

Multilateral development aid for Africa

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Abstract

Inequities and inefficiencies in development aid arise from donor–recipient motivational conflicts, agency problems, and institutional deficiencies. Recent thinking on reforming official aid recommends technocratic solutions including recipient ownership, selectivity, budgetary grants, and multilateralization of aid management. Locating persistent policy failure in Africa primarily in its political institutions, this paper explores three alternative models of multilateral aid for reconciling need and effectiveness. They are the European Union's (EU's) model of regional aid, the International Development Association's (IDA's) model of concessional loans, and a synthesis model (S-model). Implications are drawn for redesigning aid to Africa that would adequately account for the peculiarities of the world's most prominent development challenge.

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1. Introduction

When it comes to development finance from official sources, the years 2005 and 2006 promise to be a financial bonanza for Africa. The recommendations of the recently released reports of the Commission for Africa (COA, 2005) and the U.N. Millennium Project (UNMP, 2005) are expected to be acted upon by the donor countries. The reports call for nothing less than a war on poverty by scaling up aid, reducing unsustainable debt, and putting Africa on the proverbial development ladder.

In September 2000 at the United Nations Millennium Summit in New York, the international community committed itself to a medium-term development agenda comprising eight goals,

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which came to be known as the millennium development goals (MDGs). They consist of commitments to halve extreme poverty, achieve universal primary education, eliminate gender disparity in education, reduce infant and maternal mortality by two-thirds, ensure environmental sustainability, and develop a global partnership for development (UNMP, 2005).

In order to meet the MDGs by the target date of 2015, development aid is slated to be doubled from the current annual flow of US\$ 70 billion—one-quarter of which is earmarked for Sub-Saharan Africa (SSA). This big push for a sustained annual growth rate of 7%, which is needed to halve the rate of extreme poverty, has intensified the spirited debate on certain aspects of the theory of development and its practice. The buzz words of the burgeoning literature on aid include ownership, multilateralism, good governance, selectivity, transparency, mutual accountability, and outcome-based evaluation.

The primary objective of this paper is to use comparative institutional analysis for identifying the broad contours of a sound aid relationship between powerful donors and weak recipients. It specifically seeks to throw some light on the much-debated dilemma involving the need to scale up investment-oriented aid to SSA in an environment of limited absorptive capacity and pervasive corruption.

To appreciate how SSA provides the most dramatic illustration of the crisis of confidence involving development aid (van de Walle and Johnston, 1996; World Bank, 1998, 2000), consider the past patterns of aid flow to the region. Home to one-third of the world's extremely poor, SSA currently receives some US\$ 20 billion per year, inclusive of relief aid. With some 13% of the world's poor people, SSA countries received nearly one-quarter of the US\$ 2 trillion of net Official development assistance (ODA) dispensed over the past 40 years (OECD, 2004).¹ In per capita terms, small countries received substantial amounts (Botswana, Senegal, Mauritius, and Zambia), while the two largest countries benefited much less (Nigeria and Ethiopia). Compared to South Asia, SSA received more aid than is justifiable based on its population share and less aid based on the depth of its poverty (the exceptions being Botswana and Mauritius).

Fig. 1 depicts a rapid increase in net ODA during the period 1960–2000. Aid to the region has a high grant element. However, the share of technical assistance, often considered of dubious value, is low. Disillusion with the performance of aid, especially structural adjustment assistance, explains the substantial reduction of aid flows in the 1990s. This trend is just beginning to be reversed, perhaps in a dramatic way, as 2015 approaches for the implementation of the millennium development goals (UNMP, 2005).

From various perspectives, SSA is a baffling outlier (Devarajan et al., 2004; Artadi and Sala-i-Martin, 2003; Easterly and Levine, 1997; Collier and Gunning, 1999). It is the only region where real per capita income is falling or stagnant for a significant portion of the population; capital accumulation, public or private, has had only a modest impact on growth; the risk-adjusted private rates of return are low; political instability is endemic; and vulnerability to fluctuations in primary export earnings and aid flows is high.

The current intergovernmental aid regime, whether mediated by bilateral or multilateral agencies, is accused of being ill-suited for meeting these challenges. The shortcomings include

¹ Official development assistance (ODA) is an unrequited transfer from rich governments to poor governments that takes the form of pure grants, technical assistance, or concessional loans (with a grant element of at least 25%). ODA is undertaken by the official sector with economic development as the main objective. Global resource flows refer to net receipts (private plus official), while net ODA is exclusive of reflows in the form of official debt service payments.

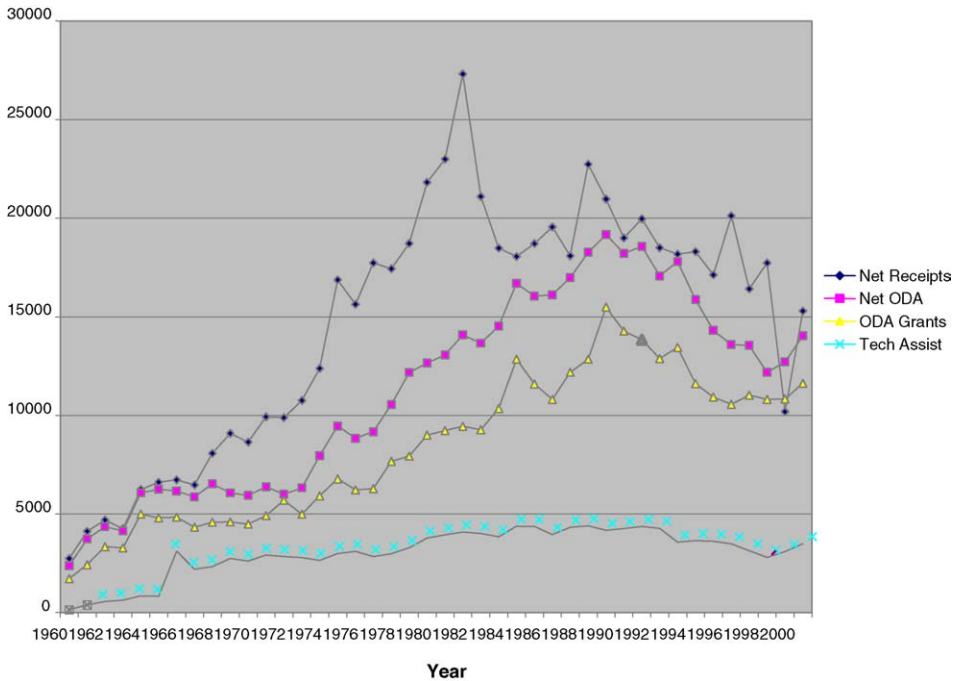


Fig. 1. Foreign resource flows to Sub-Saharan Africa, 1960–2000 (millions of US\$ in 2000 prices; source: OECD, 2004).

severe agency problems (adverse selection, moral hazard, and fungibility), highly asymmetrical power relations between donors and recipients, coordination failures among donors as well as among recipients, and inadequate attention paid to local circumstances or a rigorous evaluation of final outcomes.

