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**POLICIES AND FINANCE FOR ECONOMIC
DEVELOPMENT AND TRADE**

This report is written by Peter Gibbon, Caroline Hambloch, Rasmus Hundsbæk Pedersen & Ole Therkildsen and published by DIIS as part of the 'Tendencies in Development Policies' grant.

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INTRODUCTION

This report explores the political and economic impact of natural resource development, particular of oil and gas, in sub-Saharan Africa, and reviews aid for trade (A4T) initiatives.

THE FIRST PAPER

Spending priorities and industrial policies in Sub-Saharan Africa when natural resources grow: potentials and pitfalls, examines how newfound oil and gas resources in Mozambique, Tanzania and Uganda will be used in the future. Based on the proposition that country- and sector-specific political dynamics are at the heart of different development outcomes, it argues that ruling elites in the three countries will continue to prioritize social over productive sectors. As is the case at present, spending will not be particularly targeted at poorer segments. This makes political sense in efforts to win elections and stay in power.

But with greater financial muscle, the influence of donors and the Washington Consensus will decline. These East African states will take on a more pro-active role in extractive industries as well as in other productive sectors. The provision of aid will not be 'business as usual' either. Aid will still be needed to reach post-2015 goals, even in some newly 'rich' countries, but recipients will be more selective in who they work with and under what conditions. Such answers are obviously somewhat speculative, but they are needed to come to grips with some of the major changes that natural resource riches may bring about.

THE SECOND PAPER

The Politics of Oil and Gas Contract Negotiations in Sub-Saharan Africa, reviews the state of the art in petroleum contract negotiations on the continent. Much attention has been paid to the management of revenues from petroleum resources. An entire body of literature on the resource curse has developed which points to corruption during the negotiation of contracts as well as the mismanagement of revenues on the continent. This provides the basis for policy advice for countries as well as donors, suggesting that transparency and anti-corruption initiatives can lift the curse. Though this paper is sympathetic to these initiatives, it argues that the analysis may underestimate the inherently political nature of the negotiation of contracts.

The paper argues that the resource curse need not hit all countries on the African continent. By focusing on changes in the relative bargaining strength of the actors involved in negotiating processes, it points to the choices and trade-offs that invariably affect the terms and conditions of exploration and production activities. Whereas international oil companies are often depicted as being in the driver's seat, the last decade's high oil prices may have shifted power in governments' favor. Though their influence has declined, donors may still want to influence oil and gas politics under these circumstances. This requires careful analysis of the game. Support to local communities and authorities may be one avenue for donor support.

THE FINAL PAPER

Aid for Trade: An Update on Recent Trends and Recent Research and Evaluation Findings, reviews recent developments and econometric and evaluation studies of A4T's impact. A4T accounts for a very large and steadily increasing proportion of sector-allocable aid. Since support to Private Sector Development makes up around 40% of A4T, evaluations in this area are also considered. Overall, the impact of A4T appears to be positive, though limited; more attention should be focused on recipient country targeting, project portfolios with complementary interventions at different levels, targeting trade impacts and outcomes other than increased exports, adopting a more structured approach in work with private sector actors, and improved results measurement.

An offshore oil rig is illuminated at night, with its lights reflecting on the dark blue water. The rig has a tall central tower and several platforms. In the foreground, a blurred white car is visible, and a concrete curb separates the road from the water. The background shows a clear night sky with some clouds.

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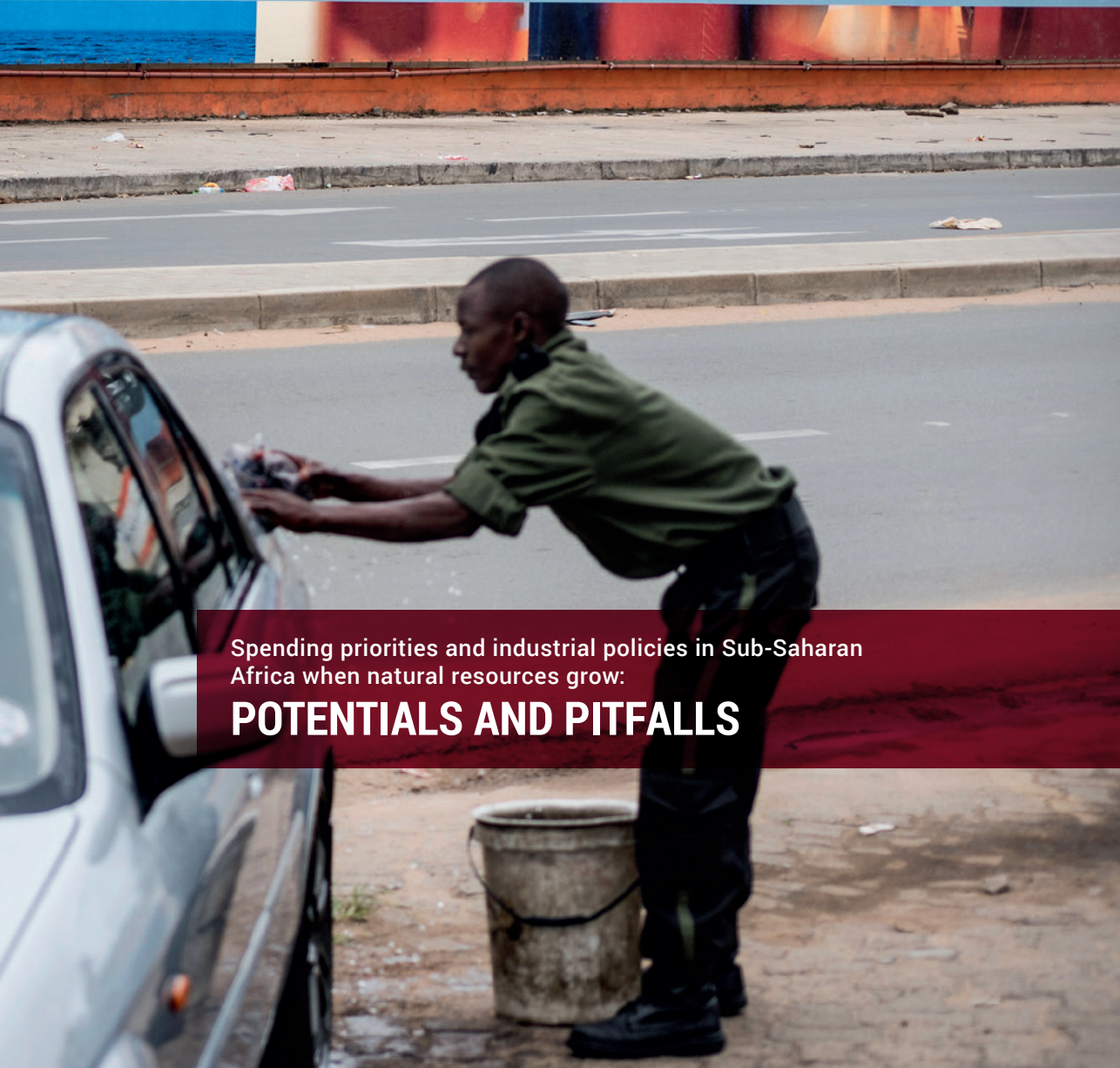
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Energia, Indústria, Infraestruturas & Cidades e Saúde.



Spending priorities and industrial policies in Sub-Saharan
Africa when natural resources grow:

POTENTIALS AND PITFALLS

ABSTRACT

Natural resource endowments in Mozambique, Tanzania and Uganda will give these countries stronger economic muscles. What will they use them for in the future? Based on the proposition that country- and sector-specific political dynamics are at the heart of different development outcomes, it is argued that ruling elites in the three countries will continue to prioritize social over productive sectors. Spending will – as is the case at present - not be particularly targeted at poorer segments. This makes political sense in efforts to win elections and stay in power. However, with bigger financial muscles the influence of donors and the Washington Consensus will decline. States will take on a more pro-active role in extractive industries as well as in other productive sectors. The provision of aid will not be ‘business as usual’ either. Aid is still needed to reach post-2015 goals -- even in some newly ‘rich’ countries – but recipients will be more selective in who they work with and on what conditions. Such answers are obviously somewhat speculative but they are needed to come to grips with some of the major changes that natural resource riches may bring about.

HARDLY A DAY GOES BY WITHOUT SPECTACULAR NEWS FROM EASTERN AFRICA ABOUT OIL, GAS OR MINERALS:

- Among the ten biggest oil and gas discoveries in the world in 2013, five were in sub-Saharan Africa.ⁱ The largest discovery was found in Mozambique and the fifth largest in Tanzania. Both were in gas.
- Five of the ten largest green-field extractive industry investments in 2011 (oil, gas, minerals) were located in Least Developed Countries: three in Mozambique, one in Tanzania, and one in Uganda (UNCTAD (2012, Table II.4)).
- Uganda could sit on one of the largest onshore oil reserves in sub-Saharan Africa (KPMG 2013, 16).
- Coal and mineral wealth is considerable, especially in Mozambique and Tanzania (Buur et al. 2013b).
- Mozambique may become the fourth-largest exporter of Liquid Natural Gas (LNG) to OECD (PriceWaterhouseCoopers 2013).

Consequently, natural resource-driven development has moved up on the development agenda in several African countries. The interest in this among publics, governments, companies and donors hinges on the assumption that resource wealth will generate government revenues, export earnings, employment and profits. Indeed, abundant endowments may speed up economic transformation, economic diversification and poverty alleviation according to some observers (Jourdan 2008; Kaplan et al. 2011; UNCTAD 2013; UNECA 2013).

In contrast, the resource curse sceptics warn that the larger the share of natural resources in exports, the smaller the scope of productivity-enhancing economic transformation (McMillan and Rodrik 2011, 3). The surge of easy money from oil and gas “fuels inflation, fans waste and massive corruption, distorts exchange rates, undermines the competitiveness of traditional export sectors such as agriculture, and preempts the growth of manufacturing. ... Oil booms are also bad news for democracy and the rule of law” (Diamond and Mosbacher 2013).

The purpose of this brief is to assess some future implications of the exploitation of natural resource endowments in Mozambique, Tanzania and Uganda, in particular: (a) changes in their spending priorities; (b) prospects for successful implementation of industrial policies linked to their extractive industries; and (c) implications for western donors supporting these countries.

INDUSTRIAL POLICIES

refer broadly to the stimulation of specific economic activities and promotion of economic transformation in agriculture, manufacturing or services. They typically aim to foster new industrial capacity, diversify production, create inter-sectoral and inter-industry linkages, promote learning, improve productivity and shift economic activity towards higher technology and higher value-added activities. Industry policy must be industry specific, because technologies differ in their learning needs; and solutions to institutional constraints need to be tailored to the particular industry or even company (Rodrik 2008).

However, predictions about the future based on past and present trends are notoriously tricky. This brief is therefore a 'think piece.' It has one recurrent main argument, however: political dynamics will significantly influence all three aspects of natural resource-driven development listed above. Recent research shows that country- and sector-specific political dynamics significantly influence spending priorities and outcomes of industrial policies in Mozambique, Tanzania and Uganda in agriculture, agro-business, fisheries and manufacturing. These will also significantly affect how and where natural resource riches will be used. Successes are relatively few - but there are some.

Furthermore, this brief is based on the premise that the financial muscles – revenues, export earnings, loans on bond markets, inflow of FDI - of resource rich but currently low-income countries will increase, perhaps significantly so, despite perennial governance problems and uncertainties about future markets for and investments in extractive industries. Hence the questions: Are expectations about natural resource potentials realistic? Will we see increased poverty-focused spending? Can we expect more successful industrial policies that use the growth in extractive industries to create jobs and incomes in the larger economy? Will donors, including Danida, lose influence and relevance? These questions are addressed in sequence.

ARE EXPECTATIONS ABOUT NATURAL RESOURCE POTENTIALS REALISTIC?

Real per capita growth exceeded 3 percent in Mozambique, Tanzania and Uganda between 1995 and 2010, despite not yet having exploited natural resources on a large scale during that period (IMF 2013, 32).ⁱⁱ The growth turnaround has been driven by better macro-economic management; economic liberalization which led to foreign direct investment in sectors in which African countries already had, or could quickly create, competitive advantages; new discoveries of natural resources, using foreign direct investments to begin to extract them; and government spending fuelled by foreign aid. However, the impact of rapid growth on poverty alleviation has not been significant.

