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Policy Insights No. 12

The International Aid System: A Question of Perspective

by Felix Zimmermann

In a lengthy series of summits throughout 2005 – including the Gleneagles G8 meeting in July – world leaders have made encouraging promises to raise aid volumes and make its management more effective for poverty reduction. However, examinations of progress towards the Millennium Development Goals (MDGs) have made it clear that the international community remains far from achieving its self-imposed targets. It would be tempting to call for sweeping changes to the aid system, but such calls would ignore the many incentives of donor countries, aid agencies and recipient governments to resist change. With the 2015 MDG deadline nigh, the need for creative approaches to cope with their conflicting priorities is more pressing than ever.

The Aid System Is Fragmented

Think of a painting by Vincent van Gogh. At a certain distance everything looks clear. Take a step closer and things get much more complicated.

Aid volumes are not rising sufficiently: the well-publicised "0.7 per cent of GNI" target remains distant; prospects are slim for a broad international agreement on new sources of financing for development, such as global taxes on aviation fuel or the International Finance Facility (Reisen, 2004).

Aid remains unpredictable and fragmented. Donors seem unable to make multi-year financial commitments upon which recipients could rely when planning their budgets. They often apply complicated and inconsistent conditions for aid and are slow and secretive in determining how they will allocate it. Rather than co-ordinating their efforts, they continue to use different disbursement mechanisms and monitoring procedures (Saasa, 2005; Gómez Lacayo, 2005). Creative initiatives such as the global funds, run by mixed groups of public, business and non-profit organisations, only add to the confusion. (Sagasti *et al.*, 2005).

Some Ambitious Promises

Aid recipients have promised to:

- design poverty reduction strategies;
- improve governance and accountability;
- increase civil society participation.

Donors have promised to:

- increase aid volumes;
- reduce debt;
- align aid programmes with recipient strategies;
- co-ordinate with one another to reduce transaction costs.

Both have promised to:

- give poverty reduction highest priority;
- focus on results.

Donors have pledged to devote aid to the priorities chosen by recipients, but still prefer delivering it through one-off projects or non-state channels rather than aligning it to recipients' budget cycles. This prevents poor countries addressing their particular funding needs and responding to abrupt changes in international commodity prices or weather conditions affecting their harvests (*African Economic Outlook 2004-2005*). Donor reluctance to let go of the reins is also shown by their preference for taking decisions at headquarters rather than in developing-country offices. Of course, letting go is not easy when many recipient-country governments still struggle to design (let alone implement) poverty-reduction policies and stamp out rampant corruption.

Conflicting Priorities Undermine Reform

Despite these discouraging observations, many development experts seem to believe that the aid system can be overhauled entirely. The UN Millennium Project team of 256 experts has just published "the most comprehensive strategy ever put forward for combating global poverty, hunger and disease" (UN Millennium Project, 2005). The 17-member Commission for Africa has produced a report claiming that to increase growth in Africa, "the volume and quality of external aid to sub-Saharan Africa must change radically" (Commission for Africa, 2005).

Neither lengthy report thinks that reform would be simple. However, both base their ambitious recommendations on the assumption that donors, their agencies and recipients will readily begin rowing in the same direction: towards effective aid and poverty reduction. In doing so, they underestimate the importance of conflicting priorities that undermine the fulfilment of ambitious promises.

Donor governments want to reduce poverty through aid, but concerns about security, trade, migration and the environment – not to mention historical ties with ex-colonies – often weigh heavily when decisions are made about how (and to whom) aid should be allocated. These priorities also lead donors to pressure recipients into policies that may not in all cases be appropriate from the point of view of poverty reduction (Berthélemy *et al.*, 2004). Moreover, as there are no internationally agreed criteria for allocating aid – for example, according to recipients' priorities, actual needs or performance – some recipients end up as "donor darlings", leaving others as "aid orphans".

OECD work has resulted in the widely-supported Paris Declaration on Aid Effectiveness, but has shown that donor agencies also lack incentives to change. Under close parliamentary scrutiny, they face strict accountability requirements and thus quite naturally prefer to focus on measurable inputs (i.e. how much they have spent on a given project) rather than far-off results (i.e. whether their money has actually contributed to development). Who could blame them for passing on these requirements to recipient countries through stricter conditions and higher administrative costs (Martens, 2004)? Moreover, given that they are competing with other government departments (and other aid deliverers) for taxpayers' money, they may be tempted to focus on the most prominent, rather than the most effective activities. After all, direct budget support for African governments is a much harder sell than emergency relief for Tsunami victims; aid aimed at improving capacity to trade is far less photogenic than that going into education and health projects (Mc Donnell and Solignac Lecomte, 2005, for a fuller analysis of public attitudes to development co-operation).

Would it help to use multilateral aid channels such as the international financial institutions (IFIs) or the United Nations (UN) system? Not necessarily. For the big multilaterals, becoming more effective with a clearer division of roles and responsibilities might mean unwelcome reform or even staff unemployment. For some of the smaller ones, it may mean closing down entirely. So the desire for self-preservation may well prove stronger than developing-country interests (Maxwell, 2005, on failed attempts at UN reform). This is scarcely helped by the multilaterals' decision-making procedures: in the IFIs, for example, developing countries have insignificant voting shares.

