

The New Aid Approach

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Seminar trainees 'attachés
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Day 1

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Introduction to the 3-day training

DAY 1 : The New Aid Approach (RR)

- Aid as a collective-action problem
- The new aid approach as a response to aid failure
- The major components of the new approach
- Where do we stand today?

DAY 2 : Thematic Issues (RR)

- The macroeconomics of aid
- The role of the IMF, WB and other IFI
- Cracks in the aid paradigm
- Lessons for Belgium

DAY 3 : The Politics of New Aid (NM)

- The importance of politics in development
- Good governance: technocratic and political
- Policy dialogue and conditionality
- The role of Parliament and civil society

I. Aid as a collective-action problem

I.1 Some collective-action theory

- The Tragedy of the Commons
- The Samaritan's Dilemma
- The proliferation of donors
- Aid as moral hazard

I.2 Collective-action theory in the debate on aid

- donor-donor
- donor-recipient

I.1 Some collective-action theory

- A collective action situation occurs whenever the input of several actors is required to achieve a desirable joint outcome
- A collective action problem occurs when actors choose actions that produce suboptimal outcomes
- Collective-action problems are pervasive in the private and the public sector

Some examples from development

- The Tragedy of the Commons
- The Samaritan's Dilemma
- The proliferation of donors
- Aid as moral hazard

Source:

Ostrom, E., Gibson, C., Shivakumar, S., Andersson, K. (2002). *Aid, Incentives and Sustainability*. SIDA Studies in Evaluation 02/01

Acharya, A., Fuzzo de Lima, A.T., Moore, M. (2006). Proliferation and Fragmentation: Transactions Costs and the Value of Aid. *Journal of Development Studies* 42(1).

Tragedy of the Commons

- Deforestation
- Overfishing
- Global warming
- ...

The Samaritan's Dilemma

		Recipient	
		High Effort	Low Effort
Samaritan	No Help	2,2	1,1
	Help	4,3	3,4

The proliferation of donors

"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

Aid as moral hazard

- Aid that is allocated on the basis of population needs rather than government performance allows incompetent or unwilling governments to mismanage the country and postpone reforms

1.2 Collective-action theory in the debate on aid

- Two types of collective-action problems are often invoked in the debate on aid
- The first is a collective-action problem among donors (donor-donor), and supposes that there are no problems on the recipient side
- The second is a collective-action problem between donors taken as a group and the recipient government (donor-recipient)
- However, as modeled, the two problems are contradictory

The donor-donor collective-action problem

- The basic notion is that of the 'selfish donor'
- This abstracts 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

The altruistic recipient government

- This is how Roodman¹ 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)

(1) Roodman, D. (2006). *Competitive Proliferation of Aid Projects: A Model*. Working Paper n°89. Washington D.C.: Center for Global Development

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 interventions
- 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

The donor-recipient collective-action problem

- Development motivation is regarded as problematic
- Here the government is the bad guy, and donors are the good guys
- From this perspective the existence of multiple donor agencies applying stringent procedures and controls, thus constraining the room of manoeuvre of the government, is seen as inevitable, even if it creates transaction costs
- This is an instance of a principal-agent problem, with the donor as principal and the government as agent

Contradictory collective-action models

- The two collective-action problems, as modeled, contradict each other with respect to the nature of the recipient government and of donors
- Public donor agencies are not unambiguously altruistic
- An optimising recipient, victimised by donor practices, is a gross simplification of reality
 - the hypothesis echoes the institutional poverty trap theory (Sachs), 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, and worse
 - on the recipient side: governments that face a trade-off between the twin objectives of promoting development and staying in power, eventually through patronage

II. The new aid approach as a response to aid failure

II.1 Aid history in figures

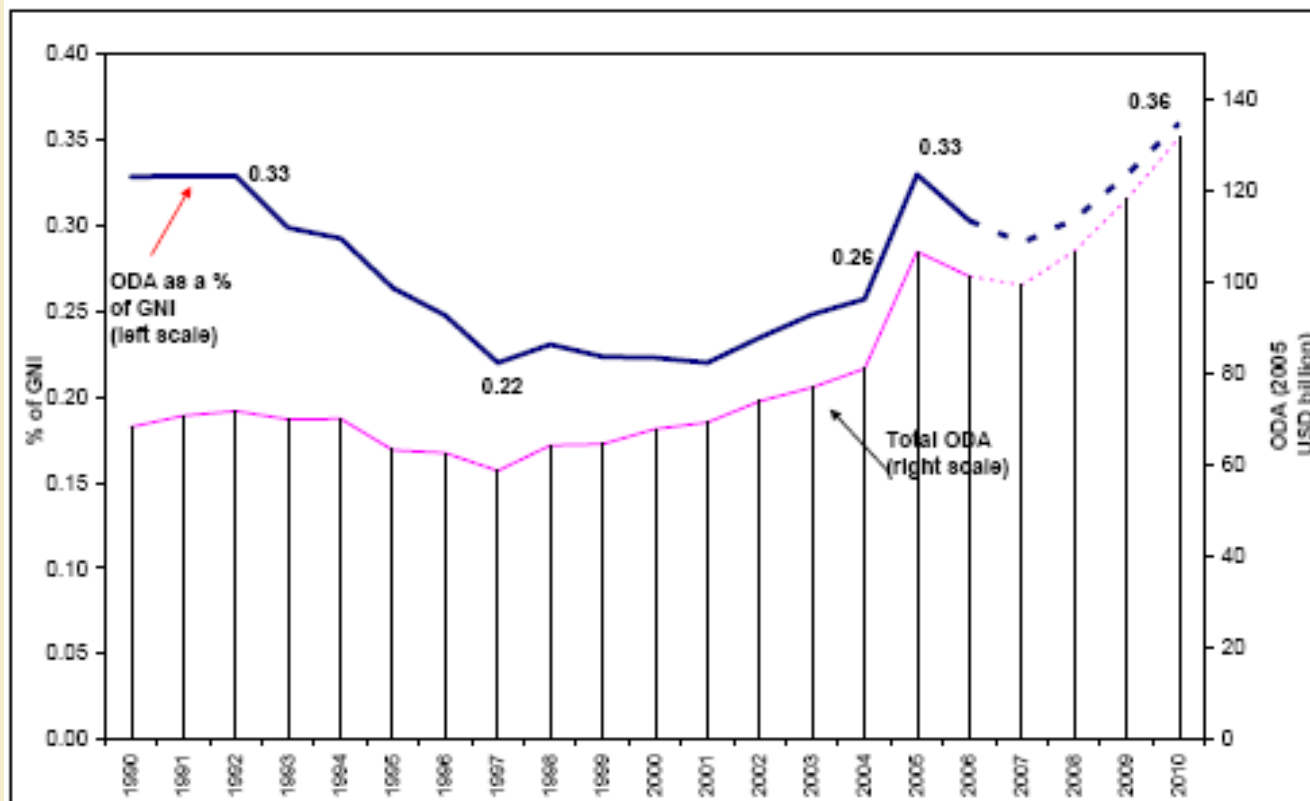
II.2 A classification of aid instruments

