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Introduction

Why is it that there is almost universal agreement that foreign aid—sometimes called donor aid or development assistance—has not been particularly effective (Collier 2002; Espina and Zinnes 2003; Easterly 2006a and 2006b; World Bank 1998)?[1] Slowly the donor community has come to realize that the problem is not primarily one of insufficient funding.[2] Rather, it appears to be related to the incentives created by the relations among donor country voters, donor organizations, technical assistance implementers, intermediary recipient governments, and final aid beneficiaries, among others (Murrell 2002). Clearly, some of these relationships are horizontal and some are vertical. In some there may be "teamwork" or competition; in others there is hierarchy, which may be well or poorly managed (or supervised).

In short, the root of the problem of aid effectiveness is *institutional.* By institutions I mean the set of rules, strategies, payoffs, and players, as well as player beliefs about all of these.[3] Thus "institution" may refer to culture, norms, markets, firms, government, organizations, and legislation. It also includes donor-recipient assistance contracts. Associated with this insight is the ever greater attention paid to governance, monitoring and evaluation, indicator design,

1. See also William Easterly, "Dismal Science," *Wall Street Journal,* November 15, 2006, p. A18; "The U.N. Millennium Project for Ending World Poverty," *Wall Street Journal,* December 5, p. A19.

2. There are those (Sachs 2005) who nevertheless believe that a significant increase in funding is a central part of the solution. I revisit this view in section 6.5.3.

3. See Weingast (1995) and Williamson (2003) for discussions of the role of institutions in economic development.

public participation, and participatory development (Williams and Kushnarova 2004). Likewise, these are not issues limited to donor aid but are also applicable to local-level government services and regulation as well as private sponsors of diverse initiatives. Part of the reason for the emerging deeper understanding of these challenges comes from advances made over the last two decades in what is now called the new institutional economics (NIE).[4]

1.1 Challenges to Effecting Change

Consider briefly the sponsors' conundrum.[5] They wish to provide development assistance to recipients (or, in the case of a central government, revenues to decentralized local governments) in an environment foreign to the sponsors and in such a way that the sponsors' explicit and implicit objectives are met.[6] These tend to be highly multidimensional (Alesina and Dollar 2000) and include a desire for the consequences of sponsor intervention to be sustainable in the long run.[7] Likewise and at least officially, sponsors would like their funds to be applied in a cost-effective fashion. Unfortunately, this is more of a challenge than first meets the eye.

To understand why one must examine the path or steps through which this process might typically pass.[8] First, the sponsor must manage and empower its own staff to identify an appropriate area for recipient country improvement and then determine the requisite intervention to address the problem. It must then find and contract an implementer, which it must monitor. The implementer will generally have to interact with agencies of the recipient government, which may in turn need to delegate to their subordinate territorial units. When presented this way, the opportunities for mistakes as well as malfeasance or shirking are formidable. Given the limited local knowledge as well as operative control the sponsor has in a typical situation, it is no wonder things do not always go the sponsor's way, ignoring whether its own objectives were appropriate in the first place.

4. See Furubotn and Richter (1999) for an extensive treatment or Azfar (2003) for a review of NIE.

5. The word "sponsor" rather than "donor" has been chosen to underscore that the mechanisms upon which the present work focuses apply to most non-market initiatives organized by an outsider.

6. "Foreign" here is in the sense of "unfamiliar," for example, a given municipality's environment is generally foreign to its central government. With regard to objectives, the U.S. Agency for International Development (USAID), for example, in spite of having an explicit Results Review and Resource Request (R4) framework (see section 3.1.4), also wants to promote trade and business with the United States, American air carriers, U.S. small business, and U.S. female entrepreneurs, not to mention having a case-specific political agenda. The question of the suitability of the donors' objectives—both in terms of their appropriateness and their number—is dealt with later.

7. The issue of sustainability is discussed later. Unfortunately, many donor initiatives tend to peter out once donor funding ends.

8. In a similar spirit, Martens and others (2002, pp. 14–28) refer to this as the "disruption in the feedback loop between donor country taxpayers and recipient beneficiaries."

These issues of control and monitoring are aspects of what economists refer to as principal-agent problems.[9] They encompass some of the central challenges for the provision of development assistance (Murrell 2002) and thus are dealt with repeatedly in this discussion. Principal-agent issues often may manifest themselves hierarchically in a "chain of command." Clearly, the longer the chain, the more susceptible an intervention is to unanticipated breakdowns or even failure. Such considerations should encourage a modicum of modesty in application designs.[10]

But there are still further challenges. Sponsor interventions such as reform activities, capacity building, or other local improvements generally require that local stakeholders coordinate—or at least cooperate—among themselves. Lack of trust and a "zero-sum" attitude lead to reluctance to work together across political groups, economic sectors, and jurisdictions.[11] Likewise, how can a sponsor separate serious from frivolous local requests for assistance?[12] In other words, how can a potential aid recipient signal to a sponsor its seriousness to engage in high-level efforts, that is, prove that its incentives are aligned with sponsor objectives? What credible commitment mechanism can the recipients employ?[13]

Sponsors have historically, albeit unintentionally, responded to these dilemmas in several ways.[14] One is to assess their own impact by measuring project inputs, for example, the number of entrepreneurs trained, the value of loans placed, amount of seed distributed, or whether an environmental law was promulgated.[15] This is easier to document to donor constituencies back home (and less risky to staff member careers) than proving outcome effectiveness associated with each of these aforementioned inputs, namely, an increase (due to training) in small- or medium-scale enterprise (SME) value added, the sustainable impact of the project loan, the impact on rural household caloric intake, or the degree of firm compliance, respectively.

Donors have also engaged in "conditionality." A country promises to do *X* in the future and the donor promises to give *Y* in the present. A more sophisticated version of this is for the donor to require the recipient to "go first," though this is often difficult because *Y* is often an input to *X*. There has been a growing

9. A set of problems associated with an arrangement in which a principal hires agents to represent her, promote her interests, or carry out actions in her stead. Examples are shareholders and their firm's managers, voters and their elected representatives, and ministers and their bureaucracies. See Azfar (2003).

