# Trends and Features of Research on Foreign Aid: A Literature Review

Pedrosa-Garcia, Jose Antonio

University of Cape Town

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Jose Antonio Pedrosa Garcia[ξ]

University of Cape Town[φ]

## Abstract

This paper reviews the economics literature on foreign aid. Aid supporters tend to emphasize results, while its detractors tend to highlight the incentives it provides (although they may still acknowledge some of aid's positive results, particularly on public health). Like the modes to deliver it, research on foreign aid has evolved over the years. From the traditional aid-growth regressions research has refocused towards micro issues, including institutional inefficiencies or sector-specific bottlenecks. This tendency is positive, in so far as it can lead to useful policy advice that improves the way aid is given. Great gaps in knowledge remain, though. Notably, the aid market is poorly understood in aspects such as donors' interaction with the recipient government or donors' coordination. In terms of political economy, recipient countries' decision making with regards to aid fungibility or the incentives provided by new types of aid (notably China's) have been largely unexplored. Moreover, the types of public goods that improve households' living standards are little understood. The scarcity of research on these questions is greatly due to lack of data – or even data opacity; if aid is to be better understood and improved, far greater efforts must be made in terms of collecting and sharing data.

Key words: Foreign Aid, Research, Literature Review

[ξ] School of Economics, University of Cape Town. Email: jose.pedrosa@aya.yale.edu

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## *1. Introduction*

This paper presents the key features and trends in the literature on foreign aid over the years, including relevant aspects relating to the policy realm and other practical concerns.[1] Foreign financial assistance was conceived as a source of finance to poor countries and territories between World War I and World War II, however, aid as we know it today emerged with the Marshall Plan after World War II (Lal 2006). The world political context changed in the aftermath of that war and foreign aid soon became a tool to gain political clients (ibid). Decades later, the end of the Cold War led to another reconversion of aid's goals, this time towards humanitarian purposes, although the old ones were not necessarily abandoned. Thanks to these changes, aid has not only survived, but thrived. The number of aid agencies has continued to increase and their business models have been reinvented, while most of the agencies created since 1945 still exist (Harford, Hadjimichael & Klein 2004a). For example, the UNICEF broadened its mandate from emergency situations to long-term issues relating to children and women everywhere.[2] As a result, the 'aid business' (Hancock 1992) has become very substantial in many developing economies, going beyond 20 per cent, 30 per cent, and even 50 per cent of Gross National Product (GNP) (Lensink, White 1999). Without counting donors that are not part of the Development Assistance Committee of the Organization for Cooperation and Economic Development (OCDE/DAC), the mean number of donors per recipient country has been estimated at 16 (Rahman, Sawada 2010).

Perhaps the most interesting aspect of aid is that, despite this expansion, it remains unclear whether it works. The debate, as old as aid itself, has intensified over the decades. Several features of the discussion can be highlighted. At its core is the disagreement as to whether aid contributes to development or not. On the one hand, some authors argue that aid leads to growth (Hansen, Tarp 2001), although it has also been suggested that national growth-inducing policies may reduce its effectiveness because good policies and aid are substitutes (Dalgaard, Hansen 2001). A second group of authors argues that aid's ability to engender growth is conditional on some key feature; for instance, aid works if it is provided to countries that implement good policies (Burnside, Dollar 2000), or if the climatic environment is appropriate (Guillaumont, Chauvet 2001). A third group argues that aid is clearly counterproductive, although the recommendations within that group also differ. Some authors argue that aid should be stopped altogether (Friedman 1995) whereas for others, the reason

[1] The Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD/DAC) defines Official Development Assistance (ODA) as "those flows provided by official agencies under the following two criteria: i) they are administered with the promotion of the economic development and welfare of developing countries as their main objective, and ii) they are concessional in character and convey a grant element of at least 25 per cent" (OECD Stat 2016).

[2] UNICEF was established in 1946 to meet the emergency needs of children in post-war Europe and China. Its full name was the United Nations International Children's Emergency Fund. In 1950, its mandate was broadened to address the long-term needs of children and women in developing countries. UNICEF became a permanent part of the United Nations system in 1953, when its name was shortened to the United Nations Children's Fund (but its acronym did not change). Source: https://www.unicef.org/about/who/index_faq.html

why the different development panaceas (such as investment or debt relief) have not worked, is because purported basic economic incentives were not taken into account in the policy making (Easterly 2002b).

