

Donors and service reform

chapter 11

Timeo danaos et dona ferentes.—I fear the Greeks even when they bear gifts.

Laocoön on the Trojan Horse

In many developing countries, external donors support service reform. In middle-income or large low-income countries, they mostly pilot innovations or implement demonstration projects. If chosen strategically and evaluated properly, these projects can be powerful. In other low-income countries the story is quite different. Donors supply 20 percent or more of public resources in more than 60 low-income countries. And they supply more than 40 percent of public resources in at least 30 poor countries—such as Bolivia, Madagascar, Nepal, and Tanzania. For these countries aid flows are obviously important for service delivery.

The international community has come a long way in understanding what makes aid more effective, focusing on the selection of recipient countries.⁵⁴³ This chapter suggests that, along with country selectivity, the way donors provide their aid matters a lot.

Donors still underestimate how difficult it is to influence reform without undercutting domestic accountabilities. Too aware of failures in the key relationships of accountability in recipient countries, donors often bypass them. This can produce good isolated projects, but it can also weaken the aid recipient's internal systems and accountability relationships (chapters 3 to 6). This chapter suggests that:

- Donors need to pay more attention to the problems in influencing service reform in recipient countries.
- They should strengthen the critical relationships among policymakers, providers, and clients. In circumventing those relationships, they can undermine the delivery of services.

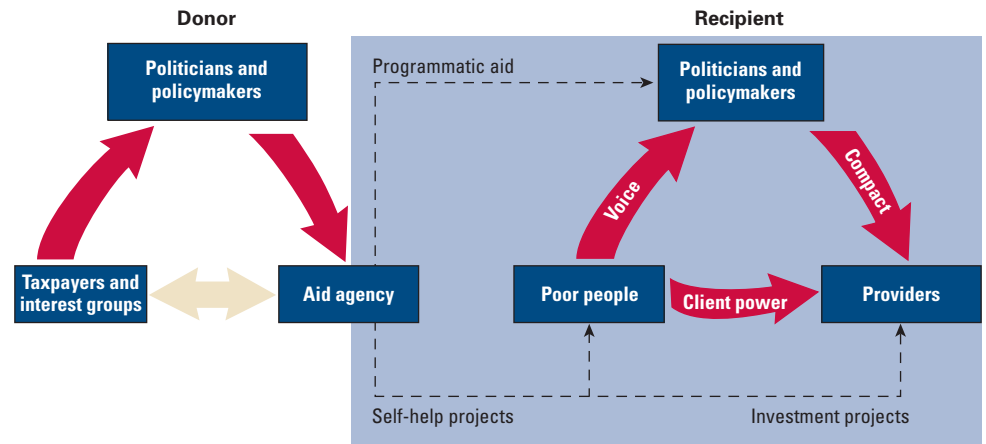
- Donors should support recipient institutions by evaluating innovations systematically, by harmonizing and realigning their financial assistance and knowledge transfers with the recipient's service delivery (particularly where aid's share of spending is large), and by focusing on outcomes and results.
- In good country environments where there are genuine reformers, donors should also integrate their support in the recipient's development strategy, budget, and service delivery system.
- In low-income countries coming out of conflict or with weak institutions, donors should support urgent social and other services, while identifying mechanisms that build transparent public institutions in the longer term. Pooling of aid will reduce transaction costs.

This is all fine, but the multiple objectives of foreign aid create incentives for donors to control their interventions directly rather than to align them with the recipient's service delivery systems. Because of these incentives, reforming aid will not be easy. Yet for service reform to succeed, donors have to attach an even higher priority to aid effectiveness and development outcomes.

Aid and accountabilities

Aid differs in important ways from domestically financed services. The beneficiaries and financiers are not just distinct—they live in different countries, with different political constituencies.⁵⁴⁴ This geographical and political separation—between beneficiaries in the recipient country and taxpayers in the donor country—breaks the normal performance feedback loop in service delivery (figure 11.1). For example,

Figure 11.1 The feedback loop between beneficiaries and donor country taxpayers is broken



beneficiaries in a recipient country may be able to observe the performance of aid agencies. But they cannot reward or punish the policymakers responsible for this performance in donor countries. The broken feedback loop induces greater incentive biases in aid than in domestic programs. So aid effectiveness is determined not only by the performance of the recipient but also by the incentives embedded in the institutional environment of aid agencies. Understanding these incentives is central to any reform of aid to support service delivery better.

The divergence and distance between constituencies and clients may be important—but there is more. Even if donor constituencies adopted client feedback as a paramount criterion for aid, there would still be difficulties in exercising external influence without undermining local accountability relationships. To illustrate the inherent problem of external actors, consider enterprise finance. When financiers or venture capitalists want to influence an enterprise they are investing in, they become an equity holder and perhaps request a seat on the company's board. Clearly it would be politically infeasible for donors to request seats in the recipient's cabinet. Yet the influence that donors exercise on the recipient's public spending often resembles that of an equity financier.

Strengthen—don't weaken—the compact

When aid flows are substantial relative to the recipient's resources, donors affect the com-

pacts between policymakers and provider organizations (chapter 6) in many ways. By influencing spending patterns and budgetary processes, donors interfere directly with the design of the compact. And by going straight to provider organizations, donors sidestep the policymaker as well as the compact.

Donors affect the recipient's spending patterns and budgetary processes in many ways.⁵⁴⁵

- Donors may support only capital spending (construction) and expect the government to supply complementary inputs (staffing, maintenance). Governments often fail to finance the complementary inputs.
- Donors may fund projects that governments are not interested in. This contradicts ownership, though it can work where a good pilot project encourages a new approach through its demonstration effect—or where a one-time intervention is needed.
- Donors may give aid to a priority sector and assume that government spending from its own resources remains unchanged. This runs into fungibility because governments attempt to smooth spending by adjusting their own allocations.⁵⁴⁶
- Donors may set targets for the share of spending in particular sectors as conditions for aid flows. Consider the current donor preference for social sectors, which appears to have increased both recipients' public spending on these sectors

and the social sector's share of aid (from 14 percent of the aid flows in 1991 to 34 percent in 2000).⁵⁴⁷ But strong donor preferences can leave other important areas underfunded or set perverse incentives in the privileged sector. In Zambia protecting social spending led to deep cuts in rural infrastructure spending—possibly creating more rural poverty.⁵⁴⁸

To avoid such distortions, donors can discuss priorities with policymakers and work to shape public expenditure during the annual budget cycle. But the recipient has to have a budget process that functions fairly well.

