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Targeting aid to the needy and deserving: nothing but promises?

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**Targeting Aid to the Needy and Deserving:
Nothing But Promises?**

by

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Targeting Aid to the Needy and Deserving: Nothing But Promises?

Abstract

By reallocating aid to where it is needed most and where a productive use is most likely, donors could help alleviate poverty in developing countries. The rhetoric of donors suggests that this insight has increasingly shaped the allocation of aid. We assess the poverty and policy orientation of bilateral and multilateral aid in different ways. In addition to presenting stylized facts based on bivariate correlations, we apply a Tobit model that captures both altruistic and selfish donor motives. We find little evidence supporting the view that the targeting of aid has improved significantly. Most donors provide higher aid to relatively poor countries, but so far the fight against poverty has not resulted in a stronger focus on the most needy recipients. The estimation results reveal that the policy orientation of aid critically depends on how local conditions are measured. Applying the widely used Kaufmann index on the quality of institutions, almost all donors failed to direct aid predominantly to where local conditions were conducive to a productive use of inflows. The response of donors to changing institutional and policy conditions in recipient countries turns out to be fairly weak. In particular, we reject the proposition that multilateral aid is more targeted than bilateral aid in terms of rewarding poor countries with better policies and institutions.

Keywords: bilateral aid, multilateral aid, fight against poverty, economic policy assessment, quality of institutions

JEL classification: F35

Targeting Aid to the Needy and Deserving: Nothing But Promises?¹

I. Introduction

Since the publication of the World Bank study “Assessing Aid: What Works, What Doesn’t, and Why” in 1998, it is widely believed that donors could improve the much criticized record of aid in the past by reallocating aid to where poverty-related needs are greatest and where a productive use is most likely. In other words, well targeted aid, i.e., aid being focussed on poor countries pursuing development-friendly economic policies, is supposed to contribute to higher income growth and the alleviation of absolute poverty in developing countries.

Recent donor initiatives such as the Millennium Challenge Account of the United States are built on this proposition. Important donors such as the World Bank claim that the allocation of aid has already become better targeted to the poor and deserving in recent years (World Bank, 2002). However, it would not be for the first time that words are in conflict with deeds.² Hence, this paper analyses the actual behaviour of all major donors since the early 1980s. In particular, we assess whether multilateral institutions provide more targeted aid than bilateral donors, and whether aid has increasingly been focussed on poor countries offering favourable local conditions.

¹ Critical comments and helpful suggestions by John Burton, Dag Ehrenpreis, Marion Eeckhout, Rolf Langhammer and the participants of the HWWA Conference on the Political Economy of Aid are gratefully acknowledged. I am grateful to my colleagues Gustavo Canavire and Rainer Thiele for their cooperation in performing the Tobit analysis, summarized in Section VI of this article. The usual disclaimer applies.

² Breuning (1995) entitled her study "Words and Deeds: Foreign Assistance Rhetoric and Policy Behavior in the Netherlands, Belgium, and the United Kingdom."

II. Where Do We Stand?

Industrialized countries grant aid to developing countries for a variety of reasons. Apart from satisfying humanitarian needs in recipient countries and fostering the recipients' economic development, Schraeder et al. (1998) list several selfish motivations of aid, including strategic and political considerations as well as the promotion of exports of the donor country to the recipient country. As a matter of fact, research conducted in the 1970s and 1980s, summarized by McGillivray (2003), revealed that bilateral donors largely pursued their own interests when allocating aid across recipients. More recently, the debate has shifted to the question under which conditions aid could achieve the objectives of poverty reduction and growth promotion. Influential contributions, notably World Bank (1998), Burnside and Dollar (2000) as well as Collier and Dollar (2001), suggested that the effectiveness of aid could be greatly improved if aid was directed primarily to poor countries pursuing development friendly economic policies. Even though this view has been challenged from different angles³, it seems to be widely accepted that donors need to be selective in allocating aid in order to support economic development in recipient countries. The most frequently mentioned selection criteria are: the level of per-capita income and the degree of absolute poverty in recipient countries as well as the appropriateness of local policies and institutions (Isenman and Ehrenpreis, 2003, p. 7).

This raises the question whether the allocation of aid is "poverty-efficient" (Collier and Dollar, 2001, p. 1788) in the sense that bilateral donors and multilateral institutions favour poor countries with better policies and institutions. Policy statements by several donors suggest that this is the case. OECD representatives reckon that academic contributions to the aid effectiveness debate had a significant impact on cross-country allocation decisions of multilateral and bilateral donors (Isenman and Ehrenpreis, 2003, p. 7). According to

³ For recent surveys of the literature, see Harms and Lutz (2004) as well as Clemens et al. (2004).

McGillivray (2003), a recent survey of ten donors reveals that developmental criteria are receiving higher priority in aid allocation, particularly by multilateral institutions. The World Bank (2002, p. 69) contends that the allocation of its aid “has improved dramatically in recent years.”

The rhetoric of donors that aid rewards efficient and honest governments is in contrast to empirical studies such as Alesina and Weder (2002), Schraeder et al. (1998), Alesina and Dollar (2000), and Collier and Dollar (2002). However, donors claiming that the allocation of aid has improved recently may object that these studies portray a picture that no longer applies.⁴ Two studies provide support to this reasoning. Berthélemy and Tichit (2004) conclude from a three-dimensional panel analysis of bilateral aid allocation that most donors rewarded good economic policy outcomes in the 1990s and paid great attention to good governance in recipient countries. Dollar and Levin (2004) stress that aid allocation has increasingly become selective. Various bilateral and multilateral donors are said to be very poverty focussed and, at the same time, very policy focussed. Nevertheless, there is sufficient reason to be sceptical whether fine words have been translated into noble deeds:

- As noted by Roodman (2004), the approach taken by Dollar and Levin (2004) cannot account for negative net disbursements of aid and treats (the large number of) zero observations arbitrarily. The log-linear regression model of these authors ignores that the distribution of aid disbursements is truncated. Apart from methodological concerns, it turns out that some quantitatively important donors such as France and the United States are neither poverty focussed nor policy focussed. As a result, "overall bilateral aid is not very selective" (Dollar and Levin, 2004, p. 14).