We do not take up here the issue of substitution or complementarity between bilateral aid (often politically tied and tailored to fit local conditions) and multilateral aid (often technocratic and uniform). Suffice it to note that citizens of donor countries are likely to prefer multilateral aid (currently about one-third of ODA) to the extent that it benefits from higher technocratic efficiency, economies of scale, and insulation from domestic principal-agent problems (Lancaster, 1999; Martens, 2002; Milner, 2004).

SSA is an ideal case for evaluating the competing proposals for reforming the current system of development aid.² van de Walle (1999), for example, identifies four approaches toward a new system of aid allocation for Africa: selectivity, need, private-sector development, and ownership. These considerations, we shall argue, are better treated as guiding principles than as alternative allocational mechanisms.

² Van de Walle (1999, p. 339) notes that ‘Africa’s current social and economic landscape is profoundly marked by aid: in a typical country, 30–40 donors in addition to 75–125 foreign NGOs fund a thousand or so distinct projects, involving 800–1000 foreign experts. . . . In most countries of the region, the aid business is typically the second biggest employer in the local economy, surpassed only by government.’ Just as telling is the fact that the Tanzanian government, while facing scarcity of high-level manpower, produces some 2400 quarterly reports annually for the multitude of its donors who are sending missions at the rate of 1000 a year.

The fundamental constraint on equitable growth in SSA is arguably neither money nor ideas. It is rather the failure of domestic institutions (sub-national governments, the business community, and civic groups) as well as the global governance system (donor governments and international institutions) to bring economic development to the masses (Cassen, 1994; van de Walle, 1999; Devarajan et al., 2001; Young, 2004). As a consequence, there is underinvestment in infrastructure and vocational-technical skills all of which are needed to absorb the millions currently locked in the subsistence or informal sectors.

It is all the more unfortunate that most reviews of the foreign aid system conveniently sidestep the political roots of the failure of aid especially in Africa (Sachs, 2005; UNMP, 2005, being cases in point). The implicit rationale is that political behavior is not readily amenable to policy manipulation or that it is endogenous to the development process itself. Independent of the source of the governance problems, the narrow fiduciary mandate of multilateral development institutions has resulted in the sidelining of the severe representation problems between recipient governments and their poorest citizens.

The paper proceeds as follows. Section 2 examines the theory of aid regarding its finance, allocation, and economic impact. Section 3 discusses the attributes of an ideal system of global development finance and explores three models of development aid from the perspective of their relevance to African realities. The first model is inspired by the structural funds program of the European Union (EU) and has not, to our knowledge, been invoked as a benchmark for development assistance outside Europe. The second model is the current International Development Association (IDA) of the World Bank. The third model (synthesis model, S-model) combines the best features of these models with due considerations of the notable structural constraints of the world's least developed region. Section 4 recapitulates the main points and teases out the notable implications.

2. Theory of development assistance

Even though a widely accepted theory of development assistance does not exist yet, a number of ideas from economic theory such as collective action, imperfect competition, and the principal-agent problem can be deployed to formulate a useful framework. This framework can then be incorporated into the standard theory of growth.

Consider the aid–poverty relationship that comprises initial conditions, factor accumulation, total factor productivity, and economic outcomes (see Fig. 2). Since development aid is at best a supplement to domestic resources, its effectiveness is best evaluated in the context of the recipient's institutional and policy environment. This environment is largely the product of a country's political economy, which is profoundly shaped by initial conditions such as endowments, historical legacies, and global geopolitics (Rodrik, 2003; Acemoglu et al., 2004; Weil, 2005).

Development aid, by augmenting productive investment and facilitating the transfer of technology, boosts overall growth. The extent to which the growth of national income reduces poverty, however, depends on the nature and magnitude of existing inequality (Bourguignon and da Silva, 2001; Sachs, 2005). We now trace out the complex channels of transmission beginning with the taxpayers of rich countries and ending with the poor in the recipient countries.

2.1. *Development finance: demand and supply*

The ultimate rationale for the existence of bilateral and multilateral development assistance is the failure of global markets to finance risky projects in capacity building and poverty alleviation.

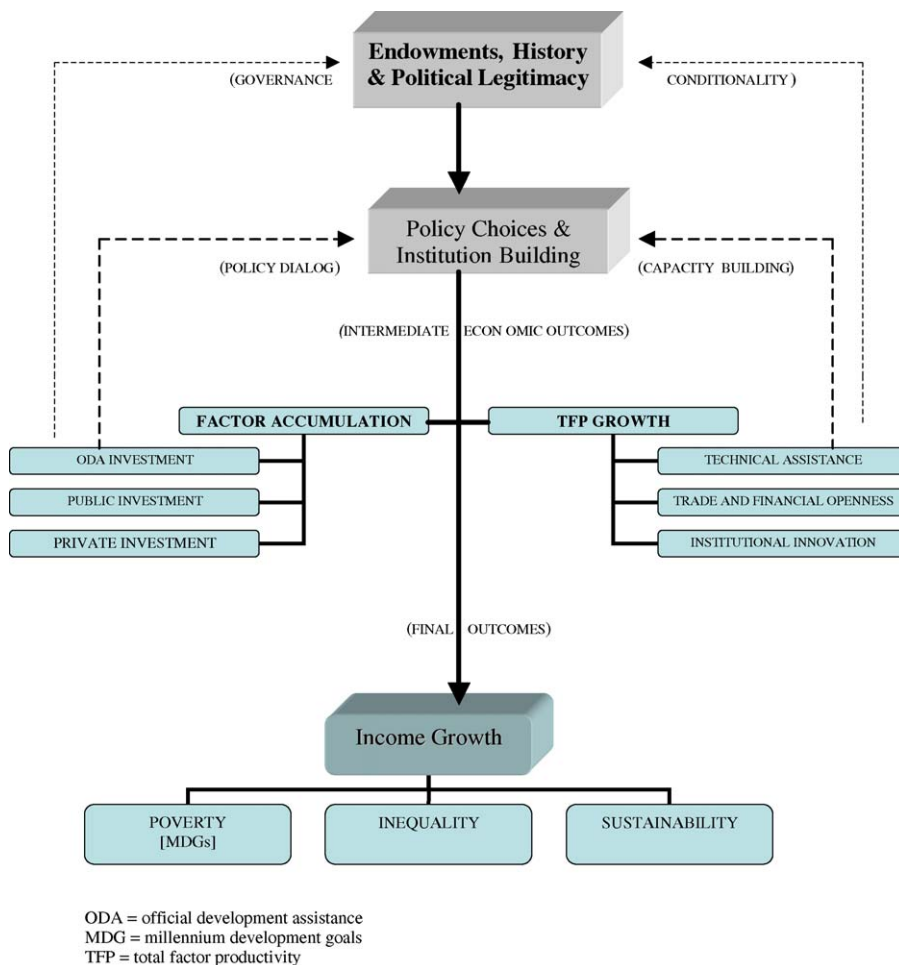


Fig. 2. A framework for aid, growth, and inequality. ODA, official development assistance; MDG, millennium development goals; TFP, total factor productivity.

The market metaphor is not always apt, but it is still useful to recast the aid relationship as the interplay of demand (uses) and supply (sources).

