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Aid as a Second-Best Solution

Seven Problems of Effectiveness
and How to Tackle Them

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February 2012

Abstract

Most rich countries developed without aid, and this 'self-development' has some intrinsic advantages. In today's massively unequal world, however, such an approach would imply very low levels of human development for several generations for many poor countries. Aid can therefore usefully be thought of as a necessary but 'second-best' solution. The challenge then is how to manage this second-best solution, particularly in the more aid-dependent states and the more fragile environments, in order to achieve sustainable results. The study examines seven problems that can limit the effectiveness of aid, and suggests possible ways of tackling them.

Keywords: aid, aid effectiveness, development

JEL classification: F35

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I am currently Chair of the Board of the Institute of Development Studies, and a Senior Research Associate at the Centre for the Study of African Economies, University of Oxford, and former Chair of OECD Development Assistance Committee, and former Director-General of the UK's Department of International Development, but this paper is not written in any of those capacities.

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1 Introduction

Until 1945, countries basically developed through using their own resources and through accessing international private capital flows. This was the history of most European countries, of North America, and of Japan after the Meiji restoration. This model has two key attractions: it guarantees ‘ownership’ of the development process by the local power structures, and it tends eventually through the social contract of taxation to encourage some form of democratic process, and thus an increasingly inclusive set of local power structures. At the same time, this self-financing model also involved highly exploitative relations with weaker countries by the colonial powers and others.

The various imperial structures created in the period from 1700 to 1945 were usually strongly geared to the interest of the metropolitan country, and seldom involved significant resource transfers to poorer areas other than for defence. In the British Empire, for example, dependent territories were expected to finance not only their own recurrent costs and development expenditure, but also the costs, including the pensions, of expatriate civil servants posted to them.

After 1945, first in Europe with post-war humanitarian aid (e.g. UNICEF) and subsequently under the Marshall Plan (Denmark received US\$385 million over 3 years, Sweden US\$347 million), and then in developing countries with the creation of bilateral aid programmes, IDA, UNDP etc., official concessional flows became significant for the first time in history. They are now not far short US\$150 billion a year, with the traditional donors of the OECD Development Assistance Committee (DAC), accounting for the bulk of the flows. There is much academic controversy over the effectiveness of these official concessional flows.

On the positive side, the ‘aid period’ which began in the late 1940s has seen the fastest rate of economic and social progress in human history despite the world’s population virtually trebling between 1945 and today. This process is continuing: thanks to economic growth, the number of countries in the low-income category fell from 60 to 39 between 2003 and 2009.¹ This progress is not mainly due to aid, which is typically just one often relatively modest input. But well-designed econometric studies do tend to suggest a statistically significant link between aid and growth,² even though only a part of aid is designed to contribute to growth in the near term. In addition, there are areas where aid has been particularly targeted which show particular progress (e.g. recent reductions in infant and child mortality following UNICEF’s pioneering work to reinvigorate immunization programmes—further scaled up by GAVI, and Global Fund successes in spreading insecticide-treated bed-nets in Africa etc.; or improvements in public financial management catalysed by the shift from balance-of-payments support to budget support, approaches with similar economic consequences but with very different incentive effects). It is no accident that studies which disaggregate aid tend to find stronger effects,³ and there is scope for more work of this kind. Given the very large

¹ As the ‘graduates’ include some very populous countries, one consequence of this is that most poor people now live in lower-middle-income countries (Sumner 2010).

² Arndt et al. (2010).

³ See e.g. Clemens et al. (2004).

increase in health-related expenditure, more work on how that links to health outcomes would be a particularly useful investment.⁴

However, claims about what aid can achieve have often been unrealistic, partly based on mis-applying the very positive Marshall Plan experience to very different institutional and political settings.⁵ Any assessment of aid has to start from a realistic appreciation of how societies and institutions develop, and an understanding that injections of external finance and expertise can only complement local resources, systems and processes. Some particularly rapid examples of aid-supported development progress have been driven by overriding the need to reposition countries in short order (for example Western Europe in late 1940s, threatened by the Soviet Union; South Korea and Taiwan in 1950s/1960s under pressure from North Korea and China; candidate countries for EU accession in 1990s/early 2000s). Aid has been particularly productive in cases of this kind, even where internal political situations left much to be desired. However, these situations are not the norm; and for many countries, not least those created artificially by the colonial powers, the sense of ‘urgent national mission’ is much harder to replicate. Some caution is in order over arguments that more aid is bound to be productive of better development outcomes—and indeed, most studies suggest that aid, like most other inputs, is subject to diminishing returns.

Many critics go further, arguing that almost all aid (perhaps excepting straight humanitarian aid) is counter-productive, usually based on concerns over its alleged effect of weakening national ownership and commitment, the danger of pushing up exchange rates to the detriment of domestic exporters, and sometimes also a concern that it can encourage too large a role for the state.⁶ Dambisa Moyo has been a particularly effective proponent of the ‘stand on your own feet’ approach to development, while Bill Easterly has documented many of the negative features of the ‘aid industry’.

However, the ‘self-financing’ approach to development has clear limits: successful self-developers of the recent past (the East Asian ‘Tigers’, Botswana, Mauritius) have usually been relatively well off in economic terms and with a strong sense of national

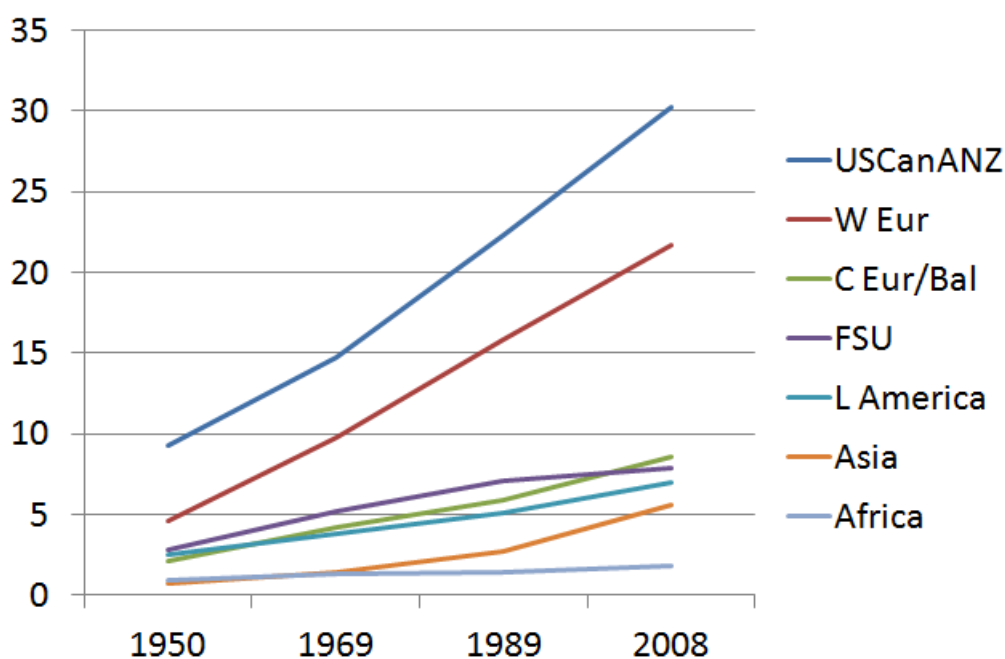
⁴ Arndt et al. (op. cit.)

⁵ ‘Claiming that aid is a panacea or, alternately, a Very Bad Thing, is a great way of selling books, but it’s also incorrect. There’s evidence to show that aid has some significant successes to its name and there is almost no evidence that well-given aid does significant long-term harm. Yet on the other hand, there aren’t any examples of aid having dramatically transformed particular developing countries. In reality, aid can help, but there are also many things it can’t do. Because aid can help we should keep on giving it. But at the same time we should also be much more humble about what we strive to achieve through it. Aid won’t end poverty and it won’t create well governed countries over-night. One of the best ways of ensuring the positive impact of aid is to accept its limitations. Be honest about what it can’t do and then stop wasting resources in these areas’ Wood (2011).

