

# Harmony or Discord

## Donor Harmonization and Multiple Objectives of Aid

### 調和か不調和か

### ドナー間の協調と援助の複合的性質

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The current debate on aid effectiveness rests on the premise that if donors harmonized their aid activities and minimized transaction costs by adopting common procedures the effectiveness of aid would be enhanced. Harmonization is one of the central tenets enshrined in the Paris Declaration on Aid Effectiveness. However, since its inception in the 1940s, aid has been used for multiple purposes by donor governments and, as the revealed preference evidence shows, often as a diplomatic or commercial expedient. This paper shows that the context of *realpolitik* which has characterized aid during the Cold War period continues to be prominent today. Until the perverse incentives that impede harmonization efforts are tackled, the harmonization agenda will fail to change the donor behavior.

現行の援助効果に関する議論では、ドナー間の協調の実現が、取引費用の削減につながり、より援助効果の向上を促すとしている。援助協調は援助効果に関するパリ宣言の主要な原則の一つである。しかしながら、援助には複合的性質があり、1940年代に始まって以来、ドナーによってしばしば外交の、または商業の手段として利用されてきた。この論文では、冷戦中援助を特徴付けていた現実政策の文脈が、今日でも際立っていることを示す。調和化の阻害要因であるよこしまな動機の問題解決に取り組まない限り、ドナーの姿勢を改善することはできない。

Keywords: Foreign aid, Official Development Assistance (ODA), Harmonization, Aid effectiveness, Aid fragmentation

## 1 Introduction

Foreign aid, or official development assistance (ODA), was in the beginning conceived as “a temporary, transitional feature of international relations” more than half a century ago (OECD, 1985: 32). Today, it has become a permanent feature

of the architecture of international relations. The number of donor agencies operating in developing countries has also expanded substantially. There are now about 467 bilateral and multilateral donor agencies working in aid business, implementing an estimate of 340,000 development projects around the

world (Deutscher and Fyson, 2008: 16; OECD, 2009a: 29). Given the institutional complexity of the global aid governance better coordination of donor activities has long been prescribed as an indispensable condition for minimizing the costs of aid delivery and enhancing the effectiveness of ‘common aid effort’ for development. Consequently, the global discourse on aid effectiveness has evolved from ‘what’ the common objectives of aid should be (and ‘where’ to spend it)<sup>2</sup> to ‘how’ it should be delivered collectively to achieve those objectives. After all many of the shortfalls of aid are directly related to the way in which donors operate and deliver it.

A key issue in the current aid-effectiveness discourse revolves around this old prescription but with a refinement: harmonization has replaced coordination as the desired scheme. Coordination, on the one hand, seeks to avoid waste and damage when the actions of any one donor affect the outcomes of another’s activities. Harmonization, on the other hand, refers to cooperation between donors to enhance complementarity of their efforts and to reduce the transaction costs of aid delivery imposed by them on recipient countries. More specifically, it relates to increased coordination and streamlining of donor activities and, in particular, to the use of common arrangements for planning, managing and delivering aid (OECD, 2005: para.32). The Monterrey Consensus (March 2002) called on donors to intensify their efforts to improve coordination and reduce transaction costs. In the Rome Declaration on Harmonization donors committed themselves to “harmonize the operational policies, procedures, and practices of [their] institutions with those of partner country systems to improve the effectiveness of development assistance” (OECD, 2003a: para.1).

The agenda was further expanded and reinforced with a set of quantitative targets in the later Paris Declaration on Aid Effectiveness. The Paris Declaration, which was endorsed in 2005 by

more than 100 countries and organizations, sets out five partnership commitments between donors and recipient countries: ownership, alignment, harmonization, managing for results and mutual accountability. These are shared responsibilities, holding each side accountable for increasing the impact of aid at the country level by changing the ways in which ODA is delivered and by putting recipient countries’ ownership at the center of the development agenda. Under these five ‘principles,’ twelve measurable indicators were agreed upon to monitor the progress of the commitments, including on harmonization.<sup>3</sup>

The driving force behind the global effort to strengthen aid effectiveness was the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), a forum for major bilateral donors where the principle of donor coordination is clearly enshrined in its mandate. By virtue of being DAC members – membership made up of like-mindedness – they share interests to such a degree that they will be able to act in unison on a wide range of global challenges, including the improved effectiveness of aid. In practice, however, relying only on the good intentions of the donor governments will not always deliver the desired outcome. There are many indications of difficulties in turning a series of initiatives to promote harmonization into tangible improvements in donor behavior. According to the DAC, progress toward better donor harmonization has proven to be slow, if not getting worse (OECD, 2008b: 18).

