

# Foreign Aid Delivery, Donor Selectivity and Poverty: A Political Economy of Aid Effectiveness

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## Abstract

This paper explores the relationship between donor motivations and aid effectiveness, by analyzing donor decisions about *how* to deliver foreign development assistance. I argue that donor choices of delivery mechanisms are not random but a strategic response to the quality of recipient state institutions. State institutions of intermediate capacity generate confidence in effective aid implementation among donors, encouraging them to deliver more aid directly through the recipient government. Weak state institutions, on the other hand, undermine donor confidence in the effective use of aid. It is in these more fragile recipients that donors will seek out alternative development partners that allow them to forgo weak and corrupt state institutions and insulate the aid from government intervention. Given the range of non-state development partners, outcome-oriented donors choose the most effective alternative channel (or mix thereof) for bypass, thereby reducing the probability of aid capture and, simultaneously, increasing the likelihood of aid success in poorly governed states. I show that donors systematically condition aid delivery on the quality of recipient institutions from 2004-2008. I present evidence that bypass reduces poverty in poorly governed countries, using instrumental variable estimation.

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# 1. Introduction

In 2008, Haiti, a developing country with an abysmal record of governance, received more than 700 million US dollars in bilateral development assistance from OECD donor countries, amounting to roughly 70 dollars of aid per capita. In the same year, Tanzania, whose institutions of intermediate strength bode well for effective aid implementation, received around 2 billion US dollars in bilateral assistance, equivalent to approximately 47 dollars in per capita aid. For recent accounts of aid policy by scholars who champion a rational and selfish donor government over one that derives utility from aid effectiveness this outcome is consistent with an empirical regularity: in spite of a high probability of aid waste donors continue to provide high volumes of per capita aid to countries with poor governance. This regularity, coupled with the assumption that aid directly adds to a government's available resources has prompted scholars to question donors' development motivations (e.g. Alesina and Weder 2002; Bueno de Mesquita and Smith 2009; Neumayer 2003).

However, this image of the selfish donor government changes when one accounts for the mechanism of aid delivery: Over sixty percent of aid to Haiti bypassed the central government and is channeled through international and local non-governmental organizations, multilateral organizations, and private contractors. In Tanzania, on the other hand, only 15 percent of the aid to Tanzania is channeled through non-state actors. The balance was given to the Tanzanian government in a bilateral, state-to-state engagement (OECD 2010).

In this paper I draw a causal arrow between donor motivations and aid outcomes. I argue that the selection of delivery mechanisms is not random but a selective response to the quality of recipient state institutions. Haiti's state institutions are dysfunctional, fraught with corruption, and lacking developmental credibility. Tanzania, on the other hand, has managed to build institutions of intermediate strength, demonstrating indigenous capacity to pursue development-oriented policies. While Tanzania's state institutions generate confidence in effective aid implementation among donors, encour-

aging them to deliver more aid directly through the recipient government, Haiti’s weak state institutions undermine donor confidence in the effective use of aid. It is in these more fragile recipients that donors will seek out alternative development partners that allow them to forgo weak and corrupt state institutions and insulate the aid from government intervention. Given the range of non-state development partners, donors choose the most effective alternative channel (or mix thereof) for bypass, thereby reducing the probability of aid capture and, simultaneously, increasing the likelihood of aid success in poorly governed states.

A focus on donor motivations and their tactical decisions about aid delivery places the study of aid effectiveness squarely on the research agenda for political scientists, which traditionally study the determinants of aid allocation (Milner 2004, Milner and Tingley 2010, Bueno de Mesquita and Smith 2007, 2009, Stone 2006, Bermeo 2008) but do not offer insights into how donor allocation behavior affect aid success.<sup>2</sup> This study connects donor decision-making with outcomes by exploiting variation in how donors deliver development assistance. Typically, scholars study aid levels, assuming that bilateral aid flows are government-to-government in character.<sup>3</sup> If we look at the how bilateral assistance gets delivered at the highest level of aggregation, however, we find that, in 2008, OECD donors committed a total of US\$ 112 billion to development assistance, delegating over 30 percent of that aid, approximately US\$ 41 billion, through non-state development actors, which include NGOs, multilaterals, and private contractors (OECD 2010). These non-state actors are hired for specific project delivery and remain accountable to the donors.<sup>4</sup>

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<sup>2</sup>A notable exception here is a recent study by Bearce and Tirone (2010), which establishes a direct nexus between donor motivations and aid success. They show that changes in donors’ strategic (non-developmental) interests from the Cold War to the post-Cold War period affect whether aid improves economic growth.

<sup>3</sup>There are many good reasons for this analytical decision. Historically, foreign aid transfers have been predominantly government-to-government, starting with large-scale U.S. reconstruction efforts under the Marshall Plan. More recently, donor rhetoric on capacity-building emphasizes the role of government-to-government aid in helping recipient governments move towards sustainable development (e.g. OECD Paris Declaration)

<sup>4</sup>To further illustrate the problem associated with the assumption that bilateral aid flows are government-to-government I offer a breakdown of US aid by delivery channels across a small sample of US aid recipients in Figure A1 in the Appendix.

This paper identifies donor delivery decisions as consequential for aid outcomes. As a senior French government official suggested during an interview: “Fifty percent, if not more, of total annual ODA-aid effort, meaning more than half of one hundred billion Euros, is about delivering the aid to the beneficiary in the recipient country. It’s about selecting the right interface, the right channels of delivery. And this estimate is a conservative one.”<sup>5</sup> What outcome-oriented donors seek is a delivery mechanisms that integrates ex ante expectations about aid success as a crucial element in the aid design stage, increasing the likelihood of success.

The plan of the paper is as follows: First, I develop my argument linking donor motivations, aid delivery decisions, and aid success. I then show that donors are in fact systematic about conditioning the aid delivery tactics on recipient institutions. Building on this finding, I proceed to assess the effect of donor delivery decisions on aid outcomes. In the concluding section I discuss the implications of my findings for the study of aid effectiveness.

## 2. A theory of donor motivations, aid delivery decisions, and aid success

At the heart of the aid effectiveness debate is aid capture. I define aid capture broadly as resulting from the mismanagement of aid in the recipient, either by intentional diversion of aid through corrupt authorities/bureaucrats or the waste of aid due to a lack of absorptive capacity.<sup>6</sup>

Each year donors give development assistance to developing countries, many of which exhibit unproductive situations in which aid goes to waste through government

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<sup>5</sup>Author’s interview with senior French government official, Ministry of Foreign Affairs, Paris, July 16, 2009.

