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## BETTER AID: RESPONDING TO GAPS IN EFFECTIVENESS

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## Abstract

Developed and industrialized nations have briefly united at ministerial meetings, set goals and laid promises and yet there are still obvious gaps in the global development aid system. Commitments and targets are unmet, goals are off track, and benchmarks are slowly implemented, if at all. Driven by rapid progress in China, the world has reduced global poverty rates, yet key areas like Sub-Saharan African have seen much weaker improvement: while poverty rates have decreased, population growth has led to growing numbers of poor people.

The effectiveness of aid continues to be the critical challenge. Aid volume is still increasing, but incentives change, new donors appear on the scene, aid flows are fragmented, and data is not captured and analyzed.

In order to fill these gaps and turn promise into action, a new strategy is needed. The future looks bleak for many of the world's poor with the ensuing impact of the global financial crisis, rising food prices, and the changing climate. Now, more than ever, effective sustainable development to alleviate global poverty is essential. Using a two-pronged approach as outlined in this policy brief, aid architecture can be strengthened, gaps filled, flows coordinated, and development sustainable and effective—ultimately making aid better.

## Commitments and Promises to Make Aid More Effective

As the rich world struggles to deal with its financial crisis, the commitment made at the Gleneagles G8 Summit in 2005 to deliver \$130 billion in official development assistance by 2010 seems less and less likely to be met. Even before the crisis there were questions as to how these commitments would be implemented. In the last few years, aid numbers have been inflated by large debt relief programs, which do not involve cash transfers, but merely write-offs of often worthless debt. But most debt has now been forgiven and the aid numbers are slipping again.

As the reality sets in that aid will not increase to the levels that were promised, the policy discussion is turning to the issue of how to improve aid effectiveness. A major ministerial conference in Accra, Ghana, held in September 2008 was devoted to just this topic, but that event did not produce significant new measures to improve aid effectiveness. Instead, it reiterated the commitment of countries to work towards implementation of the 2005 Paris Declaration on Aid Effectiveness.

The Paris Declaration is based on five key principles: ownership, alignment, harmonization, managing for results and mutual accountability. The Paris Declaration held out the promise that aid would be managed differently. It proposed benchmarks to measure progress and a structure of mutual accountability.

At Accra, a new report was discussed that summarized progress on the Paris Declaration to date. The report summarized the findings from a survey of 54 developing countries accounting for about half of all aid receipts. It makes for disappointing reading. Less than 25 percent of aid recipient countries have actionable development strategies. Less than 10 percent have sound frameworks to monitor results. Less than half of aid is reported in recipient country budgets. Donors insist on using their own fiduciary systems even where country systems are of good quality. And donors felt the need to field more than 14,000 missions to the 54 countries per year at a substantial cost; in some countries, i.e., Vietnam, they fielded over 1,000 missions per year resulting in three per day.

So while the Paris Declaration has many good ideas, in practice they are being implemented too slowly to make a material difference for achievement of the Millennium Development Goals (MDGs)—eight international development goals set by the United Nations. What is worse, the Paris Declaration excludes more than half of all aid that actually reaches countries—the private foundations, NGOs and humanitarian groups who give almost \$60 billion to the poorest countries and non-DAC official donors like China, India and some of the oil-rich countries. As a result, knowledge about and coordination with and among private donors is even more of a problem than for official donors.

It seems clear that a different strategy is needed to improve aid effectiveness. We propose a two-pronged approach: (i) pay more attention to the allocation and delivery of aggregate official aid; and (ii) fill in the large gaps in the aid architecture with a special focus on the role of private institutions.

## How Can Aid Be Made More Effective? Five Priorities for Action

The evidence on whether “aid” in the aggregate has significantly helped poor countries to reduce poverty and increase growth is mixed. That is at least in part because “aid” is itself a grab-bag of a number of elements. It includes humanitarian assistance which seeks to respond to a crisis situation that has made poverty and growth worse—so more aid and more poverty often go hand-in-hand. It includes near-term development projects like infrastructure, which can reasonably be expected to have an impact on growth within less than a decade, and basic education projects which may not have an impact on growth for ten to fifteen years when the cohort of primary school children starts to enter the labor force.

When scholars unpack aid, the results are more promising—health aid does seem to have increased health outcomes. The same is true for education. This work suggests that the allocation of aid is critically important. Aid needs to be tailored to the key challenges in each country.

Based on our recent work for the Wolfensohn Center of Development we believe five priorities need to be urgently addressed.

### **Allocation of aid**

The Development Assistance Committee (DAC) of the OECD breaks down total official aid flows into those that directly support development programs in recipient countries (“Country Programmable Aid” or CPA) and those that support other aspects, such as debt relief, emergency assistance and humanitarian relief, technical assistance (much of which is spent on experts from donor countries), and administrative overheads. The latter type of aid benefits developing countries in various ways, but it generally does not deliver financial support for development programs on the ground.