A fourth group adopts an alternative perspective and argues that aid's effectiveness depends on the goal set. Several objectives may be considered, such as poverty reduction, non-income factors such as starvation, education or health, donor countries' guilt-relief or political support, or the maximization of some aid agencies' flows (Kenny 2006). For instance, it has been found that school feeding programs significantly improve the growth and cognitive performance of disadvantaged children in developing countries (Greenhalgh, Kristjansson & Robinson 2007), or that male circumcision significantly reduces the risk of Human Immunodeficiency Virus (HIV) acquisition in young men in Africa (Bailey et al. 2007). It is argued that it is the high cost-effectiveness of aid that targets public health interventions which makes this aid worthwhile on average, even when other aid interventions may be worthless (Ord 2011).

Different diagnostics lead to different policy recommendations. Some economists call for more aid (Sachs 2014), while others say developed states should 'give what they can' (Ord 2011), and yet others claim that the international community should stop looking for big ideas and adapt its expectations to small incremental improvements (Hobbes 2014). Although warning against superficial and overly optimistic judgments on aid, a different view notes that there may be no convincing case for abandoning or rejecting aid, because the enduring justification for development assistance lies in its fundamental expression of the humanitarian impulse (Riddell 1987). Hence, the focus can only be how to improve it. To better a system that is too technocratic and accountable to donors rather than recipients, a paradigm shift may be necessary though, and complex adaptive systems has been proposed as the way to go (Ramalingam 2013). This view envisions a reformed aid system in which donors do not rigidly adhere to pre-determined blueprints, but instead engage in experimental innovation, implement projects that work in partnership with local systems, and adapt on the fly to changing conditions (ibid). The political agenda underpinning aid is a central element in the debate: focusing on small interventions weakens the scope for donors to drive recipient countries' agendas, which has been identified as a key source of the trouble aid brings to Africa (Glennie 2008).

There are also calls to finish aid. It has been defended that it is immoral to prolong aid when the results upon which aid's moral case is built (i.e. to help others) are missing (Mende 1973). Some even defend that African countries are poor precisely *because* of all the aid they have received, and add that ending aid would redirect accountability away from donors, towards recipient countries' citizens (Moyo 2009). In a similar vein, development strategies in the poorest countries should be about how to leave aid behind and end its dependence (Tandon 2008), with the central idea of reasserting an indigenous path out of poverty – especially using countries' diasporas (Phillips 2013).

## 2. *Exploring aid*

As recently as 2009, the lack of texts explaining how aid organizations work in practice was described as ‘striking’, especially given the enormous interest in the topic (De Haan 2009). Although there has been little emphasis on microeconomic explanations of why and how aid would work (or not), there are two notable exceptions. The first, Martens et al. (2002), analyzed aid focusing on principal-agent theory. The second, Mikesell focused on the assessment of development projects and programs in relation to their objectives, and the alternative forms of aid available for achieving those objectives (Mikesell 2007).

For decades, the thinking of western development economists was heavily influenced by the Solow model and its emphasis on capital accumulation through investment. Under this framework, it was expected that countries would be able to escape the poverty trap that prevented them from taking off. Once started on their virtuous circle, growth would continue and aid would no longer be needed. The successes of Marshall Aid in post-war Europe could be replicated in the Third World. The weakness of this approach as a theoretical foundation for aid became clear once it was obvious that aid investments were not leading to growth and that policies and ‘soft issues’ such as governance were critical (Krueger, Michalopoulos & Ruttan 1989).

Much of the aid debate has been driven by macroeconomic empirical evidence, usually in the form of regression-based research, a methodology that commenced in the early 1970s (Papanek 1973). That modus operandi has taken different forms to ascertain the influence of aid on (most often) economic growth (Rajan, Subramanian 2008), but also on human development indicators (Kosack 2003). The use of the regression-based methodology (or its abuse) has been criticized on technical grounds, a classic example being the 145 right-hand-side significant explanatory variables with 100 degrees of freedom (Durlauf, Johnson & Temple 2005).[3]

Another macroeconomic issue on which aid research has focused is Dutch disease. The potential concern is that large inflows of aid may induce a real appreciation of the recipient country’s currency, thereby reducing its exports’ competitiveness. Evidence of aid-based cases of Dutch disease is weak (Isard et al. 2006), although some authors have noted that aid affects a country’s competitiveness adversely, lowering the relative growth of its export industries (Rajan, Subramanian 2011). This may partly explain the lack of robust evidence between aid and growth (ibid). In their examination of twenty-six countries in Sub-Saharan Africa, Fielding and Gibson (2013) noted a variety of macroeconomic responses, but did remark that the adverse effects of aid on exports would be mitigated if aid led to investments in the traded goods’ sector (Fielding, Gibson 2013).