Many donors see a need to align aid with the recipient's compact between policymakers and providers. But there are other tendencies as well. Global funds, which are private-public partnerships at the global level, have chosen to provide funding on a project basis directly to service providers in poor countries.⁵⁴⁹ The new health-related global funds also develop policies for global procurement and distribution of commodities, such as mosquito nets, vaccines, and essential medicines.

In many ways, the delivery of global funds—from a global source of finance directly to the local provider—reflects the need for donors to demonstrate that the funds are additional to what otherwise would have been given. But it might also reflect dissatisfaction with the functioning of the recipient's relationships of accountability and with aid agencies. But it is not clear that this is a sustainable solution to the institutional problems. Evidence from Uganda indicates that global funds can pit the recipient's policymakers—in charge of the overall spending program—against its provider organizations, who directly lobby for off-budget funds at the international level (box 11.1). Parallel financing mechanisms can also undermine efforts to rationalize expenditures, reform government systems, and increase transparency at the country level.

Donors interact directly with provider organizations at various levels. Some aid agencies choose to work with line ministries. Others choose to engage providers under local governments. And others go

directly to frontline providers, such as health clinics or schools. Sectoral ministries independently lobby donors for funding. From the donor perspective competition among ministries, departments, and other organizations permits a better selection process—because hopeful recipients will do their best to reveal as much information as possible to attract donors. The result: recipients' policymakers lose control of the expenditure program, because the finance is off-budget and the activities bypass the compact. Incoherent spending allocations and uneven coverage of services ensue.

Similar competition can occur among donors, making incentive problems worse. When the recipient agency knows that if one donor threatens to withdraw due to the recipient agency's poor performance other donors will step in, few incentives exist for improving its performance.⁵⁵⁰

Some donors, including the World Bank, even circumvent provider organizations by setting up autonomous or semi-autonomous project implementation units for their interventions. Advocates of project implementation units recognize that the arrangements can undermine local capacity building, create salary distortions, and weaken the compact between the policymaker and the provider organization. But they argue that the better results outweigh the costs. A study of about 100 World Bank projects in the Latin America and Caribbean Region shows otherwise: that project implementation units have no

BOX 11.1 *The debate over global funds: Uganda*

It is like a hungry boy who sees ripe mangoes hanging abundantly from a tree, but he is not allowed to pick the fruits. The Ministry of Health remains needy, while donor money hangs around. As part of the budget and medium-term expenditure framework, the Ministry of Finance sets a limit to the amount of money that can be spent on health—as it does for all sectors—refusing to earmark excess funds for health from global funds. The Ministry of Finance argues that there are a whole host of important things that poor people need and that there are not enough resources around to provide all of them.

But health officials insist that the Ministry of Finance is constructing ceilings

below floors and that it costs much more to deliver health services than the budget allocation it receives. The Ministry of Finance counters by saying that the country's attractiveness to donors depends on its reputation for sound macroeconomic management. Global funds risk undermining this by providing resources outside the normal budget process. It is not government's intention to turn away additional resources, finance officials say, but it is important that such resources be channeled through the regular budget process.

Source: Adapted from *The New Vision*, Uganda's main daily newspaper.

significant positive impact on project outcomes, while the likely sustainability of results clearly suffered.⁵⁵¹ A parallel study in the Eastern Europe and Central Asia Region produced similar findings.⁵⁵²

In Bangladesh donors responded to a crisis by setting up a separate project management unit for the Bangladesh Arsenic Mitigation Water Supply Project—to speedily address arsenic contamination in drinking water (chapter 9). The unit bypassed the traditional water engineering departments, deemed too inflexible to respond to the emergency. Two years later it has fallen far short of expectations. The government is expected to close the project shortly, arguing that the unit, having bypassed government, was unable to deliver on the ground.

To staff project implementation units, donors tend to hire the most highly skilled civil servants, often at salaries many times what they could earn from the government.⁵⁵³ In Kenya a World Bank agricultural project paid eight local staff between \$3,000 and \$6,000 a month, many times the \$250 available to a senior economist in the civil service.⁵⁵⁴ Another study found that of 20 Kenyan government economists receiving master's degree training in a donor-funded program between 1977 and 1985, 15 were working for aid agencies or nongovernmental organizations (NGOs)—or for their projects by 1994. The study concluded: “elite external master's degrees are, in effect, passports out of the public sector.”⁵⁵⁵ In countries with many donors, salaries are likely to be bid up even more, as donors compete for qualified staff.

A better choice to improve aid effectiveness is to phase these units out and to work with the recipient's provider organizations, building their capacity. And it should take place within the compact between the recipient's policymakers and service providers. But this requires changes in incentives in aid agencies (see the last section of this chapter).

Let provider organizations manage

Donors affect management of provider organizations in recipient countries in at least three ways: by the fragmentation of aid in a large number of donor projects, by the choice of activities, and by the choice of inputs.

The costs of aid fragmentation

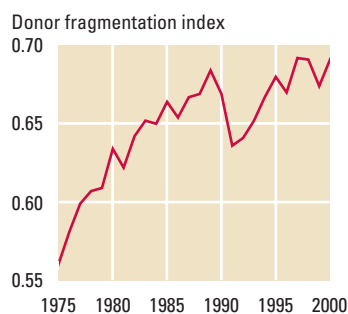
The problem with aid fragmentation is not that individual projects are misconceived—it is that there are too many projects for any to work efficiently. When a project's fixed costs are high and there are returns to scale, fragmented aid can be wasteful. Furthermore, when donors each have only a small share of the total aid in a recipient country, their stake in the country's development, including capacity building, may be reduced relative to their concern for the success of their own projects. Fragmentation also imposes high transactions costs on recipients, with large amounts of officials' time taken up by donor requirements.