Future growth rates are projected to remain high (IMF 2014, 69). News that booms in oil, gas, coal and minerals are just around the corner, or are already taking off, have therefore fuelled expectations among politicians in the three countries about further growth and about becoming industrialized middle-income countries in the foreseeable future.

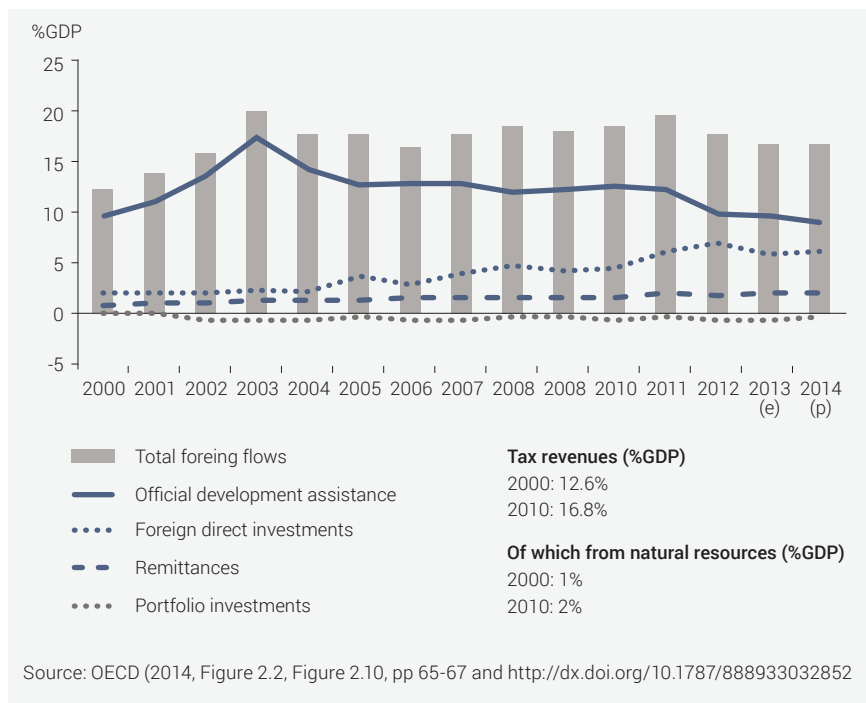
The many natural resource discoveries have also raised public expectations about more jobs, better public services and faster development (Buur et al. 2013b, 22-23), and a lively debate about the use (and misuse) of natural endowments. Civil society organizations and opposition parties are active in these debates, which have increasingly become election campaign issues and a cause of unrest in some local communities. People fear that the investments will directly hurt or not benefit them.^{iii,iv,v} This comes on top of growing public protests and violence in Mozambique, Tanzania and Uganda from 2000 to 2013 (OECD 2014, Tables 22 & 23).^{vi} In short, natural resource fuelled expectations have increased pressures on ruling elites to 'deliver.'

Yet, most of the newfound wealth is still under ground, and extractive industries are highly capital-intensive, with low direct impacts in terms of employment (International Energy Agency 2014, 160). Moreover, its exploitation depends to a large extent on the willingness of Multinational Companies (MNCs) to make huge investments. The risks involved are substantial as the global commodity markets are volatile and fairly unpredictable. Right now the leading Bloomberg Commodity Index is at a five-year low.^{vii} Moreover, the global energy markets may be changing significantly because of new technologies, economic slowdown in key markets in the North; raising but uncertain demand from China and India; and the entrance of many new energy exporters (British Petroleum 2013; Johnson 2014).

In addition, host countries do not get the full benefits of the large investments by MNCs in extractive industries due to substantial illicit transfers of funds to overseas tax heavens (Global Financial Integrity 2014), tax exemptions for investors that many regard as far too generous (Keen and Mansour 2009), widespread corruption, and inadequate poorly implemented local content and linkage policies that aim to link the domestic private sector with MNC-funded extractive industries (Buur et al. 2013).

Figure 1 aggregates the various sources of finances available to low-income countries in Africa. It shows that aid has declined in importance relatively to GDP, while Foreign Direct Investment (FDI) and remittances have increased. Moreover, the share of domestic revenues of GDP has risen by one-third from 2000 to 2010. Revenues from natural resources are increasing rapidly albeit from low levels as is the case for Mozambique, Tanzania and Uganda.^{viii}

Figure 1. External development finance and domestic tax revenues in low-income African countries (%GDP)



In the future the ratio of oil revenues to non-oil tax revenues may be 5.2 in Uganda and 1.3 in Tanzania (Diamond and Mosbacher (2013)). In addition, future cumulative government revenues from gas over the period to 2040 is projected at about \$115 billion in Mozambique and at \$35 billion in Tanzania, although gas deposits tend not to be exploited until there are clear and specific commitments to its use, as well as clarity on how it will reach the relevant end-user (International Energy Agency 2014, 154-156). Nevertheless, these income flows together with borrowing against future revenues from natural resources can be used to step up the pace of investment in power generation, water supply and sanitation, transport, education health, agriculture, manufacturing and services.

WILL SPENDING ON POVERTY ALLEVIATION BE PRIORITIZED?

A good starting point for predictions about future government spending priorities is past allocations of government funds.

Total annual government spending per capita in 2012 was \$350 in Mozambique, \$420 in Tanzania and \$280 in Uganda (ONE 2014, 11). Like many other low-income countries their fiscal space has expanded during the last decade. The social sectors in particular have benefitted from this. Per capita spending on them have increased significantly in all three countries in recent years (IMF 2013, 41-43). Nevertheless, many countries (including MTU) failed to meet their international commitments on spending made in Dakar on education (2000); in Abuja (2001) on health; and in Maputo on agriculture (2003) as shown by ONE (2014, 91-109). In addition, skewed allocations in favour of the better-off contributed to significantly reduce the poverty impact of government spending.

Strikingly, allocation of government funds to agriculture has not benefitted from larger and growing government budgets although a majority of people depend on it for a living, and a substantial share of them are poor. Actually, the share of total government spending on agriculture has decreased since 2003 (although expenditure figures for this sector are notoriously difficult to compare (ONE 2014, 101-103)). Also aggregate donor allocation to this important employment-generating sector has dropped significantly from the mid-1970s to the mid-2000s (Therkildsen and Buur 2010).

No doubt, the introduction of competitive elections since the late 1990s have had a profound influence on government spending priorities in favour of social compared to productive sectors (Kjaer and Therkildsen 2012; Kjaer and Therkildsen 2013). The former share three attractive characteristics from a ruling elite point of view: (a) they are clearly identifiable with the party in power; (b) citizens are targeted countrywide so as to gain voter support; and (c) policy implementation can provide immediate, visible results. Even single-party governments are under special pressure to win as many votes as possible. It strengthens their power and reduces the likelihood that political entrepreneurs from its own coalition desert to the opposition. Multiparty competition strengthens incentives for both populist fiscal policies (see also Khemani and Wane 2009) and for corruption related to political financing of parties and politicians (Whitfield et al 2015) .

Such political incentives are not likely to change significantly when the exploitation of natural resources starts to generate additional government revenues. In other words, the social sectors will continue to be prioritized by governments as they have in the recent past. However, as urbanization proceeds and a middle class emerges,

actual expenditures may be skewed further towards the better off than they already are. For such groups are more likely to organize and protest to exert political influence than the poor (especially in the rural areas) are able to.

Nevertheless, the huge gas deposits in Mozambique and Tanzania in particular has fuelled political incentives to increase spending on power production. This makes good sense as a high share of the population in both countries is without access to electricity, and many firms suffer from poor and erratic supplies. More importantly, it also makes political sense. Electricity was heavily subsidized in the past and this continues albeit at a lower level. But this “had no socially desirable effect in terms of broadening the access of poorer citizens to electricity: electricity access remained geographically constrained to areas inhabited by richer segments of the population” (OECD 2013, 199). There are clauses in the new gas policies of the two countries that have raised concerns that subsidization may continue (the domestic gas market will be prioritized over exports according to the new gas policies). As in the past this will benefit the relatively better off electricity users in urban areas. They are vocal and relatively influential (plans for electrification of some rural areas are also planned, however).

Predictions of this sort have inspired some to argue that natural resource riches should be transferred in cash directly to poor people as taxable income. Such arrangements already operate in several countries.^{ix} As Moss (2011) argues: “Beyond serving as a powerful and proven policy intervention, cash transfers may also mitigate the corrosive effect natural resource revenue often has on governance.” The political economy of such transfers in resource rich countries is, however, not well known. To take control of natural resource revenues out of the hands of the political elite and restoring the link between citizens and their public officials may be appealing to many – but not necessarily to the elites.

WILL (OR CAN) AFRICA USE NATURAL RESOURCES RICHES TO INDUSTRIALIZE?

There is little agreement on the answers to this complex question. Much depends on future changes in the global economy with respect to commodity relative to manufacturing goods prices, changes in production technologies and in the values chains of MNCs, the rise of China and other countries as both producers of manufacturing goods and consumers of imported energy, etc. There is an intense

debate about this (Morris et al. 2011; Page 2012; Buur et al. 2013b; OECD et al. 2013; UNCTAD 2013; UNECA 2013).^x Another important factor is the efficacy of domestic industrial policies. These are the focus of the following.

A growing agreement among researchers and some development agencies has emerged about the urgent need for poor countries to design and implement industrial policies (Lin and Chang 2009; Noman and Stiglitz 2012; Page 2012; McMillan and Headey 2014; Whitfield et al. 2015). Otherwise they cannot cope with the enormous development challenges ahead (global competition, premature non-industrialization, persistent widespread poverty despite recent economic growth; growing youth unemployment; etc.). Some developing countries have used natural resources to spur industrial development by implementing appropriate industrial policies (UNECA 2013; International Energy Agency 2014). That such policies are needed at all was controversial during the Washington consensus reign, but it is now crumbling.

Another important consensus about industrial policies is emerging. Because sustainable poverty reduction and rising standards of living is driven by economic transformation of the economy - and not economic growth per se – industrial policy should aim at such transformation (Whitfield et al. 2015, and references to the relevant literature herein). Unfortunately, the recent growth spurts in the Mozambique, Tanzania and Uganda have neither contributed much to economic transformation nor to poverty alleviation. Only few African countries have accumulated capabilities sufficient to undergo such transformation (Felipe et al. 2014).^{xi} Following Structural Adjustment Programmes many of them are back at square one, with economic structures that are remarkably similar to what they were at independence.

Economic transformation is the key word here. It is about moving the economy away from primary products based on unskilled labour towards an economy built on knowledge-based assets and skilled labour. It occurs through diversification and upgrading of the economy and through the accumulation of capabilities at micro-level (firms and farms) and at macro-level (organisations and institutions) that enables a country to produce new and more unique products (Whitfield et al. 2015). But why do some industrial policies in some countries actually succeed while others fail? An obvious explanation is that the number and capabilities of domestic capitalists are typically modest. Morris et al. (2011), for example, argue that the apparent correlation between natural resource development, weak industrialization

and low diversification of the economy is a consequence of weak manufacturing capacity in many resource rich countries rather than the crowding out effect of natural resources. This is an important insight, which is often ignored.

A standard explanation for failure – that governance is poor (as defined by standard rating indicators, for example) – is much less convincing. As shown in the research referred to above, a specific industrial policy may actually succeed despite a country's generally poor governance score. This is not to argue that governance is irrelevant. It is, but it is not necessarily governance of the sort implied by Good Governance (Khan 2012) or Doing Business ratings of the business climate (Page 2012). These general notions of governance are desirable but they are often not politically or economically feasible. To ruling elites political feasibility depends on the extent to which their support for a policy initiative may help them to gain, maintain and strengthen their political power. Three important lessons can be deduced from recent research conducted by Whitfield et al (2015) and Buur et al (2013b). It aimed to understand the outcomes of specific industrial policies in Mozambique, Tanzania and Uganda in natural resources (local content policies), agriculture, agro-business, fisheries, and manufacturing.^{xii}

First, industrial policy success depends on micro-level conditions: e.g. Do capable capitalists actually exist through whom industrial policies could be implemented? Does the industrial policy help them to increase their productivity and employment? Are non-performing beneficiaries cut off from policy-provided rents? Specifically, successful industrial policies require mutual interests between ruling elites and some capable domestic/foreign capitalists – even if this involves some extent of rent-seeking on both sides of the collaboration. Moreover, pockets of efficiency in the state bureaucracy are needed to implement policy. When mutual interests exist ruling elites have a clear interest in supporting the establishment of such pockets - otherwise not. Finally, individual firms and farms must learn to become more productive and to upgrade rather than pursuing the easiest options to turn a profit. Policy induced learning rents must therefore be provided. State bureaucrats must know the productivity constraints facing individual firms/industries in order to design effective and enforceable industrial policy – and they must have political support to withdraw support if learning does not occur. Otherwise wasteful rent-seeking prevails.

