



Original Article

A Framework for Understanding Aid Effectiveness Determinants, Strategies and Tradeoffs

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Abstract

Prominent reform agendas for aid abound. How do they relate to each other? This article tries to organise the aid reform literature by proposing a general framework for thinking about the determinants of aid effectiveness and strategies for improving the same. It presents three schools of thought on aid effectiveness: the recipient, donor and transaction costs schools. It argues that none of the reform agendas proposed by these schools dominates. Although actual aid reform agendas will combine elements of all three schools, there are in fact important tradeoffs between the recipient and the donor school reform agendas, and between the transaction costs and the donor school reform agendas. Contrary to the clarion calls of prominent aid reform advocates, aid reform in practice is a messy and difficult business.

Key words: aid effectiveness, principal–agent framework, Collier, Easterly, Sachs

1. Introduction

Debates continue over the effectiveness of aid, but even the defenders of aid agree it could and should work better. What makes aid more or less effective? Several prominent authors have claimed to have the answer to this question. In the mid-2000s, three books on aid became best sellers: Jeffrey Sachs' *The End of Poverty: economic possibilities for our time* (2005); William Easterly's *The White Man's Burden: why the West's efforts to aid the rest have done so much ill and so little good* (2006); and Paul Collier's *The Bottom Billion: why the poorest countries are failing and what can be done about it* (2007). These books give starkly different diagnoses and recommendations. Each of them is an exercise in advocacy. Convincing on their own, their combined effect can be to confuse rather than illuminate.

Sachs and Easterly are often painted as being poles apart, with Collier in the middle (Ferguson 2007). It is true that Sachs is the leading voice for more aid, Easterly the leading aid critic. But they don't disagree on everything. The two authors share a common scepticism about the use of aid to improve governance.¹ Collier, by contrast, thinks that donors can and should try to influence recipient country governance, especially through technical assistance and conditionality.

1. Easterly (2006) admonishes aid agencies 'Don't try to fix governments or societies' (p. 368); Sachs' (2005) ambitious aid plans are to finance social and physical infrastructure not improve governance (p. 297).

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If an analysis of the three authors that puts them on a spectrum from left (Sachs) to middle (Collier) to right (Easterly) is unsatisfactory, how should we understand the differences between the approaches of the three authors? The aim of this article is to set up a framework within which the contending claims of these three authors, and others, can be placed and assessed. Within the framework it establishes, the article identifies three schools of thought about aid effectiveness: the 'recipient', 'donor' and 'transaction costs' schools. Collier, Easterly and Sachs each respectively represent, although by no means exhaust, one of these schools of thought.

The aim of the article is not to argue for one particular school of thought. Some reflections are provided on the efficacy of the various strategies each recommends. But the fundamental aim is to put the three schools of thought side by side to see, when it comes down to individual aid reforms, on what they agree and on what they disagree. In particular, I highlight two fundamental tradeoffs between the three schools. This is important because aid reform is often viewed as a case of 'more of everything', and tradeoffs between different reform agendas are typically ignored.

The next section (Section 2) sets up the framework of the article and outlines in summary form each of the three schools. Sections 3–5 then provide more detail on each of the three. Section 6 analyses the overlap and disagreement between their reform agendas. Section 7 concludes.

2. A Framework for Understanding Aid and Three Schools of Thought

The aid relationship is well suited to analysis using a principal–agent framework. Donors, the principals, negotiate with recipient governments, the agents, and agree on an aid program (that is, a mix of funds and conditions, whether at the project or national level) in order to achieve development (or other) outcomes. While the approach has a natural appeal, several clarificatory remarks are in order.

First, the framework does not assume that aid funds have to pass through the recipient government. They might, but donors cannot operate without the consent of the recipient, so the principal–agent framework is appropriate regardless of whether funds are actually handed over to the recipient government.

Second, talking about principals and agents can seem politically incorrect in an aid world where the language of partnership predominates. However, designation of the donor as the principal does not imply that the donor is relatively more powerful than the recipient government. To the contrary, the whole point of the principal–agent framework is that the principal is unable to fully control the agent. Indeed, the influence the donor is able to exert might be very limited indeed. One way to think about this is to note that the recipient government has other, much more powerful non-donor principals, such as voters or other domestic interest groups.

Focus on the donor as the principal is appropriate because the aim of the article is to work out what donors should do to improve the effectiveness of their aid. There is also much that recipients can do to improve aid effectiveness, but that is a different topic.

Third, donors have several goals they want to achieve from their aid. They typically have strategic and commercial as well as developmental objectives. The framework allows for this. However, this article's normative assessment of aid effectiveness is in terms of development effectiveness, partly for simplicity, and partly because this is the case for the aid literature that it surveys.

Fourth, in an aid-receiving country, there is one recipient government but many donors. And in any given country, each donor has several projects, where each project is defined as an agreed amount of funds and set of conditions. Moreover, from the donor's perspective, there are many potential recipient country governments or agents to give aid to. As we will see, different approaches to understanding and improving aid effectiveness simplify this complex reality in different ways.