Of the total flow of official aid in 2006, which amounted to \$104 billion, only \$39 billion was delivered as CPA. Between 1975 and 2005 the share of CPA in total aid has dropped from 59% to 27%. For Africa, despite all the public announcements by donors that aid to the continent is to be ramped up dramatically, CPA has stayed approximately constant between 1985 and 2005 at about \$13 billion, while declining in per capita terms. This raises the question—do we have the right balance in aid flows? Should official donors not aim to raise the share of CPA in the total? Setting a quantitative target for the rebalancing of aid flows towards CPA would force donors to examine the most effective interventions.

### **Fragmentation of official aid**

The fragmentation of aid flows among official aid donors has been widely commented on. There are more than 60,000 publicly funded aid projects currently underway, of which more than 85 percent are smaller than \$1 million. Thirty thousand new projects are started per year.

This fragmentation is linked to growth in bilateral assistance. The share of multilateral donors in official aid has dropped over the years, from 31% in 1995 to 21% in 2005, and by even more if the EU is treated as a bilateral agency. Within multilateral aid flows, the role of the main institutions, the International Development Agency (IDA) and the Multilateral Development Banks has dropped from 47% to 36% over the same period. In the meantime, bilateral aid agencies have taken on a greater role

(often many agencies in a specific donor country, e.g., over 50 agencies in the US) and new “vertical funds”—focusing on specific issues like HIV/AIDS, or vaccines—have been created. There are now some 563 official aid agencies.

With so many players, it is small wonder that projects are proliferating. The purpose of the traditional multilateral aid agencies—to reduce fragmentation and coordination costs by bundling donor funds and deploying them efficiently across and within countries—has been undermined.

If donors want to get serious about improving aid effectiveness, they need to think hard about rationalizing official aid channels by reducing the fragmentation of their bilateral agencies, as the Japanese government has recently done by consolidating the Japan Bank for International Cooperation and the Japan International Cooperation Agency, and letting more money flow through the principal multilateral institutions.

### **Proliferation of new donors**

Proliferation of aid funding is a powerful driver of fragmentation of overall aid flows. As the number of donors grows, each will want to develop more channels for disbursing their money. This trend is most readily seen in private aid flows which have rapidly increased and now represent a major share of total external assistance received by developing countries. Data on private flows are weak, but according to our rough estimates, private donors—foundations, NGOs and faith-based organizations—channel around \$60 billion annually to developing countries. In certain sectors, especially health and education, and in some countries, private aid flows may now even exceed official flows.

Proliferation and the resulting fragmentation are not bad in and of themselves. They bring many benefits: new money, new ideas, and new energy. The most efficient markets in the world are built upon the activities of millions of firms. But these markets are subject to fierce competition. Inefficient firms go bankrupt; the efficient ones survive and prosper. With aid agencies, there are few bankruptcies and accountability mechanisms are too weak to ensure that scarce aid dollars are going through the most efficient channels. Building such accountabilities and thereby forcing the reduction of overlap, waste and well-intentioned but cost-ineffective approaches, is the essence of a more efficient aid industry.

### **Volatility of aid**

Aid flows are very volatile: five times more volatile than GDP for the average developing country, and three times more volatile than exports. Compared to a steady flow of aid of equal total amounts, high volatility reduces benefits for aid recipient countries. The cost of volatility is a well established proposition in finance theory, and it applies equally to aid for many reasons, including the difficulty of financial planning, avoidance of projects with long term payoff, poor project selection during aid booms and cutbacks on essential spending during busts. Our estimates show that there is a deadweight loss of 15-20 percent of each aid dollar, or on average about 2 percent of recipient country GDP. The impact of discontinuity of aid flows is even more severe if one considers that volatility may even be greater at the level of individual donors and for specific sectors within a country.

Donors need to accept responsibility for reducing volatility. From a technical standpoint, new instruments like countercyclical lending by IDA are being studied, but what is really needed is a politi-



cal process that acknowledges the problem, accepts joint donor responsibility and implements remedial measures.

### **Lack of scaling up in aid**

More effective aid will require more attention to scaling up. All too often donors are satisfied when they can point to projects that have achieved their immediate goals. Little attention is given to replicating successful pilots, adapting them so they can meet the needs of a large number of people and, where necessary, handing them off to other entities that could expand them with major new injections of funding. Donors frequently lack the staying power and consistency in approach to build on their own successes.

This form of scaling up is not systematically reflected in the missions and goals of donor agencies, in their operational policies and activities, in their evaluations or in the Paris Declaration and Accra Agenda for Action—the ministerial statement which summarizes the agreements reached at the September 2008 high-level forum on aid effectiveness. As a result, many donor-supported interventions are like pebbles thrown into a pond: they cause a few ripples, but have no lasting impact at a scale that really matters.