An interesting characteristic of the debate was the tendency to treat aid as homogeneous, neglecting the differences between its types. Such lack of attention, probably rooted in the unavailability of data characteristic of developing countries, persisted until relatively recently, even

[3] As cited in Easterly (2007).

though some aid critics recognized long ago that there are different aid modalities (Bauer, Yamey 1982). The different types of aid singled out include: "emergency and humanitarian aid (likely to be negatively associated with growth, since aid is given when calamities happen); aid that affects growth only over a long period of time, if at all, such as aid to support democracy, the environment, health, or education (likely to have no relationship to growth in periods of four years); and aid that is directly aimed at achieving growth: building roads, ports, and electricity generators, or supporting agriculture" (Clemens, Radelet & Bhavnani 2004). These authors find a strong positive relationship between growth and the third type of aid, while the relationship with the other types is less evident. Nowadays, even the strongest critics of aid distinguish the types of aid (Moyo 2009).

Aid has also been analyzed by comparing it with other financial flows. For instance, while aid is influenced by political variables, foreign direct investment (FDI) is more sensitive to economic incentives, and particularly to 'good policies' such as property rights in the receiving countries (Alesina, Dollar 2000). Besides capital accumulation, it is generally acknowledged that FDI promotes economic growth mainly by way of technology transfer, which explains why FDI only works with a minimum critical mass of human capital – since this limits the economy's capacity to absorb that technology (Borensztein, De Gregorio & Lee 1998). Thus, the effects of FDI come from higher productive efficiency: foreign firms have more 'knowledge' applied to production, owing to a combination of foreign advanced management skills with domestic labor and inputs (ibid).[4] The main advantages of FDI over aid are therefore twofold.[5] Foreign Direct Investments encourage economic growth and poverty relief, partly due to the incentives they provide for the transfer of 'know-how', partly because they are subject to the market test – this ensures they are carefully allocated and monitored (Klein, Harford 2005). As aid flows are not subject to these disciplines, they are not expected to be as effective. The comparison with other financial flows focused on their different qualities as follows (ibid, p.3):

| Qualities[6] | Example |
|---|---|
| Benevolent, monitored, smart | Ideal development assistance |
| Indifferent, monitored, smart | Foreign direct investment |

[4] A different issue would be what has been called the FDI-natural resource curse, i.e. do natural resources crowd out FDI? In this regard, evidence shows that natural resources have an adverse effect on FDI and that the FDI-resource curse persists even after controlling for the quality of institutions and other important determinants of FDI (Asiedu 2013). However, this topic goes beyond the scope of this dissertation.

[5] This does not imply that FDI may not have negative effects. For instance, in Venezuela some authors have reported negative spillover effects from FDI on the productivity of domestically-owned plants (Aitken, Harrison 1999).

[6] The criteria are:

a. 'How benevolent is the finance? The most benevolent finance would flow to the poorest people in the poorest countries exactly when they need it and would never need to be repaid.

b. How well is the finance monitored? Perfectly monitored financial flows would go exactly where their owners want them to go. Imperfectly monitored flows might be spent on pet projects, stolen, or wasted.

c. How much knowledge flows with the finance? Knowledge matters, whether provided as standalone advice or alongside financial flows. Much official aid is bundled with technical advice, but some private flows like foreign direct investment also come with advice and training.'

| | |
|---|---|
| Benevolent, unmonitored, smart | Careless development assistance |
| Benevolent, monitored, dumb | Workers' remittances |
| Indifferent, monitored, dumb | Bond market finance |
| Benevolent, unmonitored, dumb | Populist emergency aid |

One of the problems of regression-based research into aid is that the mechanism through which it would work is not explained, and it cannot be a "black box" if its pertinence is to be assessed (Bourguignon, Sundberg 2007). Three sequential steps are proposed: "a) External donors/IFIs to policy makers (the way aid is given), b) Policy makers to policies (governance and institutional capacity), and c) Policies to outcomes (knowledge of what works)" (ibid, p.3).