⁴ For example, the data used in Alesina and Dollar (2000) as well as Alesina and Weder (2002) do not extend beyond 1995.

- The Tobit model applied by Berthélemy and Tichit (2004) does account for the truncated nature of the aid variable. The major problem with the model of these authors relates to the policy-related right-hand variables. Policy variables taken from Burnside and Dollar (2000) prove to be insignificant. Rather than concluding that this suggests the absence of a strong policy focus of donors, Berthélemy and Tichit (2004) turn to policy *outcome* variables (see also Berthélemy, 2004). But the choices made are highly problematic. Annual GDP growth, lagged by just one period, may depend on aid, rather than driving the allocation of aid. School enrolment and infant mortality reflect the need for aid, rather the quality of economic and social policies.⁵

III. Approach and Data

The subsequent analysis involves two major steps. First, we follow Roodman (2004, p. 11) who stresses the risk that cross-country regression models are misspecified and, thus, favours a simpler approach. We calculate aid shares and perform simple bivariate correlations in order to evaluate whether aid was focussed on countries in need and with local conditions for aid to be productive. Second, we apply a Tobit model which estimates aid allocation in one step, taking the truncated nature of the aid variable directly into account.⁶ Aid to a specific recipient is specified as the maximum of “zero” and a linear combination of explanatory variables:

$$aid_i = \max(bZ_i + v_i, 0). \quad (1)$$

⁵ See Kanbur (2004) who argues that the *level* of final outcome variables such as school enrolment and mortality rates reveals need, whereas the *change* in outcome variables reveals policy performance.

⁶ See Neumayer (2003) as well as Berthélemy and Tichit (2004) for a discussion of alternative approaches.

where Z denotes explanatory variables, including both altruistic and selfish motivations of aid, and v stands for a normally distributed error term. The following variables related to developmental concerns are supposed to capture altruistic motivations: per-capita income, measured as GDP per capita of recipient countries in purchasing power parities; CPIA, i.e., the World Bank's Country Policy and Institutional Assessment, which is supposed to reflect local conditions for aid being effective; the so-called Kaufmann index (Kaufmann et al., 2003), which provides an alternative comprehensive governance indicator;⁷ and a dummy reflecting post-conflict reconstruction needs, set equal to "one" if a country received grants from the World Bank's Post Conflict Fund. The commercial self-interest of donors is proxied by bilateral exports of donors to recipient countries, expressed as a percentage of total donor exports and lagged one year. The political and strategic interest of donors is represented by colonial dummies and a dummy that reflects the special relationships of the United States with Egypt and Israel. Finally, we control for the population of the recipient country.

Part of our analysis covers aid flows in 1981-2002, but we focus on the recent past. The behaviour of major bilateral donors (United States, Japan, France, Germany, United Kingdom, Netherlands, Sweden, Norway and Denmark) is compared with the behaviour of multilateral institutions, in order to check the widespread belief that the latter have a stronger developmental focus. We draw on aid data provided by the OECD's Development Assistance Committee (DAC). Unless specified otherwise, we use net disbursements of aid. In contrast to aid commitments, disbursements reflect resource transfers actually made.⁸ The treatment of so-called Part II countries (DAC, 2004), comprising "more advanced developing countries

⁷ The Kaufmann index is highly correlated with GDP per capita, which may give rise to multicollinearity problems. Hence, we first regress GDP per capita on the index and then include the estimated residuals in the aid regressions.

⁸ Some authors, including Berthélemy and Tichit (2004), prefer commitments which constitute the only aid variable over which donors have full control. The ongoing debate on the choice of the appropriate aid variable notwithstanding, estimations are unlikely to be affected much as disbursements and commitments are highly correlated (Neumayer, 2003).

and territories (MADCT)” plus a dozen relatively advanced transition countries in Central/Eastern Europe and the former Soviet Union, is as follows: Transition countries that did not appear on the main list of aid recipients (Part I) before Part II countries were listed separately (since 1993) are excluded. By contrast, we include MADCT that have been shifted to Part II. Among them are major aid recipients such as Israel, French Polynesia and New Caledonia.⁹ Hence, ignoring the shift of MADCT to Part II may result in seriously distorted results.¹⁰

IV. Is Aid Targeted to Poor Countries?

We use several measures to assess whether aid was targeted to countries in particular need of aid: the per-capita income (US\$ in purchasing power parities at the beginning of the sub-period under consideration), the Human Development Index (HDI) presented by UNDP, and the percentage of the recipient countries’ population living on less than one dollar per day. By applying the HDI, we assess whether the allocation is based on a broader measure of need than reflected in per-capita income.¹¹ The third measure reflects the incidence of absolute poverty. In contrast to earlier studies such as Alesina and Dollar (2000), Dollar and Levin (2004) as well as Berthélemy and Tichit (2004), we account for absolute poverty as poverty

⁹ For reasons of consistency, we stick to the MADCT classification of the DAC, even though all three countries are listed as high-income countries in the World Bank’s World Development Indicators.