Rather there is growing concern that aid allocation is increasingly fragmented – donors giving aid to too many recipients in many small pieces.<sup>4</sup> The flipside of this problem is the proliferation of sources of donor aid and activities at the country level, spreading aid over too many programs and hence straining the administrative capacity of the recipient governments that need to manage donor

aid coming through a multitude of channels and programs.<sup>5</sup> According to Frot and Santiso (2008: 31), the average number of recipients in a donor portfolio increased from less than 20 in 1960 to over 100 today. To put it differently, a typical recipient country now has to deal with and burden the cost of engaging in dialogue with multiple small donors. In Tanzania, for example, it was reported that 2,000 uncoordinated aid interventions from 40 donors were undermining the capacity of the government (Helleiner *et al.*, 1995: 15). The problem is compounded also by the emergence of new donors on the global aid landscape, some transitioning from being aid recipients to aid donors (*e.g.* Brazil, China and India). This highly fragmented global aid system – or non-system – has become a real barrier to aid effectiveness, further complicating the harmonization of donor activities. For this reason, the Accra Agenda for Action (September 2008), adopted at the Third High Level Forum on Aid Effectiveness, included a specific clause committing countries and aid agencies to reduce aid fragmentation (OECD, 2008f: para.17).

The great disparities in levels of engagement and commitment, among donors, are a source of obstacles and contradictions. Donor governments are typically driven by self-interest when making key decisions on the amount, country allocation, use and the terms of their foreign aid. Put it differently, aid effectiveness is also largely determined by the incentive systems internal to donor institutions. Indeed this fact may explain why the harmonization agenda is failing to change donor behavior despite several recent institutional attempts and steps taken to promote it.<sup>6</sup> A recent DAC study found little overall indication that the incentives underlying donor practices had altered significantly since the signing of the Paris Declaration (OECD, 2009b: 3). Countries are often obliged to subordinate the priority of aid effectiveness to other concerns. The underlining motives, whether self-interested or rational, of these

donor governments affect not only the amounts of aid to developing countries, but the intended purposes of that aid. Understanding them is central to any reform of aid to enhance effectiveness.

The primary focus of this paper are the 23 member governments of the DAC, whom collectively account for around 90 percent of total global aid channeled each year to the developing world and wield considerable influence in the development community. These same donor governments are also major ‘stakeholders’ and hence the holders of controlling stakes of the important lenders of the poor, namely the Bretton Woods institutions and regional development banks. Therefore what they say or do will have major implications on the whole development community.<sup>7</sup> The paper aims to examine the viability of the current harmonization agenda, based on the premise that it suffers from collective action problems and is bound to fail to achieve its intended objectives unless proper incentives are put in place. Drawing upon a synthesis of arguments and findings from recent literature, this paper looks at the causes that de-incentivize DAC donors to behave collectively and harmonize their efforts with each other, contributing to the worsening of aid fragmentation. In particular, it considers three interconnected factors that underlie the problem: (i) foreign aid is driven by political and strategic interests; (ii) donor harmonization has costs (and they may be large); and (iii) incentives to harmonize donor practices are lacking. The paper concludes with some suggestion for way forward toward a realistic orientation for the harmonization agenda.

## 2 Mixed objectives of foreign aid

### 2.1 What is aid?

Aid is a voluntary transfer of public resources (Lancaster, 2006: 9) and its criteria relate to the development purpose, concessionality and the official nature of such flows of resources. Yet, defining

precisely what is meant by it is no easy task. Aid, as defined by the DAC, consists of transfers to countries and to multilateral development institutions which are provided by official agencies and each transaction of which: a) is strictly aimed at improving human or economic welfare of developing countries (thereby excluding aid for military or commercial purposes), and b) is concessional with at least a 25% grant component, calculated at a rate of discount of 10 percent (OECD 2008a: 1). This narrow and restrictive definition, adopted by the DAC almost four decades ago, is based on the donors' intention for which aid is given. The DAC definition categorizes a transfer as official development aid (ODA) if the promotion of welfare and development is its main objective. Nonetheless, data on ODA are derived from DAC donors' standard statistical reporting. In other words, the quality of ODA data reflects the quality of donor reporting. In practice, because the donors are the final arbiters, all transfers, including those clearly given principally for political or commercial purposes, are invariably reported as ODA. The promotion of development just needs to be one of the purposes and need not even be the most important one. Based on a review of relevant literature, this section argues that foreign aid is not always given solely to promote development but is frequently driven by political and strategic interests of donor governments.

## 2.2 Why give aid and what for?

Hans Morgenthau, one of the leading 20th Century figures in the study of political realism, regarded aid as a 'real innovation' the modern age had introduced into the practice of foreign policy (Morgenthau, 1962: 301). Boone (1996: 290) called it an "unprecedented economic experiment." Yet to suppose that foreign aid is 'an instrument of foreign policy' is a controversial matter and will be frowned upon. A more commonly accepted view is that aid is "the fulfillment of an obligation of the few rich

nations toward the many poor ones" (Morgenthau, 1962: 301) and "an indispensable expression of humanitarian concern and collective responsibility in the world economy" (OECD, 1985: 32).

That said, since its inception in the late 1940s, aid has been used for multiple purposes by donor governments with aid priorities oscillating between various objectives constantly evolving, often serving several at once. Likewise, the goals that donor governments sought to achieve with their aid are not always evident in their rhetoric. The elusive nature of, or the mix objectives of aid-giving is reflected in how the DAC members define their principle motivations for giving aid, which include: "altruistic motivation," "enlightened self-interest" and "global interdependence" (OECD, 1996: 6). While aid is the "self-evident moral imperative" and "a compassionate response to the extreme poverty and human suffering" the DAC also recognizes the fact that development benefits not only the recipients of aid but also the donors themselves as their economies are increasingly dependent on the stability and prosperity of their partners in the developing world.