In this regard, since the 1990s there has been a move towards analyzing the transmission channels through which aid would improve people's lives. A first step was to investigate whether national budget allocations in certain sectors were associated with better outcomes, an approach that provided mixed results. For instance, the effect of public spending for education and educational attainment is low, while for health outcomes the picture is more mixed (Gupta, Verhoeven & Tiongson 1999). In a different sector, higher spending on water and sewerage might not lead to a proportional increase in the quality of service delivery, as leakages –both physical and financial– are high (Wolf 2007b). More recently, economists have also analyzed the determinants of public services, such as leaders' decision-making processes to provide public goods in resource-rich countries (Sarr, Wick 2010). Three aspects of sustainability have been identified as key for the success of service delivery programs: finance, leadership, and targeting of the most vulnerable populations (Mubangizi 2009). However, overall there has been little empirical research on the links between aid and service delivery. While Wolf (2007a) explores this area, her work focuses on the effects of aid volatility in low-income countries, where a large part of public expenditure for education, health, and water and sanitation is financed through aid (Wolf 2007a).

The governance dimension is central in the debate about aid effectiveness, and is usually used against aid. For instance, some economists have analyzed aid effectiveness across different political models (elitist, egalitarian and laissez faire) to note that aid does not increase investment nor benefit the poor across political regimes (Boone 1996). According to this research, aid only increases unproductive consumption, as reflected by the size of Government (ibid).

One of the most insightful theoretical frameworks of aid and political economy is probably the Selectorate Theory of Political Survival (De Mesquita, Smith 2009). This is based on the premise that leaders grant favors to retain office. If the system is a democracy, the coalition for leaders to stay in office is large, and leaders need to provide public goods. However, in autocratic regimes the coalition is small and private goods are offered instead (ibid). In this setting, aid is an instrument which political leaders use to retain office (not to alleviate poverty). To the extent that policies in the leaders' interests favor the citizenry, policies to reduce poverty can be implemented, but such instances are coincidental (ibid). Leaders of donor countries (big-coalition countries) give aid in exchange for policy concessions from recipient (small-coalition) countries (ibid). Thus, aid favors leaders of donor and recipient countries, and harms recipient-country (but not donor-country) citizens on two accounts: with bad policies and autocratic incumbent leaders who continue in power. A caveat is that, while this theory may apply to bilateral aid, it has little to say on multilateral aid (ibid).

Another attempt to discern why aid succeeds or fails has concentrated on institutional inefficiencies and implementation issues. It has been observed that there is a critical information feedback loop, whereby those who pay – taxpayers from donor countries – are not in touch with those who receive the services – beneficiaries in poor countries (Martens et al. 2002). Therefore, correction of errors in the selection and delivery of aid is very difficult. Adding the fact that those actions may already be badly designed (e.g. due to a lack of local knowledge to conceive optimal initiatives) the problem is twofold: on the donor side, foreign aid agencies usually have multiple principals (especially multilateral organizations) who may represent conflicting interests – both for the donor and for the beneficiary. And on the recipient side, embeddedness is a critical for success in the implementation of institutional reforms (understanding embeddedness as the fact that those national officers working with donors to implement reforms may be part of the problem themselves, as those reforms may go against their own interests). Indeed, those in office are not independent of the world and, thanks to asymmetrical information, may not push hard enough for the desired change, in what has been called the 'formal-versus-informal' reform conflict (Martens et al. 2002).

Using institutional analysis, Easterly (2002a) exposes some key problems in the environment that created aid bureaucracies. He argues that this environment led those international development organizations to, "(a) define their output as money disbursed rather than service delivered, (b) produce many low-return observable outputs like glossy reports and "frameworks" and few high-return less observable activities like ex-post evaluation, (c) engage in obfuscation, spin control, and amnesia (like always describing aid efforts as 'new and improved') so that there is little learning from the past, and (d) put enormous demands on scarce administrative skills in poor countries" (Easterly 2002a). This obfuscation may have political motivations, as donors only want to highlight the positive results of their aid and keep evaluation reports on their programs very close to their chests (Riddell 1987). Ironically, this provides ammunition to aid critics, who ask: if aid is doing so well, how come there is still poverty? (ibid).

