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**Research Report**

## Is the Earth flat or is it a cube? European foreign aid, political conditionality and democracy

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## Is the Earth Flat or is it a Cube? European Foreign Aid, Political Conditionality and Democracy

### Summary

Whether political conditionality should be attached to foreign aid and whether a recipient country's level of democracy should be the benchmark for conditionality and sanctioning instruments remain highly controversial issues. This is reflected by the debates around the Agenda for Change, the allocation formula of the European Development Fund (EDF) and the European Commission's new Budget Support Policy.

Critics of political conditionality argue that democracy and human rights are too normative criteria and foster the politicisation of aid allocation instead of increasing aid effectiveness. They also claim that the level of democracy is unsuitable as a criterion, because it has no influence on economic development. However, this critique can be contested:

- From a perspective of domestic donor politics, democratic donor governments will not abstain from using political conditionality because their own constituencies expect human rights standards and democracy to be relevant for aid allocation.
- From a recipient perspective, aid is more effective in promoting inclusive development in democracies than in autocracies. Moreover, governmental foreign aid to autocracies tends to stabilise authoritarian structures and to delay democratisation.

Thus, arguing that there is little reason for using political conditionality (and sanctions) is as valid as saying that the Earth is flat. At the same time, inferring from this insight that political conditionality is bound to be effective is like claiming that the planet is a cube. After all, even sound arguments in support of political conditional-

ity have to address the demanding challenges to make conditionality work.

- The function of political conditionality must be clear. Is it used as a selection criterion, intended to ensure that foreign aid does not stabilise authoritarian structures and effectively promotes economic development? Or is political conditionality to be used in a more demanding way as an incentive to promote democracy and good governance?
- If political conditionality is to be applied more proactively to promote democratic governance, donor harmonisation is key, because only a coherent incentive system sets credible signals and has a chance to contribute to institutional reform.
- Effective political conditionality requires smart application. Comprehensive political reforms cannot be "bought" with foreign aid. Yet, realistic, tailor-made and credibly communicated incentives increase the probability of strengthening reform-minded forces and fostering gradual reform steps.

While political conditionality has been implemented effectively in some cases, successfully applying it often overstretches the political capacities of donor coordination. For Europe, this means that effective conditionality requires a more integrated approach to foreign and development policy.

- Consequently, conditionality and sanctioning instruments from policy fields such as aid, trade and investment have to be combined in an intelligent manner. Otherwise, we will continue to observe ad hoc, overly ambitious and ill-coordinated political conditionality that fails to serve its purpose.

## Democracy and political conditionality in development cooperation

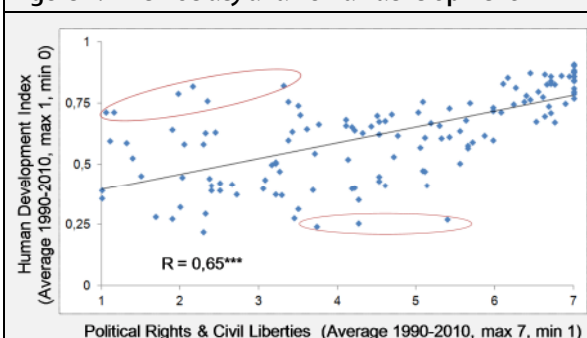
Whether foreign aid should be linked to human rights or the level of democracy is a controversial issue. The European Commission and several important bilateral donors have once again placed greater emphasis on political conditionality in the delivery of development assistance. At the same time, the declining role of foreign aid as well as traditional problems of implementing political conditionality question its effectiveness. Opponents of political conditionality argue that it is ineffective and leads to the unnecessary politicisation of cooperation. Moreover, opponents also tend to believe that democracy does not yield a developmental dividend. Instead, they explain the correlation between a society's prosperity and its level of democracy (Box 1) through the democratising effect of economic growth. Yet, several arguments against such criticism of political conditionality can be advanced:

For domestic reasons it is hardly conceivable that political conditionality will disappear from the agenda. For the European Union, it is not only formal treaties or policy statements like the Lisbon Treaty or the Agenda for Change that ask for supporting human rights and democracy in Europe's external relations. Parliamentarians, civil society and the free press will also constantly and critically scrutinise any cooperation with repressive and authoritarian regimes. Whether recipient governments like it or not, European governments have to account internally for what they do externally. Thus, if they define human rights and political freedom not only as their domestic core values but also as universal principles, European donors face domestic pressure to take democracy seriously in their aid policies.