Fifth, there are obviously many other principal–agent relationships within the aid

sector, such as between an aid agency and its consultants. Many simplifications have to be made to focus on the key donor–recipient relationships that shape aid outcomes.

To use this framework to describe three schools of thought about aid effectiveness, we need to introduce three key concepts, one of which is stressed by each of the three schools.

The first is the performance of the recipient government or agent. This is a measure of the institutional quality or governance standard of the recipient government. The better the quality or performance of the recipient, the greater the effectiveness of aid.

The second is the performance of the donor agency or principal. This is a measure of the institutional quality of the donor. The better the quality or performance of the donor, the greater the effectiveness of aid.

The third is the idea of transaction costs. This is a measure of the inefficiency of aid delivery, proxied by the number of projects, and their lack of integration with government. The smaller the number of projects, and the more they are integrated with government, the lower the transaction costs, and the greater the effectiveness of aid.

We can now set out the three schools of thought. Table 1 below gives each school a name, a representative author and a slogan. The text below articulates the case for each school briefly. More detail is provided on each school in each of the next three sections.

2.1 The Recipient School

The first school of thought focuses on the recipient government or the agent as the key to aid effectiveness. This argument became influential with the publication of the World Bank (1998) *Assessing Aid* report, which claimed to show that aid was more effective in countries

that had sounder policies. The econometrics behind this claim has since been debunked (Easterly et al. 2003), but the finding itself appears sound (Burnside & Dollar 2004) and is hardly new. A 1985 Organisation for Economic Co-operation and Development (OECD) report argued that: ‘one of the compelling lessons of experience is that aid can only be as effective as the policy, economic and administrative environment in which it operates’ (quoted in World Bank 2007, p. 37).

This approach ties in with the now widely accepted view that domestic institutions are the primary determinant of domestic economic performance (Rodrik 2003).² If this is the case, then one would indeed expect the productivity of aid in a particular country to be a function of the institutions of that country. Hence, the slogan given to this school of thought: ‘It’s the institutions, stupid’. The emphasis on promoting good governance is also supported by the finding that aid is fungible, that is, that increased aid funding to a particular sector may be at least partially offset by reduced government funding to that sector (Swaroop & Devarajan 1998). If so, the true impact of aid lies outside the sector directly receiving the funding, and donors need to be concerned not with individual aid-funded interventions, but with overall governance.

If the effectiveness of aid depends on the quality of the government of the country receiving that aid, then the message for donors would appear to be clear. Donors, as principals, should use their aid to improve the performance levels of their agents. There are two ways to do this. The donor can give more aid to governments that are better performing, or it

2. ‘Recognition of the importance of institutions was perhaps the key innovation in development economics in the 1990s’ (Williamson 2005).

Table 1 Three Leading Schools of Thought on Aid Effectiveness

<i>Name</i>	<i>Representative author</i>	<i>Slogan</i>
The recipient school	Collier	It’s the institutions, stupid
The donor school	Easterly	It’s not easy being a donor
The transaction costs school	Sachs	Too many cooks spoil the broth

can try to improve the performance of all its recipient governments. Strategies for this are described in Section 3.

Paul Collier is the most prominent example of an author in the recipient school. He writes that ‘that aid should be assessed by its ability to promote reform’ (Collier 2002, p. 2). He advocates (in Collier 2007) both the use of technical assistance (although only in support of reforming governments) and the use of conditionality (although in relation to governance improvements rather than policies). Collier is by no means a lone voice. To the contrary, he represents the mainstream. Former United States Agency for International Development (USAID) Administrator Andrew Nastios writes that all aid projects ‘should be subordinate to the larger institution-building task’ (Nastios 2010, p. 4).

2.2 *The Donor School*

Nastios and Collier express widely held beliefs in relation to aid, but not ones that are unchallenged. Some, such as Easterly, argue that improving recipient governance is beyond the power of aid. And not all accept the received wisdom of the institutional school of development economics. Sachs is an example of this, stressing as he does the endogeneity of institutions to income and the importance of geographical disadvantage.

The second school of thought focuses on problems with aid effectiveness relating not to the recipient, but the donor. Unless the principal is well intentioned and well informed, it is argued, it will be unable to reach agreements with the agents to deliver good development outcomes. Therefore, reform efforts should be directed not at the agent but at the principal.

This view would at first seem to have little support in theory given the broad acceptance that institutions determine economic performance. Aid agencies largely are part of or are funded by prosperous country governments, which have good institutions. Why then should aid agencies not be effective deliverers of aid?

Different authors have suggested at least four different reasons why aid agencies might be less effective than the average developed

country government agency. These can be brought together under the slogan ‘It’s not easy to be an aid agency’. They are explained in more detail in Section 4, but, to summarise, they relate to the multiple objectives of aid agencies, weak performance feedback loops, their high knowledge burden and their high level of discretion. Reforms under this agenda focus on tackling these weaknesses.