Little systematic evidence is available on fragmentation and its effect on the management of provider organizations. One source, though limited, is the Development Gateway database, with records on about 340,000 aid projects and programs across the developing world.⁵⁵⁶ Using the database to quantify the extent of donor fragmentation yields a mean index value for donor fragmentation across recipients of 0.87.⁵⁵⁷ (Index values increase with the number of donors active in the country and with greater parity among donors. Low values indicate a smaller number of donors, or that some donors dominate.⁵⁵⁸) For example, Tanzania has a high index value of 0.92, with more than 80 aid agencies having funded 7,000 projects over time. A similar index computed from another data set—annual aid disbursements—suggests that donor fragmentation is on the rise (figure 11.2).⁵⁵⁹

High fragmentation indices could reflect donor specialization in different sectors, so that fragmentation would be low in each sector. But mean levels of the index are only slightly lower within individual sectors: 0.85 for education, 0.77 for health, and 0.78 for water projects. High fragmentation values for most recipients show that donors do not specialize very much, either by sector or by country. Most donors are active in many sectors, in most countries: a typical recipient nation in 2000 received aid from about 15 bilaterals and 10 multilaterals (table 11.1).

How does donor fragmentation affect the recipient's provider organizations? As mentioned, little systematic evidence is

Figure 11.2 Donor fragmentation: on the rise



Note: The higher the index, the greater the degree of donor fragmentation.
Source: Knack and Rahman (2003).

available. One study finds an association between rising fragmentation and declining bureaucratic quality in high-aid countries and in Sub-Saharan Africa, controlling for changes in per capita income and other variables (figure 11.3).⁵⁶⁰ This finding suggests that donors with a small share of the aid in a country may focus more on delivering successful projects, even at the expense of government capacity—for example, by hiring the most qualified government administrators to run their projects. This collective action problem may be less severe where there is a dominant donor, who has a greater incentive to take a broader and longer-term view of the country's development.

High fragmentation means high transaction costs for recipients. Tanzanian government officials have 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, diverting efforts toward satisfying donor obligations rather than reporting to domestic policymakers. Recognizing the adverse effects, donor agencies have recently initiated measures to curb compliance costs and streamline operational policies, procedures and practices, focusing on financial management, procurement, environmental assessment, and reporting and monitoring.

High fragmentation may have an even stronger impact in low-income countries with weak policies and institutional environments. This is because the domestic capacity to implement reforms is typically highly constrained—both the political capital of reformers and the technical capacity of the administration. Fragmented donor interventions create pressure on existing capacity, by demanding both political and administrative efforts to implement change across a wide variety of areas at the same time. Aid flows are often at low per capita levels, so a large number of projects may also mean that the average value of each project is small, leading to high overhead and transaction costs.

But change has been slow. The emphasis has so far been to find common international standards and principles at the aid agency level, rather than to adapt donor

Table 11.1 So many donors . . .

	Type of aid donor	
	Bilateral donors only	Bilateral and multilateral donors
Number of recipients with 1–9 donors	3	13
Number of recipients with 10–19 donors	93	27
Number of recipients with 20–29 donors	22	69
Number of recipients with 30–39 donors	0	40
Average number of donors per recipient	14	26
Median number of donors per recipient	16	23

Note: The number of donors was calculated by using figures for total official development assistance (ODA) in 2000, provided by the OECD DAC. The number of recipients takes into consideration only the independent countries according to the list of member states of the United Nations.

Source: Acharya, de Lima, and Moore (2003), from OECD DAC data.

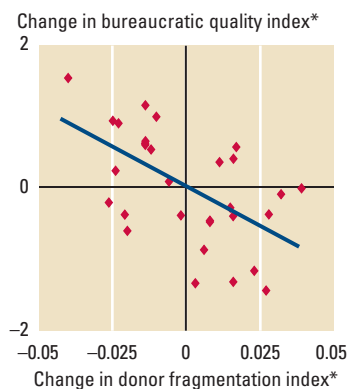
behavior to the procedures used by the recipient's service providers in their reporting to domestic policymakers. Exceptions are beginning to emerge, including Tanzania, Bolivia, Vietnam, and Ethiopia, where donors are planning to help the government develop a harmonization program rather than limit it to the donor community.

Donor influence on choice of activities and inputs

Donors also influence the choice of activities within a sector. They tend to be generous with training. In Malawi training accounts for a staggering \$4.5 million, or 10 percent of donor spending on health care a year.⁵⁶¹ It is hard to believe that the return on this investment matches the cost or that the government would spend this much on training if it had the choice. And the real cost appears to be even higher: staff may be absent from work for long periods on training courses. Training opportunities are often a form of incentive for staff. If so, the funds would likely be better used if the sponsoring donors provided them directly to supplement salaries through the budget. The \$4.5 million spent on training health workers in Malawi would translate on average to a 50 percent increase in salary for all health care staff.

The input mix in aid-financed public spending often differs from that in recipient spending. For example, donors provide far

Figure 11.3 Bureaucratic quality declines with donor fragmentation in Sub-Saharan Africa



*After controlling for the effect of initial level of bureaucratic quality, growth of per capita income, growth of population, and level of aid in relation to GDP (averaged over the period).

Note: The scatter plot shows the partial relationship between the change in bureaucratic quality (1982–2001) and donor fragmentation (based on project counts).

Source: Knack and Rahman (2003).

more technical assistance (and project vehicles) than the recipient would buy if it had the money. In Malawi technical assistance accounts for 24 percent of donor spending on health.⁵⁶² A major obstacle to addressing this issue is the shortage of data. Many recipient budgetary systems have much better data on the input mix for domestically financed expenditures than they do on donor projects, which are sometimes treated as single lines in the budget. Donor officials have weak incentives to provide full information to recipient governments. Public expenditure reviews, often critical of government spending, let donors off lightly. To improve scrutiny, better data are urgently needed.

Increase client power

Client power—the relationship between beneficiary and service provider—tends to be weak in many developing countries. This has long presented donors with a dilemma. Should they help strengthen the links between users and existing providers? Or should they find a way around the recipient's service delivery system to ensure that aid-funded services reach poor people? This becomes even more complicated in heavily HIV/AIDS-affected countries, those coming out of conflict, and those with weak and corrupt public institutions. Official donor agencies have followed the example of their nongovernmental counterparts, approaching communities and user groups directly, through sharply increased funding for social funds and self-help projects. Three main problems surface in these activities: an undermining of government and other local capacity, weakened prospects of sustainability, and the capture of benefits by elites (chapter 4).

In principle, social funds and self-help projects could operate within the recipient's service delivery system. They could also serve as entry points for the policy dialogue with policymakers and providers and hence build local government capacity rather than undermine it. But like many other projects, they tend to be operated directly by donors with little integration.

