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Orestis Vathis

Aid Effectiveness: A Literature Review

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Orestis Vathis is a PhD candidate in the Department of Political Science and International Relations at the University of the Peloponnese. He holds an MSc in Finance & Investment from Middlesex University (UK) and an MSc in Economics & Geography from Utrecht University (Netherlands). His research interests include aid effectiveness, civil society organizations, international relations and foreign policy. He has worked as volunteer in developmental NGOs and has participated in projects in Ghana, Nicaragua and Uganda.

Aid Effectiveness: A Literature Review

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Executive Summary

Development assistance is a process that began more than fifty years ago in order to stimulate economic growth in the developing world. While there is no question that over the years aid had some spectacular successes to demonstrate, such as the eradication of diseases and the increase of life expectancy in the developing world, on the other hand despite the billions of dollars spent every year on development activities, today almost three billion people live with less than $2.50 per day. Scholars have been trying for years to examine whether a link between aid and growth can be established, but despite the significant volume of work and the new econometric techniques, no consensus has been reached. In this context, proponents of aid argue in favor of an increase of aid disbursements to poor countries so as to support plans at global level - such as the Millennium Development Goals - while critics underline the negative aspects of aid and ask for major reforms. The aim of this paper is to review the aid effectiveness literature and present the different methodologies used in its analysis, investigating various factors that hinder aid effectiveness. Moreover, the role of different and diverse actors - political, institutional, financial - that have an impact on aid activities is analyzed.

Introduction

During the last decades there is a great controversy among various actors involved in the aid sector over whether aid given to developing countries is effective. Supporters of aid argue for an increase of grants and soft loans to poor countries, while critics underline the negative aspects of aid and ask for major reforms. Two popular supporters of these distinct views are Professor Jeffrey Sachs and ex-research economist in the World Bank, William Easterly. Professor Sachs (2005) a great defender of the aid process, in his book *The End of Poverty* argues that many poor countries are caught in a *poverty trap* and claims that rich countries should increase aid flows and work closely with aid recipients so as to achieve the Millennium Development Goals until 2015 and eradicate extreme poverty by 2025. On the other hand, Easterly (2006) in *The White Man's Burden* follows a completely opposite approach, sharply criticizing *the aid industry* and rejecting the concept of central planning.

This paper offers a review of the aid effectiveness literature. However, before proceeding to the analysis, the term *effectiveness* should be clarified. We adopt the concept of effectiveness as given by Cassen *et al.* (1994) concentrating on *developmental effectiveness* and mainly focusing on the impact of aid on the reduction of poverty, not taking into consideration "other motives that donors or recipients may have" (1994: 6). Such motives could include commercial interests, prospects of political gains or foreign policy agendas.

The aid effectiveness analysis is being performed through evaluation studies; this kind of evaluation is of utmost importance as answers can be given to vital issues such as whether aid has any positive or negative results, what changes should be made in policies or which way is the most efficient in delivering aid. The concept of effectiveness and evaluation becomes even more significant if we take into consideration some facts: as J. Brian Atwood (2012), Chair of OECD Development Assistance Committee, mentioned in a speech in 2012, over the last 50 years about $3.5 trillion was given to poor countries as development assistance. On the other hand, 12.5 percent of the world population - about 850 million people - is undernourished (FAO, 2012), 1.2 billion people live in extreme poverty accounting for only 1 percent of total consumption at the global level (UN, 2013) and 19,000 children under the age of five die each day from diseases that could be treated (UNICEF, 2012). But still humanity follows the same path: new plans at the global level, such as the Millennium Development Goals have been announced in order to fight poverty and hundreds of billions are spent in this quest.

1. Aid & Results

Historically, aid has gone through various stages. The same applies to the work of researchers that tried to evaluate the effectiveness of aid. However, the study of aid effectiveness is bound, among others, by the underlying theory, the objectives, the development models and the data and equipment that are available at every historical moment (Thorbecke, 2000). Still, there is no doubt that even with advanced methods, it is rather difficult to analyze the complicated process of growth and development.

In the following section, a brief review of aid literature will be presented. It should be noted that the issue of aid effectiveness is a rather complicated research question that has been analyzed in various ways. In this review, we follow the approach of Hansen and Tarp (2000) who identify three generations of aid evaluation studies: the first refers to the 1960s and early 1970s, when research was based on the assumption that there was a strong causality between savings, investment and growth. In the second generation researchers draw their attention to the investigation of the direct relation between aid and growth while in the third generation, researchers follow an innovative approach including new data and methodologies, taking into consideration factors such as institutions and policies. Despite the unique characteristics of each generation, an absolute classification of these studies is not always possible and, as it will be evident in the next section, studies from different generations might share common methodologies, research questions and data.