¹⁰ For instance, according to OECD (2004), France directed 42.5 percent of its aid to low-income countries in 1999-2002. This share declines to 36.2 percent if aid to MADCT in Part II is taken into account.

¹¹ We owe this point to Axel Borrmann and Dag Ehrenpreis, who stressed the non-income dimensions of poverty-related aid allocations in their comments to an earlier draft of this paper. The HDI comprises life expectancy, literacy and education in addition to per-capita income. The HDI is considered only for the most recent sub-period, in order to keep the analysis within reasonable limits. HDI data for 1999 are taken from <http://www.undp.org/hdr2001/back.pdf>.

eradication has become a most important objective which the donor community would like to help achieve.¹² The measure of absolute poverty is taken from Chen and Ravallion (2004).

For all three measures we divide the sample countries for which the relevant data are available into quartiles. Aid shares are calculated for the poorest quartile and the poorer half of the sample.¹³ Multilateral institutions directed about four fifths of their aid to countries whose per-capita income and HDI were below the median, and more than two thirds to countries where the incidence of absolute poverty was above the median. The poorest quartile according to the HDI received 40 % of multilateral aid in 1999-2002, even though this subgroup accounted for just 14 % of the population of the overall sample in 1999.¹⁴ Multilateral aid was better targeted than bilateral aid throughout the period 1981–2002 and in all respects, i.e., independently of whether we consider the poorer half of the sample or the poorest quartile, or which measure is taken as an indicator of need. However, the evidence does not support claims that multilateral aid has become more focussed on countries with low per-capita income and high incidence of absolute poverty. To the contrary, low-income recipients received a lower share of multilateral aid in the most recent sub-period (1999–2002) than in the more distant past.

As concerns bilateral aid, the poorest quartile of recipients received just slightly more than a quarter of aid by all DAC donors taken together in 1999-2002. Bilateral aid was rather biased towards countries close to the median. However, there are pronounced differences between bilateral donors in targeting poor countries. On the one hand, Japanese aid has been strongly

¹² Giving more aid to countries with higher absolute poverty may not necessarily be the best way to alleviate poverty. However, the question to which extent aid actually reaches the poor, especially in countries with a highly uneven income distribution and, thus, more people living below the poverty line, is beyond the scope of this article.

¹³ Note that aid reported as unallocated in the source is not included in the totals on the basis of which we calculate aid shares. For detailed results not shown here, see an earlier working paper version of this article (<http://www.uni-kiel.de/ifw/pub/kap/2004/kap1229.htm>).

¹⁴ Slightly more than half of the population lived in countries belonging to the poorer half of the sample (in terms of HDI).

biased against the poorest countries since the early 1990s, and the poorest quartile received considerably less than a quarter of US aid throughout the period under consideration. On the other hand, bilateral aid by some donors was at least as targeted to recipients with relatively low per-capita income (and low HDI values) as multilateral aid. Apart from Scandinavian donors, this also applies to the United Kingdom.

The distribution of aid in absolute terms is dominated by some large recipient countries. Berthélemy and Tichit (2004, p. 255) find a stronger poverty orientation of donors once China and India are excluded from the sample. Our analysis of aid shares, too, is affected by these two countries,¹⁵ even though major findings, including the weaker poverty orientation of multilateral donors in recent years, remain valid if China and India are excluded. Hence, we complement the share analysis by correlating aid in terms of per capita of the recipient countries' population with per-capita income, the HDI and the incidence of absolute poverty, respectively.

Table 1 presents Spearman rank correlations which, compared to parametric correlations, depend less on some outliers, notably small countries that received outstandingly high per-capita aid even though they were fairly advanced economically. The results underscore that the targeting of aid differs considerably between bilateral donors. Throughout the period 1981–2002, targeting proved to be fairly strong for Norway and Denmark. Germany, the Netherlands and Sweden have improved the targeting of per-capita aid since the early 1990s. It is mainly because Japan and France have failed to strengthen the poverty orientation of aid why multilateral aid continued to be targeted more strongly to countries with lower per-capita

¹⁵ For instance, the share of the poorest quartile in total bilateral aid remains almost constant at about 30 % throughout the period of observation if China and India are excluded. The declining share of this group observed for the full sample is because China and India have left the poorest quartile since the early 1990s due to high income growth. More details concerning the comparison of aid shares with and without China and India are available from the author upon request.

income in 1999–2002 than bilateral aid of all donors taken together.¹⁶ Yet, the correlation results cast further into doubt that multilateral aid has increasingly been directed to countries with low per-capita income. Moreover, multilateral institutions and most bilateral donors have in common that the focus on countries with high incidence of absolute poverty lost momentum in 1999–2002, compared to 1993–1998 (not shown).

V. Is Aid Concentrated in Countries with Good Policies?

According to the World Bank (2002, p. 29), "financial assistance is being increasingly allocated to countries that have reasonably good policies and institutions – that is, the countries that can best use aid for poverty alleviation." For evaluating which countries offer promising local conditions for aid to be effective, the World Bank refers to its own Country Policy and Institutional Assessment (CPIA). However, comprehensive information on the CPIA has not been made available to the public. We draw on the limited evidence presented in Collier and Dollar (2001), who classify developing countries into five CPIA categories ranging from very good to very poor.

