Ministry of Foreign Affairs of the Netherlands

Radboud University

Special Working Paper Series on 'Unintended Effects of International Cooperation'

Working Paper No. 2017/2

Aid and Good Governance: Aggregate Unintended Effects of Aid

Geske Dijkstra*

Abstract

Although donors generally aim to improve governance in recipient countries by various means, critics claim that the aggregate effect of large aid flows is to deteriorate governance. Aid weakens domestic accountability, sustains authoritarian regimes, weakens government capacities and increases corruption. This paper reviews the empirical evidence for these unintended effects of aid. It finds that the negative effects of aid on governance are much exaggerated. Furthermore, varying effects per time period and per donor imply that donor intentions matter: donors that are serious about their intended effects on governance are able to mitigate possible negative unintended effects of their aid.

Key words: aid - good governance - unintended effects

*Erasmus University Department of Public Administration and Sociology (DPAS)

This paper has been presented at the 'Unintended Effects of International Cooperation' conference on January 16&17, 2017 at the Netherlands Ministry of Foreign Affairs in The Hague. The opinions expressed in this article are the author's own and do not reflect the view of neither the Netherlands Ministry of Foreign Affairs, nor the Radboud University, or any other affiliated institutions.

1. Introduction

There are two main relationships between foreign aid and good governance in recipient countries (Hoebink 2006). First, many donors have used good governance as a criterion for the aid allocation, although the extent to which they apply this criterion varies by donor and by period (Dollar and Levin 2006, Hout 2007). Second, aid often has the specific aim to promote good governance. Donors may do so through various aid modalities, such as projects, technical assistance, or through the policy dialogue around budget support and debt relief. Yet, regardless of the different aid modalities, the sum of all aid to a particular country may also have effects on governance, and these aggregate effects of aid are usually unanticipated and unintended.

This paper aims to give an overview of the evidence on these aggregate effects of aid on governance.

It examines the effects of aid on different dimensions of good governance. Rothstein and Teorell (2008) distinguish two dimensions of good governance, namely elements that concern the *access to* authority, and elements that concern the *exercise of* authority. In this paper, I distinguish three dimensions, as in Kwon and Kim (2014), and they are roughly in line with the World Governance Indicators: a political, administrative and judicial dimension. The political dimension corresponds to the access to authority and includes issues like civil rights, checks and balances, the possibility of replacing governments by elections, and political stability. The other two dimensions cover the earlier mentioned exercise of authority. Administrative governance is about the capacity of governments to effectively formulate and implement policies, and judicial governance is about respect of citizens and the state for the institutions that govern economic and social interactions, such as laws, property rights, and the judiciary itself. This is usually measured by the indicators rule of law and absence of corruption (Kaufmann et al. 2010).

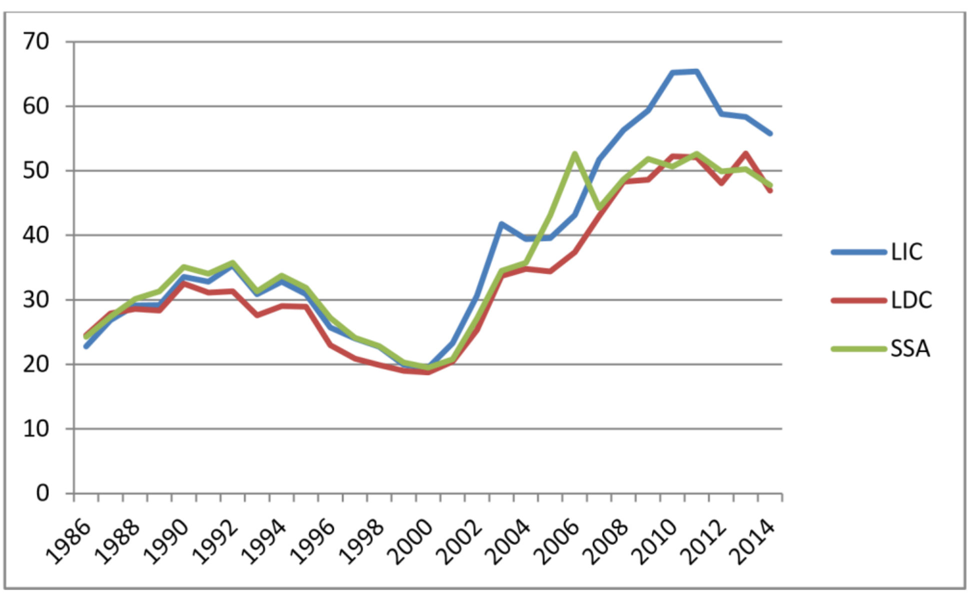
Large aid flows are often said to weaken domestic accountability in recipient countries because executive governments are no longer dependent on consent of parliaments or the population at large (Moyo 2009, Moss et al. 2008, Sogge 2002). This affects, in particular, the political dimension of good governance, as it may weaken democratic accountability. Aid may also strengthen authoritarian regimes directly, or exacerbate existing inequalities and thereby stimulate domestic conflict. As to the administrative dimension, the presence of a large number of donors and projects, each with their own implementation and reporting requirements, may weaken domestic administrative capacities. Finally, aid is often said to undermine the rule of law and to increase corruption. All these possible negative effects are unintended by individual donors, and are expected to appear or to become more serious when aid flows are large relative to the size of recipient economies.

While several authors stress these unintended negative aggregate effects of aid, many of them are just postulated. This means that it is important to examine the evidence. To what extent are the aggregate effects of aid indeed negative for governance, or is it possible that aggregate effects are positive? This paper examines the evidence, and concludes that the picture is not as negative as many aid critics and aid observers claim. In addition, donor intentions and donor behavior matter for mitigating these negative effects. While there have been improvements over time, there is certainly room for further improvement. In order to have an idea of the size of aggregate aid flows in relation to recipient countries' economies, the paper begins by presenting some figures on these relationships. Section 3 discusses some methodological and data issues relevant for examining the relationship between aid and good governance. The paper then reviews the evidence on aid's aggregate effects on the political, administrative and judicial dimensions of good governance. The final section concludes.

2. Aid flows and recipient countries

At the end of the previous century aid fatigue prevailed. Aid volumes decreased, and in particular those to low income countries, as part of the flows was directed to new aid recipients in Eastern Europe and in the former Soviet Union. At the turn of the new millennium the aid climate changed. The renewed optimism about what aid could achieve was fueled by, among other things, the successful debt relief campaigns and the agreement on the Millennium Development Goals. Yet, in recent years, total ODA volumes have begun to stagnate again under the influence of the global crisis that hit developed countries hard. These trends are also visible in the aid flows per capita to low income countries (Figure 1).