Second, macro-level conditions for industrial policy are also important: e.g. Do influential ruling elite factions mobilise support for specific industrial policies? Does support for an industrial policy actually strengthen the political power of ruling elites

(or is it hot air?). However, ruling elites are vulnerable because clientelism is a key feature of politics in all low-income country whether democratic or not. Vulnerability arises either because of internal contestation in the ruling coalition or because of threats from the opposition to their power. This makes it difficult to mobilize support for specific industrial policies that - by design - are conflict-prone because benefits are targeted to some capitalists and not to others. It is often the lack of political authority due to factional conflicts among elites groups rather than lack of “political will” that explains policy failure in both multiparty democracies as well as in authoritarian regimes.

The third lesson is that conducive micro- and macro conditions for industrial policies must exist simultaneously. This explains why there are relatively few cases of successful policy implementation in African countries – although they do exist as documented by Whitfield et al (2015). This also helps to explain why a transformation of agriculture, on which most poor people depend for a living, has proven to be so difficult in African countries. Small holders are not well organized, and as a group they typically contribute little to government revenues and other resources that ruling elites need to maintain power. Instead, a relatively small number of larger firms in manufacturing, services, finance and (increasingly) in extractive industries are much more important for ruling elite survival and consolidation. Some of these firms that have good relations to the ruling elites – or if owners are themselves part of that elite - are likely to benefit most from such relations.

The bottom line is that the conditions for successful industrial policies needed to mitigate the risks of resource abundance and spur economic transformation and upgrading are partly incompatible with the political dynamics in these countries (see also Altenburg and Melia 2014, Chapter 7). An understanding of the political economy of these dynamics is the basis for more relevant aid.

WILL DONORS BECOME IRRELEVANT?

It will not be “aid business as usual” in those low-income countries that start to generate substantial revenues from natural resources in the foreseeable future.

Figure 1 shows that the relative importance of aid for low-income countries in Africa (that include Mozambique, Tanzania and Uganda) is declining compared to other financial flows. Nevertheless, “aid remains essential,” particularly in low-income countries and fragile states (World Bank 2013, 15). The financial requirements for post-2015 sustainable development frameworks are simply huge^{xiii} – even if future government revenues from extractive industries may grow fast and become big;

even if finances from private investments, FDI, remittances, loans and other sources will be mobilized; and even if more effective and less corrupt institutions may emerge (which is not certain if resource curse pessimists are right).

The recipients' increasing financial muscle will enhance their autonomy vis-à-vis donors. In the past aid was often used to influence recipient policies (the Paris declaration and other statements notwithstanding), but donor conditionality-based approaches did not work as intended. They may have looked convincing on paper but were only partially complied with in practice. Therefore greater autonomy will not change donor-recipient relations significantly except on one important point. With increasing financial muscles recipient countries can now finance more of their priority activities themselves – even if donors object. In the past, if donors refused to fund a major activity, recipients often did not have the funds to do it themselves. It strengthens autonomy, of course, that China and other 'new' donors have become active especially in resource rich countries (Kragelund 2011).

Moreover, the Washington Consensus, which does not favour targeted industrial policies, is crumbling. It did not work well in Africa (Noman and Stiglitz 2012) and many African politicians are now inspired by the East Asian countries (China in particular). Consequently, current donor supported market-enhancing reforms that aim to facilitate private sector growth through improvements in governance across all economic sectors are likely to receive less ruling elite support in the future. Moreover, industrial policies already undergo significant changes. Mozambique, Tanzania and Uganda now seek to carve out a larger role of state-owned enterprises in the extractive industries, and to prepare for more pro-active industrial policies (International Energy Agency 2014).

This implies that donors should 'work with the grain' in their (selective) support of pro-active industrial policies. If such policies are not incompatible with donor aid objectives they should be supported when they have clear political support from the ruling elite. For without such political support, both industrial policies and donor support to them, will fail. "Best fit" rather than "best practice" is the crucial factor.

Moreover, sustainable poverty alleviation requires broad based economic transformation and productivity increases as argued earlier. Donor support to the private sector should focus on that and focus on pro-active industrial policies with such aims. Everything that links high-productivity firms/sectors with smaller and small firms are potentially relevant targets (provided such initiatives have real

domestic political backing). It is not just a question about maximizing the number of jobs, but of helping to create jobs with higher productivity.^{xiv} And it is not just a question of direct support to poor people, but of support to reduce the structural conditions for poverty.

A major challenge in extractive industries is that they cannot – and do not – create many jobs even though these “enclave” sectors usually are high productive. Local content policies are therefore needed. They aim to strengthen spill-overs and the links between local firms and MNCs so as to generate employment and domestic capabilities. So far they have had limited successes - also where donors have been involved (Buur et al. 2013b; OECD 2013; Altenburg and Melia 2014). Few linkages and spill-overs were created. Political support to implement policies was often weak and provided as patronage rather than used to upgrade local firms. The argument for donor support in this field therefore builds on the significant potentials for linkage formation related to extractive industries that exist, and on their potential impacts on economic transformation and sustained poverty alleviation. Furthermore, the sector is among the fastest growing in many African countries, which also makes it commercially interesting for some donors. Finally the start-up and development of industries linked to extractive industries is slow, takes time and requires funds as well as the technical and institutional know-how that some donors may be able to provide. Supporting skills training and technical education in the sector is obviously also relevant. Likewise, donors may tie their numerous value chain development programs specifically to promote value chains with extractive industry firms, and target the larger local firms that (potentially) have the best possibilities to create jobs through such links (Buur et al. 2013a).

However, governance problems related to extractive industries abound and evidence based knowledge about how to tackle them effectively is very limited. The resource curse pessimists are clear. “... where one-party dominance or outright authoritarian rule prevails, as in Ethiopia, Gambia, Tanzania, and Uganda, oil wealth will further entrench it [Mozambique also belongs to this category]. And where democracy is struggling to sink roots [e.g. Kenya, Liberia, Malawi, Senegal, Sierra Leone], it could easily overwhelm weak state institutions” (Diamond and Mosbacher 2013).

This pessimistic view – shared by many observers – needs to be modified, however. Research shows that while “formal political institutions and mechanisms matter for revenue management and can improve the governance of natural resources,” it also shows that “a resource bonanza can change the underlying configuration of political

interests around the distribution of these revenues. [...] Standard remedies for mitigating the resource curse can backfire if they take insufficient account of pre-existing political and institutional contexts” (Centre for the Future State 2010, 68).

Unfortunately, such contexts are often ignored when donors design their interventions, and reliable evidence on what works and what does not is also scarce. The Extractive Industries Transparency Initiative (EITI) - of which Mozambique and Tanzania but not Uganda are members - is voluntary. Its reputation among many donors is good, but it has only been independently assessed by a few. Shaxson (2009), for example, is rather skeptical. Outcomes of the Kimberley process on diamonds seem to be better (Ross 2008). The Publish What You Pay initiative seeks to expand transparency beyond financial flow (PWYP refers to itself as EITI++). This includes contract terms, stock exchange listings, accounting standards, and a range of other objectives. The PWYP targets the private sector more directly than does the EITI, and favors a mandatory approach (Haufler 2010, 66), but its efficacy does not appear to have been independently evaluated. And “despite a substantial amount of literature on corruption ... very few studies focusing on anti-corruption reforms [exist], and even fewer that credibly assess issues of effectiveness and impact” (Johnsøn et al. 2012, iv). For donors that want to work on basis of evidence – and not just doing the right things - this is a major challenge.

More generally, and due to increased financial muscle among some low-income countries, a reduction of general budget support towards sector support is likely. Maputo’s aid community has already started to prepare for a future when the country will graduate “from aid to resource dependence” (Frühauf 2014, 28-30). Those in Dar es Salaam and Kampala may follow suit although in a slower tempo because natural resource riches will not be developed as fast here. One reason for the switch is that it will become increasingly difficult to persuade voters in donor countries to provide unchanged volumes of aid when revenues from natural resources grow significantly. Another main reason is that many donors are re-assessing their commitment to general budget support and to aid due to governance concerns. Recent events in all three countries show this.^{xv}

As a consequence, project and sector support may become preferred aid modalities. Many donors continue to prioritise poverty alleviation. Moreover, natural resource development will make the commercial potentials in Mozambique, Tanzania and Uganda increasingly attractive for businesses in donor countries. Project support

may facilitate involvement of businesses from donor countries, while sector support may actually enable donors to target their support more on poverty alleviation initiatives than the general budget support approach allowed them to do.

Finally, demand for 'old-fashioned' technical assistance could increase. Low-income countries endowed with natural resources face a host of complex challenges to exploit and use them for economic and social development. To address these challenges and develop the necessary systems often requires considerable technical expertise. Demand for such knowledge-based arm's length technical expertise is likely to be in much demand in the future.

CONCLUSIONS

Natural resource endowments can help to spur industrialization and economic transformation without which sustainable poverty alleviation is not possible. Although the dangers of the resource curse are real, so are the potentials. Exploiting such potentials must surely be as good for development as growing cassava. These points are especially important with respect to natural resource driven development in Mozambique, Tanzania and Uganda:

- When thinking about aid to African countries and to activities related to extractive industries the challenge is not just to help to create “a few thousands of decent jobs, but millions... especially ... where structural transformation, and the quality jobs that go with it, are still by and large on the starting blocks” (ReCom 2014, 50).
- Unfortunately, the direct employment generation in extractive industries is very low, and linkage and local content policies have been poorly designed and implemented. The political support for them has been weak – possibly because few domestic capitalists have had sufficient capacities to participate in the relevant value chains.
- Nevertheless, there are signs that industrial policies will be pursued with greater vigour than in the past, but success is only likely in specific subsectors where mutual interests between entrepreneurs and (typically fragmented) ruling elites exist. Policies that enable productivity increases and economic transformation are crucial for sustained poverty alleviation. However, industrial policies targeting smallholder agriculture are, as has generally been the case in the past, unlikely to attract much sustained political support.

- On the other hand expectations of increasing natural resource revenues will compel ruling elites to continue to favour spending on social rather than productive sectors so as to win votes and gain/maintain power in competitive elections. Such spending may not be particularly pro-poor, except if natural resource funded large cash transfer programmes are set up.
- Governance problems related to extractive industries abound, but donor anti-corruption approaches in this field are rarely evidence-based.
- As the relative importance of aid decline (because domestic revenue mobilisation and FDI grow and the Washington consensus crumble), donor influence in natural resource rich low-income countries will change. Donor funds are still clearly needed to reach ambitious post-2015 goals, but recipients will increasingly be able to fund activities and policy-approaches themselves – also in case of conflicts about good governance and about Washington consensus based policies.
- Natural resource wealth exploitation will make some low-income countries more commercially attractive: here donors will increasingly look for synergies between aid and their businesses at home.

- i <http://www.forbes.com/sites/christopherhelman/2014/01/08/the-10-biggest-oil-and-gas-discoveries-of-2013/> (accessed October 2 2014).
- ii Whether the recent resource price boom primarily caused or merely reinforced the region's ongoing growth is hotly debated (see Altenburg and Melia 2014, 2-3).
- iii In Tanzania, a referendum on a new Constitution is planned for 2015. The division of revenues from extractive industries among Zanzibar and mainland Tanzania has been one of the controversial issues. The final draft does not solve it.
- iv <http://www.economist.com/news/middle-east-and-africa/21589492-countrys-leaders-must-and-can-prevent-slide-back-civil-war-gas-fired?frsc=dg%7Ca> (accessed November 11, 2013).
- v In southern Tanzania according to Africa Confidential. In Mozambique, the resource boom has raised public expectations "dramatically." Unrest in Maputo in 2008 and 2011 was largely driven by price spikes for food and transport. Rural unrest was linked to resettlement activities in Cateme to make room for Vale's mining operations (Frühauf 2014, 19-20 & 51). Recently, Uganda has been rocked by a series of demonstrations over surging commodity prices – particularly petroleum – as inflation has hit 30 percent. http://www.nytimes.com/2011/11/26/world/africa/uganda-welcomes-oil-but-fears-graft-it-attracts.html?smid=nytcore-ipad-share&smprod=nytcore-ipad&_r=0 (Accessed November 2011).

