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Development Effectiveness at the Country Level

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Preface

Development cooperation has increasingly come under pressure to both increase and better demonstrate its effectiveness. There are several reasons for this:

- unsatisfactory development progress in many developing countries,
- international cross-section analyses questioning the effectiveness of official development assistance,
- difficulties faced by the aid profession in demonstrating the effectiveness of its efforts,
- the high pressure under which the international community has put itself by taking far-reaching decisions in the last few years with a view to increasing the effectiveness of development cooperation (e.g. the 2000 UN Millennium Declaration and the 2005 Paris Declaration on Aid Effectiveness, both cornerstones of what is called the international aid effectiveness agenda).

Efforts to enhance the effectiveness of aid should be based on a sound knowledge of what development cooperation has actually achieved in terms of effectiveness. Yet our knowledge in this respect is rather sketchy for two basic reasons. First, development cooperation has long focused on inputs (i.e. the resources mobilized for aid purposes) and outputs (i.e. the products and services financed from aid) rather than on outcomes (the benefits resulting for the intended target groups) and impact (the positive and negative, direct and indirect effect produced by a development intervention). Second, despite the growing attention paid to outcomes and impact methodological problems make their proper assessment a difficult and tricky endeavour, especially when the analysis is not confined to individual projects but extends to the country level, i.e. the question of how far aid has contributed to the overall development of recipient countries.

It is, ultimately, the latter question that interests tax payers in the donor countries. They may be convinced to some extent of the usefulness of aid when aid institutions demonstrate the effectiveness of projects and programmes. However, being confronted almost daily with bad news about lack of progress, persistent poverty, humanitarian disasters and civil strife in many countries, the public wants to know whether aid, considered in the aggregate, actually works, whether it has a positive impact on development and, if so, why nonetheless the situation in many partner countries appears to be worsening. Yet it is particularly difficult to provide answers to questions of this kind. And when no precise answers are forthcoming, there is much room left for controversies, justified *and* unjustified criticism and, eventually, for confusion.

The German Development Institute is currently preparing a volume entitled *"Die Wirksamkeit der Entwicklungszusammenarbeit: Ziele, Befunde, Herausforderungen"* (Improving Aid Effectiveness: Goals, Evidence and Challenges). One part of the volume, devoted to evidence of aid effectiveness, contains four chapters: one dealing with methodological aspects, one summarizing the results of statistical cross-country analyses of the impact of aid on economic growth, per capita income and/or poverty reduction in recipient countries, and one presenting evidence of aid effectiveness at the project level.

Because of the aforementioned interest in the overall impact of aid, the institute thought it important to include a chapter on the evidence of aid effectiveness at the country level. We therefore invited Robert Picciotto, former Director of the World Bank's Operations Evaluation Department (OED) and currently Visiting Professor at King's College, London, to deal with

this aspect. He contributed a paper which, in addition to addressing methodological questions and presenting extensive evidence, discusses a number of issues raised in the current debate on aid effectiveness (e.g. the fungibility of aid, the micro-macro paradox or the conditions under which aid can be expected to be most effective).

Since the issue of aid effectiveness at the country level appears to be both under-researched and particularly contentious, the institute wishes to make Robert Picciotto's paper available even before the volume comes out. We have therefore decided to publish the paper in advance in our series *DIE Discussion Papers*. We take this opportunity to thank Robert Picciotto again for his highly stimulating contribution.

Bonn, May 2006 Dr. Guido Ashoff

Contents

Summary 1

Introduction 3

1 What has development achieved? 4

2 Does aid make a difference? 5

3 From projects to country programs 7

4 The micro-macro paradox 9

5 Can country assistance strategies be evaluated? 12

6 What did country level evaluations find? 15

7 Where is the aid industry going? 18

8 What is to be done? 21

Boxes

Box 1: The debate about the true value of aid 11

Box 2: Country assistance strategy and project portfolio outcome ratings 15

Summary

While we know a lot about how countries become prosperous, we have only begun to understand how aid contributes to economic growth and poverty reduction. The development record is mixed and no robust association between the volume of aid and development performance has been unearthed. Cross country regressions do not throw much light on the reality of aid. The novel mix of qualitative and quantitative methods fashioned by independent evaluators is more informative regarding aid effectiveness both at project level and at country level. A new brand of country assistance evaluations demonstrates that success at project level matters even if it does not always translate into success at country level – the 'micro-macro paradox'. Well managed aid works when it uses instruments that are tailored to specific country contexts. Budget support mechanisms and program aid instruments have a role to play in some circumstances. Projects are the aid vehicles of choice in others. The popular notion that development effectiveness can be ensured through the targeting of aid towards countries that are classified as good performers by idealized sets of indicators has been discredited. Conversely, recent policy research findings suggest that, despite the risks involved, aid does the most good when it privileges the weakest and poorest economies and those most vulnerable to shock. To achieve development effectiveness at country level, coherence of interventions is critical as is judicious sequencing. Development operations should be (i) selected to fit within coherent country assistance strategies; (ii) aligned with the priorities of the country and (iii) coordinated with other policies and the actions of partners. This is because the quality of aid matters as much as its quantity since it is a transmission belt for ideas, a device to train development leaders, an instrument to build state capacity and a platform for policy experimentation and dissemination. The final proposition offered by this paper is that professionally administered aid works but that it would work even better in concert with reforms of rich countries' policies. The new development agenda should extend beyond aid. It should aim at levelling the playing field of the global market and at peace building in the zones of turmoil of the developing world.

"Each project may not look formidable on its own but the combined impact of hundreds of coordinated projects could far outweigh empty words and rhetoric."

Junichiro Koizumi, Prime Minister of Japan (2005)

Introduction

What makes countries rich or poor? Why are some countries prime movers of economic expansion while others are mired in stagnation? How do resources, technology and social arrangements interact to generate development? These questions are being widely debated in this 'year of development' (Birdsall / Rodrik / Subramanian 2005) but they have preoccupied economists since the eighteenth century. Malthus viewed the discovery of *"the causes of the wealth and poverty of nations (as) the grand object of all enquiries in Political Economy"*.[1] Adam Smith laid the foundations of classical economics in order to elucidate the 'progress towards opulence and improvement' of nations. Since then, we have learnt a great deal about how economies grow.

By contrast, we know far less about how aid contributes to development. The notion that rich countries have an interest (indeed an obligation) to help alleviate poverty reduction in faraway lands is only half a century old. The aid industry is the 'new kid on the block' of international relations. Public support for aid is still volatile and fragile. This is because we live in a world of states (rather than a world state) and *"the people for whose benefit aid agencies work are not the same as those from whom their revenues are obtained"*.[2] Along the chain that links rich countries' taxpayers and the poor citizens of developing countries slippages inevitably occur. Absent the accountability provided by the voting booth, the construction of an effective feedback mechanism is central to the legitimacy of aid (Martens 2005).

This is why aid agencies exist. They mediate between the preferences of donors and recipients and they manage the risks inherent in the transfer of resources. To this end they have had to design elaborate institutional arrangements in order to justify to taxpayers in rich countries that the funds they have provided through their taxes have been put to good use. The poor citizens of recipient countries are equally keen to know that the funds provided by rich countries for their benefit have not been diverted towards non-productive uses. To this end, a wide range of controls (auditing requirements, competitive bidding, supervision missions, etc.) has been put in place.

Fiduciary controls are necessary to guarantee development effectiveness. But they are not sufficient. Auditing may have confirmed that the funds were used for the purposes intended. However, such purposes could have been misconceived; the means used to achieve them could have been poorly selected or the aid administration may have been incompetent or inefficient. Ultimately, what citizens want to know is whether the benefits of the aid have been commensurate with the costs and whether poverty was reduced as a consequence of the aid.