The evidence in Table 2 does not support the proposition of a well targeted allocation of aid. The CPIA is rated good or very good for 44 countries out of the overall sample of 96 countries. This CPIA 4/5 group accounts for 74 % of the population of all rated countries (excluding China and India from this calculation, the population share is still 49 %). Hence, the share of aid granted to this group should clearly exceed 50 % if it consisted of strongly preferred recipients of aid. Multilateral institutions as well as several bilateral donors failed to

¹⁶ Similar to Japan, the distribution of French aid in 1999-2002 appears to have been guided by the broader HDI concept, rather than the narrow measure of the recipients' per-capita income. The opposite pattern prevails with regard to Scandinavian aid. The pattern for all bilateral donors taken together resembles the pattern observed for France and Japan. However, the difference in poverty focus between all bilateral donors and multilateral donors is hardly affected, since multilateral aid, too, was correlated more strongly with the HDI than with per-capita income.

meet this criterion in 1999–2002. The same applies if most recent aid commitments (in 2002–2003) are used, instead of net disbursements of aid. The share of the CPIA 4/5 group is lowest for aid disbursements by Scandinavian countries and the Netherlands, which is in sharp contrast to the targeting of poor countries discussed in the previous section and puts into question the conventional wisdom that the developmental orientation of these donors is strongest. Furthermore, the evidence is in conflict with the World Bank’s claim that multilateral institutions focus their aid more strongly on countries with good policies than bilateral donors, who are said to be more “constrained ... by geopolitical objectives” (World Bank, 2002, p. 32) when deciding on the allocation of aid.

The impact of some large recipients on the policy orientation of aid in absolute terms may be reduced if aid is considered in per-capita terms. The World Bank uses the per-capita measure to make the point that the allocation of aid has improved. However, the per-capita measure may lead to distorted results unless the treatment of outliers is made explicit. The impact of outliers with particularly high per-capita aid is reflected in that the median of per-capita aid always is substantially below the average (Table 3). This discrepancy is typically larger for the group of countries with good and very good policies (CPIA 4/5). In other words, outliers are concentrated in this group so that average aid flows tend to overstate the policy orientation of donors.

This applies to multilateral institutions in particular. Claims that multilateral institutions preferred countries in the CPIA 4/5 group over countries in the CPIA 1/2 group appear to be valid if the comparison is based on averages. However, this preference is only because the CPIA 4/5 group comprises five countries with a population of substantially less than one million and outstandingly high per-capita aid inflows (in descending order of aid in 1999–2002: St. Kitts and Nevis, St. Lucia, Cape Verde, Guyana, and the Maldives). If these five recipients are excluded, the average reported for the CPIA 4/5 group falls from US\$ 17.7 to

US\$ 7.5. This adjustment underlines the impression to be gained from comparing the median, namely that countries with good policies were treated *less* favourably by multilateral institutions.

A similar picture is shown for all bilateral donors taken together, although the median suggests that the discrimination against recipients with good policies is less severe. Some bilateral donors (France, Norway and the United States) directed higher per-capita aid to countries with poor policies. On the other hand, the median of aid granted by Japan, the United Kingdom and Denmark to countries in the CPIA 4/5 group exceeded the median of aid granted to countries in the CPIA 1/2 group, as one would expect if donors favoured recipients with development-friendly policies.

VI. Do Poor Countries with Better Policies and Institutions Receive More Aid?

The relatively strong policy orientation of Japan referred to above may be just a side effect of its aid being concentrated in neighbouring Asian countries which happen to be rated favourably and with whom Japan trades intensively.¹⁷ More generally, this case exemplifies the limitations of a univariate analysis. It is in two ways that we address this issue in the following: First, we consider the CPIA in combination with the income status of recipients, thereby taking into account that more advanced countries tend to have a better CPIA rating. Second, we estimate a Tobit model in order to control for selfish aid motivations and isolate the effects of different developmental concerns on aid allocation.

We restrict the sample by applying two alternative thresholds of per-capita income, US\$ 2000 and US\$ 4000 (in purchasing power parities), in order to assess whether donors discriminate between more favourable and less favourable policy and institutional conditions *within* groups

¹⁷ The share of China, India, the Philippines and Thailand amounted to one third of Japanese aid, compared to 15 % of aid by all DAC donors taken together.

of recipient countries with similarly high per-capita income (Table 4). These thresholds closely resemble the average per-capita income of low-income countries and lower middle-income countries, respectively, as defined by the World Bank. The smaller sub-sample consists exclusively of low-income countries, while the larger sub-sample extends into the lower medium-income range. Consequently, the number of countries with a CPIA of 4 or 5 is reduced from 44 countries to 8 and 20 countries, respectively, whereas the number of countries with a CPIA of 1 or 2 is only reduced from 31 countries to 21 and 27 countries, respectively. In other words, aid recipients with better policies are concentrated in the higher income categories.

The median of per-capita aid increases when the calculation is restricted to recipients with lower per-capita income. This confirms that most donors grant more aid to poorer countries.¹⁸ However, French aid remains biased against countries with better policies even if we control for per-capita income of the recipients. More surprisingly, a similar bias can be observed for Sweden when the sample is restricted to countries with per-capita income below US\$ 2000. This is in conflict with conventional wisdom, even though it underscores the earlier finding of Schraeder et al. (1998) that the allocation of Swedish aid left much to be desired. The extremely high share of Swedish aid reported as unallocated in the DAC source may, at least partly, explain this surprising result.¹⁹ In contrast to the afore mentioned donors, the distribution of US aid and Norwegian aid is no longer biased against recipients with better policies. The policy orientation of Danish aid appears to be strongest in Table 4, largely

¹⁸ In line with the evidence presented in Table 1, Japan and France are notable exceptions: Japan provided less aid to poor countries with a CPIA of 1 or 2 than to all countries in that CPIA group; the median of French aid in 1999–2002 turns out to be lower for the restricted sample with a CPIA of 4 or 5.

