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Re-conceptualizing the international aid structure: recipient donor interactions and the rudiments of a feedback mechanism

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Introduction

International aid has traditionally been understood with the perspective of the donor as the main active determinant of aid flow. The recipient is often considered a passive, if not stagnant actor in the allocation of aid. New literature has begun to consider that recipient countries are not at all as passive as they may seem.¹ They are rational actors seeking to utilize funds from international aid to maximize their welfare in the face of budgetary constraints.² Their behavior changes constantly in response to incentives presented by interactions with donor behavior in the international aid structure. The complex series of interactions between donors and recipients not only have an impact on the immediate effectiveness of aid, but fundamentally re-conceptualize how the structure for international aid has traditionally been understood.

Recipients' behavior has both a direct effect on the impact of aid, as well as an indirect effect on donors who seek to use their aid to fulfill a specific agenda.³ Similarly to recipients, donors respond to incentives and change their behaviors in order to meet their goals. This situation allows for a series of interaction between donors and recipients which has traditionally not been taken into account. I argue that these previously overlooked interactions may reflect the presence of the rudiments of a feedback mechanism through which recipients provide a series of indirect signals which donors inadvertently receive when monitoring the impact of their aid. Unfortunately this mechanism is incomplete and often goes

¹ See Villanger (2004).

² See Mosley et al. (1987).

³ Donor motives have long been a subject of much interest in international aid literature. See Macdonald and Hoddinott (2004); Alesina and Dollar (2000); Schraeder et. al (1998) ; and McKinlay and Little (1977). These motives are composed mainly of self-interested variables; however, there is evidence of a humanitarian impulse.

unnoticed or, even worse, is misinterpreted by donors who do not account for incentives faced by recipients when monitoring aid effectiveness or the impact of their own behavior on these incentives.

When aid effectiveness is assessed without accounting for recipients' active role in the international aid structure, failure of aid is often blamed on donors' aid allocation behavior or on recipients' inability to receive aid efficiently due to inadequate original institutions. Not much attention is usually placed on the impact of recipient behavior and recipient-donor interaction on the actual structure of international aid allocation. This impact, however, is extremely important in determining the overall effectiveness of the international development effort. By omitting these important factors, the current model for the international aid structure cannot correctly assess the true impact of aid or pinpoint obstacles to better effectiveness.

Due to the serious shortcomings of the current model of the international aid structure, effective analysis of the problems in international aid is difficult and often inconclusive. Solutions based on these analyses not only fail to address real structural problems, they also overlook potential solutions embedded within the very structure of international aid. A better understanding of the incentives inherent to this structure as well as greater emphasis on the true nature of the donor and recipient interactions is essential to improving our present model of the international aid structure and building a more efficient and sustainable system. An improved model of international aid based on the intricate relationships between donor and recipient incentives and behaviors may lead to structural reforms which target changes in donor and recipient incentives to ameliorate inefficiencies in the system of aid transfers and maximize effectiveness.

This article is organized as follows. Section I provides a brief overview of the traditional model for international aid. Section II offers an analysis of the main incentives facing donors and recipients documented in current literature. Section III substitutes these incentives into the traditional model of the international aid structure and isolates a feedback loop embedded within donor-recipient interactions. Section 5 offers some concluding remarks and calls for a new model of the international aid structure.

I. An overview of the international aid structure

This section offers a brief summary of the international aid structure as it is understood in aid literature. Part 1 offers a summary of how the flow of international aid has traditionally been measured and conceptualized; part 2 gives a description of the main players, and part 3 explains how these two components —players and aid flow— come together in the traditional model for the international aid structure.

1. Aid flow

The structure of international aid is orchestrated around the transfer of resources from one country to another. This transfer takes many forms and comes from players in both the public and private sector. Much of international aid literature focuses on governmental aid flow, traditionally measured in the form of Official Developmental Assistance. Official Developmental Assistance (ODA) is a statistics developed by the Development Assistance Committee (DAC) members of the Organization for Economic Co-operation and Development (OECD) —an international organization promoting government cooperation in aid and global development efforts— to measure aid flow from the public sector. It is defined as:

Flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element of at least 25 percent (using a fixed 10 percent rate of discount). By convention, ODA flows comprise contributions of donor government

agencies, at all levels, to developing countries (“bilateral ODA”) and to multilateral institutions. ODA receipts comprise disbursements by bilateral donors and multilateral institutions. Lending by export credit agencies —with the pure purpose of export promotion— is excluded. (OECD, Glossary of Statistical Terms).

This statistics measures as best as it can, government aid flows to recipient countries on the DAC list of recipients as well as to multilateral agencies. However, ODA is only a measuring tool and can only measure what it has been designed to measure. Ultimately, a number of aid flows are not included in ODA. ODA does not include aid from the private sector, such as private corporations and charities, or NGOs that raise their funding from private donors. Perhaps most importantly, ODA does not measure the many billions of dollars per year which flow directly to citizens of recipient countries from friends and families abroad. These private flows constitute a substantial percentage of all aid flows. Aid from the private sector (not including private citizen remittance) accounts for approximately 15% of all measured aid flows.⁴ Remittances are not part of the DAC’s measurement of total aid flow; however, conservative estimates of remittances have been estimated at least between 59 and 81 billion USD per year.⁵ The actual role of remittances in development is still to be determined; however, preliminary research by the IMF suggests that they may have a negative effect of GDP growth. These findings, however, lack an explanation for this seemingly inverse relationship between remittance and GDP and are inconclusive in determining the true impact of remittances in funding poverty reduction and social programs, which may have a more diluted effect on economic growth.

Recently, there has been an increase in literature on the effect of the form of development assistance on the overall impact of aid flow. Although DAC statistics have categorized aid in a number of sectors such as health, education, and social infrastructure, recent literature such as Knack 2001 or Whitfield 2009 calls for a closer look at the actual administering process of aid. They argue for breaking aid down into categories which reflect what type of aid (i.e. technical assistance, emergency aid, and debt relief) is actually being provided in order to assess its effectiveness. Just as importantly as what is being provided, however, is how aid is provided. Such distinctions include the coordination of aid, its involvement of the local governing institutions, or community involvement. Another distinction of aid type, as tied or untied, has gained attention from the academic community.⁶ The quality of aid assistance provided may impact not only its effectiveness but its effect on donor and recipient behavior. Trends in the quantity as well as the quality of aid may have an impact on the structure of international aid and on the incentives created for donors and recipients by this system.