Is development working? Does aid make a difference? Why do project and country level results differ? Does country level conditionality work? How do we know whether aid programs

1 Letter to Ricardo dated January 26, 1817; from J.M. Keynes, Collected Works, X, 97–98 (quoted from Landes 1998, frontispiece)

2 The principal-agent problems associated with aid (multiple principals, incoherent objectives, information asymmetries, monitoring costs, distorted incentives etc.) are explored in Martens et al. (2002).

are meeting their goals at the country level? Where is the aid enterprise going? What should be done to improve its effectiveness? These are the basic questions on the public mind. This chapter reviews the evidence and draws the implications for development cooperation.

1 What has development achieved?

There are good news and bad news in development. During the 1960–80 and the 1980–2000 periods annualized per capita growth rates were 2.1 percent and 3.6 percent for developing countries compared to 3.3 percent and 2 percent for rich countries. The narrowing of the gap between the per capita incomes of rich and poor countries during the second period (compared to its expansion during the first period) implies progress towards convergence and evinces hope. But if we leave China and India out,[3] per capita incomes in poor countries rose by an annual average of only 2.3 percent and 1.2 percent for the same two periods (Bhalla 2002). This indicates growing divergence in per capita incomes during both periods and induces gloom.[4]

Regional differences are large. For 1980–2000, East Asia achieved 6.6 percent annual per capita growth, South Asia 3.4 percent, Middle East and North Africa 1.2 percent and Latin America 0.5 percent – while Sub-Saharan Africa regressed by 0.3 percent annually. The differences are even more striking among countries: during 1990–2000, GDP per capita grew by 9.2 percent annually in China and declined by 12 percent annually in Georgia. Such divergences in performance have massive implications for human welfare.

Growth has a cumulative impact on living standards. If, in John Lennon’s words, we ‘imagine, there is no country’ the development narrative is positive (Bhalla 2002). Average social indicators have recorded major gains: life expectancy rose from 55 years in 1970 to 64 years in 2000; infant mortality rates dropped from 107 per thousand in 1970 to 58 in 2000; literacy rose from 53 percent in 1970 to 74 per cent in 1998; the number of people suffering from chronic malnutrition declined from 35 percent to 17 percent of the population.

But here too, there are major variations across regions and countries. In thirty-two countries life expectancy actually fell in the 1990s because of the HIV/AIDS epidemic. In Africa progress in infant mortality was much slower than elsewhere – from 116 in 1980 to 91 in 2000 while the number of the undernourished actually increased from 168 million to 194 million. The impact on poverty has also been highly differentiated around the world.

As a share of the total population, poverty dropped between 1981 and 2001 – from 67 percent to 53 percent for the two dollar a day benchmark. But once again the improvement is almost entirely due to China’s extraordinary growth performance and, in per capita terms, China received very little aid.[5] Elsewhere, the growth in the number of the absolute poor has exceeded

3 In both countries taken together, per capita incomes grew by an average of 1.8 percent annually in the first period and by a hefty 6.1 percent during the second period.

4 In terms of purchasing power parities, the per capita incomes of rich countries rose by 3.3 percent and 1.6 percent in the two periods while it rose by 2.1 percent and 3.1 percent for all developing countries and by 2.5 percent and 0.7 percent if China and India are excluded.

5 Likewise India received modest levels of aid in per capita terms and yet it has been growing rapidly since the reforms of 1991.

the reductions. Based on the two dollar a day benchmark, the number of poor people worldwide increased from 2.5 billion in 1981 to 2.7 billion in 2001 (Chen / Ravallion 2004). Tragi cally, in Sub-Saharan Africa, overall poverty rates have been rising instead of declining and this is a region that has received a great deal of aid.[6]

2 Does aid make a difference?

The fortunes of aid recipients vary. Some aid recipients have experienced growth rates that are unprecedented in world history. Whereas the United Kingdom took about sixty years to double output per person (1780–1838), Turkey did it in twenty years (1957–77), Brazil in eighteen years (1961–79), and China and Korea in ten years (1977–87). Between 1966 and 1990, Thailand tripled its real per capita income and India doubled its per capita income (World Bank 1998).

By contrast, Ethiopia and Zambia saw no income per capita growth at all[7] and both countries received vast amounts of aid. In 2001 four countries (Malawi, Niger, Honduras and Kyrgyzstan) received aid averaging 15 percent of gross national incomes and experienced negative per capita income growth while six other developing countries with GNP per capita growth rates in excess of 7 percent (Angola, Azerbaijan, China, Latvia, Moldova and Turkmenistan) averaged aid dependency rates of only 3 percent.

Aid pessimists may conclude that aid can be a curse while aid optimists will retort that little can be concluded from one year data given the long lags between aid flows and development results. Aid advocates will also point to Eritrea, Uganda, Ghana, Mozambique, Tanzania that displayed GNP per capita growth averaging 4.8 percent and they will probably argue that such performance would not have materialized without aid that averaged 22 percent of their gross national incomes. Evidently, these are countries where, based on other corroborating evidence, aid appears to be working.

Thus, it seems that aid does not always work. But it does not always fail either. Development is not a simple process and firm generalizations about aid are hard to come by. The literature points towards a positive association between aid volumes, growth and poverty reduction but the relationship is weak and contested. A systematic review of cross country correlations suggests that the effect of aid volumes on growth is small and statistically insignificant in the aggregate (Roodman 2004). This is in part because the econometric studies that underlie this conclusion do not distinguish between aid channels, instruments or modalities.[8] Nor do they take account of the social and institutional environment within which aid activities are embedded.

6 Whereas its share of the developing world's population is about 10 percent. Based on OECD data, Sub-Saharan Africa received a third of all aid in 2004 – US $ 26 billion out of a total of US $ 78 billion (OECD/DAC 2006, Table 25).

7 Relative to the United States, the real per capita income of Thailand rose from 10 to 20 percent; India's from 5 to 7 percent while Ethiopia's and Zambia's dropped from 2.4 percent to 1.8 per cent and 8.5 percent to 3.8 per cent respectively (World Bank 1998, 31).

8 A study that decomposes development grants and loans finds that loans to countries with good development policies promote growth whereas grants do not (Sawada / Kohama / Kono 2004).

The quality of market institutions appears to be a significant antecedent of growth. For example, the 'rules of the game' governing the investment climate in developing countries – measured by the ease of starting a business – is strongly correlated with labor productivity (World Bank 2004).[9] The weaker the property rights regime and the rules-based governance practices, the poorer the country. Banking sector penetration measured by the ratio of bank deposits to GDP is far lower in low-income countries (21 percent) than in upper middle-income countries (49 percent). Macro-economic policy is an important factor as well: low-income countries that experienced relatively good growth (higher than the median rate) had unsatisfactory fiscal, public spending and macroeconomic policies in only 16 percent, 38 percent and 16 percent of the cases respectively – compared to 51 percent, 59 percent and 29 percent for countries with growth lower than the median rate.

Does this mean that aid always works better in environments where policies comply with all the strictures of the development establishment? So far, the burden of evidence does not confirm that the aggregate volume of aid gives better results in countries where policy indicators (e.g. as measured by the World Bank) are good (Roodman 2004). This could simply mean that we do not know exactly how to measure the quality of policies in different country environments. Alternatively, the resource transfer dimension of aid may not be all that relevant, i.e. aid is less about money than about ideas, linkages and demonstration effects – what has been labelled 'the centrality of side effects'(Hirschman 1995).

Unfortunately, policy research has concentrated on the volume of aid. Yet, practitioners know that the quality of aid (the efficiency of its delivery, the choice of instruments selected, the adequacy of aid terms, etc.) is as important as its volume. They note that the conclusions reached by aid pessimists are based on studies that have examined the impact of aid over too short a period and/or included humanitarian aid negatively correlated with growth because it is given in times of crisis. Recent work at the Center for Global Development (Clemens / Radelet / Bhavnani 2004) shows that correcting for these distortions aid has a large and positive impact on growth.[10] Every dollar of aid raises output by 1.6 dollars in present value terms and the authors of the study assert that the correlation is highly significant and robust. It is not sensitive to the quality of policies or the level of incomes.

