

Donor responses to corruption in deteriorating governance environments

Query:

Are there any cases or empirical studies on the reactions of donors when faced with corruption or deteriorating governance situations? Are there any clear-cut official positions for U4 partner agencies on how to react in such situations?

Content:

- Part 1: Cases of Donor Disengagement in Corruption-Prone Environments
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Summary:

There have been some examples of donors disengaging, suspending or reducing aid to a country on account of corruption, human right abuses or undemocratic regimes. These cases have been extensively covered by the media, such as in Zimbabwe, Chad, Kenya, Uganda, Tanzania and Malawi. As yet, no joint response has been explicitly formulated by the donor community on whether/how to engage with countries where governance deteriorates. In practice, while there is a growing consensus on the need to maintain sustained engagement in fragile states, donors are faced with the challenge of identifying appropriate forms of engagement. Engagement through civil society organisations or UN agencies remains an option with the view to bypassing corrupted government structures. When sustaining support to high risk countries, aid modalities have also been designed to prevent and reduce corruption risks and promote anti-corruption reforms through the use of conditionality or strengthened public finance management systems when providing direct budget support.

Part 1: Cases of Donor Disengagement in Corruption-Prone Environments

There have been some cases where donors have disengaged from a country or withheld funding on account of corruption or suspicion of corruption. Such approaches have mainly been used in cases where corruption was uncovered in development programmes, as an aid conditionality to promote anti-corruption or democratic reforms in some countries or to sanction undemocratic and corrupt regimes. While such cases are reported in the media, the decision-making process of disengaging does not appear to be systematically documented through publicly accessible reports or document. The Helpdesk has found little evidence of a concerted approach to disengagement or case studies documenting the process of disengaging.

Most recent cases where aid has been suspended on account of corruption or governance concerns have been extensively reported in the media.

In corruption-prone environments, suspension of aid has been used in some cases to protest against deteriorating environments and/or promote anti-corruption reforms, making the passing of anti-

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Date:

25 April 2008

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corruption legislation a condition for development assistance. In such cases, suspension of aid is usually made on a temporary basis, as a "quasi-exit", until the country circumstances improve.

In the case of the "**Chad-Cameroon Pipeline**" for example, the World Bank decided in January 2006 to withhold new loans and grants to the Government of Chad and suspended disbursement of International Development Assistance funds allocated to the country. The withheld funding amounted to a value of approximately US\$ 124 millions. This decision was triggered by amendments of the country's Petroleum Revenue Management Law passed by the National Assembly which, in the World Bank's view, would have loosened controls on the use of oil revenues. The Government of Chad finally agreed to pass a budget law specifying that 70% of oil revenues would be allocated to priority poverty reduction programs as well as to take measures to strengthen the monitoring, transparency and accountability of oil revenues.

Tanzania provides another example of such an approach. In December 2006, Denmark reduced its general support to **Tanzania** by 20% for the financial year 2007/2008, as the Government of Tanzania did not fulfil its commitment to present long awaited anti-corruption legislation. This came a few months after Norway had announced in August 2006 suspending funding to a road project in the country, after embezzlement of funds worth US\$ 1 million was uncovered. (<http://www.afrik.com/article10324.html>). Corruption concerns have also recently led Finland to consider cutting bilateral aid to the country. In March 2008, while currently continuing aid to Tanzania, Finland announced withholding the disbursement of an additional € 2 million for General Budget Support until a special audit of the Bank of Tanzania is completed. A decision based on this audit will be made in the coming weeks on whether the case of misappropriation of funds currently investigated at the central bank will affect Finland's support to Tanzania for 2008/2009. (<http://formin.finland.fi/public/default.aspx?contentid=124018&nodeid=15145&contentlan=2&culture=en-US>).

In some cases where corruption was uncovered in development programs, donors have suspended foreign aid until funds were recovered. In 2005 for example, the Government of **Mozambique** agreed to refund more than US\$ 200,000 worth of Swedish development aid, after an audit indicated that part of the funds allocated to the educational assistance programme had been used in ways not covered by the agreement. The money was spent on scholarships for close relatives of officials. (<http://news.bbc.co.uk/2/low/africa/3580029.stm>). This article mentions a similar instance involving EU aid to the Ivory Coast, where dozens of government officials were arrested for fraud. EU assistance was suspended until the Government refunded the stolen money.

