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Aid Harmonisation and Alignment: Bridging the Gaps between Reality and the Paris Reform Agenda

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The Paris agenda on aid effectivess emphasises support for recipient-owned development strategies, increased use of national systems and more co-ordinated and predictable donor actions. Monitorable targets for such behaviour have been agreed, but the connections with expected development benefits are as yet unproven. Alternative views of the rationale for aid agencies, transaction costs and conditionality, in which there is rarely complete preference alignment and trust between donors and recipients, introduce further complications. Four additional policy measures are identified which cannot be managed easily within the Paris agenda: better international balancing of aid allocations; new instruments with longer commitment horizons; liquidity arrangements to enable 'scaling up' across several countries; and independent aid rating institutions linked to market-like sanctions.

1 Introduction

The 'Paris agenda', a shorthand for the results of the Paris High Level Forum on aid effectiveness (28 February-2 March 2005), refers to a threefold commitment to reform the delivery of development assistance. It entails: (i) systematic support for recipient-owned plans for the attainment of development results; (ii) increased use of national administration systems, and (iii) more co-ordinated and predictable actions among multiple aid actors. This article traces the likely benefits of implementing such an agenda in order to identify implicit assumptions about enabling conditions and risks. On this basis, it outlines a 'results framework' against which the benefits might be judged. It then investigates the features of today's international aid landscape that may be considered most at odds with this agenda and the model of aid effectiveness that underpins it.

The most significant progress achieved at the Paris Forum itself was agreement in principle on a set of monitorable targets for changes in donor, recipient and joint behaviour. As of mid-June 2005, these remain subject to final endorsement and minor improvement, but already they constitute the core of a new compact on 'mutual accountability', binding the 60-plus participant nations and institutions. This is intended

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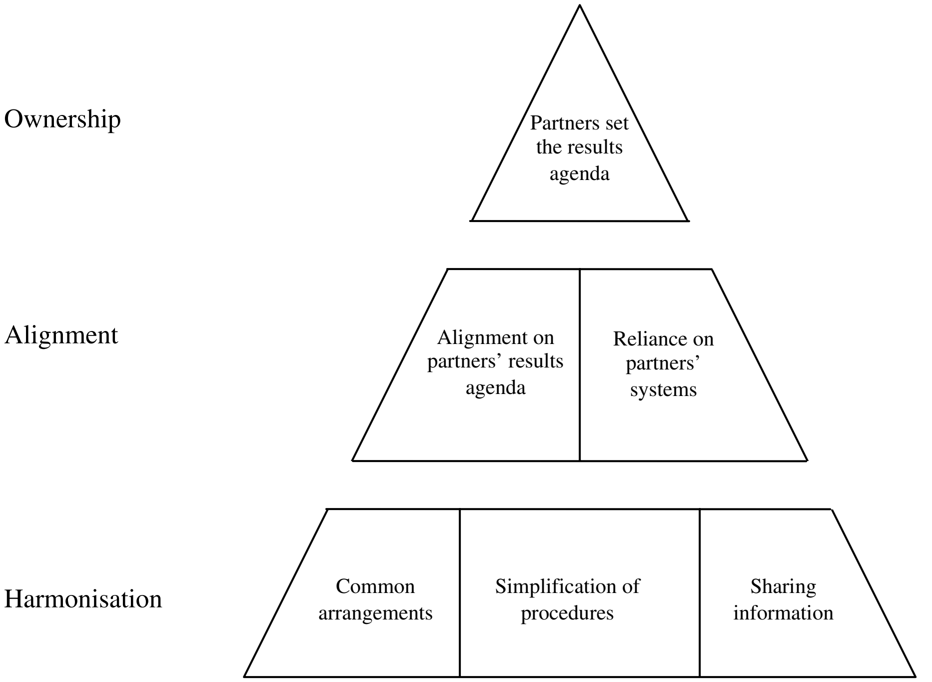
This article contrasts the Paris aid-effectiveness model with alternative views in the literature as to the rationale for aid and for the existence of aid agencies. It considers the hypothetical prospect of complete preference alignment and trust at country level between donors and recipients, and their implications for aid agency incentives. It also revisits donor 'fragmentation' versus 'consolidation' from a recipient perspective, considering trade-offs between transaction costs and risk spreading. Finally, it identifies four institutional obstacles that cannot be tackled effectively at the country level, but which arguably stand in the way of the collective-action objectives of the Forum. This selection applies the principle of *subsidiarity,* specifying the minimum action required at other levels (cross-country and global) to validate country-level efforts.

The four 'actions beyond the reach of Paris' are: (i) better international balancing of country aid allocations; (ii) aid instruments with longer commitment horizons, yet adequate safeguards for donors concerned about policy reversal; (iii) alternative arrangements for 'scaling up' allocations to meet country priorities otherwise judged feasible; and (iv) credible mutual accountability mechanisms, with effective sanctions for non-compliance.

2 The thinking on aid effectiveness leading to the Paris Forum

The three main elements of the aid effectiveness agenda set out in the Rome 2003 and Marrakech 2004 Declarations, and revisited in Paris, are: ownership, alignment and harmonisation, each emphasising results (OECD, 2004, 2005). The first element commits the development community to 'respect the right – and responsibility – of the partner country itself to establish its development agenda, setting out its own strategies for poverty reduction and growth'. The second commits donors to align their development assistance with the 'development priorities and results-oriented strategies set out by the partner country' and to 'progressively depend on partner countries' own systems' (for example, for financial management and audit), while stressing that partner countries should strive to improve them. The third commits donors to implement good practices in aid delivery, including to 'streamline and harmonise their policies, procedures, and practices … *and develop staff and management incentives ... to foster recognition of the benefits of harmonisation*' (emphasis added). Figure 1 summarises these elements schematically in an 'aid effectiveness pyramid'.

Figure 1: Aid effectiveness pyramid



Source: OECD (2004).

2.1 Recipients and donors

Considerable efforts have already been undertaken at country and international level in pursuit of these aims, as set out in the Paris progress report (OECD, 2004). In particular, donors and recipients have formed joint groups to help co-ordinate budget support and sector-wide approaches in many countries, usually involving a joint performance assessment framework (in some instances with targets for donors as well as recipients) and some standardisation of conditionalities and procedures.

Some countries (for example, India, Afghanistan) have experimented with a more directive approach, refusing to deal with more than a small number of donors at a time or in a given area, and assigning specific roles to them. They appear to have incurred no obvious penalty in terms of aid reduction or suspension (though this remains to be seen over longer periods). A number of 'joint assistance strategies' involving tighter than ever co-ordination between individual recipients and several major donors are in various stages of preparation in Asia and Africa, notably Tanzania. These approaches may cement the rising *soft power* of well-organised recipients, or they may add more layers of process without corresponding improvements by way of binding mutual accountability or added flexibility in aid use; it is still too early to tell which result will predominate.