These motivations do not carry the same weight, however. The literature on aid allocation (*e.g.* Maizels and Nissanke, 1984; Boone, 1996; Alesina and Dollar, 2000; Ostrom *et al.*, 2001; Gunning, 2005) reveals that donors are by far less altruistic than they claim to be, largely pursuing their own interests when allocating aid across recipients. Gunning (2005: 49) explains that because development objectives are not the sole (or sometimes even a partial) aim of many donors' foreign aid, they tend to score low on aid effectiveness when judged only against development criteria. Alesina and Dollar (2000: 40-41) empirically show that bilateral aid has only a weak association with such development objectives as poverty, governance and good policy. Waly (2004: 23) demonstrates that the incentive system that prevails in both bilateral and multilateral aid agencies

does not reward good projects but instead reward the number of accepted projects regardless of their quality.

Major donors such as the United States, Japan, France, Germany and the United Kingdom have all used aid as an incentive or a 'reward' for recipients to change decisions or policy stances in ways that favor donors (Maizels and Nissanke, 1984). For example, Alesina and Dollar (2000: 45-47) found that Japanese aid was highly correlated with the UN voting patterns (*e.g.* inducing aid recipients to vote in favor of Japan's bid to become permanent member of the UN Security Council), whereas French aid was overwhelmingly biased towards its former colonies as an important means to safeguard its sphere of influence. The same study also found that U.S. aid tended to favor democracies but paid no attention to the quality of governance of receiving countries, using aid as leverage to reach certain political outcomes even in corrupt countries. For example, following the 9-11 terrorist attacks, Pakistan emerged as the U.S.'s key geopolitically strategic ally in the fight against terrorism, so the U.S. government immediately lifted its aid sanctions to Pakistan (imposed since 1990) and offered a bilateral debt relief worth one billion U.S. dollars (Burnell, 2004: 7).

There are 'altruistic' donors (*e.g.* Norway) that fully espouse the poverty-efficient allocation of aid (as defined in Collier and Dollar, 2002: 1475-1476), targeting poor countries with good policies and institutions, in order to increase the development impact of their assistance as shown in results of several studies (see Alesina and Dollar, 2000; Alesina and Weder, 2002; Berthélemy, 2006). OECD (2009c: 24) also highlights that one of the key factors that contributed to the increase in priority for aid's development purposes in some of the European donor governments was the commitment to policy coherence for development at the highest political level within those countries. By contrast, when such

political commitment to policy coherence was weak, the development purpose of aid was also the weakest. This may be one factor affecting countries such as Australia, France, Italy, Japan and the United States which, according to Berthélemy (2006: 191), are judged among the most 'egotistical' donors. Donor rankings based on new measures of aid quality developed by a team of World Bank economists seem to confirm these broad assessments (Knack *et al.*, 2010: 24, Table 3).

For all the pronouncements about development being above politics and how politics should be kept out of foreign aid policy making, it never happens and it would be naïve to expect it. The context of *realpolitik* that has characterized aid during the Cold War is just as pronounced as ever today. Aid remains highly sensitive to political factors which play a large part in translating need into effective demand and in turn donor support for aid, influencing their aid resource allocation. Every key decision in the history of foreign aid has been shaped in important ways by domestic political considerations (Lancaster, 2006: 18). Burnell (2004: 9) argues that "the size and shape of the aid market are a political construct." In the case of the United States, for example, Fleck and Kilby (2006: 211) observed that the pattern of aid allocation depended on the composition of the government in power. A good example of how political variables instrument the purpose of aid can be seen in the case of the United Kingdom. When Tony Blair became the Prime Minister in the late 1990s, his Labor government implemented a major reform, significantly upgrading the status within government and the resourcing of its Department for International Development, and allocated aid in a more development-oriented manner. Hence, political shifts may cause major changes in the distribution of aid.

Diplomatic purposes of aid have undoubtedly had a boost from the events of September 11, 2001,

igniting the drive for ‘aid securitization’ as part of the global fight against terrorism (see Aning, 2007; Howell and Lind, 2008). As was the case during the Cold War, aid is regarded as a means of dampening the social discontent in the developing world that can feed terrorists impulses (Lancaster, 2006: 14).<sup>8</sup> Empirical studies, if taken literally, support this view. Azam and Delacroix (2006: 332) found a positive correlation between the level of foreign aid received by a country and the number of terrorist attacks originating from that country. They reckon that aid had been used by donors “as a way of purchasing some involvement by the recipient government in this fight” (Azam and Delacroix, 2006: 341). Therefore, strategic non-altruistic donor behavior can be profitable (from the donor’s point of view) and can thus be expected to continue to dominate the aid allocation agenda in the near future.

### 3 Impact of harmonization

Ownership is widely regarded as a precondition for development (OECD, 2008: 18). When developing countries are not in the driver’s seat to steer their own development path, or when donors fail to respect their leadership, then the results from development assistance will most likely be unsustainable. Thus, the aid effectiveness agenda acknowledges “the primacy of ownership” (Stern *et al.*, 2008: 2). Within the framework of effective development partnerships, donors have committed themselves to respect the partner countries’ right and responsibility to “exercise effective leadership over its development policies and strategies, and coordinate development actions” (OECD, 2005: para.14).