Most assessments of social funds and self-help projects focus on poverty targeting. Overall, the evidence suggests that centralized

systems do better at identifying poor communities than at identifying poor households or poor individuals.⁵⁶³ The effectiveness of targeting varies widely, which suggests the importance of unobserved attributes of communities. Some studies show that public service delivery—measured by access to infrastructure or outcomes—improved through community involvement,⁵⁶⁴ and others, that performance could be better.⁵⁶⁵

Yet social funds and self-help interventions continue to face serious challenges of sustainability. One challenge arises from the cultural and social context of communities and their capacity for collective action. It is not clear that the self-help approach can benefit fractured, heterogeneous communities that have little capacity for collective action. Alternative methods of service delivery may suit such poor communities better. But there is little factual evidence on this because evaluations typically do not compare social funds and self-help projects with conventional service delivery mechanisms. Nor do they take into account the negative side effects. The sustainability of self-help projects can be in jeopardy if line ministries or local governments ignore them once they are completed. Unless communities can ensure continuing support for recurrent costs and staff, they may not be able to sustain their project.

Donors need to disburse funds fast and to show visible results quickly to supporters or taxpayers. A recent study in a Sahelian country, also applicable elsewhere, shows that these needs may be incompatible with reducing poverty.⁵⁶⁶ When donors are impatient, when they compete with similar agencies for good projects, when they do not have the capacity to monitor activities on the ground, they may choose particular groups to work with—risking the capture of donor funds by elites. Impatient donors may even make the patient donors attach greater weight to quick results, undermining the prospects for poverty reduction. This becomes a serious problem when malevolent elites capture donor funds for private gain. But that need not be the case (box 11.2).

Social funds and self-help projects should be designed for each context, with best-practice templates as initial guides only. Rapid

expansion of such projects by donors with little experience may not be feasible. Rather than implementing numerous enclave operations in a single recipient country, donors could pool support openly and transparently to achieve better results in scaling up and preventing elite capture—even when bypassing the policymaker-provider relationship in a failed state or low-income country under stress.⁵⁶⁷ Where conditions are right, the pooling of aid should not stop with the donors—it should extend to national and local governments and other providers, private for-profit and not-for-profit.

Donors can also promote other initiatives to enhance client power. They can encourage citizen monitoring of service providers, such as report cards and public expenditure tracking surveys (chapters 5 and 10, and see spotlight on Uganda). They can help monitor the use of services and support benefit-incidence analyses to identify the groups missing out. Keep in mind, however, that involving providers in the design of the monitoring process is critical to ensuring buy-in for the results.

Promote voice

Promoting citizen voice through formal political mechanisms or through informal advocacy groups or public information campaigns is one of the most difficult endeavors

for donors. Yet donors attempt to do it in many ways—a testament to the importance of voice in service reform. The attempts include imposing conditions and setting performance criteria on aid flows where voice is weak, providing direct support to democratic governance, and actively promoting transparency and participatory processes.

By imposing conditions donors try to replace the weak voice of citizens in disciplining policymakers (chapter 5). Yet donor conditions are fundamentally different from citizen voice, which is diffuse, after-the-fact, and a long-term process. In the 1980s structural adjustment loans extended conditions in projects to a wide spectrum of government economic policies, processes, and public spending. There is ample evidence today that conditions based on promises do not work well, because they undermine ownership of the reform program.⁵⁶⁸

When policymakers are not encouraged to develop their own positions on, say, privatization of water supply or other services, but rely on donor conditions in taking action, they can more easily deny responsibility for a later failure. It is not the quantity of aid that makes the recipient's policies good or institutional reforms happen. Empirical studies show that aid finance is ineffective in inducing policy reform in a bad policy environment.⁵⁶⁹ What works

BOX 11.2 Social Investment Fund: Jamaica

There are more questions than answers on how self-help projects really work. Do they improve participation and targeting? Do they build capacity for collective action? One way to answer these questions is to analyze how the process works in a particular political, social, and cultural setting.

A case study of the Jamaica Social Investment Fund integrates quantitative and qualitative data from five pairs of randomly selected communities. Each pair has similar social and economic characteristics, but only one of the pair participated in the social fund. The fund typically uses NGOs to mobilize communities to participate. The NGOs work closely with local elites, such as pastors and teachers. Project selection is not generally participatory but is driven by this small, motivated group. Once construction of a service facility commences, however, the group is often able to

motivate a larger group to contribute to the project. And once completed, the service facility is generally viewed as belonging to the community and there seems to be wide satisfaction with the outcome. But it also appears that the positive social benefits from a community-based intervention may be difficult to sustain in the long term, particularly in communities beset by deep divisions.

Quantitative data on 500 randomly chosen households from the same five pairs of communities mirror these qualitative findings. Within-community "preference targeting" is poor, with three of the five participating communities not obtaining the project preferred by a majority. By the end of construction, however, 80 percent of the community members expressed satisfaction with the outcome. More educated and networked individuals dominate the selection process and are more likely to have their priori-

ties met. The Social Investment Fund also appears to have improved trust and capacity for collective action, but the gains are greater for more educated and networked individuals. So the process might be characterized as "benevolent capture": elites dominate the process but in a way that eventually benefits the community. Both participating and nonparticipating communities show more community-based decisionmaking, indicative of a broad-based effort to promote participatory development.

The Jamaica Social Investment Fund shows that self-help does not necessarily "empower the poor" and can be either supply or demand driven. But community involvement does seem to make service delivery more effective by increasing ownership and participation and by improving the capacity for collective action.

Source: Rao (2003) and Rao and Ibáñez (2003).

better is choosing recipients more carefully, based on performance (country selectivity), and setting conditions that reward reforms completed rather than those promised.⁵⁷⁰

Traditional conditionality does not work well. How can donors then allocate aid so that it provides a strong incentive for the recipient to promote citizen voice and undertake service reform and thus increases aid effectiveness? In principle, there is broad agreement today that, instead of conditions, the aid compact needs to contain verifiable indicators that can measure performance. But, in practice, the use of performance indicators has not yet changed the incentives underpinning the relationship between recipients and donors.⁵⁷¹

Few performance indicators used today measure outcomes; most still measure inputs and processes. So far the link between these operational performance indicators and the outcome targets articulated in poverty reduction strategies remains vague. And there are few transparent mechanisms

to allow donors to signal the conditions for a recipient to expect an increase or reduction in aid. Initiatives to improve the measurement of results are under way, but it will take time to establish an effective link between the volume of aid and performance.