10. I thank Johannes Linn for raising this concern.

11. This can also lead to what economists call coordination failure.

12. Economists call this a risk of adverse selection.

13. Note how credible commitment is related to monitoring. When precommitment is credible, a donor may use its funds more effectively since monitoring costs would be lower.

14. It is outside the scope of this book to provide a full review of aid mechanisms and aid effectiveness. See World Bank (1998), Zinnes and Bolaky (2002), Svensson (2003), Collier and others (1997), and Martens and others (2002) for treatments of these issues.

15. In its R4 framework, USAID euphemistically calls these intermediate results.

literature as to why conditionality often fails.[16] This makes the so-called merit good (X) appear to the recipient (or rather the "agent" of the recipient or principal) as a "price" it must pay to get what it wants (Y). It is hardly likely that the recipient will implement Y with much enthusiasm under such an arrangement. Moreover, where the government is not fully accountable to its population's interests, conditionality tends to be "time inconsistent," namely, once the donor has fulfilled its side of the bargain, it is not in the donor's interest to penalize the country if the government defaults on its side—especially if the government changes over the course of the agreement period. Kenya and the donor community have played this game so many times that *The Economist* in 1995 called it a "ritual" (as quoted in Svensson 2003). Why would donors tolerate this behavior? Svensson (2003) and others point out that part of the reason is the way in which donors allocate assistance. First, the donor's country teams that develop the projects rarely experience much of an opportunity cost to the funds they program. They operate under the implicit rule of "use it or lose it." Second, within departments of the donor organization, there tend to be positive bureaucratic incentives to maximize their budget size rather than their program effectiveness, an observation made many years ago by Niskanen (1971) in conjunction with government in general.

Now sponsors have come full circle and are beginning to focus on meeting their own objectives more effectively. For example, participants at the 2005 Paris High-Level Forum issued the Paris Declaration on Aid Effectiveness, in which they "committed their institutions and countries to continuing and increasing efforts in harmonization, alignment, and managing for results, and listed a set of monitorable actions and indicators to accelerate progress in these areas."[17] Likewise, Martens (2005) observes that in the 1980s and 1990s, emphasis was on donor agenda and thus conditionality, whereas more recently it is on ownership and donor alignment, the brokering of which is the role of an aid agency. He therefore concludes that the job of aid agencies is "to mediate between diverging preferences of donors and recipients and package aid flows in a contract that reduces ex post uncertainties for donors" (p. 20).

It is natural to ask, therefore, whether there might be a way to design sponsor interventions so as to minimize the consequences of the sponsor's operational and informational inadequacies.[18] Research suggests that the answer may lie in harnessing the power of incentives rather than in trying to fight them (Brook and Petrie 2001; Zinnes and Bolaky 2002; Kremer 2003; Collier 2002).[19] Such incen-

16. See, for example, Collier (2002) and Svensson (2003).

17. Aid Harmonization and Alignment, "Paris High-Level Forum (2005)" (www.aidharmonization.org/secondary-pages/Paris2005).

18. There is also the important complementary approach of better designing institutional incentives *within* a donor to make development effectiveness a principal objective of its bureaucracy. This is the approach taken by Ostrom and others (2002), Collier (2002), Zinnes and Bolaky (2002), and Svensson (2003).

19. An online version of Brook and Petrie (2001) is available atwww.gpoba.org/docs/05intro.pdf.

tives would be simple, "bright," transparent, easily and objectively assessable, and necessarily focus on outcomes, not inputs. They would encourage the "players in the aid game" to use their asymmetric local knowledge in a way aligned to the sponsor's objectives. As a likely corollary, it would probably require that the recipient have a predominant role in the identification of both problems as well as solutions. Based on these insights, one might speculate that the preferred mechanism to deliver aid would also encourage recipient country stakeholders to collaborate rather than fight each other for a "piece of the action."[20]

This may seem to be a tall order for aid delivery. However, based on my own field experience as well as a careful reading of the innovation and experimentation literature spawned by the failure of aid effectiveness (Espina and Zinnes 2003), I have proposed elsewhere an approach that appears to hold promise.[21] The approach is called prospective interjurisdictional competition (PIJC) and brings together several desirable, tried-and-true, incentive-compatible mechanisms found in existing projects. A principal goal of this book is to assess the broader applicability of PIJC toward improving the effectiveness of development assistance.

The Brookings Institution's Wolfensohn Center for Development, with its mandate to explore and assess emerging new solutions to development problems with an eye to sustainability and scalability, has identified the PIJC mechanism as a potentially powerful technology for its mission.[22] Given the lack of a comprehensive written assessment of this mechanism, it has solicited the present book to fill the lacuna.

1.2 The PIJC Concept

As understood in the public finance literature (for example, Oates 2002) interjurisdictional competition (IJC) often occurs naturally as states, municipalities, and even countries compete in a tacit, decentralized way to attract business investment and new citizens with high human or financial capital. In this "game" jurisdictions use tax holidays, regulatory and immigration exemptions, publicly paid-for amenities and infrastructure, and even direct subsidies. The push toward devolution and decentralization worldwide may also be considered as utilizing IJC principles. And many more creative applications have been implemented: overlapping public utility jurisdictions (Frey and Eichenberger 1999), environmental certification (Afsah and Vincent 1997), local government report cards

20. Harford and Klein (2005a, 2005b) argue that it is this competition to redistribute donor funds rather than produce value added that leads countries that receive substantial donor aid to appear like countries with rich natural resource endowments.