Suspension of aid may also be linked to the government indicating no signs of political will and commitment to address the corruption situation. In **Malawi**, several donors including the EU, the USA, Denmark and Britain suspended or scaled down their aid invoking widespread corruption and economic mismanagement, after high level fraud and mismanagement was uncovered in the country in 2002. (<http://news.bbc.co.uk/1/hi/world/africa/1665141.stm>). In the case of Denmark, the cooperation was not perceived as functioning satisfactorily, which played as a contributing factor to the exit decision. The government had refused technical assistance to address corruption problems, forcing instead the Danish Ambassador who had raised governance concerns to leave the country. (Please see: (<http://omvarlden.nu/sida/jsp/sida.jsp?d=1509&a=32048>)).

Donors may also decide to exit countries where the country circumstances - with regard to the political or governance situation - are likely to make development assistance ineffective or unacceptable. Partial or full disengagement is then imposed as a form of sanction on corrupt or undemocratic regimes. In such cases, donors strive to compensate the potential negative impact of this decision on the people by using alternative ways to deliver aid. In some cases, they've strived to bypass government structures and provide aid in the form of humanitarian assistance, through UN agencies and non-governmental organisations.

Zimbabwe constitutes one of the most notorious examples, where human right abuses, corruption, and deteriorating governance have resulted in donors' disengagement. Most donors have ended, reformulated or drastically reduced their bilateral aid to Zimbabwe in recent years. Among other grounds, the EU resolution on Zimbabwe passed in 2002 refers to corruption and the "looting of an estimated € 8, 5 billion worth of movable assets by senior officials since February 2000". The resolution commits to providing Zimbabwe with emergency humanitarian aid *"to be dispensed in a non-partisan manner, including through non governmental agencies which are not under the control of Mugabe in order to prevent the misappropriation of food by ZANU-PF"*.¹ In May 2006, Hilary Benn, the UK development minister endorsed a similar policy in an interview: *"The UK will not give any funds directly to government unless things change significantly"*. (<http://news.bbc.co.uk/1/hi/business/5019522.stm>). The Government of Zimbabwe responded by making it illegal for NGOs to receive foreign aid.

Uganda provides another example where donors have withheld part of their support until the governance and political situation improves in the country. In August 2006, the UK Government announced a reduction of budget support to Uganda by £20 million from a planned £50 million after an economic and governance assessment raised concerns over the government's commitment to the independence of the judiciary, freedom of the press and association and multi-party politics. (<http://www.dfid.gov.uk/news/files/pressreleases/uganda-reduction.asp>). The same year, the World Bank decided to pull out of Uganda's privatisation and didn't extend its technical support to the Privatisation Unit, invoking political interference and lack of transparency for its decision. In December 2005, Sweden had also decided to withhold a part of budget support for political reasons and reallocated it to humanitarian assistance in Northern Uganda. In August 2006, Sweden finally decided to resume the withheld budget support to support poverty reduction, while cutting a further 10% due to insufficient progress by the Government of Uganda in fulfilling central undertakings in the agreement, particularly with regard to protecting human rights and promoting democratic governance. (http://www.sida.se/sida/jsp/sida.jsp?d=137&a=25150&language=en_US).

In **Kenya**, the resignation in 2005 of John Githongo from his position of permanent secretary in the office of the president in charge of governance and ethics triggered strong reactions and statements from the donor community, resulting for example in the United States withholding US \$2.5 million in aid to Kenya's anti-corruption campaign. (<http://www.africa.upenn.edu/afrfocus/afrfocus021105.html>). More recently, after the post election violence that took place in Kenya following the 2007 December elections, Scandinavian countries (Norway, Sweden and Finland) suspended their support to one of the key government programmes, urging the Kenyan Government to put an end to the political violence. Government departments affected by aid suspension include the judiciary, the police, prisons, the Kenya Commission on Human Rights as well as the Kenya Anti-Corruption Commission. (http://www.newsfromafrica.org/newsfromafrica/articles/art_10903.html).

In the absence of systematic research or documentation of disengagement processes and impact, it is difficult to conclude whether and under what circumstances such forms of political pressure have been used and can be successful in yielding the expected results and promoting a sustained political will to address corruption in developing countries. At the same time, there is a growing consensus that such measures are likely to impose a heavy burden on the segments of population which are most dependant on aid assistance. More research is needed to assess whether the political impact of pressures exercised on governments through aid withdrawal outweigh the devastating impact that such measures have on the livelihoods of the most vulnerable groups of society.

¹ Please see:

http://www.europarl.europa.eu/pv2/pv2?PRG=CALDOC&TPV=DEF&FILE=020704&SDOCTA=17&TXTLST=1&POS=1&LASTCHAP=57&Type_Doc=FIRST&LANGUE=EN.