Rigorous evaluations combining qualitative and quantitative assessments are rare in the development system but when such evaluations are conducted professionally and independently they deliver robust judgments about aid quality. Of course, aid quality matters on both sides of the aid relationship. A large number of organizations of varying competence channel aid to poor countries. They pursue diverse agendas. Even for a single donor, aid is often saddled with multiple objectives (e.g. poverty reduction, democracy promotion, security concerns, commercial interests, etc.). Most damaging perhaps is the frequent misalignment of goals and practices in relation to the recipient country, especially in the poorest and most aid-dependent countries where aid administration 'on the ground' is weak.

In brief aid quality has four dimensions: (i) the consistency of ends and means within a project or program (in terms of its relevance, effectiveness, efficiency and resilience to risk); (ii)

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9 All statistics in this paragraph are from this source.

10 The study refers to aid designed to have a positive impact within four years (whether in the form of budget support or the lending for infrastructure, industry, or agriculture). It accounts for more than half of all aid flows.

the congruence of aid and non-aid policies within the donor country; (iii) the degree of harmonization and coordination of aid programs among donors; and (iv) the alignment of aid goals and practices with the country's own. Performance in terms of all four dimensions is important for aid effectiveness. This is why aid effectiveness is so hard to achieve. Similar considerations underlie the 'policy coherence for development' agenda that has become a central focus of 'whole of government' approaches in many OECD countries (Picciotto 2005).

3 From projects to country programs

Until recently, development evaluation had concentrated on the first dimension – the linear connections between aid inputs and development outcomes. Projects were perceived as the main unit of account. Obviously, development effectiveness is far easier to evaluate at this primary level because projects connote clear objectives, well defined features and a systematic approach to getting things done. They specify the shared goals, distinct accountabilities and reciprocal obligations of the partners. While shunned by macroeconomists who look at aid as a resource transfer, they are popular with politicians keen to fly the national flag on successful projects. They also appeal to a group of social scientists who conceive of development as microeconomic in nature and embedded in society. For them, the transformation processes associated with development are local phenomena that take place at the community level where social relationships are forged.[11]

Thus, and until macroeconomists captured the commanding heights of the development profession, projects were 'where the action was'. For Albert O. Hirschman (1995), projects *"have much in common with the highest quests undertaken by human kind"*. They are *"privileged particles of development*", *"units or aggregates of public investment that, however small, still evoke direct involvement by high, usually the highest, political authorities"*. They produce visible results that taxpayers in rich and poor countries alike can understand and appreciate. For all these reasons, projects have long been (and are likely to remain) essential vehicles of development assistance.

The positivist assumptions that underlie projects are that (i) national leaders can be influenced through the visible impact of specific investments; (ii) societies can learn from experience and (iii) development interventions can overcome the legacy of conditions over which decision makers have little or no control (e.g. geographical handicaps, lack of skills or limited natural resource endowments). But projects are not implemented in a vacuum. Just as they impact on the institutional environment, their beneficial impact varies according to the country context. Conversely, projects are not ends in themselves. They are levers of country development, symbols of international cooperation, metaphors for modern management, platforms for social learning and incubators of national leadership.

Besides, from the very start of the development enterprise, nation-building was an explicit objective of development cooperation. Then as now, bilateral aid frequently aimed at diplomatic leverage. Politically, projects were justified by considerations of national security or

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11 This perspective underlies the participatory development doctrine, the fruit of disappointment with centralized, top-down initiatives and highlights the information advantages of local actors. However, these may be offset by the risks of elite capture and misappropriation of funds in weak states (Roland-Holst / Tarp 2002).

commercial advantage. Economically, they were conceived as slices of country investment programs and their justification was measured in terms of their net contribution to the country's gross national product measured by a rate of return. As the role of good policy came to light, the project instrument was reshaped to promote explicit reforms and fashioned to generate development knowledge (Rondinelli 1993). Later, as governance emerged as a critical determinant of country performance, the institutional development impact of projects emerged as a notable criterion of aid effectiveness.

In short, projects have always been used as policy tools and their designs have gradually adapted to changing conceptions of development. But they involve substantial transaction costs and have no comparative advantage in countries that have acquired the institutional strength to manage effectively large scale poverty reduction programs. In such countries, budget support makes sense. Instrument selectivity is critical to aid effectiveness.

By now, it has become an article of faith within the aid establishment that the success of development operations (project aid as well as program aid) should be measured in terms of their cumulative effects at the country level. Up-scaling of operational results has become a major preoccupation of aid managers. For the development community today, it is the direct and indirect impact of the portfolio of externally funded operations (along with the other services funded by the aid) rather than the aggregation of benefits from individual operations measured case by case that matters: the country has become the privileged 'unit of account' and this is all to the good.[12]

The realization that development requires a sound policy framework and sound institutions rather than simply more and better public investment funded by aid has had a major impact on the aid industry. All aid agencies now shape their operations and sequence their interventions to achieve strategic results at the country level. Thus, the design and implementation of country assistance strategies has come to the centre stage in aid management. Typically, the design of a country assistance strategy involves the judicious structuring of operational portfolios combined with technical cooperation and an explicit dialogue with country authorities about the policy objectives of donor involvement.

In this context, it is no longer sufficient to measure development effectiveness project by project or even program by program. Individual operations must now be conceived as building blocks of the country assistance strategy. They are expected to fit within a coherent design: the country program edifice is expected to rest on sound institutional foundations; to be buttressed by the beams and pillars of good policies and to be held together by the cement of partnership. Only then do aid projects and programs contribute to large-scale social transformation and sustainable development. Most development agencies are equipped with evaluation systems that track the results of individual projects and programs. While not all of these systems are reliable, the most rigorous confirm that, as long as success is measured operation by operation, 'aid works' (Cassen et al. 1994).

12 While serving at the World Bank in the 1950s, Paul N. Rosenstein-Rodan advocated a broadening of the project approach to encompass the entire economy – through investment in country development programs. Only when macroeconomic policy conditionality took centre stage did his vision prevail. By then, however, the 'big push' public investment driven growth theory that he had consistently promoted was discredited.

4 The micro-macro paradox

For reasons elaborated above, the shift in focus towards country assistance strategies has moved the goal posts of the aid enterprise to a higher plane. This is why the micro-macro paradox (which holds that project results are satisfactory whereas country results are less so) has proved exceptionally damaging to the aid industry. It first came into view when the debt crisis of the early 1980s unfolded and development economics gave way to the neo-classical resurgence. Suddenly, basic questions about the premises on which aid had been provided emerged.

A cottage industry of cross-country studies came into existence. Unfortunately, it failed to establish meaningful correlations between aid volumes and growth at country level. A recent review of this literature (Doucoulagios / Padalm 2005) draws three overarching conclusions (labelled as 'sad' by its authors): (i) aid has a small impact on savings and investment behaviour; (ii) aid and growth are positively correlated in the aggregate[13] but the effect is modest, volatile and of dubious statistical validity; and (iii) the hypothesis that good policy generates good aid outcomes has not been proven: multiple regressions and attempts to replicate the positive results with new data have failed to achieve statistical significance.

Several explanations have been offered.[14] Each contains a grain of truth. While none are wholly convincing on their own, they add up to a formidable set of potential obstacles to aid effectiveness. The first set of explanations addresses the workings of aid in recipient countries.

