Aid Effectiveness and Selectivity

Pre-Print of the DAC Journal 2003, Volume 4, No. 3

OECD

Aid Effectiveness and Selectivity: Integrating Multiple Objectives into Aid Allocations

OECD DAC/Development Centre Experts' Seminar
Paris, 10 March 2003

OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

– to achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;

– to contribute to sound economic expansion in member as well as non-member countries in the process of economic development; and

– to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and the Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

In order to achieve its aims the OECD has set up a number of specialised committees. One of these is the Development Assistance Committee, whose members have agreed to secure an expansion of aggregate volume of resources made available to developing countries and to improve their effectiveness. To this end, members periodically review together both the amount and the nature of their contributions to aid programmes, bilateral and multilateral, and consult each other on all other relevant aspects of their development assistance policies.

The members of the Development Assistance Committee are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States and the Commission of the European Communities.

OECD DAC/Development Centre Experts' Seminar

"Aid Effectiveness and Selectivity: Integrating Multiple Objectives into Aid Allocations"*

Paris, 10 March 2003

Abstract. This paper reports on recent work on improving the effectiveness of aid allocations, and extends the scope of analysis beyond the aid-policy-growth-poverty linkages to include three new elements: a broader range of poverty-relevant objectives and effectiveness constraints of aid; practical experience in the application of quantitative analysis to allocations; and analytic approaches to determining shares of aid through multilateral channels and for global public goods. There is wide consensus on the main allocation criteria for effectiveness in reducing poverty through pro-poor growth: the level and incidence of poverty and the development performance of partner countries. Other variables that raise the impact of aid on growth are helping vulnerable countries adjust to shocks, debt relief and post-conflict reconstruction. Considering broader development and humanitarian objectives, aid should also be allocated to prevent violent conflict and to improve governance and social conditions in "difficult partnerships". In addition, global public goods are severely under-funded, and there is some evidence of under-funding of multilateral programmes.

* This paper has been prepared by Paul Isenman and Dag Ehrenpreis of the Development Co-operation Directorate's Policy Co-ordination Division. Any comments or queries should be addressed to <dac.contact@oecd.org>.

TABLE OF CONTENTS

SECTION I

RESULTS OF THE OECD DAC/DEVELOPMENT CENTRE EXPERTS' SEMINAR

"AID EFFECTIVENESS AND SELECTIVITY: INTEGRATING MULTIPLE OBJECTIVES INTO AID ALLOCATIONS"

Paris, 10 March 2003

Executive Summary

On 10 March the Development Assistance Committee (DAC) and the Development Centre of the OECD co-sponsored a seminar on improving the effectiveness of aid allocations. This seminar updates and extends the results of its predecessor seminar in January 2001, introducing three new elements: taking account of a broader range of poverty-relevant objectives of aid (*e.g.* dealing with external shocks and armed conflict); practical experience in application of quantitative approaches to allocations; and analytic approaches to determining shares of aid through multilateral channels and for global public goods. The seminar was attended by representatives of aid agencies and NGOs and by researchers from OECD and developing countries. The main conclusions of the seminar are explained briefly below and spelled out in the main report; it and other seminar documents are available at: <www.oecd.org/dac/wpeff/Mar2003ExpertsSeminar >.

The most important finding is that there is strong and growing consensus among official aid donors and among researchers on how to make cross-country aid allocations more effective in poverty reduction. This covers *both* maximizing the number of poor who benefit from the growth-enhancing impact of aid *and* providing some aid, for examples to help avoid failed states, that impacts directly on poverty reduction. This growing consensus is not just academic. Variants of it, tailored to individual donor needs and views, are already being used to help guide cross-country allocation decisions of multilateral and bilateral donors.

Regarding cross-country allocations, there was a strong and growing convergence of views, as had been suggested in the excellent summary paper by Mark McGillivray of the World Institute for Development Economics Research (WIDER), on the main criteria for effectiveness in reducing poverty. These criteria are: the level of poverty (as proxied by average per capita income, concentrating ODA heavily on the lowest income countries; the incidence of poverty (as proxied by population); and the development performance of partner countries. The past debate about the importance of particular macro-economic policies in affecting the impact of aid on growth (and hence on income poverty reduction) has given way to a broad acceptance that partner country development efforts have an impact on aid effectiveness analogous to the way they have an impact on returns to investment as a whole. As discussed below, important differences remain on the margin, including how much weight to give to population and to performance, respectively, and how the latter should be measured.

There is growing agreement as well on other variables that raise the impact of aid on growth beyond what country performance would otherwise suggest. One is helping countries adjust to shocks, with some evidence that this can be extended to countries vulnerable to shocks or subject to a heavy debt burden. A related finding is that aid in post-conflict situations is particularly effective in increasing growth during a window of about five years, peaking about three years after the end of the conflict. Two other recent studies suggest that political stability and pro-poor public expenditure programmes increase aid impact. Given the need for economy in the number of criteria (see below), these could be taken account of in the governance and poverty focus aspects of measures of country performance.

One of the major objectives of the seminar was to look at the need to consider objectives that go beyond just maximising the growth impact of aid on poverty reduction. Again there was consensus at a broad level. Aid to prevent violent conflict, including terrorism, is an example, as is humanitarian aid. Another, reflecting recent policy work done by the DAC and multilateral donors is on the need to continue some aid to difficult partnerships, or what the World Bank refers to as “Low Income Countries Under Stress” (LICUS). This aid would be to help address governance and institutional issues as well as to help deliver basic services.

As presentations from the World Bank, the Netherlands, and the United States illustrated, a number of multilateral and bilateral donors are already making use of the results of this stream of analysis for making country allocation decisions. The purpose is not to deny political decision makers the final decisions, but to inform them of the allocations suggested by the criteria and weightings (elasticities) they have previously approved. In other words, the starting point for decision making on allocations becomes the results of this quantitative approach, rather than simply the previous year’s level or ad-hoc preferences. One speaker noted that this kind of approach can also be adapted to take account of donor political priorities (*e.g.* regional or linguistic).

The discussion showed that within the broad consensus there were substantial differences in practice that would impact on patterns of allocation.

- Different donors use, as is appropriate, differing judgements on which variables to include and how to measure and weight them. For example, the Dutch allocations guidelines favour smaller countries much more than do the World Bank’s; and the United States Millennium Challenge Account uses a different approach to measuring country performance than does the World Bank or the African Development Bank.

- A shared concern to reduce the weight of what one speaker referred to as “fashion, politics and commerce” in allocations led to two opposing views about how many variables to take account of in quantitative approaches. Some felt that anything more than a minimum number of criteria led to opacity, which would encourage political leaders to ignore quantitative approaches entirely. Others felt that excluding important variables would lead to more ad-hoc and perhaps arbitrary decisions, and that what was important was to be transparent on choice of criteria and weighting. Striking a balance between these views should depend, in part, on the importance - in percent of variance - of the variable(s) that would otherwise be excluded, and hence subject to ad-hoc decisions.

- There was continuing discussion of how to take account of financing requirements of specific projects and programs, or the use of particular aid instruments (such as budget support). Should they affect the size of country allocations or be taken account of within the totals that emerge from quantitative allocation approaches? The latter is the more common view among donors using quantitative approaches. There is clearly a need for more work on this question as it applies to looking at competing requirements that come from national poverty reduction strategies.

- Another area identified for further work was the extent to which allocations by a given donor should take account of allocations by (the sum of) other donors. If not, there is a danger that some countries will get so much aid that it becomes subject to the widely-agreed phenomenon of declining – and eventually negative – marginal returns; at the same time other countries may end up, in aggregate, significantly under-funded. One speaker from a developing country forcefully made the point that it is necessary to look at an aggregate "matrix" of aid supply and demand across countries.

There was broad agreement that improving aid allocations was only one among the many factors that determine aid effectiveness. These range from country ownership and leadership, donor practices, and capacity strengthening. Broader development, rather than just aid, effectiveness, requires going on to trade, investment and other issues well beyond aid, i.e. to policy coherence for development. These other aspects of aid effectiveness are discussed in other DAC fora while this seminar concentrated on an aspect that is generally neglected: allocations.

The session of the seminar on **the share of assistance that should go to (through) multilateral institutions and to Global Public Goods (GPGs),** was intended to present preliminary results of the limited work done to date. For example, DFID's initial work showed that the multilateral share of its financing should increase. However, its initial quantitative analysis excluded variables that would have gone in the other direction. Sweden's presentation noted that the dividing line between bilateral and multilateral aid was becoming blurred, for example in the case of joint budget support for country led programmes.

Both presentations showed that there were major areas of apparent under-funding of GPGs – or, more generally, of programmes that required international collective action at the regional or global level. Agricultural research was such an area, where extensive evaluation had shown big returns. Others noted that most GPG-related programmes had not been carefully evaluated, that evaluations often ignored expensive complementary inputs at the national level, and that one should not go overboard on GPGs. Still, the general view was that there was a strong likelihood of under-funding of GPGs. There was also agreement on the need for more analytic work and evaluation to better inform policy makers on choices regarding funding for multilaterals and GPGs.

Comments at and after the seminar suggested that participants had found it useful both for operationalising quantitative approaches and for identifying areas of emphasis for further research and analysis, and would welcome an appropriate forum for continuing an informal exchange on this topic.

Main points from the presentations and discussion

Multiple objectives of effective aid – the analytical framework

Professor Mark McGillivray, WIDER, presented a summary paper of recent research on aid effectiveness and selectivity in aid allocation.[1] The paper initially refers to World Bank research that has spawned a number of subsequent academic studies. All agree with the fundamental thrust of this research: that aid is effective in promoting growth and, by implication, in poverty reduction. This has proved to be a particularly robust conclusion, drawn by practically all-subsequent empirical studies of aid and growth.