There is also tension between the monitoring and incentive functions of performance indicators. Donors, preoccupied with fiduciary concerns, tend to keep a close watch on the programs they support—hence the focus on short-term process undertakings rather than genuine outcome measures as triggers for performance evaluation.⁵⁷² But this can lead instead to micromanagement, exactly what the new system of performance-based conditions is intended to avoid. This tension, if unresolved, makes aid compacts incoherent.

Many bilateral donors go further and support electoral participation and democracy directly and use aid to induce and reward such reforms (box 11.3). For example, donors rewarded Ghana for holding free elections in 1992, despite the excessive public spending prior to the elections that resulted in poor macroeconomic performance.

Donors also support informal mechanisms to strengthen citizen voice. One is to promote participatory processes in the development of poverty reduction strategies and budgetary processes (box 11.4). But aid agencies and recipient governments sometimes have different views on what form the participation should take. Aid agencies seldom hold a dialogue with parliamentarians, stressing instead the extragovernmental aspects of participation, involving a wide range of civil society. Members of parliament sometimes view the donor emphasis on civil society as undermining the legitimacy of elected representatives, particularly in emerging democracies. They also question the legitimacy of NGOs selected to speak for “the people.”

Donors have encouraged many low-income countries to open policy debates and discussions when preparing poverty reduction strategies. Governments are working to bring the views of a wider range of stakeholders into discussions. Madagascar, Rwanda, and Vietnam now have more timely information, make greater use of

BOX 11.3 *Donors support democratic governance*

Most bilateral donors explicitly include promoting democracy among the goals of their aid programs. The U.S. Agency for International Development alone spends more than \$700 million a year on programs—supporting free elections, fostering civil society organizations, and strengthening parliaments, judiciaries, and political parties. Election assistance is the highest-profile component of democracy promotion. Particularly in postconflict situations, numerous bilateral donors, international organizations—such as the United Nations, the Organization of American States, and the Organization of Security and Cooperation in Europe—and private organizations send observer missions and provide assistance to election administrators. More than 80 international groups observed the 1996 elections in Nicaragua. Aid for promoting democracy has increased from 0.5 percent of total official development assistance in 1991 to 5 percent in 2000.

The donor approach to democratic governance—democracy, participation, human rights, and the rule of law—has striking similarities to the rest of aid: a heroic short-term effort to get countries through a sudden takeoff to democracy. Rather than try to reproduce certain types of institutions,

donors could more actively nurture core political processes and values, such as representation, accountability, tolerance, and openness. Legislative aid programs have often failed due to donors' lack of knowledge about the political and personal dynamics of the institutions they are trying to reshape, their determination to apply models that do not fit the local situation, and their focus on technical solutions (such as new rules for staffers or Internet access) for deeply political problems.

To overcome some of these problems, the Swedish International Development Agency (SIDA) has initiated a new type of analysis of the underlying interests and power relationships as part of a program to support political institutions in Burkina Faso, Ethiopia, Kenya, and Mali. In electoral assistance SIDA has moved to longer-term programs and closer donor collaboration in South Africa and Zambia. In Cambodia it supports a “national issues forum” to air public debates on topics like corruption and trafficking in women and children on television and radio across the country.

Sources: Carothers (1999), Ottaway and Chung (1999), Knack (2001), and SIDA.

local languages, and use participation more than consultation. There is also evidence that these processes are influencing a shift toward broader consultation on government decisions beyond the poverty reduction strategy. But major challenges remain in regularizing greater openness in government decisionmaking.

Poverty reduction strategies seek to promote stronger citizen voice, with an effective link to public spending. But they also seek to change the relationship between recipients and donors by stressing the recipient's ownership of the reform agenda. There are often tradeoffs when one instrument is used to achieve multiple goals. Countries preparing the early poverty reduction policy papers (PRSP) faced many challenges in managing the participatory process and linking their strategy to the budget, while adhering to tight timetables for debt relief for which a PRSP was a condition. Experience in many countries suggests that when a government presents a national development strategy, supported by broad ownership and well-defined sector priorities, this contributes in no small measure to attracting broad donor support. Moreover, it also offers a framework to better align and harmonize donor support.

Align aid delivery with service delivery

For donors that want to align their aid delivery with service delivery in recipient countries, this Report has three important messages.

- First, evaluate interventions and aid projects for impact. More systematic evaluations of, say, an intervention's effects on student learning or health status are critical for scaling up in both middle- and low-income countries. Evaluation linked to early steps toward rebuilding state capacity is important in situations where donors are working through alternative service providers due to conflict or state failure.
- Second, to reduce the costs of aid fragmentation and to build capacity, work with other donors to harmonize and align policies, procedures, and practices

BOX 11.4 Donors support transparent budget processes: Tanzania

Since 1997 Tanzania has conducted an annual public expenditure review, led by the government with the participation of donors and a wide range of civil society. A primary objective is to review the government's forward expenditure plans in its medium-term expenditure framework, to discuss the program with donors, and to confirm the external financing. From its inception the initiative also had the objective of developing a public consultative process to engage a wide range of domestic constituencies on the government's performance and forward plans. The working group overseeing the process is led by the Ministry of Finance but includes members from donors and a range of nongovernmental bodies.

Several features of the process show how donor accountability requirements can be met in a way that promotes a sustainable domestic system of accountability:

- Not tying the consultations to a single donor or financing instrument. Individual donors can use the process in their own monitoring and review procedures.
- Grounding the review process in the domestic policymaking and budgetary cycle, rather than in donor review pro-

cedures that open the possibility for domestic constituencies to use the process increasingly for their own purposes of legislative scrutiny, feedback, public comment, and lobbying.

- Expanding the scope of the review over time, from immediate donor concerns—how donor interests have been addressed in budget plans or how donor finance features in the framework—to broader concerns of policy and performance, such as the government's overall strategy and how it is reflected in budget plans, performance record, and efforts to strengthen service delivery. The review also provides a national forum for attending to various sectors and lower levels of government.
- Having domestic players take on a greater role over successive budget cycles, both in government and among constituencies outside the executive, including the legislature and civil society groups.