¹⁹ Unallocated aid rose from 23 % of total Swedish aid in 1981-1986 to 40 % in 1999-2002. According to comments provided by Dag Ehrenpreis, this rise may be due to democracy-supporting aid to Latin America, which is held clandestine for security reasons or handled by regional organizations.

because various countries with a CPIA of 1 or 2 did not receive any aid from this donor.²⁰ The United Kingdom ranks second in terms of targeting aid to poor recipients with better policies. The United States, Japan and Germany granted about twice as much aid to poor countries with better policies, independently of whether the income threshold is set at US\$ 4000 or US\$ 2000. The differences in the policy orientation of individual bilateral donors have as a consequence that the median of total bilateral aid is just about US\$ 5-6 higher for poor countries with better policies. Nevertheless, Table 4 points to a relatively strong policy orientation of bilateral donors compared to multilateral donor institutions.

The latter result casts into doubt the World Bank's (2002, p. 32) assertion that multilateral institutions are less constrained by geopolitical objectives. It is mainly in this regard that the Tobit analysis offers additional insights. The results reported in Table 5 support the World Bank's view in that the exports of donor countries to recipient countries did not affect the allocation of multilateral aid, whereas the export-related self interest of DAC countries provided a strong incentive to grant bilateral aid.²¹ Yet, the Tobit results do not confirm that multilateral aid is superior to bilateral aid. As concerns the poverty orientation of aid, poorer countries got more aid from both bilateral and multilateral donors. Likewise, there is little difference between bilateral and multilateral donors with regard to the two dummies included in our estimates. Post-conflict resolution did not result in higher multilateral aid throughout

²⁰ It may be noted that the results reported in Table 4 for Denmark and the United States are not affected by the choice of the threshold of per-capita income. This is because the same (low-income) recipient countries represent the median, e.g., Madagascar for Danish aid and Burundi for US aid to countries with a CPIA of 1 or 2.

²¹ To examine whether large bilateral donors were able to push through their export interests in multilateral aid institutions, we constructed a specific export variable for the multilateral regressions that is defined as the sum of exports from the nine most important bilateral donors to each recipient, divided by total exports of the nine donors. Note also that the population variable turns positive in the regressions for bilateral aid, though less significantly so than for multilateral aid, if the export variable is dropped. The weaker relationship between bilateral aid and country size is largely due to the behaviour of two major donors, France and the United States. France, in particular, exhibits an extremely strong small-country bias. For a detailed presentation of Tobit results, refer to: <http://www.uni-kiel.de/ifw/pub/kap/kap.htm>.

the period under consideration, while bilateral donors provided more aid to post-conflict countries only in 2002.

As concerns the policy orientation of aid, both bilateral and multilateral donors directed significantly more aid to well governed recipients if the CPIA is applied as a measure of the quality of local conditions. In particular, we do not find the policy orientation of aid provided by the International Development Association (IDA) to be stronger than that of multilateral aid from other sources, even though donors other than IDA could be expected to have more reservations to accept the World Bank's CPIA as a guiding principle for allocating aid. Most notably, the policy orientation of almost all donors is highly sensitive to the measurement of local conditions. The policy orientation turns out to be extremely weak when local conditions are measured by the (residuals of the) Kaufmann index, instead of the CPIA. This discrepancy is probably because the policy orientation of aid is overstated when applying the CPIA measure. In contrast to what one might expect, the variance of the more precise (but not publicly not available) CPIA index values appears to be much smaller than suggested by the range from "one" to "five" for the CPIA categories used here. According to Dollar and Levine (2004), the standard deviation of the CPIA index values across developing countries is just about 20 %.

The Tobit estimates for specific bilateral donors (not shown) underscore that the poverty and policy orientation of aid differs between donors. In line with Dollar and Levin (2004), we find that the group of poverty oriented donors (Scandinavian countries, Germany, the Netherlands and the United Kingdom) was also relatively policy oriented as long as the CPIA is used. With few exceptions, however, neither the poverty focus nor the policy focus has become stronger since the late 1990s. The Tobit analysis also confirms that the relation between the per-capita income of recipients and Japanese aid was particularly weak; essentially the same applies to French aid. In the case of Japan, the coefficient of the CPIA appears to be high, but

this result is far from robust. This supports the above argument that granting aid to deserving recipients was not the primary motive underlying Japan's aid allocation. Yet, we find a striking similarity for almost all bilateral donors, namely that the policy orientation of aid turns insignificant when applying the Kaufmann index as an alternative measure of local conditions.²²

Furthermore, the Tobit analysis shows that former colonies still received significantly more aid from France, the Netherlands and the United Kingdom in recent years, whereas the colonial dummy should have become less relevant if recipient need had increasingly shaped the allocation of aid. In the case of the Netherlands, its former colony Indonesia became the most important aid recipient after the Asian crisis, even though local conditions were rated poor by the World Bank. This explains why the Netherlands reported the highest share of aid directed to countries with poor and very poor policies in 1999-2002 (Table 2). Likewise, strategic interests remain a dominant factor in the allocation of US aid to Egypt and Israel. Finally, export-related interests still have an important impact on aid allocation by some bilateral donors. This applies especially to France and Japan, but export-related interests also shaped the aid allocation of donors such as Denmark which are often regarded as altruistic, notably Denmark.

VII. Do Donors Respond to Changes in Institutional and Policy Conditions?

In addition to the summary index used in the Tobit analysis, Kaufmann et al. (2003) offer more specific information on six aspects of the institutional conditions prevailing in a large number of countries. Two aspects, namely the control of corruption and the rule of law, are of particular interest in order to assess how donors have reacted to changes in the institutional

²² Denmark provided the only notable exception.

framework. A third aspect, voice and accountability, is considered to check whether donors increased aid to countries where democratic values were strengthened. We use the difference between indicator values reported for 2002 and those for 1996 as a measure of institutional changes. Given that each indicator ranges from -2.5 to 2.5 , with higher values corresponding to better institutional conditions, positive differences reveal institutional improvements and should be associated with an increase in per-capita aid.