2. The players

The international aid structure is composed of two main types of actors: donors and recipients. These seemingly unified “players” are the culmination of complicated relationships and interactions between individual actors whose individual motives and actions influence the general aggregate behavior of “donors” and “recipients” in this model.

Donors aid, for example, has traditionally been further divided into two main types: bilateral — aid given directly from one country’s government to another —and multilateral— aid collected from various donor countries and distributed by an international, multi-governmental agency. There are over forty bilateral donors who have allocated a significant amount of aid over the past five years. They include members of OECD and DAC (See Table 1), as well as increasingly important class of contributors such as Brazil, India, South Africa, The United Arab Emirates, Israel, and most recently, China, which do not belong to such international organizations.⁷ Bilateral aid is by far the most

⁴ See OECD, DAC1 Official and Private Flows: <http://stats.oecd.org/Index.aspx?DataSetCode=TABLE1>.

⁵ See Chami et al. (2005).

⁶ See Clay, Edward J., Matthew Geddes and Luisa Natali. (2009).

⁷ Non OECD donors: Brazil, The People’s Republic of China, Columbia, Estonia, India, Israel, Kuwait, Latvia, Lithuania, Monaco, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, and The United Arab Emirates.

quantitatively significant form of aid and accounts for approximately 75% of all measured government administered international aid⁸. While bilateral donors are numerous, they make varying amount of contributions. The bulk of bilateral aid (70%) is allocated by only four key donors: U.S., Japan, France, and Germany.⁹ Although as blunt figures, these contributions are impressive, they constitute only a very small part of their GNI.

TABLE 1
DAC AND OECD MEMBERS

DAC (24)	OECD (31)
Australia	Australia
Austria	Austria
Belgium	Belgium
Canada	Canada
Denmark	Chile
Finland	Czech Republic
France	Denmark
Germany	Finland
Greece	France
Ireland	Germany
Italy	Greece
Japan	Hungary
Korea	Iceland
Luxembourg	Ireland
Netherlands	Italy
New Zealand	Japan
Norway	Korea
Portugal	Luxembourg
Spain	Mexico
Sweden	Netherlands
Switzerland	New Zealand
United Kingdom	Norway
United States	Poland
Commission of the European Communities	Portugal
	Slovak Republic
	Spain
	Sweden
	Switzerland
	Turkey
	United Kingdom
	United States

Source: Own elaboration.

⁸ See OECD, DAC1 Official and Private Flows: <http://stats.oecd.org/Index.aspx?DataSetCode=TABLE1>.

⁹ See Alesina and Dollar (2000).

Non-DAC members' increasing supply of international aid falls almost completely outside of conventional intergovernmental organizations' records and is not usually subjected to the same level of scrutiny as OECD-DACs. Although their aid contributions are very difficult to quantify due to lack of sufficient oversight and documentation, these newer sources of aid occupy an interesting position in the international aid network as both donors and recipients of international aid.

Bilateral donors do not coordinate their aid allocations. Instead, responding to individual incentives, they independently determine the quantity of their aid, choose recipients, and elect the sectors of economic, political, or social development where they would like to concentrate their aid. Consequently, there is quite a bit of overlap as all bilateral donors give to most of the wide array of recipient countries in almost all sectors of development.

Multilateral donors comprise the other 30% of governmental aid.¹⁰ They are very numerous but in general can be categorized as related to five types of organizations: United Nations organizations, the two Bretton Woods institutions (World Bank and IMF), European Union institutions, regional banks, and sector specific aid agencies such as the Global Fund to fight AIDS, Tuberculosis, and Malaria. The top three multilateral donors are the European Union institutions, the World Bank's International Development Association, and the Global Fund to Fight AIDS, Tuberculosis, and Malaria.¹¹ The largest multilateral organizations such as the United Nations, the World Bank have a myriad of smaller agencies. These smaller agencies tend to be more specific in their goals, however, there exists quite a bit of overlap and lack of inter-agency coordination as these sub-agencies tend to appear organically without being part of an architected organization-wide plan. Similarly with bilateral donors, multilateral organizations also suffer from lack of coordination with each other as well as with bilateral donors.¹²

While governments are not the only donors of international aid, they will be the only "players" considered in this model. This simplification is made both for the sake of simplicity and due to the lack of sufficient data on aid flows from these other sources. These additional sources of international aid, however, are a rich area for further research and may contribute significantly to the academic community's understanding of the international aid structure.

Recipients are the final active players we will discuss in this segment. In the DAC list of ODA recipients, they are classified by income levels as Least Developed Countries, Other Low Income Countries, Lower Middle Income Countries and Territories, and Upper Middle Income Countries and Territories¹³. Countries, such as Saudi Arabia, which have passed the "High Income Country" threshold of a per income capita of over \$10,065 per capita "graduate" from the recipient list and aid flow to that country is no longer counted towards ODA. Non-OECD-DAC countries such as Brazil, The People's Republic of China, Columbia, and India also populate this list.

In terms of raw quantity, data from the OECD¹⁴ suggests that more aid goes to the continent of Africa; this aid, however is dispersed unevenly among Africa's 61 countries. Despite its development issues, as a continent, Africa received only 3 more USD per capita than Europe in 2008. Measured in net ODA, Africa is the second main recipient of aid (a close second to Asia). The top five recipients in the developing world as indicated by a 3 year average (2006-2008) were Iraq, Nigeria, Afghanistan, Ethiopia, and Tanzania. The largest aid recipients since 1970 are Bangladesh, Indonesia, China, Iraq, Egypt, Pakistan, India, and Tanzania. While each of these countries has experienced its own unique trend in aid allocations, it is hard to ignore the fact that the highest consistent receivers of international aid include rapid developers, high-achievers, investment magnets such as China and India as well as countries of high military strategic importance (especially to the United States) such as Egypt, Iraq, and Pakistan.

¹⁰ See OECD, DAC1 Official and Private Flows: <http://stats.oecd.org/Index.aspx?DataSetCode=TABLE1>.

¹¹ See OECD. (2010) "Development Aid at a Glance: Statistics by Region, 1.Developing World."

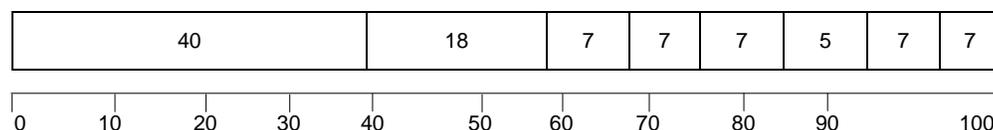
¹² See Easterly (2007).