William Easterly is a leader within this school. He writes: ‘Bureaucracy works best where there is high feedback from beneficiaries, high incentives for the bureaucracy to respond to such feedback, easily observable outcomes, high probability that bureaucratic effort will translate into favorable outcomes, and competitive pressure from other bureaucracies and agencies’ (Easterly 2002, p. 226). Unfortunately, ‘[a]ll of these conditions are unfavorable in foreign aid’ (p. 226). Therefore the ‘[a]id bureaucracy fails’ (Abstract). He and a range of other authors argue for various reforms to address these problems, detailed in Section 4.

2.3 *The Transaction Costs School*

The preceding two schools gloss over the fact that aid in a single country will typically be delivered by many donors and through even more projects. If each project carries fixed transaction costs, this is highly inefficient, and, according to the transactions costs school, should be the focus of efforts to improve aid effectiveness. As per the slogan of Table 1, ‘Too many cooks spoil the broth’. The reform agenda is a simple one: the number of independent aid projects should be reduced. This requires harmonisation (greater donor coordination) and alignment (greater donor cooperation with the recipient government). Harmonisation can be thought of as reducing the number of donor projects, while alignment integrates donor with government projects. The assumption is that transaction costs increase not only with the number of projects, but with their lack of integration with government. Therefore, both harmonisation and alignment reduces transaction costs.

This has been, for the last 10 years, the official aid effectiveness reform agenda, under

the banner of the 2005 Paris Declaration, which promotes both harmonisation and alignment. It is also championed by authors such as Jeffrey Sachs (2005, pp. 276–7).

The following sections provide more details on each of the three schools of thought summarised above.

3. Improving Recipient Government Performance

If what really matters for aid effectiveness is recipient government performance, then, the recipient school argues, aid donors should focus on giving more aid to better governments and/or on improving governance in the countries they provide aid to. This section considers these two sets of strategies in turn.

3.1 *Selectivity: Giving More Aid to Better Governments*

The World Bank and other multilateral development banks use explicit performance grading systems to guide the allocation of the concessional funds they disburse. These funds are distributed according to formulae that give more aid to countries that are (i) poorer, (ii) more populous and (iii) better governed. Bank staff grade countries against various criteria, such as macroeconomic management and corruption, to come up with an overall performance rating. If there are two countries of the same size and poverty level, the one with the higher performance rating will get more aid funds.

Bilateral aid agencies make less use of performance as a criterion for aid allocation. The United States has gone the furthest in this direction with the creation of the Millennium Development Corporation, which has explicit governance and other criteria that have to be met if its funds are to be accessed.

The methods described above promote *ex ante* selectivity: more aid flows to governments judged to be better performing. But the same logic would also support the use of *ex post* selectivity. Results-based aid—where aid is paid only if and when results are delivered—if it works, automatically directs more aid to better performing governments.

Better performing countries do get more aid, at least by some measures. In 2004, among low-income countries, those classified (by the World Bank rating system mentioned above) as having ‘very low’ government capacity received less than half the aid per capita of those countries with ‘high’ capacity: \$30 versus \$70 (World Bank 2007, Table 4). However, Easterly (2007) finds only weak evidence of a shift to increased selectivity over time.

While such methods sound promising, the limits of disbursing aid on the basis of performance are increasingly apparent. Even in the World Bank system, India’s access to concessional aid is capped to promote aid flows to Africa, presumably because the latter is seen as being in greater need and unable to attract as much private finance. More generally, sentiment has shifted in recent years in the direction of providing not less, but more aid to countries with weakly performing governments (or ‘fragile states’).³ Some argue that, given the anti-development nature of their governments, only aid can provide an external stimulus for change (van de Walle 2005). Moreover, weakly performing states can impose costs on others (Collier 2007). And poor countries with good governments will get rich over time anyway; efforts should be focused, it is argued, on countries which are stuck in poverty traps (Sachs 2005; Collier 2007). As Collier puts it, selectivity ‘squeeze[s] aid out of the very countries that have the biggest problems’ (2007, pp. 109–110).

3.2 *Using Aid to Promote Good Governance*

Whether or not selectivity is exercised in the choice of recipients to advance aid effectiveness, all donors attempt to use aid to promote

3. Take the case of USAID for example: ‘USAID will turn its attention toward failed and failing states, which the President’s *National Security Strategy* recognizes as a source of our nation’s most significant security threats—international terrorism and proliferation of weapons of mass destruction . . . [T]o prevent human suffering and protect our national security, we must devise bold, new approaches to arrest the slide of weak states toward failure’ (USAID 2004).

good governance or, in our terminology, recipient performance. The rationale for this is normally, of course, to improve development effectiveness overall rather than just aid effectiveness, but that should not disqualify such strategies from being considered as aid effectiveness ones.

There are four main ways in which aid can be used to improve government performance: three of them are well established and the fourth new.