Part 2: Engaging or Disengaging in Deteriorating Governance Situations

When confronted with high risk or deteriorating environments, donors face the dilemma of engaging, not engaging or disengaging. These various examples indicate that suspending aid has been an option that has been considered and implemented by various donors when confronted with corruption, human right abuse or undemocratic regimes.

Disengaging

Donor Policies on Disengagement in Deteriorating Governance Situations

"Donors must be prepared to reject engagement in country framework partnerships where recipient governments' initiatives are seen as non-credible and local ownership is clearly absent or agreed monitoring benchmarks are consistently missed." This recommendation emerged from a Conference organised in Maastricht by the Netherlands Minister for Development Cooperation in April 2000 that brought together representatives from government, civil society, and regional and international multilateral organisations in the bilateral donor community. The Utstein group endorsed the work of that Conference through the Utstein Ministerial Statement on Combating Corruption.²

In its policy paper on aid conditionality, **DFID** explicitly outlines the circumstances in which the UK will consider reducing or interrupting aid, in situations where the country moves significantly away from agreed upon poverty reduction objectives, significantly violates human rights or other international obligations or in cases where a significant breakdown in financial management and accountability lead to a risk of funds being misused through weak administration or corruption. (<http://www.dfid.gov.uk/pubs/files/conditionality.pdf>). Whether in deteriorating governance situations or not, DFID also publicly communicates zero tolerance to corruption each time fraud or corruption is identified. The agency claims that it *"always takes action to recover lost funds. Future funding may be withheld from partner governments where arrangements for preventing or detecting fraud and corruption do not improve"*. (<http://www.u4.no/document/showdoc.cfm?id=132>).

CIDA also articulates elements of a disengagement policy in a paper on anti-corruption programming dated June 2000, that endorses the Maastricht Conference recommendations. (Please see: [http://www.acdi-cida.gc.ca/INET/IMAGES.NSF/vLUIImages/HRDG2/\\$file/EngQ&S.pdf](http://www.acdi-cida.gc.ca/INET/IMAGES.NSF/vLUIImages/HRDG2/$file/EngQ&S.pdf)). Non-engagement and disengagement should be options chosen by donors in circumstances where there are neither credible efforts nor political will to address the governance situation. It is therefore essential to assess local ownership, leadership and commitment against corruption. Even when disengagement takes place, continued donor support for civil society groups and regional networks should be maintained albeit perhaps at lower levels.

Other donors have established explicit criteria for the co-operation with partner countries, which can be used to determine whether to continue support or not in corruption prone environments. For example, **the Netherlands** uses both poverty criteria (IDA eligibility) and governance criteria (using World Bank's CPAI index) in this respect. **Denmark** has also established a set of criteria including governance and poverty. In neither case, however, would non-adherence to the criteria lead to an automatic exit. (<http://omvarlden.nu/sida/jsp/sida.jsp?d=1509&a=32048>).

² In 1999, the Ministers for Development Cooperation of the Netherlands, Germany, Norway, and the United Kingdom met on the Island of Utstein and decided to join forces and intensify their cooperation on a number of issues, including the fight against corruption. They are since referred to as the "Utstein Group".

Review of Development Agencies' Exit Practices

In practice, exiting a country is often a complex and controversial process, negatively perceived by the various stakeholders in recipient countries and donor countries. Unpublished research by Alf-Morten Jerve (CMI) on donors' exit strategies mentions that if problems of corruption and misuse of aid are found in many aid recipient countries, they have rarely been used as a reason by donors for exiting. The media may play an important role in this regard, by putting donors under pressure to react to blatant deteriorating circumstances in countries such as Zimbabwe. A review of four donor principles and practices for exit conducted in 2005 and published in 2006, looking at the Netherlands, Norway, Denmark and Sweden, comes to a similar conclusion. The review of 85 country exits by the four donors since the 1990s indicate that country and sector exits tend to be manifestations of broader development agendas such as the need to concentrate to fewer sectors, countries or programs for more effectiveness. (Please see: <http://omvarlden.nu/sida/jsp/sida.jsp?d=1509&a=32048>).

Disengagement based on lack of progress against agreed benchmarks, corruption or unexpected developments in recipient countries raise a series of concerns that may discourage resorting to such drastic solutions. Such exit decisions are made unilaterally, with no opportunity for the partner country to gradually prepare and adjust to donors' phasing out. In such extreme cases, the recipient country has to adjust as best as possible, with a potentially damaging impact on the most vulnerable groups in society. The Helpdesk hasn't found empirical evidence of the impact of such strategies within the time frame of this query and a comparative assessment of countries such as Zimbabwe, Malawi or Eritrea, including of how they coped with donors' disengagement may be useful to conduct in order to assess the impact of exit strategies on recipient countries.