¹³ See OECD, Annex 1 DAC List of ODA Recipients.

¹⁴ See OECD. (2010) "Development Aid at a Glance: Statistics by Region, 1.Developing World."

The most popular sector for aid by far is the social sector which received 40% of all ODA, and the economic sector (18%) (see figure 1). Aid allocations to the social sectors, especially education and health programs have undergone a steep increase since the 1990s while aid to economic sectors such as transport and communication infrastructures, banking, and agriculture has seen a gradual decline.¹⁵ Aid in the form of debt relief has also increased consistently in the last two decades, peaking between 2004 and 2006.

FIGURE 1
DONOR COMMITMENT BY SECTOR
(In percentages)



Source: OECD, "Development Aid at a Glance: the Developing World," August 2010.

While there is much information available on the direction and quantity of aid flow, not much research has been done on the quality of aid. Very little is known about how and through what mechanisms aid has traditionally been administered at the local level. There has been some interest in recent literature in the possibility that the quality of aid and the form of aid disbursement can have a great impact on local institutions as well as the overall impact of aid.¹⁶ The potential impact of the quality of aid on the overall structure of international aid will be discussed in further details in section 2.

3. The traditional structure of international aid

Traditional aid literature has generally focused on the creation of models explaining the complex relationship between aid allocation and growth (i.e. See Bagchi (1970) or Dalgaard et al. (2004)). While the structural relationship between aid and growth has occupied center stage, relatively little attention has been paid to the systematic analysis of another essential structure—the structural relationships determining the transfer of resources from donors to recipients.

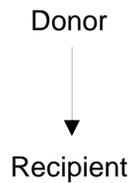
Much of traditional literature assumes this model to describe the structure of donor-recipient relationships surrounding aid flow (see figure 2)¹⁷. In this model of the international aid structure, aid flow and influence both flow in only one direction: from donor to recipient. Donors make their aid allocation decisions without accounting for recipient need in order to fulfill a series of self-interested goal. Recipients have little to no influence on these decisions. This structure places all agency on donors and does not account for interactions between the two parties outside of the transfer of resources. It also obscures the possibility that recipients also may have a degree of influence over donor behavior.

¹⁵ See OECD. (2010) "Development Aid at a Glance: Statistics by Region, Developing World".

¹⁶ See Van de Walle (1999) and Whitfield (2009).

¹⁷ This diagram resembles the traditional dyadic relationship represented in Villanger (2004) but differs that it allows only for a one-way direct interaction between donors and recipients.

FIGURE 2
TRADITIONAL DONOR-RECIPIENT RELATIONSHIP



Source: Own elaboration.

Recent literature (i.e. Villanger (2004)) has begun to question that model and have pointed out its inability to reflect the complex systems of relationship between the many actors such as donors, recipients, foreign companies, and local NGOs participating in this system. Such studies have opened the study of incentives facing recipients and have highlighted the importance of changing incentives on behavior. These studies, however, have not yet challenged the basic donor/recipient structure and have not yet explored the effects of these interactions on the existing model. Villanger (2004) suggests a triadic relationship involving more players such as international companies; however the fundamental assumption concerning the donor-recipient relationship and the overall structure for international aid remains untouched. In this article I challenge the fundamentals of this model of traditional aid structure. I not only introduce a series of interactions not taken into account into the present model, but later on I call for a new model of the structure of international aid altogether.

In the next section introduce a series of assumptions essential to the re-conceptualization of the international aid structure. I argue that 1) all “players” in the international aid structure respond first and foremost to incentives, 2) Donors face a number of incentives, one of which is meeting their designed goal for aid allocations, 3) Donor aid allocation behavior affects the incentives faced by recipient countries, 4) recipients adjust their behavior to these incentives, 5) the change in recipient behavior has a direct impact on aid effectiveness, and finally 6) Donors concerned with the impact of their aid adapt their behavior according to their interpretation of the problem. I conclude with the suggestion that these interactions depicted above constitute a rudimentary feedback mechanism inherent to the system of international aid.

II. The individual incentives and motives behind international aid supply and demand

In order to analyze the interactions between donors and recipients and their effect on the international aid structure, we make several distinct assumptions. We assume first and foremost that all “players” in the international aid structure are rational actors who attempt to maximize their own welfare and respond to incentives accordingly.

The motives for bilateral donor aid allocations have been well documented in international aid literature¹⁸ as composed of self-interested factors from abroad and from the domestic political climate.¹⁹ Alesina and Dollar (2000) find that bilateral donors respond to self-interested variables such as a recipient’s history of colonization, recipients’ voting pattern alongside the donor in the UN, as well as commercial and strategic interests. Each of these individual motives, however, stems from the same general rational among donors: that aid can establish commitment and dependency in recipients.²⁰ McKinlay and Little (1977) argue that donors can use aid to establish commitment and dependency in a recipient country in order to realize certain self-interested foreign policy goals. Consequently, the level of commitment and dependency established through aid is a function of the degree of

¹⁸ See Macdonald and Hodinott (2004); Alesina and Dollar (2000); Schraeder et. al (1998) ; and McKinlay and Little (1977).

¹⁹ Although bilateral aid has been found to be determined by mostly self-interested factors, Alesina and Dollar (2000) also found some evidence of a humanitarian impulse.

²⁰ See McKinlay and Little (1977) and their model surrounding commitment described as an attempt by one state to register its support for another and dependency based on one party’s overreliance on another resulting in a situation where one side can terminate a relationship at no cost, while the other can only do so at a very considerable cost to himself.

interest that the donor has in low-income recipients. In short, the main incentive behind bilateral aid behavior is a desire to build commitment and dependency in recipient countries in order to fulfill a set of interests.

Alesina & Dollar (2000) find that although donors generally respond positively to political openness (democratization), they do not respond to variables that make aid effective in reducing poverty, openness of economy, and strengthening of broader civil rights and law enforcement institutions. This observation supports the concept that donor focus is on certain foreign policy interests (i.e. democratization), and not on recipient needs (i.e. the reinforcement of strong governing institutions).