21. See Zinnes (2004), Meagher and Zinnes (2004), and Zinnes, Meagher, and Giovannelli (2006).

22. See www.brookings.edu/wolfensohn/about-us.aspx.

(Public Affairs Foundation 2004), and allocation of bilateral donor assistance.[23] However, the power of IJC is potentially much broader. It is also a fundamental component of adaptive evolutionary processes in which entities continually test their survival mettle in an ever changing environment of competing alternatives (Young 1998). Thus IJC can be thought to apply to any set of alternative institutions, which could refer to cultural manifestations (such as religions); intragovernmental ministries, departments, or agencies; intergovernmental organizations (for example, across donors), and of course private volunteer organizations (nongovernmental organizations [NGOs]).[24]

While experience is growing with these innovative applications, the writings describing them and their lessons learned are scattered across several disciplines. This makes it hard to identify underlying factors responsible for their performance. In fact, a comprehensive assessment of their performance in the public policy sphere does not appear to exist.[25] However, some of the theory developed in a series of articles in the 1980s (Lazear and Rosen 1981; Nalebuff and Stiglitz 1983; Green and Stokey 1983) does investigate the efficiency issues considered here in regard to tournaments, certification, and direct contracts.[26] Those articles, as well as the present discussion, underscore the importance of uncertainty and who bears the risk of the tasks (though, in fact, this book goes further by considering the issue from the perspective of both the team player itself as well as the decisionmaker *within* the player team).

Green and Stokey (1983), for example, start by identifying two sources of (additive) risk, the idiosyncratic efforts of the player and the common shock affecting all players. Briefly, they find that when the common shock "is sufficiently diffuse, then the optimal tournament dominates using independent contracts," and if the number of players is sufficiently large, then a player's rank is sufficient information for the tournament's sponsors to know the player's output level of effort net of the common shock. I will draw on these insights in later chapters. One difference in the present application, however, is that the jurisdictions in principle *want* the reforms but face, in part, a collective action problem whereas these authors have in mind employment contracts in which effort by definition causes "disutility." Nonetheless, these results pose a challenge to the tournament designer since they presuppose that it is easier to quantitatively measure the player's input performance over output performance.

Meanwhile development of new uses of IJC based on the new institutional economics proceeds apace. Examples of potential applications for technical assist-

23. See the Millennium Challenge Corporation website at www.mcc.gov.

24. With regard to IJCs and donors, see William Easterly, "Tired Old Mantras at Monterey," op-ed., *Wall Street Journal,* March 18, 2002.

25. One that comes close is Mookhergee (2006).

26. A *tournament* can be defined as a contest in which "reward structures [are] based on rank order" rather than achieving a particular performance (Green and Stokey 1983, p. 350).

ance, which are summarized below, include women's entrepreneurship and youth employment in Morocco, the dairy sector in Uzbekistan, human trafficking in Bangladesh, higher education in Nigeria, and human rights in China (Druchel, Russell-Einhorn, and Zinnes 2005). Of particular interest are applications under development that harness interjurisdictional competition *prospectively* as a mechanism to guide public policy and allocate development assistance so as to create substantially more effective and sustainable outcomes (Meagher and Zinnes 2004). Prospective here means that the players—whether local government jurisdictions, agencies within a central government, or NGOs—explicitly agree in advance to compete in a game with predefined explicit rules and rewards, which may be in the form of goods, services, financing, or recognition and publicity.

Activities in a PIJC Application

As described in detail in section 2.1, a generic, tournament-based PIJC comprises a number of activities or steps, some of which can be simplified or even skipped, depending on initial conditions and objectives. Say the sponsor wants subnational governments (SNGs) to implement a reform (for example, improving the budgeting process) in a target region. First, the sponsor must make the objective explicit to stakeholders (for instance, more efficient use of existing fiscal resources through better management and transparency of the budget) and identify a list of tasks, each of which either fulfills or contributes to the objective (for example, conformity of SNG budget to budget code or consolidation of extrabudgetary funds). The task list should derive from stakeholder consultation. Next the sponsor assigns a quantifiable, actionable indicator and aggregation weight to each task (such as the degree to which the budget is standardized or the percent of off-budget funding reduced).[27] The weights reflect the sponsor's view of the task's importance to the objective and may be thought of as game points. Then rule brochures are prepared, and the sponsor convenes a conference with representatives of all prospective teams (SNGs) to explain the game. During the actual tournament period, the SNGs would compete to amass as many points as possible. They do this by allocating their efforts across a subset of tasks (or reforms) of their choosing on the aforementioned list, subject to time, budget, collective action constraints within the community, and based on their collective preferences. During the tournament the sponsor offers technical assistance, generally in the form of multiplayer workshops and not one-on-one site visits. Note how this demand-driven approach is also allocatively efficient: only the communities can know their own cost functions and preferences, and only the sponsor can know its own (marginal) valuations of the proposed tasks. Likewise, since participation is voluntary, reforms only occur with the complete cooperation of

27. Indicators may be dichotomous (for example, all extrabudgetary funds have been converted, yes or no) or continuous, and may contain thresholds (for instance, no points given unless certain parts of the budget meet the standards).

representatives of the population of potential "players"—in short, the tournament has great legitimacy.

Sustainability and Scalability

Sponsors have rightfully recognized that their effectiveness must be measured not just by whether a development initiative is successful but whether it is likely to remain so, especially once the sponsor has departed—a project characteristic referred to as sustainability. Often sponsors also want to know how portable a successful project is (replicability) and whether it might work at different sizes of implementation (scalability). Portability refers to the potential for implementing the initiative among different groups of similarly characterized players, for example, a set of jurisdictions in a different region of the same country or even in a different country.[28] Furthermore, scalability and scale are not the same thing. Scale refers to the size required for a successful application, which will be discussed during examination of the initial conditions required for utilizing a particular incentive mechanism. Finally, to a lesser extent, project scope is considered, that is, the diversity of applications or sectors for which use of an incentive mechanism may be suitable. This book, therefore, not only evaluates the effectiveness but also the sustainability and scalability of the PIJC concept in general and application experience in particular.[29]

Need for Assessment

Clearly, the PIJC concept sounds good in theory, but does it work in practice? Fortunately, as shown in chapters 3 and 4, there are many public policy initiatives in the developing and transition countries that are based on full or partial prospective interjurisdictional competitions. Likewise, I shall argue that the development community has considerable experience with each of the components of a PIJC, so the feasibility of implementing these components as part of a single application would appear reasonable to explore. For example, governance indicators have been used extensively by such donors as the U.S. Agency for International Development (USAID), the World Bank, the European Bank for Reconstruction and Development (EBRD), and the Millennium Challenge Corporation (MCC).[30] The Organization for Economic Cooperation and Development (OECD) also promotes governance indicators as a tool in government effectiveness (OECD

28. In fact, scalability also comes into play during the testing of a PIJC in a new location, since the preferred protocol would usually entail administering a small pilot program first, especially if the intervention is planned for a relatively large geographic area or is likely to be costly in financial or political terms.