Though it is not always clear who the ultimate customers are, the demand for aid is driven by the need of the poorest countries for grants and soft loans, and by the middle-income countries for soft loans as well as hard loans with long maturity (Rogerson, 2004). The supply of development finance, on the other hand, comes from two distinct but related sources. One is from official sources in the form of official grants and debt. The other is from private sources in the form of charity, remittances, or investment (foreign direct investment and portfolio investment).

In light of the high risk, high transaction costs and imperfect information, private investment to regions such as SSA is likely to be undersupplied. If the market failure argument is taken to

heart, the optimal sequencing is for tax-financed, poverty-alleviating official aid to pave the way for profit-seeking private flows.³

A number of proposals and initiatives are presently under active consideration to supplement, if not to supplant, the current funding of ODA. One approach is to triple the current flow by enforcing the longstanding pledges of the member countries of the Development Assistance Committee (DAC) to provide 0.7% of their gross national income in aid. However, considering the fact that donor countries' constituency generally is not responsive to large foreign aid allocations, innovative funding sources have also been proposed to raise revenues while reducing negative externalities. These sources include modest global taxes on international bads (arms trade, military spending, international air transport, and hydro-carbons), on the forex market (Tobin tax), and on global commons (geostationary satellites, oceanic resources including fishing and minerals, and the Internet). The imposition of a Tobin tax on foreign exchange transactions alone could, at a 0.2% rate, quadruple the current annual ODA flows to some US\$ 300 billion (Atkinson, 2005).

2.2. Mechanism of aid: agency chains

The donor–recipient relationship is pervaded by uncertainty. Since optimal risk sharing is untenable, there is no guarantee that aid will lead to successful outcomes in the presence of multi-tiered principal-agent problems (Grossman and Hart, 1983; Martens, 2002; Milner, 2004). The current aid system is, in fact, a double patronage system. The first level links the multiplicity of donor and client governments, while the second level links client governments with their domestic constituencies.

Three critical links in the chain of delegation, all of which are bedeviled by the principal-agent problem, are worth noting:

- (a) *Do donor agencies do the bidding of their principals?* As principals of donor agencies, taxpayers in the DAC countries presumably prefer an incentive system that would ensure automatic compliance. However, the goals and instruments set out for the aid agencies by the multitude of donors are diverse and often conflicting. The aid bureaucracies, especially the bilateral agencies, do not always enjoy the kind of autonomy necessary for an efficient technocratic approach to development management (Lancaster, 1999). This, in turn, makes it difficult for an aid agency to fulfill its principal's objectives. Overall, the incentive environment faced by aid agencies tends to foster a culture of disbursement rather than delivering concrete results. Scarce administrative resources are diverted toward compliance work and away from learning from past mistakes (see Easterly, 2003).
- (b) *Do recipient governments do the bidding of the donor agencies?* While donors may target the poor, rent-seeking governments with weak domestic political restraints may instead favor their narrow constituencies (van de Walle, 2001). Mistrust and lack of collateral for sovereign loans impel lending agencies to impose onerous input-based or ex ante conditionalities that

³ SSA is ironically a net exporter of both capital and skills. Over 40% of private wealth in SSA is held abroad with the stock estimated in the range of US\$ 300 billion. For every dollar borrowed by an African country, roughly 80 cents are repatriated (Boyce and Ndikumana, 2002; Fosu et al., 2004). The flipside, of course, is the prospects for remittances eclipsing foreign aid flows to the region. Interestingly, the volume of concessional flows and inward FDI (concentrated in extractive sectors) to SSA are of comparable magnitude—half of each going to 10 or so countries (ADB, 2004).

have been shown to be generally ineffective (Boone, 1996; Svensson, 2000; Collier and Dollar, 2002). The alternative, ex post rewarding of good performance, unduly punishes well-intentioned recipients with low capability while rewarding capable but less needy countries. Furthermore, the convergence of views reflecting the policy imperatives associated with the so-called Washington Consensus has given donors enormous collective influence over recipient governments' behavior (Rogerson, 2004; Stiglitz, in press).

- Ideally, official debt is a contract among key stakeholders. The nature of sovereign debt is such that donor agencies can lend only to governments. The real debtors of concessional loans are, however, the present and the future generations of the recipient country's citizenry. This realization may have led to the latest round of forgiveness, granted in June 2005 by the G-8 countries, of which some US\$ 40 billion debt was owed by 18 mainly African countries.
- (c) *Do the recipient agencies do the bidding of the intended beneficiaries?* The ultimate stakeholders of the aid relationship may be poor people, but they rarely have an effective voice in the design or in the evaluation of aid-funded programs. The unwillingness of the government to use foreign aid to serve the poor in developing countries weakens the poverty-reducing effects of development aid.

The above discussion indicates that the agency loop of accountability is clearly not closed. There is a missing link in the current model of aid allocation between the primary, taxpaying principals in the donor and the secondary, aid-targeted principals in the developing countries. The lack of effective self-evaluation by the intermediaries (i.e., donor agencies and recipient governments) has inevitably produced unsatisfactory results that are decried widely (Hansen and Tarp, 2000; Easterly, 2002; Kanbur, 2003).

2.3. *Economic impact of aid: growth and transmission mechanisms*

The effects of development aid on growth and structural transformation have given rise to an inconclusive debate. Some cross-country studies, after decomposing aid into its consumption and investment components, find an unambiguously positive relationship between aid and growth (Clemens et al., 2004). Another set of studies finds that the effect is conditional on the quality of institutions and policies (Burnside and Dollar, 2000). A third set of studies finds no relationship between aid and growth (Easterly et al., 2004; Hansen and Tarp, 2000). It seems that the aid–investment–growth linkage is neither well-understood nor statistically robust.

When one goes beyond agency chains and cross-country regressions, it becomes clear that the effectiveness of development aid is also thwarted by a long and poorly understood economic transmission mechanism that links aid and growth. In a simplified form, impact analysis focuses on the four links, each with an uncertain outcome (see Fig. 2 for a schematic outline):

- (a) *Do donors know best?* Given the complex nature of the development process and the ever-changing intellectual fashions, there is little evidence to support the claim that donors have an indisputably superior knowledge of the right institutions or even appropriate development strategies (Lancaster, 1999; COA, 2005). A consensus has yet to emerge among economists on the package of reforms needed in Africa, which extends beyond the usual remedies such as macroeconomic stabilization, lowering corruption, and liberalization (Easterly, 2003; Rodrik, 1999; Stiglitz, 2004).
- (b) *Does aid buy good policy?* The evidence so far shows that aid cannot buy reform in countries where the political establishment shows little or no desire for reform (World Bank, 1998;

Devarajan et al., 2001; Svensson, 2000). In the absence of growth-promoting institutions and policies, large financial transfers may even be counterproductive because they would likely strengthen the incentives of recalcitrant governments against mobilizing domestic resources (Brautigam and Knack, 2004).