⁶ A further argument concerns ‘fungibility’. When aid finances an activity of sufficiently high national priority that the country would have undertaken it anyway, aid is arguably ‘really’ financing some other (by definition) lower priority item. There are longstanding arguments about the extent of fungibility, well summed up by Ian Little with the aphorism that fungibility is always more than the donor thinks but less than the recipient wants. Of course some types of aid (e.g. general budget support) are specifically designed to be fungible, based on the view that national priorities are reasonable (as is the case also with IMF programmes); some others (e.g. very large spending on vertical health programmes) will have some fungibility, but still seem to result in large ‘additional’ expenditure in the area of focus. In general, fungibility is more problematic from the donor perspective in countries whose national priorities may be considered seriously sub-optimal.

identity, which has translated into willingness to restrain consumption in order to invest for the future. A self-development approach by the most least developed countries (LDCs) would imply very low levels of human development for several generations (or reliance on dubious deals that mortgage a country's natural resources). There are both humanitarian and self-interested reasons (e.g. the handling of global issues such as migration pressure, insecurity, risks of infectious disease, climate change) why this would be bad news for rich countries in today's highly globalized world. The level of inter-state and inter-regional inequality is extremely high by historic standards (Figure 1), despite recent signs of 'convergence' in national incomes per head in PPP terms between slow-growing OECD countries and rapidly-growing emerging economies. The overall case for continued concessional inter-state transfers, provided that they are effective, therefore remains.

Figure 1: GDP per head by region (1990 \$)



Source: Author's figure using data from the Maddison World Tables.

I find it helpful therefore to think of aid as intrinsically a second-best solution as compared to 'home-grown' development, but still a necessary one given the impossibility of local resources financing basic government services in many poor countries (and the potential of relatively modest amounts of aid in transferring skills to lower middle income countries and helping them deal more appropriately with their own marginalized communities). So, to my mind the challenge for those involved in aid (and other inter-state official concessional transfers) is how to manage this 'second-best' solution, particularly in the more aid-dependent countries and the more fragile environments, by recognizing areas of weakness and by putting in place approaches which mitigate them.

This study therefore examines some of the problems which affect the effectiveness of aid,⁷ and considers what lessons we can learn from the experience of the past few decades and how we can individually and collectively manage this second-best solution in order to maximize its benefits and minimize negative aspects. This requires a hard look at what aspects of the status quo need to change. However, before doing so, it is important to consider the changing context within which such flows are provided.

2 Aid effectiveness: a changing environment

The international context for aid and other concessional international transfers has changed markedly over the years, important moments being the oil shocks of the 1970s, the debt crises of the 1980s and 1990s, and the collapse of the Soviet Union. Long-running demographic and economic trends are particularly powerful drivers of change.

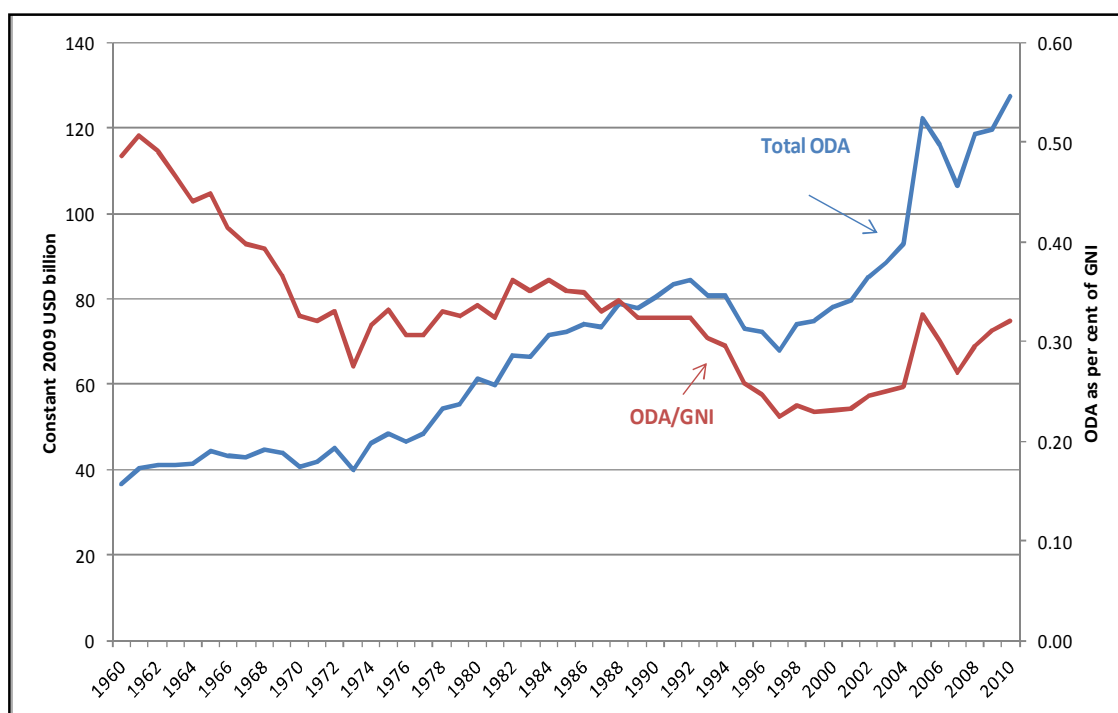
It is evident that at least two factors are currently reshaping the context for aid in a substantial manner. Both reflect the massive economic progress of the recent past, and in particular the outpacing of OECD growth first by the emerging economies and more recently also by the LDCs.

2.1 Changes in the supply of aid

The first is the changing patterns in the supply of concessional assistance. As Figure 2 shows, after a significant decline in real terms after the fall of the Berlin Wall and the diversion of attention to Central and Eastern Europe and the former Soviet Union, ODA from DAC members rose sharply to 2009 (leaving out of account the ‘bulge’ in 2005-06 caused by major debt write-off to Iraq and Nigeria in particular).

⁷ This study takes the usual course of equating ‘aid’ with Official Development Assistance (ODA) as defined by the OECD-DAC and analogous flows from other official sources, typically South-South co-operation on grant or highly concessional terms. Note that this therefore covers not just financial assistance (both for investment and for consumption) but also technical assistance, development-related research, training, assistance provided through non-governmental organizations and so on. (ODA also covers humanitarian aid, to which special considerations apply, and which is not considered in this study.) It should be borne in mind, however, that ODA exists in a wider and changing environment of other cross-border flows, such as private charitable transfers, remittances, foreign direct investment and debt-creating flows, whether from the bond market, from export credit agencies or from multilateral development institutions. Some of what follows is relevant in some respects to some of these other flows.

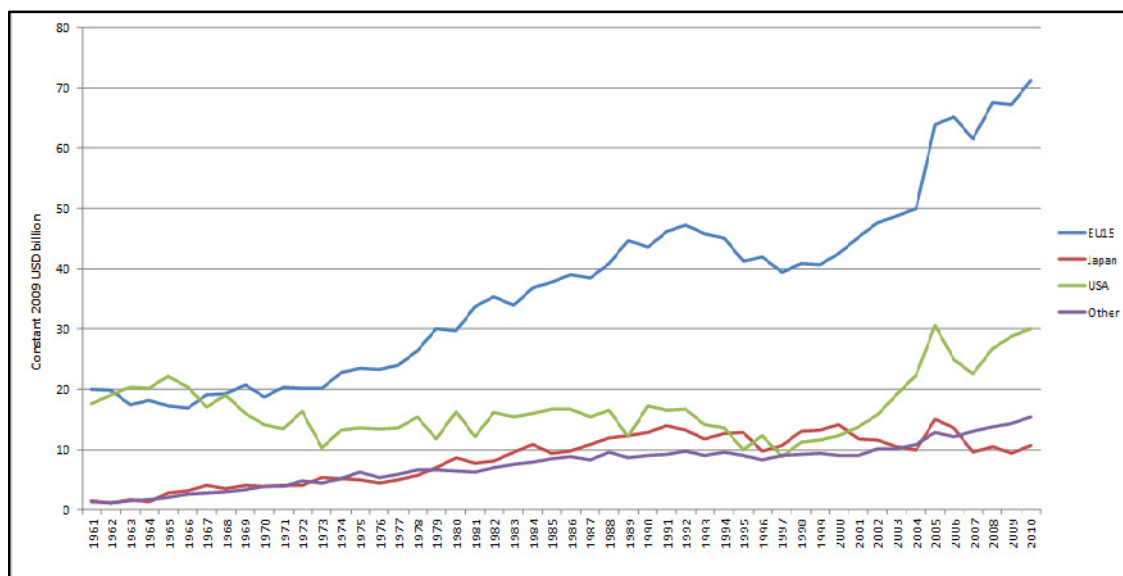
Figure 2: Official Development Assistance over 50 years



Source: This figure is reproduced here with the permission of OECD-DAC.

EU member states account for the largest share of the DAC total, though flows from the US, the largest single official donor, have also risen sharply in recent years (Figure 3).