29. The reader may refer to Hartmann and Linn (2008) for a recent review of the literature on and sponsor experience with scalability.

30. Popular sources for governance indicators include Freedom House, Transparency International, International Country Risk Guide, Polity IV, and the Heritage Foundation.

2004).[31] In addition, development assistance applications are turning more and more to performance- or output-based contracting (OECD 1999).[32] Finally, donors already use competition to better target assistance, such as in their grant programs for SMEs, for civil society organizations (Polishchuk and Brown 2002), and even for their own sources of innovation (Wood and Hamel 2002). Hence, to help evaluate the suitability of PIJC in terms of its potential for sustainable success as well as scalability, section 2.5 lays out a simple assessment framework. Then in chapters 3 and 4 this framework is used to examine a series of selected past and present sponsor applications.

1.3 Overview of PIJC in Developing and Transition Countries

To provide the reader with a clearer picture of PIJC use, a number of extant PIJC applications are summarized according to several policy categories; many of these applications are then described in more detail in chapters 3 and 4. Likewise, to illustrate the potential of the PIJC approach, the final category describes several applications that have so far only made it to the solicited proposal stage.

What is *not* included is the largest category of interjurisdictional competitions, namely, those that are *not* prospective—that is, where the rules are not agreed to by the players in advance. In those cases the rules of the game are unwritten and amorphous. Examples of such would be investment promotion games among competing countries in the form of export promotion zones or sites for foot-loose foreign factories, and tax competitions across states within a federation (such as the United States or the European Union). Many of these nonprospective tournaments are clearly a "race to the bottom" in that they encourage players to compete by offering exemptions on some fiscal, social, or regulatory requirements rather than by strengthening them.[33]

Local Government Reform Initiatives

These are cases where a sponsor has used a local government tournament as a means for both encouraging local reform efforts as well as allocating its aid. In Russia, for example, as a major component of a fiscal reform loan, the World Bank has run a tournament in which eighty-nine regions compete for budget support

31. As is the case with any powerful tool, the scope for misuse is also ubiquitous (Arndt and Oman 2006).

32. See also Brook and Petrie (2001).

33. While it is usual for competition to whittle down the economic rents of parties to a transaction, the aforementioned exemptions typically carry hidden redistributional consequences in that the parties who benefit from winning are not the ones who bear the costs of the exemptions. The latter parties may be sectorally, geographically, or even temporally distinct from the winning parties. Such decisionmaking is often the result of principal-agent failures. Ironically, since such exemptions are typically given to foreign investors, it is the weaker domestic firms that are forced to compete against the foreign direct investment under the stricter fiscal or regulatory regime.

of $6–9 million apiece by implementing a range of reforms and administrative improvements on extending budget coverage, making local tax law more transparent and consistent with federal legislation, improving expenditure management, strengthening information and audit functions, and improving debt management (see chapter 4). Quantitative targets (indicators) are used to ensure transparency and objectivity. So far fifteen regions have won, and the Russian government has been so impressed with the results that it has committed its own budget funds through 2008 to run three more tournaments.

USAID has funded the Center for Institutional Reform and the Informal Sector (IRIS Center) at the University of Maryland to design and run a quasi-tournament to encourage further deregulation of administrative barriers degrading the business environment in Romania (chapter 3). Simple indicators were used to focus local efforts to address five specific impediments. Most efforts required effective private-public partnerships for success. Out of the eighty municipalities in the country, twenty-nine actively took part and four cities "won." Here, rather than pecuniary rewards or extra donor technical assistance, winners received unprecedented publicity and acknowledgement, which they viewed as a valuable signal to outside investors of their business friendliness (and mayors appreciated as political capital).[34]

In Honduras USAID funded the design and implementation of a competition among municipalities to carry out reform tasks in the areas of good governance, sustainability and commitment to maintain and attract investment, and absorptive capacity for future technical assistance (chapter 4). Out of all the municipalities in the country, thirty-five were deemed eligible to compete. Then their past performance was measured against seven indicators. Municipalities that scored the highest on the aggregation of these indicators—what USAID called the sustainability quotient—won a rich array of technical assistance. Here again the mayors specifically pointed to the political capital they believed winning would confer.

The World Bank is also running a project in nine Nigerian states to strengthen local government use of federation transfers (Esmail and others 2004; Terfa 2005a and 2005b) by including local government areas (LGAs) as beneficiaries in the other components of the International Development Association (IDA) and Global Environmental Facility (GEF) grant-funded technical assistance program (see chapter 3).[35] This project component grades participating LGAs according to a "scorecard," with eight indicators and their subindicators, to assess LGA commitment to effective service delivery (looking at administrative efficiency, budget and financial appraisal, and overall financial integrity) and responsiveness to rural

34. USAID recently ran a procurement to implement a PIJC to address governance issues in Bolivia (USAID 2006).

35. The World Bank program is called the Local Empowerment and Environmental Management Project (LEEMP).

communities (Terfa 2005a, p. 4-1). This initiative is especially interesting because it focuses on *poverty reduction* and on *scaling up* (Terfa 2005a, p. 1-7).

