Aid effectiveness: determinants and strategies

Stephen Howes

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The big questions in aid

• Does it work?

• What is the future of aid?

• **How to make it work better?**
  – Aid volumes large and increasing
    • DAC aid $120 billion
    • Non-DAC about $10 billion
    • NGO aid about $70 billion
Introduction
Compelling, popular but conflicting prescriptions

• Sachs:
  – “Extreme poverty is a trap that can be released through targeted investments ... implemented as part of a global compact between rich and poor countries.”
  – “Harmonization of aid in support of a single MDG-based poverty reduction strategy is vital.”

• Easterly:
  – “[A]id cannot achieve the end of poverty”
  – “Don’t try to fix governments or societies.”
  – Aid agencies should be “individually accountable for individual, feasible areas of action.”
    • “the vaccines, the antibiotics, the food supplements, the improved seeds, the fertilizer”

• Collier:
  – Aid “part of the solution” “to turn the societies of the bottom billion around”
  – “aid should be assessed by its ability to promote reform.. at the country level.”
Huh?

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<th>Ambition?</th>
<th>Harmonization?</th>
<th>Governance?</th>
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<tr>
<td>Sachs</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Collier</td>
<td>Somewhat</td>
<td>Maybe</td>
<td>Yes</td>
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<td>Easterly</td>
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Aim for today

• To present a general **framework** for **understanding** the *determinants* and *strategies* for aid effectiveness.
  – To help us situate different reform agendas
  – And understand the trade-offs

• Limitations:
  – Judge aid from a developmental perspective.
  – Little to say about what aid should be used for: apart from governance.
  – It’s a framework, not an answer.
The framework
Principal agent framework

• Used for problems where one actor (the principal) wants to achieve a goal, but can only do so indirectly through another actor (the agent) who can’t be directly controlled, but who can be influenced through incentives.

• For example:
  – An employer and employees
  – Voters and their government
Principal agent framework applied to aid

• In aid, the donor wants to achieve objectives, but can’t do so directly.

• Instead, the donor has to work with or through the recipient (host) government to achieve outcomes.

• Note this does not mean that
  – the donor is more powerful
  – that donor has to actually give the aid to the host government
  – that the aid relationship is not a partnership
The aid scene in a principal-agent framework

Domestic interests

Donors

Projects

Host government

Outcomes
A simplified model

Domestic interests

Elections or other decision procedures

Donor agencies

Funds and conditions (≡aid)

Host government

Actions

Outcomes
Host governments as the weak link?
(“It’s the institutions, stupid.”)

Domestic interests

Donor agencies

Funds and conditions

Host government

Elections or other decision procedures

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Outcomes

Weak link?
The importance of domestic institutions for development (and aid)

- “Recognition of the importance of institutions was perhaps the key innovation in development economics in the 1990s.”
  - John Williamson

- “one of the compelling lessons of experience is that aid can only be as effective as the policy, economic and administrative environment in which it operates.”
  - DAC Review of 25 years of ODA (1985)
Donors as the weak link? ("It’s not easy being an aid agency")

- Domestic interests
- Donor agencies
- Host government
- Outcomes
- Funds and conditions

Elections or other decision procedures

Weak link?
Comparison of an education department and an aid agency

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<th><strong>Education department</strong></th>
<th><strong>Aid agency</strong></th>
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<tbody>
<tr>
<td>Geographical coverage</td>
<td>One country (or region within country)</td>
<td>Many countries</td>
</tr>
<tr>
<td>Sectoral coverage</td>
<td>One sector (or subsector)</td>
<td>Many sectors</td>
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<tr>
<td>Level of expertise (of sectoral and geographical area)</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Goals</td>
<td>Well-defined</td>
<td>Vague</td>
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<tr>
<td>Ability of funding to achieve goals</td>
<td>Moderate to high</td>
<td>Low</td>
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<tr>
<td>Number of policy choices</td>
<td>Few</td>
<td>Many</td>
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<td>Relationship to beneficiaries</td>
<td>Close (parents and taxpayers)</td>
<td>Distant (non-taxpayers)</td>
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Aid transactions as the weak link
(“Too many cooks spoil the broth”)

Domestic interests

Elections or other decision procedures

Donor agencies

Funds and conditions

Host government

Actions

Outcomes
The transaction costs of aid

• “Decades of experience in development assistance have shown that the impact on development is seriously reduced when aid relationships are poorly structured or aid delivery mechanisms are inadequately designed.”
  — OECD DAC

• In 2007, Prof. Ron Duncan undertook a review of assistance for economic governance in the Pacific. He found that:
  “country officials, mainly at a high level, were overburdened with visits by staff of international and bilateral agencies and their consultants on TA assignments ... The frequency of such visits is placing severe stress on the countries’ limited capacities and hindering their ability to undertake other work.”
Strategies to improve the quality of the host government

A. Link aid more closely to performance (create competition for aid)
   a. Use *ex ante* selectivity.
   b. Use more results-based aid

B. Improve the domestic institutions of aid recipients
   a. Demonstration projects
   b. Technical assistance
   c. Conditionality
   d. Strengthen civil society
Strategies to improve the quality of donor agencies

A. Strengthen the poverty reduction objectives of donor agencies

B. Make donor agencies more accountable
   a. More independent and rigorous evaluation.
   b. More transparency

C. Reduce the knowledge burden of donor agencies
   a. Be selective
   b. Decentralize.
   c. Encourage staff specialization.
   d. Do simple projects

D. Make donor agencies less discretionary.
   a. Support operational independence
   b. Selectivity.
   c. Reduce aid volatility.
Strategies to reduce transactions costs

A. **Harmonize donor activity.**
   a. Use of common procedures, including program-based approaches (SWAps)
   b. Selectivity

B. **Align with governments.**
   a. Use government systems to manage aid projects.

C. **Work more with non-government and private sector partners.**
Bringing it all together: how to improve aid effectiveness

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How the different reform agendas fit into this framework

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Limitations and trade-offs between aid reform strategies
Limitations of the institutional/host government approach

- Institutions are key, but what purchase does aid have on institutions?
- The governance paradox means that aid least successful in improving governance where governance is weakest.
- Conditionality and TA have shown their limitations. Will building demand for good governance be any more successful?
Limitations of the Paris Declaration approach

• The underlying principle of partnerships is an important one.

• But, the Paris Declaration has failed on implementation. 2011 OECD evaluation finds that
  – On harmonization “much further effort ... is required”
  – On alignment “limited if any overall increase”

• Key donors have reservations.

• Alignment only works if recipient government is effective.

• The way donors and recipients interact is shaped by the incentives they face.
Limitations of aid agency reforms

• The only strategy which will work in all aid environments.
• But the geographical disconnect which is the ultimate source of aid ineffectiveness can never be changed.
• Do we really always want to prioritize aid accountability over all other objectives?
• When does aid accountability become aid paralysis?
Everyone agrees on the importance of selectivity

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Some parts of the aid reform agenda are (relatively) non-controversial

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But the key reform proposals are contentious

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Impossibility theorems in aid

- Aid is either transformational or accountable.
- Aid is either harmonized and aligned or accountable.
Conclusion

• It is useful to think of aid effectiveness in terms of three groups of determinants -- donor, host, and transaction costs -- and strategies to influence each.
• Beware of both single and across-the-board aid reform agendas.
  – No single aid effectiveness agenda obviously dominates.
  – There are inherent and mostly unrecognized trade-offs between common aid effectiveness agendas.
• Limited generalizability means plenty of scope and need for aid research, though potentially limited returns.
Thank you

devpolicy.anu.edu.au (web)
devpolicy.org (blog)