Figure 3: DAC members' net ODA – 1960-2009

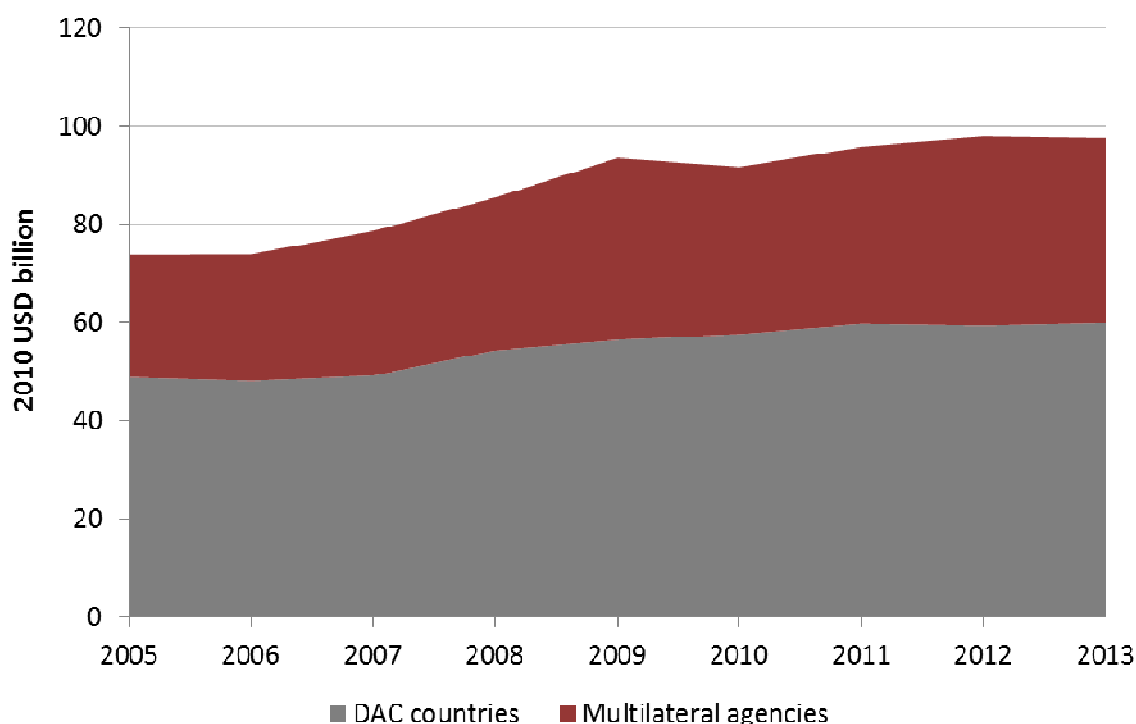


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However, the latest forward look by the DAC at likely levels of ODA that is planned on a country basis (country programmable aid, or CPA, which is measured on a gross basis) suggests a sharp levelling off of flows from traditional providers as many of these

countries experience low growth and major constraints on public spending across the board (Figure 4).

Figure 4: CPA 2005-2013 – actual (2005-10) and programmed (2011-13)



Source: OECD-DAC Aid Predictability Report, 2011. This figure is reproduced here with the permission of OECD-DAC.

In more detail, the real annual growth rate of CPA is expected to be at 1 per cent up to and including 2013 for both low-income and lower-middle-income countries (LMICs) compared to a 14 per cent annual growth for the past three years for the former and 3 per cent for the latter. CPA to upper-middle-income countries (UMICs) is projected to decline at a real rate of 1 per cent per year. Gross aid to China is expected to remain at US\$2.1 billion annually, though the net figure will be much lower. As Figure 4 also demonstrates, the multilateral share of gross CPA is tending to rise (from 34 per cent in 2005 to a peak of 40 per cent in 2009 as multilateral banks responded to the effects of the banking crisis, and a prospective 39 per cent in both 2012 and 2013), despite stagnation of DAC members' contributions to multilateral agencies. This is largely driven by two factors: first, the 'recycling' effect of the soft loan arms of the multilateral development banks⁸ and second the extensive use by bilateral donors of 'multi-bi' arrangements, even though their core support to multilaterals is at best stagnant.

Meanwhile, flows from Southern providers have increased significantly, and already in 2008 stood at some US\$15 billion a year (Table 1). This is still well below the proportions reached in the late 1970s when Middle Eastern donors briefly accounted for

⁸ MDB's gross soft fund lending increasingly reflects the now very large repayments on earlier lending. As countries graduate, this could lead to temporary self-sufficiency on the part of some such funds (Moss and Leo 2011).

over 25 per cent of total ODA and CMEA⁹ countries a further 10 per cent, but represents a major shift—and very probably this time a lasting one—away from what was a historically unusual near-monopoly of ODA-type flows by DAC members in the 1990s.

Table 1: South-South co-operation, 2008

| Provider | US\$ million | Multilateral share (%) |
|---------------|--------------|------------------------|
| Saudi Arabia | 5,564 | 10 |
| China | 3,957 | 2 |
| Venezuela | 2,330 | 0.4 |
| Arab Agencies | 1,024 | -- |
| India | 785 | 22 |
| Brazil | 437 | 14 |
| Kuwait | 283 | 8 |
| Thailand | 178 | 7 |
| South Africa | 127 | 40 |
| Others | 658 | n/a |
| TOTAL | 15,346 | |

Source: UN International Development Co-operation Report, 2010.

In addition, private charitable flows from both foundations and voluntary agencies, especially from North America, have also grown markedly (data supplied by DAC members give figures for NGOs based in their countries of some US\$22 billion in 2009, up from US\$15 billion in 2005, but other estimates are much higher).¹⁰ The Bill and Melinda Gates Foundation, in particular, operates at a scale that has significantly redrawn a good deal of the architecture of the international financing of the health sector. The largest US-based NGO, World Vision, has an annual budget of US\$2.57 billion and 46,000 staff.¹¹

The context for aid effectiveness is therefore much influenced by the rising, if still relatively modest, share contributed by countries and agencies other than the classic ‘traditional’ suppliers grouped in the OECD-DAC, although the latter remain overwhelmingly the main contributors to the multilateral aid system.

2.2 Implications of economic growth in aid recipients

These changes on the supply side have been matched recently by the second major change: robust economic performance over several years (despite the effects of the 2008 ‘Northern’ banking crisis) by most remaining low-income countries, including those in Africa. These countries are seeing rapid growth in domestic revenue (in Africa, now

⁹ Council for Mutual Economic Assistance: the collective aid organ of the Soviet Union and its Allies.

¹⁰ Worthington and Pipa (2010) give a figure of US\$49 billion for NGOs and foundations, based in just 14 DAC member countries.

¹¹ OECD (2011a).

some US\$450 billion a year, or roughly ten times aid flows, though this figure is skewed by South Africa). They have access to more sources of finance: not just non-DAC official providers and private charitable flows including from foundations, but also remittances and non-concessional flows such as FDI and now in some cases important debt-creating flows such as the bond market and export credits. For many of them, aid, still mainly from DAC members, will continue to be a vital and relatively stable source of development finance for at least a couple of decades, and the aid effectiveness agenda is thus still relevant. But the last time so many relatively poor countries had such access to non-concessional flows was in the 1970s, when many poor decisions were taken on both sides which led to the debt crises of the 1980s. A broader look at development effectiveness therefore needs to take account of how creditworthy recipients can be encouraged to use semi-concessional and non-concessional funds for effective investments. This covers everything from project selection and analysis, project design, management, monitoring and evaluation, as well as raising issues about the respective roles of the public and private sectors. Ways of encouraging safe borrowing are a high priority.¹²

2.3 Global public goods

However, a third factor could be equally significant. This is the gradual recognition by policy communities outside traditional development actors that the achievement of important global goals, whether in addressing climate change, the risks of infectious disease, migration, instability and so on, is likely to require significant transfers of concessional resources to poorer countries over an extended period. This potentially brings new resources to the table, but also exerts pressure on aid budgets to be reshaped to address the issue in question. Longer term, one may anticipate that an increasing proportion of international official concessional transfers will be earmarked for one or other global public good, and perhaps increasingly managed not by development agencies but by line ministries in richer countries responsible for the initiative in question. Many of the lessons learned by the provision of ODA seem likely to be relevant to such flows, not least the danger that local ownership may be weak where the donor specifies the objectives too narrowly. Involving different policy communities on both donor and implementing countries in addressing common concerns over effectiveness seems likely to become increasingly important.

3 Aid effectiveness: seven key problems

The aid literature suggests¹³ that while a high proportion of activities are successful in their own terms this is often not matched by country progress: i.e. aid ‘less than the sum of its parts’. Seven important characteristics of aid can, in my view, diminish its effectiveness. Many of these are relevant to other forms of international concessional flows, whose main purpose may be support of global public goods rather than development as such, as well as to at least some forms of non-concessional flows.

The seven problem areas are:

¹² See on this in particular Collier (2011).

¹³ Dating back at least to Mosley (1986).