The UN Industrial Development Organization (UNIDO) Investment Promotion Office, in recognizing its frustration with finding bankable cofinancing opportunities for its programs in the Maghreb, teamed up with the IRIS Center to design a PIJC to stimulate local government initiatives to improve the business and investment environment in Morocco (chapter 4). Morocco was chosen because it had recently enacted sweeping legislative reforms to devolve spending and regulatory authority down to various levels of SNG. Since these reforms were de jure, the provincial governors, communal councils, and business leaders showed great interest in exercising these new powers. A pilot tournament was designed in collaboration with local stakeholders to encourage communes to undertake tasks that would require the de facto application of the new laws. Pre- and posttournament quantitative benchmarks would be taken, and the top-ranked communes would receive both substantial technical assistance and computer hardware while their local firms would be offered trade missions in Europe and access to cofinancing.

Revenue Sharing

The trend in fiscal federalism and decentralization in general has brought to the fore the question of how national and lower-level revenue sources are to be shared. While this is not the place to review such an important literature, among its conclusions are that "successful decentralization cannot be achieved in the absence of a well-designed fiscal transfers program" and that "the role of [such] transfers in enhancing competition for the supply of public goods should not be overlooked" (Shah 1997, p. 32).[36] For example, "in Mexico, South Africa and Pakistan, federal revenue sharing transfers finance up to 99 percent of expenditures in some provinces" (Shah 1997, p. 31).

Several of these cases of revenue sharing or intragovernmental transfers may be viewed as a type of PIJC.[37] In these cases jurisdictions are aware that their transfers will depend on recent or expected performance. For example, in South Africa "the central government has implemented a conditional grant aimed at providing incentives for reform of urban services for large cities after having devolved powers to city governments" (Ahmad and others 2005, p. 21). Moreover, the role of the donor in the PIJC is taken up by oversight committees (Bolivia), provincial

36. See also Smoke (2008), Bahl and Linn (1992), and Oates (2002) as well as Shah (1997) for a review and assessment.

37. On the other hand, the literature on the design of equalization grants (see, for example, Martinez-Vazquez and Boex 1999) does not seem explicitly to advocate using revenue sharing to stimulate expenditure effectiveness competition among recipients. Of course, no such ambiguity exists on the raising of revenues, for which competition among subnational government units should be avoided at all cost.

finance commissions (Pakistan), or grant commissions (for instance, in Australia, India, and Nigeria).[38]

Steffensen (2007) provides an in-depth operational analysis of performance-based grants to SNGs. He surveys many known developing country examples in which "performance-based grants (PBGs) provide incentives for [local governments] to improve their performance by linking the access to and size of the release of grants with their performance in predetermined areas" (p. 10; emphases omitted).[39] PBG objectives include improving administrative performance, organizational learning, and accountability; bringing funds on-budget; and streamlining and coordinating donor support (Steffensen 2007, p. 11). This implies that such grants *supplement* the objectives of other grants; they are *not* used to fund core services or recurrent costs.[40] According to Steffensen, the purpose of PBGs depends on the level of development: they start with process-oriented goals (institution building) and later focus on sector output targets (such as service delivery).[41] He classifies these into single and multisector grants, where the latter offer greater latitude to SNGs to choose how to invest. Like Zinnes (2006), Steffensen notes that PBGs allow "spending where performance is good and absorption capacity is available, and where funds are not misused" (p. 12, emphases omitted), and can be used to create "a balance between adherence to national targets and ensuring local autonomy/efficiency" (p. 15).

At the same time, efforts to improve accountability and governance, especially at the subnational level of government, have led to the expanded adoption of performance-based budgeting, "the allocation of fiscal resources based on the achievement of specific, measurable outcomes" (Fielding Smith 1999; Moynihan 2003). They are similar to the PIJC in that they involve expenditure allocation decisions upon which lower levels compete (the budget lines, so to speak), strategic planning in which core tasks and government goals are identified, and performance information that is used to manage and measure performance. Moreover, the last is often explicitly made available to the general public: "some U.S. states, such as Missouri and Virginia, provide extensive performance data on government Web sites" to increase accountability to the public (Moynihan 2003). This kind of information is also provided by EU states (see box 1-1).

38. See, respectively, Faguet (2000), Ahmad and others (2005, p. 23), and Martinez-Vazquez and Boex (1999, p. 39).

39. The countries include Uganda, Kenya, Tanzania, Nepal, Bangladesh, and Sierra Leone, with projects under way in Sudan, Ghana, Philippines, Cambodia, Indonesia, and the Solomon Islands. This experience seems to belie the observation by Bahl and Linn (1992) that "the threshold level of economic development at which fiscal decentralization becomes attractive appears to be quite high."

40. This was a key concern of Afonso and Guimarães (2008).

41. The institution building found in process-oriented PBGs associated with lower levels of development would, for example, focus on good governance, accountability, and financial management; participatory development planning and budgeting; resource mobilization; expenditure management; audit reports; and transparency.

Box 1-1. *Linking Budget Support to Performance*

The European Commission is explicitly linking part of its budget support to performance. The amount to be disbursed is based on progress in social service delivery, notably health and education, and in public expenditure management. Progress is measured by a small number of performance indicators agreed to by the recipient and the European Commission. Indicators are typically drawn from the recipient's poverty reduction strategy. For the first set of countries, the most frequently used indicators are

—planned and actual expenditures in the social sectors,
—differences in unit costs of key inputs between the public sector and the market,
—use of primary and antenatal health care services,
—immunization rates,
—enrollment rates for boys and girls,
—births assisted by medical personnel, and
—cost of primary education (private and public).

After a joint evaluation by government and donors, a score is calculated for each indicator: one point if the agreed objective is attained, half a point if there is evidence of "considerable positive development," and zero if there is no progress. The budget support provided is the maximum amount available multiplied by the (unweighted) average performance score (ranging from zero to one). The approach is not mechanical and also takes into account external factors.

