The Trouble with Cash on Delivery Aid:
A note on its potential effects on recipient country institutions

Note prepared for the CGD Initiative on 'Cash on delivery Aid'

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Introduction

The past few years have seen a clear trend, at least in the aid discourse, away from old-style *ex-ante* conditionality aimed at 'buying reforms' to a new focus on *ex-post* verification and 'rewarding' reforms or development outcomes. The clearest example of this trend is the Millennium Challenge Account, but also the introduction of performance *tranches* in budget support programmes, linked to both reform and development outcomes, and the move towards selectivity through the design of aid allocation criteria which evaluate countries' past policy reforms (e.g. IDA's CPIA). The CGD initiative on 'cash on delivery aid' builds on some of these previous attempts to link aid disbursements to results, however defined, but focusing more specifically and exclusively on clear indicators of development success, such as getting children through primary education.

The main rationale for some of these shifts has been the recognition of the failure of past aid delivery modalities that linked disbursements to 'commitments to reform', regardless of final outcomes. The underlying claim is that linking aid disbursements to specific progress indicators, especially development outcomes, not only prevents donors from meddling in recipient countries' domestic policy-making and micro-managing development interventions, but also provides the necessary incentives for recipient governments to focus their policies and efforts on achieving results. However, the claim that aid, if effectively designed and deployed, can be a powerful incentive for reform and results-orientation in recipient countries, and that donors can indeed influence the development orientation of recipient governments by linking their support to specific outcomes is fraught with potential contradictions, and still needs to be validated by solid empirical evidence.

In this brief note, we will provide some thoughts and considerations on the potential effects on recipient country institutions and processes of 'cash on delivery' aid modalities. In short, we think that the CGD proposal is based on assumptions in support of which little evidence is available, and this leads us to highlight some of the potential challenges that 'cash on delivery aid' is likely to face. In response to these challenges, three basic pre-conditions for 'cash on delivery aid' to work seem to emerge. The first one is a careful design of the mechanism itself, in order to avoid 'target-induced' distortions and other common pitfalls of financing mechanisms linked to performance (this will be the main focus of discussions in the upcoming CGD meeting). The second one is linked to the need for this new aid modality to either supplant other existing ones or be of significant enough weight in order to provide strong incentives for results-orientation. Finally, the third one stems from the recognition that external actors may have limited leverage on domestic political realities and accountability, and therefore need to select target countries on the basis of the existence of clear domestic drivers for results-orientation.

The premises and assumptions of cash on delivery aid

The discussion note prepared by CGD states that cash on delivery aid "could demonstrate new ways of providing foreign assistance, encourage local innovation and be conducive to the strengthening of local systems and institutions", by increasing transparency, focusing on outcomes, forcing donor compliance with harmonization and alignment objectives, and generating evidence on aid's impact on local institutions. While the argument is quite clear and convincing, there are some underlying assumptions that are not discussed at any length in the CGD discussion note, nor in the 'Payments for Progress' Working Paper by Owen Barder and Nancy Birdsall (2006). The two main ones are: (a) that donor countries and development agencies are willing and able to adopt a 'hands-off approach' to aid delivery, and to commit to a 10-year funding horizon for specific countries, linked only to progress in development outcomes; and more importantly, (b) that cash on delivery aid provides an adequate and strong enough incentive for recipient governments to focus on achieving monitorable development outcomes. The note focuses mostly on the latter assumption, and considers some of the important challenges that might undermine the effectiveness of cash on delivery aid.

Playing devil's advocate: some of the potential pitfalls of cash on delivery aid

The perils of targets

Both the CGD discussion note and the Barder/Birdsall working paper discuss issues related to the choice of indicator to which cash on delivery aid should be linked in some detail, so it is not necessary here to cover those arguments again in any detail. In summary, one of the main issues relates to the fact that focusing on a specific indicator (such as completion of primary schooling) implies focusing the attention on certain sectors (or sub-sectors) and disregarding others, which may lead to distortions in resource allocation and to attempts to manipulate the data. In the more specific case, focusing on completion rates for primary education may mean that the quality of education suffers, or that scarce resources may be diverted from other priority areas which could be just as important (think, for example, of secondary and tertiary education). It may also mean that a lot of effort is wasted by recipient governments in ensuring that the data is manufactured in order to show a positive picture. These are not insurmountable problems, as the CGD discussion note notes, but are a very important reminder, echoing many experiences with target-based approaches in developed countries, that the wrong incentives can lead to significant institutional failures.

What to do with poor performers?

'Cash on delivery aid' is designed to reward good performance. Better performing countries will receive more aid, but this still leaves open the issue of what to do with non-performing countries where lots of poor people live, which might be in dire need of additional resources. Should they be disregarded? If so, can it be assumed that that will provide a positive incentive for the government to redouble its efforts in pursuit of better indicator scores? If not, should other aid flows be able to compensate them for the loss on 'cash on delivery' allocations? And if that happens, does that then not completely undermine the case for ‘cash on delivery’ aid, given that countries know that they will receive aid regardless of performance?