Other aspects may be solved through more rigorous evaluations. Aid evaluation has always been challenging due to the high number of factors involved in aid programs. Up until the 1970s, cost-benefit analyses were common. From them 1980s, new challenges to evaluate aid appeared as changes in aid took place – in particular, the trend away from project-based aid towards policy-based lending (Berlage, Stokke 1992). As a result, traditional approaches such as cost-benefit analysis became increasingly limited (ibid). To achieve better evaluations, and although all economists do not necessarily agree (see e.g. Ravallion 2011), in recent years there has been a significant emphasis on randomized evaluations as the most scientific method to assess aid programs (Banerjee 2007).[7]

Despite the issues that remain open in the debate, a number of facts about aid have been learnt over the years. With regard to growth, for example, foreign assistance seems to matter more to tackle large negative shocks (Guillaumont, Chauvet 2001), and aid and growth don't have a linear relation (Kourtellos, Tan & Zhang 2007). Aid shows decreasing returns (Dalgaard, Hansen 2001), which may even follow a Laffer style curve, i.e. turning negative beyond a certain threshold of around 40-50 per cent of GNP (Lensink, White 1999).

Regarding the determinants of aid, it seems evident that a vital factor determining aid flows (and their effectiveness) is how recipient governments use the aid they receive (Feeny 2007). In a model assuming bounded rationality and an interactive relationship between the two factors of donors' aid-giving behavior (internal memory and environment), four main motives for aid were detailed: instrumental or self-centered, humanitarian or recipient needs-based, ideological, and incremental or inertia – i.e. where actual levels of aid allocations depend on previous levels (Imbeau 1989). The conclusion was that the instrumental reason is the best explanation once inertia has been accounted for (ibid). Thus, it seems clear that in addition to economic need, aid donors respond to political and strategic considerations such as colonial past and political alliances (Alesina, Dollar 2000). These motives can also change over time; for instance, the rising importance of Chinese aid in Africa (motivated by the availability of natural resources), may have contributed to a shift of US foreign aid to make it more recipient-needs' based (Amusa, Monkam & Viegi 2016).

Other authors have also examined the extent to which aid is allocated to reduce poverty. Sawada et al. (2008) find that in the late 1990s and the early 2000s, grant allocations from Canada, France, Japan, the Netherlands and the UK were consistent with the necessary conditions to reduce poverty (Sawada, Yamada & Kurosaki 2008). The overall results show allocation patterns consistent with poverty targeting, although there is a negative population scale effect, reinforcing the view that "strategic motives exist" (ibid). Finally, the coordination among major donors towards global poverty reduction has recently improved (ibid).

It has also been argued that with a poverty-efficient allocation, aid would sustainably lift out of poverty around 19 million people per year, whereas with the actual allocation it lifts out an estimated 10 million (Collier, Dollar 2002). From that standpoint, the other goals of aid (e.g. support to donors' strategic interests) could be considered as a tax to poverty-reducing aid.

## *3. From theory to policy*

Given what is known, how should foreign assistance be provided? Policy-makers do not always follow economic theory principles (as aid may be given for other geostrategic political motives), and translating knowledge into policy-making remains a challenging issue. With inconsistencies in the

[7] Also known as randomized control trials (RCTs).

body of knowledge it is not easy to offer consistent policy advice; e.g. while there is no agreement about whether aid leads to growth, it is also argued that aid volatility is negatively associated with economic growth in the long run (Markandya 2010), and that donor proliferation linked to free-riding leads to a sub-optimality of aid flows (Rahman, Sawada 2010).

What seems clear, looking at aid flows over time, is that conditionality has decreased (Harford, Klein 2005a) and country selectivity has increased (Dollar, Levin 2006) — effects that may have been associated with one another.[8] It has been argued that the reason for increased country selectivity is the lack of credible punishments for breaching conditionality clauses (Djankov, Garcia-Montalvo & Reynal-Querol 2006). Increased selectivity meant seeking recipients with better policies (Dollar, Levin 2006) and stricter screening of recipient countries by donors. For instance, in 2004 the USA established the Millennium Challenge Corporation (MCC), which a country has to undergo performance assessments on 17 policy indicators before it can become eligible to receive assistance.[9] In the multilateral arena, in 2005 the World Bank started elaborating its Country Policy and Institutional Assessments (CPIA), which rate countries against 16 criteria from four clusters: i) economic management, ii) structural policies, iii) policies for social inclusion and equity, and iv) public sector management and institutions (World Bank 2011). These initiatives for higher selectivity were probably a consequence of evidence that more corrupt governments had not been receiving less aid – if anything the opposite (Alesina, Weder 2002). The emergence of such evidence supported the thesis that aid helps dictators, and had strong effects on some donors (De Mesquita, Smith 2009).