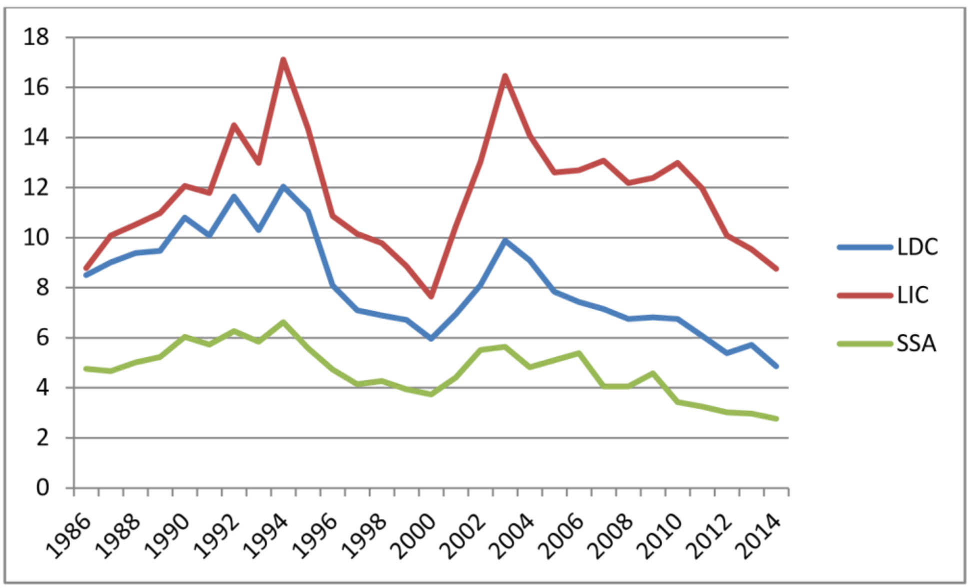
Figure 1. net ODA per capita in US$, 1986-2014; averages for groups of countries*



*LIC: Low Income Countries, LDC: Least Developed Countries (UN classification) and SSA: Sub-Saharan African countries.
Source: elaboration of data from World Development Indicators

Yet, what matters for the effects of aggregate aid flows to a country is the size of the aid flows relative to the size of the recipient economy. In many low income countries, aid tended to finance around 50 percent of the government budget and an even larger share of the government investment budget. Aid flows were also large relative to total Gross National Income (GNI) and to the total investment expenditure of countries. However, in recent years many Sub Saharan African countries, and low income countries in general, have experienced high growth rates. The question is therefore what happened to aid dependence in these countries.

Figure 2. Net ODA as share of Gross National Income, in percent, 1986-2014 for different groups of countries



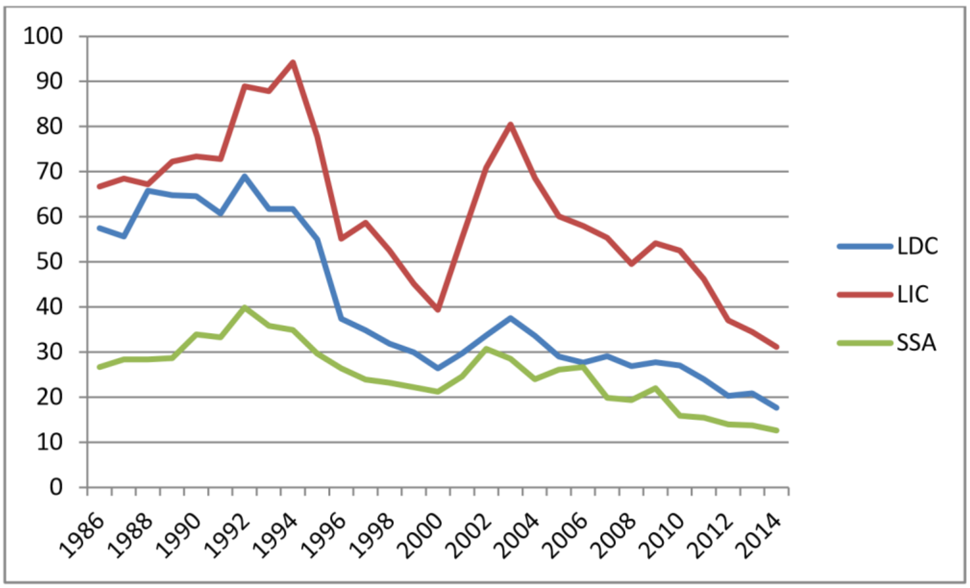
Note and source: See Figure 1.

Figure 2 shows that for Sub Saharan African countries (SSA), aid as percentage of GNI peaked in 1994 at 6.6% and then again in 2003, at 5.6%. After that it gradually decreased to 2.8% in 2014. This category includes large economies such as Nigeria and South Africa. The trend for low income countries is more or less the same but at a much higher level. By 2014, aid still represents 8.8% of GNI, on average.

For the category of Least Developed Countries,[1] this is 4.9%. It is perhaps more revealing to look at aid flows in relation to country's gross capital formation (Figure 3). For low income countries, this still proves to be a sizable 31%. The percentage is lower for the average SSA country (13%) and for the Least Developed countries (18%). In sum, although aid dependence has decreased over the last ten years due to high growth rates in low income countries, it is still quite high.

At the same time, the number of donors and other aid agencies has continued to increase. Next to DAC donors and multilateral institutions, there is an increasing number of non-DAC donors such as China, Brazil and Venezuela, and there are also increasing numbers of vertical funds such as PEPFAR and GAVI, private foundations such as the Bill and Melinda Gates foundation, as well as increasing numbers of NGOs and small private initiatives. This means that donor proliferation and fragmentation has continued to increase (Schulpen et al. 2011). Recipient countries have to deal with an ever larger number of aid providers.

Figure 3. Net ODA as share of gross capital formation, in percent, 1986-2014 for different groups of countries



Note and source: See Figure 1.

In order to give an example of this fragmentation, I examined gross ODA disbursements to social infrastructure (the largest sector) in one of the African donor darlings, namely Mozambique. The total amount from bilateral DAC donors in 2015 was US$ 642 million, while the total number of projects was

[1] UN classification, includes middle income countries to the extent that these economies suffer from other vulnerabilities such as smallness and export concentration.

911. This means the average disbursement per project amounted to US$ 0.7 million. With this average project size, it can be expected that the administrative burden on low income countries is still high.

When comparing average project size between 2008 and 2015 for the same sector but now on the basis of gross commitments, it seems that average project size has decreased over time (Table 1). The year 2008 is selected because it can be assumed to represent the high point of the commitment to the Paris Declaration (High Level Forum 2005). After 2008, the enthusiasm for the principles of that Declaration ownership, alignment and harmonization seems to have decreased. This is also evident from, for example, gradually decreasing volumes of general budget support from that year onward (Dijkstra et al. 2012).

Table 1. Gross disbursements (in US$ millions), number of projects and average project size (in US$ millions) for social infrastructure in Mozambique, 2008 and 2015.

