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Power to Consumers? A Bottom-up Approach to Aid Reform

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2005 will be remembered as the year of calls to double the amount of aid to poor countries. Yet unless developing countries themselves are offered genuine choice about which aid agencies they want to work with, the effectiveness of aid in reducing poverty will decline, and the rhetoric about recipient country ownership will remain empty.

The problem is that there are too many cooks in the kitchen. Since it came into existence about sixty years ago, the aid system has expanded continuously. The latest newcomers include the Millennium Challenge Corporation (MCC), the Global Fund to combat Aids, Tuberculosis and Malaria (GFATM), and the still unborn International Financing Facility (IFF). This multiplicity of agencies, each striving to demonstrate relevance, is compounded by a multiplicity of agendas – shaped among other things by the Millennium Development Goals discourse, security concerns linked to the 'war on terror', geo-strategic considerations, self-interested economic and trade linkages, and a host of 'western' concerns, such as climate change, democracy and gender equality.

The lack of either a clear regulatory environment, or a market mechanism to force a more rational 'division of labour' among the various agencies involved generates a number of inefficiencies. These range from poor coordination to high transactions costs and stark inequalities between 'donor darlings' and 'donor orphans', often unrelated to the recipient country's track record. The table below shows the extent of this proliferation.

How can the situation be improved? The key is to give aid consumers (recipient countries) more choice, offering the prospect of greater donor specialisation according to comparative advantage. Developing countries do not want to be presented with only one option – the Dutch, and only the Dutch, doing water, the British, and only the British doing education. At the same time, they also cannot afford to satisfy the whims of fifteen different agencies in a single sector, as they do now. Some choice is essential, and it is aid recipients who should exercise that choice.

There are two ways to proceed. One option is to leave the initiative to donors to develop common procedures, share their analysis, mount joint missions and establish mutual accountability mechanisms. However, the downside of this 'top down' approach is that donors have little concrete incentive to mend their ways, and partner countries have few mechanisms for keeping donors truly accountable. A better option is to build choice from below.

One example is Afghanistan, which decided in 2002 to set the ground rules for donor engagement in reconstruction. These included identifying lead donors in each sector and setting minimum amounts of donor financing to be pooled in budget support or trust funds. A Joint Assistance Strategy being prepared between donors and the Government of Tanzania also tries to build consumer choice. It will include the channelling of higher proportions of aid through budget support, and commitments to a more effective division of labour among donors, including delegated cooperation and so-called 'silent partnerships'.

Based on the evidence of these and other cases, developing country governments aiming to improve the aid system need to bear in mind a number of important factors, including a detailed understanding of: the specific dimensions of different donors (such as volume, type, timeframe and reliability); the breadth, depth and terms of availability of professional experience provided; the sensitivity of different agencies to country ownership and sovereignty; the degree of reciprocal trust developed over time; the flexibility of donor systems and procedures, and the degree of willingness to adapt them to existing country systems; the record of success or failure of past donor interventions; and the nature, costs and risks of donor conditionalities involved.

Most of this information is readily available to aid recipients, who are nevertheless often uncomfortable about confronting donors directly. This is where the aid community should have the integrity to allow independent assessments at country level. Such ratings would be used to build mutual accountability at the country level. Synthetic findings and league tables could then be compiled by a neutral organisation and disseminated widely, much like Transparency International scores countries in terms of corruption.

The actions proposed above would constitute a first step towards changing the aid relationship from the bottom up.

Existing Division of Roles in the Aid System

Type of assistance	Special Purpose Funds				Projects & Programmes		
Donor	Humanit Assistance	Emergency & Reconstr	Technical Assistance	Debt Relief	Project Finance	Sector Support	Budget Support
Multilateral							
UN	✓	✓	✓	–	✓	✓[2]	–
IDA	–	✓	✓	–[1]	✓	✓	✓
RDBs	–	✓	✓	✓	✓	✓	✓
EC	✓	✓	✓	✓	✓	✓	✓
Bilateral DAC members	✓	✓	✓	✓	✓	✓	✓

1. No direct funding, but assistance in organization; 2. Limited support

There are four more important actions countries receiving aid should take. First, demonstrate their commitment to poverty reduction by having credible long-term development strategies. Second, put in place measures, such as setting up improved systems for performance monitoring and financial audit, to demonstrate transparent and accountable use of donor funds. Third, following the examples set by Afghanistan and Tanzania, develop concrete rules for donors to engage in projects and programmes. Fourth, demand greater donor country transparency on the criteria used to determine aid allocations.

If funds are to follow demand, a similar approach would have to be supported internationally. For example, if UNICEF turns out to be a more popular choice for health programmes among recipient countries than WHO, then it should be funded at the expense of WHO. Similarly, if multilaterals are preferred to bilateral aid, then the money should follow the demand, and bilateral aid should shrink. There's an important lesson here for the IFF: if recipient countries are asked to select the channels through which they prefer funds to reach them within a given country envelope, the IFF could proactively reshape the aid architecture. They could use third-party donor ratings as a guide in doing so. Or maybe, donor agencies might have to pre-qualify as conduits for IFF, based on country ratings. This is potentially the first time in the history of aid that recipients could exercise such a choice across donor countries, whereby funds originating in one might be managed by another.

Finally, an efficient forum is needed, based on existing mechanisms, to discuss country-level problems of accountability and aid effectiveness. This could be achieved by opening the DAC to full membership by developing countries, streamlining the UN's ECOSOC, growing a regular surveillance role out of the World Bank's Development Committee, or some combination of the three. Such forum would act as a regulator which addresses the failures of the 'aid market'. If it can be done for central banking and telecommunications, it is probably not beyond human ingenuity to do it for development. Whether there is enough political appetite for it in rich countries is another matter.

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