The first and perhaps the oldest way to promote good governance is through demonstration effects. If an aid-financed project, say to build a road, uses transparent tendering and strict supervision and manages to produce a good-quality road for a low cost, this could induce the recipient government to replicate the approach embodied in the project elsewhere in the sector and perhaps even in other sectors.⁴

The second is through technical assistance. Technical assistance aims, through the provision of experts and training, to build the capacity of national staff and institutions, and to deliver technical services in a wide range of areas from engineering to health to financial management. Technical assistance constitutes about 25 per cent of official aid on average (Office of Development Effectiveness (ODE AusAID) 2008).

A third way to improve the performance of the recipient government is through the use of reform conditions and provision of incentives. Whether or not aid is allocated on the basis of performance, donors can set up reform conditions that need to be met before that allocation can be accessed. This long-standing practice is known as budget aid (that is, aid not tied to any particular expenditures), a form that makes up about 5 per cent of OECD aid.

A fourth and much newer governance-promoting tool is for aid agencies to try to generate domestic demand for reform. This might be done, for example, by supporting non-government organisations that campaign

against corruption or monitor government performance.

All of these mechanisms have potential, but each is also problematic.

Innovative practices introduced through projects can have a profound effect, but there is no guarantee that they will work, let alone be replicated. Even if they are, they may make little difference to performance if other more fundamental governance problems are not tackled, such as the prevalence of corruption. These problems may themselves overwhelm the pilot projects.

The value of donor-provided technical assistance is much debated. Many governments certainly look to donors to provide technical assistance. The market for consultancy advice is not well developed in many developing countries, and especially not for international advice. Countries often do not know to whom to turn and would find it difficult to negotiate with expatriate experts, and to justify and finance the salaries they command within their normal budget process. They often find that their own procurement processes are cumbersome and would lead to enormous delay in the hiring of consultants. For small and fragile states, expatriate staff are required not so much to build as to provide capacity: both the private and the public sector of such countries will be reliant on imported skilled staff into the indefinite future.

On the other hand, some argue that donors provide too much technical assistance (Reinikka 2008, p. 186), that advisers are all too easily and often ignored, that capacity building is often an elusive goal (AusAID 2008) and that the provision of advisers can in fact 'suck out' rather than build capacity (Fukuyama 2004). Collier (2007) argues that what matters is the timing. Technical assistance should only be provided to governments attempting reform or a 'turnaround'.

The efficacy of conditionality is likewise debated. Threats to withhold funds if conditions are not met may not be credible because donors are under pressure to disburse (Svensson 2003). Most studies 'conclude with scepticism about the ability of conditionality to promote reform in countries where there is no

4. A good example of this comes from China where World Bank projects are credited for the more general use of international competitive bidding by the Chinese government (Burki 2005, p. 140).

strong local movement in that direction' (World Bank 1998, p. 51). Case studies (Devarajan et al. 2001; Howes et al. 2008) show that conditionality can be effective at the margin, but also confirm that '[p]olicy formulation is primarily driven by domestic policy-economy' rather than external leverage (Devarajan et al. 2001, p. 5). Collier (2007) argues that policy conditionality has failed, but advocates governance conditionality (p. 110).

Finally, strengthening civil society is another difficult task. Too much donor support can undermine the legitimacy of non-government organisations, leaving them open to the accusation that they are serving foreign interests. And countries with weak governments typically have weak civil societies. The contrasting success of citizen monitoring projects in Uganda and India is suggestive of the variable returns from such approaches (Khemani 2008).

One general challenge facing all these methods is the 'governance paradox', first applied by Steedman (1995, p. 14) to technical assistance. Steedman argued that 'The greater the constraints posed by governance related factors, the less likely it is that attempts to reform the systems of the latter . . . will succeed'. This does not only hold for technical assistance. It can also be argued that poorly performing governments are less likely to adhere to policy conditionality, are less likely to be able to learn from demonstration projects and are less likely to be open to influence from civil society. If so, then aid for governance will be least effective where it is most needed, in low-governance environments.

4. Improving Donor Agency Performance

Different authors have suggested at least four different reasons why the performance of aid agencies might leave much to be desired.

First, as noted earlier, donor programs are ruled by multiple objectives. Although it is difficult to quantify the tradeoffs, the less the extent that development is the dominant objective of a donor agency, the less effective it will likely be with regard to that objective.

Having multiple objectives can hardly be said to be unique to an aid agency. But there are three other aspects of the operating environment of an aid agency which imply that it faces a harder task than the average agency.

The first of these, and thus the second in our overall list, is that normal feedback mechanisms that serve to discipline domestic government agencies do not work in the case of aid (Easterly 2002; Svensson 2008). Taxpayers in the donor countries have little knowledge and perhaps little interest in the efficiency of aid spending.⁵ The intended beneficiaries (the overseas poor) have a strong interest in, but may have little information and certainly have no direct political influence over, aid agencies. Their only influence is typically through their own government and the pressures it can exert, but, even for a strong domestic government, the indirect nature of this link must weaken the feedback mechanism.