The performance-based system highlights the quality of data. According to the European Commission, the system is not an end but a means: getting policymakers and the public in developing countries to pay more attention to results than to declarations of intentions and conditions set by donors.

So far, 30 percent of the European Commission's budget support is linked to performance indicators. This is deliberate, motivated by the desire to introduce a new approach gradually and to balance performance rewards and the recipient's need for predictable budget finance.

Source: World Bank (2005b, box 11.7).

Dissemination and Signaling

Perhaps the second most prevalent use of PIJC (after donor grant programs) is jurisdictional recognition awards, for example, "blue-ribbon" city competitions.[42] The example analyzed here is the Ford Foundation's promotion of the Galing Pook Foundation in the Philippines (see chapter 4). This program was established in 1993 with the hope of stimulating a response to the then new local governance code. Galing Pook runs a tournament with the goal of "building the capacities of local government units by disseminating, popularizing, and replicating" best practices of awardees (Galing Pook Foundation 2005). The winners of the tournament are determined through a multilevel screening process. The only reward to winning is national recognition and publicity, which apparently municipal politicians covet. Over its history to date almost 3,000 local governance programs have competed, 175 of which have won some category of recognition.

The Indonesian environmental authorities developed a simple yet astonishingly effective disclosure program concerning large enterprise environmental performance based on a signaling model (chapter 3). These firms were color coded to reflect the degree to which they were meeting national standards, world standards, and state-of-the-art performance. The simple color codes, which were advertised and which the firms displayed, were easy for the person on the street to understand, unlike more precise statistics, and social pressures among elites led owners and managers to improve their environmental performance to avoid negative peer and social stigmas.

Donor Country Allocations

At least two multilateral aid agencies use a quasi-PIJC approach to allocate their financial resources at the country level. The IDA uses a complex set of sixteen public expenditure management indicators to evaluate the progress of heavily indebted poor countries (HIPCs) and to set country allotments.[43] The MCC conducts a veritable tournament by only offering to work with countries that score above the median for their group on sixteen governance-related indicators (chapter 4). The hope is that the lure of substantial funds—for example, $300 million in the case of Mongolia's proposed compact—will create a consensus of special interests within a country to focus on good governance. Many and from many quarters (Thiel 2004; Boone and Faguet 2002; Collier 2002; Svensson 2003) are essentially calling for donor aid to be disbursed in a more competitive fashion with greater recognition of opportunity costs and based on effectiveness.[44] Ironically, with the two

42. Even China has gotten into the act (see Dollar and others 2004). Appendix A includes a description of ten of these.

43. See IDA and International Monetary Fund, "Update on the Assessments and Implementation of Action Plans to Strengthen Capacity of HIPCs to Track Poverty-Reducing Public Spending," April12, 2005 (www.imf.org/external/np/pp/eng/2005/041205a.pdf).

44. See also Easterly, "Tired Old Mantras."

exceptions just noted, most of the competition in the market for aid is among the donors fighting for the attention of recipient country governments. Finally, some donors have been looking retroactively at how they have been allocating assistance (World Bank 1998), and some have even scrutinized their own programs. A particularly revealing example is found in box 1-2 concerning the International Labor Organization (ILO), which ran an internal assessment activity requiring that employment generation performance exceed the mean for projects in the program, thus giving this evaluation activity a tournament structure.

Donor Grant Programs

Many donors run grant programs, too numerous to list, aimed at every development sector imaginable. These are structured as tournaments and often aim at encouraging experimentation. Some encourage civil society to engage in service provision or public participation in oversight of local government. Others aim to encourage technology transfer and collaboration between recipient and donor countries. Still others seek to discover new approaches to perennial problems, such as the World Bank's Development Marketplace in which outside proposals compete for a reward based on a subjective appraisal of innovativeness, relevance, and feasibility (Wood and Hamel 2002). Likewise with globalgiving.com, in which proposals vetted for effectiveness compete for funding over the Internet like goods sold on eBay, only that contributors may participate by investing less than the full amount.[45]

On a larger scale, there is the World Bank's *kecamatan* (district with many villages) development program (KDP; chapter 4) in Indonesia that seeks to address the ineffectiveness of top-down aid programs in reducing local-level poverty. In this project participating kecamatans receive a block grant budget of $50,000–150,000. An intervillage meeting is then held to decide collectively which of the projects proposed by its villages should be funded. Villages can develop reputations for good project outcomes during the five competitive replenishment rounds of the overall project, which has disbursed over $1 billion to the poorest 34,233 villages in the country. The overall project appears to be successful since the government took over funding it once the World Bank's financing was exhausted.

Management Control

To improve its effectiveness and ability to respond to an often hostile Congress, USAID in 1995 developed a monitoring system that "required managers to: (1) establish performance indicators, (2) prepare performance monitoring plans, (3) set performance baselines, (4) collect performance data, and (5) periodically assess data quality" (see Williams, Adley and Company 2002). One component

45. Of course, the project is only executed once enough investors contribute to reach the full investment amount.

Box 1-2. *ILO Program for Small Enterprise Development*

Like most programs, Small Enterprise Development (SEED) had been feeling the pressure within the Employment Sector of the International Labor Organization to demonstrate an impact on employment generation and determine the cost-effectiveness of its various programs. Moreover, senior management was genuinely eager to learn more about the employment impact and efficiency of their business development service (BDS) programs. Over the period 2001–2004, the ILO's InFocus Program on Boosting Employment through Small Enterprise Development did a small impact assessment of the effect of SEED BDS programs on employment and income generation, covering over sixty countries in Asia, Africa, Latin America, and eastern Europe.

These impact assessments were then used to channel SEED funds to the program that was most efficient in terms of cost and employment generation. Program leaders within the main BDS activities, therefore, paid considerable attention to the results of the impact studies, regardless of the country hosting the activity. They were told that additional funding would be contingent on their activities having an employment impact greater than or equal to the average of the other BDS activities.

