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Corrupt governments do not receive more state-to-state aid: Governance and the delivery of foreign aid through non-state actors☆

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ABSTRACT

A core result of the aid allocation literature is that the quality of governance in recipient countries does not affect the amounts of foreign aid received. Donor countries may still give aid to poorly-governed countries because of a dilemma they face: those countries most in need typically also lack proper institutions. This paper argues that donors try to resolve this dilemma by delivering aid through non-state actors. Using aid shares as well as absolute amounts of aid allocated through state and non-state channels and considering different dimensions of governance, we provide evidence that bypassing governments via NGOs and multilateral organizations is indeed a response to weak recipient state institutions. The effect is stronger in aid sectors where donors can more easily switch between channels, and weaker for higher levels of economic self-interest among donors.

1. Introduction

After a period of general pessimism regarding the effectiveness of foreign aid (e.g., Boone, 1996), the World Bank's much-cited 'Assessing Aid' study (World Bank, 1998) marked a turning point, suggesting that donors could contribute to economic growth in developing countries, but only if they focused their engagement on recipients with reasonable levels of governance. Even though the empirical results that underlie the World Bank's conclusion (Burnside and Dollar, 2000) were later shown to be fragile (Roodman, 2007), the donor community has recurrently stressed the importance of good governance for effective development cooperation (e.g., DfID, 2011; Hout, 2007). Yet, a core result of the aid allocation literature is that the quality of governance in recipient countries has hardly affected the amounts of aid actually committed and disbursed (e.g., Bueno de Mesquita and Smith, 2009; Hoeffler and Outram, 2011). This appears to hold most robustly for corruption, the element of governance that has been given particular attention by donors (e.g., Clist, 2011; Easterly, 2007; Nunnenkamp and Thiele, 2013). Alesina and Weder (2002) even provide evidence that corrupt governments receive more aid.

The most common explanation for the fact that aid flows do not seem to reflect recipient countries' quality of governance is that considerations of recipient merit are dominated by other donor motives. There is ample evidence, for example, that donors pursue a variety of political self-interests when giving aid. These range from preserving ties with former colonies (Alesina and Dollar, 2000) to influencing the voting behavior in the Security Council or General Assembly of the United Nations (Dreher et al., 2008; Kuziemko and Werker, 2006) or the outcome of specific elections (Faye and Niehaus, 2012). Foreign aid is also used to further trade links with recipient countries (Berthelemy, 2006).

An alternative explanation, from which this paper departs, is that donors may hesitate to withdraw support from badly-governed countries as a result of a dilemma they face: exactly those countries most in need of assistance also tend to lack proper institutions. One way of trying to resolve this dilemma is to bypass recipient governments and deliver aid through non-state actors. While a sizeable share of aid by OECD donor countries is indeed channeled through non-state actors, the reasons underlying this pattern are not well understood. Some papers examine whether the conventional donor motives – need, merit and self-interest – differ between aid channels but take the existence of these channels as given and do not try to explain why aid is delivered through state or non-state actors. Dreher et al. (2010), for example, find that Swedish aid that is directly transferred to recipient governments is targeted towards countries with lower GDP per capita whereas aid channeled through NGOs is not. Nunnenkamp and Öhler (2011) document that the various aid channels employed in Germany differ significantly in the extent to which need and merit are taken into account but that no aid channel is unambiguously superior.

This paper explicitly investigates the role of recipient governance for donors' decisions to channel aid through state or non-state actors. A similar argument has recently been made by Dietrich (2013) in the political science literature, according to which bypassing governments via

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NGOs, private contractors, public–private partnerships and multilateral organizations is a response to weak recipient state institutions.[1] In addition to providing an explanation of why donors channel aid through non-state actors, we also contribute to the debate on donor motives. Specifically, we interpret bypassing as evidence that donors are not as selfish as the aggregate relationship between aid and governance would imply. The rationale is that bypassing at a sizeable scale is hardly plausible without donor altruism because self-interest can best be pursued through direct state-to-state interactions. Indeed, on average 25% of all aid committed in 2008 was in the form of state-to-non-state transfers. There is considerable variation across recipient countries, ranging from 8% at the 25th percentile to 40% at the 75th percentile. Governance alone explains up to 30% of this variation.

Our analysis proceeds in three steps. First, we analyze the relationship between institutional quality and the share of aid that is given to a recipient country as state-to-state transfer. In addition to conventional indicators of institutional quality, we use multiple dimensions of "bad" governance such as human rights violations, lacking representativeness of the government, or high levels of military expenditures. We are thus able to obtain a more comprehensive picture of the motives that might lead donors to circumvent governments. Second, we analyze the absolute amounts of aid allocated through different channels to get an indication of the scale of bypassing. While a higher share of foreign aid channeled through non-state actors would hardly matter for a weakly governed recipient country if overall donor engagement in that country was very low, higher absolute amounts would point to bypassing that is quantitatively important. Using absolute amounts also enables us to directly relate our findings to the previous literature on aid and governance that is based on specifications in levels (e.g., Alesina and Weder, 2002). Third, we check whether there is heterogeneity in the relationship between governance and the channel of aid delivery that is consistent with donors bypassing weak state institutions. We first test whether bypassing varies across aid sectors as it should be easier for donors to work with non-state actors in some sectors than in others. For instance, donors may be able to channel aid through NGOs in the case of emergency assistance or health interventions such as vaccinations, while this may be more difficult for larger-scale projects such as investments in road infrastructure. We then check whether donors with a higher degree of self-interest are less inclined to use non-state aid channels in countries with poor governance as they want to preserve their leverage with recipient governments.