This weakening of the feedback loop implies that, everything else being equal, one would expect worse performance from aid agencies than from the average domestic government agency.

Third, aid agencies have a greater knowledge burden than the average domestic agency. Domestic agencies have a national or subnational geographical coverage and usually focus on just one sector, say education or health. Aid agencies have to work across many countries and many sectors. Their staff may lack cultural as well as technical knowledge. This inevitably imposes a much higher knowledge burden on aid agencies and gives rise to the risk that these agencies will lack the knowledge to intervene effectively.⁶

5. Non-government organisations have a strong interest in development. But they are often a large recipient of government funds, and they also want to build the aid constituency. Both of these factors constrain their willingness to provide critical feedback on government aid programs.

6. . . . donors tend to know relatively little about the societies or institutions in which they are trying to bring about change. Most aid officials spend a few years in any one country. Few speak local languages . . . To help bring about behavioural or institutional change in foreign environments, it is imperative that the agents of change be

Finally, aid agencies have an enormously high level of discretion in what they do. Overall, their funds fall well short of what is required to achieve any externally imposed goals (such as the Millennium Development Goals). They are thus left free largely to set their own goals, to define the way in which they will 'do good'. But there are so many ways in which aid agencies can pursue this mandate. There are good arguments to work in every poor country, and in every sector, and on every cross-cutting issue. There is little by way of rigorous calculus that can guide these choices. The resulting discretion gets exercised at both the political and administrative level.⁷ It results in a very large number of activities because there is a good argument for doing everything, and the tendency is therefore to do a little of everything. Discretion thus increases complexity and fragmentation and adds to the knowledge burden. The high level of discretion also means that there is too much change, as new arguments are constantly put forward for new areas (geographical and sectoral) of emphasis. Aid is notoriously volatile as a result (Kharas 2008).

Again, the comparison with a domestic agency is instructive. An education department, for example, will have fairly well-defined goals (universal access and improving academic standards), only a few choices (for example, more teachers or more pay for teachers) and will normally have stable policy and funding settings.

The reform agenda for aid agencies for the recipient school follows closely from this diagnosis. On the first point, if agencies want to maximise their impact on development, they should have a single development objective. To strengthen the performance feedback loop, there should be greater efforts directed at performance monitoring and independent evaluation, more transparency, and a greater focus on results. To reduce the knowledge burden, aid

deeply knowledgeable about that environment' (Lancaster 1999, p. 493).

7. Collier (2007, p. 184) notes that Clare Short, when Secretary of State for International Development, delinked 'disbursements of aid from her own visits', but puts this forward as the exception that proves the rule.

agencies can devolve operations to field offices, hire national staff to build local knowledge and reduce staff turnover. Hiring of thematic experts also strengthens the sectoral knowledge base. A number of reforms would reduce discretion, including greater selectivity and less political involvement in aid decision making.

Pursuing the goal of improving donor agency performance also has implications for the type of projects agencies commit to. To improve performance feedback, agencies should only implement projects which are easy to monitor. To enhance accountability, they should avoid cooperation. To reduce the knowledge burden, and also to reduce discretion, they should take a selective approach, working in a limited number of countries and sectors. An objective of reducing the knowledge burden also implies that agencies should find out what works and stick to it, favouring long-lived and repeat projects.

Easterly (2006) has been the leading advocate within this school, with his calls for independent evaluation, specialisation and for aid to be used to provide easily measurable but important outputs such as 'the vaccines, the antibiotics, the food supplements, the improved seeds, the fertilizer, the roads, the boreholes, the water pipes, the textbooks, and the nurses' (pp. 358–9).

Many other economists have joined the call for more and more rigorous evaluation (for example, Banerjee & He 2008).⁸ Others in this school have focused elsewhere. Lancaster's concern is the knowledge burden. Drawing on USAID experience in Africa, she concludes that 'where goals were relatively simple and technologies were known (or learned quickly) and brought tangible benefits to Africans in a relatively short period, they had greater

8. Even Nastios (2010), whose claim it is that aid agencies are over-scrutinised, wants more independent evaluation. While a full assessment of Nastios' views is beyond the scope of this paper, it is worth noting his two main arguments. First, the desire to hold aid agencies accountable should not, contra Easterly, influence the type of aid provided, and in particular should not lead to an orientation away from governance. Second, the type of scrutiny applied is wrong, with too much emphasis on monitoring (for compliance) and results management (of the overall program), and too little on evaluation.

success and sustainability' (Lancaster 2002, p. 96). Projects were 'less successful when they involved a complex set of activities or behavioural or institutional changes' (p. 95).⁹ Other analysts who focus on the incentives faced by aid agencies emphasise the importance of transparency and competition (Klein & Harford 2005; Barder 2009).

Some progress has been made on most of these reform fronts.

Most agencies have increasingly untied their aid, signaling less weight for commercial objectives. Few have gone as far as the United Kingdom as to legislate a developmental objective for aid. Donor agencies from emerging economies probably have greater emphasis on commercial interests.