Donor motives, although mostly self-interested, do not necessarily have to be solely for the benefit of donors. McKinlay and Little (1977)'s model allows for the economic development of recipient countries as a donor goal. In this instance, aid allocation is given with the goal of spurring development in a recipient country. However, even in such a situation, the donor's focus is not on recipient need, but on development as a foreign policy goal. For the most part, donors' behavior, and their incentives for providing aid, is primarily affected by fulfillment of their individual agenda. And while they are very concerned with the impact of their aid, they may judge the 'effectiveness' of aid as meeting these smaller, for the most part self-interested goals and have less of an incentive to monitor the effect of aid on international poverty reduction and growth among the most needy, or to change their aid allocating habits to serve these broader goals.

More recently, studies have shown that bilateral donors' aid allocation behavior is not only affected by factors abroad based on donors' foreign policy goals, but also by domestic factors. Tingley (2010) suggests that domestic political ideology may affect levels of foreign aid allocations. Conservative governments, for example, contribute less of their GDP to international aid.

The motives behind multilateral aid allocations and the incentives faced by international aid agencies have also been a topic of interest in current literature. Neumayer (2003) finds that multilateral aid agencies focus on recipient economic need measured by per capita income (although not by other measurements of welfare) and some take into account human development needs when allocating aid. Neumayer (2003) finds tentative evidence that multilateral agencies also support political liberalization. However, similarly to bilateral donors, multilateral aid agencies do not respond to stronger civil rights or law enforcement institutions reflective of low levels of corruption. Aid agencies' aid allocations also share the less populous and colonial country bias discussed in Alesina and Dollar (2000) in addition to having a third bias towards countries distant from the centers of Western world. This data suggest that multilateral agencies may be motivated by humanitarian goals to a greater degree than bilateral donors. However, they may be working towards fulfilling the goals they see as most important and interpret which aspects of human need to most focus on. Their perceptions, however, may not accurately reflect the true needs of their recipients.

Despite their seemingly more humanitarian intentions, international aid agencies have had little success in meeting broad development goals (Easterly 2007). They suffer from similar lack of coordination as bilateral donors, share some of their aid allocating bias, and seem to share the inability to pinpoint and address recipients' most urgent needs. This failure to attain aid effectiveness defined as poverty reduction and economic development by both donors and recipients may lie in the fact that not only do they not know what their recipients truly need, but that they lack incentives to find out.

In 2006, international aid critic, William Easterly made an insightful comment on the nature of international aid which is pertinent to this article:

Foreign aid is a public entity spending the money of rich people on the needs of poor people. Unlike most market transactions, the recipient of the aid goods has no ability to signal their dissatisfaction by discontinuing the trade of money for goods. Unlike the provision of domestic public goods in democracies, the recipient of aid-financed public services has no ability to register dissatisfaction through voting. With little or no feedback from the poor, there is little information as to

which aid programs are working. Nor is there much incentive for the aid agency to find out what works when there is little accountability (Easterly 2006 in Easterly 2007 p. 330).

While aid agencies may mean well, the lack of a feedback mechanism as well as a lack of accountability has not left aid agencies with a lack of incentives to take a pragmatic approach to aid, scale down their broad goals and focus on clear, provable goals. Aid agencies have been allowed to grow with little coordination and have not organized themselves efficiently or their aid efficiently.²¹ The incentives faced by both bilateral and multilateral agencies explain the sluggishness of aid reform. Global poverty reduction and development do not present urgent incentives for bilateral donors, and while they are a goal for multilateral donors, these agencies lack incentives to change their aid allocating behaviors speedily.

Recipient countries also face incentives. These incentives can be broken down into two categories: economic welfare and political welfare. Firstly, recipients seek to maximize their own economic welfare in face of budgetary constraints. The goal of recipient governments in this case is not a broad long-term goal such as development as may be assumed, but rather “intermediate goals” concerning government expenditure, tax revenues and public borrowing as is documented by Mosley et al. (1987). Their goal at all times is to maximize their economic welfare by minimizing their costs.

In addition to budgetary motivations recipient governments are also influenced by political motives. Boone (1996) offers a framework in which politicians seek to maximize the welfare of a specific segment of the population—their constituents. The type of regime dictates the make-up of this constituency. Boone (1996) offers three extreme alternative political regime which best explain this framework. An Elitist government which seeks to maximize the welfare of a fixed ruling coalition composed of high-income political elite. An Egalitarian which seeks to maximize the welfare of its less wealthy citizens, and a Laissez-faire government which seeks to lower distortionary taxes and encourage higher investment. This later form of government thus seeks the welfare of a minimum but substantial segment of the population which will benefit directly from such policies. However, a substantial fragment of the population benefits from improved economic conditions. Boone (1996) argues that only the elitist form of government wastes aid in the sense that it has no impact on the quality of life of a substantial part of the population. He argues that based on the persistent lack of aid effectiveness, it is possible that recipient governments are primarily elitist. Recipient government behavior is thus generally influenced by two main impulses: to minimize the cost of governing, and maximizing the welfare of their constituents—in most cases a small economic and political elite. These two goals are not always aligned, and at times they call for different courses of actions. The interactions of changing conditions on these two goals will influence their behavior.

Donor aid allocation behavior plays a big role in changing the conditions and incentives faced by recipient governments. For one part, international aid has come to represent a substantial proportion of many of recipient countries’ budget.²² This translates to an increase in aid dependency in recipient countries, and consequently, greater donor influence. Villanger (2004) also suggests that donor requests and conditionalities associated with aid can also affect the politically important constituents of local governments. For this reason, donor allocating behaviors are closely watched as minute changes can have an important impact on recipient incentives and consequently recipient behavior.

This effect on recipients has received increasing attention in literature. Mosley et al. (1987) shows that international aid has a negative indirect effect on the spending patterns and ultimately on the policies of recipient countries. International aid can be highly fungible and offers an opportunity for recipient governments to redraw their spending programs and switch funds which would have been used for a project now receiving international aid to another purpose. This new purpose can be productive which may help improve income, or ‘wasteful’ by using newly freed resources to increase the size of the army, pay off debts, or reduce taxation or reducing borrowing. These newly allocated funds will be spent

²¹ See Whitfield 2009.

²² See Villanger (2004).

with no future returns. Other studies have found that great quantities of aid increases rent-seeking in individuals and decreases productive activities.²³ This effect is particularly strong in countries with large public sectors. Knack (2001²⁴) has also found that aid dependence can undermine the quality of governance and public sector institutions by weakening accountability; encouraging corruption; increasing conflict over control of aid funds; siphoning off scarce talent from the bureaucracy; and alleviating pressures to reform inefficient policies and institutions.