- (1) aid can simply be inefficient;
- (2) aid can lead to dependence;
- (3) government-to-government aid may crowd out the private sector, and encourage the state to take on more than it can effectively deliver;
- (4) aid can weaken local accountability by strengthening the executive at the expense of countervailing forces;
- (5) government (and other) spending is open to malpractice and inefficiency in all countries, and particularly where institutions are weak, and accountability to donors trumps accountability to local stakeholders;
- (6) donors have mixed motives, including political influence, cultural promotion and commercial self-interest, which may affect the development value of their aid spending; and
- (7) aid can be an alibi for donors failing to take action in other areas where reforms would help developing countries more but may be domestically painful for them.

The remainder of the study addresses each of these problem areas in turn, and considers how the negative aspects of aid can be mitigated—in other words how best to manage this second-best solution.

4 Inefficiency

Aid can certainly be delivered in an inefficient manner. It would indeed be surprising if there were not significant inefficiencies when one considers the number of different donor agencies, bilateral and multilateral, number of individual activities, inter-donor competition, high transaction costs, predilection for commissioning consultants' reports, shifting donor priorities, and so on. The European Union stands out as an area where collective potential is not being fully realized, despite a very large collective aid budget and obvious scope for policy coherence. There are particular risks when money, even if limited, is apparently 'free', and needs to be committed or spent in line with donor budget cycles. Staff often move too frequently, long-term relationships are often poorly developed.¹⁴

No aid recipient wants to be heavily dependent on a single donor or a tightly-knit small group of donors. This is a real concern in some parts of the world, such as the Pacific. But in most aid-recipient countries the reality is the opposite: donor proliferation and duplication. The monitoring of the Paris Declaration shows that even such an apparently simple thing as more joint analytical work by donors involved in a sector shows very

¹⁴ A small but perhaps typical example was a decision by the UK in the late 1980s to engage in an innovative 10-year relationship with the University of the South Pacific. By the second year staff had changed, and the model was declared inappropriate. On the other hand, evaluations have complemented donors that have stayed engaged with specific sectors over a long period (see e.g. DANIDA (2005)).

little progress over the past five years. There are good examples of sector-wide approaches, delegated co-operation or harmonized monitoring and reporting requirements. But these practices are by no means the norm.

While attempts to have a more rational division of labour, organized by donors, have made some recent progress (see below), there has been too little discussion of what a pro-development allocation of concessional resources would look like: key dimensions being between low-income and middle-income countries and between well-performing and fragile ones. In any case, the increasing flows from non-DAC sources mean that more actors are involved in more sectors. And there seems to be no tendency for the average size of activities reported to the Creditor Reporting System to rise (though these figures are hard to interpret).

All in all, therefore, the harmonization aspect of the aid effectiveness agenda has made little progress. It is worth asking ‘why?’ It seems clear that some real-world incentives work against rationalization of donor effort.

(a) Bilateral agencies

Thus, for bilateral donors, diplomatic considerations may go some way to explain the fact that many of these donors still spread their programmes over a large number of countries; while the sectoral proliferation of individual donors at country level may be partly explained by HQ-driven pressure to be active in ‘popular’ sectors (which themselves change over time), and by the willingness of staff in donor offices to say ‘yes’ to suggestions that they take an interest in more sectors. The most effective countervailing incentive on the donor side will probably be the continued pressure to cut their own administrative costs, which for bilateral agencies may typically be by reducing country coverage. Indeed, signs of this are now visible, notably within the European Union, supported by discussions of a more rational division of labour.¹⁵ A more serious discussion of the rationality or otherwise of aid distribution is overdue, and could be assisted by some grounded academic work.

(b) Multilateral agencies

Simon Maxwell argued at the time of the Paris Declaration that the slogan should be ‘Don’t harmonize, multilateralize’; and increasing multilateral delivery could be one way to achieve rationalization. The trends here are interesting: on the one hand there has been little change in the percentage of donor aid going to core support for the multilaterals; on the other the share of gross CPA (which is more relevant than net ODA when considering aid delivery issues) delivered through multilateral channels is high and tending to rise. This is for two reasons. First, the soft fund model of the Multilateral Development Banks (MDB), despite the effects of a significant grant share, delivers constantly rising loan repayments to be recycled to a gradually shrinking clientele; and

¹⁵ The DAC report that ‘In total, 162 aid relations between DAC EU members and partner countries are expected to be phased out over the next few years, representing 8 per cent of DAC EU global CPA in 2009. Nine Partner countries in Europe are the most affected, with 25 per cent of all DAC EU aid relations to be phased out. Many of the countries in Europe are upper-middle income countries and some are already negotiating future membership in the European Union. The 2009 CPA volume corresponding to these aid relations represented 16 per cent of DAC EU aid to Europe. Similarly, nearly 17 per cent of all DAC EU aid relations in Africa are expected to be phased out in the next few years, corresponding to 6 per cent of all DAC EU aid going to Africa in 2009.’ (OECD 2012).

second, donors, despite frequent expressions of concern about multilateral effectiveness, continue to increase the amount of aid that is delivered by multilaterals under ‘multi-bi’ arrangements. This results from a series of ‘bottom-up’ decisions taken in institution-specific contexts. These are in turn influenced by ‘top-down’ decisions such as Germany’s ceiling of 30 per cent for its multilateral aid, or in some case by multilateral strategies (as with DFID’s Multilateral Aid Review). There is, however, no collective view on the appropriate balance between multilateral and bilateral aid.

Given the importance of multilateral delivery, we need a wider and more honest dialogue about how to improve its effectiveness—not only rationalizing the sundry methods used by DAC members to assess multilateral effectiveness¹⁶ but also building a real dialogue with emerging donors and not least with the recipients of multilateral aid about how to ensure adequate coherence at country level and improved delivery of aid. There is much that is good about many multilateral institutions, from increasingly inclusive governance to the provision of untied funds; but the scope for turf battles, institutional self-protection, poor personnel policies and the like is unfortunately large.

As part of this, there needs to be an appropriate balance between targeted international funds, as in health and climate change, and funding which is able to respond to poorer countries’ needs across the board or at sector level. Both have their place, but there is more work to do to deliver large targeted programmes in aid-dependent countries in a way that facilitates rational planning and sustainable delivery across the sector while still benefitting from the energy and innovation that such targeted funds have brought.

One ‘architectural’ problem is that there is at present no international forum with the scope to examine the effectiveness of the multilateral system as a whole or to assess competing priorities in a collective way, although the OECD-DAC is laying the foundations with an annual report on flows through the multilateral system. A particular priority should be to bring together the still too separate worlds of finance ministries and development agencies in support of this. This is a challenge that should be discussed further, for example between the OECD (both DAC and the Development Centre), the Development Committee, and the UN Development Co-operation Forum.

(c) The European Union

The European Union represents a special case and a special opportunity, not least because its members are collectively by far the largest contributors to aid finance, the European Commission provides more country programmable aid than either the World Bank or any individual member state, and fewer stakeholders are involved than in ‘pure’ multilateral agencies where representation is typically much wider and involves recipients as well as donors.

The European Union accounts for 16 out of 24 members of the DAC (the EU-15 and the Commission). During my chairing of DAC (2003-07), the only time when the EU spoke with one voice was at the Paris High-Level Forum on Aid Effectiveness, where a clear European position was extremely influential in the outcome. The inability of the EU, despite increasingly common approaches to development issues, to speak with a collective voice more frequently is remarkable. I remain depressed that opportunities to

¹⁶ It is encouraging that the most advanced such system, the Multilateral Organizations Performance Assessment Network (MOPAN), is moving into a new and closer relationship to the DAC.

rationalize EU representation in the International Financial Institutions (IFI)—with clear benefits to both Europe’s voice and the need to recognize the growing economic weight of Asian countries—were not taken years ago.

Equally, despite what appear to be genuine (and much-needed) improvements in the planning and delivery of aid by the Commission, Europe remains far short of what one might expect of a system delivering US\$13 billion a year to countries all around the world. Where is the counterpart to the Chief Economist of the World Bank, or maybe a couple of other top-level professional staff of international repute? Can the new institutional arrangements avoid a retreat into narrow political and commercial approaches? Is there scope for a real entente between the Commission and the European Investment Bank (which itself surely needs internal reforms to give proper weight to its sizeable but too often marginalized external lending)? And in a Europe where many member states seem bound to wish to sustain their own national aid programmes, can there be a more explicit division of responsibility between the central institutions and those of member states? It is ironic that the European Union has been central to the world’s largest inter-country reform project—the integration of the new member states, with all that has meant for institutional, economic and social, and political change—but still finds it so difficult to marshal its astonishing collective assets for sustainable development in poorer countries.