Aid can be classified according to several criteria, e.g. based on its purpose, such as food aid, etc. A different typology relates to the way of delivering it. From World War II till the late 1970s, the main modality to deliver assistance in poor countries was project-based aid, at the core of what has been called the "Western" model (Hayter 1971). The Western model is characterized by funding from donors extended on a project basis and managed by expatriate professionals (Tisch, Wallace 1994), who typically can be in the country from a few months to about 3-4 years. This has been criticized because it can lead to cultural imperialism, as Western advertising, media or consumer goods reach all everywhere in the world (ibid). Though project-based aid is still important at present, the period when project-based aid reigned was characterized by a combination of growing world demand, foreign aid and stable commodity prices that favored a worldwide decline in poverty and an improvement in basic measures of human welfare (Mohan et al. 2000). During this time, there was 'international adjustment', and the burden was shared by donors and developing countries (ibid). In the 1970s, events such as the end of the gold standards in the US or the oil price crises favored a paradigm shift

[8] Including tied aid, a type of conditionality that restricts the ways in which aid can be spent by the beneficiary country. As a form protectionism, the most criticized form of tying aid required that it be spent purchasing products or contracting private sector companies from the donor state (Jepma 1991).

[9] The MCC is a U.S. foreign aid agency whose most distinctive feature is 'competitive selection': before a country can receive MCC assistance through the Millennium Challenge Account (MCA), its performance is examined on 21 independent indicators (Source: https://www.mcc.gov/who-we-fund/indicators).

towards neoclassical/market-oriented policies (ibid). The shift led to structural adjustment programs in the early 1980s, where the burden of adjustment fell disproportionally on vulnerable segments of the population (Mohan et al. 2000; Tisch, Wallace 1994). Structural adjustment programs were characterized by lending (notably by the World Bank/IMF) conditional on countries' undertaking the policy reforms required.[10] When aid is lent, the amounts tend to be considerably larger than when aid is granted (i.e. given). Heavy lending for structural adjustment programs was at the root of great criticism against aid; pumping substantial amounts of money in poor countries with weak governance systems can result in corruption spikes where what was lent was lost (Payer 1991). Besides corruption, towards the late 1990s it became clear that structural adjustment was costly: it was widely criticized for its effects on the poor, countries' debt kept mounting, and the expected results were hardly being achieved. Debates about how to help countries ease their debt burden started (e.g. with Highly Indebted Poor Countries Initiative, HIPC[11]). Thus, from the early 2000s grants increased in importance –vs loans (Harford, Hadjimichael & Klein 2004b). Both grants and loans became increasingly aimed at middle-income countries and at recipients with good policies –vs. low-income economies and those with bad policies (Harford, Klein & Tilma 2004).

Budget Support (BS) also grew from the early 2000s (Eifert, Gelb 2005), a move to support their fiscal consolidation from the revenue side also motivated by debt sustainability concerns, as well as to promote more ownership in recipient countries. Later, some evidence has shown that BS is correlated with progress in the Human Development Index and the Millennium Development Goals (Beynon, Dusu 2010). However, BS is no magic bullet either, some authors arguing that it may contribute to moral hazard by expanding recipients' national budgets and avoiding necessary reforms (Brautigam, Knack 2004). Thus, if more aid does lead to deteriorations in governance, BS may lead to moral hazard in the form of lower tax-to-GDP ratios, or reduced efforts to mobilize national resources (Feeny 2007).

Turning further into policy, the most central initiative to promote aid results was the 2005 Paris Declaration on Aid Effectiveness (PD). The PD is based on five principles (OECD, 2012):

1. *Ownership*: Developing countries set their own strategies for poverty reduction, improve their institutions, and tackle corruption.
2. *Alignment*: Donor countries align with, and use, local systems.
3. *Harmonization*: Donor countries coordinate, simplify procedures, and share information to avoid duplication.
4. *Results*: Developing countries and donors shift to, and measure, results.
5. *Mutual accountability*: Donors and partners are accountable for development results.

[10] Also known as policy-based lending.

[11] In 1996, the World Bank and the International Monetary Fund launched the HIPC Initiative to create a framework for all creditors, including multilateral creditors, to provide debt relief to the world's poorest and most heavily indebted countries, and thereby reduce the constraint on economic growth and poverty reduction.