Not surprisingly, progress over such a broad and ambitious spectrum as the Paris agenda is seen as at best uneven thus far, including by its more committed donor and recipient country participants. On the recipient side, this breaks down into three distinct environments. *Middle-income countries,* facing on average fewer donors and being less dependent on them overall, often prefer to steer the relationship with each donor individually, rather than working with a donor syndicate (this preference is revisited later). At the other extreme, *fragile states* and other low-governance environments deserve special attention, principally because the linchpin of country ownership rarely obtains in them, and donor stances are correspondingly more guarded. Promising new responses are being considered (such as 'shadow' alignment), but they have yet to be proven. It is not entirely clear whether the core response from Paris to such situations is to do much more, do much less or with more caution, or try something entirely different.

In the middle, there is a substantial group of relatively *well-performing low-income countries* facing multiple donors and high aid dependence. They form the core battle-ground of the aid effectiveness agenda, as currently defined. These countries seek a material pay-off from the Paris agenda in terms of more flexible and predictable aid and less conditionality from the donor collective, in exchange for intensified efforts on aid co-ordination and public finance management on the recipient's part. Or, in other words, less (or less intrusive) upward accountability in exchange for more downward accountability.

On the donor side, the harmonisation agenda has also hit early policy constraints in some areas. These include aid untying, where robust sovereign interests are at stake. There is also the limited domestic flexibility many donors have for adjusting country aid allocations to fit local strategies, for shifting resources quickly between sectors and instruments, or for forsaking explicit or implicit conditions, which inevitably increase aid volatility. (A modern development paradox is the donors' proclaimed intent to build 'new' multi-year aid partnerships on the much longer, more predictable timescale essential for lasting social transformation, *provided* each donor retains the power to suspend aid unilaterally at any time. In the absence of credible arbitration procedures restraining the scope of donor intervention, this juxtaposition is politically and morally untenable.) In all these areas powerful national or institutional interests and incentives vie with weaker signals in favour of greater collective discipline across donors. Some of these are discussed below.

2.2 A results framework? Transaction costs and governance benefits

More immediately, this agenda which so overtly emphasises results is not yet very explicit as to its own results framework. Its benefits are usually presented primarily in terms of reduced costs of aid management, which would in future either no longer be inflicted on recipients, or be saved by donors and passed on to recipients in the form of added net flows (see, for example, OECD, 2003). This logic focuses attention on *transaction costs* and their attribution across development actors. The image of a small poor country receiving more visiting donor 'missions' than there are days in the year is the badge of shame that has fuelled top-level commitment to change in some agencies.

By this narrow 'transaction cost' standard, there is no conclusive evidence that the Paris agenda approach is succeeding, or will succeed if adopted more widely, at least not in the short and medium terms. On the contrary, there is a plausible basis for expecting total transaction costs to continue to *rise* for a lengthy transitional period.

This is because the new costs of intense multi-donor co-ordination and monitoring processes, for example for budget support, will have to co-exist with the legacy of traditional project-type aid mechanisms which will take many years to wind down as a share of the total and in absolute terms (Killick, 2004). Moreover, from the perspective of institutional economics, as discussed in Section 5 below, some aid transactions have distinct benefits for donors (for example, in reducing the uncertainty of contract enforcement). The Paris agenda does not explicitly integrate these.

In any case, a consistent baseline of aid management costs at country level that would permit rigorous evaluation of the benefits of harmonisation in the form of cost savings in years to come has yet to be established. We only have comparable data for the bilateral donor administration costs as reported to the DAC and scored against official development assistance, and these are just the tip of the iceberg. A bigger cost pool is either financed through the service and interest charges of the multilaterals, absorbed under technical co-operation and project management rubrics at the project or programme level, or simply borne by recipients in various forms. It will thus be hard to tell, even years from now, whether there have been major net savings in aid-related transaction costs passed on to recipients, savings in some places at the expense of increased costs in others, or no significant savings at all. Establishing and monitoring such a baseline, which involves some challenging disaggregation of donor reporting, is therefore a priority for development research, to the extent that transaction costs really matter – and they must, to some extent.

A more compelling case for aid effectiveness, in this Paris agenda sense, surely rests on its potential impact on the quality of governance, especially of fiscal management and public expenditure choices, in the recipient country. As external assistance generally supplies only a modest fraction of the resource pool for recipient country development, aid arguably has a multiplier effect in helping to 'lock-in' pro-poor national policies and institutions through the more or less effective deployment of this bigger pool of resources. It does so, goes this argument, by encouraging domestic accountability mechanisms, such as budget processes, and their link to development outcomes via better public decision-making. In the principal-agent approach of institutional economics, it repairs the 'broken feedback loop' between recipient and donor citizens, by ensuring that donors broadly adopt the accountability framework linking recipient country citizens with their governments.

Whether effective aid delivery efforts actually lead to better national governance institutions and whether the latter deliver major development outcomes are two separable questions, to which a growing body of country-based research relates. This is concentrating especially on tracking the poverty outcome effects of budget support. (A major multi-country, multi-donor budget support evaluation programme on this subject is still at the inception reporting phase, and is expected to yield findings in 2006.)

At this point, early indications are, on the first question, that better co-ordinated aid arrangements are indeed associated with improved national expenditure management. We do not yet know for sure *why* this is so, or which way the causality runs, since we know very little about the underlying drivers of complex institutional change, let alone the impact of aid on them and whether this impact is sustainable (Evans, 2004). At worst, aid agencies may be indulging in high-risk 'monocropping', transposing institutional models which evolved in quite different contexts and timeframes in developed countries, rather than encouraging durable home-grown solutions. It is also possible, according to aid sceptics like Easterly (2001a), that donors can only ‘support genuine change on those precious occasions on which it happens’, assuming they can even detect it. However, they cannot bring change about. In this view, countries decide to develop the relevant institutions and, being demonstrably serious in their intent, persuade donors to underwrite them. This improved ‘branding’ also carries weight in terms of progressive access to more flexible, less crudely conditional forms of aid. Such a reverse sequence is certainly plausible for the ‘donor darlings’ where general budget support is a substantial share of overall aid, as in East Africa.