- (c) *Does aid-related reform buy “productive” investment?* This issue has two distinct dimensions: the extent of additionality of ODA to public investment, and the degree of complementarity between ODA investment and private investment. The available evidence suggests that the bulk of aid tends to augment government consumption rather than to close the financing gap of productive investment (Boone, 1996; Easterly, 1999; Devarajan et al., 2004). Foreign aid may have a weak signaling effect for risk-averse private investors, if, as Evrensel (2004) shows, aid is perceived to be ineffective in increasing the productive capacity of the recipient countries.
- (d) *Does investment buy growth?* Aid boosts demand and capacity utilization in the short run with possible adverse consequences for the tradable sector as the real exchange rates appreciates. It also enhances supply in the medium-to-long-run by expanding capacity. This may come primarily in the form of positive spillovers from aid-augmented public investment in infrastructure, health, or education (Adam and Bevan, 2003; World Bank, 2005a).
- (e) *Does growth result in the reduction of poverty and inequality?* Generally, the growth elasticity of poverty is less than unity. A possible reason for this outcome is persistent inequality in the distribution of assets, political influence, or skills, which singly or in tandem can thwart growth from alleviating poverty appreciably. Aid expenditures tend to benefit the non-poor and the urban population disproportionately. The inability or unwillingness of governments to provide universal access to essential public services prevents the poor from taking full advantage of opportunities provided by aid-related economic activity. Maximal poverty reduction inevitably requires active involvement by donors and governments alike to directly target the poor (Bourguignon and da Silva, 2001; Brautigam and Knack, 2004; Hansen and Tarp, 2000).

The high transaction cost of delivering aid and the uncertainties surrounding the net impact of aid on the poor, even when properly delivered, have triggered calls for humility. One approach pleads for modest expectations and advocates aid projects for poor people which focus on tangible improvements in their daily lives (Easterly, 2002).

3. Models of aid

The above discussion suggests that an ideal aid program is needs-driven, targets the right sectors or means-tested beneficiaries, goes to well-governed countries, complements other sources of productive investment, and is coherent and sustainable (COA, 2005; UNMP, 2005). A well-designed program of multilateral aid must, therefore, embrace at least four fundamental principles. The first two principles define the donor–recipient relationship, while the remaining two principles apply to the modalities of aid provision. We use these attributes of good practice to evaluate alternative models of aid design:

- (i) *Partnership and subsidiarity:* The current aid system over-stretches the scarce managerial resources of SSA as an entirely avoidable fragmentation raises the cost of managing the multiplicity of small donors. This state of affairs has induced insistent calls for moving toward the extreme points of the spectrum: full donor competition or full donor coordination (van de Walle and Johnston, 1996; World Bank, 2005a; OECD, 2005).

Sharing common goals and objectives is perhaps the most characteristic feature of partnership. To distinguish it from paternalism involving unequals, all parties (donors, central government, and local authorities) will have to approve national development plans proposed by the recipient government. Respect for policy sovereignty or recipient ownership often confronts the reality of wrong-headed policies that are preferred by myopic regimes. It is only after aligning the incentives of donors and recipients that authority can be devolved to the lowest agent (subsidiarity) and the bulk of aid money can be provided in the form of non-earmarked budget support.

- (ii) *Ideas versus money*: Financial aid is little more than a supplement to a developing country's own productive resources. By reducing marketing and transaction costs, a well-designed aid program complements domestic investment, maximizes the tax effort of recipient governments, renders fungibility a benign problem, and avoids the tying of aid that reduces the true value of the aid to the recipient (Collier, 1999; Clemens et al., 2004; UNMP, 2005).

If the ultimate goal of official aid is to build up private-sector capability and to phase out aid dependency, the transfer of knowledge about good economic practice and appropriate production technology is more important than the transfer of money. The conventional government-to-government or agency-to-government relationship must then steadily give way to linkages with private-sector development (Lancaster and Wangwe, 2000; Meltzer Commission, 2000). Multilateral development banks may have to model themselves after the International Finance Corporation and the European Bank for Reconstruction and Development by mobilizing their traditional tools (co-financing, insurance provision, credit rating, and technical assistance) to promote entrepreneurship, trade integration, and international creditworthiness.

- (iii) *Sufficiency and reliability*: Given the enormous need for investments in physical and human infrastructure in SSA, aid would have to be scaled up (by a factor of two or more) in order to meet threshold requirements for social overhead subject to the constraints of (expandable) absorptive capacity (UNMP, 2005; COA, 2005; World Bank, 2005b). When binding capacity constraints are ignored, the balance between Dutch disease and productivity gains is likely to favor the former.

Aid is currently volatile and procyclical much like private investment and export earnings from primary goods (Bulir and Hamann, 2003). One study, for example, suggests that three-fourths of the large welfare losses from macroeconomic fluctuations can be eliminated by making the current level of aid to Africa fully anti-cyclical (Pallage and Robe, 2001). Aid must, therefore, be predictable (i.e., equality of commitment and disbursement) in order to stabilize public revenue, finance investments with long gestation lags, and leverage long-term private investment.

- (iv) *Poverty selectivity versus policy selectivity*: Deservedness has two important dimensions, which are likely to involve trade-offs between need (poverty) and effectiveness (policy and capability). With respect to poverty intensity, aid programs will have to delineate the grant-intensive⁴ needs of low-income countries, which enjoy little or no access to international

⁴ The primary rationale for preferring grants to soft loans is that, given the equivalence of loans and grants (at least in perfect markets), grants have the additional virtue of eliminating a predictably unsustainable, and hence forgivable, debt burden. The litany of objections to the grants-only idea includes the difficulty of replenishing pure grants, intensification of aid dependency, and foreclosure of access to private market. Parenthetically, only two SSA countries (Botswana and Mauritius) currently have sovereign credit ratings.

capital markets from those of the middle-income countries. The latter find concessional loans attractive less for their cost than for their long maturity as capital markets adjust the portfolio of financing on offer depending on perceived risk (Evrensel, 2004; Rogerson, 2004). Effective use of aid, on the other hand, has two dimensions. One is institutional capability, in terms of administration and budgeting. Another is policy priorities which, along with institutions, may be thought of as endogenous to aid flows.

With these considerations in mind, we now turn to the three multilateral models of aid: the European Union model of regional aid, the IDA model of multilateral aid, and the S-model of aid to Africa. A synopsis of the basic features of each model is provided in Table 1.

3.1. *The EU model of regional aid*

The EU ‘regional aid’ program, as opposed to its ‘development aid’ program, is the gold standard for multilateral economic assistance. Despite important differences between SSA and the laggard European economies, the model holds many instructive lessons for Africa aid. First, the model makes it clear that the long-term goal of development aid, regional or global, should be to prepare recipients to gain effective access to the international markets for goods and factors. Second, the EU regional aid program contains most, if not all, of the attributes of an ideal development aid program enumerated above.

The European Union has three broad classes of aid programs. The first class is designed for insiders, i.e., structural aid to member states. The second class is capacity building aid to accession candidate countries (Bailey and de Propriis, 2004).⁵ The third class caters to the needs of the non-European developing countries, most of which are former European colonies.⁶ Much like the Japanese aid program, the European Commission tends to define aid in broader terms to cover trade and immigration. It has signed aid-linked trade agreements with a group of low-income Asian, Caribbean, and African (ACP) countries, from Lome I in 1975 to Cotonou in 2000.