Moreover, there is an *effectiveness argument in favour of allocating aid more selectively* according to levels of democracy. Unlike autocratic regimes, democratic governments must engage in inclusive political competition for the support of encompassing majorities of the population. For purely selfish reasons of democratic leaders, their economic policies must be geared more closely to the provision of public goods than those of authoritarian governments. In contrast, autocratic leaders primarily need to satisfy small and powerful groups, such as the military, a business oligarchy or a dominant state bureaucracy.

The strong correlation between levels of democracy and levels of socioeconomic human development (see Figure 1) can, at least to a large extent, be explained by the effect of democracy on inclusive economic development. Recent cross country evidence leaves little doubt about the validity of this causal chain. Higher levels of democracy come along with more inclusive education and health care systems. In democracies there are fewer incentives for governments to cartelise and monopolise markets in order to privilege small groups. Redistribution effects to the advantage of the poorer sections of the population can also be identified in more democratic countries, which also tend to better pro-

**Figure 1: Democracy and human development**



A comparison of 142 countries shows the positive link between the level of democracy (higher figures indicate higher levels of political freedom and civil rights) and socio-economic development as measured by the Human Development Index HDI. The correlation coefficient between democracy levels and the HDI is around 0.65. If one excludes statistical outliers such as the oil-rich autocracies Bahrain, Brunei, Kuwait, Saudi Arabia, and the cases of Cuba and Singapore as well as some landlocked countries in Sub-Saharan Africa (Malawi, Mali, Niger), the coefficient increases to 0.77.

Source: own design

tect their citizens against the worst consequences of natural disasters (see references).

To be clear: This evidence does not mean that corruption and rent-seeking is not a problem in democracies. It is also not meant to play down the governance problems in many OECD democracies. Neither do these findings imply that all authoritarian regimes are incapable of generating economic growth. What this evidence implies, however, is that democratic governance produces a welfare dividend.

Stated differently: There is no convincing empirical evidence to back the claim that democracy is of little developmental value. The effectiveness of development cooperation tends to increase in more democratic recipient countries, because democratic governments have a stronger internal incentive than autocracies to use foreign aid in a way that enhances development. Finally, there is growing evidence that government-to-government aid has a political amplification effect, as it tends to stabilise the sort of political regime it encounters. As such aid inflows are highly fungible, governmental development cooperation may easily stabilise authoritarian structures in autocracies.

Thus, it is difficult to argue against political conditionality as a means for allocating aid more selectively. Although there may be exceptional, case-specific grounds for cooperating with non-democratic regimes, such cooperation needs to be explicitly justified *ex ante*.

## Donor harmonisation – a challenge to effectiveness and harmonisation of conditionality

Despite those reasons for applying political conditionality, it is still far from certain that conditionality is used effec-

tively for the purposes of development cooperation. For this a number of exacting criteria must be satisfied. Of prime importance is the harmonisation requirement for the bulk of aid that is primarily geared towards promoting economic development. As hardly any donors carry the economic and political weight needed to promote political reforms on their own by imposing conditions, political conditionality must be designed as a harmonised system of incentives.

### A harmonised approach is needed

This calls for a shared idea for the function that political conditionality is meant to perform. Are criteria for democratic governance and human rights to be used primarily for the selection of countries and the allocation of resources in order to enhance the effective use of these resources? Or does conditionality have a more ambitious function, in that it is also used to promote democratisation and “good” governance? Moreover, there is a need to clarify whether a dynamic or static view should be taken. Is the partner government's recognisable desire for change with regard to human rights and democratic governance the yardstick (dynamic approach)? Or is there a certain critical “threshold value” which needs to exist (threshold approach)?

Donor governments should also agree on a common hierarchy of objectives. Are human rights and democracy more important than financing poverty alleviation? Should the risk of macroeconomic instability be accepted when, say, cooperation with a country that is repressive, but dependent on development cooperation is terminated? Which political criteria carry more weight: corruption, human rights violations or authoritarian governance? At least some common ground in these questions must be identified among aid providing governments, because only then will there be a chance of using conditionality as a measure for supporting political reform or preventing a deterioration of democratic governance in critical situations.

Unfortunately, most donor governments still have a long way to go in this respect. When providing Budget Support – a supposedly highly coordinated aid instrument – donor governments have consistently failed to coordinate their behaviour related to applying political conditionality. Evaluations and academic analyses have revealed that the absence of a coordinated political dialogue and a harmonised disbursement policy in line with political conditionality criteria has precluded coherent signals to partner governments. Similarly, attempts to implement the European Commission's new Budget Support Policy, the discussion around political governance criteria in the allocation formula of the EDF and the debate about whether and how results-based aid approaches should be applied in more political fields show how differently political conditionality is conceived among European donors. Overall, this leads to a cacophony of signals, which provide no coherent scheme of incentives to recipient countries, even in cases, where

foreign aid continues to be very important for the recipient's national budgets. Moreover, the inconsistent design of political conditionality and its often ad hoc implementation by donor governments shows that their behaviour is generally geared towards sending policy messages to their own domestic constituencies, rather than by considerations of aid effectiveness.