- vi See "Social Protest, an African Perennial" African Futures, October 7. <http://forums.ssrc.org/african-futures/2013/10/07/social-protest-an-african-perennial/> (accessed October 8, 2014). The International Labour Organization has made similar findings.
- vii <http://www.ft.com/intl/cms/s/0/e0197496-426e-11e4-9818-00144feabd0.html?siteedition=intl#axzz3HQyIBRwc> (accessed September 22 2014).
- viii Even data on present natural resource revenues are poor and projections about future revenues vary widely due to uncertainties about the investment decision of MNCs, long-term commodity price trends, and governance conditions on the ground. Consequently, revenue figures from natural resources differ between sources. In Mozambique, extractive industries contributed 2 percent to GDP in 2012 and generated more than \$100 million in revenues in 2011. This was a 60 percent increase, but only made up 2 percent of the state budget of close to \$4.5 billion (while 45 percent was funded by foreign grants and loans); see <https://eiti.org/Mozambique> and <https://eiti.org/news/big-increase-oil-and-gas-revenue-mozambique> (accessed October 18 2014). A Financial Times article claims that such revenues amounted to \$1 billion in 2013. Moreover, extractive industries account for a rapidly increasing share of exports (and foreign exchange earnings): 67 percent in 2011 compared to 38 percent in 2000 (Revenue Watch Institute 2013). Tanzania has been a substantial exporter of gold for some years (12 percent of exports in 2012) and large discoveries may make it a major gas exporter in seven to ten years' time but a final commitment to invest in the huge off-shore gas deposits has yet to be made. Extractives revenue represented approximately ten per cent of total government revenue in 2011/12 according to <https://eiti.org/Tanzania> (accessed October 18 2014)). Uganda's main exports are still coffee, cotton and tobacco. Gold comprised nine percent of the country's total exports in 2005 and they have grown since then <http://www.resourcegovernance.org/countries/africa/uganda/extractive-industries> (accessed October 18 2014). The importance of extractive industries is set to grow further in the foreseeable future because an oil refinery and pipelines are being built and are expected to bring substantial benefits (PriceWaterhouseCoopers 2013; OECD 2014, Table 7).
- ix E.g. South Africa, Malawi, Brazil, India, Indonesia, Bangladesh, Nepal, Namibia, Botswana, Colombia, Honduras, Armenia, Panama, Jamaica. Not all of them are based on natural resource revenues, however.
- x See also a review article in the Economist. <http://www.economist.com/news/special-report/21621158-model-development-through-industrialisation-its-way-out-arrested-development> (accessed October 7 2014).
- xi The measure is based on four features of a country's export basket: (i) its sophistication; (ii) its diversification; (iii) its "standardness" and (iv) the possibilities that it offers a country to export new products with revealed comparative advantage. Among 96 non-high-income countries China and India score highest on an index based on these factors; Haiti, Mauritania and Benin are at the bottom. Mozambique, Uganda and Tanzania (in that order) are in the middle of this ranking.
- xii They developed and used Elaborated Political Settlement Theory in this research. Empirical details about their findings – and about differences in industrial policy implementation across the three countries - can be found in the two references.
- xiii At present there is no comprehensive analysis of the financial implications of post-2015 goals (Arakawa 2014, 5). These goals may include: "getting to zero" on poverty by 2030; finding ways of addressing low-paid jobs, 'jobless growth' and youth unemployment; providing social and economic infrastructures in rapidly growing cities and neglected rural areas; providing global public goods and managing global risks from climate change to infectious diseases (Evans 2013).
- xiv The number of artisanal miners is large, but their conditions rather neglected. This important issue is not dealt with here.
- xv In Mozambique, donor concerns range from a government backed \$850 million bond for an untested tuna fishing company to alleged fraud in the sectors of agriculture, education and health (Frühauf 2014, 29). In Tanzania suspension was decided in mid-2014 following the disappearance from the Bank of Tanzania of \$500 million (http://um.dk/da/~/_media/UM/Danish-site/Documents/Danida/Resultater/Svindel/C%201300-1399/case_1%20340_report_1.pdf accessed November 11 2014). Fifteen percent of Danish aid to Uganda was reallocated primo 2014 following the passing of anti-gay laws (The Guardian (UK), February 2014).



THE POLITICS OF OIL, GAS CONTRACT NEGOTIATIONS IN SUB-SAHARAN AFRICA

By: Rasmus Hundsbaek Pedersen, DIIS, 2014

SUMMARY

Much attention has been paid to the management of revenues from petroleum resources in Sub-Saharan Africa. An entire body of literature on the resource curse has developed which points to corruption during the negotiation of contracts, as well as the mismanagement of revenues on the continent. The analyses provide the basis for policy advice for countries as well as donors; transparency and anti-corruption initiatives aimed at lifting the curse flourish. Though this paper is sympathetic to these initiatives, it argues that the analysis may underestimate the inherently political nature of the negotiation of contracts.

Based on a review of the existing literature on contract negotiations in Africa, combined with a case study of Tanzania, the paper argues that the resource curse need not hit all countries on the African continent. By focusing on changes in the relative bargaining strength of actors involved in negotiating processes, it points to the choices and trade-offs that invariably affect the terms and conditions of exploration and production activities. Whereas international oil companies are often depicted as being in the driving seat, the last decade's high oil prices may have shifted power in governments' favor. Though their influence has declined, donors may still want to influence oil and gas politics under these circumstances. This requires careful analysis of the game. Support to building capacity in the institutions that govern and regulate the petroleum sector as well as to local communities and authorities may be avenues of engagement for donors.

INTRODUCTION

More countries in Sub-Saharan Africa have become petroleum economies since new discoveries of oil and gas were made in the 1990s and 2000s due to a combination of technological innovation, higher fuel prices and increased levels of investments (IEA 2014). Recently, a virtual oil and gas hype has gripped countries in eastern and south-eastern Africa, and with good reason; the potential new revenue streams are substantial. In a country like Tanzania the costs of establishing the single most expensive investment alone, a two-train liquefied natural gas (LNG) plant including infrastructure, is estimated to amount to approximately US\$ 20 billion in 2012 prices. Simulations indicate that government revenues may reach around US\$ 3 billion annually (Baunsgaard 2014; Ledesma 2013). By comparison, Tanzania received US\$ 1.77 billion in official development assistance in 2012.

The prospect of large revenues profoundly affects a country's whole political and institutional set-up – its political economy. The management of wealth rises up the political agenda: how are the benefits from these resources to be distributed? This paper focuses on the political economy of oil and gas in Sub-Saharan Africa. Much attention has been paid to the characteristics of contracts and the management of revenues. By focusing on the relations – the 'relative bargaining strength' – between the main actors in the negotiating processes prior to the signing of contracts, the paper aims to shed new light on petroleum politics on the continent. It is based on a review of the literature on the experiences of countries in Sub-Saharan Africa that have entered the natural resource game recently and have yet to develop their resources. These countries differ from pioneer petroleum countries like Nigeria and Angola because they may have been influenced from the outset by the new types of administrative procedures and policy guidelines that have emerged since the late 1990s in order to prevent the resource curse: the Extractive Industries Transparency Initiative (EITI), the Publish What You Pay (PWYP) financial transparency initiative, private petroleum companies' CSR programmes, and the proliferation of policies aimed at enhancing local content and local participation, to mention but a few.

The paper argues that these good governance initiatives may have been important in setting an agenda, but they do not influence negotiating processes to the same extent as do other factors that are more fundamental to the context of the negotiations: geological features, market fluctuations and national politics. However, petroleum affairs are gradually changing on the continent. Whereas the late 1980s and the 1990s were characterized by liberalizations, low prices, weak governments

and a myriad of domestic and foreign interests (Clarke 2008, 66ff), a prolonged period of high oil prices on the world market means that contemporary negotiating processes are being influenced by markets and national politics in new ways.

The paper argues that host governments have become more assertive. Whereas it is often claimed that international companies are in the driving seat, an 'obsolescing bargain' may be developing, that is, a shift in favor of the government once investors have invested (Patey 2014a, 17). Donors, on the other hand, see their influence reduced, and if they wish to be relevant to petroleum politics, for instance, in order to promote social and environmental sustainability and the eradication of poverty, they need a realistic understanding of national politics and of their diminished role in it. They need allies, for instance, by linking up with domestic elites with overlapping agendas. Local communities may benefit from this development too, though benefits sometimes have been more programmatic than real. It is still unclear if the recent fall in oil prices heralds a new turn in the 'commodity resource cycle' that will alter the relations between actors fundamentally (Bindemann 2000; Mossavar-Rahmani 2010) or if they are mere fluctuations with no long-term effects.

The recent focus on transparency and contract disclosure, typically based on assumptions about irregularities during the negotiation of contracts, may skew the analyses of petroleum negotiations out of two reasons. First, negotiating processes are inherently opaque, to some degree even to the actors themselves (Kheili 1995). In a competitive environment in which governments are vying with each other to attract private-sector investments and private companies are vying for attractive investment rights, all actors guard their bits of information carefully. Some degree of confidentiality is probably unavoidable. As one informant phrased it, when governments enter into negotiations with private-sector investors, a balance has to be struck between creating a level playing field for them both (which means that the government cannot share all its information about its negotiating strategy) and total transparency (see also Radon 2007, 98). Secondly, since these processes involve trade-offs as well as major decisions about the development of the national exploration and production regime, they are extremely political. From a donor perspective the challenge should therefore be how to influence these processes. The focus on transparency is important, but it also risks diverting attention from where decisions are really made.

These characteristics of petroleum contract negotiations make research a challenge. Not much has been written on the topic. Therefore, the paper is based on information extracted from the existing literature, though this is often about the

later stages in the petroleum project cycle. Literature searches were conducted in EBSCOhost, one of the major online reference systems for full text database searches, combined with cross checks in Scopus, which sometimes includes more Africa-relevant material, and with Google Scholar on Tanzanian petroleum affairs. Search phrases systematically combined words like 'gas', 'petroleum', 'oil', 'contract', 'Africa', 'Tanzania', etc. in order to find as much relevant material as possible. Much literature dates from the 1980s, as it was responding to the nationalizations of the 1970s. The review of the broader literature is therefore combined with a more in-depth analysis of Tanzania, for which a particular literature search was conducted to include policy and project documents, 'grey' consultancy publications and current new items. During two short field trips to the country during the writing of this paper, I also talked to several people knowledgeable about the sector. It is my hope that the combination of overview and case study analysis will provide a valuable insight into the contemporary negotiating processes of petroleum contracts.

NEGOTIATIONS IN COMPETITIVE ENVIRONMENTS: BUILDING CONTRACTUAL RELATIONSHIPS

In a perfect market situation, the rents that a government can expect to extract from oil and gas production would be decided through competitive bidding processes. However, the auctioning of oil and gas exploration rights rarely takes place in perfect markets. Investment decisions are made in an environment of uncertainty and limited knowledge. Negotiation processes are therefore not only about distributing rents, but also about distributing risk. This implies that actors use judgment and make trade-offs and that no single model result can be achieved (Blitzer et al. 1985; Hurst 1988; Radon 2007). Inspired by Hurst (1988, 161) factors influencing negotiations can be summarized in three overall categories: geological features, political risks and market contexts.

- Geological features include both risks and expenses related to geology. Most often, there is limited knowledge about the geology of the area that is about the subject of negotiations, both among the host government and investors, and nine out of ten exploration efforts end up being loss-making (Radon 2007). Even if deposits are found, the costs of exploiting them vary and may be higher than what world market prices can justify (Blitzer et al. 1985; IEA 2014).
- Political risks include the fiscal regime, contract stability and access to finance. The fiscal regime (or fiscal system) covers all the payments made to a government, that is, not only the payment of rents related to production (Khelil

1995). These, and contract terms in general, may change over time and affect profitability. Developing countries are perceived to be particularly risky because of their lack of experience and volatile political cultures. These risks also affect access to finance (Radon 2007; Hurst 1988).