EU’s structural funds (SF), perhaps the most desirable but the least feasible of the three models of development aid, have three components (European Commission, 1999). The first, the European Regional Development Fund (ERDF), claiming about half of the SF budget, provides financial assistance to the most disadvantaged regions of member states. The fund concentrates on productive investment, infrastructure provision (especially roads), and investments in health and education, and enterprise development. The second, the European Social Fund (ESF), with one-quarter of SF funds, aims to tackle unemployment and social exclusion by making it easier to

⁵ Pre-accession aid is short-term-oriented. Commitments, which account for a quarter of EU’s global aid budget, have amounted to 18 billion euros for 1990–2004. There is a large number of enlargement conditionalities involving political, economic and technical issues (European Commission, 2000, 2004a,b).

⁶ The bulk EU development aid is bilateral. EU multilateral aid to poor non-European countries, which currently accounts for three-quarters of EU aid and about half of global ODA, is managed by a division of the European Commission—the European Development Fund (EDF) out of the budgetary allocation to the Directorate General for Development (which constitutes two-thirds of the aid dispensed by the Commission). In 2001, Europe Aid was created as a separate implementing agency that appraises, monitors, and evaluates all external assistance programs (Grimm, 2004). Although its rhetoric is more populist, the Commission’s approach to development aid to non-members is broadly similar to that of the International Development Association (see European Commission, 2000, 2004a; Maxwell and Engel, 2003). The Commission has recently begun to devolve decision-making to country-based delegations, issues country strategy papers (CSP), and swears by the ‘three Cs’ (coordination, complementarity, and coherence).

Table 1
Comparative features of the three models of multilateral aid

Feature	Relevance	SF (EU)	IDA (WB)	Synthesis (S)
Adequacy	Funding level	High: driven by the commitment to ensure income convergence to the EU average	Low: no specific target for reduction of poverty; at the mercy of donor replenishments	Medium: contractual targets negotiated by donors and clients under international standards
Predictability	Capacity building			
	Long-term planning	High: multi-annual planning under transparent conditions	Low to medium: soft loans subject to intellectual fashions and priorities of lender	Medium: multi-year based on mutually agreed development plans and investment programs
Additionality	Funding level and conditions			
	Fungibility	Ensured: matching funds are mandated	Uncertain: donor offers best projects though PRSPs mitigate fungibility	Ensured: donors have a say in the utilization of all resources, aid or domestic
Selectivity	Incentive to invest			
	Client-owned plan	Yes: country submits plan o commission responding to publicly set priorities	Yes: largely donor-dictated framework for utilizing repayable loans	Yes: aid supplements client's own development finance
Reciprocal accountability	Donor coordination			
	Poor: stakeholders	Yes: democracy at national and EU levels	Partial: inter-governmental, not directly to citizens	Yes: to all fundamental stakeholders
Governance	Taxpayers: principals			
	State	Precondition for accession; deepened post-accession	Narrowly bureaucratic: focus on corruption and budgetary management	Broadly construed: accountability to citizens and stakeholders
	Market			
	Civil society			

Sources: Various (see text).

get access to the labor market. This entails promoting equal opportunities, fostering the creation of new jobs, and supporting the development of higher skills and qualifications. The third, the European Agriculture and Guarantee Fund (EAGGF) supports improvements in the efficiency of agricultural structures, investment in food processing and marketing, and compensatory payments in less-developed areas.

The SFs are in the final analysis matching funds that are designed to leverage domestic investment for the purpose of reducing interregional economic disparity. By composition of spending, they fall into three categories: programs designed to influence the pattern and volume of private capital formation, programs designed to promote the development of public physical infrastructure (claiming over two-thirds of the funds), and programs designed to build up human capital through training.

One aspect that interests us from the standpoint of reliability is that structural funding is packaged in the form of a multi-year program (the community support framework, CSF) that is agreed upon among regional, national, and community authorities (European Commission, 2001; Roberts, 2003). The current principles and criteria for the allocation of regional funds include spatial or sectoral concentration of investment, partnership, coordination, and integration with national plans, joint planning and programming, subsidiarity to the local level, and close monitoring through progress reports, financial control, and evaluation of program effectiveness.

EU financing mitigates fungibility and donor ownership by building complementarity into the domestic investment programs of laggard member states. This is done through the mechanisms of matching funds (co-financing ceilings varying by objective and project category from 15% to 85%), and additionality (maintenance of past levels of public-sector structural expenditure). The composition of funding by project class for the three CSFs of Portugal, for example, shows that economic infrastructure received an average of 45% of the funds, human resources 20%, and private-sector production 35% (Pereira, 1997).

Just as important for weaning off recipients from international aid are the institutional objectives of regional aid. They include local-government capacity building for the planning and implementation of innovative projects, and promoting efficient and accountable public-sector expenditure management. The rhetoric of partnership and subsidiarity in the policy process implicitly acknowledges the critical role of local ownership, as opposed to over-reliance on externally imposed mandates, in sustaining EU-funded projects (Roberts, 2003).

Enhancing inter-country and inter-regional convergence continues to be the central concern of regional aid. Through this mechanism, worth emulating in the redesign of Africa aid, the EU aid programs help to lift poorer accession countries and laggard regions even in rich member states (notably Germany and Italy) to a stage beyond which national policies and market forces would take care of uneven development.

3.2. *The IDA model of multilateral aid*

The multilateral development banks (MDBs), the World Bank and the four continent-wide development banks, play a special role in the world of development assistance by bundling concessional loans with knowledge transfer. However, unlike the European Commission, which answers to the European Parliament and the European Council, these international bureaucracies wield power without sovereignty on behalf of the strongest of the DAC member states in their dealings with the weakest developing countries.

The World Bank Group channels its lending to governments through two lending arms: the International Development Association for soft loans to the low-income countries with little or

no access to private capital markets, and the International Bank for Reconstruction and Development (IBRD) for hard loans to the middle-income countries with measurable but insufficient access to private international capital markets.

The IDA, unlike the better-endowed IBRD or IMF, receives the bulk of its resources from 3-year replenishments from donor countries. IDA lending falls in three broad categories: investment (infrastructure, production sectors), policy-based aid (quick disbursing adjustment loans conditioned on specific institutional and policy reforms), and non-investment aid (social services). As concerns for direct poverty alleviation rose in the 1990s, the share of social sector loans tripled to about 40% of its total portfolio (OECD, 2004).⁷

Three criteria are used to determine which countries are eligible to borrow from IDA (2005): relative poverty, defined as GNP per capita below an established threshold (currently around US\$ 900); lack of creditworthiness to borrow on market terms; good policy performance, defined as the implementation of economic and social policies that promote growth and poverty reduction. For borrowers like India, eligible for both IDA and IBRD funds (blend countries), allocation takes into account creditworthiness for access to other sources of funds as well as the ability to use IDA resources effectively. The share of IDA lending to SSA increased from one-third to one-half of net ODA inflows into the region between 1973 and 2003 (IDA, 2005).