There is not yet similar clarity over the importance of recipient country policies for effectiveness. Many studies have failed to confirm the empirical results of initial World Bank research indicating that aid is effective *only* in countries with "good policies", although there is acceptance among researchers that better governance and policies, reasonably defined, in all probability render aid more effective.

The paper updates and extends the coverage of the lead paper for the previous similar seminar.[2] It includes more recent research on the contribution of aid to growth and also covers other objectives, constraints and development factors. The overall focus is on the relevance of these issues for poverty-efficient aid. It identifies a range of criteria on which poverty-reducing aid allocation or selectivity might be based.

The paper is based on two key notions. The *first* is that effectiveness of aid in promoting growth is contingent on a range of factors in addition to policy parameters, such as conflict risks and other forms of socio-economic vulnerability as well as political stability and other aspects of governance. The *second* recognition is that, more importantly, the ultimate objective of aid is poverty reduction or, more broadly, enhanced human well-being. This is clear from the adoption of the Millennium Declaration and its derived Millennium Development Goals (MDGs), which identify multidimensional poverty reduction as the ultimate objective of development efforts. Aid for fuelling growth is vital as of various means by which this objective can be achieved.

A number of important points emerge from the paper. Regarding effectiveness, aid fundamentally works, but its impact differs across countries depending on the conditions they face. Aid seems to work better in post-conflict situations, in structurally vulnerable countries (including those undergoing trade shocks), in politically stable regimes and in countries with good governance records. However, diminishing returns to its impact on growth appear to set in at high levels of aid intensity. Aid is also associated with increased public expenditures, including those which are pro-poor, despite some fungibility problems.

After the Cold War, donors have given more emphasis to developmental criteria than previously, including selectivity according to both poverty needs and policy performance, although political

1. World Institute for Development Economics Research of the United Nations University, Helsinki, Finland.

2. DAC/DEV Experts' Seminar 17 January 2001 on *Aid Effectiveness, Selectivity and Poor Performers* with the lead paper "Policy Implications for Aid Allocations of Recent Research on Aid Effectiveness and Selectivity" by Jonathan Beynon, Department for International Development, United Kingdom. See website: <www.oecd.org/dac/wpeff/Jan2001ExpertsSeminar>.

factors continue to constrain a fuller embracing of such criteria. There is evidence that biases favouring small countries persist, but little evidence that aid allocations take specific account of governance, shocks and post-conflict criteria.

For poverty-efficient allocations, the paper emphasises two points. The *first* concerns bilateral development assistance programs: donor governments need to continue their efforts to base aid more on developmental criteria and less on political and commercial self-interest. This is not as great a challenge as some might assume, given that most have pursued development criteria for longer and to a greater degree than commonly asserted, although recent geo-political developments have led to more emphasis of the latter.

The *second* point concerns the channels through which aid contributes to poverty reduction. Aid effectiveness in promoting growth varies according to a range of factors, and aid can reduce poverty through other channels than growth. One such channel, for which there is empirical support based on the literature identified in the paper, is the impact of aid on pro-poor public expenditure. It is not only the rate of growth that matters, but its quality is at least as important, including composition, distribution and sustainability. Hence aid for improving the poverty-reducing quality of growth is vital as a complement to aid for faster GDP growth.

The paper examines the issue of diminishing returns to aid that may result from rapidly increasing aid while absorptive capacity remains limited. This is a potentially serious issue if selectivity results in significantly increased aid to individual countries.

Capacity to make effective use of aid is a particular problem of countries at the lower end of the scale of policy performance, some of them with high poverty incidence and severity. One solution is, where necessary and feasible, to provide support for basic social services other than through governments. The World Bank has suggested in-country "independent service authorities" (ISAs), which could include non-governmental organisations (NGOs). Allocating aid in such non-traditional manners would mean more aid to poor countries facing severe governance difficulties (called "Low Income Countries Under Stress" by the World Bank, and "difficult partnerships" by the DAC).

The discussants praised and strongly endorsed the Summary Paper as an excellent short overview of recent literature on aid effectiveness in relation to multiple objectives and different types of development constraints. It manages to include a large number of relevant studies covering different, complementary aspects, while presenting them in a structured and easily accessible way with a focus on issues, results and policy implications re aid allocation. The paper was generally recommended for wide circulation in the international development community.

In the discussion, there was remarkable rallying around the main conclusions emerging from the research results as presented in the Summary Paper. The sharp differences previously emphasized in the academic literature seemed to have dissipated in favour of more nuanced, complex and sophisticated assessments. One speaker even thought that we are "at the end of history" for this type of debate, although the discussions showed that the consensus, albeit wide, does not extend quite that far.

The main conclusions from the previous seminar remain and emerge even stronger from this one: aid works for growth and development more generally. It works better for poverty reduction when allocated to low-income countries with reasonable policies. And it works increasingly well over time, as more attention has been given to learning lessons of aid effectiveness. It remains vital to convey this message to decision-makers, opinion leaders, and civil society more generally to ally the effect of broad publicity of aid failures and of past analysis indicating that aid was generally ineffective or worse.

There is also broad agreement that aid works better where governance is better. The relevant measure of performance is generally agreed to include both economic and social policies, and more generally the quality of governance and institutional (including implementation) capacity. "Good policies" could not be defined generically other than as those policies that contributed significantly to political goals in each specific country. The research evidence indicates that democracy enhances the impact of aid on both economic growth and human development through features such as political and civil rights and public accountability. At the same time, political instability reduces the impact of aid.

There is now general recognition of the importance of aid for reducing economic vulnerability and mitigating shocks, including natural and other humanitarian disasters and armed conflicts. This result is not just a matter of responding to needs, but in particular to enhance aid effectiveness for pro-poor growth and for more direct poverty reduction impact. A particular aspect of vulnerability as highlighted in the discussion was the debt burden.

The main message emerging from empirical research on vulnerability and shocks is that aid has not been as effective in responding to shocks and volatility *e.g.* in commodity prices as it could have been, sometimes even aggravating the volatility due to lagged responses. Adjusting such schemes for quicker response *e.g.* by using automatic triggers is a major challenge for aid effectiveness. Meanwhile, a general increase of aid allocations to countries that are more vulnerable in this regard is a step to consider.

Concerning armed conflicts, the discussion emphasised the importance of aid allocations for preventing them, for humanitarian aid when they occur and post-conflict reconstruction aid. With reference to the causes of armed conflict, cost-benefit analysis demonstrates the superiority of aid for conflict prevention over post-conflict reconstruction aid. This point highlighted the need to work with countries in risk of conflict, focussing on alleviating proven risk factors like inequality between ethnic and social groups.

In this regard, national social cohesion was seen by a discussant as crucial to policy reform and development performance, by increasing the political room for manoeuvre for governments. Analysts need to consider policy performance as an endogenous variable determined by political realities and constraints set by general developments in society. The commitment of the political leadership to reform and poverty reduction and the formal accountability of governments to parliaments and the electorate are still key factors. Thus, democratic institutions were considered essential, and aid for democratic development is important.

The other discussants emphasised that donors must not give up on policy change where reforms are slow or lacking but engage with stakeholders in dialogue in each country concerned on how best to support a potential or nascent reform process. This was a real challenge in many cases, but should not be discarded as impossible. Good governance was an ongoing learning process with development. Neither *ex ante* nor *ex post* conditionality should be excluded. If the MDGs were to be reached in all countries, then donors were bound to work with all partner countries and find strategies appropriate for each one of them. There was broad agreement about using some aid to promote the spread of ideas, to civil society as well as governments, and to build relevant capacity, in the effort to lead to future policy and, more generally, performance.

One issue for discussion was to what extent allocations across countries were/should be driven by the financing requirements of specific projects and sector programs rather than by policy and governance performance indicators at national level. There was a recognised role for *ex ante* evaluation of projects and programmes in different countries, considering a wide set of development-related objectives, as a basis for aid allocations. One participant stated this as "contents matter, not just the country allocation". There was not, though, any specific discussion of whether or what particular projects or programmes should increase multi-year allocations overall.

While much appreciating the increased realism of including multiple objectives and constraints in the aid allocation analysis, several participants expressed some apprehension that trying to formalise this in comprehensive models or allocation formulas would make both analysis and decision-making too complicated: "Complexity is the enemy of clarity". They argued also that too much complexity would cause allocation guidelines to be ignored and decisions made on a political basis. Considering this risk, they argued that a better way would be to establish a few basic allocation criteria and then apply them flexibly, adjusting for additional factors depending on their relevance case-by-case. Others argued that while allocation criteria should be simple and clear, leaving out important variables from the underlying analytical models would also result in politically biased decisions. Rather a balance should be struck.

Finally, it was pointed out, and generally accepted, that there is a "fallacy of composition" problem in aid selectivity. If all donors apply the same country-allocation criteria, they risk ending up giving all such aid to the same subset of countries (the "good performers"). This could create significant problems of diminishing or even negative returns, while the vast majority of poor countries would be under-funded and risk falling into deeper poverty and instability. Each donor must therefore consider what other donors might be doing. Aid needs/demand and supply should be viewed in a matrix at sector, national and international levels. The role of aid coordination both within and across countries is crucial in this regard.

Implementation issues and practical experience

Donor governments and aid agencies made three presentations

The *United States* presented the new Millennium Challenge Account (MCA) on the basis of testimonies at the US Senate hearings on 4 March by Andrew Natsios, USAID Administrator, and Steven Radelet of the Centre for Global Development (CDG).[3] The MDC allocation criteria will apply to one additional third of US ODA. Country eligibility is based on a set of clear and concrete and objective criteria, which are to be applied rigorously and fairly. The criteria are simple enough, especially compared to the maze of rules and regulations applying to the budget of USAID, which will be concentrated in MCA non-qualifier countries. The latter may receive aid with the specific purpose of helping them get over the MCA threshold.