While the intention was clearly to encourage greater project effectiveness, it did not easily translate into action. This was not necessarily due to staff laxity or corruption but rather to the large size of the ILO bureaucracy, where organizational changes are regularly made and staff is transferred internationally. The result was a loss of knowledge, dilution of original efforts (like evaluations), and less effective implementation. Apparently the outcome of this attempt to evaluate aid effectiveness was never published in a working paper, which makes one question how much interest there truly was in redressing the findings of the assessments. It seems that almost none of the BDS programs did especially well. Within a couple of years, the director of SEED was transferred, and the program was restructured so that the team was absorbed by various other subsectors of the employment sector. Some team members were transferred internationally to other ILO offices; others left ILO and moved on. So, in the end, SEED did get an idea about what worked and what did not; however, it is likely that this information was not used as effectively as it might have been. Moreover, the current ILO website confirms that several of the same old programs have continued with or without the old managers.

Source: Former SEED staff member, confidential communication, 2006.

of the system was the annual Results Review and Resource Request (R4) reports (chapter 3). USAID's individual country missions would send these to Washington as a management device "to link resource allocations and performance" (General Accounting Office 1996, p. 13). The system was also expected to generate some "race-to-the-top" competition among project officers, missions, and even bureaus within the agency.

Public Service Provision

Prospective contests have been used to raise the quality of public services such as education, health, parks, solid waste, and water infrastructure management, to name a few. France and Britain use competitive concessions to manage the waterworks across their river basins. Such "yardstick competition"—in which each concessionaire's performance may be judged by the average performance of concessionaires in the other basins—allows the water ministries to overcome the monopoly nature of water provision.

Poor or inadequate public services are a way of life in most developing countries, though these services are an important input to poverty alleviation. In Jharkhand, India, the Citizen Report Card (CRC) initiative (see chapter 3) "is a simple but powerful tool to provide public agencies with systematic feedback from users of public services . . . [by eliciting] feedback through sample surveys on aspects of service quality that users know best, and enabl[ing] public agencies to identify strengths and weakness in their work" (Public Affairs Foundation 2004). The CRC provides a benchmark on the initial quality of public services (in rural credit, forestry, health, education, and drinking water), as perceived by the intended beneficiaries, through "a comparison with other services, so that a strategic set of actions can be initiated" (Public Affairs Foundation 2004).

To achieve a substantial reduction in illiteracy, especially among females in order to ensure an immediate social and economic impact on the country, the government of Senegal launched a literacy education program using public-private partnerships (PPP) to exploit the private sector competencies (chapter 3). Literacy course development and instruction were outsourced to private entities by utilizing competitive bidding based on *quality,* not price, which was fixed per enrolled beneficiary. Funding proposals were generally developed between groups of villages and a community-based organization (CBO), and then scored by a special government selection committee. Over five years, the program funded 99 proposals (out of 368) and trained 200,000 women.

Charter Schools

These are intended to revitalize and improve the effectiveness of public schools (O'Reilly and Bosetti 2000, p. 19) by using market mechanisms such as school choice plans. Though they receive public funding, each school is autonomous and has a unique charter (O'Reilly and Bosetti 2000, p. 20). The license of charter schools must be renewed every five years and requires that the charter school exceed (typically) the average score of the regular public schools in standardized testing. Chile permits Catholic schools access to public education financing to compete against public schools; Canadian provinces allow choosing among public and private schools for the receipt of their property tax dollars (Shah 1997, p. 32).

Potential Proposal Stage Applications

By now it should be clear that the potential range of applications of the PIJC concept is rather broad. Yet the richness of the approach continues to be tested, as proposals submitted to sponsors (and their reactions) attest.

The Foreign Agricultural Service of the U.S. Department of Agriculture considered a proposal to organize a series of agricultural subsector competitions among counties (*rayon*s) in Uzbekistan (Zinnes, Hansen, and Miller 2005).[46] The purpose was to improve the local institutional and technical support environment along the consumption-production chain. A tournament mechanism would encourage stakeholders within each competing rayon to engage in both collective action and individual efficiency improvements to increase the quantity and quality of their output *actually consumed.* The project would also involve local university partners who would not only provide the requisite local knowledge but also experience increased human and institutional capacity. Winning rayons would then receive rewards (such as further agricultural technical assistance, regional promotion of their agricultural products, access to international trade shows, or improvements in local infrastructure).

Together with the Bangladesh National Women Lawyers' Association, the IRIS Center formally proposed to the U.S. Department of State to introduce a set of tasks, focused on the problems of trafficking in persons, to encourage local officials and NGOs to improve local provision of law enforcement and social services.[47] Key elements included measurable, actionable benchmarks; a competition among localities based on the benchmarks; and publicity and extra technical assistance to the local governments of the most improved localities as rewards for success. Public discussion and transparent reporting on local progress would have an advantage over government-led programs in that it would not be susceptible to accusations of political motivation, not be hostage to ministry inaction or inattention, and not be held back by the slowest or worst performers.

Those with great expectations for Nigeria were greatly dismayed that no Nigerian university placed among the top 1,000 in a 2004 ranking of universities world-

46. Also unusual in this proposal was its plan to cover the project's costs in Uzbekistan with the local currency generated from sales of PL-40 wheat (bought from U.S. farmers with USDA aid funding).

47. This description has been paraphrased from Cadwell (2005).

wide conducted by *The Times.*[48] The minister of education of the Federal Republic of Nigeria requested I draft a preproposal for running a "tournament" among higher education institutions in Nigeria to encourage and empower local collaborative efforts to overcome "local obstacles" to school performance. Tasks were to include more powerful parent-teacher associations to improve public input and an independent source of accountability, greater parent involvement in providing after school activities, better local government oversight of school officials and budgets, more effective community provision of campus and neighborhood security, creation of part-time paid work in the community for students, greater administrative transparency, and better planning. Critically, the tournament was also to stimulate links between the educational and business investment environments, making better and more jobs go together.

