The Future of Aid 2

The Big Push

Imagine that you are in 2030, reviewing the aid industry over the past 25 years. This Note offers one possible scenario—responses of the aid industry to falling numbers of people in absolute poverty and to the growing ability of poor countries to borrow from the market. A companion Note offers a second scenario. Organizations use scenario planning to prepare for the very long term. Good scenarios are plausible stories about the future, recognizable in the trends of today. The ideal scenario encourages thinking about possible responses. It is in this spirit that this scenario is offered.

Trends to 2005

It was clear by 2005 that three trends were shaping the aid industry. First, incomes had been rising rapidly in many developing countries over the past few decades, especially in East Asia and India. Fewer countries were very poor.

Second, more developing countries were able to borrow from banks or bond markets at attractive terms. And much of the money flowing to developing countries was no longer government debt but private borrowing, equity and foreign direct investment, and even remittances from migrant workers.

Third, new players—official agencies and unofficial ones, usually called nongovernmental organizations (NGOs)—had been entering the market for aid, a market that had seen a century of entry by aid agencies and no exit. The new entrants were not only of the traditional type—from new donors such as China, Slovenia, and Thailand—but also of entirely new types—agencies with different approaches to raising or disbursing funds. These new types included the Millennium Challenge Corporation, distributing most of its grants to countries meeting objective standards, and the Global Fund to Fight AIDS, Tuberculosis, and Malaria, focusing on a tight group of cross-border problems. In response to these three trends, the aid industry emphasized “harmonization,” the buzzword for trying to coordinate the efforts of different aid agencies.

Reinventing the industry

Looking back from 2030, it is clear that these three trends would force the traditional model of foreign aid to change. The aid industry was steadily transformed from one dominated by a
few large agencies to one that was far more competitive and far more subject to competition from such substitutes as bonds, loans from private banks, and private giving.

Traditional development needs also were changing. Good-value loans to governments were not in short supply: as spreads narrowed and credit ratings improved, most developing countries became able to borrow commercially at attractive terms (see Martin, Harford, and Klein forthcoming).

As a result of these changes, more and more aid agencies were supplying fewer and smaller poor countries. To some extent the industry was becoming a victim of its own success: the share of the developing world’s population living in extreme poverty had declined by nearly half in just two decades. The population and economic weight of very poor countries had also fallen: with China, India, and Indonesia too well-off to receive subsidies from the International Development Association (IDA), IDA recipients generated less than 1 percent of world GDP in 2030, down from 5 percent in 1970 (figure 1).

In retrospect, the trajectory of the aid industry was already clear by 2005: it was going to be large grants, ever-more-sophisticated technical advice, and harmonization. The grants were preceded by louder and louder calls for a “big push”—for example, in the U.K. government’s proposal for an international financing facility and in the much-cited report of the UN Millennium Project (2005). With richer donors and fewer badly struggling countries, the logic was that grants, if aimed well, could buy development. The technical advice was a much quieter success story. The 1970s and 1980s had seen widespread fiscal instability and inflation; by 2005 these blights had been met head-on and subdued by many developing countries. Few people noticed, because as one problem was solved the discussion would move on to the next, such as providing infrastructure or cutting red tape. Finally, harmonization had become an obsession of an increasingly competitive industry by 2005.

2010–20: drowning in the “common pool”

By 2010 the aid industry was attempting to kill two birds with one stone: by delivering large grants through a “common pool” mechanism, the Multilateral Fund for Development, it aimed to scale up the amount of aid delivered while also reducing the costs of a fragmented industry.

The rules of the fund, agreed to by donors in 2009, were designed to maximize grants to directly support recipient government budgets—and also to make negotiations with multiple donors much more efficient. Each developing country presented a development strategy to donors, which could then decide to support the strategy, or not, with grants made through the fund. The fund rules prohibited earmarking and specific conditionality: each donor simply had to decide whether or not to support the development strategy of each recipient. Donors unhappy with how the money was spent simply gave less next year. Few donors sent every penny of aid through the fund, but many sent substantial proportions.

The common pool approach embodied high hopes (Kanbur and Sandler 1999), but difficulties quickly became apparent. The strategy was rooted in the conventional wisdom of the early 21st century: find a developing country with good policies and institutions, send aid, and stand back. It worked well for middle-income countries with mature institutions. But many other countries struggled to use the aid effectively. The trouble was that policies and institutions are changed by large flows of aid—which is exactly what washed over the handful of the poorest countries that met the standards set by donors. For such countries the aid flows had effects similar to those of the well-known “resource curse”: manufacturing and agriculture were squeezed by appreciating exchange rates.
More important, democratic institutions were compromised in the rush for control of the new money (see Djankov, Montalvo, and Reynal-Querol 2004; and Knack 2000). Practitioners became disillusioned with the Multilateral Fund for Development, and some began to comment blackly that promising reformers had been drowned in the common pool.