	2008			2015		
	Volume	Number	Average	Volume	Number	Average
Australia	1	2	0.5	1	3	0.3
Austria	5	20	0.3	0	8	0.0
Belgium	15	33	0.5	8	27	0.3
Canada	48	9	5.3	40	34	1.2
Czech Rep				0	1	0.0
Denmark	61	10	6.1	2	6	0.3
Finland	32	13	2.5	24	28	0.9
France	16	12	1.3	2	30	0.1
Germany	29	46	0.6	47	18	2.6
Greece	0	1	0.0			
Iceland				2	1	2.0
Ireland	49	64	0.8	28	46	0.6
Italy	117	79	1.5	9	35	0.3
Japan	13	19	0.7	28	58	0.5
Korea	45	7	6.4	103	19	5.4
Netherlands	59	15	3.9	18	8	2.3
Norway	22	37	0.6	26	27	1.0
Portugal	19	54	0.4	11	42	0.3

Spain	28	76	0.4	5	38	0.1
Sweden	10	20	0.5	10	9	1.1
Switzerland	18	18	1.0	4	4	1.0
UK	41	13	3.2	13	23	0.6
USA	464	92	5.0	419	169	2.5
Total	885	494	1.8	674	478	1.4
Total excluding USA	628	548	1.1	381	465	0.8

Source: OECD Statistics, Creditor Reporting System (CRS). OECD.org/DAC, accessed 2 January 2017.

3. Methodological issues

It is not easy to establish a causal relationship between aid on the one hand, and good governance on the other. First, aid is just one of many factors that may influence the quality of governance in recipient countries, and probably a relatively small factor. Econometric studies are to some extent able to control for other possible factors, such as the level of development, economic growth, and the presence of valuable natural resources. The first two are expected to have a positive influence, the latter a negative one. Yet there may be other country-specific historical or other factors that are not included in these studies, and this may create omitted variable bias. There is not much that econometric studies can do about this, however.

Second, aid is provided for many different reasons and in many forms. We cannot expect all aid to have a development motivation. To the extent that aid is provided for strategic, commercial or other reasons related to own interest of the donor, its effect on good governance can be expected to be lower. With respect to aid modalities, it can be expected that the fungibility of aid matters for some of the negative unintended effects of aid. If donors provide closely monitored project aid to specific purposes, or they give their aid to non-government organizations, some of the negative unintended effects of aid on the political and judicial dimensions of governance can be mitigated (Table 2). This will prove to be important for the outcomes of the presented studies in this paper, and of course also for the policy implications.

Table 2. Aid fungibility and unintended effects on governance, by dimension

	Fungibility matters	Fungibility does not matter
Political dimension	Supports authoritarian regimes	Weakens domestic accountability □ less democracy Enhances political instability

Administrative dimension		Weakens government capacity □ fragments policies, undermines capacities
Judicial dimension	Supports clientelism and patronage	Weakens domestic accountability □ more corruption

Third, it is very difficult to establish the direction of causality and to exclude endogeneity. Aid may be provided *because of* bad governance or *because of* improving governance. Both cases would distort conclusions on the effect of aid on governance, in different directions. Endogeneity would distort results if there is a third factor that influences both the amount of aid and the good governance outcome. This could be the growth rate, for example. Simple ordinary least squares (OLS) regression analysis cannot deal with reverse causality or endogeneity. For this reason, many studies instrument for aid, meaning that they first estimate aid flows on the basis of factors unrelated to the governance outcomes, and then use the results of this first regression to estimate the impact of aid on governance. Studies that attempt to deal with endogeneity and reverse causality can be expected to have more valid outcomes.

Fourth, the validity of the data can be a problem, and in particular of the data on good governance. Most of the indicators for good governance are based on perceptions, and often these are expert perceptions (Arndt and Oman 2006). In the political dimension of governance, these perceptions may have a more or less objective basis, for example if they assess the presence of institutions and procedures for citizens to express their preferences for policies and leaders, the presence of civil liberties, or the extent of institutionalized constraints on executive power, to mention a few dimensions used in the Polity IV index. However, expert opinions are much more subjective when it comes to assessing the bureaucratic quality of governments or the extent of corruption. Several authors argue that perceptions on governance are often influenced by western ideas, leading to lower assessment of government effectiveness in South Korea and Taiwan, for example (Kurtz and Schrank 2007) and/or are mixed up with policy outcomes (Grindle 2004, Rothstein and Teorell 2008) or ideas on good policies – which in turn are often also influenced by western ideas (Van Waeyenberghe 2009). These factors weaken the validity of results of virtually all presented studies, especially those for the judicial and administrative dimensions of governance.

4. Aid and the political dimension of governance

Aid dependence implies that governments are more accountable outward, i.e. to donors, than inward, i.e. to parliaments or domestic constituencies in general (Boekestijn 2009, Moss et al. 2008, Sogge 2002). Furthermore, large aid flows may have the perverse effect of reducing tax efforts, which may further undermine state building. Historically, taxation has been important in increasing the accountability and legitimacy of executive powers. Increases in government revenues were usually needed in times of war, inducing Charles Tilly to his famous expression "the state made war, and war made the state".[2] Several authors claim that foreign aid plays the same negative role as the availability of highly valued resources such as oil. Countries with a resource curse, be it due to oil or aid abundance, tend to have lower levels of democratic accountability. Although less pronounced in the literature, there are also authors who claim that aid makes control of the state and aid resources more valuable and therefore increases the number of coup attempts and domestic conflict in general (Grossman 1992).

It is important to recognize that next to possible negative unintended effects, there may also be positive aggregate effects of aid on democracy and political stability. When aid leads to higher education levels or more socio-economic development in general, it can be expected that people will be more interested in and capable of participating in political decision making, and will be less inclined to solve their disputes in a violent way. The aggregate effect of aid on the political dimension of governance is therefore an empirical issue. A first relationship to be considered is that between aid and democracy. Subsequently, I examine the evidence on the relation between aid and political instability.

Goldsmith (2001) examines the impact of aid on democracy in Africa over the years 1975-1997, using the Freedom House's 'Freedom Index'. He concludes that aid had a small but significant positive effect on democracy. Knack (2004) looks at a much larger sample of between 96 and 105 countries and examines the period from 1975 to 2000. He observes that according to both the Freedom House index and the Polity IV index many aid recipients experienced an increase in democratization. However, he finds that aid did not play any role in these improvements, and this finding was robust to various model specifications and to the use of exogenous instruments for aid.

