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The Politics of Public Health Aid: Why Corrupt Governments Have Incentives to Implement Aid Effectively

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Summary. — Conventional wisdom suggests that foreign aid is more effective in less corrupt states. Recently, however, research is emerging that suggests that this argument may be too broad and that the effect of governance on aid effectiveness is masked by the study of aggregate aid flows. I focus on the public health sector and develop an argument of strategic compliance: corrupt recipient governments have incentives to comply with donor objectives but they will do so in aid sectors, in which compliance is cheap. I use two-step Generalized Method of Moments (GMM) as my primary estimation technique. I find strong and robust evidence for my argument.

Key words — foreign aid effectiveness, health aid, corruption, immunization, DTP3

1. INTRODUCTION

Conventional wisdom in the aid effectiveness literature suggests that good governance in the recipient translates into effective aid use. While most research judges effectiveness in terms of economic growth (Burnside & Dollar, 2000, 2004; Bearce, 2009), other studies examine the conditioning effect of governance on aid using other development outcomes (Kosack, 2003; Masud & Yontcheva, 2005). In spite of their different approaches to studying aid effectiveness, what these studies share is their focus on the role of institutions in the aid implementation process, assuming that institutions have a uniformly positive effect on aid effectiveness. Once we disaggregate aid by sector, however, the role of institutions might be more complex.

Consider a country like Bangladesh, which ranks among the world's most corrupt countries by most indicators (Transparency International, 2006). Bangladesh received US$ 833 million in foreign aid in 2006, of which US$ 170 million was health-related aid. In spite of high corruption levels Bangladesh has shown noteworthy success over the last 15 years in improving the provision of basic health services. Donor representatives frequently applaud Bangladeshi cooperation in addressing basic needs of their citizens, with a particular emphasis on child health outcomes, yet point to the persistence of disparities across income groups (e.g., World Bank, 2002). As a senior US government official said during an author interview: "Bangladesh has always shown receptivity when it comes to doing things differently, especially in the health sector. And whether a country is receptive to our calls will affect the nature and size of our assistance." [1]

Similarly, Mali, which also ranks on the bottom of Transparency International's corruption index (2006), recently received a favorable mentioning by an OECD health aid assessment (2009). The report indicates that Mali has made "marked progress in recent years in managing aid for health" (p. 34), but accomplished little in other sectors. Important sector-specific steps that contributed to positive developments in both cases include a focus on targeted and sustained immunization, national awareness campaigns on the treatment of diarrhea, special government programs to reduce pneumonia-related deaths, better sanitation, and better access to safe water.

For existing theories of aid effectiveness focused mostly on the quality of governance, such anecdotes might appear anomalous. The high corruption scores should mean that Bangladesh's government would channel considerable amounts of public health aid for private gain, with less to spare for development purposes. [2] Indeed, why then would the government of Bangladesh and other similar country cases make any attempt to use public health aid effectively?

I argue that donors approach aid effectiveness differently in highly corrupt countries. They anticipate weak institutions and look for sector-specific progress as signals for recipients' willingness and ability to use aid effectively. Such policy, in turn, generates incentives among corrupt governments to assess costs related to compliance with donor goals across the different foreign aid sectors. Differences in compliance costs across sectors induce a policy of strategic compliance: recipients will favor cooperation with donors in sectors that rank highly on donor policy priorities and, more importantly, in which compliance is relatively cheap. This strategy allows corrupt recipients to accomplish at least some developmental tasks successfully, thereby justifying additional aid inflows.

The results of this paper show that research on aid effectiveness might benefit from the study of politics within specific aid sectors. After all, foreign aid is given to accomplish a variety of goals, which differ in importance to donors and recipient governments; thus, affecting probabilities of sector aid success. At a minimum, this paper might encourage scholars to reexamine the conventional wisdom that predicts an aid-governance multiplier effect and that assumes governance to have a uniformly positive effect on aid effectiveness.

2. THE ROLE OF INSTITUTIONS FOR AID EFFECTIVENESS

A large number of works have examined the role of institutions in aid effectiveness. Among economists, the study of aid effectiveness has been around for more than a decade, with a

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focus on economic growth. Burnside and Dollar's (2000) seminal piece introduces governance into the aid effectiveness debate. They find that aid increases growth but only when it is combined with "good" economic policies, including openness, monetary policy, and fiscal policy. Similar evidence is found in Collier and Dollar (2002), which shows that foreign assistance has a positive effect on economic growth if a recipient country's quality of economic institutions and policies is high. Burnside and Dollar (2004) shift their focus from policies to institutions, finding empirical support for a multiplier effect of good governance.