1.1 First and second generation aid effectiveness studies

Back in the 1960s, the main concept for explaining poor economic results was based on the lack of savings, a factor that was leading to the stagnation of the economies of less developed countries, since these were not favorite destinations for private foreign capital (Hjertholm *et al.*, 2000). The underlying theoretical background for this concept was based on the Harrod and Domar models which relate savings with investment and consequently growth (Cypher and Dietz, 1997). Less developed countries lacked the necessary capital to retain the required investment rate so as to achieve the planned growth rate and aid was assumed that can fill this savings-investments gap (Easterly, 1997). Back then it was mistakenly assumed that aid flows increased the capital stock of less developed countries in a one-to-one relation, without any part of it being directed to consumption (Hansen and Tarp, 2000). Apart from the savings gap, a second growth constraint was introduced, the trade gap (Chenery and Strout, 1966) which was based on the assumption that since not all the needed capital goods could be produced locally, imports were necessary; however, exports are not usually at the necessary level in order to supply the required foreign exchange and the latter could become a constraint on growth (Bruton, 1968).

While aid was initially considered to play a favorable role for growth, it was soon argued that aid flows might have an adverse result and harm the economies of poor countries. Friedman (1958) and Bauer (1972) were among the earliest scholars to underline the negative effects of aid on development. Focusing on the components of the development theory of the 1960s, historically the first one who reported that foreign capital inflows might displace domestic savings was Haavelmo (1963, cited in Morisset, 1989: 1710). Griffin and Enos (1970, cited in Ouattara, 2008: 672-673) argued that there are three possible ways through which aid flows could reduce domestic savings: first, local governments might change their policy over public expenditure or taxation; secondly, easier access to credit for entrepreneurs might hurt their motive to save and third, aid flows might increase consumption. Weisskopf (1972) also underlined the last two possible causes. Over the years, these issues have been under extended scrutiny by various researchers, though results -some of which are presented below- are ambiguous. Hansen and Tarp (2000) in their survey of first generation evaluation studies find that almost two thirds of those that support the negative effect of aid on savings suffer from methodology flaws. The two authors argue that aid is not negatively related to growth. Earlier, Papanek (1973) and Mosley (1980) had found negative effects of aid on domestic savings, a finding confirmed by Taslim and Weliwita (2000), examining the case of Bangladesh. Similarly, Snyder (2000), Morisset (1989), Ouattara (2008), Gyimah-Brempong (1992) and Shields (2007) tried to shed light on this issue but no consensus has emerged. Following the concept of savings-investment gap and that of trade gap, researchers have gone one step further, arguing that there is another factor interconnected with aid and growth: the fiscal gap (Bacha, 1990; Taylor, 1994). This gap refers to the difference between public income and expenditures (Iqbal, 1997). Governments of poor countries cannot maintain a constant rate of public expenditures and aid inflows are supposed to fill this gap.

As stated earlier, the second generation of studies focuses on the direct relation between aid and growth. The first two generations do have common characteristics, such as the underlying growth models and the contribution of capital accumulation. These studies either focus on investment as a factor that leads to growth or other analysis models are used (Hansen and Tarp, 2000). As in the first generation studies, no consensus exists among researchers. Hansen and Tarp (2000) review various studies and conclude that aid improves investment; while only half of the studies find that aid contributes in the growth process, some authors argue that a large number of these studies suffer from analytical weaknesses. Other researchers such as Mbaku (1993, 1994), Vasudeva *et al.* (1994), Khan and Hoshino (1992) and Mosley *et al.* (1992) find contradictory results.

1.2 Third Generation

Hansen and Tarp (2000) describe the four areas where the third generation studies innovate: in the data set used for analysis, in the analytical toolkit so as to include factors such as economic policy and institutions in relation to the new growth theory, in the way the endogeneity of aid is analyzed and last in the non-linearity of the aid-growth relationship. This new generation starts with the work of Boone (1994, 1996) who focuses on the relation between politics and aid effectiveness and argues that aid does not contribute to growth; rather, he concludes, it increases the size of government and consumption – but not consumption of poor people. Soon after, Burnside and Dollar (1997) contributed significantly in the aid effectiveness literature underlining that aid indeed affects growth positively if implemented in a good policy environment, especially concerning fiscal, monetary and trade policies; however, even in this case, aid has diminishing returns. Thus, they conclude that for an efficient use of aid, flows should be directed to poor countries that follow *good* *policies*. A well-known example of the good policy concept is the implementation of the Marshall Plan in Europe after the Second World War; the institutional quality and the administrative and judicial structures of European countries were among the vital components for the success of the intervention (Degnbol-Martinussen and Engberg-Pedersen, 2003). Its effectiveness highlighted the link between growth and the political environment (Agnew and Entrikin, 2004).