It is clear from such studies that donor aid allocating behavior can affect recipients' incentives and have an impact on recipient behavior, and that these changes may be negative. Donor behavior, however, is also indirectly affected by recipient behavior. These changes in the strength of the recipient's public sector can have a direct impact on aid effectiveness and affect donor incentives.

A concern with the impact of aid is the last piece in the recipient-donor interaction. Due to donor incentives, this piece has been missing for decades. In the last two decades, however, it has strengthened.²⁵ International aid agencies by their very definition are created to provide aid. While they have as their incentive to provide as large of a quantity of aid as they can, they have no incentive to do so quickly and efficiently and their very size makes it difficult to do so. And while they are slow to gather feedback on the impact of their aid, their very existence depends on the public's trust that they can have an impact. It has become increasingly apparent however, that they are falling short even of their own standards.²⁶ The pressure, which due to lack of accountability to recipient governments had been missing, has finally manifested itself. Aid agencies are under more pressure than ever to make a difference, and to do so quickly. Now, more than ever they are concerned with showing proof of their impact and are beginning to attempt to measure it. Easterly (2007)'s assessment of aid agencies' progress to improve their aid practices shows that areas of aid allocating behavior which have undergone the most reform, such as decrease in aid tying and decrease in food aid have occurred over the last decade and a half. Multilateral and bilateral donors, now more than ever, are under pressure to meet their development goals for aid allocations adapt their behavior according to their interpretation of the problem.

While the impulse to adapt behavior now exists, a lack of understanding of the system of international aid continues to hamper effective reforms. Due to the lack of a clear and direct feedback mechanism, the signals from recipients to donors embedded in data on the impact of aid are either being overlooked or misinterpreted by the donors. The direction of future reform in the present model of the international aid structure is completely subjected to donor interpretation and does not take advantage of recipient-donor interactions to inform decisions. In this situation, donors may continue to miss the point and adopt ill-informed reforms which may aggravate the situation. The following section attempts to reconceptualize the traditional model for international aid and highlights possible rudiments of a feedback mechanism already built into donor-recipient interactions.

²³ See Economides et al. (2004).

²⁴ See Djankov et al. (2006) for similar research.

²⁵ See UN Millennium Project goals or Paris Declaration.

²⁶ See Easterly (2007).

III. Substituting interactions into the traditional model

As the previous section demonstrates, recipient-donor interactions play an important role in changing aid allocating behavior and on aid effectiveness. In this section, we supplement the traditional model of the international aid structure with a series of assumptions concerning the nature of recipient-donor interactions in order to simulate their effects in light of current popular proposed reform solutions.

Let us first build a hypothetical case incorporating all of our assumptions. We will take the traditional one-way aid transfer model presented in section 3, which is represented by a simple vertical arrow representing aid flow from donors to recipients. To isolate recipient behavior effects on the structure, let us assume “perfect” donors. Perfect here refers to the donors’ own list of “good” behavior.²⁷

First and foremost, we assume generosity, by which we mean donor allocation of at least 0.7% GNI²⁸ and the willingness to provide even more assistance given need.²⁹ Secondly, for the sake of simplicity, we do not assume conditionalities as these vary quite widely and depend very much on donors’ subjective interpretations which are at times at odds with recipient interests.³⁰ The other most popular proposed patterns of donor behavior, however, are not compatible (see Van de Walle (1999)):

²⁷ Easterly (2007) offers a list of benchmarks agencies themselves have stated: generosity, donor coordination, selectivity, less aid tying, less food aid, less technical assistance.

²⁸ See http://www.oecd.org/document/19/0,3343,en_2649_34447_45539475_1_1_1_1,00.html.

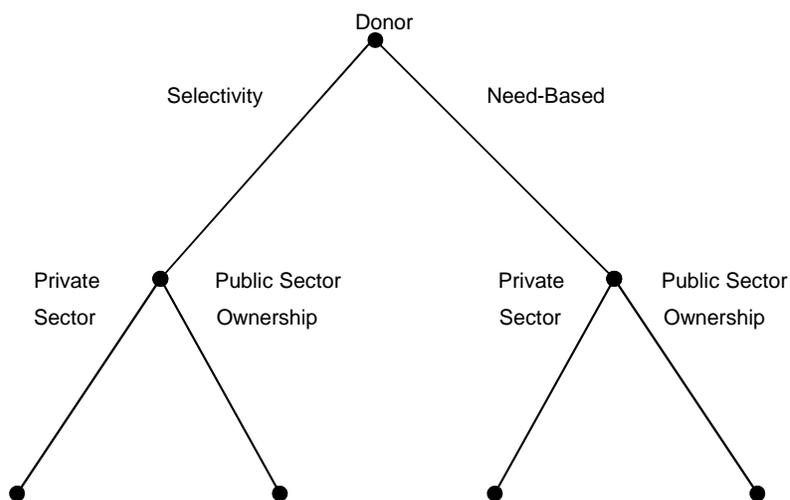
²⁹ Although there exists a debate about whether there should be more or less aid (see Whitfield 2009), donors themselves have called for an increase in aid allocations (see UN Millennium project goals for example).

³⁰ See Villanger (2004).

selectivity is directly opposed to need based allocations, and the concept of allocating more aids to the private sector —a method of bypassing the public sector— is at odds with the call for more recipient “ownership” and participation in aid projects. These incompatible proposed solutions can be broken down into reforms of the quantity of aid allocations (selectivity and need based) which dictate how much aid to give to different recipients and reforms of quality (private sector and ownership) which dictate how aid is to be distributed to and used by the recipients. We will represent these different proposals and impacts of their adaptation by utilizing a tree depicting these choices of policy³¹ (see figure 3).

In our example, we assume that donors make decisions at two different levels of the decision tree model. They first choose the quantitative aspect of their aid flow as either selective or need-based, and secondly they choose its quality by choosing to give to the private sector and bypass the local government institutions by giving directly to NGOs and local communities or to encourage greater involvement and integration of projects into the public sector (Van de Walle (1999)). We do not directly assume coordination. This is partly due to the fact that “perfect” coordination would require donor-donor coordination which we could not control for in the traditional model of the international aid structure, and also because such an assumption is not necessary for some level of coordination among “perfect” donors. Since all perfect donors are following the exact same aid recommended allocating policies, their individual aid flows will be identical. They will all present the same incentives to recipients and inadvertently re-enforce each other’s signals.

FIGURE 3
DONOR DECISION TREE



Source: Own elaboration.