We obtain robust evidence for bypassing of governments in relative terms and for the case of corruption and military expenditures also in absolute amounts of foreign aid that is channeled through non-state actors. A one standard deviation decrease in the quality of governance is associated with a two to four percentage point lower share of aid delivered through state actors. As expected, bypassing is targeted towards aid sectors where the degree of substitutability between channels of delivery is high and becomes less prevalent with a higher degree of economic self-interest.

2. Data and descriptive analysis

Data on the channel of delivery come from the OECD's Development Assistance Committee (DAC). Through its Creditor Reporting System (CRS), DAC documents all flows of Official Development Assistance (ODA) of DAC member countries (as well as some non-DAC countries and multilateral organizations) to developing countries. The CRS offers donors the option to report the channel of delivery for every aid transaction to a recipient country. The available channels of delivery include (i) the public sector of the recipient government, (ii) national and international NGOs, (iii) multilateral organizations such as UNDP or the World Bank, and (iv) other development actors such as private contractors.

The share and absolute amount of ODA delivered via different channels to a given recipient country are based on the bilateral aid commitments of all DAC member countries in 2008.[2] Commitments are commonly used in aid allocation studies because they constitute the only variable over which donors exert full control if for some reason recipients lack the willingness or administrative capacity to request committed resources (see, e.g., Neumayer, 2003). For almost a third of the 181,852 bilateral aid transactions recorded by the CRS in 2008, the channel of delivery is not readily coded. This is because the channel of delivery is not a mandatory item in the CRS. We code these missing cases by determining whether the implementing organization (whose name is mandatory to provide) belonged to the public sector, was an NGO, a multilateral organization or another non-state development actor.[3]

The focus of our analysis is on whether aid is channeled through state or non-state actors. In the following, we therefore only distinguish between aid channeled through the public sector (henceforth state-to-state aid) and aid channeled through NGOs or multilateral organizations (henceforth state-to-non-state aid). Our main outcomes of interest are the share of state-to-state aid as well as the absolute amount of state-to-state and state-to-non-state aid in 2008.

Fig. 1 plots the share of state-to-state aid, overall and by donors. Overall, 75% of aid committed in 2008 was in the form of state-to-state aid. In other words, an important share of aid is delivered through non-state channels. There is considerable variation across donors. The share of state-to-state aid exceeds 90% for donors such as Germany, Japan, and France, but is only between 40 and 60% for the Netherlands, Sweden and Norway, who all belong to the group of donors that are considered to be driven more by recipient need and less by economic or political self-interest than other donors.

The share of state-to-state aid varies considerably over aid sectors, too. As Fig. 2 shows, humanitarian assistance stands out as being predominantly channeled through non-state actors. Among the remaining sectors, the share of state-to-state aid ranges from 55% for governance, via 77% for health and education to almost 95% for infrastructure (see Table A1 in the appendix for definitions of the sectors). This pattern is consistent with the notion that it should be easier for donors to bypass the recipient government in sectors where the degree of substitutability between state and non-state actors is relatively high. By high degree of substitutability we mean that, for reasons unrelated to governance, state actors should have no large comparative (dis)advantage over non-state actors when implementing a project in a given sector. Hence, bypassing should be more prevalent in sectors such as governance or health where donors can run relatively small-scale projects that do not require much coordination with the recipient government (e.g., support to advance civil and political rights, female empowerment, feeding programs or basic health care including vaccination campaigns). Bypassing should be less prevalent, however, in sectors such as infrastructure where donors typically run relatively large projects that require strong and continuous high-level support from the recipient government and where little support may be provided by non-state actors such as NGOs (e.g., roads, dams or electricity supply). In fact, most development NGOs including Feed the Children, World Vision, Food for the Poor, Catholic Relief Services, Care, or Amnesty International focus on sectors like food security, health, education, or

[1] An alternative donor response to weak governance is to bypass recipient aid management systems and to rely on parallel systems of aid delivery instead (Knack, 2013).

[2] As of 2008 DAC member countries include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and the United States. In the very few cases for which aid commitments were not reported, we used aid disbursements instead.

[3] We take a recent year for which a fairly complete dataset could be compiled and refrain from adding a time dimension to the analysis because this would provide little additional explanatory power given the highly persistent governance indicators. However, we test whether our results are robust to using other years (see robustness checks below).