In addition to institutional changes, the change in two policy-related variables is taken into account: (i) consumer price inflation provides a proxy for macroeconomic stability in recipient countries; (ii) the share of exports plus imports in GDP of recipient countries is supposed to reflect their openness to trade. The change in both variables refers to the difference in annual averages for 1999-2002 and 1993-1998. Conventional wisdom suggests that aid can be used more productively in countries that are macro-economically stable and more open to trade. Hence, aid should be related negatively with higher inflation, and positively with a higher trade-to-GDP ratio if donors took changes in these policy-related variables into account when deciding on the allocation of aid.

Changes in aid are defined as the difference between per-capita aid in 1999-2002 and per-capita aid in 1993-1998. The relevance of the five institutional and policy-related indicators for the distribution of bilateral and multilateral aid is assessed by calculating Spearman rank correlation coefficients. All correlations are for the restricted sample of developing countries with per-capita income below US\$ 4000 in 1999, in order to control for the income status of recipients. In addition to net disbursements of aid, we analyse aid commitments. This is because disbursements may be relatively slow to react to changes in local conditions. Current disbursements may be related to projects and programs which extend over several years and were agreed prior to changes in local conditions. By contrast, donors have more discretion to

adjust new commitments to institutional and policy changes.²³ Furthermore, to allow for a delayed reaction of aid and check the robustness of results, we perform additional correlations based on the change in aid commitments between the two most recent years for which data are available (2002/03) and 1993-1998.

Table 6 reports few statistically significant correlations between changes in institutional conditions and changes in per-capita aid.²⁴ Multilateral institutions and some bilateral donors responded to democratisation in recipient countries, reflected in changes for voice and accountability, by increasing aid disbursements.²⁵ By contrast, none of the donors adjusted aid disbursements to institutional changes concerning the rule of law. The same is true for aid commitments, which is in conflict with the proposition that donor reactions should be stronger if measured by commitments rather than disbursements. Moreover, with few exceptions, donors did not respond to efforts of recipients to fight corruption, even though the development community holds strong views on the detrimental effects of corruption.²⁶ This corroborates the earlier finding of Alesina and Weder (2002, p. 1136), who conclude: “There is no evidence that less corrupt governments receive more foreign aid.” It is also in line with Alesina and Weder (2002) that the correlation results in Table 6 do not point to stronger reactions of multilateral aid to changes in the control of corruption.

²³ We owe this point to several participants of the HWWA Conference on the Political Economy of Aid.

²⁴ For selected cases of how aid responded to particularly pronounced changes in institutional conditions in some recipient countries, see the earlier working paper version of this article (<http://www.uni-kiel.de/ifw/pub/kap/2004/kap1229.htm>).

²⁵ For a similar finding, see Berthélemy and Tichit (2004).

²⁶ For example, Weder (2000, p. 293) argues that “corruption is one of the most important obstacles to development.”

As concerns policy-related variables, neither bilateral nor multilateral donors systematically supported the process of opening up to trade of various developing countries by increasing aid to these countries. Multilateral institutions as well as several bilateral donors also failed to reward successful macroeconomic stabilization efforts, reflected in lower inflation in 1999–2002, by increasing aid disbursements. Changes in inflation are more strongly correlated with aid commitments than with aid disbursements. Typically, however, the correlation results are robust, even if we allow for delayed reaction patterns by calculating the change in aid commitments on the basis of most recent data. Different definitions of the aid variable notwithstanding, the reactions of most major donors to changes in institutional and policy conditions proved to be fairly weak.

VIII. Summary and Conclusions

Multilateral institutions and most bilateral donors provide more aid to relatively poor countries. Yet we find little evidence supporting the view that foreign aid is well targeted. Our results are more in line with the bleak findings of Collier and Dollar (2002) than with the good news offered by Dollar and Levin (2004). In contrast to the rhetoric of donors, the targeting of aid to low-income countries has not become stronger in recent years. This is not to ignore that the targeting of aid differs considerably across important bilateral donors. Furthermore, the present analysis may fail to capture the effects on aid allocation of most recent donor initiatives such as the Millennium Challenge Account of the United States. Reportedly, it was only in April 2005 that the first grant was made out of the Millennium Challenge Account (US\$ 110 million to Madagascar; *The Economist*, 2005, p. 77).

In the light of the slow implementation of recent donor initiatives, it is not surprising that we find the distribution of aid across all developing countries to be in conflict with the proposition that aid has been granted increasingly to where the institutional and policy

framework rendered it more likely that aid could be used productively. Judging local conditions by the World Bank's Country Policy and Institutional Assessment (CPIA), bilateral and multilateral donors did direct more aid to well governed recipient countries, once other aid determinants are controlled for. However, the policy orientation of aid appears to be overstated when applying the rudimentary information publicly available on the CPIA. Replacing the CPIA by the Kaufmann index on institutional conditions, the policy orientation turns out to be extremely weak. In any case, the proposition that multilateral aid has a stronger policy orientation than bilateral aid is rejected.

We also qualify the widely held belief that Scandinavian countries and the Netherlands are superior donors, particularly compared to France, Japan and the United States, in the sense that their aid allocation is driven by altruistic motivations. With the exception of Denmark, institutional conditions in the recipient countries, measured by the Kaufmann index, had no significant effect on aid. Moreover, while export-related interests figure most prominently for major donors such as France and Japan, selfish motives have also influenced the aid allocation of allegedly superior donors such as Denmark. Likewise, it is not only for France and the United Kingdom but also for the Netherlands that post-colonial ties remain an important aid determinant, which appears to be in conflict with the notion that aid has increasingly been targeted to the needy and deserving.

