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FROM HAND OUTS TO HAND UPS: MAKING AID EFFECTIVE

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Increasingly aid donors are concentrating on the effectiveness of development assistance. Rob Quinn discusses how coordinated, effective and tailored aid strategies are more important than the volume of aid in achieving the ultimate aim of poverty reduction.

Introduction

"More effective development assistance means improvements in the lives of hundreds of millions of people: more food on the table, healthier babies, more children in school. These are things worth fighting for – and properly managed foreign aid can make a big contribution."

J.E. Stiglitz (Dollar and Pritchett, 1998:x)

Aid, the transfer of finance, resources, and advice from the developed to developing world is, as with most things in life, not a simple issue. The assumption that heaping money indiscriminately upon poor countries will allow their citizens to escape poverty is not just incorrect but dangerous given the negative effect mismanaged aid can have. Over the past decade there has been a paradigm shift in both the way aid is managed and the underlying reasons for its distribution. The end of the Cold War, whilst resulting in falling foreign assistance levels, thankfully dampened a hindering element to effective aid: the strategic interests of donors. Though these interests are still apparent, focus has changed. The landmark paper "Assessing Aid, What works, What doesn't and Why" by Dollar and Pritchett (1998) commissioned by the World Bank in 1997 and overseen by Nobel laureate Joseph Stiglitz envisions a framework for aid implementation radically different in its objectives and ideas. In a nutshell, the paper argues for financial aid to those poor countries with the institutions and policies to make good use of such assistance. On the other hand, regimes lacking the capacity to dispense of funds effectively should be patiently provided with knowledge and advice in the hope that a scheme for using financial aid and competently governing their countries can be constructed

"Assessing Aid: What works, What doesn't and Why" excites with its argument that for every $10 billion invested 25 million people can be lifted from poverty, a huge improvement on the figure of 7 million prior to its release. The main question however is whether donors, both multi lateral institutions and countries are implementing these recommendations into their aid policies almost a decade post-publication? The answer stresses not only whether there is consensus on the issue, but also how aid strategies are increasing their focus on poverty reduction rather than the rich world's interests. Additionally, it is often thought that most poor countries are badly run and this is often cited as the main reason they are poor. Hence, what does the notion of ideas over money constitute and in what context can ideas be made effective? This essay will seek to answer these questions in line with a description of the new theories "Assessing Aid: What works, What doesn't and Why" puts forth. Furthermore, whilst aid is the most direct form of assistance its interaction with other foreign instruments of development (namely trade and collective security interests as suggested in the Human Development Report) will be briefly examined given that co ordination of interests on all fronts is undoubtedly the key to deep and lasting progress for the world's impoverished.

What Needs Changing?

Historically, aid has been implemented on the grounds of strategy and quantity flow. Its assessment has also been narrowly focussed on whether projects have been successfully completed and how much cash has been doled out. Intuitively perhaps this makes sense. If, for example, aid to Ethiopia has doubled since the previous year or a bridge connecting rural villages has been completed, how could this be seen as harmful? The fact is that aid dollars are worth different values to the poor in different countries (Harford and Klein, 2004). Without evaluating Ethiopia's strategy to deliver services to its poor how could increased assistance prove a success? Likewise a bridge built, whilst providing a needed resource, indicates in no way whether institutions have been strengthened or policy improved within a country so that future unaided projects might prove successful. The result of narrow focus has been an ineffective aid program (Dollar and Pritchett, 1997). Many of the developing countries most lavished in the past are among today's poorest (the Congo and Liberia spring to mind). Aid has even had a negative impact in many cases, crowding out the private sector by funding projects otherwise available under the market mechanism and causing dependence.[1] Donor fatigue following the cold war was understandable given the fact that aid projects seemed to be achieving little.

[1] Mismanaged food imports funded by aid (in many cases for emergency relief) drive down domestic markets disincentivising domestic production. (Guest 2004)

A mutual view that aid needed reform was consolidated by the World Bank in the publication of “Assessing Aid”. The paper’s findings, that is the basis upon which future recommendations for policy are founded, can be summarised in five main points (Dollar and Pritchett, 1997).

First, the notion of financial aid is in no way obsolete. However, it is crucial that it be directed toward a sound policy and institutional environment. At this stage it is quite important to understand how each of these terms is judged. Policy is indexed according to trade openness, budget surplus and inflation. Institutions are judged by rule of law, corruption and quality of bureaucracy. In environments where these are well implemented the paper claims that assistance in these environments spurs growth whilst improving health and education with a 1% decline in poverty for every 1% of growth achieved. This makes sense but encounters the difficulty that well run, poor countries are hard to find.

Second, aid can provide critical support to building these institutions and policies which are so important in making it effective in the first place. This places an emphasis on the goals of project aid. The traditional importance of cost and speed with which a project is completed take second place to the influence such a project has on the ruling institutions and policies within a country. A good reason for enforcing aid with this kind of ethos is that in most cases finances are fungible. That is the recipient does not spend them on those areas of public spending the donor had earmarked them for. Hence, building a framework through which finance can in the future be effectively funnelled to provide quality public service is the primary objective. Ultimately it is societies who decide their own fate, ‘buying’ policy is not considered favourable as helping to build it from within national institutions.