<sup>6</sup>I define aid capture broadly as resulting from the mismanagement of aid in the recipient, either by intentional diversion of aid through corrupt authorities/bureaucrats or the waste of aid due to a lack of absorptive capacity. This definition differs from Svensson’s (2000) and Winters (2010b) who define aid capture as acts of corruption.

incentives to pocket the aid for personal gain and/or limited capacity on the part of state institutions to ensure that aid reaches its intended beneficiaries. As analytical and empirical work on donors' aid implementation record shows, aid transfers between donor and recipient governments are at great risk of aid capture through agency problems and bureaucratic inefficiencies in poorly governed countries (Brautigam and Knack 2004; Djankov et al 2008; Gibson et al 2005; Reinikka and Svensson 2004, Svensson 2000). In these countries institutions fail to provide minimal levels of corruption control, rule of law, government effectiveness, and regulatory quality.<sup>7</sup>

In countries with better governance, the threat of aid capture is lower because more effective institutions provide rules and constraints that limit exploitative elite behavior and bolster administrative capacity (e.g. North 1990, 1991). What is more, governments with indigenous development capacity may (1) have better knowledge than the donor about what type of outside intervention is needed and (2) make aid implementation more cost-effective. The positive effects of engaging with recipient governments in situations where they represent trustworthy implementation partners has been discussed in the theoretical literature (e.g. Hefeker and Michaelowa 2005; Svensson 2000). If governance does not pose a problem, therefore, donors will prefer to deliver aid through the government-to-government channel, all else equal.<sup>8</sup>

When making allocation decisions, donors therefore turn to the quality of governance in recipient countries for credible signals about the extent to which foreign aid is threatened by aid capture. They assess governance quality through publicly available data on governance ratings as well as more detailed field reports provided through local implementation partners.<sup>9</sup>

From this perspective, the central issue in aid allocation is not how much aid donors provide but rather how it can be delivered so that it mitigates institutional failure and

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<sup>7</sup>What is more, others argue that government-to-government aid can increase corruption in the recipient country and incur long-term costs on the quality of state institutions (Bates 2001; Knack 2001; Remmer 2004; Weinstein 2005).

<sup>8</sup>The exception here are aid donations to civil society actors in the name of democracy promotion.

<sup>9</sup>Multiple interviews with senior donor officials documented keen awareness and utilization of governance ratings, such as e.g. the World Bank's Governance Matters Project.

ensures efficacy of aid output in places like Haiti, Sudan, or Zimbabwe where need is high, yet existing governance deficiencies pose severe risks to effective aid implementation? In light of the negative effects of aid capture on aid outcomes, scholars and practitioners have suggested that donors reduce the risk of aid capture by pursuing a strategy of country selectivity, i.e. targeting countries with higher levels of governance where the probability of aid capture is low. And while country selectivity makes sense on its face, it also implies that the countries which need the aid most get very little. Scholars like Collier (2003) and Radelet (2004) make this short-coming explicit in their writing. Easterly et al (2003), too, suggest that country selectivity may not be the appropriate path to help the world's poorest countries develop. But there does not seem to be a general consensus about what other criteria they should use.

Among practitioners, there is a growing consensus on the need to maintain sustained engagement in the worlds' poorest and often most fragile states. A senior British DfID government official makes this point vividly: "It is important to move away from the Washington consensus, which stresses development cooperation with reforming states so that they get even better. The consensus implies that we leave the Sudans and Afghanistans behind because they are too difficult. Somewhere in the last five to ten years there has been a paradigm shift with us donors acknowledging that we cannot leave the tough spots. We need to deal with these countries and still take account of state capacity but the premise must be that it is not there. We need to intervene differently."<sup>10</sup>

This popular demand for more effective aid policy also responds to pessimism generated by scholarly assessments of the effectiveness of a common government-to-government allocation tool: aid conditionality. Numerous analytical and empirical accounts of interactions between donor and recipient governments argue that donors lack the ability to credibly enforce aid contracts, in general, and attached reform conditions, in particular (e.g. Collier 1997; Mosley 1987; Stone 2004; Svensson 2003). A key insight drawn from this literature must be that conventional government-to-

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<sup>10</sup> Author's interview with senior British government official, Washington D.C., June 9, 2009.

government aid contracts may not have sufficient bite to align recipient government incentives in ways that ensure assistance reaches the intended beneficiaries.

By accounting for variation in aid delivery channels, I uncover an important mechanism of aid delivery: bypassing recipient governments. This allows donors to work around the difficulties of enforcing aid contracts in situations where the probability of aid capture is high. In making the argument about endogenous bypass tactics, it is important to distinguish between government-to-government and bypass aid. I define government-to-government aid as any aid activity that involves the recipient government as an implementing partner.<sup>11</sup> In contrast, I categorize aid delivered through non-state development channels as that which does not engage government authorities at all. There are four main types of non-state development actors: local/international NGOs, multilateral organizations, private contractors and public-private partnerships.

Local NGOs are important development partners for donors. Their issue focus and local knowledge about what types of projects are needed most make them attractive to donors who seek to deliver services effectively. Examples of local/regional NGO success stories in foreign aid delivery across the developing world include Love Live in South Africa, The AIDS Support Organization in Uganda, and the Grameen Bank in Bangladesh (see also Radelet 2004). Not all NGOs are equally virtuous and capable, however. In poorly governed countries, NGOs may not necessarily be a viable alternative for better service delivery.<sup>12</sup> To mitigate potential implementation problems of aid delivered through local NGOs, donors resort to funding international NGOs such as Oxfam, Doctors Without Borders or Care International. Like their local counterparts, international NGOs are issue-focused and typically have better knowledge of local capacities than donor officials in donor countries. Given their increased knowledge of local

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<sup>11</sup>In some instances, a recipient government receives budgetary support or programmatic aid from a donor government and is fully responsible for the implementation process. In other instances, donor governments directly engage recipient authorities by delivering aid projects or providing them with consulting services.

<sup>12</sup>According to evidence reported in Barr, Fafchamps and Owens (2005) local NGOs in Uganda are often quite young with limited expertise in delivering the kind of services that donors are interested in. What is more, local NGOs may also engage in corrupt behavior. As Barr et al (2005) find, many NGOs in Uganda do not file tax returns and are subject to little or no government scrutiny regarding the distribution of profits.

conditions and their dependence of funding on donor governments, international NGOs may be in a better position than donor agency officials to select local implementation partners that can help deliver aid more effectively than the recipient government.<sup>13</sup>

In regions of the world where viable NGO partners are not represented on the ground, or where aid projects may require economy of development, donors can turn to multilateral organizations for service delivery. Organizations like UNICEF, for instance, have generated many aid success stories around the world. Like international NGOs, many multilaterals are specialized and involved with the local sector. What differentiates them from smaller NGOs is the size of their operations and their capacity to quickly mount emergency response interventions as well as sustain more long-term service delivery programs. Yet another important type of non-state development channel is for-profit contracting. Donor governments often outsource development assistance to the private sector by awarding contracts to private contracting firms, which are hired for technical purposes, including consulting and direct hands-on assistance in the implementation of aid activities.