II.3 A classification of conditionalities

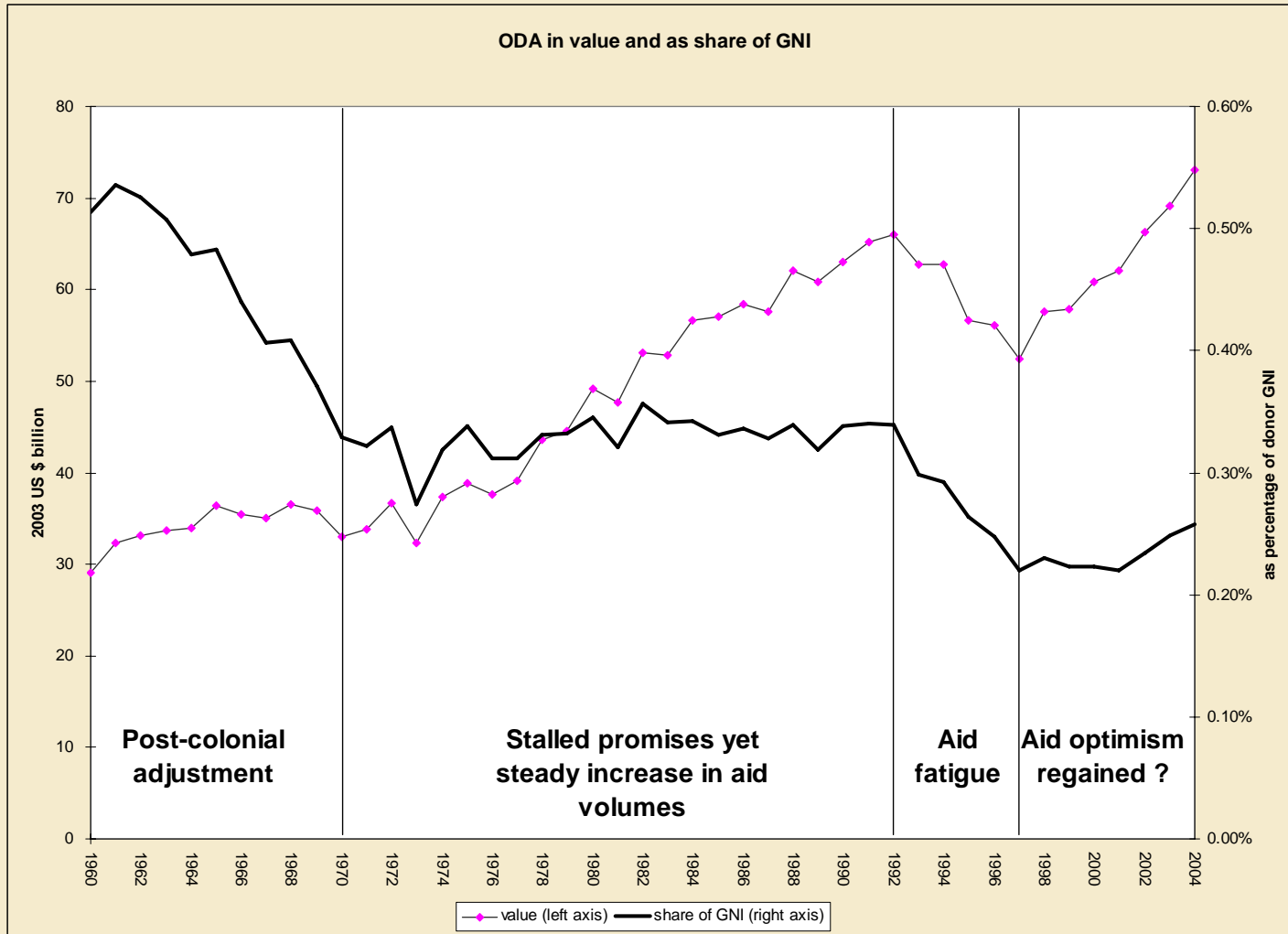
II.4 New aid as the third paradigm

II.1. Aid history in figures

CHART 2: DAC MEMBERS' NET ODA 1990 - 2006 AND DAC SECRETARIAT SIMULATIONS OF NET ODA TO 2010



Source: OECD, 3 April 2007.



II.2 A classification of aid instruments

Four characteristics of aid

1. Earmarking
2. Conditionality
3. Accountability
4. Implementation

Scale

- from 1 to 5
- increasing donor meddling

1. Earmarking

- [1] none
- [2] cross-sectoral
 - exclusion lists
 - pro-poor spending
- [3] sector
- [4] within sector
- [5] project

2. Conditionality

- [1] none
- [2] project conditions
- [3] sector
- [4] macroeconomic and social
- [5] political

3. Accountability

[1] none

[2]

[3] government system

[4]