Source: World Bank staff.

around the recipient's own systems. Where country systems are weak, they need to be strengthened to meet good practice standards, not bypassed and substituted with ring-fenced donor systems and procedures. This is crucial for aid effectiveness in low-income countries that receive a substantial part of their public resources as foreign aid. But it is also relevant in middle-income countries in sectors where donors are especially active, as in social protection in Latin America and elsewhere.

- Third, harmonization and realignment are best done at the country level and by strengthening the recipient's existing institutions. In countries with fairly good expenditure management and genuine service reforms—where donors and recipients trust each other—budget support should be considered a viable tool. Resource pooling can also be effective in scaling up service delivery and reducing transaction costs in low-income countries

that are under stress—for example, due to past or current conflict.⁵⁷³

Innovate and evaluate

Large public sector organizations—in both donor and recipient countries—focus on inputs and process evaluation rather than outputs and outcomes (box 11.5). The incentive to do this in aid agencies is even stronger because of the broken feedback loop between taxpayers in the donor country and beneficiaries in the recipient country (figure 11.1). Outcome and impact evaluations are seldom built into aid projects. Special attention is required to counter the tendency of aid agencies to be input-oriented and to increase the share of interventions subject to rigorous impact evaluation. Outcome-oriented international targets, such as the Millennium Development Goals, can add to the incentives for aid agencies to overcome their focus on inputs.

A major difficulty in assessing the impacts of any public program is that beneficiaries are rarely selected randomly. Indeed, most programs are purposely targeted to specific groups or regions. Isolating the impacts from the circumstances that led to participation is then tortuous. Yet not

doing so may produce misleading results. Schemes that select participants randomly provide the best opportunities for unbiased impact evaluation. An example is the Education, Health, and Nutrition Program of Mexico (Progresa), a large government transfer program (see spotlight). Strong evidence of its high impact led to an expansion of the program in Mexico and the adoption of similar programs elsewhere. Another example is the secondary school voucher program in Colombia, which assigned beneficiaries by lottery, making it feasible to compare those receiving vouchers with those who did not.⁵⁷⁴ A randomly assigned pilot program for treating intestinal worms in Kenyan schoolchildren has been similarly evaluated.⁵⁷⁵

In many operational settings, however, randomization cannot be applied, and other methods must be found to create a matched comparison. Even when data on beneficiaries before and after implementation exist, determining the real effects of a program or policy change requires data on matched comparison groups to get at the counterfactual of what would have happened without the policy. For some schemes that do not have baseline data, it is possible to construct an adequate control group from the postintervention data. But baseline data are needed for others, such as rural roads with far-reaching impacts on poverty, health, and education outcomes.⁵⁷⁶

Not every program can be evaluated for impact, so governments and donors should select programs for evaluation carefully, focusing on areas where new knowledge is needed. Interventions rolled out in phases because of budget and other constraints offer good opportunities for effective impact evaluation. Similarly, when a pilot is required before a large-scale rollout, an impact evaluation will generate important information for decisionmakers.

Harmonizing donor support around recipient systems

Harmonizing is easier where the recipient has a well-functioning national development strategy and budget process that can serve as the common framework. But these are not prerequisites—for even in their

BOX 11.5 *Why aid agencies focus on inputs*

The disruption in the feedback loop between donor country taxpayers and recipient beneficiaries, combined with the complexity of measuring performance, results in a focus on inputs in aid agencies. Budgets, contracts, and expenditures on projects are easier to monitor and assign than are the outputs and impacts that the aid projects produce.

Elected policymakers in donor countries impose administrative procedures on aid agencies to restrict their discretionary decisionmaking. In addition, bureaucracies tend to develop their own procedures, which increases the complexity. In this sense aid agencies are like any other large public organization. Extensive consultations with non-governmental organizations diffuse the risk of political pressure in donor countries—and complex tender and contract procedures defuse criticism by aid service suppliers. With such an incentive structure, aid agencies allocate comparatively few resources to verify

the results of aid projects or to mainstream rigorous impact evaluation. The input bias and the need to handle political problems or pressures tilt staffing toward generalists and administrators.

Yet most aid projects include a formal evaluation requirement. Process evaluations—such as audits, monitoring, and verifications that the intended action took place—are often conducted well. Outcome evaluations are seldom built in, and if done at all are contracted later to consultants. If evaluations are a small part of these consultants' foreign aid market, they also tend toward input bias and may avoid revealing results that can affect their main market. Consultants may not consciously misreport; the market pressure is usually more subtle. Contractors who work mainly for aid agencies often become generalists themselves.

Source: Martens and others (2002).

absence harmonization and pooling of aid can offer significant benefits and reduce transaction costs.⁵⁷⁷ In low-income countries coming out of conflict or in situations of very weak public institutions, a “budget within the budget”—with separate accountability mechanisms for donors—or an independent service agency funded by donors, or a consortium of nongovernmental providers chosen jointly through a transparent process can be relevant options.⁵⁷⁸ Both arrangements can be linked to public sector reform efforts, which emerge over time. But to be effective, harmonization requires a radical realignment of procedures and operational policies in donor agencies, as the health project in Bolivia shows (box 11.6).

For donor-financed services shifting responsibility—and hence accountability—toward the recipient would reduce duplication, waste, and transaction costs. It would also keep donors from crowding into a few fashionable sectors—and thus lessen concerns about absorptive capacity. And it would build capacity, improve collective learning, and create stronger incentives for monitoring and evaluating impacts and results.

A common refrain is that recipients need to improve their financial management and public procurement practices before donors can align their support around the recipient’s systems. But reality is more nuanced. First, donors need to ask whether relying on country systems is riskier than the alternative of ring-fencing. Currently, developing-country borrowers must produce 8,000 audit reports every year for multilateral development banks—5,500 of such reports for the World Bank. Such a fragmentation of activities cannot increase accountability. Second, even if it is riskier, this needs to be set against the more sustainable benefits of helping to build the recipient’s institutions and systems. Third, donors need to avoid the trap of making a given level of capacity a condition for aligning or pooling aid, when in many cases the pooling launches efforts that can get capacity closer to where it needs to be. That said, there will still be cases in which donors judge (rather than scientifically determine) that it would be inappropriate to pool, given the fiduciary risks.