Mixed priorities are not limited to the donor side. With access to non-aid sources of income, countries like India can be less aid-dependent and more politically assertive; they often prefer to pick and choose their donors, accepting low-interest loans with donor conditions rather than aid from a group of co-ordinated donors. At the lower end of the income scale, many recipients lack the capacity to deal with donors, whether co-ordinated or not, and will take aid however it is given. Fragile or conflict-ridden states generally have weak governance structures and are not in a position to take ownership of ambitious poverty-reduction plans. In such cases, donors tend to bypass recipient governments and direct aid through other channels, notably non-governmental organisations (Rogerson, 2005).

This still leaves a large group of recipient countries which ought to embrace changes to the aid system. Some, such as Nicaragua, Tanzania and Mozambique, have had positive experiences in designing poverty-reduction strategies and involving development stakeholders; they have been rewarded with more donor trust and co-ordination (Gómez Lacayo, 2005). Others, however, seem more willing to wait and see whether such changes will really pay off for their neighbours. They say that, as long as their aid keeps flowing, the immediate costs of reform will outweigh those connected with the current system of donor diversity and less predictable aid (Katseli, 2005).

Reconciling Mixed Priorities

There are thus powerful motivations to resist even the smallest improvements in aid effectiveness, so a future aid system must find ways of coping with conflicting interests. There are two diverging schools of thought on how this might be done (Rogerson, 2004). The first favours all-out competition between agencies: recipients could simply choose their preferred assistance programme from those on offer. The second shuns any comparison of the aid system to a market and claims that only stringent rules will encourage good donor behaviour. Regulatory bodies could impose sanctions or even exclude donors from a country if the costs of complying with their conditions outweigh the benefits of their aid.

The best option probably lies in a mix of these approaches. It is hard to see large donors willingly submitting to a strict international regulatory system, but market forces alone will not protect the many recipients that do not have an abundance of donor agencies knocking at their door.

To begin with, such an approach implies a deeper understanding of how individual recipient countries differ. Currently, they are most often bundled into too-broad income categories or ranked according to performance indicators such as the World Bank's *Country Policy Institutional Assessment*, which has been criticised for giving too much weight to donors' favourite policies. Many other factors distinguish recipients: their capacity to cope with increased aid; their ability to raise internal revenues like taxes or external resources through international capital markets; and their degree of vulnerability to shocks like natural disasters or violent conflict (Sagasti *et al.,* 2005; De Renzio, 2005).

Examining recipient countries with greater care would identify those in need of more "hands-on" forms of support like direct work with community organisations and the private sector. In countries with stronger governance direct budget support could be strengthened. Some countries may want assistance in managing their external sources of income, or in involving their citizens in decision making, whilst others need more scope to include productive sectors, not just health and education, in the poverty-reduction strategies they submit to donors in exchange for more aid (Gómez Lacayo, 2005). Finally, closer analysis would also reveal whether aid to particular countries should be delivered through loans, grants, or a mix of both (Cohen and Reisen, 2005).

Once a "menu" of recipient priorities is set, donors could pool their funds around those priorities and programmes that suit them best. They could display their trust by making longer-term commitments, but could insist, justifiably, on tying disbursements to the results actually achieved (Katseli, 2005). In some cases, agencies could consider "code-sharing" like airline companies – competing in some areas (or countries) and collaborating in others (Maxwell, 2005).

Such examples of good practice might also be encouraged by more transparency about donor preferences and actions. This is why think tanks such as the Center for Global Development (CGD) have devised donor ratings systems that "name and shame" those donors not towing the line (CGD and Foreign Policy, 2004). Elsewhere, a call has been made for donors to redefine the way they tally aid in order to identify more clearly the amount actually devoted to poverty reduction rather than other donor goals, as well as the results it achieves at its destination (ActionAid International, 2005; Coordination Sud, 2005).

Widen the Focus, Define the Locus

Moving forward will require

- √ Focusing on more than aid
- √ Finding the right decision-making structures

Stepping closer to the fragmented aid picture might help policy makers understand and cope better with some of their conflicting priorities. Stepping *back* and looking beyond the aid picture could be even more useful. Firstly, it would draw attention to factors outside the aid system which will be crucial in determining whether development objectives such as the MDGs are to be achieved. This would involve recognising that non-aid sources of finance – be they remittances from abroad, private financial flows or foreign direct investment – are often considerably more important than aid for economic growth. It would also allow policy makers to factor in the development impact of non-aid policies (e.g. trade, migration, agricultural and environmental policies) when making decisions about the allocation of aid.

Secondly, a wider perspective could support shifts to new decision-making forums that are less paralysed by disagreement than existing ones. A school in rural Ghana should not need the government or donors to decide whether it should fix its roof or buy new textbooks. Similarly, the government of Ecuador might want to consult with donors, but does not need a heavily-negotiated inter-governmental agreement to determine the qualifications that should be required of its teachers.

Some questions do require international resolution: can a compromise be reached on new sources of financing for development; can the roles of multilateral agencies be redistributed to prevent further overlap and confusion? Existing decision-making forums, however, have failed to broker agreement on such themes, perhaps because they have consistently ignored the views of key stakeholders:

developing country representatives and non-state actors. In response, Canadian Prime Minister Paul Martin has suggested that bringing together the heads of state from twenty leading developed and developing countries may be an effective way to address the world's most pressing problems (Martin, 2004); the "multi-stakeholder" Helsinki Group includes both state and non-state members in its search for feasible and practical policy recommendations on issues related to globalisation and democracy (Helsinki Process, 2005).

The aid picture cannot simply be repainted. Looking at it from the correct vantage point, however, will help bring out its true value in the pursuit of poverty reduction and other development objectives.

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www.oecd.org/dev/meetings/aidworkshop

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