The poverty focus is assured in the first two years by limiting eligibility to countries with per capita incomes below USD 1 435 that are eligible for World Bank/IDA[4] concessional financing. From the third year, the threshold will be increased to USD 2 975 to include lower middle-income countries. There are 16 performance indicators (with stated, published sources) in three policy areas: governing justly, investing in people and promoting economic reforms. MCA countries must score above the median on half of the indicators in each of the three policy areas to qualify.

3. See *The Millennium Challenge Account*. Testimony for the Senate Foreign Relations Committee, 4 March 2003 by Steven Radelet, Senior Fellow, Center for Global Development. See website: <http://www.cgdev.org/nv/RadeletTestimonyMCA.pdf>.

4. Currently, 81 countries are eligible for concessional financing from IDA, the International Development Association, World Bank.

The Centre for Global Development (CDG) estimates indicate that 13 countries might qualify for the MCA in the first year based on data currently available. In year 2, eligibility increases to 87 countries. This will raise the median levels of most indicators on which selectivity is based, so that only 11 countries are likely to qualify, now including China[5], Philippines and Viet Nam. In year 3, the Bill proposes a sharply expanding pool of eligible countries to include 28 nations with GDP/capita between USD 1 435 and USD 2 975, with their own median scores used to assess MCA qualification. According to the CDG, including this set of middle-income countries would divert resources away from countries with greater needs and fewer financing alternatives, and implies a risk of more weight to political factors in allocations.

The Netherlands presentation addressed how selectivity and allocation is handled in a bilateral aid programme. Both the selection of countries and the determination of the amount of aid for each country are highly political processes, but in recent years evidence from aid effectiveness studies has become a significant selectivity element. Quantified criteria have been used as much as possible to ensure fair and transparent allocations, but the results of these analyses were not used in a mechanical way to determine the final outcome. Subjective judgments play a role, not all relevant factors can be quantified, and in the end cabinet ministers and parliament decide. Capacity problems, both at the ministry and at the embassies, played a major role in guiding the selection process.

Important for Dutch aid selectivity is that a clear distinction was made between different types of aid. Country selection on the basis of poverty and performance is relevant only for structural bilateral cooperation from government to government (not more than about 12% of total aid). Other types of aid need other criteria. For instance, humanitarian emergency aid has no country limitation, nor does "thematic aid" for global public goods for environmental protection and against HIV/AIDS. And countries receiving Dutch aid to improve weak governance or for conflict resolution are obviously not selected on the basis of good governance performance.

The selection was based on three major criteria: poverty (as indicated by IDA eligibility), quality of social and economic policies and quality of governance (according to the assessment of country desk officers and embassies). Other factors are the size and quality of the present bilateral cooperation, the comparative advantage of Dutch presence (in relation to other donors), the possibility of using sector-wide approaches, and the political role of the country in the region.

Allocations among the selected countries are based equally on performance and needs. The performance indicators are social and economic policies and governance (based on IDA's CPIA[6]) plus a human rights component, and the other half by an assessment of the quality of the ongoing aid programme in the country. For aid need, three per capita-indicators were used: GNP, ODA and debt. After adding up these scores, 50% bonus was added both for least developed countries and for countries in Sub-Saharan Africa. The final score applied to the available budget gives an allocation per capita, which is multiplied by the square root of population size, thus introducing a small country bias. Moreover, a minimum allocation threshold of 10 million Euros was added to prevent unworkable small allocations.

The Dutch had found the experience of implementing systematic selectivity and allocation criteria useful, although only one element and applied to a minor part of ODA. They had used every resource allocation round as a reference (two to three times a year). The model was occasionally used as the

5. China's inclusion in the eligible group would affect the median values and thus other countries' eligibility although China will not receive MCA funds.

6. Country Policy and Institutional Assessment.

explicit rationale for country allocations. Using own performance data was expected to increase the political credibility of the model. Although no panacea, an analytical basis for the very political process of selecting development co-operation partner countries was nevertheless considered worthwhile.

The World Bank uses three basic eligibility criteria for IDA: 1) Relative poverty, defined as GNP per capita below an established threshold, currently USD 875; 2) lack of creditworthiness to borrow on market terms and therefore a need for concessional resources to finance the country's development program; and 3) minimum acceptable development policy performance. Allocation criteria give heaviest weight to performance and population (with little small country bias except for the largest countries).

World Bank staff regularly assess the quality of each borrower's policy performance. The criteria and methodology of these assessments incorporate lessons from experience as well as research findings. They include an evaluation not only of the government's policies but also of the institutions in place to implement them. In addition, a discount is applied to the ratings of countries with severe governance problems, as weak governance has been shown to be a major obstacle to development. The Country Policy and Institutional Assessment (CPIA) has 20 performance criteria grouped into four clusters: economic management, structural policies, policies for social inclusion/equity, and public sector management and institutions. The performance assessment is composed of the CPIA (80%) and the portfolio performance rating (20%).

Recently, IDA allocations also take into account factors beyond policy, poverty and population - such as external shocks and debt sustainability. Allocations are also being made to low performers, in particular to post-conflict countries, but also to low-income countries under stress (“LICUS”). This is facilitated by the new IDA terms with up to 40% as grants. LICUS allocations go for transfers of knowledge and strategic capacity building *e.g.* for accountability, rather than financial resources, but they also include basic social service delivery to the poor where possible

The IDA allocation system continues to evolve, including a strengthening of checks and balances, internal peer reviews, and the use of outside indicators. IDA is considering making the ratings results public. Lessons learned from objective outcomes increasingly inform CPIA criteria selection and definitions. The links will be tightened between IDA’s performance-based allocations, the Country Assistance Strategies and PRSPs.

In the *discussion,* other agencies reported on their own variations of these basic models. The *UK* emphasized that analytically-based models can influence but not determine policy-making. The big picture allocations were determined politically. For instance, Africa gets much more UK aid per capita than suggested by the DFID model, but the model was a major factor for intra-regional allocations. The *African Development Bank* uses an allocation model with heavy weight to performance, measured 70% by CPIA weight and 30% by portfolio performance. It also tries to assess efforts, not just results, given the importance of factors beyond government policy control. The ADB also takes account of regional development objectives

A basic issue arising from these examples of implementation of analytical models was whether to stick with objective indicators, as MCA sets out to do, or include subjective assessments as in the other examples. It was pointed out that so-called objective indicators are not necessarily of a higher quality than subjective ones, and some example were cited. Another obvious difference is in the choice between different types of indicators, *e.g.* economic freedom or broader governance indicators. Some asked if IDA overstated the governance factor, while others emphasised that it is the most crucial factor

Another issue was that of linking allocations more closely to the Millennium Development Goals (MDGs). Questions were raised how they entered into the allocations models presented, and to what extent IDA used the Bank's own poverty and inequality indicators for allocation purposes.

Practical experience had highlighted the link between size and contents of country programmes. Good performers with good poverty reduction strategy papers (PRSPs) could get more fungible aid like budget support and had higher absorptive capacity and lower transaction costs both for the donor and recipient administrations, and vice versa.

The regional dimension was emphasised. Developments in one country can affect its neighbours, and selectivity, allocations, conditionality and programme content has to be co-ordinated regionally, including regional projects and regional public goods.

Other key allocation issues:

Balance of bilateral and multilateral aid and other channels

Allocations and incremental financing for global public goods

DFID presented its recent *Strategic Review of Resource Allocation Priorities*, summarising early results of a new effort to answer the crucial question of how best to deploy ODA in the international struggle to eliminate world poverty. It covers three areas: the allocation of bilateral aid among countries; the division of aid to countries between bilateral and multilateral channels; and the division of spending between aid to individual countries (both bilateral and multilateral) and expanding the supply of international public goods.

The presentation focussed on the relative effectiveness of aid through intermediaries such as multilateral development banks, UN agencies and civil society and how DFID could further improve its effectiveness by providing incentives to make evidence-based choices and allocate aid to the most effective agencies, whether DFID or multilaterals. It summarised the results of a pilot survey of the effectiveness of various multilateral agencies against a range of criteria such as quality of staff and analytical work, commitment to poverty reduction, use of effective aid instruments and patterns of country allocation. The following ranking of effectiveness emerged: IDA, DFID, AsDF, EDF, AfDF and the EC budget.

Scaling is an important issue for taking a longer-term view about the relative balance of support between institutions. A scaling factor was introduced to establish some element of appropriate size to turn relative effectiveness into shares or actual cash amounts, by measuring scale on the basis of population, the number of poor people covered by the agency and the existing size of its budget. The results indicated that the current proportion of DFID's budget in the United Kingdom's overall ODA (72%) was far above the optimal level, which instead implied a multilateral share of that order.

DFID concluded that this was an overly simple method *e.g.* it excludes issues about overlap or complementarity between agencies – and did not propose to use it in any detailed way to inform resourcing decisions. However, the approach provides some interesting pointers about possible longer-term directions of change and zero based approaches to relative allocations. The survey suggested that the Multilateral Development Banks should retain a constant share of the aid framework. But a constant share implies a substantially rising cash amount. Considered the case for a rising cash amount, the average share over the last five years was found to be adequate and it was recommended to it as a minimum benchmark level.

It was not found possible to compare UN agency financing with other multilaterals. The UN role is primarily technical rather than financing and each UN agency is supposed to play a unique role. Financing of UN agencies is also partly construed as investment in the agency rather than providing financing to the agency as an intermediary. The return to this investment may not be directly related to the agency's effectiveness i.e. investment in a poorly performing institution may well have a high return. Further work is to be done to consider ways to inform financing based on comparisons between agencies. This would take a more dynamic approach, assessing whether the agency is improving or not, to allow a mapping of the direction of change on to the direction of financing.