Harmonization refers to cooperation between donors to reduce the transaction costs of aid delivery. First and foremost, transferring more aid through country systems depends significantly on partner countries’ ability and willingness to exercise the necessary leadership over coordinating donor

programs. If donor agencies were able to align their aid programs completely around partner countries’ policies and systems, ‘harmonization’ per se would be less of an issue. However, shifting more of the focus of donor management to recipients does not absolve donors of responsibility. Especially in cases where country ownership is weak, and where it is not possible to use recipient country systems, donors can ease this burden by adopting common arrangements (*e.g.* for disbursement, procurement, and accounting), simplifying and adopting common procedures (*e.g.* reporting requirements), and sharing information. The OECD/DAC Working Party on Aid Effectiveness suggests that “given the difficulty of achieving full alignment, aid effectiveness can be enhanced when donors harmonize their actions and adopt – where possible – simple and transparent common procedures” (OECD, 2009: 72). In this context, the responsibility for implementing harmonization goals rests primarily with donors.

Over the last decade, a vigorous debate over how to improve the effectiveness of aid has led to calls by the international community for a policy of donor harmonization, with a specific donor commitment in the Rome Declaration. A large and growing body of literature analyses why harmonization of donor practices is necessary for making aid more transparent and collectively effective. The problem of aid fragmentation and donor proliferation is well described by Knack and Rahman (2007: 178) who observed that higher aid fragmentation was associated with poorer governance in the recipient countries. The problem of fragmentation may in fact be more severe than that suggested by existing literature because there has been a proliferation of aid-giving agencies within donor countries, while most analyses assume each donor country to be a single entity (Kharas, 2007: 19). Cling (2006: 155-156) lists four key advantages of donor harmonization which are: i) reduced transaction costs for recipient

countries; ii) increased transparency and dialogue; iii) streamlined objectives and procedures; and, iv) better division of labor based on comparative advantages. However, these advantages are not without contentions as we will see below. Table 1 illustrates a number of specific actions toward effective donor harmonization.

Harmonization requires a donor to re-define and re-align its aid objectives and subordinate its own activities and outputs to a commitment towards collective actions. However, as shown in the preceding section, donors' multiple and sometimes conflicting objectives for giving aid obstruct such a collective-action process from taking place. Donors are undoubtedly concerned with development of the recipient country, but they must trade this objective off against other goals as well, such as foreign policy and commercial objectives. It is the classic dichotomy between realism and idealism. Finding an acceptable compromise between strategic interest and altruistic vision of donors' motivation can be at odds at times. That is to say that even if donors know what they should do, they may choose not to because the "correct" incentives to do so is too weak, a fact which was brought to light in the recent evaluation of the Paris Declaration (see Wood *et al.*, 2008). Though "a significant change in how we do business" (OECD, 2008b: 12) is essential, the number of interests to be accommodated appears to be too great, resulting in little progress. As long as donor interests

diverge from each other, the prospects for effective harmonization are not good (Kharas, 2007: 20).

This section examines the challenges and the possible causes of disparities in levels of engagement and commitment among donors toward a more effective adoption of the harmonization agenda. In particular, it looks at costs of and incentives (or the lack thereof) for harmonization.

### 3.1 Transaction costs

The conventional benefits of harmonization are typically associated with the reduction in transaction costs of aid. UNDP/DFID (2000: 7) defines transaction costs in this context as those arising from the preparation, negotiation, implementation, monitoring and enforcement of agreements for delivery of ODA. Lawson (2009: 10) specifies them as those costs necessary for an aid transaction to occur but which add nothing to the actual value of that transaction. The problem is often compounded by different languages and fiscal calendars used by donors, as well as duplication of various forms of analytical activities (Bigsten, 2006: 121). With harmonized donors' actions, these burdens would either no longer be imposed on recipients (freeing up their capacity to concentrate their efforts on domestic policies), or saved by donors and passed on to recipients in the form of added net flows (Rogerson, 2005: 534). To yield efficiency gains, the Paris Declaration commits donors to increase

**Table 1 Actions associated with harmonization**

Establishing common arrangements and simplifying procedures	Joint needs assessment; Coordinated donor missions; Sector-wide approaches; Joint implementation; Co-financing arrangements; Joint monitoring and evaluation; Common approaches/procedures for strategic environmental assessment
Strengthening complementarity and division of labor	Streamlining conditionality; Harmonizing financial management and procurement procedures; Delegated cooperation and joint approaches
Sharing information	Disclosing detailed and timely information on aid (commitments and disbursements, allocation, country analytic work, including diagnostic reviews, etc.) at country and sector level

Sources: Adapted from OECD (2005) and Balogun (2005)

complementarity<sup>9</sup> and rationalize division of labor based on comparative advantages, and make greater use of new aid delivery modalities such as sector-wide, program-based approaches, delegated cooperation and other innovative approaches (OECD, 2005: para.32).