Such a state of affairs, if proven, would correspondingly reduce the impact of the Paris agenda. However, if we consider the agenda’s aims to be a *joint* responsibility of donors and recipients, overall progress could be significant even if the contribution of donors to it is negligible. In this case the political signal from Paris is that recipients take control, and donors accept the transfer of power benignly. We do not much care if the improvement in ownership and alignment is directly attributable to donors – or do we?

More worryingly, on the second question, ultimate poverty outcomes are not showing commensurate improvement, when better aid practice and better national management co-exist. This may be due to long lags in improving results at the local level, or to factors independent of good fiscal governance *per se*, such as elite capture of other policies with a high impact on poverty, like land reform. This apparent disconnect certainly deserves more investigation, given the risk to donor credibility of steadily expanding budget support in the absence of a clear positive impact on poverty. For present purposes, what matters is that there may be significant risk of enabling factors at work well outside the control of the Paris agenda, and expectations should be managed accordingly. Harmonisation and alignment are useful building blocks or cells within a larger ‘logical framework’, which may have more transformational elements.

3 The outcomes of Paris: reaffirmed commitments with specific ‘monitorable’ indicators

This is not the place for a thorough review of the outcomes of the Paris High Level Forum, which took place just after the first draft of this article was written. Moreover, important follow-up work is still ongoing, so any conclusions as to its value-added must remain tentative. Nonetheless, it is clear that Paris went beyond a reconfirmation of the ideals and objectives of aid effectiveness already framed in Rome and discussed in detail above. The most obvious step forward was that donors and recipients framed quite specific ‘partnership commitments’ and linked these to clear progress indicators with timetables, i.e. targets. These targets are to be ‘measured nationally and monitored internationally’, with a likely horizon of 2010.

Table 1 provides a summary of the areas of commitment and the present state of progress, as of early June 2005, in framing the targets. It should be noted that the precise definition of each indicator (the right-hand side) is still under discussion, whilst the headline objectives (left-hand side) are essentially those enshrined in the Paris Declaration. For present purposes, the degree of ambition involved and the precise baselines used (for example, halving the proportion of situations not meeting some desirable standard, or meeting an absolute percentage goal) are not crucial. What may be more relevant is the broad nature of the collective action intended, and what key problems may have been left outside the scope of the monitoring process.

Table 1: Suggested targets for the 12 indicators of progress

	Objectives	Suggested targets
	Ownership	
1	Partners have operational development strategies. Number of countries with national development strategies (including PRSs) that have clear strategic priorities linked to a medium-term expenditure framework and reflected in annual budgets.	Halve the proportion of countries that do NOT have national development strategies with clear strategic priorities linked to a medium-term expenditure framework and reflected in annual budgets.
	Alignment	
2	Reliable country systems. Number of partner countries that have procurement and public financial management systems that either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.	Halve the proportion of countries that do NOT have procurement and public financial management systems that either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.
3	Aid flows are aligned on national priorities. % of aid flows to the government sector that is reported in partners' national budgets.	Halve the proportion of aid flows to the government sector that is NOT reported in partners' national budgets.
4	Strengthening capacity by co-ordinated support. % of donor capacity-development support provided through co-ordinated programmes consistent with partners' national development strategies.	Halve the proportion of donor capacity-development support that is NOT provided through co-ordinated programmes consistent with partners' national development strategies.
5	Use of country systems. % of donors and of aid flows that use partner country procurement and/or public financial management systems in partner countries, which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.	Halve the proportion of donors and aid flows that do NOT use partner country procurement and/or public financial management systems in partner countries, which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.
6	Strengthening capacity by avoiding parallel implementation structures. Number of parallel project implementation units (PIUs) per country.	Halve the average number of parallel PIUs per country.
7	Aid is more predictable. % of aid disbursements released according to agreed schedules in annual or multi-year frameworks.	Halve the proportion of aid disbursements that are NOT released according to agreed schedules in annual or multi-year frameworks.
8	Aid is untied. % of bilateral aid that is untied.	Continued progress.

	Harmonisation	
9	Use of common arrangements or procedures. % of aid provided as programme-based approaches.	Halve the proportion of aid that is NOT provided as programme-based approaches.
10	Encouraging shared analysis. % of (a) field missions and/or (b) country analytic work, including diagnostic reviews that are joint.	Halve the proportion of (a) field missions and/or (b) country analytic work, including diagnostic reviews that are NOT joint.
	Managing for results	
11	Results-oriented frameworks. Number of countries with transparent and monitorable performance assessment frameworks to assess progress against (a) national development strategies and (b) sector programmes.	Halve the proportion of countries that do NOT have transparent and monitorable performance assessment frameworks to assess progress against (a) national development strategies and (b) sector programmes.
	Mutual accountability	
12	Mutual accountability. Number of partner countries that undertake mutual assessments of progress in implementing agreed commitments on aid effectiveness including those in this Declaration.	Halve the proportion of countries that do NOT undertake mutual assessments of progress in implementing agreed commitments on aid effectiveness including those in this Declaration.

The intended result is, in most but not all cases, a result of the combined efforts of many donors and the recipient country, and not singly attributable to one actor or even the donor group as a whole. A slightly quirky example is where, under the larger rubric of alignment of aid flows with national priorities, indicator 3 tracks what percentage of actual flows is reported in the national budget. This requires donors, at the very least, to inform the host government whenever their assistance is not already routed through the budget; but it also requires action by the government, in collating this information and publishing it as part of the budget process.

The same example illustrates another feature of the progress indicators approach, which is to use some quite simple, even superficial, proxies for quite complex underlying processes, in order to generate some comparable data which can be readily understood and if necessary improved on in later rounds. Capturing or scoring all external aid to government in national budgets is neither necessary nor sufficient to align donor flows with national spending priorities. However, the fact that a government chooses to put 'on budget' some flows that would otherwise not be 'through budget' makes it hard for it to argue later that this spending was not aligned with its priorities. Conversely, some off-budget expenditure funded by donors might have a relatively high value in terms of the national poverty reduction strategy, despite not being identified as a priority item through this lens.

A similar 'iceberg below the waterline' problem relates to making aid flows more predictable (item 7). The substantive and sensitive issues of conditionality, selectivity and performance-related aid allocations, discussed later in this article, were to a large extent skirted in the Paris agenda. Thus, this indicator measures whether aid is disbursed according to predetermined schedules, i.e. whether donors are technically efficient and whether the country is 'on track' with the basic performance conditions built into those schedules. But it does not assess whether the scheduling itself makes aid more predictable over a longer time horizon. Indeed, the existing schedules may be quite destabilising (as in a succession of one-year budget-support programmes renegotiated from scratch and with no guarantee of continuity). But they could be executed to the letter of the relevant agreements.