Pulling out also challenges the concept of predictability of aid that is being promoted by the Paris declaration on aid effectiveness or the philosophy behind the provision of budget support. There is a general consensus among the donor community that donors need to give longer term multi-year commitments to allow for progress. Anti-corruption measures are likely to yield results only in the long term. Such reforms are usually politically costly and there is often a time-lag between policy implementation and policy impact. Disengaging on account of lack of progress against agreed upon anti-corruption targets should therefore be considered with caution. At the same time, donors are under pressure to address their constituency's concerns regarding political instability and corruption allegations. A Eurodad meeting held in 2006 discussed some of these issues. (Please see "Can donors pull out when things go wrong?" <http://www.eurodad.org/whatsnew/reports.aspx?id=460>).

In fragile or unstable contexts, formal policy positions may also be challenged by the political reality of the recipient country. While suspending aid on account of corruption may be justified by the governance or human rights situation in recipient countries, such strategies may have dissuasive social, developmental and political implications and can potentially degenerate into conflict. For example, the DFID conflict assessment for Mozambique published in 2006 states that:

[...] Governance is the key issue, and here donors face a dilemma. Clientelism and patronage may become more intense because the checks and balances in the political system are weakening and the demands for patronage are always increasing. [...] Representing more than half the national budget, aid is a major element in the patronage system but this does not necessarily mean that it is ineffective. The problem is that it operates in a strongly politicised environment and has profound political impacts. [...] If democracy erodes then the pressure for patronage within the elite may take full precedence over development. The dilemma is that a sudden withdrawal or reduction of donor aid is itself one of the potential shocks that could trigger conflict but maintaining the flow of aid uncritically will compound the underlying problems of governance. [...]. (Please see: <http://www.dfid.gov.uk/pubs/files/strategic-conflict-assessment.pdf>).

When poor governance, corruption or severe abuse of human rights justifies suspension of Official Development Assistance (ODA), donors' policies have usually been to transform it into humanitarian

assistance or support channelled through NGOs outside the immediate control of government, as recently in the case of Eritrea and Zimbabwe. (Please see: http://www.inwent.org/imperia/md/content/bereich1intranet/efinternet/fragilestates/strategies153e_lo.pdf).

Engaging with civil society groups also remains an alternative option. A background paper to the Maastricht Conference mentions the case of Bangladesh, where the governance situation would make it extremely difficult for donors to engage in a country framework against corruption. Yet there is a vibrant civil society that provides a promising alternative for engagement. Participants in the conference agreed that continued donor support for civil society groups and regional networks should be maintained at lower levels even where disengagement takes place. In the case of disengaging, there are a set of "behind the scene" strategies that can also support anti-corruption activities such as working through the UN institutions or using diplomatic missions as an approach to keep abreast of countries' changing circumstances.


Engaging

In practice, although widely publicised, withdrawing from a country on account of corruption seems to be the exception rather than the rule. There seems to be a consensus to use such approaches as a "last resort strategy" when all other political and diplomatic options have failed.

Another challenge for donors is to decide whether to engage in the first place in countries where the governance situation deteriorates. In their anti-corruption strategies, donors tend to promote a doctrine of partnership, relying on local ownership, commitment and leadership against corruption. Reviewed policy documents stress that donor partnerships must be based on clear signs of ownership and political leadership as donors should primarily focus their efforts in recipient countries that demonstrate ownership of the anti-corruption agenda and political will to seriously pursue it. (Please see: http://www.worldbank.org/wbi/governance/pdf/hague/role_bilateral.pdf). Key recommendations in this regard include that:

- Country frameworks against corruption should be developed through donor-recipient interaction and cooperation, promoting local ownership and leadership in country-specific strategies;
- Donors seriously require recipient countries to demonstrate "*systematic and objective indicators of ownership*," so that feasible and credible joint policies are established and implemented for each sector.³
- Agreed monitoring indicators must be key parts of the anti-corruption framework, including ownership/leadership indicators, consistent close interaction among broad groups of stakeholders, implementation of oversight and sanctions as well as regular reviews of transparency and accountability.

In countries where governance is deteriorating, these conditions are not often likely to be met. Most countries experiencing such degenerating situations are fragile states⁴, which are very often at risk of conflict. In spite of corruption risks, the assistance needs of these countries have to be considered and addressed, not least because poor governance is usually correlated with poverty both as a determinant and as a consequence of corruption.

⁴ The Helpdesk understands the concept of fragile state as states where the government cannot or will not deliver core functions to its people, as per DFID's working definition. The lowest performers in the World Bank's [Country Policy and Institutional Assessments \(CPIA\)](#)  are sometimes used as a proxy for fragile states.