- First, it has been asserted that aid funds are fungible and therefore that donors are not financing the activities they intend to finance: at the margin, the domestic resources liberated through aid are applied to other purposes (e.g. prestige projects or military expenditures) by recipient governments. The counterargument is that projects are not neutral channels of funds. They invariably embody 'trait-making' characteristics, e.g. capacity-building features, technology transfers or improved management methods. These aid effects are not fungible. Furthermore, diversion of domestic funds to low priority uses can be restrained by sound aid management that ensures that funds are used for the purposes intended and that public expenditure programs are adequately managed.
- The second explanation of the micro-macro disconnect concentrates on the macroeconomic consequences of aid and suggests that, in highly aid-dependent countries, aid harms the economy by creating volatility in public revenues, contributing to inflation and raising the real exchange rate so that export competitiveness suffers.[15] Thus, research by the In-

13 Disregarding statistical significance, the authors conclude that the studies they reviewed point to an average increment of 20 percent in the standard of living of poor countries' citizens attributable to aid.

14 With regard to the premise of the micro-macro paradox that project results are satisfactory, it should be mentioned that many aid agencies and nongovernmental organizations do not have credible aid evaluation systems capable of demonstrating that project results are actually satisfactory so that to some extent the paradox may be illusory. This highlights the need for independent and rigorous aid evaluation systems.

15 This phenomenon has been labeled the 'Dutch disease': it refers to the negative economic impact that rapid exploitation of a natural resources may have on the rest of the economy by triggering an abrupt rise in the value of the currency that makes other export products uncompetitive. The phenomenon was first observed in the Netherlands in 1634-37 when over-reliance on tulip exports diverted resources away from other productive pursuits. The discovery of large natural gas reserves in the North Sea in the 1960s evinced a similar phenomenon.

ternational Monetary Fund (Rajan / Subramanian 2005) finds that the impact of aid on growth reaches diminishing returns when the intensity of aid becomes excessive. But there is no mystery about how to control this phenomenon through competent monetary and fiscal policies and judicious economic management advice can be provided along with the aid.

- The third and closely related explanation deals with the political economy dimension. Allegedly, aid in large amounts creates a 'resource curse'. Competition for control of rents aggravates social tensions. Aid becomes addictive, reduces the incentives to reform, undermines the social contract between public authorities and citizens, hinders budget discipline and substitutes donor preferences for country priorities. Some studies even purport to show that excessive aid weakens economic[16] and political[17] institutions. But it stands to reason that in most cases the volumes of aid are too small to have such a pervasive and insidious effect.

The second set of explanations addresses the quality of aid on the supply side:

- Transaction costs are high: administrative costs absorb 6–7 percent of aid flows.
- Tying of aid generates needless mark-ups for goods and services that reduce the aggregate value of the aid.[18]
- Developing country policy makers have been especially critical of the quality of technical assistance funded by aid and the high cost of resident expatriates imposed by donors. On the one hand, the economic returns on well targeted and well managed technical cooperation can be astronomical since knowledge transfers can have multiplier effects and contribute to greater effectiveness of the overall financial assistance package. On the other hand, much of the technical assistance funded by aid has been provided as a quid pro quo for the assistance and it has not always been effectively used.[19]
- Geopolitical factors continue to influence aid flows. The poorest countries get less than 30 percent of the aid, and the share of aid allocated to basic social services is about half of that recommended by the United Nations (20/20 principle).

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16 Foreign investment confidence indicators (related to the quality of economic institutions) appear to be negatively correlated with large aid flows (Knack 2000).

17 Since the 1960s, the ten countries suffering the biggest deteriorations in democratic institutions received large aid inflows while the ten countries with the largest improvement in democratic institutions received modest amounts of aid (Djankov / Montalvo / Reyanal-Querol 2005).

18 According to Oxfam (2005, 8) "*too often domestic interests take precedence: almost 30 per cent of G7 aid money is tied to an obligation to buy goods and services from the donor country. The practice is not only self-serving, but highly inefficient; yet it is employed widely by Italy and the USA. Despite donors' agreements to untie aid to the poorest countries, only six of the 22 major donor countries have almost or completely done so.*"

19 According to a recent review carried out by the Independent Evaluation Group, the internal watchdog department of the World Bank, the organization "*does not apply the same rigorous business practices to its capacity building work that it applies in other areas. Its tools – notably technical assistance and training – are not effectively used, and its range of instruments – notably programmatic support, Economic and Sector Work, and activities of the World Bank Institute – are not fully utilized. Moreover, most activities lack standard quality assurance processes at the design stage, and they are not routinely tracked, monitored, and evaluated*" (World Bank 2005a, viii). See also Epstein (2005).

- Excessive aid flows can overwhelm the domestic administration. Aid fragmentation[20] through numerous channels and multiple projects may siphon skills away from core government functions through the use of salary supplements, vehicles and other perks. Poor aid coordination further contributes to the inefficiency of aid delivery.[21] Here again, aid policy reform and prudent aid management could limit the damage.[22]

These and other factors under the control of donors explain why alternative measures of the value of aid that discount its value have been proposed (Box 1).

Box 1: The debate about the true value of aid

In 2005 ActionAid International released a report that points to questionable aid accounting assumptions and massive aid delivery inefficiencies connected to distorted donor policies. These distortions are alleged to translate into hidden charges and costs that bring the true value of aid down to 39 percent of the amounts reflected in the official statistics of the Development Assistance Committee (DAC) of the OECD (ActionAid International 2005, 18).

In response (OECD/DAC 2005), DAC has argued that the adjustments estimated by ActionAid for debt relief, excessive transaction and administrative costs, misdirected aid, tied aid, overpriced and ineffective technical assistance, and hosting of refugees were based on misunderstandings about DAC statistics, and arbitrary judgments regarding the value of technical assistance as well as multiple counting of discounts. However, DAC acknowledges that debt relief where debt repayments are not being made does not create fiscal space or allocation of real resources by donors.

On the other hand, DAC maintains that debt relief has substantive value since repeated rescheduling imposes needless burdens on recipients and donors. Furthermore, DAC notes that the debt relief bubble of recent years will gradually disappear as the need for debt forgiveness declines. Similarly, DAC shared some of ActionAid's concerns about the development effectiveness of technical assistance but considered the discount excessive and noted that DAC had issued guidelines in 1991 to help remedy the problem.

Similarly, the problems of tied aid, high transaction costs, and other effectiveness issues raised by ActionAid had been fully discussed by donors and partner countries at a March 2005 conference that had led to substantive agreements on mutual accountability mechanisms under the Paris Declaration on Aid Effectiveness. Finally, DAC pointed out that DAC members had made public commitments that by 2010 could add up to at least US $ 36 billion more aid than the US $ 79 billion that was provided in 2004.

To summarize, while the micro-macro paradox has been used to discredit aid, a sober review of research results suggests that well managed aid does work albeit with diminishing returns as absorptive capacity constraints are reached. Thus, sound aid administration and effective aid delivery could overcome most of the obstacles that stand in the way of bridging micro- and macro-results.

The greatest value of the micro-macro paradox theme is that it has helped to focus on the need to reform the aid industry. The task is multifaceted: (i) to reduce the fragmentation of aid; (ii) to rely on domestic processes of aid coordination centred on poverty reduction strategy pa-

20 Tanzania alone receives funding from 80 donors for 7,000 projects.

21 The Development Gateway, an independent foundation sponsored by the World Bank, provides internet services and information to development practitioners. It includes information on 340,000 projects.

22 Ninety-one countries, twenty-six donor organisations and partner countries, representatives of civil society organisations, and the private sector met in Paris on February 28 - March 2, 2005 and committed their institutions and countries to harmonisation, alignment, and managing for results (Paris Declaration on Aid Effectiveness).

pers; (iii) to favour pooling of aid for sector-wide program and budget support where country performance warrants it; (iv) to avoid political interference in aid management.

The other useful contribution of the aid effectiveness debate has been the rediscovery of some important truths about the reality of aid. First, it is less about money than about ideas and institutions. Second, it requires sound aid policies and efficient administration. Third, it calls for effective coordination. Fourth, it needs proper alignment with country needs and priorities.

In contradiction with the policy-based aid allocation protocols that favour countries with positive ratings as measured for example by the World Bank Country Policy and Institutional Assessment (CPIA) index, aid seems to work best in economies vulnerable to external shocks (Guillaumont 2005) and in the poorest countries – even though their policies are weak (Roodman 2004).