Djankov et al. (2008) use the Polity IV index and an indicator for the existence of checks and balances to estimate the effect of aid on democracy. They control for oil income and apply many robustness checks including using instruments for aid. For a sample of 108 countries they find that aid has a negative effect on democracy during the period 1960-1999. The negative effect of aid proves even larger than that of oil. Kalyvitis and Vlachaki (2012) also conclude that aid has a negative impact on democracy in a sample of 64 aid recipient countries in the period 1967-2002. They use a binary dependent variable: a country is classified as democratic if both president and legislative are elected. Their findings are also robust to using instruments for aid. They also examine under which conditions in the recipient country aid has a negative effect on democracy, and find that the effect was larger in countries with a low democratic status to begin

[2] Cited in Moss et al 2008.

with. On the other hand, previous economic liberalization helps to soften the negative effect of aid on democracy.

Dutta et al. (2013) examine a similar hypothesis: aid promotes democratic development in countries that are already democratic, while the opposite is true in countries with dictatorial traits. They analyse 124 countries for the period 1960-2009 using the Polity IV index, and the results confirm their hypothesis. The authors conclude that aid has an "amplification effect": it can reinforce certain paths, but cannot put the country on another path.

Young and Sheehan (2014) examine the effect of aid on several measures for economic and political institutions for a large sample of 116 countries and over the period 1970-2010. In simple OLS regressions they find a positive effect of aid on democracy, but after instrumenting for aid, the effect becomes negative.

Several studies examine the effect of aid on regime survival. Kono and Montinola (2009) distinguish between current and cumulative aid, where cumulative aid is aid received over the period that a certain leader is in power. They find that cumulative aid is particularly beneficial for autocrats because they can save aid resources. Annual aid flows (current aid) are more beneficial for democrats because they will spend it in the same year. This means that aid provided over a long term helps to maintain autocracies.

Morrison (2009) postulates that aid and other nontax revenues are important for regime survival of both democracies and autocracies. In democracies, nontax revenue helps to buy-off the elites by reducing the need for taxation, while in autocracies aid can soften population protests by increasing social spending. He finds these hypotheses confirmed, implying that aid helps to maintain authoritarian regimes. Bueno de Mesquita and Smith (2010) conclude that both aid and other nontax revenue have a negative effect on regime change. Ahmed (2012) looks at the effect of aid and remittances on regime change in authoritarian states and similarly finds that both have a negative effect, so tend to sustain authoritarianism.

Overall, it seems that the conclusion is quite negative. Many studies conclude that aid has a negative effect on democratization, and some add that this holds even more in non-democratic countries. Aid tends to help autocrats to maintain their power. This is clearly an unintended effect of aid – at least for those donors that provide aid with a development objective.

However, as also argued above aid is not always given from a development perspective. Especially during the Cold War, many countries received aid for strategic reasons, no matter whether they were ruled by dictators. While strategic reasons have continued to play a role after that, benefiting, for example, Israel and Egypt, and more recently Pakistan and Afghanistan, it can be argued that during the Cold War the number of authoritarian regimes receiving large amounts of aid due to strategic reasons was larger than in the period after 1990. These larger numbers matter when assessing the average effect of aid on the political dimension of governance – which is what cross-country econometric studies do. Another factor that may have contributed to a more positive effect of aid on democratization after the Cold War, is that democratization began to figure more prominently among donors' objectives.

Most of the above mentioned studies cover a long period and include that of the Cold War. And indeed, studies covering the period after 1990 often find a more positive effect. In addition, many of the above studies that found insignificant or negative effects of aid on democratization have been replicated in order to test whether the end of the Cold War makes a difference. These studies are now presented.

Ear (2007) examines the effect of aid on the different World Governance Indicators (WGI) for the period 1996-2004. He does not find any significant effect, but the coefficient on 'voice and accountability' is most positive, pointing to positive effect of aid on democracy. Heckelman (2010) investigates the effect of aid on democratization for Eastern European transitional countries and also finds a positive effect for most of the sub-dimensions of democracy, for the period 1997-2007. More recently, Askarov and Doucouliagos (2015) find a similar positive effect for the same group of countries, albeit with declining returns to scale: above around US$ 193 in aid per capita, the effect of aid on begins to decline, and becomes negative above US$ 350.

Dunning (2004) specifically looks at the impact of the Cold War by reusing Goldsmith's (2001) data but now comparing two periods: 1975-1987 and 1988-1997. He argues that the Soviet Union's influence in Africa was already waning around 1987, and this also influenced western donors' attitudes from that year onward. He finds that there was no significant effect of aid on democratic development before 1987, but that this relation became positive and significant in the second period.

Bermeo (2016) postulates that aid does not have the same effect on governments as oil, thus contradicting earlier authors such as Morrison (2009) and Bueno de Mesquito and Smith (2010). While oil income is always fungible for any type of regime, aid may be given in different modalities according to regime type. Donors will provide fungible aid to democratic governments or to governments that are strategically important, and non-fungible aid to autocratic regimes that are not strategically important. She expects that aid will have a negative effect on democratization during the Cold War, and a positive effect after that. Furthermore, aid may still have a negative effect on democratization in case recipient countries are strategically important. Both of these hypotheses are confirmed for a sample of 129 countries over the period 1973-2000. Given that the results are so different from those of earlier studies, she also replicates the studies by Morrison (2009), Bueno de Mesquito and Smith (2010), and Ahmed (2012).[3] It turns out that both Bueno de Mesquito and Smith, and Ahmed, have not reported their findings carefully enough: there proves to be a difference between oil and aid, and between remittances and aid, such that the effect

[3] She tried to replicate the Montalvo et al (2008) study as well, but data proved to be unavailable. P. 21 .

of aid on regime change is not significant. For the Morrison study, the effect of aid proves to be positive in the post-Cold War period, while it was indeed negative in the earlier years.[4]

Kersting and Kilby (2014) examine both the long-run effect of aid in a cross-sectional study, and the short term effect of aid with annual panel data. With respect to the long-run effect, they replicate Knack's (2004) study while adding estimations for a longer time period (until 2007) and with a larger number of recipient countries. The exact replication yields the same insignificant coefficient as in Knack (2004), but the other models yield positive and significant effects of aid on democratization, showing that aid did play a role in democratization of recipient countries over the longer run. The results are robust for endogeneity and other tests.

For the short run analysis, they first estimate whether the aid allocation by specific donors is influenced by the level of democracy and/or by the strategic importance of a country, measured as being a large recipient of US military aid. All major non-autocratic donors prove to reward democratization, although some do so conditionally on the country being of strategic importance. This latter finding is used as input in the regressions estimating the effect of different types of donors on a change in the democracy index one year later. The authors conclude that DAC donors have a positive and significant effect on the change in the democracy index. This effect is negative and significant for autocratic donors, while the coefficient for multilateral aid is positive but not significant. They also find that the positive effect of aid from DAC donors weakens if a country receives more than 33% of aid from donors that do not reward democratization in case a country is strategically important. This means that there is an "incentive effect" for donors rewarding democratization no matter the strategic importance of a recipient country.