Finally, there are two areas where virtually all agencies could do a better job:

- (1) Too many decisions are taken under self-imposed time pressure—in the MDBs as a result of staff incentives to get a certain number of projects to the board before the end of each financial year; in most bilaterals by the need to spend in a particular financial year or to hit ODA targets in a calendar year. The UK has been fortunate in achieving a reasonable amount of ‘end-year flexibility’, enabling some degree of undershooting to be recouped in the following year. Of course, the problem applies to many other forms of government spending, but it can be particularly noxious when international commitments are concerned.
- (2) Staff in most agencies (and probably particularly bilaterals) move frequently, making it hard to sustain long-term relationships or, particularly where field offices have a good deal of discretion, to maintain consistent approaches. Agencies should reconsider their staff management practices to achieve an average length of time in post of say 4 years (this could mean e.g. promoted staff being compensated for not taking up their new positions immediately). The DAC could make a start by having average time in post as a statistic collected regularly from its members.
- (3) Too few bilaterals offer a sufficiently attractive career path to development specialists. Systems that are built on having senior staff revolving in from other specialisms (typically diplomatic staff) weaken the ability of the country concerned to tap the best expertise for its development programme. This is all the more regrettable as it is clear that where there is a reasonable career path, it is relatively easy for governments to build high-quality expertise in this area.

It is encouraging that new benchmarking tools are appearing (notably the Brookings/CDG Quality of Aid Index) which may permit a more pointed assessment of the factors which limit donor efficiency and effectiveness.

5 Dependence

Aid can lead to dependence. Extreme aid dependence (ODA in excess of 20 per cent of GNI) is rare except for small-island states and post-conflict situations (Table 2).

Table 2: Aid dependency – countries where net ODA in excess of 20% of GNI in 2008-9

| | 1998-99 | 2003-04 | 2008-09 |
|------------------|---------|---------|---------|
| Liberia | 25 | 44 | 132 |
| Afghanistan | -- | 37 | 46 |
| Burundi | 9 | 48 | 42 |
| Solomon Islands | 9 | 25 | 42 |
| Micronesia | 41 | 41 | 40 |
| Marshall Islands | 50 | 34 | 31 |
| Guinea-Bissau | 37 | 48 | 30 |
| Mozambique | 23 | 23 | 21 |
| Sao Tome | -- | -- | 21 |
| Sierra Leone | 14 | 36 | 21 |
| Palau | 50 | 17 | 21 |

Note: The Liberia figure for 2008-09 is distorted by debt write-off.

Source: Source: This table is reproduced here with the permission of OECD-DAC.

However, while in many parts of the world aid/GNI ratios have fallen quickly, there are a fair number of countries, mainly in Africa, which are not micro-states or conflict-affected, but where aid is over 10 per cent of GNI¹⁷ and the ratio appears rather stable, hence likely to decline only gradually (Table 3).

Table 3: Aid dependence – still an issue in Africa (% of GNI, but stable)

| Country | 1998-99 | 2003-04 | 2008-09 |
|--------------|---------|---------|---------|
| Mozambique | 23 | 23 | 21 |
| Malawi | 26 | 21 | 20 |
| Rwanda | 19 | 22 | 20 |
| Ethiopia | 8 | 19 | 13 |
| Burkina Faso | 14 | 12 | 13 |
| Tanzania | 12 | 16 | 12 |
| Uganda | 10 | 15 | 12 |
| Mali | 14 | 13 | 11 |
| Niger | 12 | 17 | 10 |
| Zambia | 16 | 20 | 10 |

Source: This table is reproduced here with the permission of OECD-DAC.

¹⁷ A more important statistic in some ways is aid finance (only a part of ODA) as a percentage of national budgets, which will typically be higher than total ODA as a percentage of GNI. However, I am not aware of an international statistical series which documents this in an accessible and consistent manner.

Such a degree of dependence brings the risk of ‘Dutch Disease’ effects which penalize the development of the tradable sector. It brings a particular risk that officials in donor agencies, even at quite low levels, may exert inappropriate leverage (or that top-level political interference takes place). There is also some limited evidence that grant aid (but not loans) may be associated with lower efforts to raise domestic revenue.¹⁸ Situations of aid dependency therefore needs both good technical management on both sides (mutual accountability, alignment, predictability, transparency etc.) but also psychological self-confidence and institutional competence on the recipient side and understanding on the donor side of the risks of abusing power. Most studies find diminishing returns to aid, as one would indeed expect.

Of course, the likely flattening out of ODA and CPA (see above) makes it very likely that aid dependence will fall significantly in the case of many recipients over the next few years. Indeed the latest DAC Report on Aid Predictability concludes that 19 countries are expected to see an increase in the CPA to GNI ratios from 2010-13, but that many more will see a decline.¹⁹ Nevertheless, the issue remains significant for a moderately large number of countries.

It is worth considering separately three kinds of situation where aid dependency is likely to be a persistent problem needing attention.

The first is the group of small, typically middle-income economies, most of them islands, where living standards have essentially been maintained by aid and remittances, where there are severe diseconomies of scale and often severe transport cost penalties, and where opportunities for self-sufficiency are poor. Such countries are probably the clearest example of aid causing Dutch Disease, but the alternative would be a very severe crash in living standards which would be strongly contested locally and often be unacceptable to metropolitan or former metropolitan powers. For some of these countries, it may be that it would be preferable to put in place a capital endowment (as in Tuvalu in the late 1980s, with the Tuvalu Trust Fund)²⁰ to underpin government revenue, and to encourage greater self-reliance than is possible when a budget is overwhelmingly dependent on short- and medium-term decisions by (usually) a very small number of donors. The number of people in these countries is small, even in aggregate, and it may well be worth some international capital investment, on a case by case basis, in order to tackle their inherent fragility.

¹⁸ Cohen et al. (2007).

¹⁹ OECD (2012).

²⁰ A Report by the Trust Fund Board in 2007 concludes that ‘In the first twenty years of operation the Fund has grown to US\$106.6 million in market value as at 30 June 2007. The real rate of return on the Fund has averaged 6.2 per cent per annum providing US\$65.7 million in revenue to Tuvalu. Of this US\$24.1 million has been used to help fund budget deficits, US\$29.2 million has been reinvested in the Fund and US\$12.4 million is held in the CIF awaiting drawdown as at 30 June 2007’. The Tuvalu Minister of Finance and Planning notes in his foreword that ‘The Fund has also been seen as an excellent alternate mechanism for delivering untied development aid to a developing country, and one that also promotes donor harmonization due to the way it operates. The government therefore invites further contributions from donors into the Fund in its attempt to continue growing the Fund’s capital’. Significantly, Tuvalu itself was already by 2007 the largest contributor to the Fund.

The second, and far more costly group, are the conflict-affected countries. The OECD has recently published the results of monitoring its own good practice guidelines for donors in 13 such situations. Its conclusions make depressing reading.

The report's key findings are that 'international actors need to give a big push to make their engagement more effective. While they have made progress in some areas such as promoting non-discrimination and aligning with national priorities and systems, they are persistently weak in others such as *exclusion* and '*doing no harm*' or in *meeting commitments such improving international co-ordination and staying engaged over time*'.

In addition, the survey identifies three issues that it sees as standing in the way of progress, namely that:

- Lessons learned and sound analysis often do not translate into programming because operational procedures remain too 'pre-packaged' and unsuitable for fragile settings or because the incentives for sustainable engagement are not there (e.g. allowing donor agencies to manage risk more consistently in fragile settings).
- Traditional approaches such as the MDGs and Poverty Reduction Strategy Papers are not always suited either: fragile settings require a sharp focus on a few priorities—at least in the immediate post-crisis—and these must include peace-building and state-building objectives to make any progress towards poverty reduction.
- Good international engagement alone is not a silver bullet: it needs to be matched by partner country leadership. This shift in paradigm is reflected in the recent push for a different way to engage emerging from the G7+ through its 'New Deal' proposal and set of commitments.²¹

As with the harmonization agenda, there is a disconnect between what most observers regard as good practice, and how donors actually behave. Admittedly, the issues are complex, and there is certainly no one-size-fits-all approach to be recommended. However, more disciplined and united donor support for emerging, locally-owned strategies has to be at the heart of any sustainable approach, and it is a matter for concern that this is often not evident, partly from incentives for individual donors to deliver 'their' results to the exclusion of broader results. At the same time, donors need to take a clear-headed approach to the competence of local delivery systems, where decisions need to be taken on what it is reasonable for the state to attempt to deliver and what is best delivered through other channels (and in both cases what safeguards are essential to limit risks of misappropriation). Ongoing research on service delivery in such environments will hopefully provide some pointers based on useful empirical evidence.

The attempt by members of the 'G7+' group of post conflict states to state their own position more forcefully is particularly welcome as a basis for better in-country dialogue in situations where aid is typically extremely large in relation to local tax revenue.

²¹ OECD (2011b).