The review did not attempt an aggregate comparison of effectiveness between civil society intermediaries and other channels. Civil society is a complement to, not substitute for, other channels of funding. The effectiveness of civil society financing needs to be assessed as does aid to governments. DFID recommended a three-pronged approach to improve the resource allocation process to civil society with 1) setting and regularly considering an effectiveness benchmark; 2) stronger and clearer tests of effectiveness, including measures of operational effectiveness as well as overall policies; and 3) introducing new financial rules more closely linked to this relative effectiveness than to historical financing.

Commitments to international public good expenditure regional as well as global-should be justified against common, and sound, development criteria. Available evidence suggests that the impact of investing in international public goods can be high and is important for achieving the MDGs, although activity and funding are not keeping up with need. For example, the cost of lifting one person out of income poverty through agricultural research and global trade expansion is estimated to be much lower (one tenth according to one seminal study) than the cost of the same impact through aid to poor countries. Control of communicable diseases could impact on 330 million lives a year by 2010; functioning ecosystems are central to 20-30% of the incomes of the poor in developing countries.

The analysis implies increased DFID funding to engage with the international community and increased programme spending allocated to trade over the next three years, and an increase in research budgets in line with overall budget increases. In conclusion, it was emphasised that this was a first effort of its kind. Much analytical work remains to be done in collaboration with the international development community, *e.g.* on international public goods. [After the meeting, information was received of a new effort in this area by a group of donors (Canada, Denmark, Germany, the Netherlands, Norway, Sweden, Switzerland, and the United Kingdom). It is called the Multilateral Organisations Performance Assessment Network (MOPAN), which will carry out regular assessments of the work of selected multilateral organisations in a number of countries where members have their own bilateral programmes.]

Sweden presented some features of its emerging new policy for global development. It emphasises policy coherence – development aspects in all policy areas – as well as promotion of global public goods and development co-operation inclusive of the perspective of poor countries and people, including a human rights approach. The presentation also included the objectives of Swedish global development policy and the proposed selectivity criteria for long-term co-operation with developing countries, to be applied pragmatically. Sweden did not consider the bilateral-multilateral distinction as sharp and competitive, but rather complementary and often blended and closely co-ordinated.

Sweden had carried out a development financing project in preparation for the Financing for Development conference in Monterrey, including a book on GPGs with a discussion of the concepts, financing and mechanisms of provision.[7] It underlines the growing concerns regarding the need for additional financing that must be addressed collectively by the international community, including national budgets – both ODA budgets and those of other ministries – as well as other public sources, private sources and partnerships. There is scope for internalising externalities through market creation, taxes, levies and fees on various international transactions.

Provision and financing of GPGs should be arranged in collaboration between national governments in OECD and developing countries, regional organisations, the United Nations, regional organisations and the international financing institutions. There is no single optimal financing solution. Conceptual work clarifies and focuses the financing issues, but does not on its own make additional resources available. To mobilise these, more policy analysis and related work is required, including on appropriate incentives and financing mechanisms. Broad participation in GPG provision requires better institutional arrangements. This highlights the need for supporting national and local activities, including capacity building and institutional development, for their roles in providing GPGs in what must be a well co-ordinated way.

An International Task Force on GPGs is about to be established by France and Sweden. The presentation ended with information about the work of the Task Force. It will define a programme of work on GPG provision and finance linked to the MDGs. It will be co-chaired by the former President of Mexico Ernesto Zedillo and Tidjane Thiam, former Minister of Planning and Economic Development, Côte d'Ivoire. The secretariat is located in Stockholm and led by the former Managing Director of the World Bank, Sven Sandström.

In the *discussion*, the issue was raised of the voice and perspective of developing countries in bilateral-multilateral allocation choices. A developing country representative found that multilateral development banks acted more consistently and with greater continuity, and also encouraged civil society participation more than bilateral agencies. Multilaterals also benefit from economies of scale. On the other hand, they provided loans rather than grants and thus contributed to the debt burden – a major problem for many poor countries. One question was how the new framework of poverty reduction strategies (PRS) with increased emphasis on programme aid and budget support, i.e. with increasing similar and fungible products from different agencies, affects the choice between bilateral and multilateral channels.

Possible omissions explaining the strong multilateral preference in the DFID analysis were: a) the desirability of some variety and competition in the aid delivery business; b) the comparative advantage of bilaterals in tackling partner countries on key governance issues; c) the value of bilateral country offices in monitoring multilateral activities and d) the importance of visible bilateral programmes for maintaining and increasing political and public opinion support for (and hence levels of) aid in donor countries.

The Dutch method of giving an allocation bonus of 50% for least developed countries and Sub-Saharan Africa was mentioned by one speaker as a good example that multilaterals might follow in order to enhance the poverty focus of aid and help reduce the vulnerability of this group of countries.

Complementarities and partnership between bilateral and multilateral agencies, including for global public goods, were emphasised. These reduce the reason to see these channels as competing for the same ODA resources. For example, bilateral and multilateral aid may be crucial for international

7. F. Sagasti and K. Bezanson: *Financing and Providing Global Public Goods – Expectations and Prospects*. Ministry for Foreign Affairs, Sweden, Stockholm, 2001.

agricultural research to have an impact on poverty reduction through dissemination, training and capacity building programmes.

There was some discussion about the reliability of the comparison between the MDG efficiency of bilateral aid and international agricultural research funds with questions of possible bias by vested interest. However, several speakers found the comparison to be based on careful methodology with solid cost-benefit analysis as its main tool. Regional research centres had proven especially effective.

Two final points made in the discussion: 1) The regional dimension – regional development banks in particular, but also to some extent bilateral agencies, are much more geared to regional public goods, integration and cross-border issues than *e.g.* the World Bank; and 2) Global thematic funds, *e.g.* for rolling back certain diseases, seemed to be on the rise. This "foundation system" facilitates a focus on certain concrete goals, and makes exit easier, because it is not seen as a penalising any particular country. However, it raised questions of consistency with country poverty reduction strategies.

Summing-up the session, the Chair stated that such a discussion on aid allocating between bilateral and multilateral, including for global public goods, had not taken the place in the DAC for a long time. However, as a result of this seminar, of DFID's strategic review analysis and of the Swedish-French Task Force on global public goods, it was likely to become a more central part of the DAC agenda in the near future.

Conclusion and follow-up

The *Secretariat* summarised the presentations and the discussion at the seminar, noting in particular the convergence of views on the main aspects of effectiveness in poverty-reducing allocations across developing countries, including poverty incidence and depth, governance and policies, vulnerability and shocks as well as pre- and post-conflict situations and how to help with social and institutional development in less well-governed countries. However, as the seminar continued on to implementation issues, the morning's statement of "the end of history" for this debate proved somewhat premature, and there is still a role for the DAC and others to facilitate analysis and exchange of ideas and experience on these issues. This is particularly true for the emerging issues discussed in the afternoon re allocations between bilateral, multilaterals and global and regional public goods.

There were many good comments about the need to go beyond allocations in order to look at aid effectiveness, including many other factors on the supply and demand side. These range from donor practices, the need for country leadership, management of the aid process, and capacity strengthening issues well beyond aid, what in OECD tends to be called policy coherence. OECD and DAC concentrate on these other aspects of aid effectiveness in other fora. This seminar concentrated on an aspect that is generally neglected: allocations. What that DAC thinks on the broad range of topics covered by the still evolving approach of aid effectiveness is stated in the new Development Co-operation Report, particularly the first chapter by the Chair, Jean-Claude Faure.

In the session on multilateral aid allocations, it was remarkable that some presenters included critical analyses of their own governments' and agencies' practices.

There is a high return from the kind of exchange of view on good practice at the seminar and from the work that was done to prepare for it. It is very much hoped that it will lead to a practical impact on aid allocations. There is a Contact Group of DAC Economists and heads of policy units that may be useful in carrying forward the dialogue. The very good papers and presentations at the seminar will be up on the website shortly.

The DAC Chair, Jean-Claude Faure, in his concluding statement found the seminar very useful and stimulating for advancing aid effectiveness after the Monterrey conference and the Rome High-Level meeting on Harmonisation of Donor Practices. There was increasing awareness of the importance of research and of results analyses. This seminar had been a powerful stimulant for enhanced convergence of action. In particular, it had helped to establish a common framework for the continued analysis and debate on aid allocations, and thus for more effective contributions to the achievement of the MDGs. A challenge for the follow-on work on aid allocations would be how to link it to the agenda of aid harmonisation and alignment to national poverty reduction strategies.