In a similar vein, Bermeo (2011) examines whether the type of donor matters for the effect of aid on democratization. She shows that aid from democratic donors has a positive effect on democratic regime change, while aid from autocratic donors has a negative effect. This is based on data from 87 countries and for the period 1992-2007. She concludes that donor intentions matter for the effect of aid on democratization.

Jones and Tarp (2016) use the Quality of Government (QoG) database for investigating the effect of aid on political and economic institutions, including democracy. They construct a synthetic measure of the QoG indicators for democracy, number of veto players, executive constraints, political terror, and judicial independence. They use several estimation methods for a sample of 104 countries for the period 1983-2010, and systematically find a positive effect of aid on this synthetic measure. When adding a dummy for the Cold War period, the effect becomes stronger.

[4] Making this distinction by period proved to be impossible for the Bueno article due to the underlying structure of the data used.

All in all, it seems that the unintended negative effects of aid on democracy are much exaggerated. Taking the more recent empirical studies into account, it is clear that a) donor intentions matter and b) that the evidence points to an overall small but positive effect of aid on democratization after 1990.

Aid and political stability

According to Grossman (1992) aid may enhance political instability because it increases the value of access to government resources. As a result, coup attempts are more likely. But the opposite can also be postulated: aid may reduce the chances of civil conflict because of its effect on socio-economic development.

There are a few case studies of African countries showing that donors have done unintended political damage and have contributed to civil conflict. In Lesotho, aid proved to strengthen bureaucratic state power at the cost of the poor peasants for which it was originally intended (Ferguson 1990). In Rwanda, aid in the early 1990s proved to reinforce existing socioeconomic and ethnic inequalities. This contributed to the "structural violence" that later erupted as real racial violence, leading to one of the most brutal explosions of violence in history in 1994 (Uvin 1998). Some authors claim that donors risk supporting the same conditions of structural violence in current Rwanda (Gaynor 2013, Reyntjens 2006, Reyntjens 2011). Van de Walle (2012) shows that donors in the Mali of the years before the coup focused too much on the executive branch of government, gave too little attention to mechanisms of horizontal accountability, and turned a blind eye to already existing threats to democracy. In that country, aid to democratization proved to constitute only one percent of total aid during the years 2000-2010.

Collier and Hoeffler (2002) examine the effect of aid (and economic policy) on the risk of the outbreak of civil war. They do not find a direct effect, but do find an indirect positive effect of aid. Aid leads to an increase in economic growth and to a reduction in the dependence on exports of primary commodities. Both have been found to reduce the risk of conflict. De Ree and Nillesen (2009) examine the effect of aid both on the onset of civil conflicts and on their continuation. In line with Collier and Hoeffler (2002) they do not find an effect on the start of conflicts, but they do conclude that aid has a negative and significant effect on the continuation of civil conflict. They control for endogeneity and use fixed effects to control for unobservable country characteristics.

Nielsen et al. (2011) investigate the effect of sudden aid *shocks* on the outbreak of domestic conflicts. They build on a model developed by Arcand and Chauvet (2001) showing that sudden drops in aid can increase civil conflict in two ways: governments reduce military spending so this reduces the "deterrence", and governments have less resources available for paying-off potential rebels. Nielsen et al. test this model with data for 139 countries for the period 1981-2005, and find that negative aid shocks indeed increase the likelihood of domestic conflict, while for positive aid shocks there is no effect. They control for endogeneity.

Gutting and Steinwand (2015) examine a possible positive effect of aid fragmentation and proliferation on political stability. The existence of more donors may reduce aid volatility and thereby diminish the chances of conflict. In addition, they hypothesize that donor fragmentation mitigates the effects of aid shocks (once they occur) on conflict. This is because the presence of more donors implies a more development oriented aid portfolio, as opposed to the presence of just one or a few donors that are often motivated by strategic interests. They test these assumptions in an empirical analysis of 106 countries for the period 1972-2007. They find that donor concentration leads to substantially more negative aid shocks, and that this has a small but significant effect on the appearance of conflicts. They also find a strong and significant moderation effect of fragmentation on the conflict-enhancing role of negative aid shocks.

Overall, it appears that aid contributes to lower domestic conflicts in an indirect way and has been shown to directly reduce the probability of conflict continuation.

5. Aid and the administrative dimension of governance

Aid may reduce the administrative capacity in recipient countries, especially if provided in high volumes and by many different donors. Morss (1984) already observes that the increase in the number of donors since the 1970s and the change toward more project aid instead of programme aid[5] led to “institutional destruction” in developing countries and especially in Sub Saharan Africa. This conclusion was based on qualitative evidence from Lesotho, Malawi and Zambia. More recent authors have also highlighted the adverse effects of government officials having to deal with many donors and projects, all with their own reporting and evaluation requirements. This not only means high transaction costs but also leads to a fragmented development policy. Donors are often only interested in the success of their own projects, and not in the quality of governance in general or the success of other donors' projects (Acharya et al. 2006). They provide technical assistance in the form of training and seminars for relevant government staff, within the country or abroad, leading to high absenteeism among government officers. Or donors set up separate implementation units for the execution of their projects, hiring the best government staff and thus poaching staff away from regular ministries (Wuyts 1996, Acharya et al. 2006). As O'Connor and Soludo wrote "The aid relationship can get stuck in a high aid- weak institutions equilibrium in which institutions remain weak and graduation [i.e. from aid dependence - gd] never occurs." (O'Connell and Soludo 2001: 1548).

---

[5] He defines programme aid as aid to a sector *and* to large infrastructural projects. The latter we would not call programme aid anymore.

So, what is the evidence? Several authors have examined the effect of aid on the quality of governance. Knack (2001) finds for the period 1982-1995 that aid has a negative effect on bureaucratic quality, measured by the International Country Risk Guide (ICRG) of the Political Risk Services (PRS) Group. Brautigam and Knack (2004) find the same effect for a sample of 32 African countries. Knack and Rahman (2007) include a formal model showing that "poaching" leads to a lower quality of domestic governments. Their empirical tests confirm that more aid fragmentation leads to a lower bureaucratic quality in recipient countries. All these studies instrument for aid in order to control for possible endogeneity: aid may be induced by low bureaucratic quality, or there may be another factor that causes both aid and low bureaucratic quality.

Rajan and Subramanian (2007) conclude that aid has a negative effect on governance in an indirect way. They show that aid has a negative effect on growth in those industrial sectors that depend on the quality of governance. Busse and Gröning (2009) also find a small but statistically significant negative effect of aid on the change in 'bureaucratic quality' between 1984 and 2004, examining 106 countries. Selaya and Thiele (2012) distinguish between aid grants and aid loans. For the period 1995-2005, they find that grants have a negative effect of aid on bureaucratic quality, while loans do not; the effect of all aid is negative.