The third group (some of them, such as Mozambique, successful graduates from the second) are relatively poor countries which have achieved a measure of stable development but remain significantly dependent on aid. They represent a key constituency that the aid effectiveness agenda has attempted to assist over the past several years. This agenda has made some progress at a conceptual level (the importance of host government ownership, alignment of aid to locally-driven priorities, greater predictability of aid flows etc. is now widely accepted), but, as the monitoring of the Paris Declaration makes painfully clear, has led to rather little measurable change of donor practices, and to only modest improvements in institutional performance in recipient countries. More energetic action is needed at country level, backed by continued external monitoring, to make a reality of the sort of 'grown-up' relationship between donors and such recipients that 'mutual accountability' was supposed to represent. Elements of such a relationship have been successfully developed in several aid-dependent countries, demonstrating that aid dependence at the sort of levels faced by many LDCs can be handled in a sustainable way where host governments pursue generally reasonable policies, build increasingly competent core institutions and manage their relations with donors in a well co-ordinated and appropriately assertive manner (a mark of most successful poor countries is their ability to say 'no' to inappropriate proposals from donors).

For some of these countries, Dutch Disease effects may be significant, and require appropriate treatment such as liberalization of imports and investing in cost-reducing infrastructure.

Areas for further attention include: developing mutual accountability processes that have some force; rationalizing donor activity between and within sectors; securing an appropriate mix of funding between recurrent transfers and capital investments and between stand-alone projects, sector programmes and economy-wide measures such as general budget support; and sustainable approaches to helping build capable and affordable institutions. Some of these countries may, following debt reduction and a few years of strong growth, be able to access limited amounts of non-concessional funding: ensuring that any such funding is used for carefully-thought out activities with a strong economic return will be vital in avoiding a further debt crisis a few years down the line (see below).

6 Crowding-out the private sector

Government-to-government aid may crowd out the private sector, and encourage the State to take on more than it can effectively deliver.

There are undoubtedly cases among the more aid-dependent states where the availability of aid has enabled the public sector to be a larger element of the economy than would otherwise be the case. In some of the more extreme cases of dependency, such as small-island economies, there may indeed be diseconomies of scale that mean that competent governance requires a public sector larger in relation to GNI than would be the case in a larger economy.

Such cases apart, the key issue is whether aid encourages governments to play a larger role in service delivery than is effective in terms of results as compared to delivery by

agents outside the public sector (which could range from religious groups and not-for-profit Civil Society Organizations (CSO) to the commercial private sector). Paul Collier has argued, for example, that donors may be unthinkingly applying a European model of service delivery by the state which may indeed no longer be viable even in Europe, and that a better model, particularly in fragile environments, would be large-scale contracting with non-State agents through some kind of independent service authority. There are certainly examples (such as the education programmes of the Bangladesh Rural Advancement Committee (BRAC) in Bangladesh) where coverage has been expanded through NGO routes far faster (and, in this case, it would seem with better quality and excellent attention to the needs of girls) than would have been possible through government. Equally, there are cases (such as health in Cambodia) where an initial expansion of coverage through NGOs has been replaced with an expansion of government services (in this case with an ‘internal contracting’ model). A collaborative research effort by Oxford University, the World Bank, DFID, OECD and the Overseas Development Institute is looking to draw some lessons about good practice from a set of case studies on innovative forms of service delivery in fragile environments. Collectively, we need to know more about what works and why in this area.

The recent DAC report on how its members work with civil society organizations²² shows that DAC-wide, over 30 per cent of food aid, disaster prevention and emergency relief, and for population and reproductive health (which includes large HIV/AIDS programmes) is channelled through NGOs. For other health sector interventions, the proportion is a little over 20 per cent, and for sectors such as education and environmental protection, the proportion is of the order of 10 per cent. The Global Fund, which specializes in tackling HIV/AIDS, Malaria and TB, devotes something like 33 per cent of its funds to CSO-led interventions. Whether such proportions are right, too low or too high, can only be established through more detailed work at country level.

Donors seldom provide ODA directly to state-owned enterprises which could be financed commercially, since tied aid to such enterprises was effectively banned by the Helsinki Disciplines of 1991. This has very probably contributed to the cull of state-owned enterprises across many developing countries, and encouraged the use of private finance for telecommunication, IT and major power projects. Consistent IFI advice has also encouraged divestment of commercial enterprises from the public sector. It seems unlikely that aid is encouraging ‘statism’ in productive enterprise.

7 Over-powerful executive

Aid can strengthen the executive branch of government at the expense of countervailing forces, with bad consequences for local accountability. This is the counterpart to donor officials having too much clout: a small number of key ministers and officials on the recipient side may become divorced from effective scrutiny by parliaments, civil society, media etc.

²² OECD (2011a).

This is an issue to be taken seriously, even if, as argued by Paul Collier in ‘Is Aid Oil?’,²³ aid is probably less vulnerable to causing perverse results than are large flows of cash from the exploitation of natural resources.

In principle, the response needed is obvious—to strengthen both formal and informal means of holding governments to account. Support is needed not just for elections but more broadly for representative institutions throughout the electoral cycle; not just for Parliaments but for audit bodies; for civil society institutions; for the media; for think tanks and universities.

A certain amount is already happening. Some 13 per cent (US\$17 billion) of all DAC ODA is delivered to or through NGOs, principally but not entirely ‘Northern’.²⁴ This is an impressive amount, but by far the larger part of this is for delivery of inputs (food, humanitarian relief etc.) through NGOs, and is unlikely to have a strategic impact on holding governments to account. Programmes exist for supporting parliamentarians, auditors, media and so on; the Hewlett Foundation is leading work on supporting emerging think tanks; and a good deal of support flows to universities through various channels, though there is scope for more work to assess how effectively it is helping to build competent and sustainable institutions of higher education. Some donors, including DFID, earmark some of their budget support for strengthening institutions that hold governments to account.

However, much of this work is one-off, not co-ordinated, nor particularly strategic (in the sense of changing local realities in a sustainable fashion). There is a good case for donors improving their support for parliamentary networks, for INTOSAI (the collectivity of Supreme Audit Institutions), and CSO networks such as the International Budget Partnership to improve in-country diagnostics and inter-country comparisons to help guide investments in some of these areas.

8 Ineffective spending

Spending by governments and indeed non-government organizations is open to malpractice and inefficiency in all countries, and particularly where institutions are weak, and accountability to donors trumps accountability to local stakeholders. In many ways this is a key and under-discussed aspect of the constraints to aid effectiveness. While donors have invested heavily, and with a degree of success, in public financial management—an area that is of evident concern from the point of view of propriety, and also susceptible up to a point to standard, targeted interventions—there has been less attention to inefficiency and ineffectiveness in actual delivery, not least by the public sector. This applies to both capital projects and recurrent activities. Whereas in many OECD countries, it is routine for national audit authorities to scrutinize the effectiveness as well as the propriety of spending, such disciplines are rare in poorer countries.

One positive aspect of aid is that it typically comes with some degree of outside scrutiny. While imposed conditionality has been shown to be largely ineffective,²⁵ the

²³ Collier (2005).

²⁴ OECD (2011a).

²⁵ See e.g. Killick (1997).

policy dialogue and application of knowledge from elsewhere that aid often brings can be extremely valuable. The dialogue between the World Bank and China in the 1980s, as the latter gradually opened up its economy, is a classic example. The association of capital investment with institutional and policy reform that has been a hallmark of MDB financing over the years has also been productive (though of course there is also controversy over whether the advice offered by the MDBs has been too influenced by particular schools of thought in developed country members of these institutions, who have typically had a controlling voice).

Another positive aspect of aid-financed activity has been the use of independent evaluation—typically almost unheard of in poorer countries for activities not financed with aid until very recently, the evaluations of cash transfer programmes in Mexico being a celebrated exception. The value of these evaluations has however been somewhat weakened by their donor-driven nature. Evaluation (particularly impact evaluation) commissioned by implementing countries rather than by donors (and ideally extending well beyond projects and programmes supported by aid) would be likely to feed back more readily into the reform and adjustment of programmes and to learning lessons from major capital projects. Building interest in and capacity for host-country-led impact evaluation is a high priority.

As in many OECD countries, the selection, appraisal, management and monitoring of major capital projects is often an area where performance is poor, due to lack of capacity and experience and/or perverse incentives (for example due to donor or local deadlines, to political interference or to opportunities for corrupt gain). These issues are all the more important where projects—or, still more, consumption expenditure—are financed through loan finance on market-linked terms, potentially leading to unsustainable accumulation of debt. As many low-income countries have unusually low levels of debt after the write-offs of debts incurred by the so-called Highly-Indebted Poor Countries, using their increased capacity to borrow in a sustainable way is of paramount importance. Donors and recipients should increase their attention to sound appraisal, management, monitoring and evaluation of capital projects, particularly where borrowing is concerned.