³¹ This illustration of donor decisions concerning aid allocation as a decision tree is inspired by Van de Walle (1999)’s use of game theory to create a model depicting donor choice to disburse aid to recipient countries despite recipients’ failure to comply with conditionalities.

1. Selectivity

In the first scenario, we explore the different impacts of the choice of a selective or need-based form of aid allocation. We will first analyze the choice of selectivity. Again, in order to achieve a “perfect” set of donors, we assume that all donors have the same criteria and look for the same characteristics in a recipient. We also assume that all donors follow the same criteria of sound institutions and policies suggested by Burnside and Dollar (1997).

In our scenario perfect donors have adopted these policies first and foremost because they are pressured to care about the impact of their aid³² and are consequently monitoring its effectiveness defined by the success of the specific project and general progress in the sector of investment. While donors care about impact, they cannot affect it directly. The impact aid-giving behavior will always be mediated by recipient behavior and global factors. Let us hold global factors perfectly constant so that they cannot aid or hinder the effects of aid.

In this “perfect” situation, almost all international aid (with the exception of emergency aid to the poorest) goes to a limited number of countries which meet the donors’ standards based on current literature on selectivity such as Burnside & Dollar (1997) stressing the importance of sound recipient institutions and policies. All other countries do not receive aid, regardless of their need. Keeping in mind that the goal of recipient governments is to keep governing costs low, this sudden loss of massive quantities of international aid is a very strong incentive for recipient countries to change their behavior to regain their aid allocations. We cannot assume, however, that all recipient countries change. According to our assumptions, recipient countries will only change if the cost of their change in behavior is less than or equal to³³ the cost of aid withdrawn. The cost of change includes budgetary costs to revamping public institutions and also political costs of angering important constituents. This choice can be represented as:

$$C\Delta \leq C (-\text{aid})$$

According to this assumption, countries with a particularly high dependence on aid, or with sound institutions and consequently low costs for changes in behavior are the most likely to change their behavior according to donor preferences. Countries which are not able to adapt their behavior due to the high costs of change face the danger of being trapped in a dire situation in which they are unable to provide even the most basic public infrastructure services to their citizens. Given the fact that they were not able to change due to the bad shape of their institutions, it is doubtful that they will be able to rally quickly enough to avoid instability. This puts them in a desperate situation and aggravates the situation all the more.

We have ascertained which countries are most likely to change their behavior when faced with changes in incentives associated with the quantity of aid. Let us now observe how the different qualitative policies involving the private or public sector can affect recipient incentives, the ultimate impact of aid, and donor behavior. These three factors affect one another in an endless loop.

³² DAC documents stressing the importance of aid effectiveness as an important goal in the international aid community, the increasing use of rhetoric surrounding improved aid effectiveness demonstrated in the 2005 Paris Declaration as well as the United Nations self-professed commitment to meeting its millennium goals all demonstrate the desire to demonstrate that the international aid community is having a concrete impact. The frequency of the call to increase aid effectiveness suggest that aid agencies are facing the pressure of measuring and presenting their impact.

³³ We will be very generous in the assumption that recipients’ preference is to change and they will do so in a situation when the costs of change and the loss of aid is equal.

2. Private sector

The chosen few recipients will receive a sharp increase in aid allocations. This aid, however, can go to the public or private sector. Donors, motivated by a distrust of the recipients less efficient infrastructures may prefer to give it to the private sector. This method attempts to bypass the central governing institutions of the recipient countries by allocating it directly to NGOs, local charities and institutions, civil societies, and the like. This method allows for better micro-management and more efficient implementation of individual projects and greater donor control.³⁴ This approach, however, distances the public sector and sends strong signals to recipients for greater influence in the local sectors. Reacting to these signals for greater donor involvement, the recipient countries will do exactly that. Without donor actions tailored to signal otherwise, they will create ways to increase donor involvement at every level of aid projects (and of course invest in a larger bureaucracy able to handle the increase in paperwork and negotiations associated with increased conditionality). These surges in donor participation will mostly come at the expense of local participation in the donor dominated sectors as recipient countries, attempting once again to lower administrative costs as much as possible, focus their efforts in other sectors. Without recipient government support, however, and the government coordinating projects into a plan for overall development, sector-wide improvement is difficult, and even as individual projects succeed the overall situation may remain the same or worsen as recipient governments continue to withdraw funds from that sector. Partly due to these factors, NGOs have little sustainability (Van de Walle (1999)) and a limited national-wide impact.

Donors base their behavior on impact. They will see the improvement in individual projects where local institutions play a lesser part and the lack of sector-wide improvement. These progressions, coupled with donor lack of faith in local governments and institutions which lead to even further distrust of recipient governments and more attempts at micro-management. They will most likely interpret the lack of greater impact as donor success hampered by local institutional failure. The response will be for more donor direct involvement and less local recipient involvement. Responding to these signals, recipients will react by doing even less. This situation is prime breeding ground for recipient government insipidity and corruption documented by Mosley et al. (1987), Economides et al. (2004), and Knack (2001) in the presence of large quantity of aid flows. In this scenario, the quality of governance in the “chosen” few countries will decrease. After countless rounds in this endless cycle, the result will be local governments worse off than before the aid influx, minimal overall impact, and donor dissatisfaction.

We have just argued that recipient behavior will change according to donor signals. Recipient countries assessed these preferences not only according to what donors say, but also according to how they act and what type of countries and behaviors they seem to be currently supporting. Recipient countries seeking to change will look closely at the behavior of the few selected countries. These on-looking countries who are able and pressured to change their behavior will read donor-recipient behavior as calling for larger bureaucracy and a willingness to accept more donor influence and deal with attempts at micro-management. The “perfect” donors, motivated by the desire to see result will call for further reform; given their previous experiences, these reforms will call for even greater donor involvement. Recipients’ changing behavior will go undiagnosed as will the reason for that change.

3. Ownership and public sector involvement

The previous scenario occurs under the assumption that donors do nothing to encourage greater participation of the recipient’s central government. Let us create an alternate scenario in which donors make a serious attempt at involving public sector of the recipient countries. There are two possible approaches to this reform. Donors can encourage greater recipient government participation through a

³⁴ See Van de Walle (1999).

new approach called Sector Investment Programmes (SIPs). In this approach, donors agree to a sector plan, provide the funds, and the recipient governments takes the initiative of implementing the framework. This approach seeks to solve some of the donor coordination problems, as well as the sustainability issues experienced by uncoordinated individual projects. This sector framework, however, is devised mostly by donors with little input from actual recipient governments.³⁵ This approach, however, requires a high level of coordination from donors who must first of all agree to work together on one set plan.