An interesting feature of IDA's approach is the extensive effort made to reconcile conflicts between the recipient's need and performance. The allocation formula is driven by each borrower's rating in the annual country performance and institutional assessment. Because the acceleration of economic and social development in Sub-Saharan Africa remains foremost among IDA's priorities, these countries receive priority in the allocation process, provided that policy performance warrants it.

IDA's system of performance-based allocation (PBA), in effect since 1997, is driven by two sets of considerations: poverty level and IDA country performance (ICP)⁸ rating. ICP is the sum total of all the different criteria used to measure a country's performance, the most important of which is the country policy and institutional assessment (CPIA).⁹ While governance is used as a criterion, the elements of governance that are disproportionately rewarded are stringent observance of property rights and deregulation of business. Small policy changes can lead to large differences in the governance score. In this one-size-fits-all approach, imputation is widely used in the creation of indicators. With the current data base, Kanbur (2003) argues that only a general monitoring of progress at the country level is feasible.

The comparative advantage of MDBs is in providing analytical work and technical assistance more than in dispensing money that is otherwise available (except for the least creditworthy)

⁷ Since its establishment in 1960, IDA has provided grants and interest-free loans (with a 0.75% service charge) to the poorest developing countries—at least half of which is mandated to go to SSA. Its loans, US\$ 7–9 billion annually in recent years, also come with a typical grace period of 10 years and a maturity of 40 years.

⁸ ICP is based on a two-step calculation, which involves multiplying the weighted average of the Country Policy and Institutional Assessment (CPIA) and its Annual Review of Project Performance (ARPP) by a Governance Factor (GF) derived from a convoluted formula. The GF contains the following five criteria drawn from the CPIA: property rights and rule-based governance; quality of budgetary and financial management; efficiency of revenue mobilization; and quality of public administration, transparency, accountability, and corruption.

⁹ The CPIA, which shows a bias toward economic indicators, consists of the following four broad criteria each of which has a component with an equal weight of 5%. They are economic management (20%), structural policies (30%), policies for social inclusion/equity (25%), and public sector management and institutions (25%). Each of the above criteria are rated on a 1 (unsatisfactory for an extended period) to 6 (good for an extended period) scale, and they are to be publicly disclosed from 2005 on (IDA, 2005).

from the private capital markets. The power of these international agencies over SSA countries finds expression in the formulation and implementation of the development agenda that at least in theory drives aid allocation.

Since 1999, IDA countries are expected to articulate their development vision and their strategy for reducing poverty in the form of a poverty reduction strategy paper (PRSP). PRSPs, which are jointly reviewed by the Bank and the IMF, are to include the views of fundamental interests in society, focus on poverty reduction, and incorporate the basic features of the World Bank Group's comprehensive development framework (CDF). The rhetoric of CDF emphasizes comprehensiveness and long-term orientation, country ownership of the development agenda, country leadership in the management of aid programs, and dispassionate evaluation of pro-poor programs on the basis of measurable outcomes.

The Bank's own strategic choices concerning its aid portfolio come in the form of the country assistance strategy (CAS), a non-negotiated document, on which lending operations rely. The allocation norm establishes the financial resources available for each IDA country for 3 fiscal years, including triggers that are linked to reform or implementational slippage. The allocation sets the resource envelope that each country could expect to receive, assuming the continuation of good performance and an adequate pipeline of quality projects. It is not an entitlement. In the case of a new CAS, the allocation norm sets the base-case financing scenario which may be adjusted to reflect special country circumstances.

We looked at a representative sample of CAS from South Asia and Sub-Saharan Africa. The countries with complete documentation are Ethiopia, Kenya, Mozambique, Zambia, and for reference purposes, India. We also looked at interim or progress reports for Pakistan, Bangladesh, Nigeria, and South Africa.

Three observations stand out from the CAS documents. First, the treatment of South Asia is quite different from the treatment received by Sub-Saharan Africa. India, given its higher capability to manage resources and its access to private capital markets, defends its policy sovereignty quite effectively. Second, consistent with the new rhetoric of partnership, the PRSP is intended to embody the recipient's national poverty reduction strategy that is developed in consultation with civil society while the CAS is an expression of the Bank's own priorities for that country. For those SSA countries governments that are too weak in terms of technocratic capability or political commitment to poverty reduction, the distinction between the CAS and the PRSP becomes blurred as extensive agency review requirements and intensive economic advisory services inevitably diminish policy ownership by such states. Third, the inter-country variations in policy prescriptions imply a paternalistic approach to SSA—notwithstanding the rhetoric of country ownership, devolution to country offices, and two-way accountability.

The World Bank claims to follow a nuanced objective–instrument–outcome formula. Critics note, however, that objectives tend to be broadly defined; instruments are of the straightjacket variety; and performance is linked to procedures and intermediate inputs rather than final outputs (such as MDGs). In other words, the performance-based aid allocation is made by economists at the World Bank who use a standardized process to determine the country's progress rather than the country's own needs, local circumstances, development priorities, or goals.

The IDA has certainly been a leader in shifting the focus of aid from isolated projects to coherent programs and in tweaking the aid relationship with Africa by reconciling *de facto* hegemony with the ideal of country ownership. Like other MDBs, it is nonetheless threatened by the collective action problem that emanates from the proliferation of stand-alone international initiatives (such as the U.N. Millennium Challenge Account), the growing popularity of the idea of splitting monetary allocation from service delivery, and the insistent calls for restricting

multilaterals to the role of lenders (granters) of last resort or providers of research-based consultancy services with recipients free to shop around (Harford and Klein, 2005).

An integral part of the automatic revenue approach is the multilateralization of aid to its logical conclusion by pooling much of the money into dedicated global funds. Guidelines for drawing funds from the common pools, including the provision of international public goods, can then be established jointly by donors, recipient governments, and other important stakeholders (Kanbur et al., 1999; Harford and Klein, 2005).

Let us take stock of the most instructive lessons from the two multilateral models as they might apply to African realities. Referring back to the attributes of a good aid program, the following points stand out:

- (a) Given the inherent asymmetry in the power between donor and receiver, it is hard to imagine a representation in the boards of the MDBs that comes remotely close to what the less-developed EU member states enjoy in the European Parliament and the European Commission (see Birdsall and Kapur, 2005; Stiglitz, *in press*). Nonetheless, the reciprocal accountability inherent in the concept of partnership makes it imperative for donors and Africans alike to muster their collective will to institutionalize shared decision-making. This principle applies equally well to forging a non-clientelist relationship between recipient governments and their poorest (and politically marginalized) citizens.
- (b) Where a functioning partnership is feasible, as in the case of most middle-income countries (plus China and India), the EU and IDA models suggest that it is indeed possible to establish an incentive-compatible ‘development contract’ which harmonizes donor procedures and aligns donor policies with those of the government. With donors serving as allies of the poor, aid can then serve as an effective leverage to advance the long-term interest of the weakest members of society.
- (c) The foregoing objectives call for a division of labor, based on comparative advantage, among the international development institutions, the recipient governments, the business community, and civil society. In this regard, the Meltzer Commission (2000) has taken the World Bank to task by calling its bluff of being a ‘knowledge bank’ first and foremost. It recommended that, regarding aid to Africa, the Bank emphasize technical assistance and performance-based grants rather than loans.