For a long time, it was thought that political constraints would prevent bilateral agencies submitting to independent evaluation, something that is common practice among multilaterals. However, recently Sweden and the United Kingdom have set up independent evaluation agencies. More broadly, evaluation in general and impact evaluation in particular have a higher profile and stronger constituency because of the growing awareness of the 'evaluation gap' in aid (Evaluation Gap Working Group 2006).

Perhaps the most progress has been made on transparency. A commitment on transparency was included in the communiqué from the 2008 international forum on aid effectiveness in Accra. Subsequent initiatives include the International Aid Transparency Initiative and various multilateral and bilateral aid transparency drives.

Decentralisation has also been a trend followed by most aid agencies, and this has gone with the hiring of more national staff.

9. 'We know how to build roads; we know how to organize and help manage elections. Far less is known about generating a demand for family planning services, helping small farmers expand their production or improving the accountability of newly elected governments. Very little is known about how effectively to strengthen judiciaries, civil society organizations or the civil service. Yet much of what foreign aid tries to do at present is activities, like these, involving institutional or behavioural change' (Lancaster 1999, p. 493).

Several aid agencies have recently emphasised selectivity of countries and sectors, but Easterly (2007) finds evidence of worsening fragmentation.

In all, despite some limitations, there is at least some reason to be optimistic about the progress of donor reforms. Their limitation is that they can only address the symptoms, not the underlying cause of donor weakness. Each of the problems identified by this school—the distorting impact of non-development objectives, the weak performance feedback loop, the heavy knowledge burden and the high level of discretion—can be traced back to the geographical disconnect which will always be part of aid. Aid recipients will never vote. Aid agencies will always try to achieve something for the donor as well as the recipient. Aid agencies will always be outsiders. At best, the deleterious impact of these underlying problems can be ameliorated, not eliminated.

5. Reducing Transaction Costs

It is not surprising that reducing transaction costs has been the official aid reform agenda, as indicated through its embodiment in the Paris Declaration. It is a convenient agenda for both donors and recipients to coalesce around because it places the blame for poor aid effectiveness on neither party and simply asks all to cooperate more.

However, reducing transaction costs is more than a convenient reform agenda. It is also one that makes a lot of sense.

According to a World Bank (2007) report, 'the average number of donors per country rose from about 12 in the 1960s to about 33 in the 2001–2005 period' (p. ii). At the turn of the century, the average bilateral donor operated in about 100 countries (Acharya et al. 2006). And donor fragmentation has worsened since then (Easterly 2007).

The move to whole-of-government approaches to aid delivery has further exacerbated the problem of fragmentation. In the case of the United States, the world's largest donor, the main aid agency, USAID, is responsible for less than 40 per cent of total aid, and according to Brainard (2006), some 25 US government

agencies pursue some 50 development objectives, most of them independently.

This worsening fragmentation implies a growing waste of resources on the part of both donors and recipient governments, and in particular a major burden on poor and overstretched governments. Tanzania is a widely cited example in this regard:

‘Tanzanian government officials had to prepare about 2,000 reports of different kinds to donors and receive more than 1,000 donor delegations each year. These requirements tax rather than build provider organizations’ limited capacities distorting efforts towards satisfying donor obligations rather than reporting to domestic policymakers’ (Reinikka 2008, p. 185).

Health is perhaps the most fragmented sector, with some 100 multilateral health agencies as well as probably all bilaterals active in this area. The transaction costs imposed by such an arrangement can be severed indeed. A DFID report warns that ‘There is a serious risk that weak human resource and systems capacity at central and local levels may be overwhelmed by the proliferation’ of health donors (Caines et al. 2004, p. 5).

The Paris Declaration of 2005 was both a recognition of and response to the problems in the way the business of aid is conducted. Signed on 2 March 2005 by 35 donor countries, 26 multilateral donors, 56 recipient countries and 14 civil society observers, the Declaration is arranged around five themes—ownership, alignment, harmonisation, development results and mutual accountability—with obligations under each of these for both donors and recipient governments. The core of the Declaration, in particular as it imposes obligations on donors, is in relation to two of the above five themes, namely alignment and harmonisation.¹⁰

Harmonisation requires first of all greater selectivity, or as the Declaration puts it, a ‘more effective division of labour’. Those

donors that remain engaged in a particular country or sector should act jointly, through such means as joint projects, joint assessments and joint missions.

Alignment requires donors to act under government leadership. Specifically, this means that donors would expend their funds not through their own projects and bank accounts, but through government systems and accounts.

Simplifying, harmonisation means reducing the number of donor projects, and alignment means integrating donor projects with government ones. Both can be expected to reduce transaction costs by reducing parallel processing, both among donors and between donors and government.

Sachs is one of a number of authors who support the Paris Declaration. He writes that ‘we need to fix the “plumbing” of international development assistance in order for it to be effective’ (2005, p. 269). Donors should coordinate, simplify their procedures, pool resources and work more through multilaterals (2005, Chapter 14).