Results from the Burnside and Dollar study had a considerable effect: the 1998 World Bank report *Assessing Aid* was based on their work and various institutions, such as the British Department for International Development or the Canadian International Development Agency followed their recommendations. Also this study has attracted a lot of academic attention and various scholars have contributed to the discussion that followed. In this context, similar findings have also been confirmed by Isham and Kaufmann (2000) and Durbarry *et al.* (1998). Furthermore, Collier and Dollar (2002) argue that aid is not distributed in an efficient way, assuming that poverty reduction is the ultimate target, and propose that aid should be allocated after taking into consideration the good policies that poor candidate recipient countries follow. Following that, McGillivray (2003) argues that the Collier-Dollar concept of good policies should be expanded so as to increase effectiveness. Ruhashyankiko (2005) underlines the positive role of government quality and size and finds a positive relation between aid and growth – without diminishing returns; moreover, the author argues in favor of private and commercial participation and proposes that aid should be given to countries that are not aid dependent as they can use aid in a more effective way.

On the other hand, the BD study has triggered a series of articles that are critical on the main conclusion about the good policy environment. Its methodology was one of the first points of criticism. Easterly (2003) argues that even by changing the definition of variables used as *aid* or *good policy*, results change and important variables become insignificant. Easterly *et al.* (2000) re-analyzed the BD study and found that there is no significant effect of aid in a good policy environment. Similar results have been found by other researchers such as Hansen and Tarp (2001), Burke and Ahmadi-Esfahani (2006), Karras (2006), Gomanee *et al.* (2005), Burhop (2005) and Guillaumont and Chauvet (2001).

While there is a controversy whether aid effectiveness is related to the policy environment, another relevant issue that has drawn the interest of researchers is the behavior of governments in aid recipient countries. What makes this important is the fact that aid flows are given mainly to the public sector, thus it is vital to examine how local governments act after the receipt of aid (McGillivray, 1994) since this can be decisive (Feeny, 2007) as policy makers in aid recipient countries can choose to allocate public resources between consumption and investment and for financing such activities, between taxes and borrowing (Gand and Khan, 1991) affecting considerably the growth process. In many cases, aid inflows lead to increased government spending, a phenomenon that has been described as the *flypaper* effect, meaning that revenues coming from grants induce public expenditures, while revenues coming from taxes are associated with less public expenditures (Devarajan and Swaroop, 1998). Remmer (2004) finds that aid increases the size of the government and government spending and reduces tax revenues, a result that is in contrast with market-oriented plans that many donors try to implement for the development of poor countries. The author concludes that aid might induce corruption, since it weakens incentives of politicians to follow good policies. On the other hand, Schwalbenberg (1998) argues that foreign aid does not induce corruption or the adoption of bad economic policies in recipient countries, while McGillivray and Ouattara (2005: 265) find that aid reduces governments' "revealed taxation effort". The negative impact on tax revenues can foster aid dependence as expenditures are found to increase, while borrowing decreases (Feeny, 2007). This is also a result by Franco-Rodriguez *et al.* (1998) who, studying the case of Pakistan, found that about 50 percent of aid was used for government consumption. Decline of tax revenues is found to be bigger in aid recipient countries with high corruption levels (Gupta *et al.,* 2003). In other cases, aid recipient governments may hinder efforts to reduce poverty in anticipation of more aid (Pedersen, 2001). When aid is given to corrupt governments and kleptocratic elites, "corruption-poverty spirals" are being created, hindering economic growth (Kasper, 2006: 10). High aid levels may reduce institutional quality and administrative capacity and induce rent seeking behavior in recipient countries, creating a "Zairean disease" (Knack, 2000: 2). As recipient countries become more aid dependent, infighting among powerful elites over increasing aid resources is intensified and corruption levels are augmented (Alesina and Weber, 2002). Brautigam and Knack (2004) present an excellent brief review of the literature on the aid - governance relation and present empirical results showing that in Sub-Saharan African countries, higher levels of aid are correlated with deteriorating levels of governance. Moreover, in the developing world corruption is a major factor that hinders economic development. Political power - and aid in most cases - has been abused by corrupt leaders and dictators for decades. Mohammed Suharto in Indonesia, Ferdinand Marcos in the Philippines and Mobutu Sese Seko in Zaire looted up to $50bn from their countries (Charlote, 2004). Mobutu, during his 32-year rule, was renting hypersonic Concorde planes so his family members could travel to Disneyland, while millions of people in Zaire were living in extreme poverty (Wrong, 2001). In a research that focused on thirty aid recipient countries in Africa examining capital flight, it is found that for every dollar of loan inflows to African countries, up to 80 cents are returning back during the same year and a high proportion of this capital flight is "debt fueled" (Ndikumana and Boyce, 2011: 9). The issues of policy, good governance and corruption are of utmost importance for aid effectiveness. As it is highlighted in a 1989 World Bank report, "underlying the litany of Africa's development problems is a crisis of governance" (World Bank, 1989 cited in Brautigam and Knack, 2004: 255). However, not all donors focus on corruption; rather, at the bilateral level, the more corrupt a state donor is, the more aid it allocates towards corrupt recipients, a fact that can be attributed to securing strategic interests, rather than fostering economic growth in recipient countries (Schudel, 2008).