Coviello and Islam (2006) also examine the effect of aid on bureaucratic quality as measured by the ICRG. Contrary to the previously mentioned studies, they do not find a significant effect. They argue that it is necessary to include country fixed effects, and that this may be the reason for the negative effects found in other studies. Ear (2007) comes to a similar conclusion while using the six dimensions of the Word Governance Indicators for a sample of 155 countries. When using pooled time series in a cross-sectional model, instrumenting for aid, and taking into account fixed country effects, there is no significant effect on the different indicators, except for rule of law at 10 percent significance level.
Askarov and Doucouliagos (2015) not only look at the effect of aid on democracy in transition countries (see above), but also on governance as measured by the World Governance Indicators, They do not find a significant effect for the average governance score, or for any of the components. When looking separately at US aid, this aid proves to influence government effectiveness negatively, as well as the rule of law indicator.

All in all, the evidence of the cross-country empirical studies is not unambiguous. Several studies show that aid, in particular aid proliferation and fragmentation, on average leads to a lowering of the quality of bureaucratic governance in developing countries, but these outcomes are also contested. However, irrespective of the final verdict on the overall *aggregate* effect of aid on this dimension, it is clear from any observance of the aid practice that there are unintended effects of aid proliferation and fragmentation. It is also clear that the mode of delivery matters. Since around 2000 donors and recipients have shown to be aware of these possible negative effects of donor proliferation and of bypassing government systems. This is, for example, evident from the 2005 Paris Declaration which expresses commitments to increase recipient country ownership, increase alignment to local priorities and local systems and improve donor harmonization and coordination (High Level Forum 2005). Bigsten and Tengstam (2015) estimate the benefits from improved donor coordination and from providing more resources in the form of budget support and they prove to be substantial. This means that while it is very likely that there are unintended effects of aid on domestic capacities for policy making and implementation, donors are at least partly able to reduce and mitigate these negative effects.

6. Aid and the judicial dimension of governance

Like in the other areas of governance, the theoretical effects of aid on the rule of law and on corruption can go both ways. Aid can improve the rule of law and reduce corruption by setting rules and conditions and by providing a good example, for example in procurement activities for projects. Aid may also help reducing corruption by allowing increased salaries of civil servants. On the other hand, aid may foster patronage and clientelism by facilitating the growth of public employment and of public subsidies (Van de Walle 2001, Chabal and Daloz 1999). Hancock (1989) gives a vivid account of corruption flourishing as a result of emergency aid. In the following, I examine the cross-country evidence of the effect of aid on the two judicial sub-dimensions of good governance, rule of law and corruption.

Svensson (2000) develops a model showing that under certain conditions, in particular if countries' populations are ethnically divided, more government resources lead to less productive public spending due to rent seeking. In an empirical analysis and instrumenting for aid, he finds that aid increases corruption in countries with competing groups. In other countries, he does not find this negative effect.

Knack (2001) examines the effect of aid on ICRG measures of rule of law and corruption. When instrumenting for aid, aid proves to deteriorate the rule of law and to increase corruption. Alesina and Weder (1999) also conclude that aid increases corruption. But they only look at bilateral flows and do not instrument for aid, so they cannot exclude a reverse relationship. Tavares (2003) uses the same indicator for corruption and finds for a longer time period that aid decreases corruption. He includes bilateral and multilateral ODA and does instrument for aid. Coviello and Islam (2006) also examine the effect of aid on the rule of law and corruption indicators of the ICRG and find no significant effects. As mentioned above, they include country fixed effects and argue that when this method is applied to the earlier studies of for example, Knack (2001) and Tavares (2003), the significant effects of aid vanish.

Two studies on this topic use Quantile Regression analysis. This allows for differentiating the effect of aid for countries with lower and with higher levels of corruption. Okada and Samreth (2012) find that aid reduces corruption, and that the effect is stronger at lower levels of corruption. They examine the period 1995-2009 for 120 developing countries. When looking at groups of donors, they establish that it is multilateral aid, in particular, that reduces corruption; bilateral aid has no effect. Mohamed et al. (2015) look at Sub Saharan African countries for the period 2000-2010 and do not find any effects of aid, multilateral or bilateral. However, in both of these studies it is not clear how the authors have dealt with endogeneity or reverse causality.

Young and Sheehan (2014) examine the effect of aid on one of the components of the Freedom House Index, namely the protection of property rights. This is an important aspect of the rule of law. When looking at the years 1970-2010, so including the Cold War period, and instrumenting for aid, they find that aid has a negative effect on this indicator.

Charron's (2011) paper begins by stating that the time period may make a difference for examining this question. Around the mid-1990s, many International Organizations, most notably the OECD, the World Bank, and the IMF, began an "anti-corruption movement". He argues that this may have changed recipient countries' behaviour. Recipient governments will have become more concerned about their reputation and about their future aid, as they will expect that (multilateral) donors will monitor corruption more closely. In order to test this, he uses panel data for 82 developing countries for two periods, 1986-1996 and 1997-2007. With the same ICRG indicator for corruption, he finds that bilateral aid never has an effect on corruption, while for multilateral aid there was a clear difference between the two periods: after 1997 multilateral aid proves to have a decreasing influence on corruption. He applies GMM system estimators and 2SLS to control for endogeneity (Charron, 2011).

Finally, Menard and Weill (2016) examine the two directions of possible causality between aid and corruption via Granger causality tests using a GMM dynamic panel system. They investigate the period 1996-2009 for 71 countries and use the corruption indicator from the WGI. They focus on short-run effects and find no significant effects of aid; neither for multilateral or bilateral aid separately, or for aid to certain regions.

Overall, there is little proof that aid flows systematically lead to an increase in corruption. As with the other dimensions of good governance, it is very difficult to disentangle the effect of aid from the reverse effect, and results appear to depend largely on samples, data, time periods and estimation methods.

7. Conclusion

The relation between aid and good governance is multifaceted. Donors usually are of the opinion that good governance is both an aim in itself and an instrument for enhancing development. As a result, they use good governance indicators as selection criteria in the aid allocation, attempt to improve governance through policy conditions and by having a policy dialogue with recipient governments, and attempt to improve governance through specific projects. For all those reasons, one would expect that on average, aid would improve governance. Yet, many authors claim that aid, and especially large flows in relation to the recipient economies, tends to deteriorate governance. Aid leads to weakened domestic accountability and to more corruption. It tends to maintain authoritarian regimes and to promote political instability. The presence of many donors and projects will undermine government capacities for policy making and policy implementation. This means that it is an empirical issue whether the intended positive effects or the unintended negative effects of aid on governance dominate.

This paper has reviewed the empirical evidence on the aggregate effects of aid on good governance. Like with the relation between aid and economic growth, the empirical analysis of this relationship is riddled with problems. Aid is only one of the factors influencing governance, and it is very difficult to deal with possible endogeneity and reverse causation. addition, aid is heterogeneous: it may be given for other than development reasons, and is more or less fungible. Finally, indicators for governance may be subjective, especially for the judicial and administrative dimensions of governance. As a result of these problems, it is not unsurprising that we find many different and contradicting results for the effect of aid on governance. Nevertheless, some conclusions are possible.

