

Aid Allocation through Various Official and Private Channels: Need, Merit and Self-Interest as Motives of German Donors

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Summary. — The previous literature largely ignores the heterogeneity of aid channels used by each single donor country. We estimate Tobit models to assess the relative importance of recipient need, merit and self-interest of donors for various channels of official and private German aid across a large sample of recipient countries in 2005–07. Our findings underscore the need for a disaggregated analysis of aid allocation. Aid channels differ significantly in the extent to which need and merit are taken into account. Yet, the German case does not reveal unambiguously superior aid channels.

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1. INTRODUCTION

Birdsall (2005) lists collusion and coordination failure as one of the “seven deadly sins” of donors impairing the effectiveness of aid. It is widely accepted that duplication of efforts and donor fragmentation impose high transaction costs on the recipient countries and absorb scarce administrative resources especially in the poorest among them (Acharya, Fuzzo de Lima, & Moore, 2006; Bigsten, 2006). Recipient countries typically have to deal with dozens of donor countries and multilateral aid agencies. The “aid architecture” can be fairly complex even for single donor countries. This applies especially to Germany (and the United States) (Brombacher, 2009; OECD, 2006). The Ministry of Economic Cooperation and Development (BMZ) accounted for just half of German (bilateral and multilateral) ODA in 2006–07.¹ Apart from various ministries and non-governmental organizations (NGOs), the German aid system is characterized by a complicated structure of implementing agencies under the BMZ umbrella.

Yet donors like Germany are not necessarily main culprits of impairing aid effectiveness through fragmented aid systems. The variety of aid channels may even help achieve the multiple objectives of development cooperation, assign tasks appropriately and develop efficient aid instruments—all possible requirements for aid to be effective. The complex structure may allow for specialization among aid agencies. Indeed, the BMZ praises “the highly specialized skills” of the various implementing agencies to be “a unique characteristic of German development cooperation.”²

The recent Peer Review of the German aid system by the OECD’s Development Assistance Committee (DAC) clearly reflects this ambiguity. On the one hand, this review applauds Germany “for being active in a number of areas which tend to attract less funding from other donors” and its “considerable attention to technical co-operation as a means to promote local capacity development (OECD, 2006, pp. 11 and 17). On the other hand, the same report criticizes “confusion over priority objectives” and the “separation of bilateral country programmes into free-standing, vertically organized compart-

ments of technical or financial co-operation” (OECD, 2006, pp. 11 and 57).

Arguably, donor fragmentation and complex delivery systems are a minor problem if specialized agencies agree on a clear division of labor that prevents duplication of efforts and the presence of each single agent across the whole spectrum of recipient countries. It is in this respect that the subsequent analysis of the determinants of aid delivered through different channels may provide important insights. For instance, financial and technical cooperation could focus on recipient countries with different characteristics. General budget support through financial grants may be provided only to a subset of poor countries with reasonably good governance, while specific technical assistance may also be offered to relatively advanced countries and may be less dependent on local governance. NGO aid proper as well as ODA channeled through political foundations, clerical organizations, and other NGOs may be used primarily for serving recipient countries with weak democratic structures where government-to-government transfers are unlikely to be effective. More generally, the relative importance of aid determinants should vary across channels if aid agents specialized on selected objectives and tasks. Conversely, the case for multiple aid channels would be particularly weak if aid determinants hardly differed.

The OECD’s Creditor Reporting System implicitly acknowledges the importance of specialization and donor fragmentation within DAC countries by offering to users of its extensive database the option of breaking down total aid into “channels.” However, doing so is of little practical use. About half of aid disbursed by all DAC countries in 2005–07 remains “to be defined,” that is, is not assigned to any specific channel.

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Moreover, the “public sector” that accounts for most of the rest is no further differentiated.

Given the scarcity of relevant data, it is not surprising that the aid allocation literature has hardly addressed the question of whether the relative importance of “need, merit and self-interest” (Hoeffler & Outram, 2008), representing the three major motives underlying aid, differs between aid channels used by one particular donor country. The bulk of the previous literature compares the allocation of total aid across donor countries, notably with respect to classifying DAC countries into altruistic and selfish donors. Recent studies include Baulch (2006), Berthélemy (2006), Dollar and Levin (2006), Hoeffler and Outram (2008), Nunnenkamp and Thiele (2006), Sawada, Yamada, and Kurosaki (2008), and Younas (2008).³ Donor countries have also been compared by analyzing the allocation of specific types of aid. For instance, Neumayer (2005) focuses on food aid, while Thiele, Nunnenkamp, and Dreher (2007) cover sector-specific aid related to the Millennium Development Goals. Collier (2006) focuses on the multiplicity of aid instruments, rather than agencies. In particular, he argues that recipient country characteristics such as the level of economic development and the quality of governance should determine whether transfers take the form of grants or concessional loans. Bilateral donors, including Germany, tend to ignore that a rationale exists for both grants and loans.⁴