Third, it has been mentioned that poorly managed aid efforts have in the past completely depleted the private sector. On the other hand, where aid sufficiently complements the private investment through the provision of infrastructure, education and health services it has a ‘crowding in effect’. According to “Assessing Aid”, in a good policy environment each new aid dollar attracts a further two in investment. Aid programs additionally compliment by increasing investor confidence.

Fourth, decentralisation and participation in aid projects are seen to further improve institution building and aid efforts. This view concurs with that of Jeffrey Sachs, a development economist who established a mini project in the rural Ituri district of southern Kenya (Sachs, 2004). The project proved such a success because it had full government consent and drew on the needs of local people and responded to them whilst implanting ideas that supported the objective at hand. In this ‘bottom up approach’ the benefits of consulting with local and central levels over “doling out” policy and finance was recognised.

Fifth, the recommendation for ‘distorted’, i.e. poorly governed countries is that ideas work better than money. The report draws on the examples set by previous aid programs implemented regardless of policy and their failures to achieve progress. A staff intensive advisory approach is envisioned backed by resources sufficient only to stay in operation. It is here that “Assessing Aid” falls under the severest criticism for its subjective interpretation of aid’s impact on growth regression and adamant stance that finance is obsolete in poor policy environment. White and Lensink (2004) contend that a simple switch can be made in the equation the report uses to show how good policies make aid work. This flips the argument on its head by highlighting the need for aid to improve policy in a poor environment.

$g = \beta_1 + (\beta_2 + \beta_3 P)A + \beta_4 P + \beta_5 X + \varepsilon$: Policy impacting aid effectiveness

The following equation, representing A as aid, P as policy and X as other factors can be re written

$g = \beta_1 + \beta_2 A + (\beta_3 A + \beta_4)P + \beta_5 X + \varepsilon$: How aid can improve policy

That aid could impact policy in poor institutional/policy environments has deep consequences for “Assessing Aid” and its recommendations (White and Lensink: 2000). The potential ‘Trojan Horse’ effect of using aid to sneak institutional change under the radar could prove more beneficial and faster acting than advice. However, if this were not to be the case money would be squandered where it might have been put to use in a better environment. It could be that either interpretation is useful when attempting to improve poor performance through aid. One could argue that a polarising of bad governance does not exist, rather a spectrum including poor institutions, policies and grades from the bad to the awful. In this context a case sensitive approach could be adopted, finance and knowledge in one circumstance, pure advice in the other when trying to bring about institutional change.

Thus, “Assessing Aid”, especially when trying to assist poor regime countries is not without its critics. The paper is further attacked on econometric grounds, the indicators it uses in evaluating policy seen as too narrow and without real grounds for being more important than others.[2] How to put selectivity into practice is a further concern inadequately addressed. Whilst one country may have good policies and another has bad ones, the

[2] Whilst openness is an important indicator, level of investment in education does not figure in “Assessing Aid”.

former's may be disintegrating whilst the latter's improves. Little guidance is given on this issue. Nevertheless, the paper's findings and suggestions are profound and their general grounds for implementation credible. There also exist further measures however for making aid more effective. The Human Development Report argues for consistency and transparency on the part of donors naming irregularity in funding as a principle cause of ineffective aid (Watkins et al, 2005). Co ordination among donors, less self interest, more long term focus on policy and institution spill-over is an obvious way to make aid more efficient. The type of financial aid dispersed is also significant. Untied grants rather than loans or debt relief are concluded to be the best form of financial aid if implemented in a sound environment (Harford and Klein, 2004). More money in better policy environments, more ideas for the 'distorted', is currently regarded as the solution to the aid problem.

Are Donors Responding?

As outlined, recommendations have been in place for the past nine years. Additionally there are clear grounds upon which to gauge whether donors are following advice since evidence shows total policy negligence in aid allocation during the late 80s and early 90s. Results are encouraging. In a study comprising forty one agencies, both bi and multi lateral Dollar and Levin displayed a clear improvement in policy focus over the past decade. On the other hand poverty was targeted as much in previous decades with no increase. Their study found that little to no trade off exists between the two in donor selectivity, that is impoverished nations have not been compromised for middle income ones with better policy. This points out that well run poor countries are being increasingly targeted, in line with "Assessing Aid".

The most striking finding was the counter intuitive correlation between a country's aid effort[3] and its ability to direct aid towards poor, well-run countries (the ideal combination). Previous thinking centred around the idea that the more an agency had to disperse, the less scrupulous they were about selectivity. The counter argument which subsequently emerged suggests that donors with large aid programs relative to their country's size can grant so many resources because it is publicly recognized by their electorate that an effective job is being done and money being well spent. High effort donors also display sensitivity to policy index shifts by

[3] Aid effort is the percentage of a country's GDP devoted to development assistance, not the quantity it contributes.

developing countries. An increase in policy level was met with a fourfold increase in financial assistance from the top donors (Dollar and Levin, 2000). Whilst recognising a positive change in allocation, Harford (2004) attacks the indicators Dollar and Levin use in arriving at their conclusions claiming they are too narrow to accurately judge policy against[4]. There is, it would appear, a case for more rigorous assessment when judging country policy. Given that aid agencies use the same indexes as researchers shows how important academic rigour and accuracy are.