Clearly, the development of the capacity of key public institutions is needed if public spending is to be efficient and effective. The track record of traditional forms of technical assistance is patchy to say the least. There is typically too much attention to training and transferring skills to individuals, and too little attention to how institutions function, and to the environment within which they function. Two crucial, and insufficiently discussed, issues are:

- (1) how to enable key staff to operate productively (which has to do with objective-setting, delegation of authority, basic institutional systems and management culture, which are at the heart of institutional change); and
- (2) how to attract and retain competent staff, for which progress is a necessary but not sufficient condition. Many countries need to look again at salary differentials to enable the public sector to be a competitive employer of domestic skills; and donors need to refrain from poaching staff whose skills are in particularly short supply and be ready to accept some expansion of the public pay-bill in certain

areas, offset to the extent possible by a cautious approach to the levels of overall public sector employment.

The first issue is typically hard to fix quickly, and the second hard to fix politically. But given the importance of the good functioning of key public institutions, more effort needs to be made in both directions. For example, the combination of determined local leadership and a strong twinning arrangement with a competent external institution with a parallel function has much more potential than sending a few consultants or training mid-level staff in isolation. There are of course examples of more radical action such as setting up new institutions with special salary structures (Korea's Institute for Science and Technology in the 1960s; several revenue authorities in Africa more recently) or imposing external management on a temporary basis (the customs service in Mozambique). But these models cannot be used in more than a few isolated cases in practice.

In many OECD countries, following initiatives in New Zealand in the early 1980s, much reliance has been put on a combination of contractual-style agreements with public sector agencies and the use of various kinds of results framework. There are well-known examples of this approach causing perverse incentives, but well-designed objective setting and performance measurement is likely to be one important incentive for effective delivery where market disciplines are not available. There is however a clear danger that donors continue (and very probably increase) systems for tracking 'their' results, even when it will typically be difficult to track them effectively at least beyond output level. This approach has resulted over the years in the setting up of numerous and poorly co-ordinated monitoring and evaluation frameworks, few of which have proved sustainable once a project is terminated. There must be a stronger push to help countries develop their own results systems, open to local debate, and to use these as the basis for the necessary accountability to donor parliaments, auditors and the public. The regional development banks have been developing 'regional communities of practice' in management for results over the past few years, and this development should be encouraged. Donors should see themselves as co-investors in the development enterprise, and be ready to take credit not just from individual projects which they have financed, but from (for example) sector-wide approaches that they have helped to support and which have clear measures of achievement.

While it may often be necessary to set targets at output level, not least for reasons of effective management, there is potentially greater value (and less distortionary effect) in outcome targets. The Millennium Development Goals represent the first international attempt at a multi-country outcome framework. The evidence is that this has had a major impact on discourse, and probably a modest impact on behaviour of both donors (reinforcing, for example, attention to child and maternal mortality) and on at least some developing countries (a significant number of which have 'customized' the MDGs).²⁶ The impact of such frameworks should not be oversold, but at the same time it seems to be non-negligible.

That being the case, the design of any post-2015 results framework needs careful attention, not least since some aspects of the MDG framework are widely held to be sub-optimal (for example the lack of attention to educational achievement, to productive

²⁶ See e.g. Manning (2009).

infrastructure, or to empowerment, exclusion and vulnerability). Many groups are now studying ideas. I have suggested elsewhere²⁷ that at least six changes are desirable:

- Instead of one-size-fits-all targets which are ‘imposed’ from New York, it would be preferable to set some agreed minimum targets for key parameters to be achieved at global level, and positively encourage individual countries or groups of countries to set their own targets for these (or additional) parameters, at regional or national level. This would strongly encourage local ownership.
- The headline goals should be cast in terms of outcomes—so that for example minimum levels of educational achievement by a set age would replace ‘output’ goals such as school attendance.
- A clearer poverty focus should be built in to the design, so that targets cannot be achieved merely by shifting people just below some target level to just above it. Options include a weighting system, systematic disaggregation of reporting at least by gender and income, or setting targets explicitly for, say, the lowest quintile of the population.
- The perception that the MDGs prioritize welfare over sustainable growth and access to infrastructure services should be tackled by setting targets for access not just for water and ICT but also for transport and energy.
- Consistent with the Millennium Declaration, a new framework should take the human rights and empowerment dimension explicitly into account.
- The inadequate ‘Goal 8’ should be replaced by a set of ‘enabling conditions’ that would facilitate achievement of the new goals, and require action by governments of both rich and poor countries.

More broadly, the question needs to be addressed as to whether any post-2015 framework should not be universal in character, rather than posed solely in a development context whose relevance should hopefully decline over the medium term.

9 Mixed motives

Donors typically have mixed motives, including political influence, cultural promotion and commercial self-interest, which may affect the development value of their aid spending. The tendency is to admit to this ex post (US Cold War objectives, European commercial competition) or to blame others (Chinese interests in African natural resource exploitation) while still allowing a good deal of it to persist. These mixed motives pose particular dangers at a time when aid is under threat domestically. During the DAC Untying discussions in the late 1990s, those resisting untying were prone to argue that tying was necessary to sustain public support for large aid programmes, while those promoting untying argued that, on the contrary, people were more concerned to see development results for poor people than benefits to large companies. While for a time the second argument seems to have had more traction, there are signs that the ‘mutual interest’ logic is having a revival, even in DAC member countries.

²⁷ Kapucinsky lecture, Prague, April 2011.

This tension is not surprising. Humanitarian situations apart, official bilateral international concessional transfers normally reflect a mixture of what might be called 'direct national interest', 'broader national interest' and a more altruistic 'developmental' concern with deep and chronic poverty.

Many aid programmes, particularly in their earlier phases, have been explicitly or implicitly driven by considerations of direct national interest, for example in securing political alliances or in winning attractive contracts. Such programmes are often favoured by 'the establishment' in foreign ministries, trade ministries and the commercial sector. In some cases, there is a win/lose situation vis-à-vis other donors (the Soviet Union versus the US over the Aswan Dam in the 1950s; mixed credit competition among European donors in the 1980s). In others there may be advantages to others than the donor and the recipient (e.g. pressure on closed economies to liberalize their import regimes), but the intervention is still justified very much in terms of the donor's national interest. This motivation may be legitimate (as long as it does not offend agreed disciplines, for example on aggressive use of aid to 'buy' contracts), but it can also be problematic. Too often it leads to commitments which may appear to make sense in a short-term perspective but will over time achieve neither sustainable development nor the donor's longer-term national interest. Obvious examples are investments in prestige projects which end up as 'cathedrals in the desert' or monuments to a failing regime; or attempts to buy political support that may win the vote at the UN, but prejudice future relations with the government whose arm has been twisted.

In practice, as DAC members have become richer, they have been more willing to accept restraints on their freedom to pursue aid-financed actions that impact negatively on other donors. Two key examples are the Helsinki Agreement of 1991, which made it virtually impossible to use tied aid to finance commercially-viable projects, and the DAC Untying Agreement for LDCs of 2001. The latter however illustrates a further relevant point: restraint on direct national interest is easier to sell in relation to countries which are far poorer than the donor and present minimal political or commercial opportunities. It is observable that major providers of South-South co-operation, where the income disparity with the recipient is far lower, regard 'mutual interest' as an entirely appropriate basis for their programmes.

OECD countries have also been willing to invest increasing amounts of their aid in funds designed to support broader national interests, which ultimately do benefit the donor, but have the characteristics of public goods, in that they are non-rival (no win/lose) and non-excludable (all benefit). Typical examples are the investment in tackling infectious diseases, the Montreal Protocol which has very effectively cut chlorofluorocarbon emissions, or the establishment of better surveillance of key economic fundamentals. This willingness to give weight to broader as opposed to direct national interest seems to be correlated with donor income. Middle-income countries are by no means indifferent to public goods (consider China's investment in energy efficiency), but at their moderate levels of income they will normally prioritize domestic actions that also have value for their own national concerns over investments overseas (non-DAC providers made extremely small contributions to the recent replenishments of the Global Fund and GAVI, for example).

Similarly, altruistic concerns about poverty and destitution in the world appear to be linked to relatively wide income differential between donor and recipient states (though even here, there are cases, typically related to state failure in poor countries of strategic importance, where aid may be driven by a direct national interest in the recipient state concerned). Poverty focus is now commonplace as an explicit motivation for aid from DAC members to least-developed countries, whereas other arguments are commonly used to justify continued support to India and China (such as the German view of them as ‘anchor countries’ with global and regional significance). Altruism is easier when the donor is vastly better off than the recipient: as OECD countries feel themselves poorer, they, like emerging economies, may look more strongly to their national interests, with the risk that this will undermine the effectiveness of their aid in promoting locally-led sustainable development.