ANNEX

DOCUMENTS PRESENTED AT THE SEMINAR AND AVAILABLE ON THE OECD/DAC WEBSITE

<www.oecd.org/dac/wpeff/Mar2003ExpertsSeminar>

1. Summary Record (pdf)
2. Annotated Agenda (pdf)
3. List of Participants (pdf)
4. Aid Effectiveness and Selectivity: Integrating Multiple Objectives into Aid Allocations, Summary Paper, Professor Mark McGillivray, World Institute for Development Economics Research, Helsinki, Finland (pdf)
5. Comments on the Summary Paper by P. Jacquet, AFD (pdf)
6. Aid Effectiveness and Selectivity: Integrating Multiple Objectives into Aid Allocations (ppt)
7. Strategic Review of Resource Allocation Priorities, DFID, UK (pdf)
8. The US Millennium Challenge Account – Fact Sheet (pdf)
9. The Millennium Challenge Account: CGD Testimony for the Senate Foreign Relations Committee (pdf)
10. Country Allocations Based on Poverty and Performance in Dutch Aid (ppt)
11. IDA: Selectivity and Strategic Choices in Resource Allocation (ppt)
12. The CDG Development Friendliness Index: Aid Component (ppt)
13. Choices between Channels: Bilateral, Multilateral, GPGs – DFID, UK (ppt)
14. New Swedish Policy for Global Development (ppt)

SECTION II

"AID EFFECTIVENESS AND SELECTIVITY: INTEGRATING MULTIPLE OBJECTIVES INTO AID ALLOCATIONS"

Background Paper prepared for the Joint OECD DAC/Development Centre Experts' Seminar, 10 March 2003

by

Mark McGillivray*
World Institute for Development Economics Research
Helsinki, Finland

I. Introduction

Research on development aid has largely focused on the effectiveness of these transfers in promoting growth or on their allocation among developing countries. Rarely if ever did these research areas intersect, in that studies seeking to explain observed or prescribe optimal inter-country aid allocations did not take into account effectiveness issues and vice versa. Collier and Dollar (C-D, 2002*),* in a move broadly consistent with the IDA's long-standing approach to its country allocation system, changed this state of affairs with their "aid selectivity" approach to inter-country aid allocation. C-D, building on the empirical work of Burnside and Dollar (B-D, 1997, 2000), which concluded that the effectiveness of aid in promoting growth depended on the policy regimes of recipient countries, derived "poverty efficient" inter-recipient aid allocations. According to the prescriptive C-D selectivity approach, optimal aid allocation favours countries with high levels of poverty, low per capita incomes and sound policy regimes. Such allocations are considered poverty efficient by maximising the number of people pulled out of poverty. Countries with unsound policies regimes receive less aid in the C-D selectivity approach as these regimes lessen aid's impact on growth and thus poverty reduction.

---

* This paper is based on that cited below as Feeny and McGillivray (2003). The author is grateful to Dag Ehrenpreis, Ulrich Hiemenz, Paul Isenman, Simon Feeny, Matthew Odedokun, Tony Addison, Tony Shorrocks and Oliver Morrissey for useful comments, suggestions or background discussions. The usual disclaimer applies. Correspondence should be addressed to Professor Mark McGillivray, World Institute for Development Economics Research, United Nations University, Katajanokanlaituri 6 B, 00160 Helsinki, Finland, E-mail <mark@wider.unu.edu>.

This World Bank research has spawned a number of subsequent academic studies. All agree with the fundamental thrust of this research: that aid is effective in promoting growth and, by implication, in poverty reduction. This has proved to be a particularly robust conclusion, drawn by practically all subsequent empirical studies of aid and growth.[8] The well-known macro-micro paradox of aid is dead and buried. These studies are yet to provide such clarity over the relevance of recipient country policies for effectiveness, with many failing to produce similar empirical results to those reported in B-D, although there is acceptance among researchers that better policies, however defined, should in all probability result in more effective aid.[9] There are, however, many other areas of aid research in which there is far more clarity. These areas have been the subject of extensive research conducted over many decades and include studies on public sector aspects of aid (including fungibility), *ex post* and *ex ante* conditionality (including structural adjustment), aid and the real exchange rate, the determinants of inter-country aid allocation and NGO effectiveness. In some instances these agreements have been reached following the availability of better data sets and application of more rigorous research methods. There are also a number of new areas of research that have emerged. These include aid and conflict prevention, aid and growth in post-conflict scenarios, aid and governance and allocating aid via non-traditional channels.

This paper surveys research on aid effectiveness and aid allocation. It updates and extends the coverage of Beynon (2001, 2002), by looking *inter alia* at more recent research on the contribution of aid to growth and the determinants of observed inter-country aid allocations. The overall focus is on the relevance of these issues for poverty-efficient aid, defined as a pattern of inter-recipient aid allocation which maximises poverty reduction. It identifies a range of poverty-reducing criteria on which aid allocation or selectivity might be based. The paper is built on the recognition of two key points. The first is that effectiveness of aid in promoting growth is in theory contingent on a range of factors in addition to policy, such as conflict reduction, vulnerability mitigation, political stability, and governance. The second recognition is that, more importantly, the ultimate objective of aid is poverty reduction or, more broadly, the promotion of human well-being. This is made very clear in the adoption of the Millennium Development Goals (MDGs), which identify poverty reduction as the ultimate objective of development efforts. Fuelling growth is one of a number means by which this objective can be achieved.

The paper is structured as follows. Section II looks at new directions in research on aid and growth, highlighting work on the relevance of shocks, structural vulnerability, post conflict scenarios, democracy, political instability and absorptive capacity. Section III looks at the criteria that donors employ in allocating aid among developing countries, as evident from what donors themselves claim but also from the results of empirical research on the determinants of aid allocation. The underlying question addressed in this section concerns the extent to which the broad adoption of a policy of selectivity is possible given current allocative priorities. Section IV attempts to establish a broader concept of selectivity, by distilling various strands of argument presented in the preceding sections, and in doing so looks at a variety of channels through which aid might reduce poverty, and on which poverty efficient allocations might therefore be based.

8. See Hansen and Tarp (2000, 2001), Dalgaard and Hansen (2001), Dalgaard and Hansen (2001), Guillamont and Chauvet (2001), Hudson and Mosley (2001), Lu and Ram (2001), Dalgaard *et al* (2002) and Gounder (2001, 2002).

9. See Robinson and Tarp (2000), Beynon (2001, 2002), Morrissey (2002) and Collier (2002).

II. Aid and growth: new directions

While the research effort on aid, growth and policy is ongoing, a number of new directions on aid effectiveness have emerged. The focus remains on aid and growth, but a number of factors in addition to policy are also taken into account.

Trade shocks and aid effectiveness have been analysed in Collier and Dehn (2001). Developing countries can be highly shock prone, and trade shocks can have substantial adverse consequences for growth.[10] Shocks are defined in terms of changes in export prices and classified in terms of negative and positive shock episodes. Two shock variables are defined, for positive and negative episodes respectively.[11] The hypothesis is that aid can potentially cushion the adverse growth effects of negative export price shocks in two ways: persistently high levels of aid can provide a buffer by reducing the proportionate change in foreign currency inflows and counter-cyclical changes in aid can reduce the absolute change in these currency inflows. These effects are modelled by inserting two additional variables into the standard B-D aid-growth model: the initial level of aid and the change in aid between negative shock episodes of a duration of four years, both interacting with a negative shock variable. *Results* obtained from estimating this model indicated that the coefficients of the negative shock variable and its interaction with changes in aid were highly statistically significant. Increased aid does appear to mitigate the adverse growth effects of trade shocks, therefore. More precisely, a 40% negative price shock appears to reduce growth by 1.38% unless this is mitigated by an increase in aid. The change in the amount of aid required to provide such mitigation during the four year episode is 0.81% of GDP per year.

Structural vulnerability in recipient countries and its impact on aid effectiveness is analysed in Guillaumont and Chauvet (G-C, 2001). They, too, propose and empirically estimate an augmented B-D type aid-growth model. Structural vulnerability is a function of the size of shocks faced by countries, but also of their exposure or susceptibility to these shocks. Two types of shocks are identified: trade and climatic (due to such events as droughts, floods, cyclones and earthquakes). Trade shocks were classified twofold, into long term and short term, respectively measured by the trend in the terms of trade and in an index of the instability of real export values. Climatic shocks were measured or proxied statistically by an index of agricultural value added instability. These variables measure the size of their respective shocks. Country shock exposure to climatic factors was measured by weighting the agricultural value added instability index with the agricultural share of GDP. Exposure to trade shocks was estimated by adding the logarithm of population, as a separate variable, to the growth model, on the assumed grounds that big countries are most vulnerable to trade shocks than small ones. These four vulnerability variables were aggregated, to form a weighted index, and this index was then inserted into the aid-growth model both as a variable in its own right, but also through its interaction with aid. Results obtained by empirical estimation indicated that vulnerability and the interaction between aid and vulnerability did impact on growth, both with highly statistically significant coefficients. In particular, it was found that the impact of aid on growth was higher when vulnerability was high.

---

10. See Collier, Gunning and Associates (1999) and Dehn (2001) for further details.

11. Collier and Dehn obtain these variables from a model forecasting export prices based on an index values outlined in Dehn (2000). In this model the change in each country's export price index is regressed against a constant, a linear time trend, the change in the index lagged one period and the level of the price index lagged two periods. The residuals from this regression are then normalised. The shock variable defined as those values which exceed a critical value associated with the 2.5 percent most extreme observations in the tails of the residual distribution.

Political instability and aid effectiveness has been analysed by further augmenting the aid-growth model with an index of political instability (G-C 2002). This index is the weighted sum of *coups d'Etat* and regime changes, and is intended to measure instability of political elites or institutions. This variable influences growth directly, but also via interaction with the level of aid. As in G-C (2001), vulnerability also influences growth in these ways in this model. The results showed a highly significant and negative coefficient for the aid-political instability interaction term. Hence, it was concluded that aid effectiveness is negatively influenced by political instability, which also seemed to reduce growth directly, although this result appears less robust than that for the interaction term. The aid-vulnerability was found to be positive and significant, hence confirming the result of G-C (2001).

The impact of aid on growth in *post-conflict scenarios* is examined in Collier and Hoeffler (C-H, 2002). They note that the economic circumstances of post-conflict countries can be distinctive in many respects: the need to restore infrastructure combined with a collapse of domestic revenue can make aid unusually productive and growth can be supra-normal (Collier, 1999). Offsetting this, though, is what C-H describe as a "persistent high-corruption equilibrium" (Tirole, 1992). They empirically tested whether aid is more effective in post-conflict scenarios by a series of augmentations to the B-D aid-growth model. Based on a range of estimates, the results showed that aid is more than twice as productive in post-conflict episodes, for given policies; that there is a temporary growth spurt of approximately two percentage points higher than otherwise during these episodes; and that in the absence of aid there would be no growth spurt.