## Filling the Gaps in the Aid Architecture

Because the aid landscape is changing so rapidly, a number of gaps have emerged that must be filled if pragmatic solutions to more effective aid are to be found. Four gaps are particularly critical.

### **Transparency gaps**

The data available on private donor contributions is extremely limited. Official donor databases are cumbersome and do not track flows from important non-DAC donors, like India and China, nor from some vertical funds. Fostering effective strategic plans to make aid more effective requires greater transparency from all of development's new players. Without a comprehensive data system, the problem of gaps cannot be easily identified.

A project to improve the global database on all aid is urgently needed. Several initiatives are underway. The International Aid Transparency Initiative calls on donors to provide full and detailed information on aid to each country and reliable estimates on future aid. These are the right principles but the initiative does not specify how the data should be collected. The DAC is an obvious place to start. It needs to extend its platform of official aid flow data to cover private and non-DAC flows. However, the mechanism of voluntary reporting is not working well. Alternative, technology-based solutions need to be explored.

A related problem is the absence of systematic evaluation of most privately financed development projects. Although their supporters fervently believe that private aid is more efficient than public aid, there is little hard data to prove this. Few foundations and NGOs systematically evaluate their interventions. There are only a couple of pilot cases of evaluation of the joint impact of official and private donor activity at the country level.

## Organization gaps

Private actors have no formal representation in the current aid architecture, although their views are increasingly sought. At the same time, multi-stakeholder alliances and shifting coalitions to respond to specific development problems have much promise and have mushroomed. In July 2008, more than 70 civil society organizations from around the world created the Open Forum for CSO Development Effectiveness, with the hopes of securing private actors a formal voice in development policymaking. That effort should be supported by specific research and advocacy.

Bilateral official donors have come together in the DAC to collect and share information and to carry out peer reviews for each other's activities. But multilateral and private donors have no such forum, and they have not been invited to join the DAC activities. As a result of these organizational gaps, information and experience are not widely shared and lessons of successful cooperation among official and private aid agencies are not adequately assessed or replicated. For example, the response to the 2005 Tsunami in Aceh, Indonesia demonstrated that official and private aid agencies can work together effectively in a humanitarian effort. There are lessons that one can carry over to development aid but this has not been done. Nor do we know enough about when, where and how multi-stakeholder coalitions—which bring together a limited number of official and private donors for specific development programs—work well. All we know is that there are several cases, for example the River Blindness Eradication Program in West Africa, which are cited as evidence of highly effective aid.

## Funding gaps

Currently, funding flows are analyzed in terms of whether they meet total donor funding targets and whether they are sufficient to help countries meet the Millennium Development Goals (MDGs). However, these assessments may miss important gaps. For example, early child development, youth and urbanization are areas which are recognized as having high development payoff but in which developing countries and donors have not done enough to push forward with significant programs. There are other gaps: research in developing countries, local capacity building, regional cooperation, evaluation of privately funded interventions, and the replication of successful pilots and innovations. The Copenhagen Consensus 2008 lists thirty priority proposals for development, many of which are grossly underfunded.

## Incentive gaps

A key question on which we know too little is why aid agencies and their management and staff, despite the many good qualities they possess, habitually seem to fall short of the high expectations we have of them. Why is there so little outreach across organizational boundaries? Why so much focus on technical assistance? Why such high volatility and so little scaling up? In our view this has to do with incentives for the institutions and for the managers and staff within the institutions. It has to do with institutional and managerial accountabilities, which lead to a focus on short-term goals rather than long-term payoff; a need to please donor constituencies and institutional peers rather than clients; and a reliance on donor control and conditionality rather than country engagement and ownership. But there is very little research and analysis on this question. The internal incentive systems of aid organizations tend to be black boxes for outsiders and internal reorganization efforts tend to focus on changing organizational boxes rather than institutional values, culture and incentives.

## Top Ten Priorities for a New Aid System

Some steps to fill the gaps in the aid architecture and to improve the aid system can be taken quickly even without further research. It is vital to address the right issues and systematically learn from the experience as we move forward. The top ten priorities are:

- Build accountability for official aid agencies through quantitative metrics of aid effectiveness and quality;
- Consolidate the various aid data initiatives into a comprehensive global project;
- Evaluate private aid contributions to the MDGs;
- Understand the strengths and limitations of new private aid funding models;
- Advocate for inclusion of private aid agencies and multilaterals in DAC peer reviews;
- Draw from lessons of effective humanitarian aid coordination practices;
- Undertake joint donor aid coordination studies at the country level;
- Raise the profile of effective yet neglected cross-cutting themes, like early child development, youth and urbanization through multi-stakeholder approaches;
- Undertake institutional scaling up audits; and
- Pilot replication funds to facilitate rapid scaling up of what works.

Improvements in the effectiveness of aid will not come easily. There are no silver bullets. However, we believe with a fresh look at the problems and possible actions, analysis and advocacy along the lines suggested above, significant improvements in the effectiveness of development aid will be possible now.