### Offer incentives or buy reforms?

If political conditionality is to be used to support democracy and human rights, there is a link to the debate on incentives in foreign aid, as it is currently debated with regard to modalities of *results-based aid*. Credible (political) conditionality indicates to the partner government that a certain form of (political) achievements on its part will be followed by a certain form of development policy action. However, such a sequence, which is equivalent to an incentive, must not only be harmonised: It must also be adapted to the country context and communicated credibly.

In the recent debate on conditionality it has often been argued in general terms that development cooperation cannot buy (political) reforms. This is correct to the extent that discontinuing or increasing development assistance will not induce an autocratic regime to hold elections or to allow freedom of the press. Nonetheless, the argument must be rejected as a generalisation. Everywhere in the world, governments and political actors react to external incentives. Moreover, in a very large majority of countries, the government is not a homogenous monolith, but an aggregation that includes reform-minded and reactionary forces. An intelligent incentive policy may well strengthen the reform-minded forces and so encourage gradual improvement or impede deterioration. Even though developing countries are becoming less dependent on development cooperation, that dependence still plays a major role wherever a significant proportion of public investment is financed by development cooperation. In such cases, incentives through conditionality may have an impact, but only if sent as a harmonised, coherent signal and intelligently designed. Designing intelligently means long-term communication of the incentive system during the political dialogue, rather than waiting until highly dynamic crises occur. Designing intelligently also means no sabre-rattling by the donors with unrealistic demands, just because that is what the press or parliament at home expect. What singles out intelligently designed development cooperation is that during the dialogue political demands are formulated in such a way that they can potentially be met by reform-minded forces despite the opposition of reactionary forces.

The question is whether the actors in foreign aid are considered capable of developing and implementing such a harmonised and intelligent incentive policy. That political conditionality can be effective is evident, for example, from an examination of the EU's enlargement and neighbourhood policy. Here, political conditionality has had a



positive effect on the democratisation of neighbouring countries when they were offered the prospect of EU membership. Why? Not only because the candidates associated a major political and economic gain with accession, but also because the accession process was organised in a comparatively harmonised way, the conditions were set out clearly, came with a timetable and sequencing strategies adjusted for country contexts.

### Beyond aid: Europe's agenda

European development policy seeks to help combat poverty, promote democracy, ensure peace and also to benefit domestic economic and diplomatic interests. It is not easy to vouch credibly for political conditionality in this context, since sanctioning the political dynamics in a partner country means coming out in favour of a certain hierarchy of the many objectives pursued by foreign aid. Resolving the inherent goal conflicts by prioritising them and doing so in a harmonised way – this is the main challenge for effective political conditionality in foreign aid.

However, issues of political conditionality go far beyond the policy field of development assistance. On the one hand, political conditionality in the field of foreign aid requires a well-coordinated, realistic, tailor-made and credibly communicated approach. On the other hand, there is also an increasing need for coherence across externally oriented policy fields. Political conditionality and sanctions not only play a role in European foreign aid. European trade policy also has an array of means to bind trade relations to political criteria. The EU incorporates human rights issues – from political rights and democratic principles to labour

standards – in its trade agreements with developing countries. However, the debate and policies around EU trade conditionality and sanctions are often disconnected from the discussions on foreign aid. However, when Europe takes its external goals seriously, it cannot afford low levels of policy coherence in its external relations. Similarly, innovative approaches towards sanctioning highly repressive regimes should be embedded into a more coherent policy framework. An example is the Center for Global Development's work on *preemptive contract sanctions*. Here, the EU could confront those investing in highly repressive regimes with contract non-transferability in case of regime change, thus substantially increasing the risk for creditors and investors when cooperating with dictators.

Yet, building a coherent framework regarding political conditionality and sanctioning mechanisms across several policy fields will not work in a decentralised coordination scheme involving 28 member governments, the Commission, plus the External Action Service. Let's face it: If Europe's external relations are to be effectively linked to the support of democracy and human rights, there is a need for a substantive step forward towards a truly integrated foreign, development and security policy. What is currently becoming obvious in the case of the EU's domestic financial and economic policies is also foreseeable for its foreign, development and security policies: Without closer integration, the economic and political importance of the EU and its member states will wane – as will their opportunities for influencing the resolution of urgent European and international issues to their own advantage. Unfortunately, whether European governments are up to this challenge is a different question.

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