The effect of *democracy* on the aid-growth nexus is examined in Svensson (1999). Democratic institutions (such as political parties, elected representatives, free speech and the right to organise) should provide a recurrent and institutionalised check on government power, encouraging governments to use aid productively and preventing them from using it unproductively. Thus it is hypothesised that aid will have a greater impact on growth the greater the degree of democracy. The degree of democracy is measured using indicators of political and civil rights from Freedom House and formed into an index. In this aid-growth model, democracy impacts directly on growth and also via its interaction with aid. Thus the democracy index appears twice, alone and as part of an interaction term. Results obtained from estimating this model indicated that while democracy had no significant direct impact on growth, the coefficient attached to interaction between aid and democracy was almost without exception significant and positive. Svensson concluded, therefore, that the growth impact of aid was conditional upon the degree of democracy.[12] Kosack (2003) also drew this conclusion, but in the context of the impact of aid on the quality of life, the latter measured by the Human Development Index.

Aid "*transmission mechanisms*", *i.e.* channels through which aid can potentially contribute to growth, are the focus of Gomanee *et al.* (2002a). Aid can effect growth directly, but also through its impact on investment, imports, public sector fiscal aggregates, and government policy. Conscious recognition of these mechanisms has important implications for modelling the aid-growth relationship in order to avoid double-counting the impacts of aid. Gomanee *et al.* tested for the presence of the aid-investment-growth mechanism, finding strong evidence that it existed. Morrissey (2002) suggested, on the basis of this result, that government policies can play an important role in enhancing aid effectiveness through seeking to improve the productivity of investment. This also applies to the other mechanisms. For example, policies aimed at improving the productivity of government expenditure should improve aid's impact on growth provided the aid-fiscal aggregates mechanism exists. This research is linked with the extensive and long-standing literature on aid and public sector

12. An alternative interpretation is that the impact of democracy on growth is contingent on the level of aid. This points to a more general interpretation problem regarding the aid interaction terms used in the aid-growth literature.

fiscal behaviour, which generally finds that aid is associated with increases in government expenditure categories, including pro-poor expenditures, the fungibility problem notwithstanding. Gomanee *et al.* (2002b) look at aid and pro-poor expenditure directly, using the above-mentioned transmissions mechanisms approach, *finding* that aid is associated with increases in these expenditures and in turn improvements in welfare.[13]

Diminishing returns to aid effectiveness have been examined closely by most recent aid-growth studies, through the inclusion of an aid-squared term in their models. This tests for non-linearity in the aid-growth relationship, with aid being positively related to growth up to a certain level of aid and negatively related thereafter. The coefficient on the aid-squared term is consistently negative and significant, indicating that there are diminishing returns to aid effectiveness. This is a seemingly highly robust finding, with almost all studies reporting such a relationship, with negative returns setting-in when the aid inflow reaches anywhere between 15% and 45% of GDP. This has been interpreted as indicating limited aid absorptive capacities, with recipient governments being limited in the amounts of aid they can use effectively (Clemens and Radelet, 2003).[14]

III. Aid allocation: policy and practice

Emanating from influential empirical research conducted in the late 1970s and early 1980s, there is a widespread belief that donors pursue political, economic and strategic interests in inter-country aid allocation, especially bilateral aid allocation of the larger donors, and that developmental or humanitarian concerns, including the reduction of poverty, receive a relatively low or even zero weight in this process.[15] The pursuit of these interests, together with the presence of a bureaucratic inertia, is of concern as it effectively constrains the adoption of a selectivity policy, or basing aid allocations on developmental criteria in general.

How significant is this concern? There are grounds for suggesting it is not terribly significant, although evidence is mixed. A simple inspection of aid statistics reveals a slight upward trend, over recent years, in shares of total and DAC ODA going to the least developed, low income and sub-Saharan Africa countries. Although weak evidence, this is consistent with the emerging view that since the end of the Cold War there has been a shift in allocative behaviour, away from non-developmental criteria.

---

13. The relevant literature is surveyed in McGillivray and Morrissey (2001a). Recent studies falling within this literature include Feyzioglu, *et al.* (1998), Franco-Rodriguez *et al.* (1998), McGillivray and Ahmed (1999), Swaroop *et al.* (2000), McGillivray and Morrissey (2001b) McGillivray (2000) and Mavrotas (2002).

14. Among the studies reporting diminishing returns are Collier and Dollar (2002), Collier and Hoeffler (2002), Hansen and Tarp (2000, 2001), Dalgaard and Hansen (2001), Hudson and Mosley (2001), Lensink and White (2001) and Dalgaard *et al.* (2002). Heller and Gupta (2002) provide a useful discussion of this issue, along with the related problem of Dutch Disease. Note though that Gomanee *et al.* (2003), using a general technique specifically designed to detect threshold effects, struggle to find evidence of such returns and therefore question the inferences drawn by previous studies.

15. See McKinlay and Little (1977, 1978a, 1978b, 1979) and Maizels and Nissanke (1984). McKinlay and Little (1979, p. 243) concluded that there are "no grounds for asserting that humanitarian criteria have any significant direct influence" on aid US allocation. Maizels and Nissanke (1984, p. 891) concluded that US, British, French, German and Japanese "bilateral aid allocations are made ... solely ... in support of donors' perceived foreign economic, political and security interests".

More important is evidence regarding donor intent. Increased aid to poor countries might not result from donors consciously giving preference to these countries because they are poor. Empirical studies of revealed donor motives offer insight to this issue. Indeed, some relatively recent studies have shown that the empirical methods of the late 1970s and early 1980s research do not yield robust results, owing to the separate estimation of recipient need and donor interest models and the implicit, questionable assumption that *either* recipient needs *or* donor interests determine aid allocation. Some of these more recent studies have initially replicated the results of these studies, but corrected for this and other methodological flaws, showing that both recipient need and donor self interest were relevant to inter-recipient aid allocation during the 1970s and early 1980s. Even US per capita aid allocation, often thought to be the least developmental, has been shown to favour poorer countries during the early 1980s.[16] These results have been confirmed by practically all subsequent research, including analytically and econometrically more rigorous studies, not only for the major bilateral donors but for many smaller ones as well.[17]

Added to these results are signals from donors themselves that developmental criteria are receiving a higher priority in aid allocation. A recent survey of 10 donors, conducted by DFID indicated that increased emphasis is being given to "selectivity", defined broadly not only in the C-D sense, but also to encompass broader developmental concerns, such as governance, program implementation and absorptive capacity (DFID, 2002). Among the more pro-active donors in this regard are the United Kingdom, and in particular, the Netherlands (DFID, 2003, Droeze, 2002). Perhaps the best known donor initiative is the US Millennium Challenge Account (MCA), which aims allocate aid to a relatively narrow range of recipients on the basis of various indicators of need, performance and governance.[18] The DFID survey does however note that "politics continues to play a significant role in priority setting" (DFID, 2002, p. 5), implying that this sets a limit to how much donors can respond to purely developmental issues. There are also the efforts of multilateral agencies, which have a clearer developmental focus in allocating aid. The IDA and the African Development Fund, in particular, utilise enhanced performance-based allocation frameworks in determining aid levels allocated to recipient countries.

While both actual initiatives or statements of intent from donors and the results of the empirical studies are on balance encouraging, it should be emphasised that in most instances non-developmental criteria, especially trade promotion, remain a priority for many donors. One should also note the results of studies which have tested for specific relationships in the allocation of aid. Based on these studies, there is mixed evidence regarding whether donors reward countries for their observance of civil and political liberties or for having low levels of corruption, some evidence of a bias in per capita aid against larger countries, no evidence that donors base allocation decisions on trade shocks, little evidence that the quality of recipient policies matter for the allocation among African countries, and

16. See McGillivray and White (1993) and McGillivray (2002). This conclusion was based on the coefficient attached to income per capita, a commonly agreed although far from perfect indicator of need, being significant and negative in a combined recipient need-donor interest aid allocation model.

17. These studies include those based on cross-section and, more recently, time series data. The former studies include McGillivray and Ozcowski (1991, 1992), Gounder (1994), Trumball and Wall (1994), Wall (1995), Tarp *et al.* (1999), Alesina and Dollar (2000) and Berthélemy and Tichet (2002). Those based on time series data include Gounder (1999), Gounder and Sen (1999) and Feeny and McGillivray (2002a, 2002b).

18. Radelet (2002), Birdsall *et al.* (2002b), Kaufman and Kraay (2002) and Clemens and Radelet (2003) are among the studies comprising the very rapidly growing literature on the MCA. Birdsall *et al.* and Kaufman and Kraay look at governance and other indicators and how the MCA might use them.

evidence that donors have not responded appropriately to post-conflict situations in the allocation of aid among countries.[19]

IV. Aid selectivity: towards a broader concept?

A number of key points emerge from the preceding discussion. Regarding effectiveness, aid fundamentally works, but it is clear that its impact differs across countries depending on the conditions they face. It is agreed that policies do or at least potentially matter for the effectiveness of aid, although there is ambiguity over whether this has been correctly observed from empirical estimates of aid-growth models. Aid seems to work better in post conflict situations, in structurally vulnerable countries (including those undergoing trade shocks), in politically stable regimes and in countries with good governance records, although there would appear to be diminishing returns to its impact on growth. Aid is also associated with increased public expenditures, including those which are pro-poor, the fungibility problem notwithstanding.

Regarding aid allocations, they have been based on developmental criteria, although not to the extent that most observers from the development community would want. Donors are giving more emphasis to developmental criteria than previously, including selectivity in manners broadly consistent with C-D model, although political factors constrain a fuller embracing of such criteria. There is evidence that biases favouring small countries persists, but little evidence that aid allocations are based on the specific criteria of governance, shocks and post-conflict scenarios.