- The market context may cover a range of factors. Obviously, the fluctuation of prices on the world market is likely to affect investors' interests, though they are likely to make decisions based on long-term expectations. Distance to markets is still an issue, since developing countries' domestic markets are relatively small, and operations therefore typically target world markets (IEA 2014; Asche, Osmondsen, and Tveterås 2000). Because of transportation costs, which are higher for gas than for oil, governments compete regionally; a country like Tanzania competes more with neighboring Mozambique than with Norway on the terms and conditions it may offer international petroleum companies (Khelil 1995; Blake and Roberts 2006; Radon 2005; see also Mitchell and Mitchell 2014).

In reality, contracts are formulated on the basis of actors' relative bargaining strengths, influenced by the three factors outlined above.

The negotiating parties also navigate in an environment of imperfect information. It is often stressed that there is an asymmetry of information and that oil companies possess better information about a discovery's geological features and how to exploit it, in particular after they have had the chance to do some exploration (Radon 2007). They also often have more resources for and more experience in negotiating contracts. However, a contract is a relationship. Due to the resources that are invested in oil and gas operations, it is most often a long-term relationship (Hurst 1988; Boucher, Hefting, and Smeers 1987). For the sake of stability, these relationships should ideally be characterized by some degree of goodwill and a fair balance of interests between the investor and the government. However, evidence suggests that short-term price fluctuations may affect contract regimes (Stroebel and van Benthem 2012; Hogan and Sturzenegger 2010). Therefore, companies often seek to insert stability clauses into contracts, that is, clauses that refer to international treaty obligations and that freeze contractual and regulatory matters for the lifetime of a contract, especially in developing countries, which are perceived to be particularly volatile (Radon 2007).

These precautions reflect the fact that the contractual relationship is dynamic, as the relative bargaining strength changes over the course of a project cycle. Whereas companies may be in the driving seat before the signing of contracts, once the investment has been made and the infrastructure for exploration and extraction put in place, the government has the upper hand. As noted by Bridge and le Billon, when oil begins to flow, there is pressure from resource holders to renegotiate the terms agreed at the outset (Bridge and Billon 2013, 29). This reflects what has been called the reemergence of the 'obsolescing bargain', that is, 'an initial favorable bargaining strength for international companies [that] shifts in favor of the government over time, as fixed asset investments increase' (Patey 2014a, 17; see also Hogan, Sturzenegger, and Tai 2010, 9).

The relative bargaining strength also relates to market conjunctures. Bridge and Billon wrote their book after a long period of sustained high oil prices. Indeed, the high prices in the 2000s led to a wave of renegotiated contracts, which increased governments' take, and of various kinds of direct and creeping expropriations (Emeka 2008; Hogan, Sturzenegger, and Tai 2010; Stroebel and van Benthem 2012). In contrast, Chakib Khelil in 1995, based on a larger study of changes in fiscal systems in 144 countries that was carried out when oil prices were low, observes that most changes reduced the government's take (Khelil 1995). Fluctuations in petroleum prices are increasingly incorporated into contracts, which in turn tend to become increasingly complex over time (Jacobsen 1987; Aghion and Quesada 2010). In sum, in an oligopolistic environment like that of oil and gas, relationships are characterized by some degree of mutual dependence among actors. Renegotiations of contracts are therefore not uncommon. Even a stable country like Norway initially offered better terms to attract investments, only to increase the government's take a few years later (Hognestad 1987). Indeed, the same study referred to by Khelil above showed that more than half of all fiscal systems were changed over the years.

BOX 1. CONTRACT NEGOTIATION IN TANZANIA

For a long time, the prospects of oil and gas production in Tanzania were dim. Geologically the country was largely unsurveyed, politically it was not attractive to private foreign companies after the period of nationalizations in the 1970s, and in market terms it was distant from buyers in the more developed markets. Though gas reserves had already been discovered in 1974, it was not until thirty years later, in 2004, that production began, and only on a small scale and with donor money. This situation changed around the turn of the millennium, when sustained high world energy prices and a more stable policy environment made Tanzania an increasingly attractive investment destination. The four bid rounds that have been carried out so far have attracted a number of companies, including some larger players like Shell, Statoil/ExxonMobil, Petrobras, CNOOC, RAK Gas, Mubadal and Gazprom (Confidential 2007, 2012; James and Jones 2014).

The first major deep sea gas discovery was made around 2010. Since then, a number of discoveries have steadily increased the total proven gas reserves in the country, which currently stand at more than 50 trillion cubic feet and are expected to rise to 200 trillion cubic feet within the next two years (Petzet 2012; Daly 2014). According to the latest estimate by the Tanzania Petroleum Development Corporation's (TPDC), the national oil company, international oil companies have invested almost USD 5 billion in the country (Citizen 2014).

Not much is known about the negotiating processes involved beside the fact that they are headed by TPDC. The Tanzanian opposition has alleged that bribery has been involved in the award of licenses between 2004 and 2007 (Confidential 2012). The involvement of a middleman in one deal and a couple of non-competitive awards could be indices of irregularities. However, with 25-26 licenses awarded in the first three competitive bidding rounds and more coming, and still no substantial evidence, it is hard to sustain claims of corruption on a larger scale at present.

Nonetheless, heated political discussion has taken place, with calls from civil society, the opposition and even ministers and tax authorities to review and renegotiate contracts, creating the impression of a not very stable policy environment (Ledesma 2013; Obulutsa 2012; Authority 2014; Manson 2014). The recent row over a leaked addendum (TPDC 2012) to the production sharing agreement (PSA) of 2007 between Statoil and TPDC contributed to this impression. The opposition and civil society noticed that the addendum deviated from the model PSA, resulting in a significantly lower government take, which thus confirmed fears that the government lacked the capacity to negotiate contracts (Bærendtsen 2014).



However, it soon became clear that the issue was more complicated than anticipated; the original PSA was made for oil exploration, but Statoil found gas, which is more expensive to process (Lamtey 2014). In August, the Natural Resource Governance Institute (NRGI) published an analysis of the Statoil deal based on the available information. They concluded that it was 'not out of line with international standards for a country that had no proven offshore reserves of natural gas at the time when the original contract was signed' (Manley and Lassourd 2014, 1). Though it is unclear what NRGI means by 'international standards' (Bofin 2014), their assessment is somewhat in line with those of other analysts, who found that Tanzania's model PSAs were generally favorable to the government (Newcombe 2014, 14; Baunsgaard 2014).

The aftermath to the addendum affair did not make things any better. After changing positions several times over, the government created a conflict with the legislature by finally refusing calls for disclosure of contracts even to the parliament (Kasumuni 2014; Mirondo 2014). There is no doubt that the disclosure would help demystify the content of the contracts. It would also, however, raise a number of other questions. First, whether it would weaken the government's relative bargaining position vis-à-vis international oil companies in a less than perfect competitive environment. Secondly, whether it would really contribute to reducing the political tensions that may have more to do with the forthcoming elections than with matters of substance. In other words, disclosure is unlikely to solve the contentious issue that a government needs some level of discretion to deviate from the model when negotiating a contract.

Some observers are wondering whether the political climate, combined with a toughening of terms for exploration and production in the model PSAs, will reduce foreign investors' appetite for investing in Tanzania. The companies behind a major potential investment, the construction of a multibillion dollar LNG plant in the south-eastern part of the country, have already announced that they will not make a decision until after the forthcoming elections in 2015 (Confidential 2013). Some see further confirmation in the fact that the last bid round only attracted a few bids for the eight blocks on offer (Guardian 2014; see also Kabendera 2014; Makene 2014).

IT'S POLITICS, STUPID: NATIONAL OR INTERNATIONAL OIL COMPANIES

The judgments and trade-offs that are made when deals with foreign oil companies are struck are linked to national politics (see Box 1). Decisions on the structure of the national exploration and production landscapes are also political in nature. Investments in exploration and production are typically capital-intensive and require

specialized skills and knowledge to an extent that African host countries can rarely lift alone. The involvement of an international oil company is often required (Hurst 1989). But should national companies play a role too?

Many scholars suggest that African countries are better off with the highest possible oil prices than with stakes in operations because of the reluctance of international oil companies to let national oil companies in (Hurst 1989), the more transparent processes associated with pure revenue streams (Clarke 2008) and the 'better performance and greater efficiency' of private oil companies when compared to public ones (Wolf 2009). On top of that, accountability may become blurred when the state at the same time acts as the owner of companies and as the regulator of the very same companies (Gary 2008). Finally, national oil companies in Africa have often been seen as vehicles of patronage.

Still, most countries wish to develop their own oil industries. National oil companies are seen as potential vehicles for capacity development, transfers of skills and technologies and, ultimately, industrialization (Berrie and Leslie 1978; Marcel 2013). The negotiation of contracts requires skills and knowledge that can only be fully achieved through national capacity developed in or through a state's own oil and gas sector. Furthermore, it has not gone unnoticed that the bigger reserve-holders globally today are not international oil companies, but national oil companies in the Middle East and South America that have generated huge revenues for their owners (IEA 2014, 53; Bridge and Billon 2013, 39). African petroleum economies like those of Nigeria and Angola have also gradually developed their own industries, which now, furthermore, have begun to expand abroad (Clarke 2008, 510).

There have been ebbs and flows when it comes to ownership. The 1960s and 1970s saw waves of nationalizations and the establishment of national oil companies. The tide reversed with the neoliberal reforms of the 1990s, which brought the market back in (Bridgman, Gomes, and Teixeira 2011). Today there may be a new equilibrium underway, and again this seems to be related to world market fluctuations. After a period of high oil prices, governments are better positioned to toughen contract terms and demand carried interests in operations, joint ventures and local content in production processes (Marcel 2013).

For countries that have not yet entered the petroleum economy, there may be a further incentive for state involvement in exploration and production in the fact that the competitive bidding rounds that are typically recommended as better alternatives may not be feasible. Frontier areas with no proven reserves may only attract few or

no bidders, which makes auctions uncompetitive and puts the government at a disadvantage (EITI 2013, 14; Marcel 2013). It may therefore choose to engage more directly in exploration activities in order to improve the prospects of attracting investors.

However, the strengthening of national oil companies imply trade-offs between policy objectives and economic gains. First, bigger stakes in operations will invariably reduce revenue, at least in the short term. Secondly, despite the strong political interests in promoting national oil companies these companies tend to be difficult to control in the longer run; National interests and the interests of national oil companies are not always the same (Noreng 1994).

IS THERE A RESOURCE CURSE? LIMITS TO TRANSPARENCY INITIATIVES

The discovery of hydrocarbon deposits is often depicted as a blessing in disguise. However, the problematic effects that natural resource wealth has had on African countries have given rise to a concept and an entire body of literature: the resource curse. According to this literature, resource-rich countries have observed slower economic growth and higher levels of corruption than have resource-poor countries in Africa. There are a large number of possible explanations for this, covering both economic and political aspects or a combination of the two (Ross 1999). Much resource curse literature tends to focus on informality, irregularity and corruption, often in conflict or post-conflict situations, as the major explanation (see, for instance, Oliveira 2007). The assumptions about corruption have been so strong in the resource curse literature that empirical research into these matters has hardly been deemed necessary (Clarke 2008, 526; Billon 2014).

Over the last 25 years, a number of initiatives have been taken to address corruption in the extractive sectors, more or less explicitly referring to the resource curse theory. The most notable may be the Extractive Industries Transparency Initiative (EITI) of 2002, which aims to improve transparency and reduce corruption in resource-rich countries. It involves governments, private companies and civil-society organizations and entails mechanisms that aim to reduce corruption by targeting the reputational concerns of states and companies through public naming and shaming. Whereas the initiative has been successful in promoting anti-corruption norms, a recent review of anti-corruption instruments suggest that it may have been less successful thus far in changing behavior. The review points out

that EITI's claim to success is based on the high number of actors that ascribe to its transparency standards, but that the evidence for compliance is 'very limited' (Johnsøn, Taxell, and Zaum 2012, 39-40).

More in-depth analyses from Nigeria, which was among the first countries to join the EITI process, suggests that progress against corruption may have more to do with political will unrelated to the EITI process than to EITI itself (see Box 2). If this political will wanes, so will progress against corruption (Asgill 2012; Shaxson 2009). This has to do with the fact that, even though EITI may provide the tools for civil-society organizations and the media to put pressure on governments and companies, this does not address existing power inequalities. If groups are marginalized, civil-society organizations are weak or accountability mechanisms are stymied by entrenched elite interests, EITI is unlikely to have any significant effect. Issues like power and politics are important, but they tend to be overlooked in the EITI process.