Dealing with factors outside government control

Focusing on development outcomes makes it more difficult to disentangle the weight of factors within governments’ control and that of other external factors which affect development indicators. External economic shocks and natural disasters are classic examples of factors which fall well beyond government control, but which might affect primary schooling completion rates, and therefore aid allocations according to the ‘cash on delivery’ formula. The CGD discussion note proposes a ‘re-negotiation clause’, which allows recipient countries to “petition the donor to reset the baseline to a level equal to the primary completion rate three years earlier” in case of adverse external circumstances. Taking external factors into account in practice, however, could prove much more tricky than what indicated in the CGD discussion note. Experience shows that it is difficult to find a workable compromise. Knowing that donors face a pressure to disburse allocated aid funds, recipient countries can often effectively argue against a reduction in their aid entitlements, reducing the incentive effect that ‘cash on delivery aid’ is likely to have.

The effects of other aid modalities

Most recipient countries receive aid through a range of instruments and modalities, from debt relief to technical assistance, from specific projects to sector programmes and general budget support. Cash on delivery aid would most likely be an additional modality that recipient governments have to ‘accommodate’, with potential additional transaction costs, and in competition with new sources of development assistance, such as Chinese aid in Africa. Cash on delivery aid is quite similar in its conception and design to the performance-based *tranches* in general budget support programs, which link additional disbursements to the achievement of specific outcomes, some related to specific reform measures, others to improvements in specific development indicators. Therefore, lessons about the potential effectiveness of cash on delivery aid could be drawn from a recent evaluation of general budget support programs in seven countries[1].

The evaluation found a series of positive effects of general budget support on recipient country institutions, including on transaction costs, on budget transparency and on allocative and operational efficiency. On the other hand, however, it found that “the potential effects [of general budget support] were reduced in cases where large flows of aid remained off-budget and/or un-integrated with national planning and budgeting procedures. This is partly because of the continuing direct consequences of modalities running in parallel, and partly because it limits the scale effect of [general budget support].”[2] In general terms, therefore, it can be reasonably argued that innovative aid delivery mechanisms, such as general budget support or ‘cash on delivery aid’, which aim at addressing some of the perverse incentives which characterise other aid modalities, can only be effective if there is at least a proportional reduction in those other modalities which reinforce perverse incentives, including the majority of project-based assistance. Yet, while donor discourse in recent years has focused a lot on the need for such a shift, in reality not much has

[1] IDD and Associates (2006).
[2] IDD and Associates (2006), page S12.

changed in donor practices on the ground, as the budget support evaluation cited above and the 2006 survey monitoring commitments included in the Paris Declaration on Aid Effectiveness have demonstrated.

The main factor shaping donor willingness to let go of 'old ways of doing business' has to do with incentives internal to donor agencies, partly driven by their institutional history and their upward accountability to domestic constituencies. As highlighted in some of the work CGD did through its MCA Monitor, even a bold initiative such as the Millennium Challenge Account has often failed to deliver on the promise to provide untied and flexible assistance to countries that passed the tough qualification tests, intervening heavily in the definition of areas of intervention, implementation modalities, and so on. If cash on delivery aid is to be another, additional modality, representing a small percentage of overall aid, not only is its incentive effect likely to be greatly reduced, as in the case of general budget support, but its existence is likely to put additional strains on overstretched bureaucracies, which would face conflicting and competing incentives linked to different aid modalities, with little space for the kind of innovation and policy experimentation that cash on delivery aid aims to promote.

Can aid make governments more accountable to their own people for results?[3]

As indicated above, cash on delivery aid is premised on the assumption that tying aid disbursements to concrete development results will provide a strong incentive for recipient governments to focus their efforts on achieving those results. It also assumes that those low-income countries that cash on delivery aid is likely to target have not only the willingness, but also the capacity to improve the effectiveness of service delivery in key areas of public intervention such as education. In principle, the mechanism is fairly straightforward. By linking disbursements to achievement of results, and not to specific policies and processes to achieve them, cash on delivery aid gives governments much needed space for policy experimentation and for a locally-tailored search for efficiency and effectiveness in public spending. It also upholds the more philosophical principles of sovereignty and self-determination. The financial reward, which can be flexibly utilized, represents the concrete incentive. Additionally, the transparency and simplicity of the link between development results and aid disbursements can stimulate expectations of positive outcomes by domestic constituencies, which over time can strengthen government accountability to its own citizens.

In practice, however, the picture often looks different. From the wider political science literature, in particular focusing on Africa, we know that many poor, aid-dependent countries typically have highly balkanized administrations, with little policy coordination at the cabinet level and downwards, and almost no functioning mechanisms for rewarding or punishing ministers or officials on the basis of the performance of their departments. It is also well established that with a few marginal exceptions, voters do not assess candidates and governments in terms of general programmatic principles or performance standards. That does not mean that voters are uninterested in obtaining development benefits (decent schools, clean water, jobs), but

[3] The discussion in this section is largely based on Booth et al. (2006).

only that they perceive that informal networking and patronage are more effective ways to obtain them than demanding better general standards of public service[4].