While there is considerable variety among these bypass channels, they share two main characteristics that justify my decision to subsume them all under the category “bypass.” First, they all are independent development actors that provide donors with the opportunity to channel their funds through actors other than the recipient government. Second, the primary mission of these non-state entities is poverty alleviation. Such an issue-focus implies that non-state development actors generate the majority of their funding through poverty reduction projects (i.e. their promise of implementing aid projects effectively), thus making their organizational survival more dependent on their performance in this issue area. Recipient governments, on the other hand,

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<sup>13</sup>Francken, Minten, and Swinnen (2011) show evidence that humanitarian aid allocated through international NGOs in cyclone-hit Madagascar is more needs-oriented (and unconditional on impact) than government-mediated disaster relief. In a similar vein, Jennifer Brass’ detailed study of where NGOs locate projects within Kenya uses project-level evidence to show that NGOs go to areas where demand for aid is high. Büthe, Major, and de Mello e Souza’s (2011) work, too, provides evidence that private development aid, allocated through international NGOs, is allocated in places where need is highest; yet, expectations about aid success do not appear to influence their allocation behavior.



have multiple objectives and can often tap sources other than aid for the process of revenue-generation, such as e.g. natural resources and investment. Also, given the multitude of non-state development actors, donors can potentially punish bad implementation performance by switching to another organization. In countries with low levels of governance countries, donors view bypass aid as more insulated from aid capture. I thus advance the following hypothesis: when the quality of governance is low, OECD donors bypass recipient governments and channel a greater proportion of their aid through non-state development actors.

In offering this selection hypothesis it is important to clarify what I am not arguing. I do not claim that donors expect bypass aid to be completely insulated from aid capture. As evidence from officials with donor government suggests, donors are acutely aware of potential implementation difficulties arising from delegating aid to non-state development actors. However, as suggested above, non-state development actors largely depend on donor funds for their survival -a fact, which should generate considerable performance pressure on any organization and conceptually distinguishes the non-state actor from the recipient government. In addition, several for-profit NGO rating agencies exist (e.g. ForeignAID Ratings LLC) that provide donors with assessments about the financial efficiency and institutional development of NGOs. I thus re-emphasize the relative nature of my argument: donors will opt for bypass in poorly governed countries because they expect bypass aid to have a greater likelihood of achieving the desired outcome than government-to-government aid.

In light of the endogenous nature of donor bypass decisions, the important question then becomes: does bypass in fact reduce poverty? Many studies that examine aid effectiveness gauge the success of aid by its impact on economic growth. In the world's poorest countries, however, economic growth may not serve as the most appropriate measure for aid success. For growth to occur many moving parts need to fall in place. At a minimum, one would like to see a healthy and educated population to take advantage of growth opportunities. Yet, the Haitis and Zimbabwes fail to provide their citizens with even the most basic elements of human development. In

such environments the effect of aid is visible in the short-run, at the level of absolute poverty as measured in infant or child mortality. The subsequent empirical analyses of impact of bypass aid on poverty, after having demonstrated the systematic nature of donor bypass decisions, therefore, examines aid success on the basis of these poverty indicators.

### 3. Research Design, Data, and Analyses

#### 3.1 Selection of Aid Delivery Mechanisms

I first explain donor decisions to bypass recipient governments across 22 OECD donor countries. The universe of recipient countries includes ODA eligible countries as defined by the OECD (including low, lower middle and upper middle income countries). I test my argument at two levels of analysis. At first, and given the diversity of donors in my sample, the main unit of analysis is the donor-recipient dyad year. I then test my argument at the monadic recipient year level, taking into account my conjectures about average bypass behavior. My temporal domain ranges from 2005 to 2009.<sup>14</sup> Second, I test my hypothesis of the effectiveness of aid on a sample of developing countries that are eligible for Official Development Assistance (ODA). The data are in cross-sectional time series format. The unit of analysis is an aid-eligible country year.<sup>15</sup>

#### **The dependent variable: donor bypass**

My empirical analysis asks: Does recipient governance explain donor decisions to bypass government institutions? The outcome of interest therefore are donor decisions to bypass government institutions. To construct a measure of bypass I use new data drawn from the OECD CRS aid activity database. The OECD began collecting (donor reported) information on the “channel of delivery” in 2004, when it became an optional reporting item on the new CRS++ reporting scheme. Information on the channel of

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<sup>14</sup>While the temporal domain is limited because of data availability, the years under study allow us to analyze current donor allocation behavior and policy.

<sup>15</sup>Although future research will account for the temporal dynamics of aid delivery decisions, my current focus is on tackling the issue of endogeneity through appropriate causal inference tools.

delivery conveys how foreign aid is delivered: it records the amount of bilateral aid flows channeled through five channel categories. These include government-to-government aid as well as aid delivered to non-governmental organizations, multilaterals, public-private partnerships, and other development actors.

I operationalize the decision to bypass in two different ways: My main measure of bypass is continuous and captures the proportion of aid delivered through non-state development actors. When donors allocate funds to a particular country, what proportion of the assistance goes to non-state actors? Table 1 presents the proportion of non-state aid each donor country allocates across its recipient countries in 2008. Sweden tops the list with 73 percent of its aid channeled through non-state actors, followed by Finland and Spain. Italy pursues bypass tactics with nearly half of its bilateral funds, soon followed by the United States, which outsources more than 30 percent of its bilateral funds. At the bottom of the bypass table are Portugal, France, and Greece which send less than 10 percent of their aid through bypass channels.<sup>16</sup>

Table 1: Proportion of Aid Channeled Through Non-State Actors by OECD DAC Donors 2008

Donor	Proportion of non-state aid	Donor	Proportion of non-state aid
Sweden	0.73	Australia	0.37
Finland	0.68	United States	0.34
Spain	0.68	Denmark	0.30
Norway	0.63	Belgium	0.29
Netherlands	0.61	United Kingdom	0.27
Canada	0.61	Austria	0.15
Ireland	0.59	Germany	0.10
Switzerland	0.58	Japan	0.08
New Zealand	0.50	Greece	0.07
Luxembourg	0.49	France	0.02
Italy	0.43	Portugal	0.01

<sup>16</sup>I offer a more fine-grained breakdown of bypass tactics in Table A2 in the Appendix, where I show the distribution of bypass aid for the major categories of non-state aid across all donors which bypass recipient governments with more than 30 percent of their aid.