3.3. *An S-model of Africa aid*

A sensible way of thinking about the challenges of African development is to cast economic performance as a joint product of capability and opportunity. Since SSA has serious capacity constraints, openness and liberalization have failed to produce international competitiveness (World Bank, 2000, 2005b; COA, 2005). It is only when policies aim to facilitate efficient capacity building that market-oriented reforms can be translated into tangible gains in the economic welfare of the poor.

The recent change of focus from adjustment lending to policy-based lending by the International Monetary Fund and the World Bank can be seen as evidence of their belated appreciation of this reality. World Bank (2005a, p. 151), for example, notes that “aid is more effective in fostering growth and improving service delivery in countries with better policies and institutions. It is also more effective when it is aligned with recipients’ priorities, when it reduces transaction costs through harmonized and coordinated donor processes, when it is predictable, and when there is a clear focus on results.”

Very few SSA countries are at once ‘needy and virtuous,’ i.e., combine high poverty and high effectiveness. To minimize the trade-offs between need and effectiveness, the aid literature seems to be converging on the idea of sequentially combining the fundamental principles of shared governance and selectivity in determining the form and the level of aid. In fact, a recent study (Levin, 2005) finds a noticeably increased selectivity. For multilateral donors, it estimates a policy selectivity index (which measures the elasticity of aid with respect to a country’s CPIA scores) of 2.7 and a poverty selectivity index (which measures the elasticity of aid with respect to recipients’ per capita income) of -0.87 .

We meld these lessons and the notion of poverty-efficient aid (Collier and Dollar, 2002) into a synthesis model of aid for SSA. The ideas behind this model are depicted in Fig. 3 and embellished in Table 2.

Under this scheme, governance is the primary criterion for eligibility for substantial aid. If democratization, by triggering changes in domestic political alliances of interest groups, facilitates judicious liberalization, it should also lead to improved utilization of aid. Therefore, need and effectiveness jointly determines the absorptive capacity of eligible recipients. The trajectory of institutional and policy change for poverty- and policy-efficient aid can be usefully divided into four sequential stages.

The first segment covers the pre-reform stage where domestic capability is low and the State itself may be failing. Typically, the ruling elite lacks the political will to undertake basic economic reforms even though reform champions may be struggling to gain the upper hand. At this stage, the level of aid would be low (say, less than 5% of GNP), and comes primarily in the form of grants and technical assistance or policy advice (Devarajan et al., 2001). Eligibility for sizeable aid depends on a passing grade on domestic governance rating. The caveat here is that hard-headed selectivity would likely have the unintended consequence of punishing the poor in so-called ‘aid orphans.’ Examples of countries in this group are Nigeria, DR Congo, and Zimbabwe.

The second stage involves policy reforms that entail decontrol of prices, realignment of exchange rates, and reduction of tariffs and quotas. Reforms that favor markets and openness need to be underwritten with a high level of aid inflows aimed at financing post-conflict rehabilitation, macroeconomic stabilization, and expansion of key infrastructural services. The

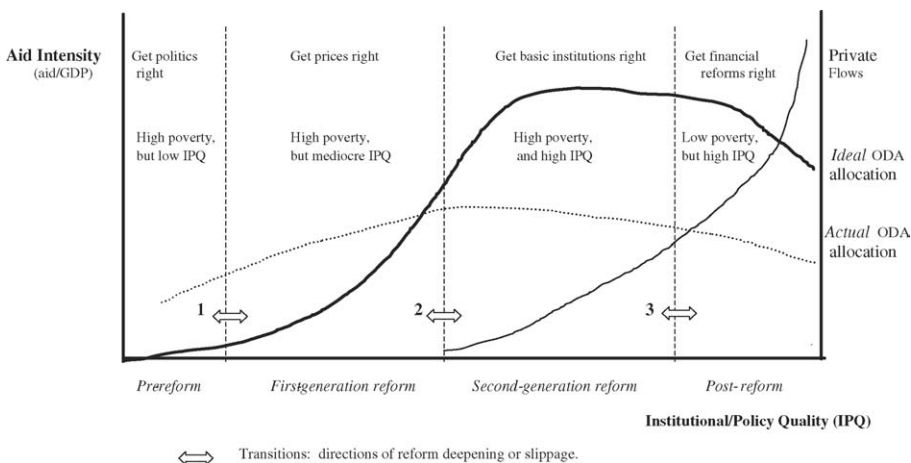


Fig. 3. A dynamic S-model of aid allocation.

Table 2

Indicators of aid dependency and aid effectiveness for a sample of SSA countries

Country or region	Population, 2001 (billion)	Net ODA, 1960–2001 (billion US\$)	Net ODA, per capita 1960–2001 (US\$)	LT Debt, per capita 2001 (US\$)	ODA/GNI, 1971–2001 (%)	ODA/G, 1971–2001 (%)	GNI Per capita, 2001(PPP US\$)	Capital flight, 1970–96 (billion US\$)	GDP growth, 1971–2001 (%)	CPIA Quintile ^a
World	6.13	2003	400 ^b	–	–	–	7468	–	–	
SSA	0.67	473	406	–	4	–	1684	274.0 ^c	2.5	
Pre-reform										
DR Congo	52	22.4	478	218	4	281	629	19.2	–1.4	4
Nigeria	130	9.5	73	240	1	2	871	13.0	3.0	5
Zimbabwe	13	8.5	661	295	3	13	2322	10.9	2.8	5
Post-socialist										
Ethiopia	66	22.7	345	87	11	32	701	8.0	3.1	3
Mali	11	13.4	1211	261	17	80	824	6.2	3.0	2
Mozambique	18	19.1	1058	247	31	31	–	–1.5	3.6	2
Tanzania	34	31.7	919	194	19	35	532	6.9	3.5	1
Market: FGR										
Cote d'Ivoire	16	15.9	970	706	5	21	1557	34.7	2.9	4
Kenya	31	23.5	765	190	7	28	996	2.5	4.5	3
Senegal	10	18.8	1923	354	11	45	1528	–10.0	2.9	2
Zambia	10	17.5	1698	551	15	24	790	13.1	1.2	3
Market: SGR										
Ghana	20	16.2	820	343	7	32	1985	0.3	2.4	1
Uganda	23	14.1	617	164	12	32	1291	3.3	5.2	1
Post-reform										
Botswana	1.7	4.8	2838	218	7	27	7954	–	10.3	–
Mauritius	1.2	2.1	1707	1437	2	11	10090	0.5	5.6	–

Sources and notes: World Bank (2004), OECD (2004), Boyce and Ndikumana (2002). (–) Data not available; G, government spending; FGR, first-generation reform; GNI, gross national income; SGR, second-generation reform; PPP, purchasing power parity; ODA, official development assistance.

^a CPIA: 1 = top 20% and 5 = bottom 20%.

^b Stock: for all developing countries.

^c Stock: for 30 SSA countries, excluding S. Africa.

expectation is that aid will have high and positive marginal returns. An endorsement from donors would also provide a strong signal to private investors to bet on the future, and thereby stem reform backsliding. Well-crafted conditionalities, preferably output-oriented, may help to ensure that aid money and the country's own resources are both devoted to high priority areas. Countries in this category include Cote d'Ivoire, Ethiopia, Kenya, Tanzania, and Zambia.