Another strategy which allows for greater recipient participation in the planning process is the “Foundation Model” suggested by Whitfield (2009). With this approach, donors do not propose their own conditions immediately; instead, they accept proposals from the recipient governments themselves. If the recipient proposal is approved, donors will fund it. However, recipient countries are held responsible to show progress on these plans and to prove that their funding is being spent where it should be. If there is proof of fraud or mismanagement of funding, donor countries have the right to withdraw their aid and take it elsewhere. This model also allows for one donor to fund one recipient country, or one plan from one recipient country. However, as we will see, lack of coordination continues to be a serious problem to the feasibility and success of this approach. Furthermore, although this method is much more flexible from SIP and allows recipients to take the lead, it also places a strain on the bureaucratic institutions of recipient governments.

In the SIPs model, with much riding on coordination with donors, recipients face the incentive to sharply increase their spending on their bureaucratic institutions in order to better accommodate donors and receive plans. This spike will sap their funding to other sectors. The spike in bureaucratic funding may even be accompanied by a spike in red-tape to stall donor evaluation and buy more time for progress on the donor proposed nationwide plans. Large frameworks for sector aid allows for increased long-term donor involvement and increased influence on domestic affairs. Unfortunately, this increase in donor influence does not necessarily translate to a more active role for recipient governments. There continues to exist the possibility that recipients will not have an active part in the planning process and will be kept in passive bureaucratic and program implementation roles. These passive roles lead to a lack of recipient enthusiasm for and investment in a national development framework they have had little opportunity to shape.

Without initial input and continuous feedback from recipients concerning the focus of the development plan and its efficacy in meeting their needs, donors may continue to be the main agents in dictating the direction of aid and to rely on their interpretation of recipient need to inform decisions. Moreover, the increasing size of the public sector coupled with large inflow of aid can decrease the quality of governance by decreasing local accountability to their constituents, increase corruption and rent seeking, and hurt the sustainability of aid projects (Economides et al. (2004)). Furthermore, lack of formal mechanisms for donor coordination increases the opportunity for recipients to adopt a hit and run strategy³⁶ due to the lack of a shared database of recipients’ past aid allocations and behavior. Lack of attachment to any particular plan on the part of recipients increases the chance that they will take advantage of this opportunity to increase their level of aid at the expense of true development.

The plans most likely to suffer from these setbacks are those which involve the most amount of recipient participation in the implementation process. This adverse impact on overall effectiveness may drown out other more subtle feedback on the impact of certain programs and recipient government involvement on sectors. Basing their decisions on the lack of aid effectiveness of programs with the most donor involvement, donors may decide to decrease recipient role even further and increase donor involvement in the design and implementation of nationwide frameworks for development; shutting out the recipient public sector and discouraging recipient feedback all the more.

³⁵ Van de Walle (1999).

³⁶ A strategy in which recipients will propose a plan and receive funding for it, mismanage it, and move on to do the same to another unsuspecting donor.

The Foundation Model suffers from similar problems of increasing recipient bureaucracy, increasing size of the public sector, potential increase in corruption and funds mismanagement. Although it is also prone to donor coordination issues, it allows for fewer numbers of donors involved in one recipient country, increasing donor ability to determine a recipient's progress, to share information, and decreasing the opportunities for hit and runs. It also allows for more accountability of the recipient government to its citizens and more agency in dictating the focus of international aid being received. These plans are more likely to reflect needs deemed most important by the recipients.

The Foundation Model depends heavily on a sound and efficient recipient government which is willing and able to lead a nationwide development program. Such governments, however, are rare in developing countries, and as we have seen, can be corrupted by the inflow of aid. Lack of donor coordination and recipient capacities are all factors which could hamper the effectiveness of this approach. Yet another important drawback in this model is the lack of feedback. In this scenario, similarly to any other using the traditional model of international aid, donors judge the effect of their aid and adapt their behaviors to changes in the overall impact of their aid. They do not account for changes in recipient behavior, or what these changes reveal about their own behavior. Due to the fact that data collected by donors is too concerned with general impact and other indicators that their self-determined goals are being met, subtle recipient feedback embedded in this more general data is being missed. The traditional model of international aid, even when enhanced with recipient-donor interaction, seems unable to break down impact and account for the factors behind international aid supply, demand, and effectiveness.

4. Need-based

If instead of opting for selectivity, donors choose to pursue a need-based approach, they would provide more aid to the recipients who need it the most. Unfortunately, these poorest recipients usually do not have the sound infrastructure and central institutions necessary to use aid efficiently and without mismanagement. Faced with such conditions, donors would most likely administer their aid using the private sector and bypassing recipient central governing institutions. This attitude would clearly signal for less recipient involvement. Lack of recipient government presence in these international projects raise the problem of sustainability would decrease the ability of individual need-based projects to have a far-ranging impact without a national framework for organizing and coordinating aid activities.

Other than signaling for less recipient government involvement, this approach would also not provide clear incentives for recipients to change their behavior significantly. Since the goal is poverty reduction, in this model of perfect donor behavior, donors' behavior would signal that poverty is the only criteria for aid. While it is possible that some recipients making minimal economic progress might slow their own growth in order to receive aid, which would exceed the returns from their own growth, most recipients' behavior would remain unaffected by donors' aid allocation patterns and would face feel no pressure to improve their governing institutions or policies. Acting almost as dead-weight, recipient governments would face a strong incentive to honker down in their old habits and accept as much international aid as possible.

Here, a final note on donor coordination. Although donor coordination is not one of our main assumptions, in this analysis we assumed that all donors followed the same policies. Even in a system composed of perfect donors, however, this is not necessarily the case. Perfect donors who seek to maximize the impact of their aid are faced with a number of different and at times contradictory propositions. In the case that some donors followed one policy i.e. selectivity, while others followed another such as need-based allocations, these two approaches would cancel each other's impact. The signals for change in recipient behaviors sent out by donors following selectivity would lose their effectiveness if aid was being allocated freely, with no pre-conditions by need-based donors. Donor coordination continues to be essential to the successful implementation of any of these approaches.