Contributing to the discussion about the aid effectiveness, various researchers focus on the issue using different approaches: Doucouliagos and Paldam (2006, 2007, 2008), using meta-regression analysis, show that aid has a positive but insignificant effect on growth. Similarly, Herbertsson and Paldam (2005) reviewing related literature, argue that aid does not help poor countries in the long-run, while Addison *et al.* (2005) find in their literature review that studies published in the last few years support a positive link between aid and growth, concluding that poverty in developing countries would have increased if it was not for the aid flows. Based on that, they argue that the declines in aid flows in the early 1990s had a considerable negative impact on growth in Sub-Saharan Africa, a finding also supported by McGillivray (2005). Asteriou (2008), Economides *et al.* (2003), Mallik (2008), Moreira (2005) and Arellano *et al.* (2005) also perform empirical research getting contradictory results. While scholars analyze whether aid has a positive or a negative impact, Durbarry *et al.* (1998) argue that there is an optimal level of aid; whereas small aid allocations may have no considerable effect on growth, too much aid might a have negative effect, a finding also confirmed by Lensink and White (2001: 52), who argue that "there is a limit to how much aid a country can absorb".

1.3 The 'micro-macro paradox'

The term *micro-macro paradox* has been introduced by Mosley (1986) and it refers to one of the most controversial issues of aid: while no significant relation - positive or negative - can be established between aid inflows and growth of GNP for aid recipient countries, in project evaluations, a positive rate of return is found for the majority of them. Cassen *et al.* (1994) find - citing World Bank Annual Reports - that on average, about 70 percent of all projects are evaluated as satisfactory or highly satisfactory. Newer data from World Bank Annual Reports (World Bank, 2008) show that the percentage of satisfactory outcomes was 76 percent in 2007, 83 percent in 2006, 81 percent in 2005 and 77 percent in 2004. Mosley (1987) indicates that the macro-micro paradox can be explained by the following three reasons: first, he raises the issue of *inaccurate measurement*; secondly, Mosley discusses *fungibility of aid* by local governments; and thirdly the *backwash effects* of aid - which refers to a hypothetical negative impact that aid may have on the private sector. Expanding these, White (1992) adds two possible causes: the first is a problem of scale analysis or over-aggregation – meaning that research should be more geographically focused. The second is an issue of data comparison between micro and macro studies: the former, use socio-economic data whereas the latter use financial data. Cassen *et al.* (1994) in their well-cited book *Does Aid Work?* are investigating, among others, the impact of project aid, sector, program lending, technical co-operation and food aid, thus focusing on the micro-level. Thus, regarding project aid, the authors find that on average this form of aid is effective, although some evaluation problems arise, such as the fact that many times evaluations are being performed by the agencies that have implemented the projects; or the factor of time - usually years after completion - that is needed until the full impact of a project can be measured. Concerning program lending, results raise doubts about its effectiveness, mainly because of co-ordination, financing level and policy issues. Food aid, an aid form that has failed repeatedly in the past - especially in war torn areas (Maren, 1997) - is being distinguished in two categories, program food aid and project food aid. Concerns about the former come from the negative impact that food aid may have on food prices, discouraging domestic agricultural production. On the other hand, Hansen and Tarp (2000: 123) conclude that "the micro-macro paradox is non-existent", a finding that is supported by McGillivray (2003: 1) who concludes that "the well-known macro-micro paradox of aid is dead and buried".