Such underlying gaps are revisited below in the form of recommendations to complement the Paris agenda. Whatever its possible flaws, however, the Paris agenda has the great merit of bringing current aid practices under a transparent and legitimate overall umbrella of universal standards and country-based monitoring.

4 Alternative research views of aid effectiveness: the rationale for aid

There is a vast literature on the links between aid, growth and poverty reduction, but as Gunning points out in a landmark paper (2004), almost all of it deals with the question 'Granted that we have aid, under what circumstances does it work well?', rather than the more fundamental question 'Why give aid?'. This can be paraphrased in several ways. For present purposes, let us consider something like 'If aid is the best solution, what precisely is the problem?'

It proves a very difficult question to answer rigorously, and the most promising candidates reviewed by Gunning – imperfections in credit markets, the growth cost of taxation, and national contributions to public goods – are not what motivate most donor activity today. The recent UN Millennium Project report (Sachs et al., 2005) has a forthright answer of its own – that aid is indispensable to bridge accumulated physical, institutional and human infrastructure gaps that are so large that they deter private investment, and hence sustainable growth and poverty reduction. This argument stands or falls on the primacy of additional capital in public hands, as compared with other factors, in unlocking better growth performance through targeted public investments and better governance – much like our discussion above of the logical framework for the Paris agenda.

Donor motivations for aid, at least as revealed by regressions of their country aid allocations, show that political and strategic considerations are still remarkably important determinants of their behaviour, compared with country need (poverty) and policies (good/bad). In particular, former colonies that are not democratic, or that have 'closed' trade policies, get on average about twice as much aid from the former colonial power as democratic, or open, non-colonies. Moreover, the degree of emphasis on poverty, democracy or openness differs from donor to donor, even controlling for strategic and historic considerations (Alesina and Dollar, 2000).

Gunning points out that, as development objectives are clearly not the sole or even main aim of many donors, it is not surprising that their aid programmes cannot be fully 'effective' when judged only against development criteria. The simple fact that country allocations are so often disconnected from poverty reduction by design, not accident, limits the field of intervention of the Paris agenda. In the extreme case that a donor is allocating aid entirely for the 'wrong' purposes, one might want them to be totally ineffectual in doing so.

A second strand of the aid effectiveness discussion, dominated by Burnside and Dollar (2000), Collier and Dollar (2002) and their critics (for reviews, see McGillivray, 2003; Beynon 2003), focuses instead on defining the policy environments in which aid, whatever justifies it, is more and less associated with poverty reduction. The crucial determinants were originally seen to be the quality of country policy performance and the incidence of poverty. This led to policy recommendations for greater country selectivity in aid allocations – an approach which in several aid agencies has now become synonymous with aid effectiveness. Despite subsequent expansion of the circumstances in which aid may be effective (recovery from shocks at low levels of policy performance, for example), and other doubts as to the explanatory power of this model, the 'poverty and performance' basis for selectivity remains strongly entrenched in donor pronouncements (for example, World Bank and IMF, 2004; Clemens et al., 2004).

However, as most bilateral donors and the European Union are still in the (Alesina-Dollar) real world of mixed objectives for aid, while most multilaterals and some bilaterals (notably the UK, the Netherlands and some Scandinavians) fully espouse the poverty-performance selectivity model, the result is a patchwork of country allocations. This has peaks and troughs only loosely related to either relative need or absorption capacity. It appears to cater well, even too well, both to the very 'good' and to the 'bad with powerful friends', but not that well to many deserving cases in between. It generates, in other words, both 'donor darlings' and 'donor orphans', and lesser anomalies (Rogerson et al., 2004).

As historic ties and strategic objectives of individual bilaterals are presumably impervious to third-party influence, how is the aid system to correct for this built-in asymmetry? The most likely answer lies on the side of the existing multilaterals, in the absence of a *deus ex machina* like the International Financing Facility, one of whose main side-benefits would be the potential to redress just such imbalances. We discuss options for achieving this correction in Section 7.

5 Alternative research views of aid effectiveness: the rationale for aid agencies

What of the rationale, not for aid, but for aid agencies, and what does it tell us about aid effectiveness? A small but growing literature, summarised in Martens (2005), investigates the role, incentives and biases of donor agencies as intermediaries between donor and recipient preferences, which can and do diverge. Misalignment of preferences can be corrected through conditionality, but that involves both substantial transaction costs and uncertainty. Donors can trade off less of the latter for more of the former. They do this mainly by investing in commitment devices for contract execution, such as monitoring of inputs, outputs and outcomes, agreed policy frameworks and procedures, etc. – much of the lexicon of the Paris agenda.

However, from this different perspective, such transaction costs also bring clear *benefits,* such as reduced uncertainty in achieving acceptable alignment of preferences (for example, ensuring that the money delivers the outputs intended, or is spent only on tied inputs). As such, it is not reasonable to expect such costs to fall steadily, unless a cheaper and equally effective commitment mechanism is to hand. The Paris agenda could benefit from screening alternative proposals from this angle. If a donor-required transaction has absolutely no value for reducing the uncertainty of meeting relevant conditions, eliminating it should be a less challenging endeavour. If its perceived benefit is significant, it is no use pretending that the incentive system that created it has vanished overnight.

The preference-alignment and incentives approach has many possible extensions. Ostrom et al. (2001), for example, demonstrate that different interests co-exist within Swedish aid, one of which lobbies for commercial as against poverty goals. However, because Sweden has no colonial ties, there are far more countries on which commercial interests can potentially be targeted, and correspondingly more flexibility to marry them with development approaches. Martens (2005) looks at the Bretton Woods institutions in terms of their superiority in information gathering and analysis over recipients and donors alike. The BWIs also offer donors a politically less contentious channel for collective action on sensitive problems, and recipients a modest but direct representation in such decisions. This underpins, among other things, the way they frame and apply conditionality.

It is worth considering one more, truly heroic, extension. Suppose the Paris agenda proved a complete success, in that preferences of donors and recipients were fully aligned, complete trust and transparency reigned, national systems were systematically reliable and relied upon, and costs of verification by donors became negligible. This may never happen in some countries and will certainly not happen in many anytime soon, but let us assume it can and will eventually happen in several important ones. What is the future for aid in such a scenario? In this state of the world, there is no need for any aid agencies to provide mediation between donor and recipient constituency preferences. Direct budget transfers between the two treasuries – as they now occur between the donors and, say, their own regional governments – would suffice. Aid agencies might still be justified as channels for the transfer of know-how and institution-building, but they would have to prove themselves in open competition with private and voluntary sector alternatives, which the recipient would be free to contract using its own funds and procedures.