Since reporting on the recently (2004) introduced data item “delivery channel” is optional, available data are affected by underreporting (OECD CRS Reporting Directives Manual 2008).<sup>17</sup> Before discussing my strategies to deal with underreporting it is important to highlight that existing evaluations of donor reporting practices suggest that underreporting is not a function of the nature of the channels of delivery. Rather, shortcomings in reporting are the result of time lags in the adoption of new reporting requirements coupled with lack of training of and resources for technical staff in aid agencies, which exhibits variation across time and donors. According to reports by Aidinfo (2008, p.16), a pro-transparency aid advocacy group, donors do not allocate enough resources, technology, or professional skills for data management and reporting, which is complicated by the fact that management requires the integration of multiple implementation levels, e.g. field and country level systems.<sup>18</sup>

To ensure the robustness of my estimations, I construct an alternative binary bypass measure, with “1” indicating that donors deliver aid exclusively through non-state development partners. This may be any combination of international/local NGOs, multilateral institutions, or public-private partnerships but it excludes government-to-government aid. Zero, on the other hand, implies that donors engage the recipient government directly, either in the context of mixed strategies (which allows for a combination of state-to-state and non-state aid) or exclusive cooperation with the recipient government. The simple coding of my binary outcome, bypass yes/no, considerably reduces the potential for bias due to reporting problems. Since my bypass measure is coded as “1” only when donors give 100 percent of their aid through bypass the expected bias in reporting is unlikely to be the cause of either false positives or false negatives, since the expected bias in reporting would be to not have information that

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<sup>17</sup>The level of underreporting varies across time and donor. Germany, for instance, exhaustively reports all its aid activities across channels of delivery since adopting the C++ format in 2005. The United States reports across channels since 2004 but its reporting on the channel of delivery category nears completion only in 2007. Canada, on the other hand, only provides complete channel information in 2008.

<sup>18</sup>To get a sense of the volume of reporting, note that in 2008 the United States provided its bilateral foreign aid in 15,510 individual aid transactions using more than seven different implementing agencies (including but not limited to USAID, the Millennium Challenge Corporation, U.S. departments of State, Defense, Agriculture, Interior, and Energy).

the aid was going through non-state channels. I limit the fraction of missing data per recipient-dyad to be less than 20 percent.

In addition I augment missing data through multiple imputation techniques. Specifically, I approach missing data analysis from a counterfactual perspective, building on work by Frisina et al (2008). I ask: what would the aid shares look like for any donor-recipient dyad had the donor allocated 100 percent of the aid across the channels? To answer this question I reallocate unreported aid flows between government-to-government and non-state aid. The extent to which the aid shares of both types increase or decrease is a function of the imputation model, which imputes values for the dependent variable at the level of the log-transformed non-state aid share. I follow Amelia II imputation principles for the imputation (King et al 1999).<sup>19</sup>

### **The explanatory variable: quality of governance**

At the heart of donor decisions about aid delivery are assessments about the likelihood of aid reaching the intended outcome in the recipient country. If state institutions are of poor quality, donors expect a higher probability of aid capture and consequently increase the proportion of aid that bypasses governments. The main variable of interest, therefore, is *Governance Quality*. To capture the quality of governance I draw on data from the Governance Matters project (Kaufman et al 2009).<sup>20</sup> I select this particular source of governance measures for two reasons: first, it provides excellent cross-sectional coverage and is available up to 2009. Second, author interviews with donor officials suggest that donor governments consult this publicly available gover-

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<sup>19</sup>To illustrate the feasibility of this method, consider the following hypothetical example: suppose a donor allocates US\$ 20 million to a recipient in 2009. Based on donor reports we know that 40 percent (or eight million US\$) was provided as government-to-government aid and 45 percent (or nine million US\$) was provided as non-state aid. 15 percent of the aid is unobserved, not accounted for by channel of delivery. At a minimum, we know that the recipient will not receive less than nine million dollars in aid through non-state channels or eight million dollars in aid through state-channels. The observed shares thus contain some information about latent values, suggesting that the partially observed channel shares would be (equal to previous levels or) strictly increasing. Similarly, we know that the recipient country's government will never receive more than (or equal to) US\$ 12 million from the donor, as the observed non-state channel share places an upper bound for how much government-to-government aid could change. The program written for the imputation in R is available from the author upon request.

<sup>20</sup>The project offers data for six governance dimensions: voice and accountability, regulatory quality, government effectiveness, rule of law, corruption control, and political stability and violence.

nance source in their assessments, with a particular focus on economic institutions such as corruption control, government effectiveness, regulatory quality, and rule of law.<sup>21</sup>

Drawing from six available indicators I construct two different governance measures: *Governance, All Inst* is a measure at the highest level of aggregation, aggregating all six governance dimensions. *Governance, Ec. Inst* is a measure which captures a state's economic institutions by including corruption control, government effectiveness, regulatory quality, and rule of law as indicators.<sup>22</sup> The values of both governance measures range between 0 to 5, with higher values representing a higher quality of governance. To illustrate recent donor aid delivery decisions in situations where the quality of governance is abysmal and where the quality of aid capture is high, I plot donor development cooperation in Sudan in 2008, which scores roughly 1 on the aggregate governance indicator. Figure 1 shows the bypass behavior of all OECD donors in Sudan, across the full range of possible bypass behavior (as captured along the x-axis). With the exception of Greece, all donor governments bypass the Sudanese government with more than 50 percent of their bilateral assistance, delegating poverty reduction to non-state development actors.

## Controls

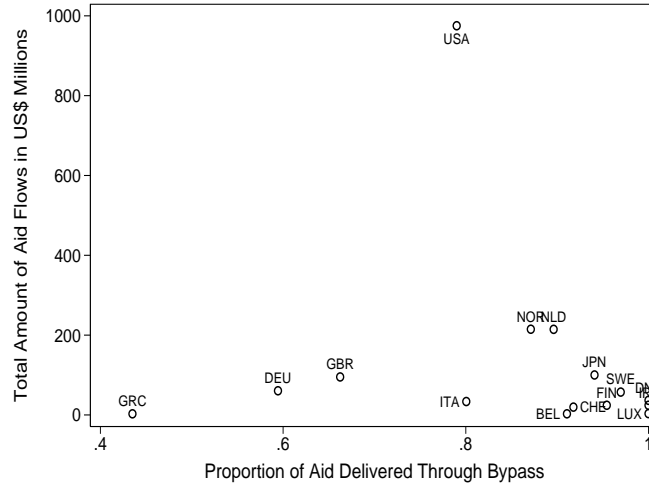
As the previous literature on aid policy maintains, various other factors shape donor decision about the allocation of aid resources, including other recipient characteristics and non-developmental donor goals. I include them as controls to provide a fully specified model. All time-varying right-hand side variables are lagged one year. I begin with the confounding effects of *Democracy* based on the understanding that some donors may conceive of democratic institutions as political constraints that limit

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<sup>21</sup>In over half of the author's interviews with donor elites, officials across US, British, German, and French donor governments specifically mentioned World Bank governance data as informing their assessments. Table A1 in the Appendix includes the full list of interviews as conducted by the author.