The third stage involves second-generation, mainly institutional reforms focused on the key economic institutions that constitute the architecture of a well-governed economy. Aid intensity will have to be maintained or even increased at this stage (say, up to one-third of GNP) if only because need and effectiveness are both high.

Pushing the envelope too far, however, has many risks. For example, in order to achieve the MDGs, annual aid flows are expected to quadruple for Ethiopia, which translates into annual aid flows of US\$ 70 per person or US\$ 5 billion in each of the next 10 years (UNMP, 2005). However, the implications of a massive infusion of aid for absorptive capacity and for the behavior of the state elite are not entirely clear.

Furthermore, at this stage, aid comes with few policy strings and increasingly assumes the form of budgetary grants. At this stage, countries begin to be creditworthy enough to attract hard loans from the development banks and the private capital markets. Countries in this category include Ghana, Mozambique, and Uganda.

The final stage is post-reform consolidation where the country has made an irreversible commitment to sound institutions and policies. Aid tapers off progressively at this stage, because diminishing marginal returns set in and private sources of investment become the dominant form of development finance. The aid takes the form of block grants. Countries that fall in this category include Botswana, Mauritius, and Tunisia.

This approach to aid allocation has several attractive features. Ex post governance conditionality is used for determining the eligibility of pre-reform countries for non-emergency aid—a strategy currently adopted by the Dutch bilateral aid program. For countries in the early stages of reform, poverty level and policy quality drive the flow of aid. For countries committed to the implementation of deeper institutional reform, effectiveness drives the volume and type of aid. Finally, there is a point at which a country is said to have graduated from international aid (as in the cases of South Korea and Botswana).

The stylized model admits dynamic considerations, too, because the aid program has to be fine-tuned periodically to preempt stalling, backsliding, or significant reversal of necessary reforms. The timing of the turning points, and the exact level and mix of aid will also have to be determined by concrete analyses of country circumstances.

As the data in Table 3 clearly suggest, there is a gap between model and muddle in SSA. First, the prescriptions of the S-model are honored only at both ends of the spectrum. Pre-reform countries (DR Congo and Nigeria) have among the lowest aid intensity, policy quality, and poor growth performance. Post-reform countries (Botswana and Mauritius) also have low aid intensity, high policy quality, and good economic performance. Second, the S-model is clearly not consistently observed in the intermediate stages of reform. Countries in the first-generation stage (such as Mozambique and Tanzania) receive more aid than countries in the second-generation stage (such as Ghana and Uganda).

An improvement in the design of multilateral aid, along the lines suggested above, would go a long way toward minimizing incentive incompatibility. There are signs that Africans are heeding the perennial call, made most recently by the Commission for Africa (2005), to improve governance. The establishment in 2001 of an arm of the African Union, the New Economic Partnership for African Development (NEPAD), indicates that elected African leaders have

Table 3
Illustrative application of the S-model of aid to SSA countries^a

Phases of reform	Major issues	Donor action or recipient response
Pre-reform	Form of aid	Binding knowledge gap: technical and advice
	Monetary aid	Low: need is high but effectiveness low
	Conditions on aid	State failure: governance conditionality
	Political strategy	Actively support reformers and visionary leadership
	Transition dynamics	Bounce back effect from post-conflict recovery
	Example countries	Nigeria, DR Congo, Zimbabwe
Policy reform [FGR] ^b	Form of aid	Infrastructural, social, stabilization, rehabilitation
	Monetary aid	High: need is high and effectiveness is rising
	Conditions on aid	Trust but verify: preempt treadmills or reversals
	Political strategy	Coherent economic team with strong popular base
	Transition dynamics	Aid infusion effect on public investment
	Example countries	Cote d'Ivoire, Ethiopia, Zambia, Kenya, Tanzania
Institutional reform [SGR] ^c	Form of aid	Sectoral, program and budgetary; TA on demand
	Monetary aid	Very high: less need but high effectiveness
	Conditions on aid	Performance-driven: capacity and trust are high
	Political strategy	Ownership stems backsliding; sensitivity to losers
	Transition dynamics	Aid plus private investment effect
	Example countries	Uganda, Ghana, Mozambique
Post-reform	Form of aid	Block grant: facilitates rising private investment
	Monetary aid	Low: diminishing returns and private markets
	Conditions on aid	Very few, if any: policy sovereignty reigns
	Political strategy	Accountable Party and corporate governance
	Example countries	Botswana, Mauritius, Tunisia

^a See also Fig. 3.

^b First-generation reforms.

^c Second-generation reforms.

finally recognized the need to create a pan-African institution that is self-consciously democratic in its aspirations (Kanbur, 2004; Tieku, 2004).

NEPAD's lofty principles include good governance, African ownership of policy, and genuine partnership with the rich countries in the areas of aid and trade, and regional integration. Its priorities are peace and stability, democracy, regional integration, and domestic capacity especially in the areas of agricultural development, human capital, and economic diversification. NEPAD's more notable reorientation of development priorities include increasing the share of spending on agriculture to at least 10% of the development budget, and reducing unproductive military expenditures. Through its African Peer Review Mechanism (APRM), it has started to rate the performance of participating governments on the above criteria (Kanbur, 2004). However, NEPAD has yet to incorporate meaningfully the voices of the private sector and non-governmental organizations.

4. Conclusions

This paper critically examines the current system of multilateral development aid and scrutinizes three alternative models of reform regarding their application to Africa. It argues that, given the coexistence of mutually reinforcing market failure and government failure in SSA, a well-designed aid program can serve as a catalyst for putting the continent on the ladder of self-

sustained development. That institutional failure, whatever its origins, is the main culprit for Africa's problems is amply demonstrated by the fact that both African skills and money thrive in the more hospitable environments of Europe and North America. Several implications follow from this diagnosis.

First, as underscored recently by the reports of the Commission for Africa and the U.N. Millennium Project, development-focused aid has to be scaled up to the threshold that would enable SSA to escape the poverty trap. Aid must also be coordinated and harmonized with each country's development agenda. Where this agenda is not credible, as is often the case, it will have to be developed jointly with donor institutions until a capable and legitimate government emerges to claim full ownership. Second, aid has to be crafted with a built-in incentive for African governments to mobilize non-aid resources for productive investment and to commit to an accountable budgetary process. That is, official aid must aim to leverage domestic as well as foreign private resources to lay down the groundwork for a robust African agricultural and industrial development. Third, and most importantly, the obstacle faced by the first two points is the misgovernance of most SSA countries. Since weak domestic governance itself is an inherent feature of poverty, developmentalist donors must design sensible external interventions to balance enforcement of international development norms and standards with protection of the precarious sovereignty of many SSA countries.

In the final analysis, development and good governance are the fruits of protracted struggles by the Africans themselves. In this regard, the tentative steps underway toward democratization and self-monitoring by African institutions are hopeful signs. This task would be much easier if donors and recipients build a strong partnership-in-development in which they cooperate to serve their respective principals. If so, the campaign to make mass poverty history will no longer seem so fanciful.

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