[5] donor systems

4. Implementation

[1] regular government systems

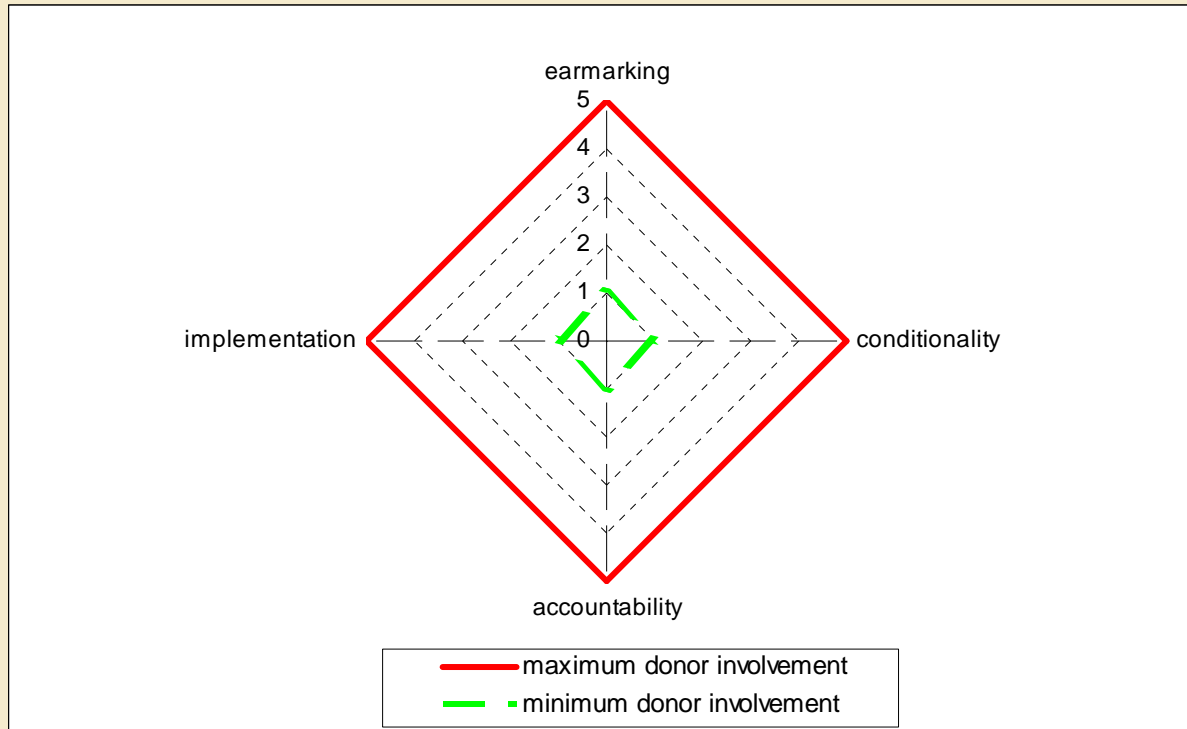
[2]

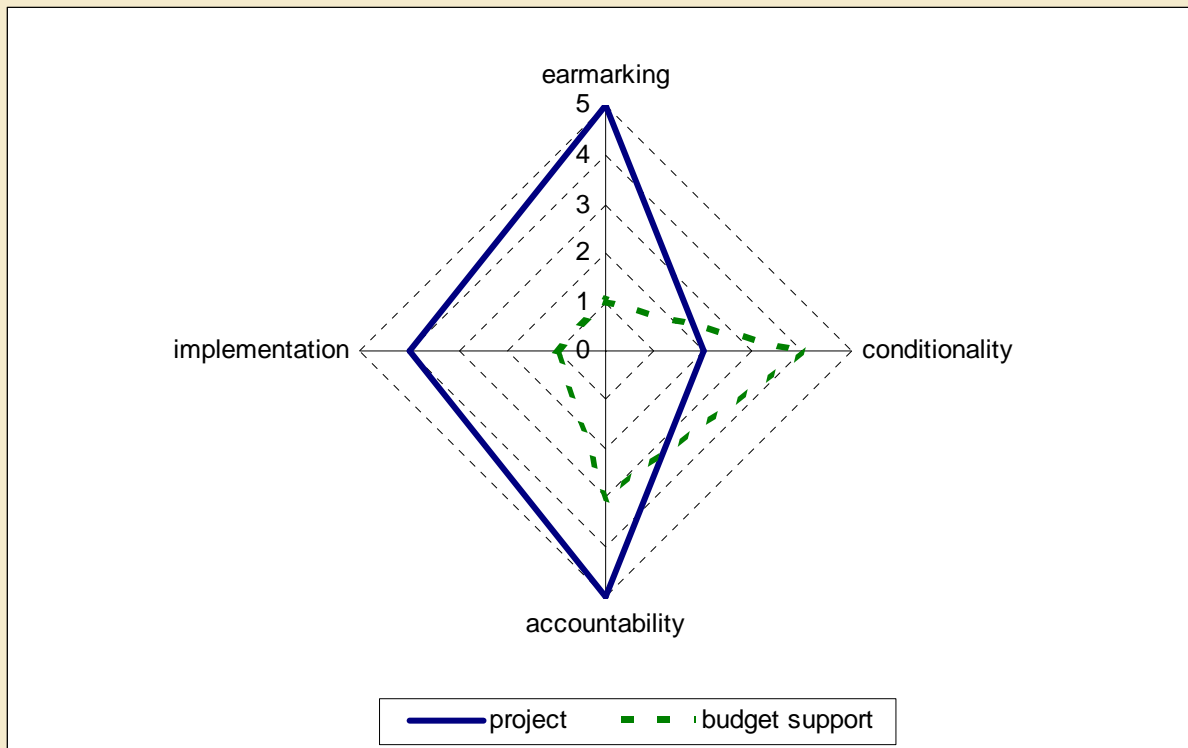
[3] specially created public agency

[4]

[5] donor systems

An aid characteristics diamond





The new aid approach is characterised by

- Limited earmarking and donor involvement in implementation
- A mixture of
 - budget support
 - TA
 - policy dialogue
 - conditionalities

Typical new aid mechanisms

- Deb relief
- Balance of payments support
- General budget support (GBS)
 - non earmarked
 - limited earmarking, e.g. pro-poor budget items
- Sector budget support (SBS)
 - or sub-sector
- Basket funding
 - donors
 - often using parallel systems
- Co-financing

II.3 A classification of conditionalities

- Focus
 - Micro
 - Macro
 - Political
- Timing
 - Ex ante
 - Ex post
 - Selectivity
- Topic
 - Input
 - Throughput
 - Output
 - Outcome
- Bite
 - Consensual
 - Unilateral

A cross-tabulation of timing and topic

	Input	Troughput: (1) process (2) policy action	Output	Outcome
Ex ante		(2) Multi-tranch WB SAL		
Ex post		(1) CS participation	EC variable tranche	EC variable tranche
Selectivity	MCA health spending	(1) MCA ruling justly		

II.4 New aid as the third paradigm

period	preferred aid modality	major constraint addressed
1960-1980	projects	<ul style="list-style-type: none"> - physical capital - human capital
1980-2000	policy based support	<ul style="list-style-type: none"> - macroeconomic policies
2000-	budget support	<ul style="list-style-type: none"> - ownership - governance

Why did donor-driven and managed projects not work ?