In general, the negative unintended effects of aid on governance are much exaggerated for all three dimensions. Furthermore, it seems that donor intentions can make a difference. This means that donors that are serious about their *intended* effects on, for example, democratization or corruption, are able to mitigate possible negative *unintended* effects.

For the relation between aid and democracy, the end of the Cold War seems to have induced aggregate positive results. While before 1990 the effect of aid on democracy was negative or nonexistent, after 1990 aid has, on average, strengthened democratization in recipient countries. This means that the possible negative effects of aid on domestic accountability are apparently outweighed by positive effects. Donors can enhance the positive effects of aid on the political dimension of governance by reducing aid, and in particular highly fungible aid, to authoritarian regimes.

The studies on the aggregate effect of aid on the administrative and judicial dimensions of governance do not have consistent results. Results depend on sample sizes, models, estimation methods, and time periods. Yet, also here it seems the picture is not as negative as aid critics claim. In particular, there is no evidence that aid stimulates corruption. In this area there is also some evidence that the time period and thus donor intentions matter for the outcomes. When, in particular, multilateral donors became more serious about combating corruption, the results became more positive.

Although no definitive conclusion can be given on the aggregate effect of aid on administrative governance, it is clear that also in this area donor intentions and especially donor behaviour can reduce the negative effects. It can be concluded from cross-country evidence and from case studies that donor proliferation and donor fragmentation have a negative influence on administrative capacities, and so do donor practices to bypass governments. Donors and recipients have come to recognize these problems and have agreed to principles like alignment and harmonization. However, the evaluation of the implementation of these principles has shown that there is still a lot be improved, especially on the donor side (Wood et al. 2011). More seriously, it seems that in recent years the situation is deteriorating. The number of non-DAC donors and agencies less committed to the Paris Declaration is increasing, and many DAC donors are backtracking from these principles. These developments may increase the negative unintended effects of aid on governance.

References

Acharya, A., A.T.F.d. Lima and M. Moore (2006) 'Proliferation and Fragmentation: Transaction Costs and the Value of Aid', *Journal of Development Studies* 42(1): 1-21.

Ahmed, F. (2012) 'The Perils of Unearned Income: Aid, Remittances and Government Survival', *American Political Science Review* 106(1): 146-165.

Alesina, A. and B. Weder (1999) *Do Corrupt Governments Receive Less Foreign Aid?* Cambridge, Ma: National Bureau of Economic Research. NBER Paper No. 1708.

Arcand, J. and L. Chauvet (2001) 'Foreign Aid, Rent-Seeking Behaviour, and Civil War'. Oxford. Paper presented to Conference "Understanding Poverty and Growth in Sub-Saharan Africa".

Askarov, Z. and H. Doucouliagos (2015) 'Aid and Institutions in Transition Economies', *European Journal of Political Economy* 38: 55-70.

Bermeo, S.B. (2016) 'Aid is Not Oil: Donor Utility, Heterogeneous Aid, and the Aid-Democratization Relationship.', *International Organization* 70(1).

Bermeo, S.B. (2011) 'Foreign Aid and Regime Change: A Role for Donor Intent', *World Development* 39(11): 2021-2031.

Bigsten, A. and S. Tengstam (2015) 'International Coordination and the Effectiveness of Aid', *World Development* 69: 75.

Boekestijn, A.J. (2009) *De Prijs Van Een Slecht Geweten: Waarom Hulp in Haar Huidige Vorm Niet Werkt.* Soesterberg: Aspekt.

Brautigam, D. and S. Knack (2004) 'Foreign Aid, Institutions and Governance in Sub-Saharan Africa', *Economic Development and Cultural Change* 52(2): 255-285.

Bueno de Mesquita, B. and A. Smith (2010) 'Leader Survival, Revolutions, and the Nature of Government Finance', *American Journal of Political Science* 54(4): 936-950.

Busse, M. and S. Gröning (2009) 'Does Foreign Aid Improve Governance?' *Economics Letters* 104: 7678.

Chabal, P. and J.P. Daloz (1999) *Africa Works: Disorder and Political Instrument.* Oxford: James Currey.

Charon, N. (2011) 'Exploring the Impact of Foreign Aid on Corruptiomn: Has the "Anti-Corruption Movement" been Effective?', *The Developing Economies* 49(1): 66-88.

Collier, P. and A. Hoeffler (2002) 'AID, Policy and Peace: Reducing the Risks of Civil Conflict', *Defence and Peace Economics* 13(6): 435-450.

Coviello, D. and R. Islam (2006) *Does Aid Help Improve Economic Institutions?* Washington, D.C.: World Bank, World Bank Institute, Poverty Reduction and Economic management Division.

De Ree, J. and E. Nillesen (2009) 'Aiding Violence or Peace? The Impact of Foreign Aid on the Risk of Civil Conflict in Sub-Saharan Africa', *Journal of Development Economics* 88(2): 301.

Dijkstra, G., A. de Kemp and D. Bergkamp (2012) 'Budget Support: Conditional Results; Review of an Instrument, 2000-2011'. The Hague: Ministry of Foreign Affairs, Policy and Operation Evaluation Department (IOB), No. 369.

Djankov, S., J. Montalvo and M. Reynal-Querol (2008) 'The Curse of Aid', *Journal of Economic Growth* 13(3): 169-194.

Dollar, D. and V. Levin (2006) 'The Increasing Selectivity of Foreign Aid, 1984-2003', *World Development* 34(12): 2034-2046.

Dunning, T. (2004) 'Conditioning the Effects of Aid: Cold War Politics, Donor Credibility, and Democracy in Africa', *International Organization* 58 (Spring): 409-423.

Dutta, N., P.T. Leeson and C.R. Williamson (2013) 'The Amplification Effect: Foreign Aid's Impact on Political Institutions', *Kyklos* 66(2), 208-228.

Ear, S. (2007) 'Does Aid Dependence Worsen Governance?' *International Public Management Journal* 10(3): 259-286.

Ferguson, J. (1990) *The Anti-Politics Machine: 'Development', Depolitization and Bureaucratic Power in Lesotho.* Cambridge New York etc.: Cambridge University Press.

Gaynor, N. (2013) 'Decentralisation, Conflict and Peacebuilding in Rwanda'.

Goldsmith, A.A. (2001) 'Foreign Aid and Statehood in Africa', *International Organization* 55 (Winter): 123-148.

Grindle, M. S. (2004) ‘Good enough governance: Poverty reduction and reform in developing countries’, Governance: An International Journal of Policy, Administration and Institutions, 17(4), 525-548.

Grossman, H.I. (1992) 'Foreign Aid and Insurrection', *Defence Economics* 3(4): 275-288.

