



# The role of smaller donors

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# Outline

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# 1. Introduction

- We start with two contrasting views on projects and, by extension, on smaller donors
- The first view pictures a variety of donors all happily doing development projects, and suggests the analogy of the market place
- The second view reflects the way projects are looked down upon in the new aid paradigm

## First view: small is beautiful

- Projects are an appropriate level for development interventions
  - level that matters to the poor
  - allows addressing local development issues
- Projects have learning spillovers
- Project proliferation is NOT an issue
  - dozens of poor countries, sectors, crosscutting issues
  - if anything: not enough projects to reach all the poor
- Development project = policy experiment (Rondinelli 1993)
- Small donors bring a healthy dose of competition
- When governments are committed, they will act in ways that are analogous to consumers in the neo-classical market
  - picking winners and dropping the losers
  - replicate successful project design features
- In countries with non-committed governments, projects allow donor to reach out to the poor, even if there are no spillover effects to government

## Second view: small is not so nice

*"Aid-recipient countries are becoming the beneficiaries of an ever-widening community of official donor agencies and international non-governmental organizations (NGOs). This sounds like good news, right? But according to recent research, the proliferation of donors may be having adverse effects on bureaucratic quality and the success of aid programs in aid-recipient countries".*

***"Aid is more effectively delivered by fewer donors"***

source: World Bank website on aid effectiveness,  
November 2006

## Some clarifications and a non-definition

- The focus is on bilateral donors
  - much of the analysis extends to multilateral and non-governmental donors
- We do not distinguish donor governments and agencies
- We exclude bilateral 'toddlers'
  - donors that are so small that fixed costs of active donorship (HQ and field representation, country expertise, sector expertise, distinct intervention cycle, ...) cannot be reasonably spread

## What is a smaller donor?

- We do not propose a precise classification
  - donor size is not dichotomous but a continuous variable
  - definition is partly subjective: donors 'feel' small
- Small donor 'syndrome'
  - donors who feel that they will 'get harmonized' under the new aid paradigm (2005 Paris Declaration)
  - and consequently suffer a loss of 'identity', 'visibility', 'value added'
  - such donors rather fund projects

## 2. Our argument

- The new aid paradigm, which we otherwise support, needs to positively address the project aid modality, something it does not
- This will not only improve its effectiveness, but will also have the useful side-effect of bringing in the small donors (and some of the very big ones) who feel uncomfortable with the present anti-project bias



## A 'portfolio' approach

- We think there are good arguments in favour of an 'aid portfolio approach' that includes
  - budget support: general and sector
  - SWAPs
  - 'new style' projects and programmes
- These different modalities reinforce each other
- We argue that smaller donors will find their niche in the lower range of this portfolio, and that this is also best from a collective action point of view
- Our approach may be contrasted with a 'purist' interpretation of the new aid approach that puts forward general budget support as the best aid modality for all

## 'New style' projects

The notion can be clarified with reference to the 2005 Paris Declaration on Aid Effectiveness, and in particular the 9 donor-related indicators

- Firstly, 'new style' projects satisfy those donor-related indicators that are project-friendly
  - 3. Aid flows reported on budget ✓**
  - 7. Aid delivered on time ✓**
  - 8. Aid untied ✓**
  - 12. Mutual accountability assessments in place ✓**

## 'New style' projects

- Secondly, they respect the spirit of the indicators that are not project friendly but can be made so:

**4. TA co-ordinated ✎**

**9. Programme-Based Approaches (PBAs) used ✎**

**10. Donor missions and analytical work pooled ✎**

- Thirdly, they intentionally disregard the two last indicators, that are anti-project:

**5b. National systems used 💣\***

**6. Parallel PIUs avoided 💣\***

### 3. The new aid paradigm in a nutshell

- Some key words in donor-recipient relations:
  - ownership (PRSP)
  - budget support
  - policy dialogue
  - ex post conditionality and selectivity
  - new M&E
  - mutual accountability
- PRSP and the H&A agenda?
  - fully compatible
- PRSP and the MDGs?
  - both address the same poverty agenda
  - but long-term institutional perspective of PRSP may clash with drive to score on MDGs