The few papers that refer to aid channels in a donor country-specific context almost exclusively do so by comparing the allocation of aid through public and private channels.⁵ Dreher, Mölders, and Nunnenkamp (2009) analyze Sweden’s aid delivery through (Swedish) NGOs. Schulpen (1997) provides an earlier and more detailed comparison of Dutch ODA and co-financed aid through clerical organizations in selected Indian states. Similarly, Nunnenkamp, Weingarh, and Weisser (2009) are interested primarily in the distinction between Swiss ODA and Swiss NGO aid. However, these authors seem to be the first in considering various aid channels of one particular donor country. In particular, Swiss aid statistics allow for comparing the allocation of ODA from different public sources. Indeed, Nunnenkamp, Weingarh, and Weisser find that it depends on the source of NGO funding as well as the choice of the official benchmark whether or not NGOs provide better targeted aid.

The differentiation between public and private aid channels is of interest in order to assess the widely held view that NGO aid is better targeted to the needy than ODA. NGOs may be closer to the poor by circumventing (often corrupt) governments. NGOs working on the ground in a recipient country could monitor more effectively the distribution of aid to the needy, while government-to-government transfers are more likely to suffer from bureaucratic interference and higher transaction costs. On the other hand, NGOs may be reluctant to address the most entrenched forms of poverty and to work in particularly difficult local environments. Rather, they may have to demonstrate visible and short-term results in order to secure future funding through private donations and/or official co-financing. Clearly, cross-country studies, including the present one, cannot resolve the controversial debate on the poverty orientation of NGO aid.⁶ They fail to capture the poverty-oriented targeting of aid *within* recipient countries. Yet the cross-country perspective offers valuable insights on whether NGOs focus on needier recipient countries when allocating their aid. Moreover, it is possible to assess whether NGO aid is less likely to be distorted by political and commercial self-interest that official donors tend to have when deciding on the allocation of ODA.

According to the principal-agent model of Fruttero and Gauri (2005), funding concerns—notably dependence on offi-

cial refinancing—tend to weaken the incentives of NGOs to engage where they might be needed most. This could explain why Dreher *et al.* (2009) find the poverty orientation of Swedish aid delivered through NGOs to be surprisingly weak. While the distinction between private and official aid channels may be blurred by co-financing mechanisms, it would be equally simplistic to assume that aid allocation through the various official channels is driven by a uniform set of donor motives. As a matter of fact, individual donor countries such as Germany do not have full control over some aid channels. Debt relief provides a case in point: while the cancellation of repayment obligations related to ODA loans from particular donor countries counts as bilateral aid, debt relief efforts are often the result of multilateral negotiations (among members of the so-called Paris Club). As a consequence, one would expect that such aid channels are less affected by commercial and political interests that national donors might have.

At the opposite end of the spectrum, local and regional bodies often decide over the allocation of part of a donor country’s ODA. As will be shown below, the German Länder (federal states) have a peculiar aid agenda due to the fact that education belongs to their core competences in the German federal system. This is likely to result in aid allocation criteria that differ from those driving ODA from central government agencies.

Different criteria may apply even if central government agencies have the say over the allocation of ODA. This is fairly obvious in cases such as Switzerland where the State Secretariat for Economic Affairs (SECO) represents an important official source of ODA (Nunnenkamp *et al.*, 2009); SECO’s principal mandate is to “ensure sustainable economic growth” in Switzerland, for example, by helping “ensure access to all markets for Swiss goods and services and investment.”⁷ However, the relative importance of need and merit, if not the donor’s self-interest, can also be supposed to differ between implementing agencies of the same central ministry. Various German agencies are handling different aspects of international development cooperation under the BMZ umbrella (see Section 2 for details). Taking recent donor statements at face value, merit should figure most prominently as a determinant of financial cooperation, compared to (project-specific) technical cooperation. For example, BMZ guidelines explicitly state that general budget support should be granted primarily to well-governed recipient countries (BMZ, 2008). By contrast, emergency aid may be driven exclusively by need and is most unlikely to reward better governed recipient countries.

In summary, analyzing aid allocation on the basis of aggregate aid statistics is likely to blur significant differences between aid channels. Aid from a single donor country can be expected to reveal as much heterogeneity as the well-known comparisons across donor countries. This proposition is tested in the following for the case of Germany, which ranked third among all DAC donor countries with disbursed aid in the order of US\$ 33 billion in 2005–07.⁸ We discuss data issues and method in Section 2. Results are presented in Section 3, and Section 4 concludes.

2. DATA AND ESTIMATION APPROACH

(a) German aid channels

We combine two datasets on various channels through which German aid is delivered.⁹ The first source is a detailed account of bilateral ODA across recipient countries.¹⁰ In addition to separating financial cooperation from technical cooperation, this source further refines the channels through

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