Sectorwide approaches

Since the mid-1990s many countries have worked to integrate government and donor activities within a sector. In the *ideal* approach, outlined in early documents on sectorwide approaches, the government and its partners would agree on a predictable resource envelope and on a policy environment consistent with the national budget and economic strategy.⁵⁷⁹ They would then agree on how to assign resources within this envelope. Procedures for disbursement would be harmonized, and funds would be pooled. All activities would reflect a shared view of the priorities and costs of activities. Differences would be resolved by compromises in the design of programs, not in the activities undertaken. There would be no detectable difference between the approach taken on government-funded and that taken on donor-funded activities; indeed, that distinction would wither away.

Sectorwide approaches have been established in several sectors in many low-income countries—health, education, agriculture, transport, energy, and water.⁵⁸⁰ Efforts so far are only partial realizations of the ideal. To some extent determining what constitutes a sectorwide approach is still an arbitrary decision. There has been progress toward pooling funds in recent

BOX 11.6 *A case for harmonization in Bolivia*

In Bolivia three donors in the health sector agreed to cofinance construction of a building. But the fact that each donor had its own procurement procedures made it difficult to find a common approach. The donors could not pool their contribution in a common fund because the agencies’ rules prohibited channeling money to another agency. None of the agencies could accept the procedures of the others, and two of the agencies were unwilling to adopt Bolivian rules.

A thematic approach was considered first. One donor would pay for the design, another the construction works, and the third would contribute paint, air conditioning, electrical apparatus, and lavatories. Then, for practical and administrative reasons and to avoid blaming the other agencies if something went wrong, it was suggested that each donor would pay for

particular floors, procuring the materials and hiring builders according to its own standards and procedures. The idea was that one donor agency would finish the first two floors, after which the second would build the third floor, and the third would finish the building.

After long debates, one of the donors withdrew from the project. Of the remaining two, the one contributing the smaller amount accepted the rules of the donor putting up the bulk of the funds. Only one contractor would be hired, not the three previously envisaged, and just one engineer would supervise construction. One agency would oversee the entire process. The process took two years, and the foundation stone has yet to be laid.

Source: World Bank (2002i).

years, however. For the 24 programs tracked by the Strategic Partnership with Africa in 2002, 41 percent of assistance came through projects (down from 56 percent two years earlier), 13 percent through NGOs, 11 percent as common basket, and 35 percent as budget support. In Ghana's health program the pooling arrangements started with "one donor and minimal funding" but later reached 40 percent of program resources.⁵⁸¹

Preparing and implementing sectorwide approaches can be a long, drawn-out process. It can also weaken rather than strengthen the recipient's compact between its policymakers and provider organizations by taking the sector out of the domestic decisionmaking process, particularly the budgetary process, financial management and public procurement.⁵⁸² Four lessons have emerged from sectorwide approaches:

- An institutional analysis of the sector is recommended beforehand, including the sector's relation to the rest of the public sector.
- If the capacity constraint is in the lead ministry rather than the country, new personnel can sometimes be found quickly, as in the Ugandan education and health sectors.⁵⁸³
- Procedures need to be designed with capacity limitations in mind, particularly at decentralized levels. This will often involve encouraging public transparency and bottom-up monitoring to bolster simple but rigorously enforced upward-reporting requirements. Procurement procedures—often a major difficulty—need to balance rigor with simplicity.
- Capacity constraints are not a reason to delay a sectorwide approach. Few countries achieve the ideal, but most can benefit from some aspects of the process.

Assessments of sectorwide approaches have reached mixed findings. Ratings by the Strategic Partnership with Africa in 2002 show an average implementation rating for programs of between 0.42 and 0.58, depending on the sector (on a scale where 0 is poor, 0.33 fair, 0.66 good, and 1 very good). But it is possible that these relatively poor ratings

also reflect the ambitious agenda for sectorwide approaches. A tentative conclusion is that sectorwide approaches are an important part of a poverty reduction strategy, not an alternative, and the full benefits will not be realized until financing mechanisms become more flexible.

Budget support

The focus on budget support was sharpened by the debt relief for heavily indebted poor countries, allocating relief to priority sectors through the recipient's budget. Budget support restores the compact between policymakers and providers. It allows contestability in public spending. And it reduces the costs from fragmentation and separate project implementation units. Providing funds to the general budget also offers a better framework for discussing intersectoral allocations. Advocates of more funding to one sector have to show that the sector has higher returns than others at the margin.⁵⁸⁴ If funds go to sectors that demonstrably reduce poverty—directly or indirectly—donors should be flexible about budget allocations.

Budget support, like basket funding for a sectorwide approach, raises questions of fiduciary risk. But there is no clear evidence that the risk is greater for budget support than for project aid.⁵⁸⁵ Needed are transparent systems for procurement and public information to ensure that the movement of funds through the system can be publicly observed and that charges paid for services are clearly defined. Donors can contribute best by promoting these systems in the recipient country. The Utstein group of donors—the United Kingdom, the Netherlands, Norway, and Germany—has been developing monitoring arrangements along these lines. The European Union links part of its budget support to performance, using a small set of indicators (box 11.7).

What does all this suggest? That aid will work best where it is provided flexibly to recipients with sound overall strategies and well-designed sectoral programs. Flexible aid can catalyze processes within governments to produce sound strategies, rational spending programs, and effective services.

Knowledge transfers

Donor competition for new ideas can be good for the recipient. It can also create confusion, particularly in low-income countries that have weak capacity. One solution is to pool knowledge transfers and joint analytical work at the country level, including impact evaluations of interventions and programs. All analytical work supported by donors should draw on in-country capacity, including universities, government, and the private sector (box 11.8).

Poor institutions—post-conflict and “failed” states

In poor institutional environments—as in post-conflict countries or “failed” states—donors may not be able to rely on conventional channels of service provision because policymakers and providers lack the capacity or the intent to use resources well.⁵⁸⁶ Whatever the short-term or even medium-term delivery vehicle, aid should contribute in the longer term to rebuilding an effective service delivery system and public sector. The temptation to avoid the government is understandable. But without some clear and shared donor strategy for rebuilding a responsive and effective state, the proliferation of nongovernmental and community-based organizations—and self-help and social fund initiatives—will lack breadth of impact and sustainability. Civil society organizations cannot design national policies or standards. Nor can they substitute in the long term for the citizen-policymaker relationship.