That the majority of donors are becoming more selective and hence improving aid quality is a positive sign. The continuing problem lies in the fact that effort does not necessarily translate into quantity (Harford and Klein, 2004). Small Nordic countries and multi lateral institutions dominate in terms of performance and effort. It is the large rich nations, namely the USA, Japan and the EU that the lion's share of aid is allocated by and they have some of the lowest efforts[5]. Resultantly, they achieve very poor selectivity scores for both policy and poverty suggesting that their aid programs (and therefore most aid programs) are proving ineffective. A further conclusion possibly drawn is that aid is still being used for predominantly strategic purposes, given the higher security interests these countries (namely the USA) possess abroad. Flying in the face of research, a re evaluation of foreign interests is thus necessary in order for large aid flows to reach destinations where they can actually lift people out of poverty. A wider look at development could in that context prove useful.

Aid + Trade + Collective Security = Development

An examination from within of what makes aid effective is crucial towards its improvement, no less important however are its partners in the larger development agenda (Watkins and Co, 2005). Aid, trade and security are interconnected and this section briefly seeks to examine the extent to which these further components can compliment good aid policy. As has already been mentioned, large donors are not directing their aid flows in line with recommendation and empirical evidence. Redefining security threats and strategic interests in terms of human over military security is a meaningful objective for superpowers controlling the worlds aid flows. That is, recognition of the fact that reducing poverty is the vanguard in the advancing of global security interests. Such a shift has the potential to profoundly effect not only the direction of current aid flows but also their volume with profound consequences for aid effectiveness as financial gaps are filled.

[4] The index used is the Country Policy and Institutional Assessment Index.
[5] The USA contributed just 0.16% of its GDP to overseas aid in 2004.

Furthermore, economic engagement (through aid) to less developed, potentially hostile countries not only encourages cordiality, it allows for political reconciliation and hence an improved security environment (Foley, 2004). A further shared interest between aid and security is the mutual need to build and strengthen multilateral institutions. In the case of aid, such institutions are the most effective dispensers, (Harford and Klein, 2004), in security terms membership to such institutions creates an environment for consensus and peaceful negotiation, discouraging conflict (Cooper, 2003). Multi lateral institutions (mainly the UN) also rely heavily upon the partnership between aid and security policies in post conflict situations where immediate infusions of development assistance backed by good policy strengthen new, weak institutions (Dollar and Pritchett, 1997). Aid's primary role in poverty reduction, it would appear has further uses.

Another complimentary aspect of development is trade whose benefits need no introduction. It is well recognised that specialisation and trade are the back bone of economic growth and even form a part of the policy index against which donors judge potential recipients. Trade hence directly compliments aid as it provides a mechanism through which nations benefiting from institutional improvement can raise further finance to funnel into their better services. Informal trade barriers such as poor infrastructure and lack of education are the very limitations aid aims to sustainably improve through its new capacity and knowledge building approach. It would hence seem reasonable that in a bid to maximise aid effectiveness, the rich world would open its doors to trade (Guest, 2004). Complementarily in improving aid effectiveness can hence be seen as critical.

The Need for Action

In conclusion, it is positive to note that in the last ten years, effective, policy and poverty orientated aid appears to at least be on the path to progress. Of concern however, are the methodological flaws apparent in such landmark papers as "Assessing Aid" upon whose recommendation aid allocation is decided. As a result screws need to be tightened and a more rigorous set of indices offered so as to optimally judge policy measures. Additionally, 'distorted' environments and how aid is to have a positive influence upon their policies and institutions need to be more carefully examined. Given the volume of impoverished people living within them, there may be consequences for increased global inequality as aid infused states take off while others are left behind.

The overarching principle that aid is a necessary tool in the fight against poverty does not appear to be in much dispute. This is a positive given that consensus and co ordination are hugely important to achieving poverty reduction, from academia to policy to implementation among donors. It is for this reason that concerns arising about the conclusions "Assessing Aid" draws, both on the grounds of how selectivity is to be applied and policy indicators better constructed, need to be addressed. Donors are changing their attitudes. Whether they are doing so to maximum effect and with a full appreciation of both the potential for the report's advice and its flaws is questionable.

Aid is ultimately about bringing people out of poverty. Further efforts to maximise volume and effectiveness, aligning objectives with trade and collective security are crucial. Not just for the cause of economic advancement do these efforts matter, but in the interests of humanity and moral integrity. Leaving the world's poor to their fate is not an option and aid remains the most direct way in which the outside world can positively influence their lives. Out of ideas must come action, *"Look if you like, but you will have to leap"* (W. H. Auden).

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