<sup>22</sup>I exclude political stability and violence because I include variables for civil conflict (PRIO) and terrorism (GTD) in my multivariate tests. Further, I exclude political institutions from the governance indicator since donors are generally reluctant to associate governance with democracy. Rather they explicitly distinguish between good governance and good government. I therefore include a Freedom House democracy measure as a control in the multivariate tests.

Figure 1: OECD Donors in Sudan, 2008



the ability of recipient governments and bureaucratic officials to capture aid flows. *Democracy* is measured using the combined score of the Freedom House (2009) civil liberty and political rights indicators. To make the scale of the measure more intuitive I invert *Democracy* so that “1” represents the lowest level of democracy, while “7” stands for the highest level of democracy.<sup>23</sup> I control for *Natural Disasters* based on the understanding that a greater number of natural disasters in the aid recipient, as recorded by the EM-DAT database, may prompt donors to provide a larger share of the pie to non-state development actors that are specialized in post disaster reconstruction efforts. Following a similar logic, low-scale *Civil Conflict*, as recorded by Gleditsch et al’s (2002) PRIO database, may create grievances that provide incentives for donors to favor more outcome-orientated aid delivery about ensuring that aid reaches the affected, thus increasing donor propensity to bypass. I further include *Distance* to account for the geographical proximity between donor and the aid-receiving countries. As distance between donors and aid-receiving countries grows, government-to-government relations between donor and recipient governments are expected to weaken, thus increasing donor

<sup>23</sup>I also run the models using the Polity2 measure of democracy. The findings are qualitatively similar. I opt for Freedom House because of greater country-year coverage.

propensity to channel aid through non-state development actors. The distance data are drawn from Bennett and Stam’s (2000) Eugene software and are logged.

Following previous studies, I also include confounders that capture donor non-developmental objectives. *Former Colony* status, as recorded by the CIA World Factbook, allows me to account for long-lasting diplomatic ties between the donor and the aid receiving governments that may bias aid delivery in favor of government-to-government aid. *Trade Intensity*, measured as the logged sum of imports and exports between the recipient and the OECD countries by the IMF-DOT database, is a straightforward indicator of donor efforts to strengthen economic ties with the recipient government. To control for security related donor goals, I include *Security Council*, which is a binary variable indicating whether the aid recipient is a rotating member on the UN Security Council. As research by Kuziemko and Werker (2006) finds, donor governments use aid to buy votes from rotating members of the UN Security Council. I also include *Terrorism*, which captures the number of terrorist attacks in the aid-receiving country as recorded by the Global Terrorism Database. I use this measure based on the understanding that donors have incentives to assist recipient governments in their fight of terrorism (e.g. Bapat 2011, Button and Carter 2011).

To account for the confounding influence of donor ideology and economic conditions on the propensity to bypass I include *Donor Welfare*, measured as social spending over GDP by the OECD’s Social Expenditures Database, based on the understanding that greater donor commitment to domestic redistribution may translate into more generous aid giving (e.g. Noel and Therien 2000, Tingley 2010), yet may fail to generate pressure on governments to ensure the aid gets delivered effectively. Finally, I control for *Donor Growth*, recorded by the Penn World Tables, based on the understanding that as a donor’s growth performance improves, the pressure on governments to maximize aid success lightens, thus reducing the donor propensity to bypass recipient governments.

To deal with other factors that could systematically affect donor decisions to bypass recipient governments I add a set of donor fixed effects as well as a set of regional fixed



effects.<sup>24</sup> I also include a time trend variable to ensure that the observed relationship between the quality of governance and bypass is not a function of the two variables exhibiting a trend in either direction over time.

## Analysis and Results

Before I proceed to the analysis of the data it is important to provide a brief discussion of the statistical implications of using a proportional outcome measure, which requires compositional data analysis.<sup>25</sup> For any donor-recipient dyad the aid channel share is positive and the sum of the aid channels shares must be one hundred percent. Consider the aid share  $A$ , in donor-recipient dyad  $i$  for channel  $j$ . The compositional nature of the variable is expressed by the constraints that the fraction of the aid share that government-to-government or non-state channels might receive is doubly bounded, falling between 0 and 1,

$$A_{i,j} \in [0, 1] \quad \forall \quad i, j, \quad (1)$$

with  $A_{i,j}$  denoting the fraction of the aid in donor-recipient dyad  $i$  ( $i=1, \dots, N$ ) for delivery channel  $j$  ( $j=1, J$ ). Government-to-government aid and non-state aid in a given donor-recipient dyad sums to unity,

$$\sum_{j=1}^J A_{ij} = 1 \quad \forall \quad i, j, \quad (2)$$

where  $J$  is the total number of delivery channels, which equal 2 (government-to-government and non-state aid) in my case.

Following Aitchison (1986), I create a  $(J - 1)$  log aid ratio, which compares the non-state aid to government-to-government aid:

$$Y_{i1} = \ln(A_{i1}/A_{i2}) = \ln(A_{i1}/(1 - A_{i1})) \quad (3)$$

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<sup>24</sup>The regional categories are Sub-Saharan Africa, Latin America, Middle East, and Asia. The omitted regional category is Central and Eastern Europe.

<sup>25</sup>Honaker and Linzer (2006) provide an excellent discussion about this type of data. I subsequently draw on their notation style.

The advantage of log transforming proportional outcomes is that the outcome is unconstrained, allowing for a straightforward estimation through OLS. The coefficient of the log-transformed non-state share variable then describes how the log ratio of non-state aid changes with respect to government-to-government aid. After modeling, the estimates are transformed back into their original scale of interest:

$$A_{i1} = (1 + e^{-Y_{i1}})^{-1}. \quad (4)$$

and  $Y$  is log-transformed following the steps (1) through (4) above.

