than on grants, the share of official development finance funnelled into the infrastructure sectors is likely to rise, given their potential returns and ability to generate cash flows. Except in Lao PDR, official development finance and public finance have increasingly targeted infrastructure development, rather than the social sectors. In Papua New Guinea, this was a concern for government officials and development partners because of its association with deteriorating health indicators.

6. **Tax revenues as a share of GDP rise slowly (and even decline).** As their economies grow, MICs can become stuck in what has been called the 'missing middle' of development finance – when the total public resources available to a country fall as a share of GDP once it transitions from LIC status, recovering only when it is well into MIC status. While tax revenue as a share of GDP often increased, this was not enough to compensate for the relative dip in aid as a share of GDP in any country reviewed except Pakistan. In some countries, the 'missing middle' of development finance was particularly pronounced: not only did aid fall as a share of GDP, but so too did tax revenue – as seen in Sri Lanka, Nigeria and Papua New Guinea.
7. **Recipient countries rarely have strategies in place to address potential challenges and plan ahead for the transition from aid**.Among our case study countries, Viet Nam was the only one with a strategy for the transition from aid. However, this focused mainly on the types of project each source of financing could fund. Other countries plan to implement a strategy (Ghana, with its 'Ghana Beyond Aid' strategy, and Nigeria, to a certain extent) or reflect some principles of the transition from LIC indirectly through other documents (Lao PDR).

What does this mean for recipient and donor countries? Recipient countries should be clear on their priorities for external development finance and establish strategies to manage the transition from aid while protecting social sector gains by ring-fencing the share of government spending for education and health. Donor countries should broaden their transition criteria and approaches beyond income per capita, with resource allocation considering trajectories that look beyond macroeconomic performance, boosting non-concessional official finance and tax revenues.

While this is the first ever comparative assessment across recipient and donor countries, many research and policy gaps remain. As countries make their transition from aid, we should unpack and learn from the experiences of recipient and donor countries that have been through this process to ensure that we do not jeopardise the results achieved so far.

This blog draws on two papers by the author: Exit from aid: an analysis of country experiences and Exit from aid: an analysis of donor experiences.

About the author/s

Annalisa Prizzon
Annalisa Prizzon is a Senior Research Fellow at the Overseas Development Institute (ODI).

Link:
https://devpolicy.org/how-should-donors-and-recipient-countries-manage-the-transition-from-aid-reflections-from-country-case-studies-20190529/
Date downloaded: 8 May 2024