Strengths

- Allows addressing genuine poverty issues at local level
- Even in absence of a 'development state'
- Relatively simple to manage and supervise (log frame)
- High donor commitment
- High donor accountability

Weaknesses

- Weak national ownership (donor-driven priority setting)
- High donor and recipient transaction costs
- Institutional undermining of public sector
- Weak sustainability
- Fungibility (WYS≠WYG)

Why did structural adjustment not work ?

Strengths

- Sound macroeconomic management stressed
- Some technocratic governance issues addressed
- Institutional strengthening of public finance management
- Attractive modalities: budget support and balance of payments support

Weaknesses

- Government uncommitted
- Public opinion hostile
- Conditionality design faults
- Reform overload
- Long-term view on development missing

What were the major sins of donors?

- Selfishness
 - donors satisfy their own accountability needs at the expense of development effectiveness
 - they 'poach' scarce staff and recurrent resources
 - they undermine overall policy coherence
- Naivety
 - donors harbour the illusion that they can bypass a weak state and bring sustainable development results
- Arrogance
 - donors impose their own solutions (Washington 'consensus')
- Softness
 - sanctions are not applied and thus not credible

The answer from the new aid approach

- Policy reform agenda designed by the country
- Institutional strengthening of the state
- Downward accountability promoted
- Donors acting in unison
- Consensual or harmonious conditionality

III. The major components of the new approach

III.1 The comprehensive Development Framework

III.2 The Paris Declaration on Aid Effectiveness

III.1 The comprehensive Development Framework

Five core Principles

1. Country driven
 - National ownership
 - Civil society participation
2. Results-oriented
3. Comprehensive, but poverty is key
4. Partnership
5. Long-term perspective

Ownership

- Ingredients of ownership
 - locus of initiative
 - commitment
 - institutional capacity

- Levels of ownership
 - political leadership
 - government
 - state
 - society

Participation

Shift in focus :

Micro → Macro

Project → Policy

Beneficiary → Citizen

Consultation → Decision making

Evaluation → Implementation

	↗ ownership	↘
Civil society participation	→ pro-poor effectiveness	→ poverty reduction
	↘ accountability	↗
	↘democracy ↗	

Results orientation

- Results-oriented approach gives more autonomy and responsibility to the recipient
- Project aid: donors steer inputs and activities
- Budget aid: donors no longer steer inputs and activities and focus on outputs and outcomes is the only option

Impact	<ul style="list-style-type: none"> • Reduce mortality rates for children under 5 years old (dimension of poverty reduction)
Outcome	<ul style="list-style-type: none"> • Improved use of ORT for managing childhood diarrhea
Intermediate outcomes	<ul style="list-style-type: none"> • Increased maternal knowledge of ORT services • Increased access to ORT services
Outputs	<ul style="list-style-type: none"> • 15 media campaigns completed • 100 professionals trained in ORT
Activities	<ul style="list-style-type: none"> • Launch media campaign to educate mothers • Train health professionals in ORT
Inputs	<ul style="list-style-type: none"> • Trainers • ORT supplies • Funds

Comprehensiveness

- Key objective: poverty reduction
 - poverty diagnostic
 - what is poor, who is poor, poverty traps
 - why did policies not work in past?
- Macroeconomic conditions for growth
- Sector attention
 - health
 - education
 - agriculture, ...
- Crosscutting issues
 - gender
 - environment

Partnership

- Aid relationship is essentially uneven
 - just a case of 'donor-speak'?
- Long-term relationship
 - based on selectivity and thus trust
- Principles of good donorship
 - H&A
 - financial predictability
 - transaction costs kept low
 - flexibility and speed
- Mutual accountability

III.2 The Paris Declaration on Aid Effectiveness

- Starts from the premise that **bypassing** government with donor micromanaged aid is not the solution
- Neither is **bullying** government
- Endeavours to operationalise the new aid approach of **engaging with** government