BOX 2. CONTRACT NEGOTIATIONS IN A RESOURCE CURSE-HIT COUNTRY

Nigeria is notorious for widespread irregularities in its petroleum sector (Katsouris and Sayne 2013; Oliveira 2007). A leaked draft report from the country's Economic and Financial Crimes Commission (EFCC) in 2012 revealed that up to \$100 billion had been lost in state revenues over the preceding decade (Confidential 2014c). The problem goes from outright theft of crude oil via mispricing to corruption related to the negotiation and enforcement of contracts. The widespread use of middlemen and shell companies, not least during military rule in the 1990s, is a sign of irregularities (Frynas, Beck, and Mellahi 2000). Recently, conflicts over contracts have reached international courts and helped shed some new light on shady dealings that we rarely get to see.

One of the most spectacular cases began in 1998 under the reign of the dictator Sani Abacha. Back then, a promising oil block license was sold to a person with no oil experience, supposedly pushed through by the Oil Minister with the support of actors in the political and administrative elites and the dictator himself (Economist 2013; Confidential 2014d). The deal reappeared on the public agenda in 2011, when Shell and the Italian oil company, ENI, paid more than \$1 billion for the block, not directly to the owners, but to and through the Nigerian state.

Since the new deal was carried out in 2011, the dictator's son has been complaining to the EFCC that he did not get his rightful share of the revenue, and two middlemen have sued the then Oil Minister (who they believe is the real owner of block) in the London High Court for a commission fee for brokering the deal. Italian prosecutors are investigating whether ENI has paid bribes to win the license, something the company denies because the contract was with the Nigerian state, not the private license-holder. However, the New York Supreme Court has stated that the Nigerian state had merely acted as a straw man in the deal. Global witnesses have called the case a 'lesson in corruption' (confidential 2014b, 2014d, 2014a).

According to a 2011 report, some progress was made in the fight against corruption in Nigeria after the return to civilian rule in 1999, but the report also shows that priorities in this regard have changed from one president to another. Much remains to be done (Abutudu and Garuba 2011). This raises some important questions about how to influence petroleum affairs if anti-corruption is a matter of political will just as much as of transparency rules and regulations.

The limits to EITI and similar initiatives may have to do with a skewed analysis from the outset. In recent years, the resource curse diagnosis has been challenged by a number of scholars who question the causality between the extraction of mineral deposits, slow economic growth and weak governance indicators. Most point to the fact that there are countries, even in Africa, that have managed to exploit their resources productively simply because they are doing many things right (Buur et al. 2013). This finding redirects analytical attention towards the role of institutions that manage resources. Informality may persist in the better governed countries, but in less harmful ways. It is, in other words, the context-specific combinations of formal and informal institutions that matter.

Duncan Clarke has reached a similar conclusion regarding the oil curse, highlighting that what is typically depicted as the outcome of the curse – weak and corrupt institutions that fail to develop the economy in any productive way – most often predate oil's arrival on the scene (Clarke 2008, 537). This implies that weak institutions are not necessarily caused by wealth generated from petroleum assets, but that institutions are weak from the outset. This weakness may indeed be exacerbated by the discovery of new resources. Therefore, it matters when and where deposits are found and extracted; a country's political and institutional set up at the time of extraction matters for how resources are managed.

BOX 3. DONORS' WANING INFLUENCE IN THE DEVELOPMENT OF TANZANIA'S PETROLEUM INDUSTRY

For long, donors were vital in facilitating the cooperation between the Tanzanian state and the private foreign companies that could provide know how and capital. From a commercial point of view, the country was not an attractive investment destination. Geologically, it was largely unsurveyed. Politically, after the nationalizations of the 1970s, the country was deemed risky. And in market terms, the Songo Songo gas field that had been found in 1974 was small, world market prices were low, and the costs of transporting gas to developed markets were too high.

In 1979, when private-sector interests in developing Songo Songo were exhausted, the World Bank and other donors stepped in with credits to finance further exploration activities (Davison, Hurst, and Mabro 1988). This included training TPDC personnel in exploration activities and in project and financial management (Bank 1991). In 1988, Davison et al. observed that the TPDC was 'well supplied' with engineers and geologists, many of whom had been trained by the Norwegian aid agency (Davison, Hurst, and Mabro 1988, 210). Donors also supported the development of Tanzania's regulatory framework. The Petroleum (Exploration and Production) Act of 1980 was formulated with British Commonwealth support. An important aspect of the Act is to provide security for investors. This is no small feat after the previous decade of nationalizations of private companies under Tanzania's version of African socialism.

It was the production of electricity for local consumption that finally led the way to the commercial production of gas. A call by donors for a reform of the electricity sector in the early 1990s resulted in the re-commercialization of electricity services, including an opening up for private-sector power involvement in electricity production (Ghanadan 2009, 407). The Songo Songo Gas-to-Electricity Project, which only started producing electricity in 2004, thirty years after the discovery of the gas field, also became a reality with donor support. The project involves support from the World Bank, the European Investment Bank and SIDA, without which it would probably not have been possible to attract private foreign capital. Unlike other projects of this type, equity ranks over debt in the Songo Songo project (Hobbs 2001).

With higher world market prices and private investment projects underway, relations between the Tanzanian government and donors changed after 2000. Donors are still involved in the Tanzanian petroleum sector, but their role has become more advisory now that they are less needed for infrastructure investments. Norway is explicitly mentioned as being involved in the making of the draft petroleum policy, and it is also involved in other aspects of the current reform row that is changing the entire Tanzanian institutional and regulatory framework. Other bi- and multilateral donors are also trying to influence the development of the sector (Kamndaya 2014; Mission. 2013), but some are complaining that the government no longer listens.

WHAT DONORS CAN DO

The discovery of major oil and gas deposits in Sub-Saharan Africa means that donors' ability to influence the governance of natural resources is decreasing. Once petroleum deposits are discovered, the relative bargaining strength of actors – host governments, international oil companies, local communities and donors – changes (Mahmud and Russell 2002). Host governments become more assertive, and donor influence is reduced. Despite recent price fluctuations, the time when donors had a decisive say over petroleum policies and institutions (see Box 3) is probably over.

Generally, donors are likely to achieve more if they work along with the government's priorities rather than if they work against them. The identification of mutual interests provides a good point of departure. Some do so already. It is hardly a coincidence that oil-exporting Angola and Nigeria – not exactly beacons of transparency and good governance – were the biggest recipients of oil-importing US aid to Africa in the mid-2000s, though this may now be changing due to the US shale revolution (Klare and Volman 2006; Ndumbe 2004; Blas 2014). Less clear-cut is Norway's position. Through its own petroleum industry, Norway has economic interests at play in many places. Furthermore, however, through continuous support to capacity-building over many years, it has also been able to influence governance standards in developing countries, seemingly in the direction of more transparency, participation and openness (see Box 3). Indeed, Norway's example may provide elements to a model for donor engagement: while acknowledging that they are not direct partners in the negotiation processes, donors can contribute to building capacity in the institutions that govern and regulate the petroleum sector. Among the more important elements highlighted in the literature that deserve support is the establishment of an independent auditing capacity, in particular if a state participates directly in production through the development of its national oil company (Gary 2008; Marcel 2013; Bauer, Rielveld, and Toledano 2014).

Anti-corruption and transparency initiatives provide another possible avenue through which donors may seek to influence petroleum politics. There is donor money behind EITI, which provides an increasingly influential standard for the extractive sectors. By requiring some of the main actors – governments, companies and NGOs – to work together (EITI 2013, 40), it constitutes an innovative attempt to create a debate on these matters. EITI has been important in setting an anti-corruption agenda in many countries. The evidence that it has been successful in achieving compliance with this agenda is far less conclusive. This has to do with the political character of petroleum resources. Traditionally, petroleum in Sub-Saharan Africa has been considered closer to high politics, that is, it is seen as a strategic

national resource that should be dealt with at the national level, with limited participation by actors other than state agencies and investors (Noreng 1994; Bridge and Billon 2013). The power inequalities may be influenced by initiatives characterized by voluntary participation like the EITI, but they are unlikely to be fundamentally changed by it.

If donors wish to influence the agenda in the direction of more participation and a better distribution of benefits, they have to acknowledge that petroleum is also about politics and relative bargaining strengths. This requires careful analysis of the political game and, in particular, of the interests of domestic elites. In a recent article on China's oil-backed loans, Ane Alves stresses that the impact of foreign involvement relies on the institutional structure of a country's oil sector and political economy. She finds that China is less successful in a liberalized context like Brazil than in a country like Angola, where the executive controls the oil sector closely (Alves 2013). In liberalized markets, the US strategy of improving the investment climate (for its own oil firms) may be more successful (Klare and Volman 2006). In other words, an avenue for influencing negotiating processes would be to ally with the actors, who may have overlapping agendas.

The proliferation of requirements for local content, community participation and CSR in laws and the increasingly ambitious CSR programmes of private companies testifies to the fact that there are other actors who may also be interested in doing good. These initiatives may not always be set in motion out of benevolence; experience has shown that conflicts at the local level may affect the profitability of operations. This does not make the incentive to make them work smaller. However, it has turned out to be difficult in practice (see Box 4). Often local-level actors are too weak to enter into any meaningful dialogue or partnership with governments and oil companies. Until recently, communities were not even on the radar when contracts were negotiated (Radon 2007, 91). The build-up of capacity of local-level actors and of those representing them at the national level is therefore no less important than that of the national authorities. This is also acknowledged by the petroleum industry itself, which, due to disappointing result of past programmes, increasingly stresses that it has to build on existing local capacity in order to make social investments successful. Where private oil companies previously tried to avoid local authorities, they are increasingly seeking to strengthen their capacity in order to create partners, increase transparency and improve the government's ability to respond to demands (IPIECA 2008, 14).

Donors without private-sector interests may play an important role as honest brokers in facilitating these relations among actors; governments preoccupied with national affairs may not always pay much attention to local interests, and, despite CSR programmes, private companies are only likely to work with communities as long as there is a business case for doing so. By supporting the capacity of existing local authorities and cooperation among actors, donors may have to look beyond the western-inspired NGOs based in the capitals and work with local governments at various levels, trade unions and associations of employers, and community, traditional and religious leaders. Ideally, support should not only include support to participation in specific investments projects, but also in formulating the policies and regulations that shape these projects prior to operations.

BOX 4. INVESTORS AND COMMUNITIES IN TANZANIA'S GAS SECTOR

In the 2000s, Tanzania witnessed a move away from the do-no-harm approach to more interactionist relationships between investors and communities. This is reflected in changes in both policies and practice. Policy-wise there has been a change from the 1980 Petroleum Act, which merely states that operators shall affect as little as possible (Petroleum (Exploration and Production) Act 1980 1980, 73.3), towards more elaborate requirements on companies regarding how to engage with communities. Both the new Gas Policy and the Draft Petroleum Policy call for more formalized relations between communities, local government authorities and investors by making CSR activities contribute to local development plans (Draft Petroleum Policy 2014; The National Natural Gas Policy of Tanzania 2013).

The larger foreign oil companies currently involved in exploration and production are indeed taking a pro-active role by initiating impact assessments, preparing CSR activities and drafting memoranda of understanding with the government. Western companies are typically more ambitious in this regard than required by Tanzanian law, partly because of vigilant publics at home and partly because it is required in order to access international finance, for instance, from the World Bank's International Finance Corporation (IFC), which tends to set the standards on social and environmental issues. Recent violent protests in the south-eastern city of Mtwara against the construction of a gas pipeline have only increased the companies' interests in making the right entry. Experience from elsewhere in Africa indicates that non-Western firms may be less focused on CSR, but that they are catching up (Patey 2014b).

Despite progress, however, the challenge is to make these initiatives work in practice. Tanzania has a long tradition of drafting superb laws, only to see provision undermined by insufficient implementation. Observers point to the problem of coordination when both central and local governments as well as local communities and private investors are involved. In particular, the low capacity of local governments, ill-equipped and understaffed in this field as they are, and of local communities should be addressed if they are to engage in any meaningful dialogue and cooperation with investors and the government. The monitoring and enforcement of investor promises also require capacity. Communities affected by a rumored industrial park in the vicinity of the expected LNG plant in southeastern Tanzania will be beyond the reach of petroleum companies' CSR policies and thus deserve particular attention.