## 4. The theoretical arguments against projects

- From an institutional economics perspective, the arguments against projects can be broken down in two distinct sets, each addressing a particular collective action problem
- The first set of arguments looks at collective action problems on the donor side, and tends to assume that the recipient government is a development maximiser, but powerless in its dealings with, and eventually subverted by, donors
- The second set of arguments looks at the problem on the recipient side, and assumes that the recipient government is less than fully committed to development

## 4a. The donor collective action problem with projects

- The 'selfish donor'
  - we abstract from donors objectives that may conflict with the development objective, such as commercial and foreign policy interests
  - 'selfish donors' pursue development, but in ways that are visible and thus 'fake-attributable', in conformity with donor fads, and supervisable and accountable by donor standards, even when doing so reduces the development impact of aid
- Knack and Rahman (2004), Roodman (2006)

## The altruistic recipient government

- This is how Roodman (2006) models the recipient:
  - “We will assume throughout **for the sake of tractability** that the recipient is a development maximizer” (p.6, my emphasis)
  - In fact, and not surprisingly from the perspective of the new aid paradigm, it is a central authority such as the Ministry of Finance that is cast in this role, “(...) *It has the propensity to perfectly maximize development within the ambit of its powers, while the line ministries generally do not*” (p.6)

## How is development impact reduced?

1. Wasteful transaction costs imposed on the recipient
  - lack of standardisation of intervention cycles, financial reporting standards, fiscal years
  - excessive number of donor missions
2. Development planning weakened
  - national priority setting and planning undermined
  - fiscal planning: 'poaching' of recurrent cost
3. Public service undermined
  - 'poaching' of qualified staff
  - higher salaries in donor projects do not reflect higher marginal societal productivity



## What is the prediction about smaller donors?

- All donors internalize a fraction of the external costs imposed on the government by their own projects
- The smaller the donor, the less it feels the negative impact on its own projects
- Therefore the more fractionalised the donors, the more damaging selfish behaviour becomes
- In this sense, smaller donors are worse offenders than big donors

## 4b. The recipient collective action problem with projects

- Here the recipient is cast in the role of the villain
- From this perspective, projects are understood as a form of conditionality, imposed by the principal (the donor) on the agent (the recipient)
- The argument against is that such project conditionality is largely ineffective because of fungibility

## 4c. Some problems with the theoretical argument

- We will first make a general criticism of the model
- And subsequently address four specific arguments against projects:
  - transaction costs
  - development planning
  - public sector staff
  - fungibility

## Unsatisfactory modeling of the problem

- An optimising recipient, victimised by donor practices, is a fairly trivial case in the debate on aid modalities
  - the hypothesis echoes the institutional poverty trap theory (Sachs et al. 2004), but this is highly disputed
  - development states probably profit from any aid modality
- A realistic theory should exhibit the following features :
  - on the donor side: selfish donors
  - on the recipient side: governments that face a trade-off between the twin objectives of promoting development and staying in power, eventually through patronage

## In addition a realistic theory should

- allow for learning spillovers from projects, as well as negative spillovers (staff and recurrent budget poaching)
  - take into account information asymmetry between the donors and the recipients on local development actions by the latter, giving projects an additional ‘reality check’ spillover
  - envisage several modalities at the same time (BS and projects)
- Such a model, at least in its deductive mathematical version, becomes ‘intractable’
    - in plain language, this means ‘inconclusive’
    - in other words, the theoretical case against projects as a generic category is not entirely convincing

## Transaction costs

- All aid is subject to considerable transaction costs
- Not all project transaction costs are a waste of resources
  - e.g. reporting is useful for M&E and corruption control
  - the present absence of such 'transaction costs' in the case of BS is a major weakness, not a strength!
- Efforts at reducing wasteful transaction costs are welcome
  - Paris Declaration and its monitoring constitute a valid attempt to overcome this type of collective action problem
  - this a a crucial feature of 'new style projects' (supra)