An International Policy Dialogue conference was organised by InWEnt and the German Federal Ministry for Economic Cooperation and Development (BMZ) in Bonn in November 2006 on "Stay Engaged! Fragile States and Weak Governance: A Development Policy Challenge?" The need for sustained involvement in crisis states, even under difficult conditions, was unanimously recognised by all participants. (Please see: http://www.inwent.org/ef/events/fragile_states/08717/index.en.shtml). In such situations, the challenge remains to identify appropriate strategies to assist fragile states and prioritise policy interventions. A summary of the discussions that took place in this forum is reproduced as follows:

"Countries with a very low level of governance, but with reform-oriented elites, can receive support in the form of capacity development and must be encouraged to increase participation by their citizens in reform efforts. Countries with low-quality governance and elites unwilling to reform, on the other hand, must be engaged in a critical dialogue; at the same time, donors must launch projects to assist marginalised sections of the population and develop new contacts with civil society, particularly at the local level. Finally, in countries where the situation continues to deteriorate, as in the case of Zimbabwe, a minimum level of support should be maintained, but outside state structures."

Although not specifically dealing with corruption issues, some of the international community emerging practices and guidelines to deal with fragile states can also provide a framework on how to engage with countries with weak or deteriorating governance situations.

The **OECD DAC Principles for Good International Engagement in Fragile States** may provide guidance in this regard. (Please see: http://www.oecd.org/document/46/0,2340,en_2649_33693550_35233262_1_1_1_1,00.html). The Principles recognise that fragile states confront particularly severe development challenges such as weak governance, limited administrative capacity, chronic humanitarian crisis, persistent social tensions, violence or the legacy of civil war. A common response to these challenges based on shared principles can help maximise the positive impact of engagement and minimise unintentional harm. The Principles emphasise the need to:

- Take context as the starting point
- Ensure all activities do no harm
- Focus on state-building as the central objective
- Prioritise prevention
- Recognise the links between political, security and development objectives
- Promote non discrimination as a basis for inclusive and stable societies
- Align with local priorities in different ways in different contexts
- Agree on practical co-ordination mechanisms between international actors
- Act fast...but stay engaged long enough to give success a chance
- Avoid pockets of exclusion ("aid orphans")

Part 3: Mitigating Corruption Risks in Deteriorating Governance Situations

While aware of the need to stay engaged, the challenge remains for donors to identify how to engage in a situation where corruption is deteriorating in order to mitigate corruption risks and provide appropriate safeguards to protect aid from corruption. From this perspective, prevention is a supporting strategy to pursue when engaging/staying engaged in high risk countries.

Prevention Measures as a Response to Deteriorating Governance Environments

In the wake of the recent Kenya situation that had been largely unforeseen by most observers, some discussions have taken place within the international community on how it would have been possible to anticipate such developments in order to prevent conflict escalation. Donor joint assessments of the governance situation in fragile states could constitute a first response to deteriorating environments, including a corruption assessment, as corruption undermines state legitimacy and may feed into political instability. A comprehensive diagnostic of the governance situation can equip donors with the information they need to anticipate and prevent such dramatic developments as well as identify ways to address the deteriorating circumstances before they lead to conflict outbreaks.

As such, corruption prevention efforts can be seen as an important component of any strategic response to deteriorating situations. As reflected in **donors' anti-corruption strategies**, before suspending or reducing development assistance, donors' responses to corruption have prioritised approaches aiming at protecting aid from corruption and supporting country-led anti-corruption efforts by:

- Enforcing stricter internal controls to limit possibility for abuse;
- Supporting countries in developing effective systems for managing aid and reduce corruption risks;
- Adopting conditionality with the implicit threat of aid reduction or suspension;
- Supporting projects that have an anti-corruption impact or strengthen national accountability systems.

(Please see a compilation of anti-corruption policies and documents: <http://www.u4.no/projects/utstein/policydocuments.cfm>).

The Terms of Cooperation

The terms of cooperation agreements provide opportunities to make these principles operational, prevent corruption and create conditions and opportunities for taking appropriate action during the implementation of donor supported programmes. Corruption risks must be addressed at each stage of the project cycle, including during the planning, entering into agreement, as well as implementation, reporting and evaluation phases of the project.

Effective anti-corruption strategies require regular cost-effective corruption risk assessments and decision making and formulation of cooperation agreements should ideally systematically discuss and address corruption risks.