The common sense proposition that aid works best in a good policy environment may not have been confirmed for the simple reason that the development community has had a hard time figuring out precisely what good development policy means in diverse country environments, how to measure it and what levers to pull to get economies moving forward and societies to change for the better. As stated at the beginning of this chapter we still have a lot to learn about the impact of aid on development. Evaluation of country assistance strategies is still new. To this topic we now turn.

5 Can country assistance strategies be evaluated?

Major shifts in doctrine have characterized the history of aid with major consequences for development. Geo-economic considerations, geopolitical interests as well as development ideas have influenced the design of country assistance strategies. The numerous swings in the authorizing environment of aid and the evolving conceptions of development that they have generated have had a major impact on country development. Is it possible, in this charged context, to assess objectively the development impact of country programs funded by aid? On the one hand, workmanlike evaluation instruments have been designed and they have been tested with credible results for individual country assistance programs (Conway / Maxwell 1999). On the other hand, independent and professional evaluation is still the exception rather than the rule within the aid system.

Evaluation arrangements are weakest in the nongovernmental organizations (NGOs) that have been most critical of the international financial institutions (Kruse et al. 1997). Yet the share of aid flowing through them is substantial, e.g. the Department for International Development of the United Kingdom gives more aid through British NGOs than through the World Bank Group (£ 233 million vs. £ 206 million in 2004/5). Aid to NGOs is growing: the share of total ODA by all DAC members channelled through NGOs rose from 2 percent in 1998–99 to 5.3 percent in 2003–4 (OEDC/DAC 2001 and 2006, Table 18).

The proliferation of aid actors means that the sum of individual country assistance programs by diverse donors may be less than the sum of its parts, another dilemma that may contribute to the micro-macro paradox. It highlights the need to carry out fully integrated evaluations of all official development assistance at the country level. This kind of evaluation has yet to be tested. But there is every reason to believe that it is feasible and that the time is ripe for carry-

ing out such evaluations of the total impact of aid on individual countries. The experience with joint evaluation processes and products has been thoroughly examined and the lessons have been drawn and disseminated (Breier 2005).

Successful experiments in joint evaluations of country assistance strategies (involving two partners) have taken place (Edgren / Molund / Berlin 2005). Thus, in his 2003 Development Cooperation Report (OECD/DAC 2004, 18), the Chairman of the Development Assistance Committee of the OECD outlined a fourfold hierarchy of evaluations of aid effectiveness (impact of all aid on one country; effectiveness of the development cooperation system; evaluation of an individual donor contribution to the total system; and development effectiveness of an individual donor agency). Initial proposals for piloting evaluations focusing on the uppermost levels of this hierarchy are being reviewed by the DAC Network on Development Evaluation.[23] Finally, there is growing consensus within the profession regarding the basic approach to country assistance evaluations.

First, the quality of country assistance strategies should not be judged merely through aggregation of project results, important though these are. High quality country programs are more than a collection of disparate projects and the interaction of projects and other aid instruments must be taken into account. It is the impact of the full package of projects and services that needs to be identified, i.e. the difference between actual outcomes and the outcomes that would have materialized without donor intervention. In principle, this requires the estimation of counterfactuals but the methodology of scenario-building is not mature[24] and the generation of meaningful counterfactuals is still in its infancy. Therefore, the best that can be done within the budget constraints faced by evaluators is to use a mix of program evaluation methods including those that have long been in use in the assessment of social programs in industrial countries.

This means above all judging country assistance strategies against common criteria. High quality country assistance strategies should be selective. Their priority areas should be selected with care so that projects and other development services included in country programs form a synergistic whole both relative to one another and to the interventions of other donors. The right instruments should be selected. The design of operations should be grounded in a constructive dialogue with country authorities and should take account of the interests and capabilities of other partners. Projects and other services should be competently managed in line with the operational policies of the donor and backed by professional analyses of development potentials, policy constraints and capacity-building needs (Ashoff 1999).

Second, verifying compliance of country strategies with the development doctrines currently in vogue is not a useful test: each developing country is unique and the track record of grand development theories has proven to be mediocre. The pertinence of country assistance goals must be judged case by case taking account of country potentials and needs, implementation

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23 The World Bank joined forces with the European Bank for Reconstruction and Development (Kazakhstan), the African Development Bank (Lesotho), the Inter-American Development Bank (Peru and Rwanda) and the Islamic Development Bank (Jordan and Tunisia) while Norway, Sweden, Australia and New Zealand teamed up for reviews of their Malawi and Papua New Guinea programs respectively.

24 Long-term growth models (let alone large-scale econometric models) are expensive to construct and they are not very reliable. Country comparisons can provide useful pointers but the performance of one country cannot be used as a reliable benchmark for another since no two countries are alike in their factor endowments and their institutional frameworks.

capacities and the determination of country authorities to address policy obstacles. Third, development results do not always equate with aid performance not only because aid accounts for a small part of the government's budget in most instances[25] but also because country level outcomes are ultimately shaped by the host of historical, geographical, political and policy factors.

In the absence of resilient hypotheses about the linkages between policy inputs and development performance, country assistance strategies cannot be evaluated by simple linear methods that examine the extent to which operations are geared to pre-ordained policy tenets. More reliable is triangulation of evaluation methods focused on three major dimensions:[26]

- the quality of individual operations, country dialogues, coordination with partners and analytical/advisory services;
- a development impact assessment, involving a 'top-down' analysis of the principal program objectives and their achievements in terms of their relevance, efficacy, efficiency, resilience to risk and institutional impact; and
- an analysis of attribution (or contribution) in which the evaluator assigns responsibility for program outcomes to the various actors according to their distinctive accountabilities and reciprocal obligations.

In evaluating the expected development impact of an assistance program, the evaluator gauges the extent to which major strategic objectives are relevant and are likely to be achieved without material shortcomings. Programs typically express their goals in terms of higher-order objectives, such as poverty reduction or attainment of the Millennium Development Goals (MDGs). The country assistance strategy may also establish intermediate goals, such as improved targeting of social services or promotion of integrated rural development, and specify how they are expected to contribute toward achieving the higher-order objective.

The evaluator's task is then to validate whether the intermediate objectives have produced (or are expected to produce) satisfactory net benefits, and whether the results chain specified in the country assistance strategy was valid. Where causal linkages are not adequately specified upfront, it is the evaluator's task to reconstruct the causal chain from the available evidence, and assess relevance, efficacy, and outcome with reference to the intermediate and higher-order objectives.

Evaluators also assess the degree of client ownership of international development priorities, such as the MDGs, at national and, as appropriate, sub-national levels. They examine compliance with donor policies, such as social, environmental and fiduciary safeguards. Ideally, conflicting priorities are identified in the strategy document thus enabling the evaluator to focus on whether the trade-offs adopted were appropriate. However, the strategy may have glossed over difficulties or avoided addressing key development priorities or policy constraints. This inevitably affects the evaluator's judgment of program relevance.

25 Aid accounts for less than 10 percent of public expenditures in over 70 percent of recipient countries.

26 Whereas this approach reflects international financial institution experience, other development agencies use somewhat different approaches; e.g. the European Union considers the impact of aid and non-aid policy vectors in assessing the relevance, quality and size of its country program and the resulting influence on the recipient country and its partners; the Swiss Development Corporation emphasizes participatory techniques and country involvement in the evaluation process, etc.

The efficacy of program implementation is judged by the extent to which program objectives are expected to be met in ways that are consistent with corporate policies. Efficiency ratings concern the transaction costs incurred by the donors and the country in connection with the implementation of the country assistance program. Finally, sustainability has to do with the resilience of country assistance achievements over time and institutional development impact refers to the capacity-building benefits of the country assistance strategy.