It was argued that the PD would make a difference because it was intended to monitor progress on accountability (OECD 2006). However, the PD proved to be no panacea and was complemented by the Accra Agenda for Action (AAA) in 2008, the aim of which was to strengthen and deepen implementation of the PD (OECD, 2012). The AAA pushed some PD principles into concrete actions, especially in the areas of ownership, inclusive partnerships, and delivering results (OECD, 2012). For instance, since the Paris Declaration in 2005 significant efforts have been exerted to reduce the practice of tying aid, especially by the OECD, and today it is arguably marginal (Clay, Geddes & Natali 2009). However, new donors are bringing new challenges. For example, China does provide finance that meets the definition of ODA but this share is relatively small. Export credits, non-concessional state loans or aid used to foster Chinese investment do not fall into the category of ODA (Brautigam 2011).

One of the most noteworthy recommendations of the AAA was that the predictability of aid should be increased. The issue of predictability was a reaction to recipients' demands and involved two aspects. The first one was to give at least a medium-run horizon (typically 3 to 5 years), so that the recipient country could better plan ahead with the help of policy tools, such as Medium-Term Expenditure Frameworks (MTEF).[12]

The second aspect demanded by recipients was that donors meet their pledges, as often commitments are incompletely materialized. Indeed, compliance with commitments to deliver more aid has received mediocre ratings (G8 Research Group 2007), although donor countries performed well when it came to debt cancellation (G8 Research Group 2015). The delivery of the 0.7 per cent target of ODA relative to donor's Gross National Income (GNI) has also been a challenge which few donors have achieved (OECD 2002). Since Sweden became the first country to meet it in 1974, Scandinavian countries such as Denmark, Finland or Norway have had the best performance in that regard, although other countries such as the Netherlands or Luxembourg have also performed relatively well (OECD 2002).

Although incomplete aid delivery may be an issue, many recipient countries often lack the capacity to absorb the aid they receive (even though it is not all the aid they were promised). Isard et al. (2006, p.12) insist that these absorptive capacity constraints "are largely microeconomic phenomena and should be analyzed and addressed as such" (Isard et al. 2006).

### *4. Other practical issues*

As noted above, the overall challenge in the aid discussion is that there isn't a very clear idea about whether it works, and/or under what conditions it does so. It has been asserted that, "the winners write economic history" (Easterly 2002b). This incomplete understanding is rooted, at least partially, in the

[12] An MTEF is a planning and budget formulation process that Governments can use to establish credible projections of public revenue collection (usually within 3-5 years), and to allocate those resources based on strategic priorities.

data deficiencies which characterize developing countries. The paucity of good quality data has had several effects on the aid literature, including some selection bias. The nature of these effects is conceptually similar: insufficient hard evidence impedes an understanding of the intricate channels through which aid may have a positive impact on the final beneficiaries. However, although the distinctions are more illustrative than clear-cut, there are degrees of ignorance with different consequences. First, extrapolating from developed countries, economists may sometimes defend a specific viewpoint without the rigorous data analysis warranted, which can lead to poorly substantiated statements about the pertinence of aid (see e.g. Friedman 1995).

The lack of data may also impede us from seeing the broader picture. If aid can be considered as a "market", aid assessments are mostly based on the supply of aid, whether primary (donor's principal—often taxpayers), or secondary (aid agencies), but rarely on the demand of aid (beneficiaries).[13] When the demand of aid is analyzed, it is usually at the level of recipient countries' governments, and rarely at the level of the ultimate beneficiaries (citizens – ideally the poor). Such lack of attention to the final beneficiaries arises because household surveys hardly collect data on development projects. Therefore, the emphasis is often placed on inputs, frameworks, plans, technical assistance or training instead of results (Martens et al. 2002). Additionally, since the clear mechanisms through which the final beneficiaries would benefit are not well defined, it is not difficult to see aid as a 'black box' (Bourguignon, Sundberg 2007). As noted earlier, to address such deficiencies there have been calls for more monitoring and evaluation (Martens et al. 2002), as well as for better evaluations (Banerjee 2007).

Even where data is available on all sides of the aid market, its informational value vis-à-vis the intended analysis may be limited. A clear example of this is the failure of OECD data on aid to distinguish between types of aid (i.e. disaggregating aid flows by sector only started in 2002). A second example of data shallowness hampering research relates to aid fungibility. It is well known that aid is fungible, however, the aid literature has rarely taken this characteristic into account – probably a result of difficulties in measuring how decisions are made and how shadow savings would be used (e.g. if a donor condones debt to a poor country). After decades of development aid, the most influential work on the issue was done in the late 1990s (Devarajan, Rajkumar & Swaroop 1999).