Still, any reform entails costs – institutional, financial and political – such as those associated with changing work modalities, and these may be large enough to become a disincentive for countries to change the way they conduct themselves. In fact, it is plausible to expect total transaction costs to actually rise during this lengthy reform process. What harmonization ultimately does is simply transfer transaction costs from the recipient side to the donor side. The decrease in, for example, direct administrative costs may be counterbalanced by newly generated transaction costs arising from increased coordination among donors and management of moral hazard. Any collective choice process will likely to result in considerable debate about the criteria to be used to determine individual donor contributions, *e.g.* a decision on how much to contribute to pooled resources. How to negotiate the distribution of gains and losses from a possible agreement has often been a problem historically. Moreover, not all transaction costs are deemed bad as some have categories of benefits, such as reduced uncertainty of contract enforcement (Rogerson, 2005: 535). Lawson (2009: 15) summarizes different types of transaction costs which may be generated by

harmonization (Table 2).

While there is a lot of anecdotal evidence on transaction costs, we know very little about the magnitude of aid-related transaction costs at country level. The evidence so far only demonstrates the exceedingly difficult nature of identifying and measuring transaction costs of aid (*e.g.* UNDP/DFID, 2000; Balogun, 2005; Acharya *et al.*, 2006; Lawson, 2009). Such a lack of an accepted method or good underlying data demonstrates why the existing literature has rarely sought to measure transaction costs directly. The DAC, for example, did not attempt to measure transaction costs associated with the implementation of the Paris Declaration, but reported on the perceptions of both donors and recipient governments in this regard (OECD, 2008b: 26-27). Therefore, without the reliable baseline data, it will be very difficult to assess whether there have been major net savings in aid-related transaction costs, or savings in some donor agencies but at the expense of increased costs for others, thus, cancelling out the overall savings in the process (Rogerson, 2005: 535).<sup>10</sup>

### 3.2 Collective action problem

When there are many independent, uncoordinated donors on the ground, responsibility for success or failure is diffused, and no single donor has much at stake in the recipient country (Knack and Rahman, 2007: 177). As Mancur Olson argued, a collective action problem occurs “in a large

**Table 2 Nature of transaction costs generated by aid harmonization**

Search costs	Identifying like-minded donors and appropriate opportunities for undertaking joint activities
Bargaining & Decision costs	Defining, negotiating and agreeing mutually satisfactory conditions for harmonization
Policing & Enforcement costs	Fulfillment by all donors of agreed reporting requirements. Monitoring of fulfillment by other parties. Reacting to censure parties not fulfilling commitments.

Sources: Adapted from Lawson (2009: 15, Table 3)



group in which no single individual's contribution makes a perceptible difference to the group as a whole it is certain that a collective good will not be provided unless there is coercion or some outside inducements" (Olson, 1965: 44). The proliferation of donors increases the risk of creating incentives for individual donors to "shirk" a collective action that maximizes the recipient's overall development in favor of distinct aid activities that contribute to donor-specific objectives (Knack and Rahman, 2007: 177). Indeed, governments oftentimes opt for "the high politics of bilateral diplomacy" over collective action (Burnell, 2004: 11). They also often "muddle through" the collective choice process due to the weak incentive structure for revealing one's true intent for supporting or opposing certain courses of collective action (Stevens, 1993: 5). As a consequence, donors may agree to coordinate (as 'means') but without sustaining common objectives of collective action (as 'ends'), thus resulting in half-hearted commitments by individual donors.

Even under the assumption that the broad motives and aims of the donors are, if not identical, at least compatible, Halonen-Akatwijuka (2004: 2-4) shows several ways in which missing or asymmetric information can cause coordination failures in development aid. When donors with common goals simultaneously implement complementary projects but have incomplete information about other donors' budgets, coordination failure can occur due to inefficient allocation of aid to that sector. Similarly, if the utility of each donor depends also on the amount of projects funded by other donors, resources may again be allocated inefficiently across projects due to incomplete information about the other donors' activities. For instance, major policy shifts like increased sensitivity to the quality of institutions and governance (*e.g.* corruption) encouraged the 'herding' behavior of donors (Frot and Santiso, 2009: 25). Such coordination failure results from

donors' tendency to crowd into countries where aid is perceived to work well (*i.e.* donor darlings) while leaving other equally deserving countries with less aid (*i.e.* donor orphans).

Consequently, division of labor for complementarity has been identified as a critical dimension of the harmonization agenda. The Paris Declaration commits donors to "Make full use of their respective comparative advantage at sector or country level by delegating, where appropriate, authority to lead donors for the execution of programs, activities and tasks" and "Work together to harmonize separate procedures" (OECD, 2005: paragraph 35). What this essentially means is that donors are obliged to subordinate their sovereignty over aid decisions to a collective decision-making process. In other words, a donor, call it Country X, must be willing to cede control of some of its aid money to the "lead donor" in a given case. However, to the extent that the goals of Country X differ from those of the lead donor's, this will make it harder to convince Country X's taxpayers to support the effort. Moreover, the loss of direct control over aid decisions to another donor would undermine domestic constituencies for foreign aid in Country X and lead to a fall in domestic support for large aid budgets.