6 What did country level evaluations find?

Based on these principles, the World Bank's Independent Evaluation Group compared the outcomes of World Bank financed lending operations with those of fifty-five country assistance programs subjected to independent evaluation. As noted above, evaluation ratings of country assistance strategies (CASs) give pride of place to results and to the principles of effective aid endorsed by the development community. It is therefore significant that a positive association between the ratings ascribed to project results and country assistance strategy outcomes exists. However, it is not strong. A summary of the country assistance strategy ratings and of the project portfolio ratings appears below (Box 2).

Box 2: Country assistance strategy and project portfolio outcome ratings

Project performance	**Country assistance strategy**[a]	
	Satisfactory	Unsatisfactory
Satisfactory	Chile 02, El Salvador 01, Uruguay 00, Brazil 03, Guatemala 02, Maldives 99, Peru 03, Vietnam 02, West Bank/Gaza 02, Yemen 99, Argentina 00*, Bulgaria 02*, Lithuania 03*, Mexico 01 (1989–1991)*, Mexico 01 (1997–2000)*, Uganda 00*, Eritrea 03*, Jordan 03*, Kyrgyz 01*, Rwanda 04 (1995–2001)*, Bolivia 98*, Burkina Faso 00*, Cambodia 99*, Cameroon 00, Dominican Republic 03*, Egypt 00*, India 01*, Indonesia 99*, Kazakhstan 01*, Mexico 01 (1995–1996)*, Mongolia 02*, Sri Lanka 99* *32 CASs*	Costa Rica 00, Peru 03, Zambia 03, Lesotho 02*, Mexico 01 (1992–1994)*, Morocco 97*, Yemen 99* , Paraguay 01*, Bulgaria 02*, Ecuador 99*, Haiti 02*, Jamaica 99*, Nepal 99*, Russia 02 (1992–1998)*, Ukraine 99*, Zimbabwe 03* *16 CASs*
Unsatisfactory	Ethiopia 99, Ghana 00, Russia 02 (1999–2001) *3 CASs*	Rwanda 04 (1990–1994), Guatemala 02, Papua New Guinea 00, Cameroon 00 *4 CASs*

[a] The year noted after each country listing refers to the publication date of the country assistance evaluation. Where different ratings apply to different periods they are noted in parenthesis.

The asterisk (*) connotes a marginally or moderately satisfactory (or unsatisfactory) rating rather than a fully satisfactory (or unsatisfactory) rating for one or both aspects of performance.

Source: World Bank Independent Evaluation Group

Frequent congruence between project level and country level results …

Remarkably, in 58 percent of the country assistance strategies (32 out of 55) the country dialogue, the operations selected and the country's own priorities were found to be in appropriate alignment and the overall results were positive both at the project level and at the higher plane of country strategy.[27] In 11 out of these 32 successful cases where there was no disconnect between the performance of the strategy and the projects, fully satisfactory ratings were awarded for both performance aspects. Even hardened aid sceptics might be impressed by the major development influence of professionally selected and well implemented projects documented in convincing detail at the country level in these objective and revealing evaluations.[28]

For example, in Brazil, a selective country assistance strategy grounded in sound analytical work built on the successful stabilization program of the *Plano Real* to attack root causes of poverty through human resource development, access to basic services and privileged attention to the depressed northeast region. This was complemented by a good support program for environmental protection and by adjustment loans targeted to fiscal reform, social protection and energy sector reform that achieved mixed results. In China, the World Bank achieved excellent results through (i) workshops geared to persuasion of senior policy makers; (ii) a trust enhancing dual track approach that combined well targeted investment lending and a gradualist approach to policy change, (iii) utmost care in the selection of partners; and (iv) systematic pursuit of demonstration effects whether technological, managerial or policy-based.

In Tunisia, a well crafted country assistance strategy and a judicious mix of investment and adjustment lending helped move the country towards early achievement of the MDGs through sustained growth (more than 5 percent annually during 1996–2002), economic diversification and patient support of market-oriented structural reforms. In Vietnam, the country assistance strategy emphasized poverty reduction based on extensive economic and sector work and careful tracking of nationwide results in synergistic combination with project lending.

In another 12 cases marginally (or moderately) satisfactory ratings were awarded for the strategy and fully satisfactory ratings for the portfolio. For example, the Burkina Faso strategy achieved a moderately satisfactory rating. The economic reforms did reduce inflation and trigger growth. However, these big picture reforms (including a lacklustre privatization program) did not translate into poverty reduction despite aid levels four times as high as the African average. The sluggish progress on social indicators was linked to severe natural resource constraints, high population growth, seemingly intractable land tenure problems and the HIV/AIDS epidemic. The top-down approach to participatory development (a legacy of its colonial and revolutionary past) contributed to the failure to trigger genuine social development.

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27 A review of Country Assistance Evaluations contained in a recent publication of the World Bank's Evaluation Group (Chibber / Peters / Yale, eds., 2006) draws on twenty-five reports produced during 2001-03. They reach similar conclusions: the alignment between strategy and portfolio ratings is 60 percent.

28 All the Country Assistance Evaluation reports of the World Bank's Independent Evaluation Group (formerly known as the Operations Evaluation Department – OED) briefly summarized in this section are available online: http://www.worldbank.org.

In another 6 cases, the country strategy was rated fully satisfactory while project portfolio ratings were marginally satisfactory. For example, with strong and well managed World Bank and bilateral donor support, Uganda rose from the ashes to achieve impressive results in economic stabilization, growth and poverty reduction despite the ravages of HIV/AIDS. However, chronic institutional weaknesses remain to be addressed (weak local governments, fiduciary assurance gaps, corruption). They have contributed to a less than sterling project implementation record while the halting progress towards democracy, the chronic insurgencies of the border areas and the turmoil of neighbouring countries threaten political stability.

Potential performance shortfalls or positive turnarounds are not fully captured by ratings. Thus, the moderately satisfactory scores for the performance of the Bolivia country assistance strategy for 1985–96 were accompanied by prescient warnings about the lack of progress on structural reforms – concerns that were dismissed by policy makers at the time given the 'halo effect' of a highly successful macroeconomic stabilization program.[29] Similar evaluation ratings for the Indonesia country assistance strategy of 1990–98 struck a balance between the remarkable poverty reduction achieved with World Bank support and the failure to address corruption issues and financial sector weaknesses. The latter proved to be the Achilles' heel of the strategy when a financial crisis swept over East Asia.

At the bottom rung of the performance ladder there was no mismatch between ratings at the project and country levels (i.e. the Independent Evaluation Group concluded that the World Bank failed to achieve its assistance objectives both at project and country level) in 4 countries (Cameroon, Guatemala, Papua New Guinea and Rwanda 1990–94). These were instances where all aspects of the country assistance strategy had to contend with severe governance obstacles that proved impervious to country dialogue, analytical work or lending.

… but there is such a thing as a micro-macro disconnect

19 cases involve a full micro-macro 'disconnect'. In 16 of them, outcomes were unsatisfactory at the level of the country assistance strategy even though average project outcomes were satisfactory. In one such case (Costa Rica 1990–2000) the country assistance strategy failed even though the economy performed well and poverty reduction results were impressive. This is because the World Bank had pressed for reforms that did not conform to the development strategy adopted by the country. Inevitably, country relations languished and the objectives of the strategy could not be met while the few projects that were implemented produced good results.

In 15 cases, projects in the country portfolios met most of their objectives efficiently while country performance was poor or mixed. The causes of the micro-macro mismatch vary considerably. In some cases, satisfactory outcomes were achieved on projects that had limited relevance given poor governance (e.g. Paraguay) or a rapidly deteriorating political situation (e.g. Zimbabwe). In Morocco, the Bank abstained from lending (and/or the borrower opted not to borrow) for relevant operations that had raised critical but controversial policy issues that, according to the evaluators, might have been achieved results had they been attempted. In the other cases, project outcomes were rated satisfactory but the government was slow in implementing reforms (e.g. Russia 1992–98) or backtracked on them (e.g. Peru).