The options for donors range from selectively supporting existing programs, such as immunization programs operated by the government or private providers, to establishing an independent service authority with a temporary mandate to deliver or regulate basic services.⁵⁸⁷ In between are self-help projects and social funds. An independent service authority and a social fund are ways to deliver services in difficult circumstances, perhaps by wholesaling to a local consortium of NGOs, religious organizations, and private firms. Such organizations require institutional autonomy to

BOX 11.7 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.
- Births assisted by medical personnel.
- Enrollment rates for boys and girls.
- 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 but 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: European Commission.

ensure high standards of accountability directly to donors. To deliver on such standards, hiring may have to be outside the public sector. Again, donors should coordinate and pool their support to reduce waste and duplication, financing both recurrent and capital expenditures.

Donors face the challenge of finding a balance between short- to medium-term institutional failures and the long-term creation of an effective state that can deliver on its public responsibilities. Donors have sought to address short-term service needs through national and international NGOs, social funds, United Nations agencies, or a combination of these providers. What needs to be given equal emphasis is the identification of country-specific paths for strengthening capacity and reduction in patronage and corruption. Nongovernmental channels for service delivery can thus play a very important role but should be seen as a transitional strategy to strengthen state capacity in the long term.

Even in the weakest states donors and domestic stakeholders would benefit from

BOX 11.8 *Pooling knowledge transfers*

To improve access to infrastructure services for poor people, several donors have pooled funds to augment and disseminate knowledge on infrastructure services. These facilities, administered by the World Bank, provide a source of knowledge and advice that is “fire-walled” from the Bank’s lending activities. Donors in the pool are Canada, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United Nations Development Programme.

The Energy Sector Management Advisory Program, a global technical assistance program, focuses on energy in economic development, with the objectives of contributing to poverty alleviation and economic development, improving living conditions, and preserving the environment. It focuses on:

- Market-oriented energy sector reform and restructuring

- Access to efficient and affordable energy
- Environmentally sustainable energy production, transportation, distribution, and use.

The Water and Sanitation Program assists central governments, municipal agencies, local authorities, NGOs, community organizations, private service providers, and external agencies in helping poor people gain sustained access to better water and sanitation services. It focuses on:

- Policy, strategy, and institutional reform advisory services
- Innovative solutions to problems, including pilot and demonstration projects
- Strategically selected investment support services, including networking and knowledge sharing.

With its strong field presence in Africa, South and East Asia, and the Andes, the program has a well-established network of sector specialists who can respond quickly to the changing demands of clients.

The Public-Private Infrastructure Advisory Facility is a technical assistance facility helping developing countries to improve their infrastructure through private sector involvement. It pursues its mission through:

- Technical assistance to governments on strategies for tapping the full potential of private involvement in infrastructure
- Identifying, disseminating, and promoting best practices related to private involvement in infrastructure.

Source: World Bank staff.

pooling efforts for a better results. Harmonization of aid may not be feasible through budget support, but agreement on a common framework and implementation arrangements for service delivery will help avoid too heavy a burden on limited domestic capacity. Further, it is important to share lessons and to recognize that aid may be less effective when modalities that work in good policy environments are transferred to other situations. The flexibility of “eight sizes fit all” includes a strong emphasis on country context.

Why reforming aid is so difficult

The unintended negative effects of donor behavior are not a recent discovery. *World Development Report 1990: Poverty* (World Bank (1990)) discussed the role of aid in poverty reduction, drawing attention to many similar problems. Why has there not been more reform? Why, for instance, are donors so reluctant to channel aid as part of the recipient’s budget?

Simplifying donor policies, procedures, and practices and directing aid flexibly through sectorwide approaches or the budget process would lower the high transaction costs in low-income countries and allow recipients to pursue their objectives more efficiently. That could be done if

donors were driven solely by the motive to reduce poverty—and if recipients were perceived to be committed to the same goal. But the world is more complex. Incentives in aid agencies and the political economy of aid in donor countries work against this:

- Aid agencies want to be able to identify their own contributions, often through distinct “projects,” to facilitate feedback to taxpayers and sustain political support for aid flows. A new hospital is easier to showcase than the outcome of policy reform or budget support.
- Aid agencies, facing disbursement pressures, need to show quick results to taxpayers—and NGOs, to their contributors. This is easier when donors are in charge of interventions.
- Politicians and policymakers in donor countries cannot dismiss the interest groups that support them, groups that may place a high priority on funding like-minded groups in developing countries.
- Many donors limit the market for aid services and supplies to their own nationals (tied aid). Foreign aid sustains a large consultancy industry in OECD countries—estimated at \$4 billion a year for Sub-Saharan Africa, or 30 percent of aid to the continent.

- Preferences for spending differ among donors and between donors and recipients. Donors often are most comfortable with service delivery systems of the type operating in their own country. For instance, British and Nordic advisers are familiar with a clinic-based free health service and so prefer to support those systems in low-income countries too.
- Fiduciary concerns and incentives in aid agencies cause donors to focus on monitoring inputs and processes. Again, the monitoring is easier in project aid where the donor controls the design and implementation of each intervention.
- Donors may want to persuade aid recipients of the value of a different approach through a pilot project, to show success.
- Bilateral donors distribute their aid budgets across a large number of recipients and sectors, to increase the visibility of their programs or to leverage or reward diplomatic support from recipient nations.⁵⁸⁸ More specialization among sectors or recipients, however efficient, could expose a donor to charges that it is neglecting, say, a global health crisis or a regional humanitarian crisis. Such con-

siderations help explain why the typical bilateral donor in 2000 provided official development aid (ODA) to about 115 independent nations. Even omitting recipients that received less than \$100,000, the mean number of ODA recipients for each of the 22 major bilateral donors was 95.

These multiple objectives create incentives for donors to finance and directly control their aid interventions. That creates problems for recipient countries: donors often do not know (or don't care) what other donors and the recipient are doing, which results in duplication, waste, and gaps in services.⁵⁸⁹ These days donors tend to favor social sector projects over other public expenditures. If they do not pay attention to what the others are doing, they may concentrate too much on higher-priority sectors, leaving sectors with a lower priority, such as rural roads in Zambia, short of funds. Or there may be gaps in the priority areas simply because nobody is looking at the big picture. But priorities among donors vary, and their approaches change over time.⁵⁹⁰ So there is some scope—and hope—for improvement.