Gutting, R. and M.C. Steinwand (2015) 'Donor Fragmentation, Aid Shocks, and Violent Political Conflict', *Journal of Conflict Resolution*.

Hancock, G. (1989) *Lords of Poverty: The Power, Prestige and Corruption of the International Aid Business.* New York: Atlantic Monthly Press.

Heckelman, J.C. (2010) 'Aid and Democratization in the Transition Economies', *Kyklos* 63(4): 558.

High Level Forum (2005) 'Paris Declaration on Aid Effectiveness'. Paris: OECD-DAC.

Hoebink, P. (2006) 'European Donors and 'Good Governance': Condition Or Goal?' *European Journal of Development Research* 18(1): 131-161.

Hout, W. (2007) *The Politics of Aid Selectivity: Good Governance Criteria in World Bank, US and Dutch Development Assistance.* London & New York: Routledge.

Jones, S. and F. Tarp (2016) 'Does Foreign Aid Harm Political Institutions?' *Journal of Development Economics* 118: 266-281.

Kalyvitis, S. and I. Vlachaki (2012) 'When does More Aid Imply Less Democracy? An Empirical Examination', *European Journal of Political Economy* 28: 132-146.

Kaufmann, D., A. Kraay and M. Mastruzzi (2010) 'The Worldwide Governance Indicators: Methodology and Analytical Issues', No. 5430. Washington: The World Bank.

Kersting E. and Kilby C. (2014) 'Aid and Democracy Redux', *European Economic Review* 67: 125-143.

Knack, S. (2004) 'Does Foreign Aid Promote Democracy?', *International Studies Quarterly* 48(1): 251266.

Knack, S. (2001) 'Aid Dependence and the Quality of Governance: Cross-Country Empirical Tests', *Southern Economic Journal* 68(2): 310-329.

Knack, S. and A. Rahman (2007) 'Donor Fragmentation and Bureaucratic Quality in Aid Recipients', *Journal of Development Economics* 83(1): 176-197.

Kono, D.Y. and G.R. Montinola (2009) 'Does Foreign Aid Support Autocrats, Democrats, Or both?' *The Journal of Politics* 71(2): 704-718.

Kurtz, M. J., & Schrank, A. (2007) 'Growth and governance: Models, measures, and mechanisms', *The Journal of Politics*, *69*(2), 538-554.

Kwon, H. and E. Kim (2014) 'Poverty Reduction and Good Governance: Examining the Rationale of the Millennium Development Goals', *Development and Change* 45(2): 353-375.

Menard, A. and L. Weill (2016) 'Understanding the Link between Aid and Corruption: A Causality Analysis', *Economic Systems* 40(2): 260-272.

Mohamed, M.R., S.R. Kaliappan, N.W. Ismail and W.N.W. Azman-Saini (2015) 'Effect of Foreign Aid on Corruption: Evidence from Sub-Saharan African Countries', *International Journal of Social Economics* 42(1): 63-47.

Morrison, K.M. (2009) 'Oil, Nontax Revenue, and the Redistributional Foundations of Regime Stability', *International Organization* 63 (Winter): 107-138.

Morss, E.R. (1984) 'Institutional Destruction Resulting from Donor and Project Proliferation in SubSaharan African Countries', *World Development* 12(4): 465-470.

Moss, T., G. Petterson and N. Van de Walle (2008) 'An Aid-Institutions Paradox? A Review Essay on Aid Dependency and State Building in Sub-Saharan Afrca', in W. Easterly (ed.) *Reinventing Foreign Aid*, pp. 255-281. Cambridge, Ma: The MIT Press.

Moyo, D. (2009) *Dead Aid: Why Aid is Not Working and how there is another Way for Africa.* London/New York: Allan Lane; Penguin Books.

Nielsen, R.A., M.G. Findley, Z.S. Davis, T. Candland and D.L. Nielson (2011) 'Foreign Aid Shocks as a Cause of Violent Armed Conflict', *American Journal of Political Science* 55(2): 219-232.

O'Connell, S.A. and C.C. Soludo (2001) 'Aid Intensity in Africa', *World Development* 29(9): 1527-1552.

Okada, K. and S. Samreth (2012) 'The Effect of Foreign Aid on Corruption: A Quantile Regression Approach', *Economics Letters* 115(2): 240.

Rajan, R.G. and A. Subramanian (2007) 'Does Aid Affect Governance?', *American Economic Review* 97(2): 322-327.

Reyntjens, F. (2011) 'Constructing the Truth, Dealing with Dissent, Domesticating the World: Governance in Post-Gemnocide Rwanda', *African Affairs* 110(438): 1-34.

Reyntjens, F. (2006) 'Post-1994 Politics in Rwanda: Problematising 'Liberation' and 'Democratisation'.', *Third World Quarterly* 27(6): 1103-111117.

Rothstein, B. and J. Teorell (2008) 'What is Quality of Government? A Theory of Impartial Government Institutions', *Governance: An International Journal of Policy, Administration and Institutions* 21(2): 165-190.

Schulpen, L., B. Loman and S. Kinsbergen (2011) 'Worse than Expected? A Comparative Analysis of Donor Proliferation and Aid Fragmentation', *Public Administration and Development* 31(5): 321-339.

Selaya, P. and R. Thiele (2012) 'The Impact of Aid on Bureaucratic Quality: Does the Mode of Delivery Matter?', *Journal of International Development* 24(3): 379-386.

Sogge, D. (2002) *Give & Take, what's the Matter with Foreign Aid?* London: Zed Books.

Svensson, J. (2000) 'Foreign Aid and Rent Seeking', *Journal of International Economics* 51: 437-461.

Tavares, J. (2003) 'Does Foreign Aid Corrupt?', *Economics Letters* 79: 99-106.

Uvin, P. (1998) *Aiding Violence: The Development Enterprise in Rwanda.* Connecticut: Kumarian Press.

Van de Walle, N. (2001) *African Economies and the Politics of Permanent Crisis, 1979-1999.* Cambridge: Cambridge University Press,.

Van de Walle, N. (2012) 'Foreign Aid in Dangerous Places: The Donors in Mali's Democracy', No. 2012/61. Helsinki: UNU-WIDER.

Van Waeyenberghe, E. (2009) 'Selectivity at work: Country policy and institutional assessments at the World Bank', European Journal of Development Research, 21(5), 792-810.

Wood, B., J. Betts, F. Etta, J. Gayfer, D. Kabell, N. Ngwira, F. Sagasti and M. Samaranayake (2011) 'The Evaluation of the Paris Declaration: Final Report'. Copenhagen.

Wuyts, M. (1996) 'Foreign Aid, Structural Adjustment and Public Management: The Mozambican Experience', *Development and Change* 27(4): 717-749.

Young, A.T. and K.M. Sheehan (2014) 'Foreign Aid, Institutional Quality, and Growth', *European Journal of Political Economy* 36: 195-208.