2020–30: discovering discipline

While the pool system did not deliver what had been hoped for, it represented an important step toward the aid system we enjoy today in 2030. Technical assistance was a case in point: by forbidding grants for specified projects, the pool system prevented the old practice of providing money bundled with technical assistance. But that weakness became a strength: by providing cash rather than technical assistance, the pool system left recipients free to buy their own assistance on the open market rather than accepting whatever ad hoc program was bolted onto a loan. A more professional and competitive market for technical assistance emerged as a result.

The pool system’s shortcomings also made it clear what had been missing: trying to minimize the costs of chaotic competition was all very well, but what about trying to maximize the benefits? What was needed was a set of systems to impose discipline on donors, service providers, and recipients alike, making them accountable to one another.

The first step toward such discipline was a shift away from the pool as slush fund: rather than cash, recipients received “service credits” that they used to buy services from official aid agencies and accredited commercial service providers (figure 2). This service credit scheme helped to raise the game of aid agencies and encourage entry by infrastructure providers, consultants, and many others. At the same time it supplied aid in a form that was harder for recipient countries to spend unwisely or corruptly, because service credits were redeemable only with recognized agencies and firms. The scheme, which had seemed implausible when proposed nearly 20 years earlier (Easterly 2002), was much easier to implement with the pool in place.

Most important, the service credit scheme cried out for better monitoring and evaluation—a demand that could no longer be ignored. Commercial providers needed to be accredited; aid agencies that delivered services needed to be rated so that credit holders could direct their credits to the most effective; recipients needed to be monitored to assure donors that they were deserving of service credits in the first place. Some donors, skeptical of the credit scheme, used intensive evaluation to justify alternative approaches. A virtuous spiral quickly developed: the service credit scheme strengthened demands for better evaluation, while better evaluation bolstered the case for the service credit scheme (figure 3).

Once the service credit scheme was established, donors were able to experiment with new ideas, giving credits directly to municipalities or even small communities, secure in the knowledge that the system was more and more resistant to waste and abuse. Other donors, armed with the ratings of agencies, felt happy to fund those with a proven track record. But agencies with poor ratings lost funding and struggled to survive.

Some aid agencies specialized in service delivery, competing with NGOs and private firms. Others became fund managers on behalf of donors; the best found that they were also able to act on behalf of foundations and charities.

An important side effect was the marginalization of political aid. Clearly outside the loop of service credits, monitoring, and evaluation, aid that was driven by realpolitik became easy to distinguish from aid that was benevolent. (In an early initiative to isolate aid funds from political considerations, the United States set up the Millennium Challenge Corporation in 2002. Its funds were supp...
posed to be disbursed according to objective criteria, and it was scrutinized to see whether it lived up to this promise.) Political aid did not stop, but it shrank—and benevolent aid burgeoned as public suspicion of foreign aid ebbed in rich countries.

Struggling with the big issues in 2030

All this is not to say that the aid industry of 2030 functions perfectly. While many problems have been solved or are being convincingly addressed, others seem intractable, even given the achievements of today’s aid system.

The problems are twofold. The first is to address global dangers such as contagious diseases or global warming. The technical work of designing solutions is not hard. What gets in the way is politics. As the world gets richer, countries have the luxury of taking an obstructive stance on one project or another. In 2005 religious and cultural disputes were already undermining global cooperation on HIV/AIDS, though few people foresaw that the disputes would worsen rather than ease. Policy on climate change was even more theological. That such value differences continue to be as important as ever is hardly a surprise.

The second problem is to deal with failed states. Although they have been a hot topic for more than three decades, the international community has yet to formulate an effective response. In many failed states entrepreneurs are scraping out a living by tapping into the laws and institutions of the outside world. But failed states simply do not fit the strictures of the common pool. In the past few years we have seen promising experiments using private firms and NGOs to deliver services while bypassing governments. The hope is that these new approaches will help countries reach a point where the official aid system can help them. But this is speculative. Looking forward to 2050, we can only conclude that if the last of the truly poor are to be helped, the aid industry will have to go through yet another revolution.

Note

1. An early example was the peer review process launched in the Consultative Group to Assist the Poor (CGAP), where donors reviewed and rated one another (http://www.cgap.org/projects/donor_peer_reviews.html).

References


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