Weak engagement by parliamentarians and civil society organizations in the policy process partly reflects general constraints such as resource and capacity shortages, but also weak traditions of transparency and accountability. As a consequence, many low-income countries have hardly any culture of evidence-based policymaking inside government. The fundamental question, then, is whether donors can, or indeed should, place themselves as the main agents attempting to promote a results-focused government and accountability culture, when that is clearly not predominant within each country. Some have argued for the need of such external ‘agencies of restraint’ (Collier 1991), but the question that is increasingly being asked is if in the long term such external interventions don’t end up undermining domestic accountability processes.

The focus on government ‘ownership’ of development policies, promoted through processes such as the Poverty Reduction Strategy Papers (PRSPs), is an attempt at promoting better domestic accountability. Yet, where politics is mostly about personalities and patronage, and not about issues, there is not a ready constituency for holding the government to account. This could be regarded as the main reason why PRSP processes have not led to an upsurge of accountability to citizens. In these circumstances, donor staffs and visiting consultants (and Northern think-tanks?) tend to underestimate, or at least not to acknowledge publicly, the true weakness of effective domestic demand for good performance and the political realities that lie behind this weak demand, and to exaggerate the ability of external initiatives to transform the way national political systems work.

Taking these factors into account, some of the claims made about the potential benefits of the kind of *ex-post* conditionality promoted through cash on delivery aid are fraught with contradictions and untested assumptions about the nature of aid relationships and their political basis. Cash on delivery aid implicitly assumes that even if the donor and recipient have different ideas about policy, they have broadly the same preferences at the level of results. This notion is only superficially persuasive. Of course, politicians like everyone else favor better health and education outcomes for poor people. But the test is whether in practice they choose actions that would promote that objective over actions that correspond to any of the other objectives they have as participants in a particular political and social system. In many cases, evidence has shown that political realities may dictate a different short-term focus, depending on political cycles, elections, conflict, and so on.

Conclusions: on donor and recipient country dynamics

Proposals such as the one for ‘cash on delivery aid in education’ promoted by CGD seem to be based on problematic assumptions about the political economy of aid relationships that are not based on any extensive empirical evidence. Yet, the concept is intuitively appealing and potentially useful. From our discussion above, we can identify three main pre-conditions for cash on delivery aid modalities to work. Firstly, cash on delivery aid needs to be designed in such a way as to take into account all the

[4] See, for example, the work of Chabal and Daloz (1999) and van de Walle (2001, 2005).

potential distortions generated by performance-based reward mechanisms, such as resource misallocation, country selection criteria and attribution of responsibility. Secondly, cash on delivery aid needs to take into account the potentially contradictory incentives stemming from the existence of other aid modalities, which could undermine its incentive effect. Thirdly, cash on delivery aid should not be based on the assumption that its incentive effect will work regardless of country circumstances, in particular regarding political culture and domestic accountability mechanisms. In many cases, external actors can have very limited influence on these factors, and in some cases they can even undermine them. Cash on delivery aid is more likely to work where it builds on existing domestic mechanisms for holding government accountable for results. In the case of education, this may mean strong Parent-Teachers Associations, active media and civil society monitoring, or an independent legislature.

These pre-conditions, however, are not easily met, for two sets of reasons. On one hand, regardless of donors' promises to focus aid on performance, the current political climate in donor countries, and the influence of domestic politics and other foreign policy objectives, might limit donors' capacity to provide clear incentives for recipient countries to focus on performance. Also, given the difficulty that many donor countries are facing in living up to their promises to substantially scale up aid levels, the necessary additional resources might just not be available, unless there is a substantial redistribution from other aid modalities to cash on delivery aid. And the continued presence of numerous different modalities might not only dampen the incentives provided by cash on delivery aid as an additional modality, but also put additional strains on recipient countries' overstretched bureaucracies.

On the other hand, as already highlighted above, the social and political reality in recipient countries is such that an aid-backed incentive for results may not work. Little research exists on the impact of aid on politics in recipient countries. The incentive effect of aid is based on the assumption that recipient governments would react positively to a shift in aid focus towards performance. But this assumption is not very well substantiated. Politicians in recipient countries, faced with the challenges of political survival, may choose priorities other than development outcomes, and citizens may prefer using informal patronage networks rather than active engagement in policy processes to promote government accountability.

In order to more properly underpin proposals for innovative aid delivery modalities, and avoid the potential negative consequences of aid on institutions in recipient countries, we need an approach that is based on a robust understanding of the political economy of both sides of the aid relationship, taking into account not only donor incentives and capacities, but also the reality of policy and political processes in recipient countries.

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