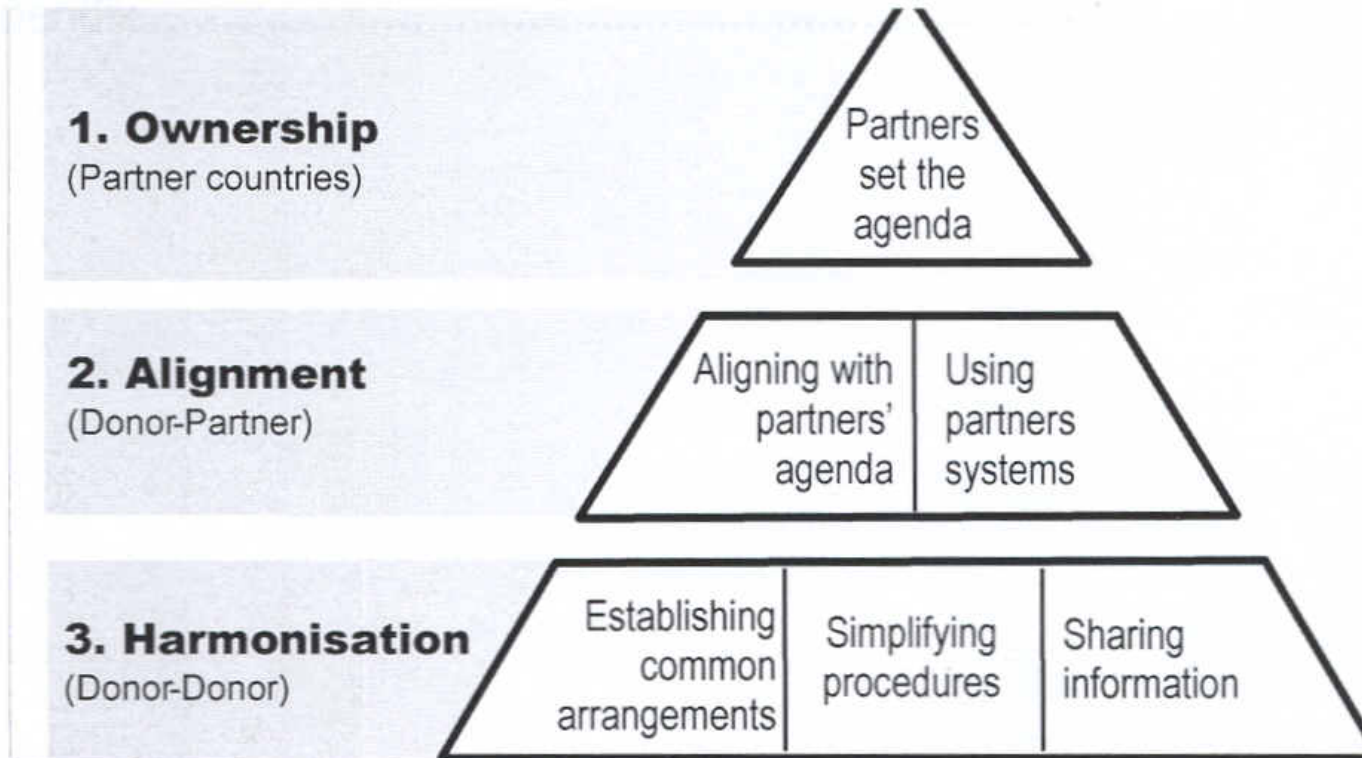
The Paris agenda

- Urges recipient countries to improve their
 - policy priorities (PRSP)
 - PFM systems
 - procurement systems
 - results orientation
- Urges donors to react by increasingly aligning and harmonizing their aid
- Budget aid is the 'flagship' among aid modalities when it comes to alignment

Harmonisation and alignment

- Harmonisation = among donors
 - establishing common procedures
 - simplifying procedures
 - exchange of information
- Alignment = between donors and recipients
 - national strategy setting and planning
 - national budgeting and implementation
 - national control and audit
 - national M&E

Figure 1: **The Rome Agenda**



Progress indicators

12 progress indicators



9 with respect to donors

3 with respect to recipients

Three recipient progress indicators (with baseline data)

		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%

This suggests that

- The new aid approach is a high risk undertaking
- Policy dialogue and assorted conditionalities will be key
- Success will require institutional strengthening and capacity building
- Donors should work closely together, not only on management, but also on policy issues

Progress indicators

12 progress indicators



9 with respect to donors

3 with respect to recipients

Some indicators concern **harmonisation**,
others **alignment**

Nine donor progress indicators

3. Aid flows reported on budget
4. TA co-ordinated
- 5b. National systems used
6. Parallel PIUs avoided
7. Aid delivered on time
8. Aid untied
9. Programme-Based Approaches (PBAs) used
10. Donor missions and analytical work pooled
12. Mutual accountability assessments in place

IV. Where do we stand today?

IV.1 Donor indicators

IV.2 Recipient indicators

IV.3 Aid modality indicators

IV.1 Donor indicators

- All important bilateral donors signed the Paris Declaration
- New aid approach is dominant at DAC and is supported by the World Bank
- The like-minded countries remain fully committed
 - Nordic countries
 - Netherlands
 - UK
 - Switzerland
 - Canada
- Some of the skeptics show interest
 - Germany
 - France
- But two big donors (US, Japan) only seem mildly interested

IV.2 Recipient indicators

comment: snapshot from mid 2006

- 63 LICs (low-income countries)
- 50 countries have full PRSP
 - of which roughly half from SSA
 - of which roughly half HIPC
 - four countries have a 2nd generation PRSP
- Annual Progress Reports
 - first: 34 countries
 - second: 20 countries
 - third: 6 countries
 - fourth: 1 country

IV.3 Aid modality indicators

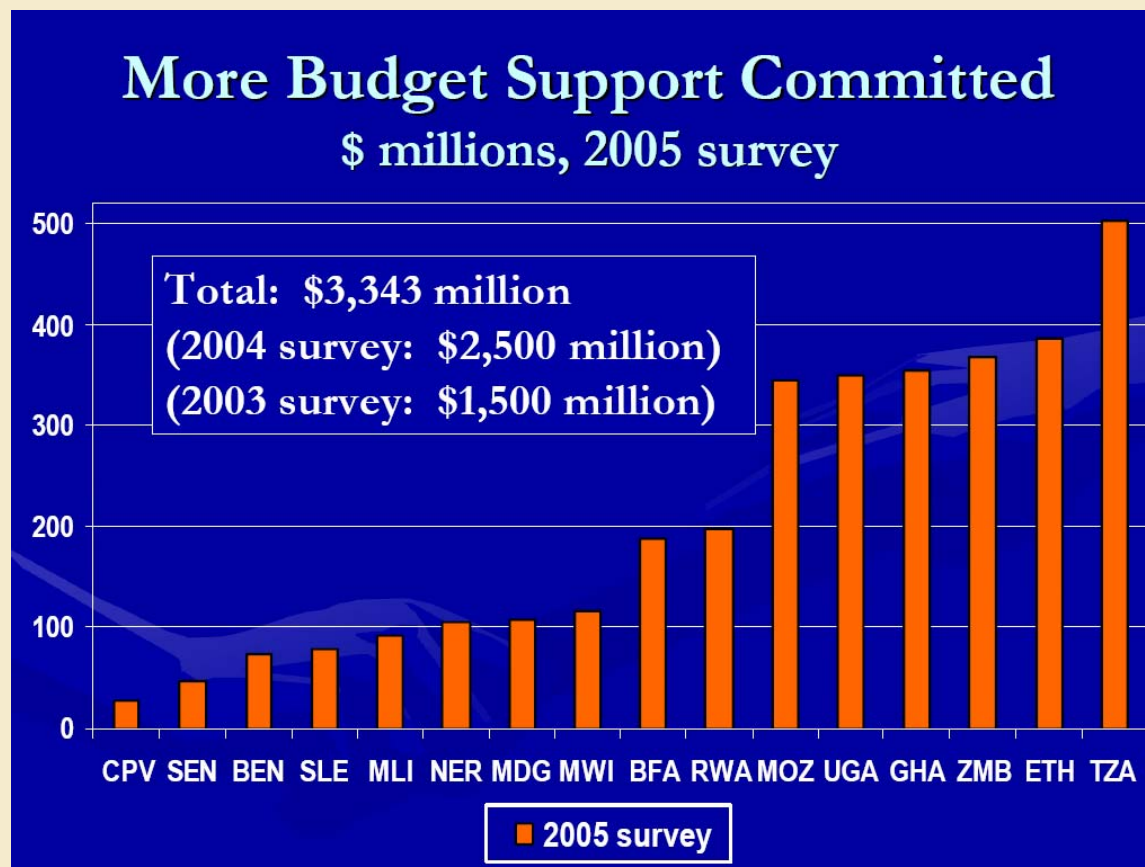
Table 1. ODA for Sector Programs, General Budget Support and Debt Relief
(Commitments, US\$ million at 2004 prices, 2001-2004)