## Development Planning

- The arguments in favour of planning at the higher than project level are correct
- The new aid paradigm is a major step forward in this direction
- If donors successfully address this issue through macro-support (GBS with policy dialogue and TA), then 'new style' projects become useful complementary tools

## Public service

- Brain drain can become brain gain if there is 'restitution' of staff, so the problem should not be overstated
- Nevertheless, donors' selfish poaching of high quality staff from the public sector is a problem
- The problem should not be associated with one aid modality (projects) only
- We hypothesise that the pitiful state of the public service in aid-dependent countries is more due to neo-patrimonial policy regimes than to donors
- 'New style' projects can reinforce rather than impede such reform



## Fungibility

- Three types of fungibility may be distinguished
  1. macroeconomic fungibility (effect of aid on taxes)
  2. sector fungibility (effect of aid on net sector spending)
  3. project-level fungibility (effect of aid on 'unbundled' project features such as know-how transfer, sound management, corruption control, beneficiary participation, equity, environmental sustainability)
- All types tend to get conflated in the discussion
- As a consequence, the theoretical argument is muddled

## And what if smaller donors start doing BS?

- They are welcome, in fact the new aid approach urges them to do so
- In a 'purist version' of the new aid approach, this mainly means BS
- However multi-donor BS creates its own problems
  - avoidable donor transaction costs (duplication of country analytical work, plethoric donor delegations to policy dialogue, etc.)
  - a serious collective action problem emerges if the recipient is not a development maximiser

The base-line data for the three recipient-related indicators for monitoring the Paris Declaration suggest that BS may indeed be subject to severe collective action problems

		2004 data	2005 data
1.	Operational development strategies	9%	19%
2a.	Reliable PFM systems	33%	26%
2b.	Reliable procurement systems	36%	na
11.	Results-oriented frameworks	4%	22%

## There are some counterarguments

- There are mechanisms of donor coordination that avoid some of these problems
  - joint multi-donor PAFs
  - joint monitoring and reviewing
  - combined with variegated donor response
- There are attractive positions ‘half-way in the kitchen’: co-financing, silent partnerships
- The problem is less acute or non-existent at level of sector budget support
- Yet the conclusion remains that the management of BS and especially the attendant policy dialogue and conditionalities become very unwieldy as the number of active donors increases

## 5. The empirical arguments against projects

Four types of empirical arguments will be discussed:

1. prevalence of fungibility
2. aid works in good policy environments only
3. micro-level evidence
4. aid proliferation lowers the impact of aid

## 5a. Fungibility

- It is unclear whether the argument of (sector) fungibility applies when the country is highly aid dependent
- Fungibility evidence is mostly of the macro and sector variety, and thus largely inconsequential in the case of 'new style' projects

## 5b. Aid works in good policy environments only

- There are indications that we can be more optimistic than that (Clemens et alii 2004)
- But it is undoubtedly true that aid works better in good policy environments
- This however is not an argument against projects per se, especially not under a 'portfolio approach'

## 5c. Micro evidence on projects

- Substantial evidence from project level suggests that projects benefit from donor inputs (Wane 2004)
- For a long time, micro evidence was dismissed as irrelevant because of 'overriding' macro evidence
- If there is no micro-macro paradox, then the micro-evidence is back in force



## 5d. Aid proliferation is bad

- Probably all in the aid business agree that there is unnecessary and harmful donor proliferation
- Empirical evidence that proves the negative impact is sparse and suggestive rather than conclusive (Knack and Rahman 2004; Acharya et alii 2006)
- Also this evidence cannot be construed as a criticism of projects as a generic category

## 6. Conclusion

- We agree with much of the current criticism of donor practices in the field of project aid
- In the dominant aid discourse this is however generalised into a criticism of projects as a generic category that is neither theoretically nor empirically founded
- We argue instead for a 'portfolio approach' of aid modalities that includes 'new style' projects , alongside BS and SWAPs
- In terms of the Paris Declaration, we basically say that alignment should be optimised, not maximised
- Our proposal has the additional advantage of allowing donors to choose aid modalities that correspond to their comparative advantage and that reduce collective action problems

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**Thank you !**