A number of evaluations of the Paris Declaration have now been completed. The most recent, in 2011, finds that ‘much further effort on more active harmonization is required’ (Wood et al. 2011, p. 19) and that there is ‘limited if any overall increase by most donors in the use of country systems and processes’ (p. 24).

It also unclear whether attempts to harmonise and align have actually reduced transaction costs. A key instrument used has been the sector-wide approach (SWAp). But McNee (2012) summarises the literature as finding that ‘[t]here is no evidence that SWAps have decreased transaction costs, and in fact some evidence that they have led to an increase’ (p. 16). Alignment is at best a controversial strategy for fragile states, one that could actually reduce aid efficiency due to recipient government weaknesses (Svensson 2008).¹¹

10. Of the 13 targets used to monitor progress under the Paris Declaration, eight relate to alignment and two to harmonisation, with only one for each of the other three. Ownership and managing for results are matters largely for recipients, while mutual accountability requires partners and recipients to review progress together.

11. The Paris Declaration itself recognised this limitation, with its targets requiring that donors align only with recipient governments who achieve high international ratings with regard to their public financial management and procurement systems.

The lack of progress with regard to implementation of the Paris Declaration is commonly attributed to the political economy of donors. Barder (2009) argues that we should try to change the incentives of donors rather than impose a central planning solution that is doomed to fail. Emerging donors as well as some traditional donors show little interest in implementing Paris, and the political momentum behind the Declaration appears to have waned. Neither harmonisation nor alignment get a mention in the aid community's most recent communiqué, the 2011 Busan Declaration.

6. Synergies and Tradeoffs

Each of the three schools of thought tends, not surprisingly, to be critical of the other. Thus, Collier is sceptical of the value of donors aligning their efforts with governments in fragile states. Nastios, also of the recipient school, argues that in fact aid agencies already come under heavy scrutiny through various oversight mechanisms. Easterly, although he supports country selectivity, argues that donor agencies simply cannot influence recipient performance and that they have long promised but never delivered coordination. Sachs argues that, once recipients reach a threshold level of governance, they are able to make effective use of aid, and posits that the main problem with donors is simply that they do not cooperate enough.

However, the analysis of the preceding sections suggests that none of these schools obviously dominates as a set of reform strategies. Each has strong arguments for and against it. The recipient school of thought tackles the key determinant of development (and therefore aid) effectiveness. The donor school tackles reforms most clearly under donor control. And aid transaction costs appear to be high and increasing.

But the set of strategies advocated by each school also each suffer from a serious weakness, if not a fatal flaw. Aid has limited purchase on the quality of institutions, especially in the weakest governed states, because of the governance paradox. The ultimate cause underlying donor agency ineffectiveness is something that can never be changed: the geo-

graphical disconnect. And trying to impose a central planning straightjacket on the chaotic aid world seems unrealistic, and not necessarily desirable, again especially in the weakest governed countries, where alignment is a risky strategy.

What then to do? Although each of the three schools has its advocates, most actual aid reform programs suggest elements from all three, combining advocacy for a strong focus on governance, reforms to improve donor effectiveness and greater coordination. The Australian 2006 White Paper on Aid, with which I had some involvement, is just one example of this. It advocated the use of aid to provide incentives to Pacific island governments to reform. It argued for the establishment of an Office of Development Effectiveness to improve evaluation. And it committed to looking 'for opportunities to use partner country processes and systems in aid program delivery' (Australian Government 2006, p. xiii). Here and elsewhere, the various reforms taken from the playbooks of the three reform schools are combined, on the implicit assumption that there are no tradeoffs between them.

There are indeed some reforms that are supported by all reform agendas. In particular, selectivity is a recurring theme across all three schools.

There are also reforms advocated by one school, which are not contradicted by any other. Aid management decentralisation to reduce the knowledge burden will not undermine, and might enhance, strategies to improve governance or to strengthen coordination.¹²

More generally, there would seem to be no tension between the first and third schools. The strategy of improving recipient quality is largely about what to do with aid (technical assistance, budget support, aid to civil society and with demonstration impacts) whereas the strategy of reducing transaction costs is about how to give aid (in a coordinated manner).¹³

12. Although the related strategy of hiring national staff can undermine recipient performance.

13. Although Sachs (2005) himself is against focusing the provision of aid on governance reforms, there is nothing in principle to stop the Paris Declaration principles being applied to the use of aid for governance.

Unfortunately, however, for anyone who wants to craft an aid reform package, there are important tradeoffs between the second (donor) school and both the first and the third. There are reforms that make sense from one perspective, but are contraindicated by another.

First, efforts to improve donor quality by strengthening performance feedback can undermine efforts to improve recipient quality. This is because strengthening feedback is not just about promoting evaluation. It is also about the choice of project undertaken and support for projects that are more easily evaluated.