Among political scientists, at the heart of research aid effectiveness is the conditioning effect of political institutions. For instance, Bueno de Mesquita and Smith (2007) show that democratic governments with large selectorate and winning coalition have strong incentives to invest the foreign aid in producing growth-promoting goods. Dictatorships, on the other hand, need to satisfy a small selectorate and winning coalition and can pocket more of the aid revenue. Focusing on institutional variation within democracies, Wright (2010) examines the role of personalism in aid effectiveness. He shows that leaders of countries with high levels of personalism have incentives to pursue corruption by systematically targeting government spending to narrow constituencies, rather than growth-promoting public goods. Kosack (2003) also investigates the conditioning effect of democracy but looks at human development. He shows that more democratic governments are more effective at channeling aid by improving peoples' lives, as measured with the Human Development Index.

Although studies differ in terms of how they study aid effectiveness and what institutions they identify as conditioning the effect of aid on development outcomes, what they all share is their focus on aggregate levels of aid. This focus is problematic as it overlooks the heterogeneity of aid flows. After all, donors give aid to achieve a variety of goals (Clemens, Radelet, & Bhavani, 2004; Rajan and Subramanian, 2005). Increasingly, then, scholarship has turned to disaggregating aid by sector and to studying its effects on more specific outcomes (Michaelowa & Weber, 2007; Mishra & Newhouse, 2009).

This paper adds to the study of aid effectiveness in two ways: First, it disaggregates aid by sector. Specifically, it analyzes the effect of health aid on the provision of basic services in recipient countries. Second, it develops and tests an argument about "strategic compliance" that explores strategic aid implementation behavior of corrupt leaders and explains why foreign aid to certain sectors might yield better results than to others in corrupt societies.

3. DONOR PRIORITIES AND THE NEW AID ARCHITECTURE

What makes health aid effective? It is important to place this paper's overarching research question in light of what some scholars have labeled a "new" global aid architecture, which situates poverty reduction at the center of donor concerns and policies (Mosse, 2005; Renard, 2006). In the Millennium Development Goals human foundations for development and needs-oriented aid giving take center stage; and it is among the world's very poorest countries where progress is often very difficult to achieve. While donor policy frequently suggests that strong state institutions are important for effective aid implementation, allocating foreign aid selectively in favor of more capable recipients implies that countries which need the aid most get very little.

(a) *Corruption and public sector output*

If countries have weak institutions they face an a priori credibility problem. Corruption, in particular, represents one of the most persuasive challenges to sustainable development and effective aid implementation (Davis, 2003; Goldsmith, 1999; Rose-Ackerman, 1999). [3] Following Mauro (1995) I define corruption broadly as the use of public office for private gains, which is difficult to monitor for the public. A growing body of research suggests that corruption hampers development in a variety of ways. For instance, it distorts income distribution and tax systems (Chang, 2007). Corruption also yields misallocated social welfare spending, by systematically targeting the loyal base (Lui, 1985). In addition, Gupta, Davoodi, and Tiongson (2002) show that, aside from generating incentives to misallocate public spending, corrupt systems of governance also affect the quality of public service output. And finally, rent seeking shrinks the opportunities available to developing countries as investments become less productive and private and foreign direct investments decline (Mauro, 1995; Okrulhik, 1999; Wei, 1999).

In light of the negative effects of corruption on development, donors should be highly suspicious of countries such as Bangladesh and Mali. Like many others, these states have no means to signal credible commitment to development via institutions. But governance criteria or, more specifically, the level of corruption may not to be the only benchmark informing donor perception of a recipient's commitment to development. As a senior British government official highlighted: "There has been a significant paradigm shift somewhere in the last 10 to 15 years where everybody says that you cannot leave the tough spots. You still take account of corruption and state capacity but your premise is that it's not there. You look for small steps. You look for changes in behavior." [4]

Institutions may be credible signals but donors also look for and are willing to reward "positive trends" in development. As a senior German government official suggests: "We always look at corruption and governance but their role is not necessarily critical in making allocation decisions. Most of all, we are interested in trends. If we see positive signals in terms of behavior then we want to intervene more. If there are negative signals then we need to re-evaluate our commitment. We favor spending our foreign aid in countries that show positive trends in spite of weak governance ratings. Liberia and Burkina Faso are good examples: governance is weak and corruption is entrenched but their willingness to reform has encouraged us to support the government. Guinea Bissau, on the other hand, has weak governance ratings, high corruption, and shows no positive behavioral trends. We choose not to cooperate with their leadership." [5]

(b) *Donor constraints in aid allocation*

A quick glance at aid allocation patterns among Western donors confirms that substantial amounts of foreign aid continue to flow to corrupt countries. And while this might suggest a policy failure to some (Alesina & Weder, 2002; Easterly & Pfutze, 2008), it may well be indicative of donor practice that is often overlooked in the literature: recipient governments' "good behavior" in foreign aid sectors, irrespective of their poor national institutions, matters for allotment. When evaluating the high fiduciary risks associated with spending money on the world's poorest and often most corrupt countries, donors look for specific sector-related progress. And progress may simply be a function of how well recipients respond to donor objectives and use the aid to address devel-