An internal audit of SIDA's management of contributions in corruption-prone environments provides a comprehensive overview of how **SIDA** manages corruption risks in three high risk partner countries and seventeen contributions. This audit formulates a series of recommendations, strongly emphasising the need to conduct in-depth corruption risk assessments for each of the intended contributions as a key element for decision making as well as the formulation of the agreement. The report further recommends that agreements regulate a number of points in order to deal with corruption, including special conditions for support/continued support, regulations of procurements, operational and financial reporting, repayment obligations, possibilities of terminating agreement, frequency, scope and focus of audits. A reliable and relevant corruption analysis and discussion of corruption risks should also be carried out for each proposed allocation. (www.sida.se/shared/jsp/download.jsp?f=IR04-02_Corruption.pdf&a=3048).

SIDA's management proposed an action plan in response to this internal audit, reinforcing their intolerant attitude towards corruption and committing to repeatedly communicate it both internally within the organisation and externally to partners as follows: "*SIDA does not compromise on the*

quality of its development cooperation, will only disburse funds when conditions and requirements are fulfilled, will never accept corruption, will always act upon suspicion of corruption and will always ensure to inform those concerned within and outside of SIDA". (Please see: <http://www.sida.se/shared/jsp/download.jsp?f=SIDA3435en+Management+Respons.pdf&a=3048>).

The Use of Conditionality

Some forms of conditionality have been attached to development assistance and loans by multilateral and bilateral organisations, including requirements to enhance aid effectiveness such as anti-corruption measures as well as more controversial policy conditionality in the areas of privatisation or trade reforms. The use of conditionality may contribute to reduce fiduciary risks in countries where corruption is pervasive. But there is also a set of challenges attached to this approach. For example, the principle of promoting country ownership may conflict with the need to ensure that aid is used effectively for its intended purpose and conditionality may ultimately undermine local ownership and genuine commitment for reform. The predictability of aid may also be undermined if funding is withheld or reduced due to weak performance in fulfilling the cooperation agreement's conditions. As a result, the general trend in this regard goes towards gradually moving away from policy conditionality, while providing some forms of safeguards to ensure effective use of donor funds.

In March 2005, DFID published a policy paper revisiting its guidelines on aid conditionality. This policy clearly states that effective aid partnership should be based on shared commitment to reducing poverty, respecting human rights and international obligations as well as *"strengthening financial management and accountability and reducing the risks of funds being misused through weak administration or corruption"*. This policy generally calls for a reduction in aid conditionality, especially in the sensitive areas of policy conditionality. However, the policy notes that "fiduciary" and "process" conditionality should be maintained to ensure that adequate finance and accounting systems are in place in recipient countries. Conditions providing safeguards against corruption and relating to the fulfilment of international law should also be maintained, the policy explicitly states that *"The UK will use conditionality to ensure that aid is not used corruptly or for purposes other than those intended"*. (Please see: <http://www.dfid.gov.uk/pubs/files/conditionality.pdf>)

A **Review of World Bank Conditionality** published in 2005 indicates a similar evolution, with a general decline of the use of policy conditions in sensitive areas such as liberalisation or privatisation, while conditions in public sector governance areas have grown rapidly in recent years. In Low-Income Countries Under Stress (LICUS), conditions are attached to loans to address minimum levels of fiduciary control in these countries. In LICUS countries, the largest concentration of conditionality is found in public governance areas. All loans to LICUS countries had public expenditure management conditions and around 54% of conditions and 68% of benchmarks were targeting public governance areas. Fiduciary conditions vary from country to country but typically cover the areas of procurement, budget management, monitoring and evaluation and disclosure. (Please see: <http://siteresources.worldbank.org/PROJECTS/Resources/40940-1114615847489/webConditionalitysept05.pdf>).

The **European Union** also introduced elements of conditionality in its foreign aid policy, with the promotion of human rights, democratic values as well as rule of law being integrated as "essential elements" of different cooperation agreements. The ACP-EU partnership agreement signed in Cotonou in 2000, for example, explicitly addresses issues of "good governance" as a "fundamental element" of the agreement, with the agreed-upon definition of good governance including the fight against corruption. Under such cooperation agreements, serious cases of bribery and corruption can give rise to a consultation procedure. Although carefully worded, the agreement provides for the suppression of cooperation "as a matter of last resort" if measures to remedy this situation are not taken. The Cotonou Agreement does not define the "serious cases of corruption" that can lead to the suspension of the co-operation. The EU communication on a comprehensive strategy against corruption states that the consultation procedure has taken place in one case, *"when the European Union was deeply preoccupied by the lack of transparency in the public accounting system and by*

the risks of serious corruption in particular in the management of natural resources and the exploitation of monopolies in a partner country". (Please see: http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=en&type_doc=COMfin al&an_doc=2003&nu_doc=317).