I now estimate my model using OLS regressions with robust standard errors clustered on the recipient country. In order to investigate possible bias from serial correlation, I apply the Wooldridge test for panel data (Wooldridge 2002, p. 282-283). The insignificance of the test-statistic ( $p = 0.33$ ) indicates that I cannot reject the null hypothesis of “no first-order autocorrelation” and conclude that my findings are not biased by temporal correlation of the errors. The following equation (1) delineates my statistical model.

$$Bypass_{it} = \beta_0 + \beta_1 QG + \beta_2 Z + \epsilon_{it}, \quad (5)$$

where *Bypass* is the continuous log-transformed (OLS) variable (see equations 1 through 3),  $i$  represents country and  $t$  represents year,  $\beta_0$  is the intercept,  $\beta_1$  and  $\beta_2$  represent the vectors of coefficients to be estimated,  $QG$  denotes the quality of recipient governance as described above,  $Z$  denotes the vector of control variables as described, and  $\epsilon_{it}$  is the error term of the equation.

In Table 2, I present the central findings of the model. The first column presents OLS results for a base model (Model 1) estimating the proportion of aid delivered through non-state development actors, which includes the *Governance, All Inst.* measure and draws on data that are completely reported across delivery channels. The second column offers OLS results for the fully specified model (Model 2), which focuses on the effect of economic institutions on donor delivery decisions as captured

Table 2: Explaining Bypass To Aid-Receiving Countries, 2005-2009

	Model 1	Model 2	Model 3	Model 4	Model 5
	OLS	OLS	OLS	Probit	OLS (MI)
<i>Governance, All Inst.</i>	-1.902** (0.23)				
<i>Governance, Ec. Inst</i>		-1.578** (0.19)	-1.682** (0.29)	-0.127** (0.04)	-1.232** (0.17)
<i>Freedom House</i>		-0.117+ (0.07)	-0.097 (0.09)	-0.064** (0.02)	-0.071 (0.07)
<i>Civil Conflict</i>		0.437** (0.11)	0.483** (0.14)	0.003 (0.03)	0.321+ (0.23)
<i>Natural Disaster</i>	0.023 (0.08)	0.036 (0.06)	0.046 (0.09)	-0.119** (0.01)	0.040 (0.07)
<i>Distance</i>	0.870** (0.20)	0.830** (0.14)	0.850** (0.18)	0.410** (0.04)	0.753** (0.13)
<i>Former Colony</i>	0.247 (0.30)	0.209 (0.18)	0.353 (0.28)	0.044 (0.04)	0.267 (0.45)
<i>Trade Intensity</i>	-0.182* (0.07)	-0.184** (0.05)	-0.166* (0.08)	-0.030* (0.01)	-0.160* (0.08)
<i>Security Council</i>	-0.597 (0.41)	-0.551 (0.36)	-0.332 (0.33)	-0.079 (0.09)	-0.014 (0.42)
<i>Terrorism</i>		-0.001 (0.00)	-0.001+ (0.00)	-0.000 (0.00)	-0.001 (0.00)
<i>Donor Welfare</i>	-0.902** (0.10)	-0.903** (0.10)	-0.909** (0.09)	-0.026 (0.02)	-0.06** (0.02)
<i>Donor Growth</i>	-0.515** (0.06)	-0.517** (0.08)	-0.616** (0.05)	-0.064** (0.02)	-0.230** (0.07)
<i>Sub-Saharan Africa</i>	0.349 (0.35)	0.359 (0.34)	-0.268 (0.35)	0.263** (0.05)	0.102 (0.21)
<i>Latin America</i>	0.184 (0.42)	0.254 (0.40)	-0.411 (0.38)	0.273** (0.07)	0.132 (0.27)
<i>Asia Pacific</i>	-0.748+ (0.38)	-0.878* (0.37)	-1.434** (0.34)	-0.044 (0.07)	-0.327+ (0.25)
<i>Middle East</i>	-0.666 (0.62)	-0.513 (0.46)	-1.103+ (0.57)	0.292** (0.09)	-0.240 (0.33)
Constant	153.144 (195.09)	159.163 (227.50)	817.486** (171.62)		
$R^2$	0.33	0.33	0.33		
$\chi^2$				2793.401	
N	6728	6728	8142	8142	8142

+ $p < 0.10$ , \* $p < 0.05$ , \*\* $p < 0.01$ *Donor dummies and time trend included but not reported*

by the *Governance, Ec. Inst* measure, controlling for *Democracy, Civil Conflict, Terrorism* and all other confounding covariates. In the third column, I present Probit results for my binary bypass measure (Model 3), modeling the probability of donor decisions to exclusively deliver all aid through bypass channels. The sample size now includes donor-recipient observations for which at least 80 percent of all transactions are accounted for by delivery channels. On the basis of this slightly larger sample, I re-estimate Model 2 and present the findings in the fourth column. Finally, the fifth column presents results where the data of the continuous dependent variable was augmented through multiple augmentation techniques.<sup>26</sup>

Across all models, the coefficients for the governance measures clearly stands out. The coefficient is negative and highly significant when holding constant the effects of confounding covariates. This result holds across differences in model specifications, bypass measures, and degrees of missingness, thus providing robust empirical evidence for my thesis: to the extent that governance is a problem for aid success, donors will delegate development cooperation to non-state development actors. The other predictors of bypass that are most consistent in their statistical impact on bypass across different model specifications influence the outcome variable in the predicted direction: *Civil Conflict* and *Distance* increase donor decisions to bypass across the majority of models, while *Trade Intensity, Donor Welfare, and Donor Growth* reduce the amount of aid delegated to non-state development actors. The remaining controls, *Democracy, Natural Disasters, and Security Council* behave in the predicted direction but their statistical significance fluctuates across the models.

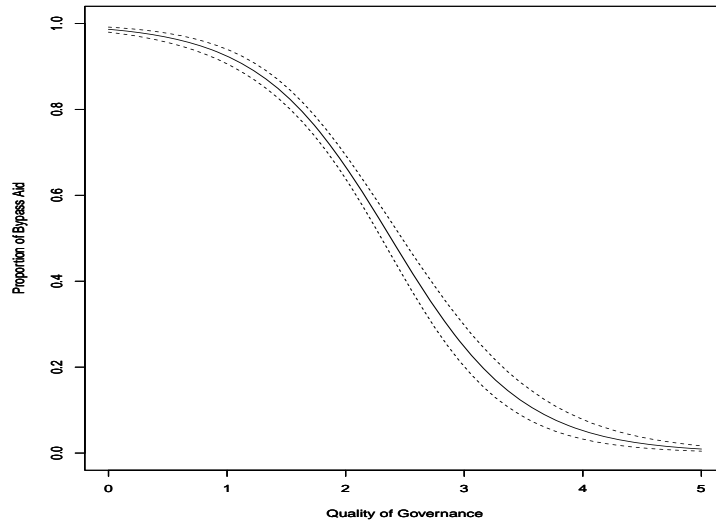
Figure 2 highlights the substantive significance of recipient governance, as estimated in Model 2 of Table 1 for donor bypass decisions using statistical simulation techniques in Zelig (Imai et al 2007). The figure graphs the expected value of bypass across the entire range of governance, surrounded by 90 percent confidence intervals. At low levels of governance (around 1) -as observed 2008 in Sudan, Chad, or Haiti- the model predicts donors to bypass with more than 90 percent of their aid. At the mean level