AID FOR TRADE:

An update on recent trends and recent research
and evaluation findings

ABSTRACT

Aid for Trade (A4T) accounts for a very large and steadily increasing proportion of sector-allocable aid. This Report reviews recent developments in the area, as well as recent econometric and evaluation studies of A4T's impact. Since support to Private Sector Development makes up around 40% of A4T, evaluations in this area are also considered. Overall, the impact of A4T appears to be positive, though limited; more attention should be focused on recipient country targeting, project portfolios with complementary interventions at different levels, targeting trade impacts and outcomes other than increased exports, adopting a more structured approach in work with private-sector actors, and improved results measurement.

Aid for Trade (A4T) rose up the list of development actors' priorities following promises made by industrial countries at the 2005 WTO Hong Kong Ministerial meeting. OECD's Development Assistance Committee (DAC) began reporting on both A4T trends and values in 2007. This Report summarizes recent trends before examining findings on A4T from two main sources. The first is a growing number of econometric studies of A4T impact, produced by academics and researchers working for policy agencies. These studies seek to estimate the impacts of different forms of A4T, including those on different aspects of trade. The second source is evaluations commissioned by donors of their own assistance within the A4T field. Evaluations in two main A4T areas are considered here. One is evaluations of projects and programmes explicitly designated by donors as falling within the A4T field. The other is evaluations of projects and programmes primarily designated by donors as falling within the field of Private Sector Development, but invariably reported to the DAC Creditor Reporting System (CRS) under the A4T category of 'Support to Productive Capacity' (see below). A further rationale for addressing Private Sector Development support here is that, to different extents, it aspires to leverage private sector resources in the service of development goals. One particular modality for this - Public-Private Partnerships (PPPs) – figures prominently in recent OECD work on A4T generally and is therefore considered here in greater detail.

A4T: RECENT TRENDS AND VALUES

DAC members' A4T commitments increased from an average of \$34.6 bn. in 2006-08 to \$48.2 bn. in 2010. They fell in 2011 before rising in 2012 to their highest level to date, \$53.4 bn. (all quantitative references in this section are to the CRS dataset unless otherwise indicated). These sums represented around 33% of all sector allocable DAC aid at the beginning of the period and nearly 40% by the end.

OECD and WTO classify A4T under three main headings: Trade Policy and Regulations, sometimes also called Trade-related Technical Assistance; Aid for Infrastructure; and Aid for Building Productive Capacity, which covers aid to economic sectors other than infrastructure. Trade Policy and Regulations accounted for 3.2% of all A4T in 2006-08, falling to 2.3% in 2012. Infrastructure accounted for 54.1% in 2006-08, rising to 57.9% in 2012; within this category, energy dominates commitments. Building Productive Capacity accounted for 42.5% in 2006-08, falling to 39.7% in 2012; within this category, agriculture dominates. A further official heading, Trade-related Adjustment, received negligible commitments throughout, including only \$380,000 in 2012.

Least Developed Countries (LDCs) have increased their share of A4T commitments, from 26% at the beginning of the period to 32% at the end. But Middle Income Countries, despite no longer accounting for a majority of A4T, still command the largest single share. The main recipient countries over the period as a whole have been India, Vietnam, Afghanistan and Egypt in that order. The main donors throughout have been Japan, the World Bank Group, the US, the EU and Germany, also in that order.

Amongst other important quantitative trends has been for A4T to regional, sub-regional or cross-border projects and programmes, as opposed to national ones, to become more important (rising to 18% of all commitments in 2011).ⁱ Also, non-DAC donors have emerged as important A4T suppliers. According to OECD/WTO (2013), the bulk of Chinese aid can be construed as A4T: China's disbursements under this heading, overwhelmingly for infrastructure, are estimated to have been ca. \$2bn. in 2011, which would place it fourth amongst all bilaterals.

Understandably, a number of DAC donors consider the aggregate values reported above to be inflated by inclusion of large volumes of assistance whose objectives have a weak or no relation to trade, and have therefore pressed for more stringent reporting criteria. One result was the breaking out in 2008 of a new CRS A4T

category – ‘Trade Development’, under the Building Productive Capacity heading. This designates Building Productive Capacity programmes or projects whose explicit trade objectives are either primary or ‘significant’. Its share of Building Productive Capacity assistance, which perhaps enables extrapolation of a more accurate estimate of the aggregate size of ‘true’ A4T, varied between 18% and 31% during the period. Clearly, breaking out of a similar category within Infrastructure assistance would be also desirable. In the meantime, some donors use the category ‘Trade-related Assistance’ to denote the sum of their assistance to Trade Policy and Regulation and Trade Development, rather than that of A4T.

Turning to thematic trends within A4T, a survey of major donors conducted in preparation for OECD/WTO (2013) found that regional integration, trade facilitation and value chain-focused activities dominated current aid policy priorities. Of these, regional integration and trade facilitation have been dominant for some time (see earlier editions of *Aid for Trade at a Glance*). This reflects the fact that policy analysis, supported by certain of the econometric studies reviewed below, generally asserts that A4T is most effective where it reduces costs of trading. Besides improved infrastructure, obvious and less costly mechanisms for this include reducing or eliminating tariff and non-tariff barriers, trade facilitation and better coordination of value chains. However, these priorities remain reflected only weakly in the current allocation of commitments. The share of combined commitments to regional trade agreements and trade facilitation within all A4T commitments did rise from 2006-08, but only from 0.81% to 1.27%.

Another emerging theme highlighted in OECD/WTO (2013) is PPPs. A majority of donors participating in the survey mentioned stated they were involved with PPPs, although evidently mostly not in the sense of the term as used in industrial countries. In industrial countries PPPs refer to arrangements in which private actors share financial responsibilities and risks with the public sector to deliver public goods and services on the public sector’s behalf. Amongst PPPs in developing countries with which donors are involved, there are only one or two examples of this kind.ⁱⁱ This point will be returned to below.

A4T policies and formalized priorities are better informed and more coherent than in the past, but the underlying practices of recipient identification and commitment allocation are not focused on where need is greatest and appear remarkably resilient to change.

ECONOMETRIC STUDIES OF A4T IMPACT

Eight econometric studies estimating the impact of A4T on recipient country trade – mostly in terms of export elasticities – were identified by the authors and are reviewed here.ⁱⁱⁱ The studies' estimations are mostly based on versions of the gravity model, in which a range of possibly confounding variables, including distance, common language and historical ties between trading partners, are controlled for. A number of the studies estimate the impacts both of A4T in aggregate and of different headings or 'sectors' of A4T, as identified above. Besides export elasticities, the studies variously also consider recipients' import elasticities, trade costs and 'time of trading' (a measure of border delays) as dependent variables.

In reviewing the results described in Table 1, the following points should be borne in mind. The results of the analyses are sensitive to differences in econometric specifications, including whether data for commitments or disbursements has been used and the time period chosen. Additionally, the accuracy of DAC data on A4T disbursements is only guaranteed from 2002 on, possibly leading to inaccurate or biased estimates of the effects of A4T on trade for periods prior to this.

Results

Seven of the eight studies reviewed estimate the impact of A4T on recipient country export elasticities or export/GDP ratios. In six of these cases a significant positive impact is found, with export elasticities ranging between +0.009 and +0.05 (+0.1 for exports/GDP). Of the two studies estimating the effect of A4T on costs of trading, one found that unit export costs were reduced (-0.047). 'Time to export' ('import') does not seem to be affected by A4T.

Note that, where this was estimated, studies consistently also found A4T resulting in positive elasticities for recipient country imports in a similar range (+0.005 and +0.034). In both cases where this was estimated, A4T also led to reduced unit import costs (-0.05 and -0.119).

Table 1: Econometric studies of Aid for Trade

AUTHOR/DATE	SAMPLE	PERIOD	MODEL	INDEPENDENT VARIABLES(S)
Cali and te Velde (2010)	100 dev. cty exporters; (130 for trade costs)	2002-07 (exports); 2005-09 (trade costs)	Augmented trade cost and export demand equations	A4T in aggregate and by 'sector' (disbursements)
Busse, Hoekstra and Königer (2012)	99 developing countries (of which 33 LDCs)	2004-2009 (depending on dep. variable)	Fixed-effects model	A4T in aggregate and by certain 'sectors' (disbursements)
Helble, Mann and Wilson (2012)	40 OECD donors; 170 trading pairs	1990-2005	Gravity	Bilateral A4T in aggregate and by 'sector'
Vijil and Wagner (2012)	96 dev. ctys.	2002-2008	Aggregation of gravity equations	A4T in aggregate and A4TI
Hühne, Meyer and Nunnenkamp (2013)	All OECD-DAC donors and recipients	1990-2010	Gravity (asymmetric)	A4T in aggregate and by 'sector'
OECD/WTO (2013)	109 dev. ctys; 200 trading partners	1995-2011	Gravity	Bilateral A4T in aggregate and by 'sector'
Pettersson and Johansson (2013)	184 countries	1990-2005	Gravity (augmented)	Bilateral A4T in aggregate and by 'sector'
Udvari (2014)	EU, US and 15 ECOWAS members	2002-2012	Gravity	Bilateral EU and US A4T, in aggregate and by 'sector'

A4T data refers to commitments unless otherwise clearly stated. Only statistically significant results reported. Results report logged values. Key for A4T 'sectors': A4TPR: Aid for Trade Policy and Regulations; A4TF: Aid for Trade Facilitation; A4TI: Aid for Trade Infrastructure; A4TPC: Aid for Trade Productive Capacity

DEPENDENT VARIABLES	CONTROL FOR OTHER ODA	MAIN RESULTS (STATISTICALLY SIGNIFICANT RESULTS ONLY)
Recipient country unit trade costs and exports	No	Recipient unit export cost -0.047 Recipient unit import cost -0.05 (No effect from A4TPR) All recipient exports +0.035, driven by A4TI (No effect from A4TPC)
Recipient country unit trade costs and unit 'time to export and import'	No	Recipient unit export cost, no observable impact Recipient unit import cost -0.119 Results severely depressed by A4T other than A4TPR and A4TF Time to export/import not affected by any of the variables
All recipient exports to and imports from trading partners	Yes (excluding emergency aid)	All recipient exports +0.009 All recipient imports +0.005 Little difference in impact between types of A4T
Recipient country exports/GDP; Recipient country infrastructure index	Yes	Recipient exports/GDP ratio +0.1 Recipient infrastructure index +0.114 A4T impacts export/GDP only through infrastructure
All recipient country exports and imports to/ from all donor countries	No	All recipient exports +0.0503 All recipient imports +0.0290: No impact on LICs' exports Results similar across A4T sectors but A4TPR 'particularly effective'
Recipient country global exports	Yes	All recipient exports +0.03. Driven by A4TPR and by impacts on LICs and IDA-eligible countries. Additional indirect impact of +0.008 to +0.012 from A4T to third countries
All recipient country exports and imports to/ from all donor countries	Yes	All recipient exports +0.0182, although significant only at 10% level: 'fully driven' by A4TI All recipient imports +0.0340
Exports within the ECOWAS	No	No observable impacts

Results on the relative impact of different A4T sectors or headings are less consistent. Two studies found no particular A4T sector to be driving results. Three of the eight found positive impacts on recipient country exports to be driven mostly by A4 infrastructure, and three found A4 Trade Policy and Regulation driving these or other positive impacts. Notably, no study found A4 Building Productive Capacity to play any significant role.

Econometric studies show A4T having a positive impact on recipients' export elasticity, although the estimated impacts are limited in scale. Results for A4T by 'sector' are mixed, although A4 infrastructure most consistently impacts exports. Studies also consistently show A4T to be associated with reduced import costs and increased imports.

LESSONS FROM THE RECENT A4T EVALUATION LITERATURE

Seven evaluations of part or all of donors' A4T portfolios published since 2010 were identified. The donors concerned were USAID (Hageboeck 2010), Finnida (Bird et al. 2011), Japan (Mizuho Information & Research 2012), Switzerland (SECO 2013), CIDA (Government of Canada 2013), DFID (ICAI 2013) and the EU (Particip 2013). Interventions covering periods of between four and ten years are assessed, with most spanning five to seven years. Annual commitments under the evaluated interventions varied between \$8.5 mn. (Canada) and \$3.65 bn. (Japan). Other than Japan's, the EU's were the only interventions with an annual commitment value over \$0.5 bn. Most interventions covered a large number of countries.