This scenario illustrates how the Paris agenda effectively asks aid agencies to work ever more diligently towards their own demise. This is a perfectly valid aim, but one which does not fit well with personal and institutional incentives in many of today's donor agencies. Indeed, in recent ODI research on donor incentives for the DAC (de Renzio et al., 2005), aid agency staff frequently identified the Paris agenda and the rapid expansion of general budget support as being synonymous, despite official pronouncements to the contrary. A gradual but irreversible shift to budget support as the default mode of operations, well ahead of the Nirvana of perfect alignment in our hypothetical scenario, could have many consequences. One of them is a perceived threat to the status and prospects of staff and managers responsible for project-level tasks and related fiduciary controls, the majority of whom do not yet see a sufficient role for themselves in the arena of policy advice and related budget support.

A final connection under this rubric relates to types of conditionality. Whilst *ex-ante* donor conditionality on the effectiveness of government spending could in principle be mutually beneficial, there is ample empirical evidence that it fails to work in practice (Collier et al., 1997). In institutional economics, this result is explained by the lack of adequate commitment devices, such as a credible threat to cut off aid. This could be because of donor constituency opposition to such penalties, or the defensive need for a development bank to protect a broader loan portfolio from default (also know as ‘evergreening’). Recipients, once aware of this, are able to pledge, stall or reverse, and subsequently re-pledge the required reforms, working around key windows for donor lock-in. There are well documented cases of donors ‘buying’ effectively the same conditionality several times over.

A plausible alternative is *ex-post* conditionality, tying increases in future aid streams to past results, an approach followed in different ways by, for example, the US Millennium Challenge Corporation and the European Commission’s budget support for several African countries. Gunning (2004) reminds us that, for this approach to have the desired incentive effect, the link to performance must be both transparent and credible. The basic premise of *ex-post* conditionality, moreover, is that past performance is a good predictor of future good use of aid. This assumption may hold true in enough ‘average’ cases for donors to rely on it pragmatically, but it remains vulnerable to major shocks and shifts in the external and internal political and economic contexts. We consider a substantial extension of ‘outcome-based’ conditionality in Section 7 below.

6 Donor fragmentation, consolidation and complementarity

Donors collaborate as well as compete in several indirect ways (for example, for budgets at the margin, but more often for reputation and influence). As the goals of aid relate largely to public welfare, not profit, all the main actors are governmental or quasi-governmental and there is much scope for collective action, market analogies should be applied with caution.

Nonetheless, viewing the overall aid system as an ‘industry’ throws up typical regulatory questions about excessive concentration versus a fragmentation which generates costs but also competitive benefits (for example, Rogerson et al., 2004). Is there a cartel-like structure in place, with all its negative connotations for aid recipients (Easterly, 2001a), to which the Paris agenda could presumably imply a further intensification? And how would this square with the finding by the World Bank and IMF (2004) that the problem is, on the contrary, too many fragmented actors, especially in Africa, with associated high transaction costs for the host government? Is there, in other words, a structural problem here that cannot be overcome through exhortation or informal arrangements at country level?

By classical measures of industry concentration (for example, the Herfindahl index, tracking the sum of the squares of the market shares of industry players), the aid system is now only ‘mildly concentrated’. But it is well below both historical levels and the threshold of concern of, say, US competition regulators, as a result of ‘a century of entry, but no exit’ (Harford et al., 2004). As mentioned in Section 4, bilateral allocation biases for given regions can sharply increase the concentration effect at the single-country level. Nonetheless, patterns of aid have diversified considerably since the end of the Cold War, and major new players (for example, Global Fund to fight AIDS, TB and Malaria, and the Millennium Challenge Account) have entered the equation.

Countries are therefore receiving money from more donors than before, implying greater fragmentation/competition at country level. But this increase is still from a relatively low base. Harford points out that the fragmentation index of 67 in 2002 quoted by the Global Monitoring Report could be produced by three equal donors sharing the entire market, while that of 56 for 1975 is consistent with a dominant donor with 60% and two runners-up with 20% each. Most consumers would not rate either set-up competitive, much less fragmented.

From a transaction costs perspective, what matter more in any case are the overall number of players and the length of the 'tail' of very small ones – for example, those which provide less than 2% each of a country's aid flows. In Tanzania, for example, over a dozen small bilaterals and UN agencies share this distinction, whereas a clear majority of aid is accounted for by only four donors, out of an overall pool of some 34. This is by no means a unique situation.

At the level of individual sectors or themes, the problem may look even worse, though definitional problems complicate the analysis. Some large donors (notably the World Bank) generally participate as one of a small handful of leading donors by size, or do not participate at all. Incidentally, this visible form of concentration tends to aggravate the perception that such donors have dominant positions. Others which are also quite large at the aggregate country level (like the UK's DFID) may also be present in several sectors in the top three rankings, but appear in others with a token financial presence, ranking as low as tenth place. This is ostensibly at odds with their overall intent of aid alignment, but reflects, for example, responses to signals of new global thematic priorities from the donor headquarters.

This more complex pattern of concentration/fragmentation paradoxically provides comfort for both the 'cartel' theorists and those who would like to see much more consolidation. This could be achieved, for example, if each large agency unilaterally adopted some variant of the Jack Welch (General Electric) motto of 'be the first or second in each business, or get out'. Fragmentation at the country level would be unchanged, but the perception of greater leverage might also be enhanced.

Obviously, relative financial share is by no means the only criterion for considering a donor's added-value or 'complementarity' with others, nor would an indiscriminate process of winnowing out all micro-donors at the country or sector level be worth the substantial loss of expertise and goodwill this could incur. A more nuanced approach would pick out those whose primary mode of engagement is technical co-operation, as against providers of large net flows. Some two-tier recipient-led arrangements for aid co-ordination which shield senior government officials from having to deal with some of the former individually, but allow indirect dialogue through periodic joint groups etc., would remove most of the up-front costs of this kind of fragmentation, at negligible financial risk. Over time, it is possible that the long-term stream of gains from tackling recalcitrant agencies becomes overwhelming, compared with the up-front political and administrative costs of doing so, and then a more direct approach is justified.

Those donors which seek even faster consolidation should give explicit assurances, if they can, that within a given country envelope, they will welcome the host government's proposals to shift to higher-priority sectors and that they will ensure that any temporary savings stay in the country. Not many donors have done so publicly.