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<sup>26</sup>I provide descriptive statistics of the variables used in Models 2 and 3 in Table A2 in the Appendix.

of governance (around 2.5) - as in El Salvador or Bolivia the expected value of bypass is lower at approximately 0.45 percent. Finally, at a governance quality level of 3.5 -as observed in Chile and Micronesia in 2008- donors are expected to provide an even smaller proportion of their aid flows through non-state development actors, with less than 20 percent delegated aid.<sup>27</sup>

Figure 2: Expected Values of Bypass Across Quality of Governance



Further, readers may request a test of my hypothesis at the recipient-year level of analysis. To the extent that my argument suggests outcome-orientation across all donors, monadic tests of donor bypass behavior should further strengthen confidence in the robustness of my results. This new estimation sample incorporates 131 recipient countries. At the recipient-year level my continuous bypass variable measures the proportion of total aid received through bypass by a recipient in a given year. Following the coding logic of the alternative binary bypass measure I construct a second dependent variable that counts the number of times OECD donor countries pursue an exclusive bypass strategy in a recipient in a given year. Table 3 presents the results.

Using OLS to estimate the proportion of bypass I show that the quality of governance

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<sup>27</sup>Figure A3 in the Appendix provides a histogram of *Governance, Ec. Inst.*

continues to be a crucial factor that drives donor decision-making. While the first column captures results from the broad governance measure (as specified in the dyadic analyses), the second column focuses on the effect of economic institutions on bypass, controlling for important confounders. The results are consistent: the proportion of bypass (out of total aid flows) increases as the quality of governance decreases.

Finally, readers might be concerned about selection effects, since the group of countries for which donors choose to bypass government institutions is not randomly selected but a function of earlier self-selection. To model the interdependence between these two decisions, I employ a Heckman sample selection model (Heckman 1979). My empirical model of the aid recipient selection stage includes *Governance Quality* as well as the set of confounders used in estimations of bypass behavior based on the understanding that these covariates all affect donor decisions whether to give aid in the first place. However, the selection stage also includes an instrumental variable that allows the estimator to uniquely identify both stages. In the present case the identification question asks: what factor influences donor decisions to give aid but is unrelated to their decision to bypass? I exploit donor wealth, as measured in GDP, as an instrument that satisfies the exclusion restriction theoretically. My logic is that the size of donor economies affects donor decisions to provide funds but is not causally related to donor decisions to bypass recipient governments.<sup>28</sup> Controlling for prior selection effects, the quality of governance remains a robust predictor of bypass: as the quality of governance decreases, donors increase the proportion of bypass aid. To the extent that aid capture is a problem for effective aid implementation in the aid-receiving country, donors systematically condition aid on the quality of a recipient’s economic institutions. Having demonstrated the robustness of my selection results the remaining part of the paper

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<sup>28</sup>One potential criticism of this particular instrument might be that the largest economies are more embedded in the global economy, with a motivation to strengthen their global economic positions. Such dynamics might systematically bias aid delivery in favor of government-to-government aid. Obvious candidate donors for which the exclusion restriction might be violated are the United States, Japan, United Kingdom, Germany, and France. However, my model specifications already control for donors’ economic motives through the *Trade Intensity* variable. To further address potential skepticism I estimated two separate selection models for which I present the results in Table A2 of the Appendix. Model 5A is estimated on the basis of the full sample, while Model 6A excludes the five major economies from the analysis.

Table 3: Explaining the Prevalence of Bypass Aid in Aid-Receiving Countries, 2006-2009

	Model 6	Model 7	Model 8	Model 9
	OLS	OLS	Poisson	Poisson
<i>Governance, All Inst.</i>	-1.059** (0.16)		-0.462** (0.07)	
<i>Governance, Ec. Inst.</i>		-1.076** (0.20)		-0.498** (0.11)
<i>Democracy</i>		0.015 (0.07)		-0.029 (0.04)
<i>Civil Conflict</i>		0.270 (0.19)		0.057 (0.04)
<i>Natural Disasters</i>	0.119+ (0.06)	0.116+ (0.07)	0.005 (0.02)	0.034 (0.03)
<i>Former Colony</i>	-0.264 (0.17)	-0.274 (0.17)	0.189+ (0.10)	0.215* (0.11)
<i>Trade Intensity</i>	-0.130** (0.05)	-0.101+ (0.05)	0.003 (0.02)	-0.010 (0.02)
<i>Security Council</i>	-0.158 (0.32)	-0.177 (0.32)	-0.115 (0.16)	-0.059 (0.16)
<i>Terrorism</i>		-0.002* (0.00)		-0.000 (0.00)
<i>Sub-Saharan Africa</i>	-0.484* (0.24)	-0.488* (0.24)	-0.130+ (0.08)	-0.140+ (0.08)
<i>Latin America</i>	-0.525+ (0.31)	-0.561+ (0.32)	-0.155 (0.11)	-0.077 (0.11)
<i>Asia Pacific</i>	-0.368+ (0.20)	-0.420* (0.19)	-0.524** (0.11)	-0.545** (0.11)
<i>Middle East</i>	-1.279** (0.40)	-1.094** (0.40)	-0.572** (0.21)	-0.655** (0.21)
Constant	2.450** (0.54)	2.257** (0.67)	1.787** (0.24)	1.736** (0.33)
$R^2$	0.27	0.27		
$\chi^2$			118.31	148.32
N	527	527	527	527

+ $p < 0.10$ , \* $p < 0.05$ , \*\* $p < 0.01$

*Donor dummies and time trend included but not reported*

focuses on the consequences of bypass on aid effectiveness.

## 3.2 Bypass and Poverty

Does bypass cause infant health to improve in poorly governed countries? My analysis incorporates all developing countries that are eligible for official development assistance. Given data constraints on aid delivery channels, which offers complete coverage across 22 OECD donors only in 2008, my initial analyses are only cover the bypass years 2007-2009.