Finally, the response of both bilateral and multilateral donors to changing institutional and policy conditions in recipient countries proved to be weak, in the light of the widespread rhetoric that policy reforms and institutional development would be supported. None of the major donors responded to changes concerning the rule of law and control of corruption in a way that could have improved the allocation of aid. Likewise, donors have failed to systematically support the process of opening up to trade in developing countries by increasing aid.

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Table 1 — Per-capita Aid^a and Per-capita Income of Recipient Countries^b: Spearman Rank Correlation Results^c

	1981–1986	1987–1992	1993–1998	1999–2002 ^d	
All DAC donors ^e	–0.14 <i>–0.17*</i>	–0.20** <i>–0.23**</i>	–0.27*** <i>–0.29***</i>	–0.24** <i>–0.27***</i>	(–0.38***) <i>(–0.41***)</i>
United States ^e	–0.17* <i>–0.20***</i>	–0.19** <i>–0.22**</i>	–0.30*** <i>–0.33***</i>	–0.33*** <i>–0.36***</i>	(–0.31***) <i>(–0.34***)</i>
Japan	–0.14	–0.14	–0.13	–0.08	(–0.17*)
France	–0.21**	–0.33***	–0.23**	–0.13	(–0.26***)
Germany	–0.19*	–0.25***	–0.54***	–0.49***	(–0.49***)
United Kingdom	–0.27***	–0.24***	–0.21**	–0.31***	(–0.34***)
Netherlands	–0.39***	–0.40***	–0.40***	–0.54***	(–0.53***)
Sweden	–0.33***	–0.34***	–0.39***	–0.50***	(–0.45***)
Norway	–0.51***	–0.52***	–0.52***	–0.50***	(–0.44***)
Denmark	–0.53***	–0.56***	–0.50***	–0.41***	(–0.39***)
Multilateral donors	–0.31***	–0.39***	–0.31***	–0.31***	(–0.47***)

^aAnnual average in US\$ per capita of the recipient countries' population at the beginning of the respective period. – ^bPer-capita income in US\$, in terms of PPP, at the beginning of the respective period. – ^c Number of observations ranges from 100 to 129; *** significant at the 1 percent level (two-tailed test); ** 5 percent level; * 10 percent level. – ^dIn parentheses: Spearman rank correlation between per-capita aid in 1999–2002 and HDI of recipient countries in 1999. – ^eIn italics: excluding Israel.

Source: OECD (2004); World Bank (2004); UNDP.

Table 2 — Distribution of Aid According to Policy Conditions in Recipient Countries (percent)^a

	Share of aid directed to countries with:			
	CPIA 4/5		CPIA 1/2	
	Disbursements 1999–2002	Commitments 2002-2003	Disbursements 1999–2002	Commitments 2002-2003
All DAC donors	50.1	46.1	21.9	25.1
United States	55.9	56.9	23.2	25.4
Japan	55.0	45.2	23.4	22.0
France	51.7	35.9	16.3	31.2
Germany	54.3	48.7	16.7	21.9
United Kingdom	50.1	52.4	16.9	15.6
Netherlands	39.6	45.5	26.2	26.1
Sweden	43.2	38.9	17.0	24.5
Norway	41.8	29.5	20.2	17.2
Denmark	41.9	49.0	9.1	4.5
Multilateral donors	47.5	36.5	20.5	28.1

^aAid to all developing countries for which the CPIA classification is available = 100. CPIA ranges from 5 (very good policies) to 1 (very poor policies); for details, see text.

Source: OECD (2004); Collier and Dollar (2001: Table 3).

Table 3 — Per-capita Aid in 1999–2002 and Policy Conditions in Recipient Countries (US\$)^a

	CPIA 4/5		CPIA 1/2	
	Median	Average	Median	Average
All DAC donors	11.55	21.69	13.60	21.18
United States	1.12	3.31	1.54	2.52
Japan	2.19	6.93	1.67	3.96
France	0.30	1.93	0.67	3.30
Germany	0.76	1.92	0.67	0.86
United Kingdom	0.25	1.30	0.10	0.70
Netherlands	0.29	0.93	0.27	0.69
Sweden	0.05	0.47	0.06	0.38
Norway	0.07	0.35	0.13	0.30
Denmark	0.06	0.43	0.01	0.15
Multilateral donors	3.77	17.70	10.25	13.22

^aCPIA ranges from 5 (very good policies) to 1 (very poor policies); for details, see text.

Source: OECD (2004); World Bank (2004); Collier and Dollar (2001: Table 3).

Table 4 — Per-capita Income, Policy Conditions and Aid Inflows in 1999–2002 (Median; US\$)^a

	Per-capita income in 1999:			
	Below US\$ 4000		Below US\$ 2000	
	CPIA 4/5 (20 countries)	CPIA 1/2 (27 countries)	CPIA 4/5 (8 countries)	CPIA 1/2 (21 countries)
All DAC donors	18.86	13.60	19.85	13.60
United States	2.98	1.60	2.98	1.60
Japan	3.07	1.61	2.43	1.22
France	0.22	0.67	0.26	0.86
Germany	1.30	0.78	1.61	0.90
United Kingdom	0.40	0.17	0.49	0.20
Netherlands	0.46	0.34	0.88	0.35
Sweden	0.09	0.07	0.16	0.22
Norway	0.16	0.13	0.17	0.16
Denmark	0.24	0.01	0.24	0.01
Multilateral donors	8.05	11.10	12.03	11.89

^aCPIA ranges from 5 (very good policies) to 1 (very poor policies); for details, see text.