Why none of these proposals has yet been implemented raises interesting questions. Are the applications inappropriate, were the proposals poorly designed, was there political resistance in the recipient country, or were the donor institutions intellectually or organizationally unprepared? While these questions are revisited in the last two chapters of the book, the short answer is that I do not believe there was a single common reason for their rejection. Still, it is likely that donor tepidness was an important factor. The institutional incentives in donor agencies encourage risk aversion, in spite of an official position to the contrary, and thus donors are reluctant to innovate, especially if one cannot point to a prior implementation.

1.4 Caveats and Contents

Before proceeding, some caveats are in order. First, while the focus is on tournaments, examination of alternative incentive mechanisms based on competition—auctions, procurement, privatization, insurance, and internal agency incentive systems (such as performance bonuses)—will be strictly limited, though they may play an important role in the effectiveness of sponsor and receipt organizations.[49]

Second, for the most part attention is limited to public policy experiences in developing and transition countries rather than countries in the OECD. Within this group the focus will be on the suitability of alternative formal incentive structures for influencing policy implementation and performance, especially when the cooperative participation of multiple stakeholder groups is necessary for success.

To make this task more manageable, however, I will not devote much attention to the political and institutional dynamics between the polity, government,

48. Times Higher Education, "World University Rankings 2004" (www.timeshighereducation.co.uk/hybrid.asp?typeCode=194&pubCode=1&navcode=120).

49. See Laffont and Tirole (1993) for an extensive treatment of many of these other types of competitions.

and sponsor that led to the selection of a particular incentive structure.[50] It will be apparent, though, that most of the cases considered here involve voluntary participation, so even if an initiative is sponsor driven—and this would run counter to the demand-driven nature of the approaches examined—individual or even all jurisdictions could opt out if they were uninterested in the sponsor's program. The fact that few do suggests that beneficiaries perceive the initiatives—regardless of their genesis—as worth their efforts. Moreover, a PIJC is usually designed to overcome adverse selection, that is, its incentive structure encourages only those who truly want the reform to self-select to participate. Thus, while each case study in chapters 3 and 4 begins with the objective stated by the sponsor and stakeholder beneficiaries, the extent to which a key stakeholder—say the government—has a different "real" motivation is not likely to diminish the outcomes of the first round of the contest. (This is also why precontest calibration through field testing of the task menu and rewards is so crucial to good outcomes.) In the longer term, a misalignment between sponsor and principal stakeholder objectives could adversely influence sustainability, especially if funding for future rounds depends on that stakeholder, a point emphasized in the case study discussion.

Third, it is important to stress that very few careful evaluations of tournaments have been done due to their newness. Without the availability of such data, the present research could not engage in the level of statistical rigor necessary to come to the definitive conclusions one would have liked. Therefore, both judgments about success or failure as well as recommendations based on apparent lessons learned must remain tentative.

Fourth, activities in the field of public policy and development assistance are extremely disparate. Hence the selection of cases whose diversity of applications and conditions reflects and illustrates the variety of public policy purposes for which PIJC might add productive performance incentives. Moreover, satisfactory outcomes under such diverse situations should increase confidence in the robustness of the approach.

On the other hand, this locational and substantive variation makes it difficult to keep up with the latest applications since, by their very nature, they are carried out in places of the world where communication is not always the best.[51] Likewise, no one country or organization has a monopoly on good ideas. This is especially true since advances in aid effectiveness are often one and the same as advances in government effectiveness, for which there are many microlevel, local initiatives under way around the world. Thus this book does not purport to be a compendium of *all* relevant projects under way or concluded.

50. I thank an anonymous referee for suggesting that this focus be made explicit. For an analysis of the political economy of policy reforms, see Brinkerhoff (2002).

51. There are donor efforts to improve communication, such as the World Bank's Development Gateway and USAID's microLINKS, which are clearly making laudable progress by using the Internet to close this information gap.

This incompleteness may not be as serious as one might think. Take the case of grant programs: once one understands the incentive mechanisms underlying the various types of grants encountered, cataloging them all would probably provide limited additional public policy information. On the other hand, this approach requires that the examples included in this book capture the range of relevant experience to date. Still, as discussed in section 2.6, there are limitations to relying on a small number of cases, even if statistical analysis is not contemplated. These include the risk associated with information from secondary or even potentially biased sources. I have tried to reduce these pitfalls by basing assessments on multiple sources, including unpublished expert opinion.

Finally, I should explicitly acknowledge the challenges of pursuing the idealized assessment models described in chapter 2.[52] One of these is to avoid the potential problems that could arise from defining the PIJC approach too narrowly. For example, as indicated above, manageability will require skirting the political and institutional dynamics that led to the choice of incentive mechanism. Another challenge relates to time: it might take a long time for some benefits of a PIJC to reach fruition; likewise, a PIJC's sustainability can only be judged in the long term, yet most of the cases examined here have not been in operation for a sufficient duration. In these instances the merits of the application are judged by the shorter-term benefits actually observed; thus I can only speculate on the application's prognosis for sustainability.

The next chapter continues the introduction of the concepts required to understand the PIJC and its component mechanisms, as well as the review of the literature begun above. It also presents the classification and evaluation frameworks used to assess experience to date with PIJC practice. In chapters 3 and 4, these frameworks are applied to a dozen PIJC examples, and additional experiences are briefly considered in chapter 5. In chapter 6 the application-specific conclusions are synthesized to analyze why some have been successful while others have not. Of particular interest is the source of an application's sustainability as well as the relevance of initial conditions. Chapter 7 concludes by weighing the pros and cons of PIJC as a development assistance delivery vehicle and identifies the institutional and other conditions under which the various types of PIJC might be most effective. Given all the caveats above, I must end on a cautionary note by underscoring that any "conclusions" reached will need to be taken as only suggestive, awaiting further study, either by more detailed research for a specific case or by identifying a larger number of similar applications.

52. I thank an anonymous referee for pointing out this concern.