TABLE 2
RECIPIENT INCENTIVES AND BEHAVIOR SUMMARY CHART

Donor Action	Change in recipient incentives	Donor signal to recipients	Recipient action	Implications
Increase selectivity in allocations	loss of massive quantities of international aid.	donors support only certain types of recipient behavior.	recipient countries change their behavior according to donor preferences and copy "chosen" recipients' behavior if $C\Delta \leq C(-aid)$.	Countries with the worst initial conditions are not able to adapt their behavior and face the danger of being unable to provide even the most basic public infrastructure services to their citizens.
	increase percentage of aid flow to private sector.	donors seek greater influence in the local sectors.	recipient governments decrease their participation in sectors receiving international aid to increase donor influence and attract more aid allocations.	Individual project success with little sector-wide improvement due to lack of recipient government coordinating presence may increase donor perception of corrupt recipient governments and increase aid allocations to private sector. Leading to decreasing quality of recipient government, minimal overall impact on development, and donor dissatisfaction.
	increase percentage of aid flow to public sector through SIPs.	donors want a substantial role in determining the direction of further recipient development plans.	recipient governments increase spending on bureaucratic institutions in order to better accommodate donor involvement and plans. Possible increase in red-tape to stall donor evaluation.	Lack of recipient investment in aid projects, and lack of accountability to constituents lead to likelihood of 'hit and run' behavior. Decreasing quality of recipient government, minimal overall impact on development, and increasing donor dissatisfaction with recipient government. Shift towards private sector aid.
	increase percentage of aid flow to public sector through the Foundation Model.	donors are looking for a recipient government which is willing and able to create its own nationwide development program.	recipient governments increase spending on bureaucratic institutions to better put forward proposals.	Greater pressure for sound government institutions.
Increase need-base allocations	donors give most aid to the most needy.	donors will support weak recipient governments and public service institutions.	recipients closest to the poverty line may slow their own growth to receive more aid. Most recipients are under no pressure from donors to change their behavior and increase development.	Donor aid allocations may have little impact overall recipient development.

Source: Own elaboration.

5. The rudiments of a feedback mechanism

As we saw in the earlier scenarios, recipient to donor feedback is an inherent part of the structure of international aid through recipients' direct effect on the ultimate effectiveness of aid and donor monitoring of that effectiveness to inform future shifts in behavior. Unfortunately, this feedback is often muddled as donors read either only their indirect impact on aid —bypassing the role of changes in recipient behavior— or the direct impact of recipients without accounting for the effect of their own behaviors on recipient behavior. Their oversight of recipient-donor interactions and the impact of these

interactions on overall aid effectiveness is due, not to a lack of concern with the impact of their aid, but rather from a faulty model of how the international aid structure truly works.

The traditional international aid structure seems overly rigid and unable to accurately represent the role of incentives on donor and recipient behavior, or the effect of changing incentives on actors' behaviors. Without these components, it cannot clearly and efficiently represent the effect of individual changes of donor and recipient behavior on the general impact of aid. Due to all these shortcomings, the current model cannot effectively analyze the subtle feedback being delivered by the system, nor can it be used as a tool to expand this muddled feedback into a true mechanism which can be used to coordinate donor and recipient behaviors. The traditional structure of aid takes a broad, bird's eye view approach to international aid when what is needed is a detailed understanding of the incentives behind donor and recipient behavior, and the effect of specific changes in either donor or recipient behavior on the overall organization of the structure for international aid and on the ultimate impact of aid.

IV. Conclusion

A realization that recipient governments are not at all passive, and are in fact savvy, profit-maximizing actors in the international aid structure has recently begun to appear in international aid literature. Villanger (2004) introduces the argument that recipient governments can adopt certain strategies within the international aid structure to force donor governments to continue giving aid even when it means going against pre-set conditionalities by using donor relationships with powerful international companies to tie their hands. He raises an interesting puzzle by asking “if it is vital for the recipients to get aid...why cannot the seemingly powerful donors force the seemingly weak recipients to implement the conditions before aid is disbursed?” (Villanger (2004) p. 335) and suggests an answer by expanding the traditional dyadic model for the international aid structure to include a third actor with its own sets of relationships to donor and recipients: international companies.

Economides et al. (2004) also makes some progress on this topic by considering that the micro-macro paradox of international aid first introduced by Peter Mosley’s article titled “Aid effectiveness: The micro-macro paradox”³⁷ may be the result of changing behavior among recipients in the form of an increase in rent-seeking. Neither of these articles, however, goes back far enough to describe the original core incentives faced by recipients, the motives of their behavior, or the effect that these changes in behavior have not only on the impact of aid but on the entire international aid structure as well. While recent literature has begun to question the place of recipients in our model of the international

³⁷ 1996. *Institute of Development Studies Bulletin* 17, 22-27.

aid structure and has suggested additions and slight modifications to the traditional model, there has been less attention to the need for a complete re-design of the current model of international aid.

Recipient country behavior and donor and recipient incentives play a role similar to that of a confounding variable in statistics in the current model of international aid. As long as they are not accounted for, the data will be skewed and assessments as well as solutions will continue to aim for a moving target. In order to correctly assess the problems facing the international aid community, and offer adequate structural reforms, it is necessary to take into account recipient and donor incentives playing out in the background and the effect of their behavior on the international aid structure.

In this article, we attempted to add subtle donor-recipient interactions to the traditional model of international aid. Simply by changing certain assumptions concerning the true structure of international aid and taking into account the fact that all actors —recipients and not simply donors— respond to incentives, we were able to improve our ability to understand the transfer of international aid and assess more critically the potential impacts of proposed solutions to the shortcoming of international aid. However, these modifications to the model were not enough.

Despite the addition of these previously overlooked components, the present model of the structure of international aid is still incomplete and needs to be re-architected. Its overly simplified structure renders it unable to explicitly represent the tremendous role played by incentives on donor and recipient behavior in the aid allocation system and the resulting complex series of interactions taking place behind every donor and recipient decision. These behind the scene interactions overlooked by the present model of international aid are not only essential to offering a deeper understand for donor and recipient behavior, they also offer exciting clues to rudiments of a feedback mechanism inherent to the system of international aid. This potential feedback mechanism represents the possibility to improve the currently inefficient international aid structure with reforms designed to better organize and analyze the feedback between recipients and donors and increase the efficiency of the international structure for aid allocations and increase its overall effectiveness.

In order to further expand our understanding of the true nature of international aid and its structure and potentially improve the quality and efficiency of international aid, model of the international aid structure needs to be changed and the rudiments of a feedback mechanism suggested in this paper analyzed in further details.

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