It seems clear that the traditional aid-growth regressions have been exhausted. Research on development aid has begun refocusing from macro to micro relations. This new approach may extend to include a geographical perspective and/or the nature of the relations considered. Regarding the

[13] Not everyone agrees with seeing aid as a market. Some authors argue that aid can have a dose of 'impure altruism', because the donor derives utility from the very fact of giving – also known as the warm glow (Andreoni 1990). Based on this rationale, to the extent that the donor gives aid out of self-interest, the exchange would lose importance. Other authors such as Marcel Mauss emphasize, based on anthropological analyses, the difference between market and gift (Mauss 2002). Nonetheless, Mauss does acknowledge that gifts supply individuals with personal incentives for collaborating in the pattern of exchanges, which supports the idea of exchange (ibid). Despite these differing views, the idea of aid as a market is increasingly being accepted (Harford, Klein 2005b). The market for aid has also been referred to as market for policy advice (Custer et al. 2015) or market of ideas for policy change (Parks, Rice & Custer 2015).

geographical perspective, analyses in the past were typically performed across countries. Individual national studies can be of real value, however. For instance, a case study from Uganda found that only 13 percent of aid reached its intended objective (Reinikka, Svensson 2004). Despite its potential to enrich the debate on aid effectiveness, research at national level has only become popular in recent years (De, Becker 2015). In terms of the nature of the relations considered, the new research approach tends to concentrate more on such micro issues as donors' incentives (Mattesini, Isopi 2008), or whether aid is associated with specific subsector results, e.g. by investigating the extent to which aid aimed at private sector development responds to constraints identified by private firms as problems (Ferro, Wilson 2011). This new focus may be due to increasing doubts about the value of aid, or to growing pressure by taxpayers to know they are getting value for their money.

There may be trade-offs to such direct, sub-sector level approaches to the assessment of aid effectiveness. Narrow relationship analyses may miss spillover effects or synergies, and assessing a development portfolio by evaluating its components individually may be incorrect. Ravallion makes the point succinctly, "the bundling of (often multi-sectorial) components in one portfolio is often justified by claimed interaction effects. But evaluating each bit separately and adding up the results will not (in general) give us an unbiased estimate of the portfolio's impact" (Ravallion 2011).

## *5. Conclusion*

An interesting generalization about the literature reviewed may be that aid supporters tend to emphasize results (whether it saves lives, reduces poverty, etc.), while its detractors tend to highlight the mechanisms or incentives it provides (although they may still acknowledge some of aid's positive results, particularly on public health). Notable examples to criticize aid relate to moral hazard (e.g. as beneficiaries know that donors will be there for them, they make less effort to undertake much-needed reforms, mobilize internal resources, etc.) or adverse selection (e.g. if corrupt governments are more likely to receive aid, which helps their leaders to stay in power).

Like the modes to deliver it, research on foreign aid has evolved over the years. From empirically-driven macroeconomic approaches (notably aid-growth regressions), analyses have been refocusing towards more micro issues, including institutional inefficiencies or mechanisms to stop seeing aid as a black box. This tendency is positive, in so far as it can lead to useful policy advice that improves the way aid is given in a specific context; an example of this, while their limitations should be acknowledged, may be the emphasis of recent years on RCTs.

Despite the tendency towards understanding the specific circumstances of time and place (Hayek 1945), few scholars adopt middle-ground views about foreign aid – notable exceptions being Riddell (1987) or Krueger et al. (1989). Indeed, in recent years views on aid are quite polarized: from economists who think it will end poverty (Sachs 2005), to others who blame it for countries' poverty in Sub-Saharan Africa (Moyo 2009). The reason for this conundrum may be that, despite the better understanding we have gained, we still know little about the mechanisms through which aid works, which favors oversimplification. Great gaps in knowledge remain in several areas. For instance, from an industrial organization perspective, the aid market is poorly understood in aspects such as donors' interaction with the recipient government or donors' coordination. In terms of political economy, the recipient country's decision making with regards to aid fungibility, the incentives provided by new types of aid (notably China's), or innovative ways of delivering it (e.g. cash-on-delivery) have also been largely unexplored. Perhaps most importantly, the types of public goods that households' find useful in improving their living standards (highly dependent on the local context) are little understood. The scarcity of research on these questions is greatly due to lack of data – or even data opacity by development interventions, which ironically provides ammunition to aid critics. If aid is to be better understood and improved, far greater efforts must be made by both donors and recipient countries in terms of collecting and sharing data.

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