1.4 Aid Disaggregation & Evaluation

Studies that have been presented earlier mainly provide results of aid interventions at the aggregate level. However, this method might not reveal valuable information about the impact of different categories of aid. An alternative path is disaggregation, an approach that can be applied to unique sectors or focus on specific forms of aid - food aid, project or program aid. Such an example is technical assistance, a form of aid that, despite having received a lot of criticism (Easterly, 2007) - for example, Collier (2007: 115) argues that "technical assistance is supply-driven than demand-driven" - its results can be extremely cost-effective, achieving returns of up to 1000 times their cost (Jones, 2013). Evaluation of technical co-operation is a rather difficult task as its implementation covers a variety of fields; for example, from experts advising on the construction of small projects to building capacity at a higher level. Necessity for evaluation of technical assistance becomes evident as technical assistance constitutes about one third of total aid flows (Action Aid, 2011).

In a wider analytical context, various researchers use disaggregated data and analyze specific sectors. Clemens *et al.* (2004) disaggregate aid distinguishing humanitarian aid, aid flows that would have a long-term result and last, aid flows that are supposed to have an effect within a four-year period and focus mainly on this last category. They conclude that indeed short-impact[1] aid is positively related to growth with diminishing returns in almost all countries, but with a variance on the impact. Feeny (2005) analyzing the case of Papua New Guinea finds that while total aid does not seem to have any effect on the growth of Papua New Guinea, project aid had a significant positive effect. Similarly, Ouattara and Strobl (2004) focusing on project and program aid find that while project aid affects growth positively, program aid has a negative role. Other researchers such as Mavrotas (2002), Gounder (2001), Islam (1992) and Cordella and Dell'Ariccia (2003) also use disaggregate data and analyze specific sectors.

2. Fungibility, Dutch disease, aid volatility

While research on aid effectiveness mainly focuses on the analysis of the direct impact aid has on growth, there are also other research paths investigating various factors that indirectly influence aid effectiveness: first, the fungibility of aid, second, the so-called *Dutch Disease* and third, aid volatility.

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[1] Short-impact aid is defined as "an aid disbursement funding an intervention that can plausibly raise GDP per capital within roughly four years to a permanently higher level" (Clemens *et al.*, 2004: 12)

2.1 Fungibility

Fungibility incurs when aid inflows are directed to different uses than those initially planned by donors and recipient governments (McGillivray and Morrissey, 2000). In addition, fungibility can occur when aid recipient governments, because of aid inflows targeting a sector, divert their own funds that would have been invested in that specific sector to another (Cashel-Cordo and Craig, 1990). Research has shown that aid flows are highly fungible (Khilji and Zampelli, 1994) and that the level of fungibility can define the impact of aid on recipients' growth rate (Cashel-Cordo and Craig, 1990). Various methods are being used in order to estimate the structure of expenditures if there was no aid. Still there are considerable difficulties, such as the fluctuations in expenditures from year to year, the variability and availability of different donors in the same country without effective co-ordination and finally the fact that not all aid flows are allocated through government's budget (Feyzioglu *et al.*, 1998).

Petterson (2007) focusing on sector aid and studying 57 aid recipient countries, finds that this form of aid is fungible - 65 percent of aid flows have different uses than the ones planned for - but supports that fungible sectoral aid is not less effective than non-fungible aid. The issue of fungibility raises also problems in the measurement of aid effectiveness (Clemens *et al.*, 2004). For example, if a school that would have been built by domestic resources is funded by aid, then the economic rate of return for this project should also include an estimate for the other activities that were funded with the diverted funds. A crucial factor that can induce fungibility is when donors and recipients do have different approaches on how money should be allocated (Devarajan and Swaroop, 1998). Conditionality and close monitoring by donors of aid flows allocation are some methods that might restrict the different use of funds. In cases where aid flows are high and monitoring capabilities are increased, levels of fungibility should be negatively related to aid flows; however, fungibility should not always be considered as a negative aspect, as a trusted recipient government that follows good policies may be given the opportunity to make alterations in aid allocations (Petterson, 2007).

2.2 Aid volatility

The issue of uncertainty and volatility of aid inflows becomes important if we take into consideration the fact that foreign aid is the most important source of capital for poor countries, especially in Africa where it constitutes, on average, about 12.5 percent of Gross Domestic Product (Pallage and Robe, 2001). Developing countries are more sensitive to external shocks and have fewer instruments and resources to overcome them (Bulir and Hamann, 2001). Volatility and lack of predictability can negatively affect medium and long-term developing plans of aid recipients (Agenor and Aizenman, 2010). Aid volatility is found to be higher in difficult partnership countries[2] in comparison to low income countries - the former receive less aid