Risks of cartel-like behaviour remain a factor against which the cost of more donor fragmentation needs to be balanced by recipients. The Paris agenda acknowledges that harmonisation does not mean standardisation, and certainly not complete symmetry of conditionalities, but this is clearly still a risk factor as seen by individual countries. The European Commission has on occasion opposed the full alignment of conditions for the release of budget support already agreed among the in-country donor group, including its own field office. This is not because of disagreement on the substance of the conditions, but because the all-on/all-off, covariant risk of total suspension of budget support, contingent on the same events, was seen to be too dangerous from a macroeconomic perspective. In such cases, the recipient should rationally seek to diversify, not align, conditionality, for the same reason.

Middle-income countries such as Morocco, with relatively few donors, explicitly prefer a pattern of relations with single donors based on their individual characteristics and strengths, compared with enfranchising any donor group, let alone a cartel. Group approaches risk incurring cross-conditionality or other forms of group leverage, and giving excessive 'hold-out' rights to the smaller donors present. Such recipients are presumably prepared to trade relatively higher transaction costs – much as we saw donors would – for less uncertainty, or at least a wider spread of risks. This is all the more important in environments where political conditionality relevant to bilaterals might be reinforced by macroeconomic conditionality from the international financial institutions. Aid harmonisation and alignment in this context means donors improving their individual offers in terms of flexibility and predictability, perhaps based on a code of behaviour agreed with government, rather than new arrangements for group-based decision-making.

The next phase of research on incentives for alignment and harmonisation should ideally focus more on such interactions between donor and government incentives in-country, and in particular on gaming strategies between recipients and a clutch of dominant donors, in heavily aid-dependent and less dependent contexts.

7 Supportive actions beyond the country level

The above discussion points to some possible policy steps that could be taken beyond the reach of local donor offices working with the recipient under Paris agenda guidelines. These all impinge on what is misleadingly called the 'international aid architecture' – suggesting conscious design – or simply the way the different parts of the aid system, managed independently under often incompatible principles, interact.

To try to work bottom-up from country level to identify minimum necessary changes at the cross-country, cross-donor and global levels that can seriously enhance aid effectiveness on the ground is a variant of the 'subsidiarity' principle. It is not a grand re-design of global governance for its own sake, and tries to economise on the scarce energies and goodwill that countries – even powerful ones like the G8 – can afford to invest. To give a pertinent example, let us assume that the fragmentation among agencies of the UN system, with their obvious overlap and co-ordination burden at country level, is a serious, legitimate concern for UN reformers. But to bring even a single small recalcitrant body under the aegis of another, let alone to close it, could consume enormous time and political attention with arguably only modest net benefits at country level. The same applies to the very smallest bilateral donors, especially in relation to the EU collective where they are EU members.

However, if recipient countries can impose ground rules that limit their share of the transaction costs of dealing with this 'tail end', as discussed above, and the relevant anchor institutions (the UNDP and the European Commission, in tune with the World Bank) perform tolerably well, there may be no urgent country-level problem to be addressed from a Paris agenda perspective. If, conversely, the overlap and friction centre on the *larger* multilaterals or bilaterals – the handful instantly recognisable in a country even without statistics to hand – we have a quite different problem to solve.

So what major gaps need to be filled between the Paris agenda and reality? Four are singled out here.

7.1 Cross-country balancing of aid allocations

The problem was introduced in Section 4. A multilateral solution would be to use the International Financing Facility, if and when it comes on stream, to focus on correcting such imbalances by giving more weight, not just to needs and performance, but to the size of the financing gap relative to the existing donor pool.

Meanwhile, some or all existing multilaterals, and particularly the multilateral development banks, could be directed to give similar added weight to the relative availability of other aid sources. This shift from an absolute selectivity bias to one which explicitly recognises these agencies' role as a balancing wheel is not without political and methodological problems. For example, an unconstrained performance-based allocation system, which crowds in multilateral funds into relatively well endowed donor darlings, arguably pulls more people out of poverty per million dollars than a constrained one, by definition. However, this is assuming there are not diminishing returns and congestion costs to aid in such environments.

Also, actual allocations ostensibly based on performance are already heavily constrained for other reasons; for example, very low per capita ceilings have been placed on funding the Indian subcontinent, or minimum shares required for Africa. Such regional policy objectives are raising the average cost of poverty reduction very significantly, even among donors formally committed to selectivity. Multilateral formulas leading to better geographic balance could therefore actually improve targeting in this sense.

By the same token, however, large-scale rebalancing could lead to serious political concerns, just as achieving the Millennium Development Goals at the global level, mainly through progress in Asia, is not a sufficient response so long as so many countries in Africa risk failure. Not all the poor, in a cross-country sense, are equal. Moreover, other objectives are at stake. If the EU were to shift a few hundred million euro from its Mediterranean programme into India, for example, it would immediately leap from laggard status to the head of the class, in strict pro-poor allocation effectiveness ratings. But this does not in itself make such a move politically feasible.

This general avenue of potential improvement nonetheless needs to be explored, using all available channels, including competitive pressure via the IFF as it nears the launch phase. At the very least, multilaterals' performance ratings and the resulting effect on country allocations should be put in the public domain and made subject to scrutiny, along with other aid flows. This should be made part of a wider framework of mutual accountability monitoring.

7.2 Expanding long-term, large-scale recurrent cost financing instruments linked only to specific development outcomes

Recipients, as we have seen, badly want longer-term predictability of aid commitments, not just predictability of disbursements against existing commitments. This is especially true for budget support linked to the funding needs of health and education services, which usually account for the bulk of the government payroll. General budget support has an inherently shorter-term focus, no longer than an IMF programme and its associated (usually 3-year) Medium Term Expenditure Framework (MTEF). Moreover, it is subject to policy and outright political conditionalties that introduce considerable short-term instability, especially if adopted by several donors symmetrically.

As mentioned in Section 5 above, some donors, notably the European Commission, are experimenting with *ex-post* conditionality,[1] relying in particular on externally verifiable outputs and outcomes such as progress on vaccination coverage, school enrolment or completion rates, etc. These have several advantages from the donor perspective also. First, the link to results is clearer for domestic audiences sceptical of general budget support, often seen as a technocratic 'B2B' (bureaucrat-to-bureaucrat) deal with its negative connotations.

Whilst reformulating such instruments as a 'Universal Education Programme' or other specific MDG-related programme, funding large-scale recurrent costs, is to a large extent about repackaging, improving public perceptions of tangible results is essential for greater aid stability. And such outcomes are not just more visible to, but also monitorable by, civil society critics in both donor and recipient countries. Care needs to be taken, however, not to exaggerate the focus on a single MDG in isolation from overall economic performance and the country's historic development achievements (Clemens et al., 2004).