29 A more recent evaluation of the Bolivia program (2005) rated the country assistance strategy as moderately unsatisfactory.

In the remaining instances of full micro-macro ‘disconnect’ (Ethiopia, Ghana, Russia 1999–2001), the World Bank achieved positive results at the country level through its analytical and advisory services even as projects failed because of weak implementation capacities in the ministries concerned. All in all, a full fledged micro-macro paradox was found to prevail in one third of the cases.

Agency performance and development outcomes do not always coincide

It is worth noting that outcome ratings do not necessarily equate with the performance of the World Bank (in terms of the quality of its country dialogue and its services) since other partners are involved in generating development outcomes and exogenous factors (e.g. El Niño or the terrorist insurgency in Peru) often intervene. In fact, the aggregate results of development interventions depend above all on the role played by the country concerned. Other major donors may also contribute to the ultimate impact of a development program. This means that a development outcome-agency performance disconnect is potentially present quite apart from the possible existence of a micro-macro paradox.

Thus, in Bulgaria during 1989–97 the objectives of the strategy were highly relevant and the Bank did good analytical and advisory work as well as sound operational work but the reforms that were the object of the strategy stalled due to political opposition and the outcome was unsatisfactory. In Haiti, Bank and donor performance overwhelmed the administrative capacity of the country due to lack of selectivity during the 1986–1997 period. Since then donor performance improved but governance dysfunctions proved insuperable and, understandably, the Bank sharply reduced its exposure through a cleanup of its project portfolio and a highly prudent stance.

In Rwanda in 1990–93 the Bank performed well overall but its efforts to persuade the government to reform its policies, improve the quality of social services, undertake public enterprise reforms and give a greater role to the private sector failed to yield fruit. In Paraguay the World Bank did good analytical work, promoted public debate about policy options and pursued a cautious lending strategy but the political situation worsened and reform measures were not taken. Risks must be taken to capture development rewards. The challenge lies in assessing development risks, sharing them and managing them.

7 Where is the aid industry going?

The aid business is in rapid transition. The development challenge is as great as it has ever been. More than a billion people subsist on less than a dollar a day. More than 800 million people are malnourished. Global inequities are staggering. If the remarkable growth rates of China and India are excluded from the statistics, the inequality of peoples and nations has been getting worse. Within some countries they are almost as serious. Complacency is out of the question. The chances of survival of a baby born in Mali are almost twenty times lower than those of a baby born in the United States. Access to immunization by children for the richest fifth of the Eritrean population is complete whereas half of the children in the poorest fifth are excluded.

At the turn of the century, the MDGs injected new energy in the poverty reduction enterprise. Aid flows are picking up again after a long and steep decline. Humanitarian activities and

voluntary peace-making initiatives are at all time high. After a long eclipse, development is back once again on the curriculum of elite universities. Development think tanks are proliferating and the growth in the number of publications, conferences and workshops dealing with development issues does not seem to be abating. Development advocacy campaigns led by international networks of nongovernmental organizations have become more professional, vocal and effective. Their aim has captured the imagination of the young: to 'make poverty history'. The aid industry still has life in it.

Unfortunately, doctrinal debates, while somewhat less strident, are still dividing public opinion and promoting aid pessimism. On the left, anti-globalization activists ascribe global poverty to deliberate mechanisms of natural resource extraction, social exclusion and cultural domination that consign the 'south' to isolation and marginalization (a 'containment' strategy directed *against* the poor), Yet, many developing countries have achieved poverty reduction by hooking up to the mighty engine of the global market. On the right, market fundamentalists argue that protectionist and 'statist' policies are to blame but many countries afflicted by weak institutions have gone through the rigors of structural adjustment without achieving poverty reduction. In both camps, democracy activists point to corrupt and tyrannical leaders that oppress their peoples and plunder natural resources – even as democracy is on the march.

The global war on terror and the Iraq conflict have generated divisions among western countries but aid is gradually being 'securitized' on both sides of the Atlantic. This may be bad news since geopolitical aid is usually ineffective. But it may portend good news if the convergence of security and development policies focuses attention on fragile states. Making progress towards the MDGs calls for special support to weak and conflict prone states that have been bypassed by aid allocation practices that discourage risk-taking and rely on indicators that confuse adverse initial conditions and weak institutions with poor performance. One can only hope that the emergence of human security as an overarching theme of international co-operation will create new dynamics that will facilitate the introduction of 'whole of government' policies that promote freedom from fear together with freedom from want.[30]

Far from being a cartel (Easterly 2002), the aid industry has become ever more fragmented and competitive (Klein / Harford 2005). New entrants include official donors (India, China, Slovenia, Thailand, etc.) along with a bewildering variety of foundations and voluntary agencies. Within individual donor countries, development ministries, semi-autonomous agencies and specialized financial and investment guarantee institutions focused on the private sector compete for public support and rely on a vast network of contractors, consultants, think tanks and academic institutions. Multi-country collaborative programs, public-private partnerships and specialized funds are being set up to address a host of increasingly severe global challenges (e.g. HIV/AIDS).

The nature of development cooperation is also changing because new mechanisms of resource transfer are dwarfing the 'money' impact of aid and creating brand new connections between rich and poor countries (as well as among poor countries). The private sector is already vastly outpacing the public sector both as a source and as a recipient of loans and grants. Worker remittances are growing rapidly and are expected to exceed US $ 230 billion in 2005. Another

30 In Sweden, a 'whole-of-government' approach for global development has been endorsed by the legislative branch. It makes all government departments accountable for the promotion of equitable and sustainable development and peace-making in poor countries

US $ 260 billion worth of foreign direct investment, equity flows and commercial loans is directed at poor countries. Thus, total private flows are at least four times as high as aid flows. The net welfare benefits that could flow from trade liberalization also represent a multiple of aid flows especially if punishing tariffs against labour-intensive products are reduced, workers of poor countries are allowed temporary access to rich countries and food-importing countries are induced to generate a successful agricultural supply response through 'aid for trade' schemes'.

Knowledge flows need liberalization too. The intellectual property rules imposed during the Uruguay round involve a reverse flow of the same order of magnitude as current aid flows. While some relaxation of the TRIPS agreement was introduced under the Doha round for life saving drugs and technological development does require patent protection, special provisions for encouraging research relevant to poor countries, for bridging the digital divide and for filling the science and technology gaps of the poorest countries are warranted to level the playing field of the global knowledge economy. Finally, the environmental practices of rich countries and the growing appetite for energy of the Asia giants may induce global warming costs for developing countries likely to exceed the value (4–22 percent vs. 7 percent of national incomes) through losses in agricultural productivity (Birdsall / Rodrik / Subramanian 2005).

In combination, all of these trends mean that (except for the smallest, poorest and most aid-dependent countries where coordination will continue to pose major challenges) the relative importance of aid flows compared to other policy instruments (trade, migration, foreign direct investment, etc.) has been reduced as a result of globalisation. But aid will remain critical to attend to emergency situations and post-conflict reconstruction, as a midwife for policy reform, as a vehicle for knowledge, technology and management practices, as an instrument of capacity-building (especially for security sector reform) and as a catalyst for conflict prevention.

Programme aid and budget support are useful aid vehicles in well managed countries. But wielded with skill and professionalism, the project instrument should regain the allure it lost when the neo-classical resurgence required a massive diversion of aid flows towards policy-based quick disbursing loans and budget support operations. Already infrastructure development and natural resource extraction projects equipped with social and environmental safeguards are making a comeback, mostly through support to private enterprises and voluntary agencies, especially in weak states. Aid for community-based social protection schemes is also rising given continuing public support for the notion that development is a bottom up, micro-process.