Source: OECD (2004); World Bank (2004); Collier and Dollar (2001: Table 3).

Table 5 — Tobit Model Results for Total Bilateral Aid and Multilateral Aid: IDA Eligible Recipients with CPIA Classification^a

Donors	Population	Donor exports	Colonial dummy	Post-conflict dummy	Per-capita income	CPIA	Uncensored observations	Pseudo R ²
All DAC countries								
1999	-1.51 (-5.51)***	116819 (10.33)***	59.0 (1.38)	-20.3 (-0.47)	-0.044 (-3.23)***	40.0 (2.81)***	66	0.09
2000	-1.38 (-4.47)***	98697 (7.36)***	45.4 (0.99)	-31.4 (-0.67)	-0.052 (-3.55)***	44.5 (2.84)***	66	0.06
2001	-0.56 (-2.04)**	68684 (5.86)***	73.8 (1.56)	13.7 (0.27)	-0.053 (-3.31)***	61.1 (3.75)***	66	0.06
2002	0.19 (-0.60)	38538 (2.81)***	25.0 (0.43)	131.8 (2.10)**	-0.060 (-3.26)***	75.5 (3.84)***	65	0.04
All multilateral agencies								
1999	0.51 (3.05)***	371 (0.05)	19.7 (0.75)	-15.5 (-0.58)	-0.041 (-4.72)***	40.9 (4.70)***	66	0.06
2000	0.80 (5.47)***	-5888 (-0.93)	6.9 (0.31)	-7.6 (-0.34)	-0.031 (-4.55)***	27.1 (3.66)***	65	0.09
2001	0.64 (3.44)***	-1048 (-0.13)	1.5 (0.04)	-37.9 (-1.14)	-0.051 (-4.34)***	38.4 (3.35)***	65	0.06
2002	0.64 (2.64)**	-7070 (-0.68)	20.6 (0.47)	10.2 (0.22)	-0.041 (-2.95)***	39.2 (2.62)**	65	0.03
IDA								
1999	0.40 (4.15)***	-1456 (-0.35)	10.2 (0.71)	-22.9 (-1.61)	-0.022 (-4.32)***	22.4 (4.61)***	57	0.09
2000	0.65 (8.41)***	-6691 (-2.01)**	6.6 (0.57)	-12.8 (-1.10)	-0.020 (-4.88)***	17.4 (4.33)***	60	0.14
2001	0.45 (4.29)***	-2510 (-0.55)	-0.8 (-0.04)	-32.9 (-1.76)*	-0.027 (-3.93)***	25.9 (3.86)***	60	0.07
2002	0.40 (2.86)***	-4789 (-0.80)	5.6 (0.22)	-6.0 (-0.22)	-0.019 (-2.35)**	26.0 (2.37)**	61	0.03

^at-values in parentheses; ***, **, * significant at 1 per cent, 5 per cent and 10 per cent level, respectively; constant term included, but not reported.

Source: Own calculations based on DAC online data.

Table 6 — Change in Per-capita Aid^a and Change in Institutional and Policy Conditions^b in Low-income Recipient Countries^c: Correlation Results^d

	Voice and accountability		Rule of law		Control of corruption		Inflation		Openness to trade	
	dis.	com.	dis.	com.	dis.	com.	dis.	com.	dis.	com.
All DAC donors	0.19*	0.27**	0.06	0.06	0.14	0.22*	-0.30**	-0.35***	0.06	0.08
United States	0.19*	0.28**	-0.05	-0.03	-0.01	0.10	-0.15	-0.10	-0.10	-0.13
Japan	0.19	0.18	0.01	0.04	-0.07	0.01	-0.25*	-0.29**	0.16	0.12
France	-0.03	-0.10	-0.13	-0.23*	0.04	-0.03	-0.19	-0.23*	-0.14	-0.08
Germany	0.21*	0.16	0.11	0.05	0.12	0.19	-0.18	-0.23*	0.11	0.21*
United Kingdom	0.15	0.16	0.08	0.13	0.02	0.07	-0.25*	-0.20	0.02	0.09
Netherlands	0.11	0.11	-0.05	0.03	-0.11	0.10	-0.18	0.01	0.17	0.16
Sweden	0.13	0.13	-0.15	-0.03	0.14	0.26**	-0.01	-0.10	0.03	-0.18
Norway	0.01	0.13	-0.11	-0.09	0.08	0.11	-0.15	-0.24*	-0.08	-0.10
Denmark	-0.06	-0.05	0.01	0.15	0.05	0.04	-0.17	-0.15	0.10	-0.01
Multilateral donors	0.31***	0.28**	0.00	-0.05	0.04	0.08	-0.03	-0.18	0.14	0.13

^a1999–2002 vis-à-vis 1993–1998; dis.: net disbursements of aid; com.: aid commitments; in parentheses: change in commitments, 2002-03 vis-à-vis 1993-98. –

^b2002 vis-à-vis 1996 in the case of voice and accountability, rule of law, and control of corruption; 1999–2002 minus 1993–1998 in the case of inflation (consumer prices) and openness to trade (percentage share of the sum of exports and imports in GDP). – ^cPer-capita income in 1999 below US\$ 4000 (PPP). –

^dSpearman rank correlation coefficients; *** significant at 1 percent level (two-tailed test), ** 5 percent level, * 10 percent level. Number of observations ranges from 61 (change in inflation) to 74 (change in voice and accountability).

Source: OECD (2004); Kaufmann et al. (2003); World Bank (2004).