On the recipient side, the potential advantage sought is twofold. First, aim to insulate a substantial portion of net aid flows with a longer commitment horizon (say a minimum of seven years). Second, remove all conditions for this portion that are not entirely derived from the recipient's goals, as framed in its Poverty Reduction Strategy Paper or related sector plans. This does not eliminate the risk of suspension, but the risk for this part of overall aid is no longer co-variant with that of general budget support, and indeed it depends on actions under government control. (Or rather, not entirely, as there is a demand side for uptake of services, etc., and this is affected by exogenous shocks of different kinds; but these mitigating factors can be assessed on their merits and allowed for in the design of the instrument.)

There remains, as discussed above, the issue of credible commitment mechanisms – the ability of donors to enforce outcome-based conditions transparently and firmly. This will also be linked to measurement lags: the phasing of *ex-post* reviews will need to be staggered every three years or more, so that progress (or the lack of it) and its attribution are transparent. All the more reason to give up micro-management on an annual or more frequent basis.

The obvious danger is that when major MDG objectives are missed, even without mitigating factors, donors using these instruments will flinch from suspending funds which explicitly support progress towards that outcome. There is an element of moral

1. There has been recent criticism (e.g. Booth et al., 2005) of the EC method of applying outcome-based conditionality, in that, for example, it sometimes uses negotiated outcome goals which are not intrinsic to the PRS, it varies aid disbursements over the short term based on indicators with long lead times, and it does not relate clearly to action attributable to the recipient government. Here we are discussing the more general case of having a significant share of the overall aid allocation depend on evidence of outcomes, not policy inputs, and keeping it shielded from most policy conditionality, beyond essential fiduciary and human rights safeguards.

hazard here. Donors would, however, be better positioned with this type of programme than with conventional instruments to seek civil society backing for a harder line. A softer line, if it came to that, could lead to effectively unconditional support, as is arguably the case now: but it could at least make it more stable over time.

A lesser objection could be that external arbiters of general budget support, in particular the IMF, would lose leverage if a big part of the budget funding pool escaped their purview. Again, this is also true for much clumsier basket funding mechanisms at sector level, whereas the proposed new instruments would at least try to tackle recurrent costs and their fiscal sustainability head-on.

For obvious reasons the design and general pace of expansion of such instruments needs to be co-ordinated at both the cross-country, single-donor policy level, and in the wider aid community. Thereafter its roll-out in individual countries depends on country-level joint processes under the Paris agenda.

7.3 Scaling up country aid envelopes in line with aspirational MDG plans: bridging liquidity gaps

The Millennium Project Report, cited above, has drawn attention to the need to build up aid programmes from technically feasible, but firmly aspirational, expressions of national development goals, inspired by the MDGs. It rejects today's situation in which national strategies – especially the PRSP – are effectively 'self-censored' on the basis of some largely external assessment of what resources may be available to augment domestic savings. At that rate, it says, the MDGs may not be achieved in some countries for many more decades (Sachs et al., 2005).

In practice, country aid envelopes are determined by individual donors, hence the donor collective, independently of the current PRSP, based on the set of factors discussed in Section 4. Over time, progress in each PRSP cycle of course influences allocations, but the adjustment is slow and partial. In the meantime, macro frameworks discussed with the IMF, and their growth, exchange-rate and inflation parameters in particular, largely govern the space available for extra public expenditure. Some assumptions are made on grant and concessional-loan financing and their sustainability, based on current donor opinion. Within certain restrictions (related, for example, to Dutch Disease), these can expand the growth and public finance targets. Increasingly, alternative incremental expenditure scenarios are discussed, contingent on securing more grant aid at the margin, and a larger above-the-line deficit. But these also tend to come in incremental steps.

What is wrong with this process, apart from its innate conservatism in terms of MDG timescales, is that it is neither transparent nor legitimate in terms of country ownership. Outsiders' views of external financing tend to close down the resource envelope discussion too soon, without sufficient exploration of alternatives. Short-term funding imperatives, such as the conclusion of a successful Fund programme review, push the horizon for non-marginal change further away.

There is no perfect way to resolve this tension. The Millennium Project suggests 'fast tracking' selected countries through some multi-donor exercise (a kind of supercharged Consultative Group) to break down such logjams. The chosen few would reach a different plateau of funding, based on radically more ambitious, needs-driven series of PRSPs within a ten-year MDG planning framework. It is not yet clear how this would succeed where other attempts have failed, relying as it does on the same set of institutions.

Experience of similarly inspired efforts on a smaller, sectoral scale, such as the Education for All Fast Track Initiative (FTI), shows that gaps can be closed, in principle, through such concerted action when they are quite small in absolute terms, falling within some 'high case' envelope for single donors applying conventional allocation rules, or drawing on the donor's current reserve funds. When quantum increases are needed, however, for many countries simultaneously, this far exceeds the scope for discretion at the country level, and may require new mandates from the donor legislature.

The aid system, in other words, is neither 'liquid' nor flexible enough for Sachs-type large-scale gap-filling across many countries simultaneously. It is geared to considering one country, or sub-region, at a time, under *ceteris paribus* assumptions of only marginal (say, 10%) overall flexibility at donor level. More importantly, it implicitly projects, from past experience, a high possibility of offsetting decreases in programmes elsewhere, due to exogenous shocks and governance problems. It is largely these 'business as usual' savings – on failing states, for the most part – that finance the surges of aid needed to fund large recovery situations and emerging successes. In addition, a number of donors (for example, the Millennium Challenge Corporation and the Global Fund to fight AIDS) now finesse country allocations altogether by asking governments to compete for funds, one project at a time, making it much harder to 'fit' funding to any country's PRSP-MDG framework, aspirational or otherwise.

Bearing in mind such systemic constraints, simply launching a large set of simultaneous MDG-driven negotiations at multi-donor, multi-country, multi-sector level is unlikely to be sufficient, and could create false expectations. A complementary approach would be to create a large enough 'reserve fund' at multilateral level to be responsive to opportunities on several fronts simultaneously. This would in effect be a 'synthetic donor', or 'silent partner', at gap-filling discussions, but could only come in with the agreement of the resident donor community and after they had made their own best efforts. This is the model being tested on a modest scale, for example, by the FTI.

Once again, the obvious candidate for a world-class synthetic donor is the IFF, with actual implementation divided among the relevant existing donor agencies. It also fits with the IFF's mission to accelerate aid, i.e. improve the liquidity, not underlying solvency, of aid budgets. But even without the IFF, a temporary reserve facility could be constituted on a rolling basis at, say, the World Bank or the IMF, like an overdraft designed to bridge spikes of aid commitments that exceed individual donor budget limits for short periods. Its carrying costs should not prove insurmountable.