Where politicians are uninformed or uninterested in aid issues, there is a risk of moral hazard arising due to the asymmetry of information. It is a classic case of a principal-agent problem, whereby bureaucracies (the agent) have much more delegated power over the amount and purposes of aid and much less public accountability (to the principal) for those decisions (Lancaster, 2006: 20). Moreover, self-interested aid agencies will seek to maximize their aid budget which, in turn, requires them to satisfy their parliaments (sponsors) and various advocacy groups (constituents). Inherent difficulties in streamlining or converging donor preferences can be exacerbated by their need for visibility to justify their

activities and therefore get more utility from them. Naturally, faced with these concerns, donors have strong motives to maintain their individually worked out projects, even if the development impact of the overall aid is thereby reduced.

### 3.3 Coordination or collusion?

In theory, if countries are mutually dependent on each other to achieve a goal (that they cannot deal with on their own, such as climate change, communicable diseases, migration, financial instability, security and conflict, etc.), then in attempting to cope with interdependence they may coordinate and cooperate with each other. These so-called 'cross-border' problems have international spillovers because of globalization and growing interdependence. Countries thus share a common interest in responding to such global challenges as their own economic welfare increasingly depends on the stability and prosperity of other countries. Likewise, donor governments often appeal to the 'global interest' with a collective rationale for uniting donors with different objectives and agendas. Indeed, the overall objectives of aid-giving have been harmonized to a certain extent by the alignment of the entire international community on the goal of poverty reduction, defined notably by the Millennium Development Goals. Aid has become a key instrument for solving the global public good problems. However, collective-choice also always needs to find compromising points in situations where harmonization will produce differing costs and benefits to those governments involved. Those who anticipate a net gain after the costs of coordination are taken into account tend to be active participants in collective choice (multilateralism). Those who anticipate net losses if they do not participate may also be active, especially if the expected losses are large. Those who see small gains or losses, however, will tend not to participate, especially if the costs

of participation are high (Stevens, 1993: 13). For this reason, participants in collective action tend to be self-selected based on their expected gains and losses.

Put differently, from the strategic interest's point of view, a collective choice process may be exploited to align the public or 'collective' interest to the country's national interest. Similarly, individual national interests may be compatible with the collective interest. For example, donors may coordinate among themselves and harmonize their practices so as to influence or gently coerce the recipient country to follow certain policy prescriptions (*e.g.* good governance). Donors can also forge coalitions based on such collective interests and ensure that norm setting in the aid business does not operate against their interests. Birdsall (2004: 9) categorizes this type of donor behavior as 'envy', claiming that donors are "neither competing nor collaborating" but "in effect colluding."<sup>11</sup> In that sense, one might even label the DAC, in the words of William Easterly, a "cartel of good intentions" uniting donors with different objectives and agendas to coordinate their aid efforts (Easterly, 2002: 11).

### 3.4 Emerging donors

Aid effectiveness agenda has long been dominated by traditional DAC donor governments. This is a thing of the past. The rise of emerging powers as donors of development assistance is bringing new challenges to donor harmonization. The DAC donors are no longer the only development actors with sources of funding. Because of their growing economies and their stronger influence as regional and global players these so-called 'emerging donors' have gained much attention worldwide in recent years. They do not fit into the traditional dichotomy of donor-recipient countries, as they maintain a dual status as both donors and recipients of aid. Their aid is also often blended with

commercial links but is framed in a language of ‘mutual benefit’ rather than mercantilism (Shafik, 2011: 3). Yet some are more important players in aid than smaller DAC donors. More importantly, they generally operate outside the existing structures and frameworks including key DAC norms like the 1978 Recommendation on Terms and Conditions and the 2001 Recommendation on Untying Aid. Developing countries today can shop around for development models and partners of their liking (Shafik, 2011: 3). China, perhaps the most ‘heavyweight’ of all emerging donors, is a signatory to the Paris Declaration on Aid Effectiveness. But it signed as a recipient country. Whether China adheres to the aid effectiveness principles when it acts as a donor is a question of the greatest interest among the DAC donors, especially in the context of its aid to Africa where aid from traditional donors is losing its relative exclusivity. The effect of China’s demand for natural resources and its ability to export cheap labor-intensive manufactures has major implications for the whole development paradigm in Africa (Goldstein *et al.*, 2006: 41).

Chaponnière (2009: 150-151) points to the fact that the Paris Declaration as it currently stands does not sufficiently reflect the diversity of aid practices and particularities of development assistance provided by emerging donors. They have not participated to the discussion as donor countries of the principles that have led to the Paris Declaration, which to some is perceived as a ‘DAC instrument’ (OECD, 2008e: 8). Clearly emerging donors want a more flexible interpretation of development cooperation in discussion on aid effectiveness. But, while recognizing and respecting the diverse aid modalities and experience of emerging donors like China’s, the DAC’s relationships with these donors may have to be rooted in ‘common interest’ rather than ‘common values’ since some of them (China in particular) consider that donors should not interfere

in the domestic policies of recipient countries – so the issue of governance for example is a non-issue for them. China is said to provide assistance “with sincerity and with no conditions attached”<sup>12</sup> although its bilateral aid is also fully tied, implemented by Chinese experts and governmental and quasi-governmental agencies (Chin and Frolic, 2007: 14). Some also object to the idea of ‘division of labor’ in the Paris Declaration, seeing it as too donor-driven and limiting the flexibility to choose donors on the part of recipient governments (Davies, 2008: 13). Therefore challenges remain in working out ways in which emerging donors can collaborate in promoting harmonization of aid between them and the DAC donors. Instead the current thinking within the DAC-hosted Working Party of Aid Effectiveness appears to be leaning toward ‘adjusting’ the aid effectiveness agenda to the increasing diversity and evolving realities of the aid architecture (OECD, 2008e: 15).