What does this mean for poverty-efficient allocations? Two points are worth emphasising. The first is an obvious one and concerns bilateral development assistance programs: donor governments need to continue their efforts to base aid more on developmental criteria and less on political self-interests. This is not as great a task as some might assume, given that most have pursued the former criteria for longer and to a greater degree than commonly asserted. The second concerns the channels through which aid contributes to poverty reduction. It must be recognised that aid can reduce poverty through its impact on growth, but that its effectiveness in promoting growth varies according to a range of factors. It must also be recognised that aid can reduce poverty through other channels. A channel, for which there is empirical support based on the literature identified above, is aid's impact on pro-poor public expenditure (there will of course be others).

Thus there appears to be a reasonable case for augmenting and extending the C-D selectivity model, just as the B-D growth model has been augmented in analysing aid and growth. Donors are well positioned to do this, and to some extent have begun to do so through their own allocation initiatives. The essence of the augmentation would appear to be relatively straightforward and emanates directly from the findings of the aid-growth studies discussed above. Aid should not only be allocated to countries with low per capita incomes and large numbers of people living in poverty and with good policies, but also to poor countries in post-conflict scenarios, to those which are structurally vulnerable, to those which have democratic and politically stable regimes, and those with broader good governance records. Based on the evidence discussed above, this should lead to a greater impact on growth and in turn poverty reduction. Indicators used in the above discussed studies provide the

---

19. For results on aid and governance and aid and corruption, Svensson (2000) and Alesina and Weder (2002), respectively. Arvin (1998) and Arvin and Drewes (2001) investigate the large country bias, updating the findings of earlier studies such as Isenman (1976) and Dowling and Hiemenz (1985). Collier and Dehn (2001) and Collier and Hoeffler (2002) look at aid allocation and shocks and aid allocation and post conflict scenarios, respectively. Birdsall *et al.* (2002a) look at aid allocation among African countries and policy.

information on which such an allocation can be based.[20] Attaching weightings to these indicators, as is required in a selectivity formula, should in principal be based on scientific empirical research, however donors will in practice assign weightings based on field experience, anecdotal evidence, intuition and political considerations.

The extension to the C-D selectivity approach is more fundamental. Based on the recognition that there are many other determinants of poverty, it would at minimum involve giving additional preference to those recipients who can translate aid into increased pro-poor public expenditure or, more simply, those governments with high levels of pro-poor expenditure on the assumption that the aid-pro-poor public expenditure elasticity is the same across all countries (C-D adopt a similar assumption regarding an income-poverty reduction elasticity). A way of formally incorporating the relevant variables and parameters into the C-D selectivity model would need to be found. In absence of this donors could simply add some indicator of pro-poor expenditure to a more general selectivity formula.

There is, however, the issue of diminishing returns to aid, presumably resulting from limited aid absorptive capacities. This is a potentially serious issue if selectivity results in significantly increased aid to individual countries. A potential solution to this problem is also a suggested solution to a possible consequence of basing aid allocation on policy regimes, that being the denial of aid per se to countries with bad policies, and possibly with high poverty incidence. Suggested by Collier (2002), it involves by-passing recipient country governments and allocating aid via in-country "independent service authorities" (ISAs), which could include NGOs. This could be done with countries with policies so bad that aid will be ineffective in any developmental sense, but with other countries at levels of aid where diminishing returns are thought to set in. Not only could this see aid being allocated to, and poverty being reduced in, countries with bad policies, but it could also relax possible absorptive capacity constraints. More generally, it would seem reasonable to assume that a broadening of the selectivity concept, and allocating aid in non-traditional manners, such as through ISAs would see more aid go to the very poorest countries. This would garner broader support for a policy of selectivity among donors and the international development community in general.

20. Kaufman and Kraay (2002), Kraay (2002), Birdsall *et al.* (2002b), DFID (2003) and IDA (2001), among many other sources, provide a range of additional indicators and discussions of their use.

REFERENCES

Alesina, A. and D. Dollar (2000), "Who Gives Foreign Aid to Whom and Why?," *Journal of Economic Growth*, Vol. 5, No. 1, pp. 33-63.

Arvin, B. M. and T. Drewes (2001), "Are There Biases in German Bilateral Aid Allocations?," *Applied Economics Letters*, Vol. 8, pp. 173-177.

Arvin, M. (1998), "Biases in the Allocation of Canadian Official Development Assistance," *Applied Economics Letters*, Vol. 5, pp. 773-775.

Berthélemy, J. C. and A. Tichit (2002), "Econometric Explanation of Bilateral Donor Aid Allocation Decisions", Paper presented at WIDER Project Meeting on the Sustainability of External Development Financing, August, Helsinki.

Beynon, J. (2001), *Policy Implications for Aid Allocations of Recent Research on Aid Effectiveness and Selectivity*, Paper Presented at the Joint Development Centre/DAC Experts Seminar on Aid Effectiveness, Selectivity and Poor Performers, January, OECD, Paris.

Beynon, J. (2002), "Policy Implications for Aid Allocations of Recent Research on Aid Effectiveness and Selectivity", in B. Mak Arvin (editor), *New Perspectives on Foreign Aid and Economic Development*, Praeger, Westport.

Birdsall, N., S. Claessens and I. Diwan (2002a), *Policy Selectivity Forgone: Debt and Donor Behaviour in Africa*, Centre for Global Development Working Paper No. 17, Centre for Global Development, Washington.

Birdsall, N., R. Levine, S. Lucas and S. Shah (2002b), "On Eligibility Criteria for the Millennium Challenge Account", Centre for Global Development, Washington, mimeo.

Burnside, C. and D. Dollar (1997), *Aid, Policies and Growth*, Policy Research Working Paper 1777, World Bank, Washington.

Burnside, C. and D. Dollar (2000), "Aid, Policies and Growth," *American Economic Review*, Vol. 90, No.4, pp.847-868.

Chauvet, L. and P. Guillaumont (2002), "Aid and Growth Revisited: Policy, Economic Vulnerability and Political Instability", Paper presented at the Annual Bank Conference or Development Economics: Towards Pro-poor Policies, June 2002, Oslo.

Clemens, M. and S. Radelet (2003), *The Millennium Challenge Account: How Much is too Much, How Long is Long Enough?*, Centre for Global Development Working Paper No. 23, Centre for Global Development, Washington.

Collier, P. (1999), “On the Economic Consequences of Civil War”, *Oxford Economic Papers*, Vol. 51, pp. 168-183.

Collier, P. (2002), Making Aid Smart: Institutional Incentives Facing Donor Organizations and their Implications for Aid Effectiveness, Forum Series on the Roles of Institutions in Promoting Growth, USAID and IRIS, Washington.

Collier, P. and J. Dehn (2001), *Aid, Shocks, and Growth*, World Bank Policy Research Working Paper No. 2688, World Bank, Washington.

Collier, P. and D. Dollar (2002), “Aid Allocation and Poverty Reduction”, *European Economic Review*, Vol. 26, pp. 1475-1500.

Collier, P., J. Gunning and Associates (2000), *Trade Shocks in Developing Countries*, Oxford University Press, Oxford.

Collier, P. and A. Hoeffler (2002), *Aid, Policy, and Growth in Post-Conflict Societies*, Policy Research Working Paper No. 2902, World Bank, Washington

Dalgaard, C. and H. Hansen (2001), "On Aid, Growth and Good Policies," *Journal of Development Studies*, Vol. 37, No.6, pp.17-35.

Dalgaard, C., H. Hansen and F. Tarp (2002), *On the Empirics of Foreign Aid and Growth*, CREDIT Research Paper, Centre for Research in Economic Development and International Trade, University of Nottingham, Nottingham.

Dehn, J (2000), *Commodity Price Uncertainty in Developing Countries*, World Bank Policy Research Working Paper No. 2426, World Bank, Washington.

Dehn, J. (2001), “Commodity Price Uncertainty and Shocks: Implications for Economic Growth”, Paper presented at Royal Economic Society Annual Conference, April, University of Durham.

Department for International Development (DFID) (2002), “Results of the Survey of Bilateral Donors”, DFID, London, mimeo.

Department for International Development (DFID) (2003), *Strategic Review of Resource Allocation Priorities*, DFID Discussion Paper, DFID, London.

Devarajan, S., D. Dollar and T. Holmgren (2001), *Aid and Reform in Africa: Lessons from Ten Case Studies*, World Bank, Washington.

Dowling, J. M. and V. Hiemenz (1985), "Biases in the Allocation of Foreign Aid: Some New Evidence", *World Development*, Vol. 3, No. 6, pp. 535-541.

Droeze, F. H. (2002), “Selectivity and Allocation Policies for Dutch Bilateral Aid”, Policy Planning Unit, Ministry of Foreign Affairs, Government of the Netherlands, mimeo.

Feeny, S. and M. McGillivray (2002a), “An Inter-temporal Model of Aid Allocation to Papua New Guinea” in B. Mak Arvin (editor), *New Perspectives on Foreign Aid and Economic Development*, Praeger, Westport.

Feeny, S. and M. McGillivray (2002b), *Modelling Inter-temporal Aid Allocation*, CREDIT Research Paper 02/10, Centre for Research in Economic Development and International Trade, University of Nottingham, Nottingham.

Feeny, S. and M. McGillivray (2003), “Aid Selectivity Aid Effectiveness and Selectivity: Integrating Multiple Objectives into Aid Allocations”, World Institute for Development Economics Research, Helsinki, mimeo.

Feyzioglu, T., V. Swaroop and M. Zhu (1998), "A Panel Data Analysis of the Fungibility of Foreign Aid," *World Bank Economic Review*, Vol.12, No.1, pp.29-58.

Franco-Rodriguez, S., M. McGillivray and O. Morrissey (1998), "Aid and the Public Sector in Pakistan: Evidence with Endogenous Aid," *World Development*, Vol.26, pp.1241-1250.