Type	US\$ amounts (2004 prices)				% of total commitments			
	2001	2002	2003	2004	2001	2002	2003	2004
Sector Programs ⁽¹⁾	641	1,984	5,404	14,666	1%	2%	6%	15%
Low Income	199	774	1,591	7,854	0%	1%	2%	8%
Middle Income	441	1,105	3,645	6,011	1%	1%	4%	6%
Unallocated	0	105	168	800	0%	0%	0%	1%
General Budget Support	4,847	5,850	6,395	5,249	7%	7%	7%	5%
Low Income	3,919	4,853	3,635	4,631	5%	6%	4%	5%
Middle Income	913	990	2,745	608	1%	1%	3%	1%
Unallocated	14	8	16	11	0%	0%	0%	0%
Total General and Sector Support	5,488	7,834	11,799	19,915	8%	10%	12%	20%
Debt relief	5,582	8,504	17,778	8,570	8%	10%	18%	9%
Low Income	2,962	5,263	14,771	7,578	4%	6%	15%	8%
Middle Income	2,601	3,102	3,003	899	4%	4%	3%	1%
Unallocated	19	139	4	93	0%	0%	0%	0%

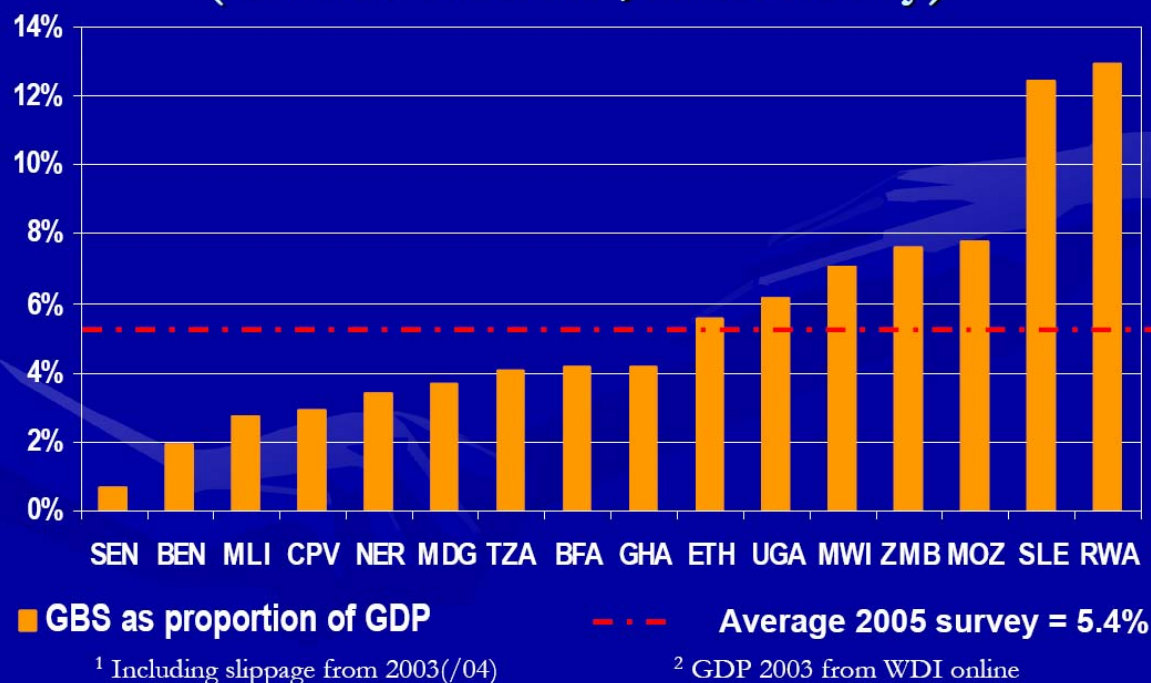
(1) Excluding debt relief and general budget support to avoid double counting. Only commitments with no investment or TC components.