#### 4 Conclusion

The rationale for harmonization is more effective aid. This collective outcome is a public good in that the production and consumption of effective aid are indivisible and that it is non-rival and non-excludable. The public good nature of aid effectiveness can be seen in the incentive to free-ride by countries who wish to benefit from the reduction, for example, in poverty but do not want to bear the costs associated with achieving that outcome. For example, in a rationalist world, individual participants are assumed to maximize self-interest at the expense of public interest. Therefore, even if harmonization efforts to improve the overall effectiveness of aid would contribute to the success of a donor’s own projects, this also contributes to that of other donors’ projects. Thus, the logic of collective action is that the incentive to support harmonization may be weak. Moreover, the current donor-led, institutional approaches to aid harmonization are not sustainable.

Donors and recipient countries convene in high-level conferences, like in Accra in 2008 and in Busan later this year, where they – armed with rhetoric – reassure each other of their commitments to act, yet return to business-as-usual once they are back in their respective capitals and headquarters. Progress is monitored by the DAC which has no coercive power to hold them publicly accountable to their commitments, other than “through a delicate game of naming and shaming.”<sup>13</sup>

To the extent that donors’ preferences would fully converge, there would be no need to maintain a multitude of donors. Rosenstein-Rodan argued forty years ago that ‘consortia’ of donors would overcome the coordination and other problems of a multitude of individual aid programs (Rosenstein-Rodan, 1968: 227-228). The literature on aid fragmentation empirically supports this thesis that a single dominant donor agency is beneficial (*e.g.* Knack and Rahman, 2007: 177; Martens, 2008: 297). All donors could delegate aid delivery to this single agency. But the history of aid-giving has shown that if all aid were to be channeled multilaterally – thus making aid *de facto* public good – only a fraction of the present volume of aid might be obtained due to the free-rider problem, as Rosenstein-Rodan also pointed out in his paper (Rosenstein-Rodan, 1968: 224). Harmonization of donors’ practices alone would not increase the overall development impact of aid to a meaningful degree. A recent paper by Frot and Santiso (2010: 42) argues that, in contrary, excessive harmonization by donors (*i.e.* no competition) may cause cartelization of aid or create “aid monopolies” which, in turn, would undermine policy ownership by recipient countries while at the same time reducing their maneuvering room and ultimately their sovereignty. Therefore a degree of competition between the aid donors should be retained. From a more practical point of view, competition in the political process may cause self-interested donors to listen to the recipient

governments.<sup>14</sup>

It is important to point out that although the aid effectiveness agenda tries to change the donor-recipient country relationship by putting ownership of the recipient countries and a spirit of partnership at the forefront, which can be regarded as unprecedented in the history of international aid, donors are still dominant in the aid relationship. The effectiveness of aid continues to be assessed on the premise that it is solely given to promote development. The problem with this approach is that it basically ignores what aid really is and why it is fragmented. It does not attempt to change the incentives donors and recipient governments face, rather it leaves it up to their good faith, and so is unlikely to radically change their behaviors. That is why, while the donors are promoting aid harmonization on the one hand, they are still competing on the other. The problem is also compounded by the emergence of non-traditional donors on the development scene. Although the long term implications of these emerging donors, like China, Brazil and India, gaining aid market strength are complex, it is certain that the future aid industry will less likely to be dominated by the traditional DAC donors. Incentives are constantly at work within donor agencies, in the interactions among donor agencies at international and country levels, as well as, in the relationship between donors and recipient governments, given the rivalries and differences in approaches to and experiences with aid-giving among donors. They are dependent on political, institutional and individual level factors that shape the perceptions and motivations of individual donors. Until the impediments to harmonization efforts are tackled, the harmonization agenda will continue to fail to change the donor behavior. In other words, the primary determinants of aid effectiveness lie elsewhere.

Indeed, the recent changes in the international aid landscape necessitate a greater focus on

transparency and accountability for both the allocation and use of development resources. To address the problem of asymmetric information, increased transparency and improved mutual accountability are key to establishing incentives to help strengthen ownership by recipient countries and achieve better development results. Both of which represent the essential elements for taking the broad aid effectiveness agenda forward. By ensuring full transparency by disclosing detailed and timely information on volume, allocation and other information on aid (*e.g.* country strategies, future spending intentions, conditionality, evaluation results), donor governments will be incentivized to translate the aid effectiveness principles into actual behavioral changes and operational practices. This would also help correct negative misperceptions of some donor governments' efforts, such as a perception that a donor uses its aid program to pursue its narrower national interests. To this end, the DAC should be empowered with the authority to take on the role of a 'watch dog' of aid quality and demand from its member governments, multilateral aid agencies and other non-DAC donors the required information. This is one concrete and actionable measure that the international community can adopt at the Fourth High Level Forum on Aid Effectiveness in Busan (South Korea, November 2011) in order to take a step forward on a path toward enhanced aid effectiveness.