In brief, through the revival of investment lending geared to the creation of institutions, the promotion of private investment and the mobilization of communities and voluntary organizations, the micro-macro paradox could be exorcised since it only haunts the money dimension of aid. Not that policy-based lending will disappear altogether. Many poor countries still need to improve their macroeconomic and their structural policies, especially those related to trade facilitation and the enabling environment for private enterprise. But they may elect to do so through freestanding advice and capacity building assistance rather than repeated and addictive dollops of quick disbursing funds.

8 What is to be done?

Once in a hole it is advisable to stop digging. A revised strategy is needed: development is moving forward but at a slow and decelerating pace and very unevenly. Since 1980, only one third of developing countries have grown faster than developed countries while another third have shown no increase in GDP per capita. In the same period, poverty decreased substantially only in Asia while it increased in Africa, Eastern Europe and Central Asia and it did not decrease materially in Latin America or the Middle East. To be sure socio-economic indicators have improved but not in Africa where they have regressed significantly. Poverty, violence and governance dysfunctions are self-reinforcing and must be addressed together. Since the end of the cold war the spread of democracy has accelerated and the incidence of conflict has been reduced but not in the poorest quartile of countries (World Bank 2005b). The front line of the war on poverty is in the fragile states of the world but also in the vast depressed and neglected areas of low- and middle-income countries, including China and India.

First and foremost, aid should no longer be viewed as the only tool in the development cooperation kit. Coherence among conflicting aims (OECD 2005) remains a major challenge for development cooperation.[31] A whole-of-government approach is needed to ensure that policy coherence for development becomes the driving force of donor countries' relations with poor countries. This means that trade, migration, foreign direct investment, intellectual property and environmental policies should all be shaped to benefit poor countries or at least to avoid doing them harm. From this perspective, aid should be viewed as the connecting thread between all policies that connect the donor country with each developing country. This implies different kinds of country assistance strategies. To help support the reorientation, multilateral agencies should use their analytical skills to evaluate and monitor the quality of rich countries' policies towards poor countries.

Second, the downside risks of current development patterns should be acknowledged and conflict prevention, conflict management, post-conflict reconstruction, security sector reform, etc. should move to centre stage in country assistance strategies and poverty reduction strategy papers. In parallel, multilateral agencies and regional organizations should use their convening power and their management skills to organize mission-oriented networks involving governments, the private sector and the civil society to design and implement collaborative programs. They would aim at global or regional threats to peace and prosperity and they would be implemented at global, national and sub-national levels. Already, major coalitions of donors are seeking to address such development challenges as HIV/AIDS that do not respect national borders. Increasingly, they will be mobilized to tackle the myriad illegal activities that constitute the dark side of globalization (e.g. the booming trafficking of drugs, arms and people) by combining law enforcement with development alternatives. In a nutshell, dealing with the downside risks of globalisation will require adopting a human security model of development that continues to favour growth but with greater priority to economic equity, social inclusion and environmental sustainability.

Third, aid should no longer be conceived and evaluated as a resource transfer mechanism. Instead, it should be conceived as a transmission belt for ideas, a device to train development

31 In the United States and among some of its allies the war on terror has replaced the anti-communist crusade as a geopolitical rationale for development assistance and this constitutes a major threat to development effectiveness as well as a potentially destabilizing approach to international relations.

leaders, an instrument to build state capacity and a platform for policy experimentation and dissemination based on good analytical work and sensitive advisory service. In the poorest, aid-dependent countries, the convening power of multilateral institutions would be used to help overcome the growing fragmentation of aid. Towards this end, the commitments made by donors to improve aid quality, eliminate tied aid, reduce transaction costs, harmonize policies across donor agencies and align aid objectives with country-felt needs and public expenditures processes should be met. But this does not mean that the project vehicle should be jettisoned. Well designed and professionally implemented through donor coalitions it can yield considerable benefits. Instrument selectivity is central to aid effectiveness.

Fourth, country assistance programs should be tailored to the political economy. Human security considerations should be prominent in strategy design. Governance should be professionally assessed and conflict analysis should ensure that aid does no harm and that horizontal inequalities are taken into account in project designs. Standard, blueprint models reflecting doctrinal positions (e.g. with respect to privatization) should be jettisoned and transfer of good practice properly adapted to the country context should be emphasized. Where government authorities are not committed to development, non-aid instruments should be used and aid should emphasize infrastructure, the private sector and civil society channels as well as local government and community level organizations where good leadership can be identified and future leaders trained. Budget support has its place but not always and everywhere.

Fifth, given limited resources, selectivity is essential but the current aid allocation system short-changes fragile states. Policy research has established that they are currently receiving 40 percent less than they should even if policy performance considerations are taken into account. Combining the potential conflict prevention benefits to the satisfactory outcomes at project level confirmed by independent evaluations of almost 60 percent of projects approved by the World Bank in fragile states during 1998–2002[32] would suggest that high risks can lead to high rewards. It is also notable that the performance of private sector projects funded by the International Finance Corporation has been as good in fragile states as elsewhere.[33]

The current system rests on three misconceptions:

- The first one has to do with 'fungibility', an abstraction that ignores institutional arrangements that are demonstrably effective in minimizing its effects through project selection, fiduciary rules, public expenditures oversight and private sector/civil society involvement. Money is fungible but not money with strings.
- The second misconception holds that policy and governance as measured by the Country Policy and Institutional Assessment (CPIA) index is a major factor of aid effectiveness. In fact, the index measures initial conditions more than policy performance. Furthermore, statistical tests do not confirm that aid works better in good policy environments as measured by the CPIA whereas they do confirm that aid works better in countries of high economic vulnerability. This is why donors are on shaky grounds when they allocate aid based on idealistic laundry lists of governance indicators that have not been validated by

32 Furthermore, current aid allocation rules do not take account of the benefits of conflict and yet research by Paul Collier suggests that, on the average, preventing a single war would save US $ 64 billion a year.

33 This conclusion is based on the degree of loss reserves, historic write-offs, default rates, equity investment measures, and independent ratings of development outcomes, normalised for the class of investment (Collier / Okonjo-Iweala 2002).

robust econometrics. Nor is results-based aid a panacea. A host of measurement problems, contractual dilemmas and principal-agent constraints will have to be overcome to turn this abstraction into reality.

- The third misconception holds that country policies cannot be changed for the better through conditionality. Of course, conditionality should not be used in a coercive way to impose the standard blueprints of the Washington Consensus (whether in its original or its enhanced forms) since it is now well established that reforms must be closely adapted and sequenced to the peculiar circumstances of individual countries. In any event, the evidence is overwhelming that one cannot ‘buy reform’. Yet, sensible conditionality is at the core of high quality aid and experience confirms that with patience, professionalism and trust, sensible operational prerequisites agreed through persuasion and country dialogue can do a lot of good and help to nurture broad based ownership of good economic management principles especially when combined with trade inducements (e.g. Mexico and NAFTA, Hungary and Poland before their EU accession) or long-term development partnerships, e.g. Bangladesh, Chile, Ghana, Uganda, Turkey, Vietnam (Branson / Hanna 2002).

Last but not least, development education should have high priority. The public in the industrial democracies should be exposed to the reality of aid, its inevitable challenges and its exciting opportunities. Currently voters vastly overestimate the share of government budgets allocated to aid.[34] Most are unaware that total aid flows declined from about 0.41 percent of the national incomes of OECD countries in 1967 to 0.26 percent today[35] or that aid absorbs only a twentieth of the resources absorbed by the military. The self-interest rationale of development cooperation in the era of globalization should be clearly articulated. In an interconnected world the problems of others have become our own. There is no prosperity without peace and there is no peace without justice.

34 Americans think that the US spends 24 percent of the federal budget on aid. They believe that 10 percent should be spent in this way whereas, in fact, the US dedicates less than 1 percent of the federal budget to aid.

35 OECD/DAC: Online Statistics Database. The United States that allocated 2 percent of its national income to the Marshall Plan now contributes less than 0.2 percent of its national income for aid to poor countries, less than a quarter of what it spends on carbonated drinks.

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