Gomanee, K., S. Girma and O. Morrissey (2002a), *Aid and Growth in Sub-Saharan Africa: Accounting for Transmission Mechanisms*, CREDIT Research Paper 02/05, Centre for Research in Economic Development and International Trade, University of Nottingham, Nottingham.

Gomanee, K., O. Morrissey, P. Mosley, A. Verschoor (2002b), “Aid, Pro-poor Government Expenditure and Welfare”, University of Nottingham, Nottingham, mimeo.

Gomanee, K, S. Girma and O. Morrissey (2003), “Searching for Aid Threshold Effects: Aid, Growth and the Welfare of the Poor”, University of Nottingham, Nottingham, mimeo.

Gounder, R. "Empirical Results of Aid Motivations: Australia's Bilateral Aid Program," *World Development*, Vol. 22, No. 1 (1994), pp. 99-113.

Gounder, R. (1999), "Modelling of Aid Motivation Using Time Series Data: The Case of Papua New Guinea," *Oxford Development Studies*, Vol. 27, No.2, pp. 233-250.

Gounder, R. (2001), "Aid-Growth Nexus: Empirical Evidence from Fiji," *Applied Economics*, Vol. 33, pp.1009-1019.

Gounder, R. (2002), “Empirical Evidence of the Relationship between Foreign Aid and Economic Growth: The Case of the Solomon Islands”, in B. Mak Arvin (editor), *New Perspectives on Foreign Aid and Economic Development*, Praeger, Westport.

Gounder, R. and K. Sen (1999), "What Motivates Foreign Aid: A Case Study of Australia's Aid to Indonesia," *Journal of Developing Areas*, Vol.33, pp.379-394.

Guillaumont, P. and L. Chauvet (2001), "Aid and Performance: A Reassessment," *Journal of Development Studies*, Vol. 37, No. 6, pp. 66-87.

Hansen, H. and F. Tarp (2000a), "Aid Effectiveness Disputed," *Journal of International Development*, Vol. 12, pp.375-398.

Hansen, H. and F. Tarp (2000b), "Aid and Growth Regressions," *Journal of Development Economics*, Vol. 64, pp.547-570.

Heller, P. and S. Gupta (2002), “More Aid – Making it Work for the Poor”, *World Economics*, Vol. 3, No. 4.

Hudson, J. and P. Mosley (2001), "Aid, Policies and Growth: In Search of the Holy Grail," *Journal of International Development*, Vol. 13, pp.1023-1038.

IDA (2001), Adapting IDA's Performance-based Allocations to Post-conflict Countries, IDA Technical Paper, IDA, Washington.

Isenman, P. (1976), "Biases in Aid Allocations Against Poorer and Larger Countries", *World Development*, Vol. 4, No. 8, pp. 631-641.

Kaufman, D. and A. Kraay (2002), "Governance Indicators, Aid Allocation and the Millennium Challenge Account", World Bank, Washington, mimeo.

Kraay, A (2002), *Growth without Governance*, Policy Research Working Paper No. 2928, World Bank, Washington.

Kosack, S. (2003), "Effective Aid: How Democracy Allows Development Aid to Improve the Quality of Life", *World Development*, Vol. 31, No. 1, pp. 1-22.

Lensink, R. and O. Morrissey (2000), "Aid Instability as a Measure of Uncertainty and the Positive Impact of Aid on Growth," *Journal of Development Studies*, Vol. 36, No. 3, pp. 31-49.

Lensink, R. and H. White (2000), "Assessing Aid: A Manifesto for the 21st Century?," *Oxford Development Studies*, Vol.28, No.1, pp.5-18.

Lensink, R. and H. White (2001), "Are There Negative Returns to Aid?," *Journal of Development Studies*, Vol. 37, No.6, pp.42-64.

Llavador, H.G. and J.E. Roemer (2001), "An Equal Opportunity Approach to the Allocation of International Aid", *Journal of Development Economics*, Vol. 64, pp. 147-171.

Lu, S. and R. Ram (2001), "Foreign Aid, Government Policies and Economic Growth: Further Evidence from Cross-country Panel Data for 1970 to 1993," *International Economics*, Vol. 54, pp.15-29.

Maizels, A. and M. K. Nissanke (1984), "Motivations for Aid to Developing Countries," *World Development*, Vol. 12, No. 9, pp. 879-900.

Mavrotas, G. (2002), "Foreign Aid and Fiscal Response: Does Aid Disaggregation Matter?," *Weltwirtschaftliches Archiv*, Vol. 138, No. 3, pp. 534-559.

McGillivray, M (2000), "Aid and Public Sector Fiscal Behaviour in Developing Countries", *Review of Development Economics*, Vol. 4, No. 2.

McGillivray, M. (2002), "Modelling Aid Allocation", World Institute for Development Economics Research, Helsinki, mimeo.

McGillivray, M. and A. Ahmed (1999), "Aid, Adjustment and the Public Sector in the Philippines", *Journal of the Asia-Pacific Economy,* Vol. 4, No. 2, pp. 381-391.

McGillivray, M and O. Morrissey (2001a), *New of Evidence of the Fiscal Effects of Aid*, CREDIT Research Paper, No. 01/13, Centre for Research in Economic Development and International Trade, University of Nottingham, Nottingham.

McGillivray, M. and O. Morrissey (2001b), “Aid Illusion and Public Sector Fiscal Behaviour”, *Journal of Development Studies*, Vol. 37, No. 6, pp. 118-136.

McGillivray, M. and E. Oczkowski (1991), "Modelling the Allocation of Australian Bilateral Aid: A Two-part Sample Selection Approach", *Economic Record*, Vol. 67, No. 197, June, pp. 147-152.

McGillivray, M. and E. Oczkowski (1992), "A Two-part Sample Selection Model of British Bilateral Aid Allocation", *Applied Economics*, Vol. 24, pp. 1311-1319.

McGillivray, M. and H. White (1993), *Explanatory Studies of Aid Allocation Among Developing Countries: A Critical Survey*, Institute of Social Studies Working Paper, No. 148, The Hague.

McGillivray, M. and H. White (1994), *Development Criteria for the Allocation and Aid and Assessment of Donor Performance*, CREDIT Research Paper No. 94/7, University of Nottingham, Nottingham.

McGillivray, M., H. White and J. Leavy (2002), “Aid Principles and Policy: An Operational Basis for the Assessment of Donor Performance”, in B. Mak Arvin (editor), *New Perspectives on Foreign Aid and Economic Development*, Praeger, Westport.

McKinlay, R. D. and R. Little (1977), "A Foreign Policy Model of US Bilateral Aid Allocation", *World Politics*, Vol. 30, No.1, pp. 58-86.

McKinlay, R. D. and R. Little (1978a), "The French Aid Relationship: A Foreign Policy Model of the Distribution of French Bilateral Aid, 1964-70", *Development and Change*, Vol. 9, pp. 459-78.

McKinlay, R. D. and R. Little (1978b), "A Foreign-Policy Model of the Distribution of British Bilateral Aid, 1960-70", *British Journal of Political Science*, Vol. 8, pp. 313-32.

McKinlay, R. D. and R. Little (1979), "The US Aid Relationship: A Test of the Recipient Need and the Donor Interest Models", *Political Studies*, Vol. XXVII, No. 2, pp. 236-250.

Morrissey, O. (2002), “Aid Effectiveness for Growth and Development”, *ODI Opinions*, February 2002.

Radelet, S. (2002), “Quantifying the Millennium Development Account”, Centre for Global Development, Washington, mimeo.

Robinson, S. and F. Tarp (2000), “Foreign Aid and Development: Summary and Synthesis” in F. Tarp and P. Hjertholm (editors), *Foreign Aid and Development: Lessons Learnt and Directions for the Future*, Routledge, London and New York.

Svensson, J. (1999), "Aid, Growth and Democracy", *Economics and Politics*, Vol. 11, No.3, pp. 275-297.

Swaroop, V., S. Jha and A. Rajkumar (2000), "Fiscal Effects of Foreign Aid in a Federal System of Governance: The Case of India", *Journal of Public Economics*, Vol. 77, pp. 307-330.

Tarp, F., C. F. Bach, H. Hansen and S. Baunsgaard (1999), "Danish Aid Policy: Theory and Empirical Evidence", in Gupta, K. L. (ed), *Foreign Aid: New Perspectives,* Kluwer, Massachusetts.

Tirole, J. (1992), "Persistence of Corruption", Institute of Policy Reform Working Paper No. 55, Institute of Policy Reform, Washington.

Trumball, W.N. and H.J. Wall (1994), "Estimating Aid-Allocation Criteria with Panel Data", *The Economic Journal*, Vol. 104, pp. 876-882.

Wall, H.J. (1995), "The Allocation of Official Development Assistance", *Journal of Policy Modeling*, Vol. 13, No. 3, pp. 307-314.

OECD PUBLICATION, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(00 2003 1B 1 P) – No. 82209 2003

Aid Effectiveness and Selectivity

World leaders are calling for an increase in the volume and effectiveness of aid. Better allocation of aid is one key way to increase its effectiveness towards achieving the Millennium Development Goals. There are a variety of views on how aid should be allocated among developing partner countries. The most prominent view, emphasized by World Bank researchers, is to enhance pro-poor growth by allocating aid among low-income countries on the basis of policies and population. Other views call for more aid to help keep vulnerable countries out of trouble – including those struggling with preventing or recovering from conflict. Others focus on the need for a more adequate response to humanitarian needs.

The results of the March 2003 OECD DAC/Development Centre Experts' Seminar reported here break new ground in showing an emerging consensus among donor practitioners and researchers on how aid allocations can take more consistent account of these broadly-shared, but competing objectives. The Experts' Seminar also advanced the debate on two related allocation issues on which further work is needed – the share of aid that should go towards Global Public Goods, and the share of global programmes that should flow through multilateral institutions.

www.oecd.org

OECD