[2] The group of 'difficult partnership countries' is defined as consisting of very poor countries that have a low level of institutional quality and follow bad policies (Levin and Dollar, 2005)

comparing with countries that perform better (Levin and Dollar, 2005). Moreover, fiscal policies can also be affected in the aftermath of a reduction in aid flows. As a result, less developed countries may cut government spending and increase taxes (Gemmell and McGillivray, 1998) or interrupt investment programs (Mosley and Suleiman, 2007) hindering growth. In this context, Lensink and Morrissey (2000: 45), analyzing the issue of uncertainty of aid inflows, argue that "aid, controlling for uncertainty, has a robust effect on economic growth via the level of investment". While aid flows are found to be highly volatile (Eifert and Gelb, 2005) in comparison to fiscal revenues (Markandya *et al.*, 2010), there is a debate over whether aid is pro-cyclical - meaning that aid levels are positively correlated with fiscal revenues and growth - or counter-cyclical (Chauvet and Guillaumont, 2009; Collier, 1999; Bulir and Hamann, 2007). For a better analysis of the volatility issues, as in other cases of aid effectiveness research, Fielding and Mavrotas (2005) make a step forward by disaggregating aid flows in two categories, sector and program aid, arguing in favor of reducing aid volatility. Similarly, Hudson (2012) focuses on individual sectors, arguing that this level of analysis should be followed so as to reach robust results.

2.3 Dutch Disease

In the aid effectiveness literature, the analysis of macroeconomic effects of aid in recipient countries has a prominent role. Among these, the issue of real exchange rate (RER) appreciation - or the so called *Dutch Disease* - has been under scrutiny by various researchers. This effect has been named after the decline of the manufacturing sector of the Dutch economy faced due to the discovery of natural gas (Nkusu, 2004). This phenomenon is also known as the *resource curse* or as the *transfer problem* (Doucouliagos and Paldam, 2007) and it is related to a rapidly expanding sector that has a considerable contribution to the economy because it creates a sharp increase in foreign exchange earnings. The Dutch disease can be divided in two phases (Godfrey *et al.*, 2002: 357): first, the "resource movement effect" and secondly the "spending effect". During the first phase, the expanding sector –in this case the aid industry - increases demand for more productive factors, thus increasing wages and prices, making production of tradable goods less attractive. In the next phase, as a part of aid inflows is directed to non-tradable goods, demand and prices for these goods also increase. Thus, inflation could also be a side-effect of these windfall revenues. Since real exchange rate equals the price of non-tradable goods to that of tradable goods, it is concluded that when prices of non-tradable goods increase, the real exchange rate appreciates (Ouattara and Strobl, 2004). As a consequence, tradable goods from developing countries become less competitive in international markets. Moreover, since most of the times aid flows are distributed through governments, the private sector can be hurt through increased government spending and by monetary policies affecting domestic credit and investment (Younger, 1992). As in other cases of aid effectiveness literature, empirical results (Rajan and Subramanian, 2009; Prati and Tressel, 2006; Elbadawi, 1999; Van Wijnbergen, 1986; Ouattara and Strobl, 2004; Nwachukwu, 2008; Kang *et al.*, 2007; White and Wignaraja, 1992; Bandara, 1995; Nyoni, 1998; Ghura and Grennes, 1993; Younger, 1992; Sackey, 2001; Nkusu, 2004) on this issue are ambiguous.

3. Harmonization and ownership

During the 1980s conditionality was the donors' path for supporting mainly macroeconomic changes in recipient countries, using a carrot and stick approach (Gibson, 2005). But this created a problem of ownership as in many cases these interventions were not the result of aid recipient governments' will (Collier, 1997). In both the macro and micro level, lack of ownership and motivation to implement the intervention "with enthusiasm and determination" hindered results (Williamson, 1994 cited in Killick *et al.*, 1998: 566). In practice, conditionality did not bring the expected results: for example, a 2001 study that examined International Monetary Fund (IMF) programs implemented over a six-year period (1992-1998) found that almost half of them were not completed (Ivanova *et al.*, 2001). Similarly, Dollar and Svensson (1998) examining 220 World Bank's adjustment projects, found a 33 percent rate of failure. At the core of the problem is the unwillingness of political and powerful economic groups in fragile countries to support the building of state institutions and their lack of interest in enhancing a "constructive engagement with their own citizens" (OECD, 2010: 10). A significant factor for an effective intervention is whether powerful elites, government staff and opposition gain or not from implementation (Dijkstra, 2004). Internal political actors in aid recipient countries are far more important than external actors (Santiso, 2001). But responsibility lies also with donors: in the past, in cases of non-compliance with the defined aims, financing continued as it was in the interest of donors not to cease funding, which could mean that debt servicing could be interrupted (Kanbur, 2000). In 1978, the then representative of IMF in Zaire's Central Bank advised that because of corruption there was "no (repeat, no) prospect for Zaire's creditors to get their money back"; however, this warning did not stop the IMF from giving Zaire "the largest loan it had ever given an African nation" (Moyo, 2009b). Such incidents are clear evidence that it is questionable whether even major international organizations such as the World Bank and the IMF can act independently (Basu, 2003). Usually the decisions for allocation of aid resources are based on the interests of their stakeholders (Dreher, 2004; Dreher and Jensen, 2007). In this context, it could be argued that effectiveness of aid has not always been a priority: as it is reported in World Bank's Assessing *Aid*, which is based on evaluation reports of well-known institutions (such as the Inter-American Development Bank, the Asian Development Bank and the African Development Bank), "securing loan approvals was a more powerful motivator for staff than working to ensure project success or larger development goals. Institutional factors critical for sustainable development impact had been neglected" (World Bank, 1998: 118).