Finally, emerging donors have become major players in the ever evolving realm of development cooperation, introducing competitive pressures into the existing international aid architecture (Woods, 2008: 1206). Policies and activities of some of these emerging donors have global impact and affect the issues addressed by the DAC, including on future aid flows and on the development prospects of developing countries and regions supported by the DAC members. Hence, improving the quality and

impact of aid requires active engagement of a larger network including these emerging donors. For this to happen, it is important to promote practical and tangible cooperation with an emphasis on sharing experiences and good practices with each other to enhance the impact of collective efforts. Nevertheless, there is the challenge of selecting 'mutually' agreeable objectives and expected outcomes within areas of 'mutual' benefit as this effort must ensure a two-way flow. The increasing influence of non-traditional donors over the international aid discourse can also provide an impetus for the DAC donor governments to reflect their own practice.

#### Endnotes

- 1 I thank the anonymous reviewers and editors for their helpful comments.
- 2 The adoption of the Millennium Development Goals, for example, has enable the international donor community to share objectives regarding on which issues to concentrate its efforts and thus move towards a coordinated approach, including in some cases sharing common policies and modalities in development assistance (Sunaga, 2004: 3).
- 3 The indicators for harmonization are Indicators 9, 10a and 10b, which measure the extent to which total aid is coordinated. More specifically, Indicator 9 measures the proportion of aid that is delivered in the framework of program-based approaches (PBAs). Indicators 10a and 10b measure the extent to which there are closer joint working practices through joint missions and joint country analytical work, *i.e.* missions or studies undertaken jointly by two or more donors, or by one donor on behalf of other donor(s). The intention behind these indicators is not simply to have more joint missions, reports or reviews but to have fewer of them overall (OECD, 2008b: 54).
- 4 Fragmentation is defined as more than 15 donors providing just 10% of a recipient country's programmable aid. The more donors that, combined, represent just 10% of country programmable aid, the more severe the fragmentation is (OECD, 2008c: 7).
- 5 The Vietnamese government, for instance, hosted 752 visiting missions from donor countries in 2007 alone, which is equivalent to accommodating more than three missions per working day (OECD, 2008b: 15).
- 6 The drafters of the Paris Declaration were aware of these incentive problems and made sure to include in it a provision concerning incentives for collaborative behavior which commits donors and partner countries to: "Reform procedures and strengthen incentives – including for recruitment, appraisal and training – for

- management and staff to work towards harmonization, alignment and results” (OECD, 2005: para.36).
- 7 The sources of both bilateral and multilateral aid originate from the same donor governments and the motivations and purposes that drive them to coordinate also apply to the motives behind channeling their aid multilaterally, which in itself is a form of donor coordination.
  - 8 The US Secretary of State, Condoleezza Rice, wrote in 2008 that “America is not an NGO and must balance myriad factors in our relations with all countries” and that it was in the U.S. national interest to align foreign aid with its foreign policy goals and to use correctly and strategically as a tool (Rice, 2008: 14). The Secretary of State Hillary Clinton’s new ‘civilian power’ strategy centers on “mutually reinforcing diplomatic and development strategies” to achieve the U.S. interests and global security (Clinton, 2010: 2).
  - 9 Complementarity goes beyond donor coordination in that it implies that each donor is focusing its aid intervention in areas where it can add most value *vis-à-vis* what other donors are doing. It facilitates the optimal division of labor between various donors in order to achieve optimal use of human and financial resources (OECD, 2008d: 7)
  - 10 Clemens (2006: 139), for example, claims that, at the very least, a major lack of coordination at the institutional or country level did not generate transaction costs large enough to change overall aid effectiveness in ‘donor-darling’ countries like Uganda and Mozambique.
  - 11 Some argue that coordination of donor practices, in of itself, may manifest a form of collusion and actually reduces aid effectiveness. Easterly (2002: 9) describes donor coordination more bluntly as “collusion among bureaucracies.” It is in their self-preservation mutual interest to collude, Easterly explains, “because advocates of one objective agree to support other objectives in return for support for their own cause.” Birdsall (2004: 9) blames the proliferation of colluding donors for causing fragmentation of aid at the recipient country level.
  - 12 Chinese Ministry of Foreign Affairs, <http://www.fmprc.gov.cn/eng/wjbx/zjzjg/zcyjs/xgxw/t24932.htm>, accessed 13 July 2010.
  - 13 A Blog post by Frot, E and J. Santiso (18 January 2010), “Crushed aid: Why is fragmentation a problem for international aid?”, available at: <http://www.voxeu.org/index.php?q=node/4497>.
  - 14 In contrast, Reinikka (2008: 183) argues that competition among donors can make incentive problems worse. Recipient governments may “divide and rule” by playing donors against each other. The recipient government knows that if one donor threatens to withdraw due to the recipient’s poor performance, other donors will step in, leaving few incentives for either side to improve its performance (Reinikka, 2008: 183). Aid dependence thus leads to a situation in which bureaucrats are often not rewarded for focusing on improving the actual development benefits from aid but rather on getting money from donors. Under such conditions, aid projects are merely viewed as a set of scarce private goods to be allocated as rents.

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