The German **Kreditanstalt für Wiederaufbau (KfW)** also introduces anti-corruption clauses in its financing agreements, requiring that borrowers or grant recipients ensure that projects have been developed without corruption. Breaches against this guarantee could result in suspension of disbursement or termination of the agreement. KfW also expands its guidelines to tendering procedures, where all participants have to pledge to refrain from corruption. (Please see: <http://www.u4.no/document/showdoc.cfm?id=35>).

The **Millennium Challenge Account (MCA)** provides another example of applying conditionality to development assistance. It was announced by the Bush administration in 2002 and created in 2004, with the view to rewarding nations "*that root out corruption, respect human rights and adhere to the rule of law*", by increasing core development assistance by 50% over three years through a Millennium Challenge Account. The MCA can be seen as an attempt to apply a form of "positive conditionality", tying aid to political, legal and economic reforms that attract aid projects rather than using "punitive" forms of conditionalities that sanction countries for weak performance in democratic governance and respect of human rights. Under the MCA, countries are selected on a competitive basis through a set of 16 indicators designed to measure a country's effectiveness at ruling justly, investing in people, and fostering entrepreneurship. The aim of the MCA is to promote growth in the recipient countries, good governance and economic policies, including control of corruption. All indicators used as a selection criteria as well as the whole process of qualifying are publicly available at the homepage of the MCA. (<http://www.mcc.gov/selection/indicators/index.php>). This programme constitutes an attempt to quantify eligible conditions, relying on statistical comparators as a decision-making tool, in order to make them transparent and reliable. Some critics have argued that the indicators used are biased toward free market economics. Others estimate that countries under the MCA improved under the MCA criteria.⁵ In terms of methodology, although criticised, the MCA constitutes an attempt to quantify the eligibility criteria and use indicators quantifying governance performance of countries. (Please see: <http://epress.anu.edu.au/agenda/011/04/11-4-A-3.pdf>).

One promising trend in the debate on conditionality is the recent attempt to move away from ex-ante conditionality arrangements and prioritise engagements with recipient countries that are based on performance, through **outcome based conditionality**. This approach consists in linking disbursement to achieved development results, with the potential to increase government ownership and promote a result based approach. This approach could potentially be applied to anti-corruption programs. The European Commission has been a pioneer in this area, by establishing a straightforward link between conditionality and poverty reduction. Although most targets in health and education have been met, experience of this approach is still too limited to conclude whether outcome-based conditionality has created incentives for poverty reduction in the assessed countries. (Please see: <http://www.eurodad.org/whatsnew/reports.aspx?id=2084>).

The Provision of Budget Support

Within the framework of the Paris declaration on aid effectiveness, donor countries have committed to a doctrine of partnership, ownership and empowerment through the scaling up of aid as well as

⁵ A study in 2006 looking at the "MCC effect" estimated that potential recipient countries improved 25% more on MCA's criteria than other countries, after controlling for time-trends Doug Johnson, Tristan Zajonc (April 11, 2006). *Can Foreign Aid Create an Incentive for Good Governance? Evidence from the Millennium Challenge Corporation.* (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=896293).

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through a shift in aid modalities towards increased use of budget support. This confirms the policy trend of aligning with country-led frameworks to conduct anti-corruption reforms. However, one of the major challenges of providing budget support is that it requires a well functioning public financial management (PFM) system as well as a sound public procurement system. Special caution should therefore be exercised when providing budget support in highly corrupt countries or deteriorating governance situations. A CMI brief on the provision of budget support recommends that (Please see U4 issue paper on direct budget support and corruption: <http://www.cmi.no/publications/publication/?2060=should-corrupt-countries-receive-budget-support>):

- Budget support is not advisable in highly corrupt countries;
- Political corruption makes budget support particularly unsuitable. A USAID evaluation of budget support in Malawi suggests that political corruption is a major cause of the bad performance of budget support in the country. (http://www.oecd.org/LongAbstract/0,3425,en_35038640_35039563_36143526_1_1_1_1,00.html).
- Budget support is counter-productive in fractionalised societies.

The provision of budget support is usually tied to measures aimed at improving government disbursement and procurement systems as well as the monitoring of government expenditures. In doing so, it is expected that the provision of budget support will foster the improvement of partner countries' PFM, through the systemic effect from funds channelled through the PFM and the direct effect of technical assistance. To determine which countries are eligible for budget support, donors are also increasingly aware of the need to carefully assess public finance management systems in recipient countries and efforts are on underway within the donor community to develop common tools for assessing fiduciary risks. The World Bank, IMF and the Public Expenditure and Financial Accountability (PEFA) working group have come up with a set of indicators to assess the quality of the PFM but critics argue that these do not contain direct indicators of corruption.