This insight is often overlooked but not completely ignored in the literature. Former USAID Administrator Andrew Nastios recognises precisely this tradeoff when he writes that ‘those development programs that are most precisely and easily measured are the least transformational, and those programs that are most transformational are the least measurable’. Easterly would agree with this statement, except that, whereas Nastios would argue that aid agencies should attempt to be transformational (by building or reforming institutions) and therefore not be so worried about measurement, Easterly would argue that they should not bother trying both because they would fail and because it would reduce donor accountability.

Second, there is also a tradeoff between improving donor quality and reducing transaction costs. The very coordination required to achieve the latter goal will undermine the accountability needed to promote the former. This is why Easterly (2006) writes of the aid industry as a ‘cartel of good intentions’ and why he argues for ‘individual accountability for individual tasks’ (p. 369; also p. 175). Indeed, there are a small group of authors (Klein & Harford 2005; Barder 2009) who oppose the Paris Declaration because they want to see less coordination (‘central planning’) and more competition to strengthen the incentives for donor performance. We would put these authors in the donor school.

There is no easy solution to these tradeoffs. Surely, lack of accountability is a weakness of donors. And we should be sceptical of claims that aid can be transformational, and of the

benefits of coordination. But even Easterly (2006) admits at one point that donors should provide technical assistance to support economic reform (p. 369), a form of aid that is intrinsically resistant to evaluation. And do we really want donors each, for example, providing text books, teacher training and school construction without coordination rather than working together with each other and the government to support education?

7. Conclusion

The framework set out in this article has four main limitations. First, it provides incomplete guidance as to what the donor should spend funds on. Aid is implicitly divided into three rough categories: technical assistance (to improve governance), budget support (to improve governance or to reduce transaction costs) and projects, harmonised and aligned to varying extents. It says nothing about what sort of sectors the projects should be situated in: should we be building power plants or distributing bed nets? Such questions are, I am confident, beyond the scope of any general framework and can only be answered on a country-by-country basis, if then.

Second, the article makes no reference to ‘ownership’, another of the Paris Declaration principles, and an oft-referred-to concept in discussions of aid effectiveness. It is commonly, and no doubt rightly, said that aid projects will only succeed if recipients ‘own’ them. This article is about what aid agencies can do to improve effectiveness. In general, it is not clear what donors can do to improve ownership, which is primarily a matter for recipient governments. Some suggest that too much conditionality undermines ownership. Another argument for alignment is that, apart from reducing transaction costs, it will increase ownership. These arguments would seem to be borne of experience, and they are certainly additional considerations to bear in mind when embarking on an aid reform strategy, but they do not decisively turn the argument in favour of or against any one reform school.

Third, it seems compelling that any governance-based aid strategy should contend with the possibility that in fact aid has a negative effect on institutional quality, no matter how it is given. There is little hard, robust evidence to back this long-asserted claim.¹⁴ And if it is true, it is a threat to any aid reform program, and it gives little guidance on how to provide aid, the concern of this article. Hence its neglect.

Fourth, the article assumes that aid is given to help countries develop. Questions of whether and how aid should be used to finance international public goods are beyond its scope.

Despite these limitations, the article, and the framework it builds, serve three purposes.

First, it helps us understand the differences between the three most prominent writers on aid effectiveness, Collier, Easterly and Sachs. Neither is intermediate to the other two. Each provides their own reform strategy, focusing, respectively, on the recipient, the donor and aid transaction costs.

Second, more broadly, the article identifies and fleshes out these three schools of thought on aid effectiveness. There are many writers on aid effectiveness, official, academic and activist, and it is useful to have a framework within which their arguments can be situated. This may prove useful for the analysis of particular aid topics: see, for example, McNee (2012) on aid for health, and Morris and Pryke (2011) for an analysis of aid reforms.

Third, and perhaps most importantly, the framework identifies important tradeoffs between prominent reform agendas to establish a simple impossibility theorem of aid effectiveness. We would like to see accountable donors working together to address critical governance problems, but we will not. We can have the first of these, or the last two, but not all three.

14. See Bauer and Yamey (1982) for an early statement of this claim and Moyo (2009) for a much more recent one. Cross-country regression results are inconclusive with regard to the impact of aid on institutions: see Knack (1999) and Ear (2007), for example. Moss et al. (2008) survey the evidence for Africa but acknowledge that their claim that aid has a negative institutional impact is a tentative one.

Anyone convinced by one of the three aid reform schools will not be bothered by these tradeoffs. If, however, like me, you find each school somewhat but not fully persuasive, then aid reform becomes a difficult and messy business, involving various strategies and tradeoffs between them.

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This article began its life as an input for the Australian National Audit Office's (ANAO) 2009 review of AusAID's management of the Australian aid program. It has since benefited from numerous comments including from the staff of the ANAO and AusAID, from my students in my aid policy course over the years, from participants in seminars and lectures presented in various Australian and Korean academic and aid institutions, and from my colleagues at the Development Policy Centre. I am very grateful for all the comments provided. I retain responsibility for any remaining errors or other shortcomings.

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