9.1 How to address these problems?

It is important to reinforce the argument that actions that reflect direct national interest should not offend against the principles that encourage sustainable outcomes. (Indeed, actions that do offend against these principles may well come back to haunt the donor at a later date.) This is not too complicated in some cases (for example, in aid allocation, the tendency of former colonial powers to allocate relatively large proportions of their aid to former dependencies does not usually produce major distortions of overall aid, not least because aid from such countries has generally declined as a proportion of the total effort). But in some other areas, such as allocations driven strongly by security-related concerns or competition for contracts or access to natural resources, there are clear dangers of aid being used in ways that are unlikely to produce sustainable outcomes and where aid will eventually (as happened in the US after the Vietnam War) come into general disrepute.

Possible options include legislation defining the purpose of aid (as the UK), strong government statements which prioritize sustainable pro-poor development, and peer pressure through G8, G20, OECD-DAC and other forums. The OECD can play a role in three further respects:

- (1) by encouraging wider accession of non-OECD countries to the Export Credit Consensus which disciplines the use of tied aid credits for commercially-viable projects (this will of course require a significant political effort by OECD governments);
- (2) by scrutinizing more aggressively transactions reported by DAC members as official development assistance where the purpose may be questionable; and
- (3) by agreeing a new metric of concessionality of ODA. The present metric (a 25 per cent grant element at a 10 per cent discount rate, whatever the currency) is self-evidently inappropriate in the interest-rate environment that has prevailed now for many years (a substantial fraction of MDB non-concessional lending meets this standard and is excluded from ODA reporting only by a separate convention). It positively encourages DAC donors (and others who look at ODA as a performance measure) to put in place operations with a low level of concessionality. It should be replaced by a metric which takes account of the cost of capital in the donor country, as used (in slightly different ways) both by

the OECD Export Credit Group for the purpose of the Helsinki Agreement and by the IMF in defining concessional flows.

Greater use of effective multilateral channels reduces some political and commercial pressures, and should in general also be encouraged, though (as noted above) important issues do need to be addressed within the multilateral system in a more co-ordinated way.

A willingness by recipient countries to decline aid that is inappropriately tied to political or commercial conditions is of course also a potentially important safeguard, but it is all too easy for decisions to be taken that are convenient for a government in the short-term, whatever their longer-term consequences. (I have noted above the particular importance of effective use of debt-creating funds.)

A final discipline is greater aid transparency, an issue highlighted at the Accra High Level Forum in 2008 and again at the Busan forum, and strongly pushed by civil society and by some DAC members. The highest profile initiative is the International Aid Transparency Initiative (IATI), which after a slow start now has actual reporting available from some significant donors including the World Bank, the Hewlett Foundation and DFID, and plans by several other donors, including the US, to do likewise, to the extent that some 80 per cent of aid from the DAC will be covered. Similarly, more country aid platforms are being rolled out. These are welcome and encouraging developments. There is still a lot to do, even for DAC members, and information will often not be available at the crucial early stage of identification and initial development of proposals. IATI assumes that 'infomediaries' will emerge to make use of its data, but it remains to be seen what the real demand will be. In the longer term, stronger transparency in recipient countries may exercise a more powerful check on inappropriate uses of aid, but this will take time.

10 Policy coherence

Aid can be an alibi for donors failing to take action in other areas where reforms would help developing countries more but may be domestically painful for them: thus donors provide a growing amount of 'Aid for Trade' while failing to develop an intra-OECD consensus (never mind with the BRICs) on the Doha Round; and set up climate funds while not addressing their own carbon subsidies. Aid should not take away from the importance of policy coherence.

Most of the more aid-dependent countries have very little leverage on the decisions that the rich and emerging countries (now to some extent working together in the G20 forum) take on issues that affect them. How can the voice of the poorer countries (excluded from the G20 and locked into a G77 arrangement at the UN which merges their voice with that of emerging economies) be strengthened and development concerns brought more explicitly into national decision-making?

On the first point, the poorer countries need to improve their own collaboration and analysis, and raise key issues forcefully but on the basis of well-considered positions, whether in dialogue with G20, in international negotiations or in bilateral exchanges with key rich and emerging economies. The joint approach by many aid-recipient countries ahead of the Busan Forum and the initiative of the G7+ group of fragile states

in the same context are encouraging models. More could and should be done by the donor community to improve poorer countries' access to good analysis and to support effective institutions (national but also regional) which can help such countries to take up well-based positions on key issues of interest to them.

On the second point, rich and emerging economies should adopt more explicit systems for ensuring that issues of policy coherence towards poor countries are properly considered, whether through properly functioning administrative systems or by legislative requirement (as in Sweden). A G20 statement on policy coherence for development would be useful. This does not mean that in cases of a clash between national priorities and the interests of poorer countries the latter should always prevail, but the first essential is to ensure that the questions are asked at the right time. Development agencies can strengthen their own voice within government by bringing sound analysis to the table. Aid, while it should never be used as a substitute for taking policy decisions, can be useful in helping negotiating partners to respond to new opportunities; and it may thus improve the prospects of good outcomes. This can provide something of a two-way-street between aid agencies and other ministries which typically lead on policy issues of interest to poorer countries.

Two organizations which could play an even stronger role going forward are the European Union and the OECD. The latter is particularly well-positioned, as it follows through the mandate from its last ministerial meeting to strengthen its development impact, to ensure that coherence issues are identified, researched and discussed in all its relevant policy communities. The Development Centre could play a particularly important role by working with key committees to research difficult issues of coherence.

11 Assessing the aid effectiveness agenda

Several of the issues raised above have been topics covered by the international discussions on aid effectiveness that have been promoted by the successive High-level Forums of Rome (2003), Paris (2005), Accra (2008) and Busan (2011). What can we make of the effectiveness of the effectiveness agenda?

The survey information available from the three monitoring rounds carried out on the Paris Declaration indicators²⁸ is clear: while progress by aid recipients since 2005 has been modest, progress by donors on most of the indicators that affect them has been glacial. Even allowing for the evident weakness of some of the Paris indicators, this suggests that many donors have done little to change their behaviour since 2005.

This gloomy conclusion needs to be seen alongside the significantly more positive qualitative picture painted by the independent evaluation of the Paris Declaration.²⁹ This concludes that 'A large, diverse group of countries and agencies have continued to display a sense of shared ownership and responsibility for the reform campaign, and have invested a great deal of effort in it. Most of [the good practices] have been found to make sense for almost all 'aid' relationships. The Declaration's core principles and commitments have built on, reinforced and disseminated the earlier good practices of

²⁸ OECD (2011c).

²⁹ Wood et al. (2011).

different countries and donors and become widely accepted norms for good practice in development co-operation. They have also provided a common vision and a common language for change. In most partner countries these norms and supporting actions have helped launch or sustain reforms that countries find to be in their interest'. A strong cross section of the country evaluations also found evidence that 'Declaration type measures ... have contributed to more focused efforts, particularly at the sectoral level' and that 'those efforts had already contributed to better development results, with good prospects of being sustainable'.

These two assessments, seemingly disparate, can to some extent be reconciled by observing that the Paris 'norms' have indeed proved influential not least for aid-recipient countries who see implementation of these norms as squarely in their interest; but that donor reaction remains very mixed. The donors who were more enthusiastic supporters of the Paris norms may have already been largely applying them before 2005, while the more cautious remain so for a variety of reasons from genuine concern (for example about the quality of country systems) to the inertia common when rule books are strongly established. To a significant extent, the High-level Forum process has encouraged more aid recipients to seek a better balanced relationship with donors despite the natural asymmetries of power—Rwanda's system of annual assessment of the quality of donor performance being the most striking example of this approach in an aid-dependent country. But there are clear limits to how far this has led to real changes in donor behaviour in general, though the evaluation points to some encouraging results in some sectors, notably health.

Against this background, how should one assess the outcome of the Busan Forum of November 2011? In some ways, the Busan outcome might seem rather modest. The Forum recognized the unfinished nature of the Paris/Accra agenda, but came up with no radical steps to advance it. It broadened the discussion, correctly, to using aid to promote effective development—thus emphasizing the links between aid and other forms of development finance, but again did not develop any distinctive new approaches in this area. It is not clear that in itself the Busan process will have done a great deal to transform, say, the depressingly low percentage of countries where solid mutual accountability processes are in place. On some points, the language of Accra was stronger and more immediate—though by the same token the Busan language is the more realistic.

However, the Forum seems to have marked a real step forward in bringing the key providers of South-South co-operation into the discussion of how to make inter-country concessional flows more effective. While the specific consequences of this will become apparent over time, the agreement by all parties on a Busan outcome document that reflects the significance of South-South co-operation is something that may well be seen over time as a key step forward in encouraging an approach to managing relations between richer and poorer nations on our planet that can be more effective and sustainable.

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