Obviously, governance arrangements would need careful design, as they will for the IFF anyway. And in particular, moral hazard issues need to be addressed, so that existing donors do not free-ride on the new facility. But these are not insoluble problems, as demonstrated, for example, by how the HIPC debt reduction initiative was organised.

7.4 Credible accountability devices with effective sanctions

One inherent asymmetry of the Paris agenda, and of the aid system in general, is that, if recipients do not match agreed performance, donors can apply clear sanctions: however, if donors underperform, no such remedies are available to the recipient. Incentives are skewed accordingly. How might this be changed?

Part of the difficulty lies in defining clear donor behaviour standards, and here the Paris agenda is instrumental. Moreover, in some countries, such as Mozambique, a parallel ‘performance assessment framework’ applicable to donors, with specific indicators (on, for example, timely disbursements) has been agreed, and is in the early stages of implementation. Individual donors are scored by stated criteria (Killick et al., 2005). A number of observers (Oxfam, 2004; Johnson et al., 2004) have recently suggested other useful batteries of monitorable indicators that would help clarify and codify such behaviours. Some of these involve financial reporting used by recipient governments, in addition to open-source information. Some involve a measure of subjective scoring or opinion surveys, including baseline surveys carried out for the DAC and others as part of the Paris process.

Such initiatives serve several purposes. At the country level, they allow for greater transparency in confronting different views of the same interactions, and support for problem-solving, even though power relations remain unequal and there is no guarantee of redress for the recipient. The possibility of ‘naming and shaming’ as well as emulation and rivalry at country level affects donor group incentives towards better performance. Also, local representatives know that such ratings can strengthen the recipient’s hand in appealing over their heads to other levels of donor management or political oversight. Access to high-level policy dialogue could be progressively restricted to, or at least heavily favour, those donors who can demonstrate minimal buy-in to the harmonisation agenda.

However, it is at the international level, where they should also operate, that these incentives are much weaker, especially when donor behaviour is dictated by arrangements beyond the discretion of the country office. There are several reasons for this, but two stand out. First, the ratings do not yet carry the authority of a respected, and widely published, independent assessment source comparable, say, to Transparency International. And second, compared with the analogy of ratings agencies in bond markets, such signals do not generate significant financial costs and rewards along with moral suasion.[2]

The first problem could be addressed by donors collectively funding, at arm’s length, a permanent platform for bidding out donor assessment contracts to independent professional analysts meeting requisite qualifications, and against agreed templates. The platform could also collect and publish such ratings by country and donor. It could take the form of a foundation, perhaps linked to the UN, but not through its development agencies, which would themselves be subject to rating.

The second problem, of sanctions, is, of course, much tougher. In a more competitive set-up, where funding of aid and delivery of aid services can be unbundled and the latter outsourced based on outcome targets, as envisaged for example in Harford et al. (2004), delivery agency ratings could be enforced by funders. For example, chosen

2. The Center for Global Development has developed and is testing a composite index of donor behaviour combining not only aid effectiveness scores but an assessment of trade, migration, security and other policies with a clear impact on development. Whilst the weighting involved in constructing such an index is highly contentious, the mere existence of such ‘league tables’ has an effect in some countries, depending of course on the place in the political spectrum from which the assessments come, and their readership.

delivery agencies might have to meet eligibility thresholds to access funding, or they could only do so to a limited extent until their ratings improved, etc.

Finally at the apex level, if constructs like the IFF or other large new multilateral facilities as discussed above become available, agency ratings could similarly be used as criteria to regulate access to funding. This alone could have a profound effect in reshaping the aid system over time, even if, as one suspects, these ratings could have relatively low weights to begin with, compared with more political criteria.

8 Conclusions

The Paris agenda, with which this overview of aid effectiveness approaches began, aims to provide an important set of public goods (alignment and harmonisation as defined above) through concerted voluntary action between many donors and individual recipient governments. This approach is now beginning to be referred to as 'mutual accountability', though that term is not yet precisely defined. It is based on underlying trust and preference alignment. It could yet generate large development benefits, if it induces significant changes in domestic institutions and policies and these lead to better use of all resources at the country's disposal. These are processes we still do not fully understand and on which evidence of success is insufficient.

This approach is vulnerable to failure, like any collective action involving large numbers of independent actors, subject to no real penalties for non-compliance. It would be worthwhile considering additional levers for change, using a market or quasi-market perspective. These could involve incentives for greater specialisation or 'complementarity' by donors, rating instruments that could inform country choices and perhaps shape allocations, as for example in the context of the proposed International Finance Facility, and other sources of innovation. Put crudely, a little more competition would be good, just in case collusion does not work!

Beyond this, there are some other systemic flaws in the 'aid architecture' that cannot be remedied by the kind of country-based co-ordination envisaged in Paris, even if it works very well indeed. In addition to missing 'rating' institutions, three major factors are lacking. First, there is no agreement on what the international community should do to achieve better balance in aid allocations across countries, so long as bilateral aid dominates and multilateral aid is not instructed to correct the resulting gaps and overlaps.

Second, there is no 'road map' for how we go forward from a top-level commitment to increase aid in general towards the 0.7%, or even a more specific commitment like the Gleneagles $25 billion extra pledged for Africa, and how this gets allocated to different countries, purposes and agencies – not necessarily in that order. Along the way, this will create problems of composition, as the donors, channels, and absorption possibilities will not be aligned automatically. Some source of overall 'bridging finance' liquidity would help resolve some of the resulting problems, at least in part.

Third, and this is perhaps its real Achilles heel, the aid industry remains completely schizophrenic about conditionality. On the one hand, we aspire to stable, long-term, predictable aid partnerships, necessary to effect the deep structural changes called for by the MDGs. But, on the other, our discussion on conditionality has brought out the deep-seated need to have multiple lock-in devices that either give us the power to rescind such contracts at any time, or allow us to believe we have it. It does not really matter whether these are framed as 'disbursement conditions' or 'eligibility criteria'. Most donor agencies use a belt-and-braces mixture of both.

There is no easy resolution of these tensions, where the rhetoric of partnership meets the political imperatives of accountability to domestic donor concerns. The modest palliative suggested in this article is to consider reserving a significant portion of all aid, in the form of large-scale, long-term recurrent-cost support, linked *only* to specific sectoral outcomes-such as primary education completion. Explaining that this money is, in fact, sending boys and girls to school makes it more likely that donor constituency preferences will coincide with those of recipients. As other forms of conditionality have egregiously failed, this one might have some merit.

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