Moreover, lack of ownership has another side effect: as recipient countries do not want to turn down opportunities for funding, they accept initiatives that donors want to set up, a fact that creates excessive burden for the state mechanisms, drawing attention and capacities from plans that recipient governments would have as a priority in other cases (Brautigam and Knack, 2004). In Tanzania, so excessive was the pressure from donors, that the government established a "quiet time" each year - lasting from April to August - where donors were requested not to engage civil services so that they had time for the preparation of important government tasks, such as the annual budget (Radelet and Levine, 2008: 436). Furthermore, the burden on aid recipient's state structures is further increased by the fragmentation of aid, a fact that reduces bureaucratic quality (Knack and Rahman, 2004). Focusing on fragmentation and co-ordination issues, Easterly and Pfutze calculate that "the probability that two randomly selected dollars in the international aid effort will be from the same donor to the same country for the same sector is 1 in 2,658" (2008: 39).

At the world summits in Rome (2003), Paris (2005) and Accra (2008) harmonization and ownership were highlighted as key steps for the enhancement of aid effectiveness. These steps were taken as past approaches - such as conditionality - proved to be ineffective and highlighted the necessity for recipient countries to be in control of development plans and interventions (Kanbur and Sandler, 1999). However, despite the guidelines for ownership and alignment from the three world summits, recent data show that more steps have to be made in this direction (OECD, 2011). These issues become even more significant if we take into consideration the proliferation of donors and the channels for the aid provision (Acharya *et al.*, 2006) and the fact that a portion of these new donors, having not participated in the past aid effectiveness world summit forums, are not aligned with the agreed principles and have set up their own agendas and priorities (UNDP, 2011).

4. The IMF and the World Bank

Two very important actors in the field of aid at a global level are the International Monetary Fund (IMF) and the World Bank. The World Bank is an organization specialized in the planning of long-term development and poverty reduction. Since its foundation after the Bretton Wood conference, the World Bank has gone through various phases, being a major participant in the evolution of the development doctrine (Gilbert and Vines, 2000). A turning point was in the 1990s when discussions on a new approach for development started thus walking away from programs mainly focusing on macroeconomic indexes (King and McGrath, 2004). In this context, it was in 1999 when the then president of the World Bank James Wolfestohn, identifying the significance of knowledge in the development process, announced the transformation of the World Bank into a *Knowledge Bank* (Morduch, 2008). On the other hand, while the IMF cannot be considered as a development agency, it does affect developing countries through adjustment advice, financial assistance and setting up conditionality regulations (Bird and Rowlands, 2005), although its role has changed considerably over the last decades (Feldstein, 1998; Bird, 1996). These two organizations work together and it is almost a precondition for a country that seeks help from the World Bank to have previously agreed to follow an IMF adjustment program (Cassen *et al.*, 1994). Apart from the World Bank, many other development banks and private institutions might relate implementation of their plans to IMF supported programs (IMF, 2002). The importance of IMF's role is evident if we take into consideration the fact that since the 1970s, the vast majority of developing countries have received support from the IMF at least one time (Barro and Lee, 2005).

In late 1999 the World Bank in co-operation with the IMF initiated the PRSP - Poverty Reduction Strategy Programs (Robb, 2002) that focused on principles such as ownership, comprehensive strategies, result-based, partnership-oriented and long-term approaches (IMF, 2013). PRSPs were to focus on four sectors: governance, macroeconomic and structural policies, improved sectoral policies and securing cost-effective funding (Levinsohn, 2003). Evaluation attempts had shown that results from PRSPs vary (Battaile and Kayizzi-Mugerwa, 2005) and further research is needed. However, a critical point is that although ownership is a priority, in various countries - such as Malawi, Kenya, Senegal, Benin and Mali - participation of members of official state bodies is not always the case (Stewart and Wang, 2003).