Three main A4T focuses can be identified from the evaluations. The main focus of the US and Swiss interventions evaluated was on development of the export capacity of recipient country firms, mainly in agriculture and mainly through TA. The main focus of the EU, DFID and Canadian portfolios evaluated was on trade-related institutional capacity in recipient countries at either the national or regional level or both.^{iv} The main focus of the Japanese and Finnish interventions was on development of infrastructure and productive capacity - mainly outside agriculture and emphasizing participation of donor country enterprises either as partners or (through FDI) as main actors. In the Japanese case there was also a strong emphasis on TA, which accounted for 70% of commitments by value. The following discussion draws on the evaluations to identify the strengths and weaknesses of each of the first two of these types of support. The third type overlaps strongly with interventions usually discussed under the heading of 'Private Sector Development' and will therefore be considered later in this Report.

The 'TA for export capacity of recipient country firms' focus

What worked well: Interventions where TA for export capacity was combined with provision of hardware, and provided in a framework of good market access and support to trade facilitation and improvements in government practices.

What did not work: Interventions where support for export capacity was pursued only via TA and irrespective of the nature of the wider business/trade environment. Interventions aimed at manufacturing firm export capacity were more costly and took longer to achieve results.

Lessons learned: Although micro- and sometimes sub-sectoral improvements in export performance could be noted from this type of assistance, there were few spillovers to the wider economy and little impact on export diversification. The large number of individual projects and project partners proved resource intensive and risked under-steering. In general results were inadequately measured and monitored; a dedicated export capacity-building results framework should be developed.

The 'building capacity of trade-related institutions' focus

What worked well: Trade facilitation support and some support to standards compliance, in both cases where this was coordinated with the trading community. Support to private sector institutions for advocacy on supply-side constraints. Support to national capacity to participate in specific regional trade-related institutions, and to adjust to the impact of the regional single market. Support to regional institutions, but only where these had political support at member state level, where member states were supported in harmonizing trade measures, and where their secretariats had networks in member states.

What did not work: General budget support, given low levels of trade mainstreaming. Support to private sector institutions in respect to impacts on international competitiveness, investment or broader integration in the international economy. Support to participation in international standard setting.

Lessons learned: A common denominator of success was engagement with and prioritization of trade development by national governments and private sectors. Poverty-reduction was neither mainstreamed nor operationalized as an objective in most interventions. More attention should be paid to identifying the potential negative impacts of new trade agreements (e.g., revenue reduction and increased vulnerability for certain groups) and to mitigating actions. Economic diversification

should be a clearer aim for assistance, especially in LDCs. In general results were inadequately measured and monitored, and where they were measured this was typically in the form of outputs.

Evaluations find that recipient government and private sector ownership is critical for success and that regional-level interventions work only when they are supported by national ones. Too little attention is given to promoting macro-level competitiveness and economic diversification, to integrating poverty reduction and mitigating trade-related adjustment costs. Measurement of results and in particular impacts is seriously deficient.

LESSONS FROM RECENT PRIVATE SECTOR DEVELOPMENT (PSD)/PUBLIC-PRIVATE PARTNERSHIP (PPP) EVALUATIONS

Six evaluations of part or all of donors' PSD portfolios published since 2010 were identified. While all the projects and programmes concerned were probably reported to the DAC using CRS A4T codes, their evaluation was mostly not through a trade lens. The donors concerned were Norway (Devfin Advisers, 2010), IFC (World Bank IEG 2012), Finland (KMPG 2012), the EU (ADE 2013), DFID (ICAI 2014) and the Netherlands (IOB 2014). In addition the A4T evaluations of Finland and Japan mentioned in the last section will be considered here. Amongst this group, some contain explicit reference to support to PPPs although most of the examples discussed do not concern delivery of public goods or services on behalf of the public sector. Consideration of PPPs in this section also draws on literature reviews by IOB (2013) and the authors.

The PSD evaluations reviewed assess interventions covering periods between 5 and 15 years, with most spanning 5-8 years. Annual commitments through the interventions varied between \$3.3 mn. (Finland) and \$22 bn. (IFC). Besides IFC, the portfolios of the Netherlands, DFID and the EU all had annual commitment values over \$0.5 bn. Interventions again covered a large number of countries. Not only are donors' commitments typically higher for A4T under the heading of PSD than they are for 'purer' types of A4T, but their focuses are more diverse. The most common are 'matchmaking' between domestic and recipient country enterprises (by 4 of the 5 bilaterals); concessional lending/equity provision for greenfield direct investment (IFC and four bilaterals); and support to microfinance institutions; support to small- and medium-scale enterprises other than through matchmaking; and business environment reform (in each case by three of the bilaterals). Because of this diversity, common lessons learned will be summarized across intervention types.

Lessons learned concerning PSD support

Result measurement frameworks often did not allow impacts of different types of intervention to be adequately assessed or compared, particularly in relation to support's overall objectives (Finnish A4T, EU, Norway, Netherlands, UK PSD).

Projects with a clear focus on poverty, based on mapping of incidence and spatial distribution, and/or on improving access to land, employment, basic and essential services or markets, were rare. But, as in 'Making markets work for the poor' (M4P) approaches they performed as well as, if not better than, other PSD projects, particularly where supported by macro-level interventions (IFC, UK PSD).

More attention should be paid to support for SME-oriented business environment reforms, other than accelerated business registration. Where provided, support to collateral registries, digital payment systems, tax reform and simple dispute settlement all appear to have high impact (IFC, UK PSD).

In terms of sectors, lending for finance (including micro-finance) dominates (IFC, Norway, UK PSD). While high impact can sometimes be documented, sustainability – e.g., graduation – is often a problem for microfinance and insufficient attention is typically paid to downsides and risks to borrowers and their management (IFC, UK PSD).

Support to large-scale greenfield investments often has significant impacts – including on poverty (as well being sustainable) (Japan, Norway). However, its favoured location – typically Middle Income Countries (Japan, IFC, Norway, Netherlands) – as well its additionality, is often problematic (Finnish A4T, EU, Norway, Netherlands). These problems are accentuated by risk-averse screening processes (Norway, Netherlands).

Matchmaking programmes usually face weak demand, in this case militating against proper screening while again skewing location (Finland, Norway, Netherlands). Failure rates were often high and, even where successful, individual projects tended to have high resource costs and only localized impacts (Norway). Cross-donor coordination of PSD support is very limited, and even within individual donor portfolios overall architectures are often confused and little centralized management or coordination is evident (Japan, EU, Norway, UK PSD, Netherlands).

PPPs

As some of the evaluations just considered show, a number of donors have supported large-scale greenfield private investment via concessional loans or other subsidies for many years. For bilaterals this type of support was typically tied, and administered through somewhat non-transparent dedicated funds. Since around 2010 some bilaterals have widened support to larger-scale private-sector investment to include grants, in return for investors committing to development goals and ceding some control over investment planning and monitoring to donors and sometimes other third parties. Sometimes also, FDI support has been untied in the process. Amongst donors, the term 'PPP' today is used mainly to describe structured mechanisms for organizing enterprise support in this way. There are at least 15 such donor mechanisms today, usually supporting 50-75% of new investments with sums in a range of \$0.25 - \$1.5 mn. A literature has emerged on the challenges of managing such mechanisms, including defining threshold development requirements, assessing additionality, defining balances of risks and responsibilities, and measuring impacts (e.g., Heinrich 2013, Brickell and Elias 2013, O'Riordan et al 2013, IOB 2013, 2014). Common conclusions here are that development threshold requirements are typically defined in terms of meeting development objectives in a very broad sense rather than being reserved to scaling up existing public-sector goods provision or addressing specific market failures; that while divisions of responsibilities are usually well-defined, clear arrangements for assigning risk are typically absent; that additionality is still not screened for in a meaningful or transparent way;^v and that result monitoring and investment supervision remain deficient.

Unfortunately, the lessons for PPPs that can be drawn from the evaluations of PSD reviewed are limited. Only three of these refer to PPPs, and none do so in detail. The Norwegian evaluation covers Norfund's investments in Aureos Capital and SN Power, of which the former was later sold to private investors and the latter (a joint venture with the partially privatised Statkraft) had at the time only one operation, described as 'minuscule'.^{vi} Norfund's support for Aureos is heavily criticized for lack of additionality.^{vi} The Netherlands evaluation complains that project reviews (on which it is based) provide insufficient information on types of cooperation with the private sector to break out PPPs as a category, but then observes that, where they could be identified, 'often the public partner (is) not...involved during implementation... (and) there (is) not always a clear agreement about distribution of risks and revenues' (IOB 2014, 14). The UK evaluation covers DFID's loan and equity participation in two new agribusiness operations in Tanzania involving Unilever and a local company respectively. Both of these were also in their infancy. It argues that DFID's co-

financing of new investments may be market-distorting, and that in any event DFID lacks the skills to properly evaluate and subsequently manage such investments. It is also implied that these projects may have been risky, although how they could be both high-risk and distortionary is unclear.

Notwithstanding measurement problems, impacts of some types of 'Building Productive Capacity'/PSD support may be substantial, although probably localized. This applies both to M4P-type interventions and to partnering in larger greenfield investment, where macro-level issues are also addressed. As well as showing they meet the general PSD challenge of additionality, 'PPPs' need to clearly allocate risk between partners and establish systems to jointly supervise implementation. Note that no 'PPP' in the evaluations reviewed included a recipient government as a partner; hence the term may be misleading.

CONCLUSION

- A4T policies and formalized priorities are better informed and more coherent than in the past, but A4T's largest share by country group still goes to Middle Income Countries.
- Econometric studies consistently show that A4T has a positive impact on recipients' export elasticity, although these impacts are limited. Of A4T categories, A4 infrastructure most consistently impacts exports, while A4 Building Productive Capacity has no significant impact. Studies also consistently show A4T associated with increased imports and reduced import costs. Thus, as with trade generally, there are losers as well as winners from A4T.
- Recent evaluations of A4T programmes identify ownership by national governments and national private sectors and combining approaches at different levels (national and regional and/or meso- or micro- with macro-) as critical success factors. In LICs, programmes need to pay greater attention to economic diversification, poverty reduction and mitigating trade-related adjustment costs. Measurement of results is seriously deficient.
- Recent Private Sector Development evaluations point to support to larger greenfield investment and to MP4/value chain interventions as having a range of positive impacts, although these may be localized. In respect of the growing popularity of so-called 'PPPs', more attention should be paid to explicitly allocating risk between partners and to jointly supervising project implementation.

- i Note, however, that only a minority of these have a focus on regional economic integration.
- ii Notably the Dakar–Diamniadio Toll Highway Project in Senegal (with IFC involvement) and the Lach Huyen Port Infrastructure Project in Vietnam (with involvement by the Japanese Ministry of Foreign Affairs)
- iii In some cases there is more than one version of the study reviewed. In all cases, it is the latest available version that is reviewed here.
- iv Note that the main DFID A4T programme evaluated was closed as a result of a finding that it had been seriously mismanaged. This concern is not examined here.
- v OECD's Donor Committee on Enterprise Development has recently sought to address this problem by issuing guidelines for assessing additionality (Heinrich 2014).
- vi SN Power has undergone substantial expansion since 2010, see www.snpower.com.
- vii It is unclear whether Norfund's 2012 divestment of Aureos, a private equity fund, responded to this criticism.

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SEMINARS:

'Social Movements and Civil Society', closed seminar, DIIS, 29.09.14

'Results Culture and Knowledge Management', closed seminar, DIIS, 3.10.14

'Multi-stakeholder Initiatives: Human Rights and Global Public Goods',
public seminar, DIIS, 20.11.14

'Aid for Private Sector Development in Africa: What Works and What Can Be Achieved?', public seminar, DIIS, 2.12.14

'Anti-gay Laws in Africa; Rights and Challenges', public seminar, DIIS, 12.12.14

'Udviklingspolitiske Tendenser', final seminar, Danish Ministry of Foreign Affairs, 17.12.14

'New Approaches to Foreign Aid in Conflict-Affected and Fragile Regions',
public seminar, DIIS, 18.12.14

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- Hoffmann, Kasper: The Role of Development Aid in Conflict Transformation



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