Source: CRS Online (Table 1)

The following slides are based on information from the Accra 2006 and Ouagadougou 2007 SPA Annual Conferences

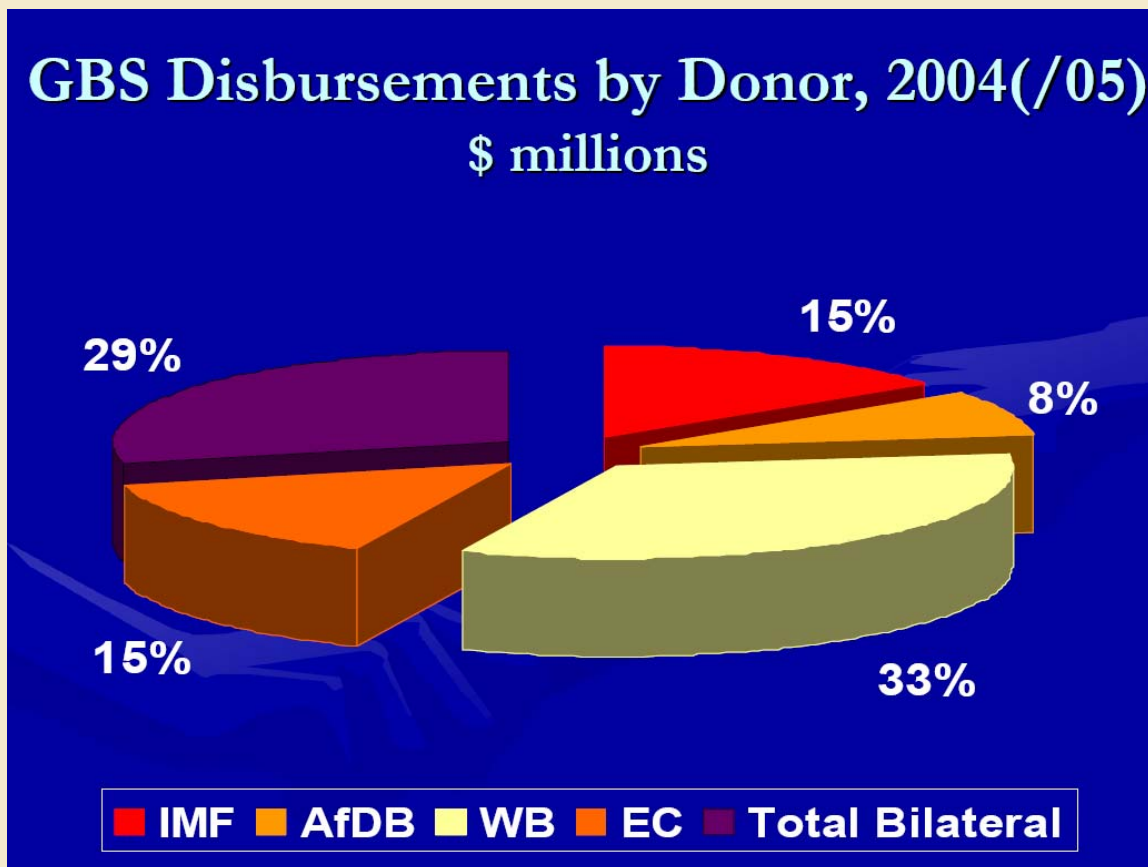


Significant Dependence on GBS (GBS as % GDP¹, 2005 survey)

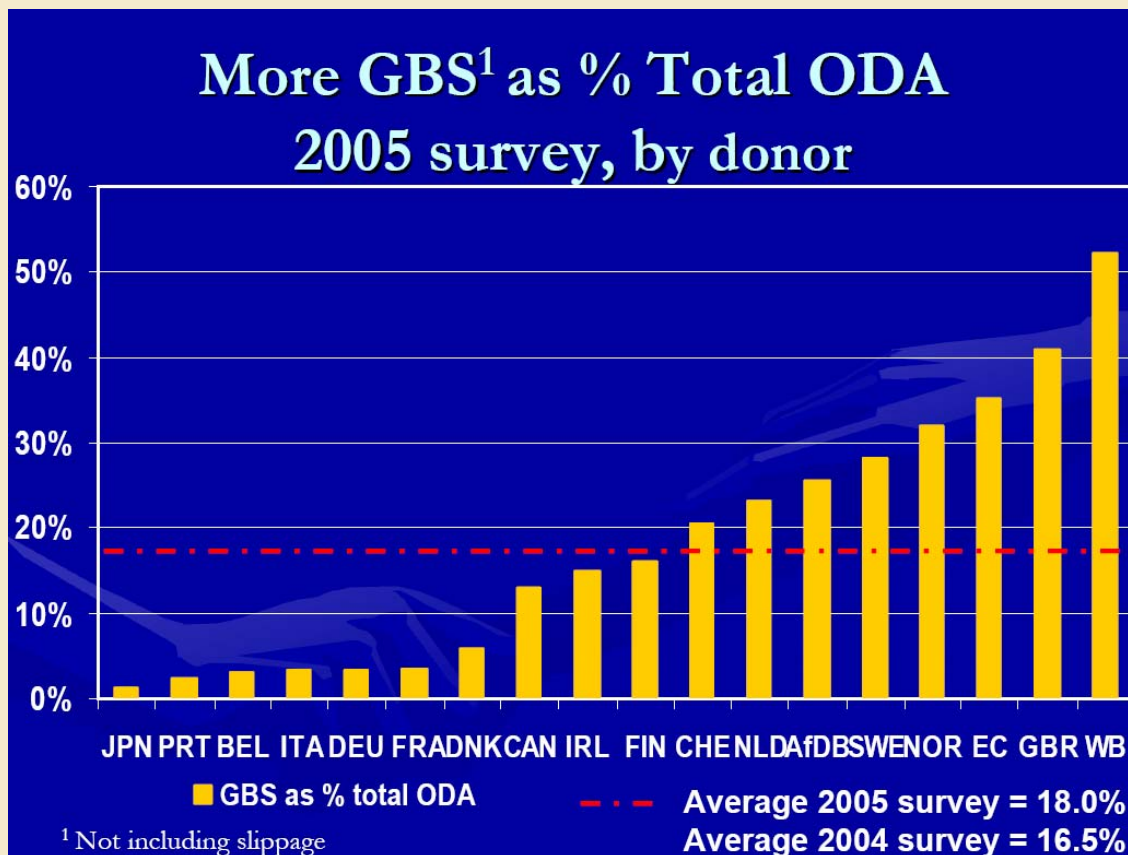


Disbursed GBS/BoPS as percent of GDP, 2005 and 2006 surveys compared (SPA 2006 survey)