On the other hand, evaluation of IMF programs is a complicated task and various methods have been proposed (Haque and Khan, 1998). While some success stories are reported, especially in East Asia, there is also a lot of criticism concerning the effectiveness of such programs and their results (Przeworski and Vreeland, 2000; Easterly, 2005) and it has been suggested that IMF policies should be rethought (Bird, 2001). The failures of IMF programs in Argentina and Russia are also two good examples that give ground to criticism for IMF (Marchesi and Sabani, 2007). In the same line, it is argued that the time an aid recipient remains under IMF programs in order to overcome a crisis is negatively correlated to the probabilities of getting out of the crisis (Conway, 2000).

Conclusion

There is no question that over the years aid has some spectacular successes to demonstrate: in the health sector for example, development assistance has contributed significantly to the increase of life expectancy in the developing world from 40 to 65 years, the eradication of diseases such as smallpox and the reducing infant mortality (CGD, 2004). Asian countries such as Korea, Malaysia and Thailand are considered to have gained considerably from aid and achieved high rates of economic growth (Sachs, 2009). In the late 1960s the Green Revolution in India, which greatly benefited from foreign funding, saved millions of people from starvation (IFPRI, 2002). On the other hand, despite billions of dollars poured into underdeveloped countries for decades, in 2010 48 percent of people in Sub-Saharan Africa were living in extreme poverty (Olinto and Uematsu, 2013). So, is foreign aid a reliable path? Or, as Dambisa Moyo (2009a) argued in her book *Dead Aid* - a work that has attracted a lot of attention - growth and poverty reduction cannot be achieved through aid (but through the engagement of the private sector, based on investments and free-market principles)?

Empirically, scholars have been trying for years to shed light on the impact that aid flows have on developing countries. Still, no consensus exists about aid effectiveness. A question that arises is why researchers get so diverse results. As it has been presented, the vast majority of these studies use econometrics and aggregate data and try to establish a solid relation between various diverse and difficult to define factors such as growth, aid and policy; all these are implemented in a variety of countries, using different econometric methods, thus making comparisons difficult.

This over-aggregation creates analytical problems (White, 1992) as valuable information that is country-specific is omitted (Feeny, 2005). Moreover, in many cases researchers run regressions with four-year observations, an approach that carries the short-coming of the time period not being long enough for some of the effects of aid to take place; even extending the under examination period does not offer a solution, as results could include *uncontrolled noise* (Clemens *et al.*, 1994). Similar analysis problems arise with the reliability of data, although many researchers use data from the World Bank (Burhop, 2005) or when applying different definitions for aid, growth and policy (Easterly, 2003). In some cases the fragility of results is so high that just one minor change in variables is enough to get contradictory results (Rajan and Subramanian, 2005; Roodman, 2007). Methodological doubts have been raised by various researchers (Hansen and Tarp, 2000; McGillivray, 2003; Burnside and Dollar, 1997, Chauvet and Guillaumont 2003; Bring, 1994; Moreira, 2005; Mosley, 1987). Thus it could be argued that it is questionable whether econometrics - despite the considerable progress that has taken place in this field - can be used for the analysis of the relation between aid, policy and growth (Addison *et al.*, 2005).

Apart from the flaws in the econometric analyses, the theoretical growth models on which econometric methods are used are poorly defined. Durbarry *et al.* (1998: 1) argue that "If aid is to be reliably identified as a growth determinant it is important that it is included within a robustly specified empirical growth model". Similarly, Cerra *et al.* (2008: 4) argue that "most of the empirical studies lack firm theoretical underpinnings". Another issue that could possibly hinder aid effectiveness analysis is a *reluctancy bias* in the aid effectiveness literature (AEL); Doucouliagos and Paldam (2007: 456) conclude that "If an AEL researcher finds several results he/she will be reluctant to report those that suggest that aid causes harm. Rather, the most significantly positive result is likely to be selected as the key finding for a given aid effectiveness study. Considering the issues, this is not surprising, but it is an impediment to uncovering the true effects of aid". This approach becomes more significant if we take into consideration the fact that a high percentage of researchers – about 35 percent - is professionally associated with the aid industry (Herbertsson and Paldam, 2005).

In any case, aid effectiveness analysis - at both the macro and the micro level - is a challenging task; finding what works - and why - is not always possible (Bourguignon and Sundberg, 2007). Still, more research is needed.

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