While assessing recipient countries' PFM, there is a growing consensus among donors to view the improvement of PFM systems as an intended outcome rather than a prerequisite for budget support. DFID for example does not require partner countries to meet minimum standards of PFM to receive budget support but look for "*a commitment to reform and a positive trajectory of change*". (Please see: <http://www.u4.no/projects/utstein/policydocuments.cfm>). In 2005 DFID also produced a guidance note on managing fiduciary risk and the risk of corruption when providing budget support (Please see: <http://www.dfid.gov.uk/pubs/files/pfma-fiduciaryrisk.pdf> as well as <http://www.dfid.gov.uk/aboutDFID/organisation/pfma/pfma-managing-corruption.pdf>).

Although a few common principles emerge from the review of donors' policies and practices in such environments, there is no joint standard model in place for responding. Challenges involved in developing a joint response in deteriorating governance environments include:

- Agreeing on common indicators and benchmarks to assess progress and set backs;
- Coming up with generic common principles that can apply to each country's specific circumstances;
- Conducting joint anti-corruption assessments;
- And in doing so, continuing to promote local ownership and leadership in anti-corruption efforts.

In practice, donor coordination of anti-corruption efforts faces a number of challenges that are more fully developed on a thematic page of the U4. (<http://www.u4.no/themes/coordination/main.cfm>).

Part 4: Further Reading

[A review of Donor Principles and Practices for Exit \(2006\)](#)

This review was undertaken in the fall of 2005 as an element in the preparation of a Joint Evaluation of Exit Strategies planned by four donors including Denmark, the Netherlands, Norway, and Sweden. This paper reviews policies and experiences of donors' exit from countries in recent years and identifies key issues for a joint evaluation of exit practices in development cooperation. (<http://omvarlden.nu/sida/jsp/sida.jsp?d=1509&a=32048>)

[Development-Oriented Transformation in Conditions of Fragile Statehood and Poor Government Performance \(2007\)](#)

This strategy sets out a framework of action for German development cooperation with partner countries characterised by difficult situations, stating that under such circumstances, there is generally no alternative to bypassing state structures to implement projects. In situations of continuously deteriorating government performance, this strategy recommends protecting vulnerable sections of the population, through humanitarian assistance channelled through CSOs.

http://www.inwent.org/imperia/md/content/bereich1-intranet/efinternet/fragilestates/strategies153e_lo.pdf

[The Role of Bilateral Donors in Fighting Corruption \(2001\)](#)

This report compiles the proceedings of the April 2000 Maastricht Anti-Corruption Conference organised by the Netherlands Minister for Development Cooperation. Particularly useful among the materials is a section providing Donor Guidelines (pp. 53-96) that includes the following articles on procedures and guidelines of donor agencies to prevent and suppress corruption, how to prevent corruption in development aid-funded projects and programs and the terms of engagement for bilateral donors. http://www.worldbank.org/wbi/governance/pdf/hague/role_bilateral.pdf

[Corruption: A Paper for the Development Committee \(2006\)](#)

This paper outlines the main components of DFID policy on corruption prepared for the Development Committee in 2006. The policy has three main elements, including 1) protecting development assistance, 2) addressing corruption more widely in country and 3) addressing global drivers. This paper also contains a short analysis of DFID's experience in implementing policy, with particular attention to concerns that have surfaced recently on the first element. <http://www.u4.no/projects/utstein/policydocuments.cfm>

[SIDA's Management of Contribution in Corruption-Prone Environments \(2002\)](#)

This internal audit reviews SIDA's management of contributions in corruption-prone environments with the view to assessing SIDA's management of corruption risks, analysing the reasons for deficiencies and recommending corrective measures. The report finds SIDA's regulations in this regard appropriate but highlights some deficiencies in practice, mainly in the identification and analysis of corruption risks as well as in the use of audit instruments. (www.sida.se/shared/jsp/download.jsp?f=IR04-02_Corruption.pdf&a=3048).

[Learning from Experience? A Review of Recipient-Government Efforts to Manage Donor Relations and Improve the Quality of Aid \(2006\)](#)

Within the framework of the Paris Declaration of Aid Effectiveness, this paper reviews the efforts of five countries seen as relatively successful examples of recipient-led aid policies and donor management, namely Afghanistan, Mozambique, Tanzania, Uganda and Vietnam.

http://www.odi.org.uk/publications/working_papers/wp268.pdf