	2005 survey	2006 survey
Benin	1.93%	1.74%
Burkina Faso	3.61%	3.61%
Ethiopia	5.52%	0.18%
Ghana	4.14%	4.16%
Kenya	N/A	0.84%
Madagascar	2.87%	2.98%
Malawi	5.40%	6.30%
Mali	1.50%	2.23%
Mozambique	7.56%	5.28%
Niger	3.41%	3.24%
Rwanda	10.29%	8.37%
Sierra Leone	9.97%	7.88%
Tanzania	3.98%	4.95%
Uganda	5.10%	3.50%
Zambia	7.63%	1.90%
Average	4.75%	3.61%



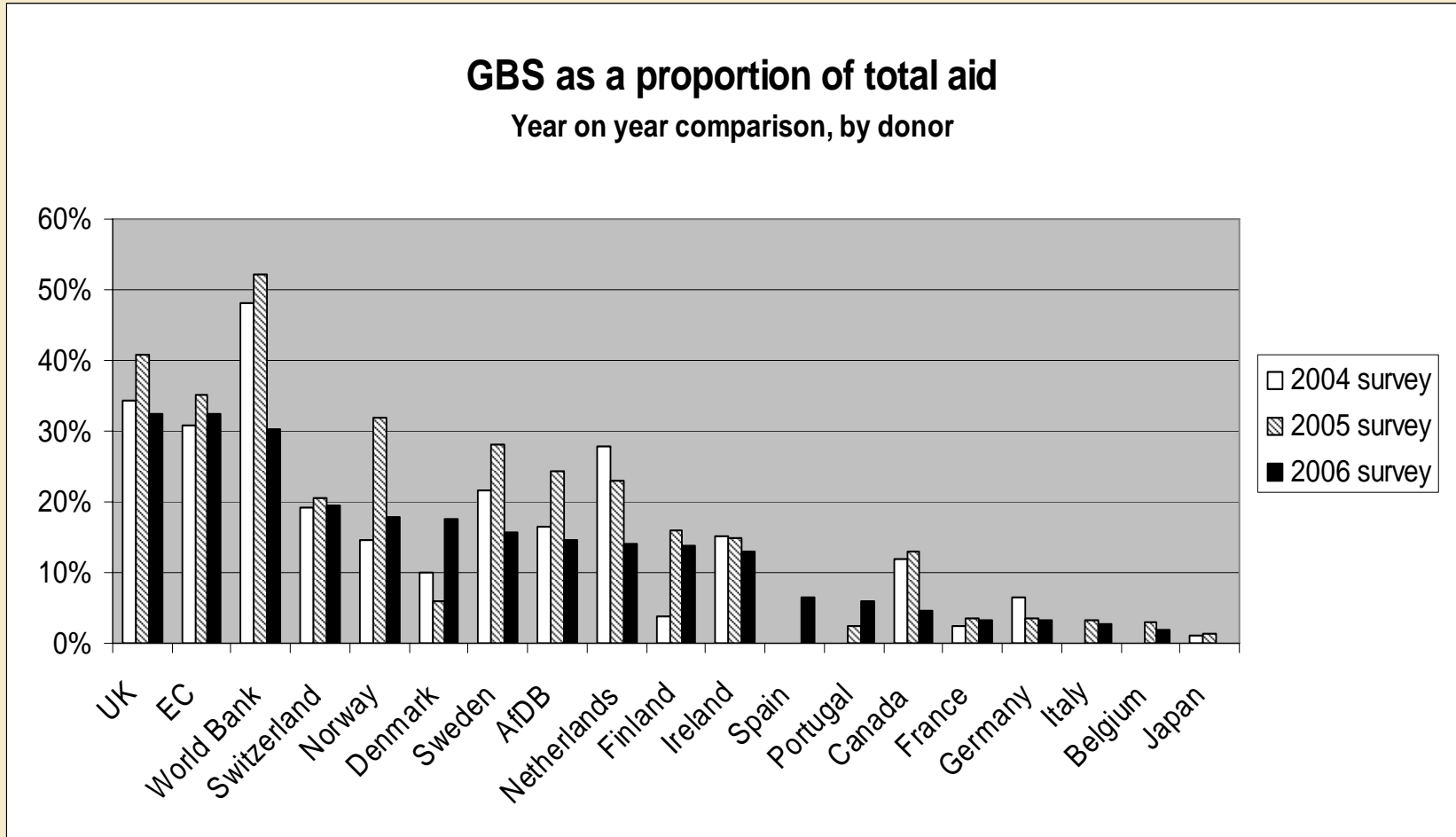
Importance of GBS to 16 African countries 2004

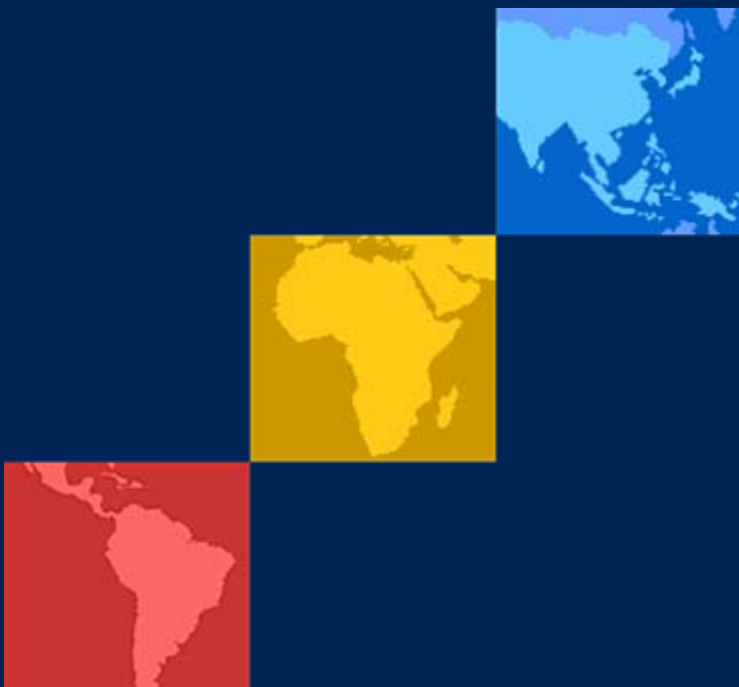


Source: SPA

Average 2006 survey = 13,1%

GBS as a proportion of total aid Year on year comparison, by donor





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