### **Measuring aid effectiveness: infant mortality rate**

In the majority of aid effectiveness studies, the dependent variable is economic growth. However, scholars have begun to use alternate measures of aid success such as, for instance, child health and education (Akhand and Gupta 2002, Masud and Yontcheva 2005). Consistent with Boone (1996), they reject the use of economic growth as a measure for aid success because “aid can increase consumption rather than investment, which would explain the disappointing results of studies of growth, but still reduce poverty through either higher consumption by the poor or greater provision of services to the poor. (p. 5) From a different perspective, Sen (1999) also advocates a shift from income and growth to more distributive sensitive measures of welfare when judging a person’s advantage and deprivation. This request is particularly appealing in the world’s poorest countries, where many lack the most basic requirements needed to take advantage of growth opportunities, such as health and education. If donors can increase consumption and the provision of services, then foreign aid is clearly valuable. There is evidence in international aid policy, which suggests that progress in meeting peoples’ needs is on top of donors’ development agendas. The adoption of the Millennium Development Goals (MDGs), for instance, associates poverty reduction with basic needs rather than with earlier donor pushes for industrialization programs. Furthermore, aid is more likely to affect basic development indicators in the short-run, while



economic growth (especially growth that is sustainable over time) requires a multitude of economic, institutional, and developmental factors to fall into place around the same time.

Infant mortality is an exceptionally useful indicator for the the cross-sectional study of aid outcomes. Infant mortality rate is a multi-causal measure of poverty, taking into account income as well as basic needs satisfaction, i.e. quality of public services across different sectors, such as water and sanitation, immunization and maternal services, education, nutrition, and disease. In addition, the data coverage is extensive, and is available for all developing countries in my sample. Infant mortality is measured as the annual rate of infant deaths out of 1,000 births. The data come from the World Development Indicators and are logged.<sup>29</sup>

### **Bypass and Confounders**

Consistent with my analyses of the selection-thesis, I measure aid delivery as the proportion of bilateral aid committed by OECD donor countries to non-state development actors. I expect bypass to have short-term effects on infant health and lag the variable one year. The infant health model includes five control variables. The first control variables are the log of income per capita and economic growth, for which the data are drawn from the Penn World Tables. My second control variable is the prevalence of low-level civil conflict, as measured by Gleditsch et al. I include a logged aid flows per capita measure to ensure that the estimator compares the effect of bypass by comparing countries with similar levels of per capita aid. I control for temporal dependence by including a pretreatment mortality indicator which captures infant mortality rate in 2000. Finally I add regional dummies and a time-trend variable.

### **Identification Strategy**

In the study of aid effectiveness, concerns with selection effects and endogeneity are real. In the previous section I have demonstrated that donor officials can choose

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<sup>29</sup>Data on child mortality, which capture mortality rates of children below five years of age, serve as another dependent variable. The results are robust to alternative specifications of the outcome.

among different development tactics and that their selection is systematic rather than random. In fact, the primary determinant of bypass, recipient governance, is strongly and negatively correlated with child health, thus acting as an important confounder in assessments of the effectiveness of bypass on poverty. Even worse, poverty reduction efforts may attract certain types of aid delivery tools, introducing endogeneity bias.

A common solution to reciprocal causation between aid and poverty outcomes is to recover some random variation in the “treatment variable,” which allows us to causally identify the effect of bypass on poverty. I propose an instrumental variable regression using two different sources of exogenous variation that are identified in the selection model above: First, I use indicators that capture macroeconomic conditions in the donor country based on the understanding that donors increase the efficiency of aid transactions as economic pressure increases: these instruments include economic growth, inflation, and unemployment. The second source of exogenous variation is recipient based: I use a dummy for rotating membership in the U.S. security council based on the understanding that donors will be more likely to deliver aid through the government-to-government channel during the years in which the recipient is member of the security council. Donors’ macroeconomic conditions are clearly external to the recipient country’s development system and are solid predictors of a donor’s propensity to bypass. Rotating membership in the UN Security Council influences donor propensity to bypass but is unlikely to be correlated with poverty outcomes. Diagnostic tests show that the instruments are relevant and valid. I use Sargan’s test for overidentification and Hansen’s J statistic to test whether the instruments as a group are orthogonal to the errors. Durbin-Wu-Hausman tests indicate that the instrumented regressors are in fact endogenous, suggesting that instrumental variable estimation is appropriate. Table 4 reports the F statistic for the excluded instruments in the first stage. Generally, a p-value of  $< 0.1$  is sufficient to avoid weak instrument problems. However, the values never quite meet the rule-of-thumb criterion of  $F=10$ , as they vary between 6 and 8 (with a value of 10 indicating that the instruments are sufficiently strong predictors of the endogenous variable).

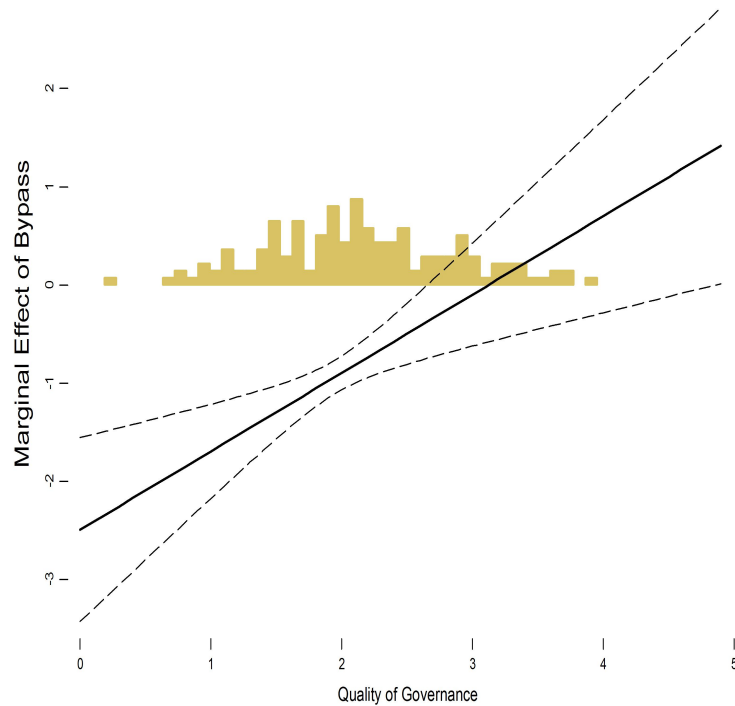
Does aid largely insulated from recipient government intervention reduce infant mortality in poorly governed recipient countries? To test the conditional nature of my hypothesis, the regression includes the critical interaction term, *bypass*\**governance* quality. My theory predicts *bypass* to be effective in countries where the quality of governance is low. I present the results in Table X. The model includes the constituent terms of the interaction individually, with the coefficient of the governance variable being negative and just missing conventional levels of statistical significance. As expected governance by itself is a strong predictor of better infant health.

Table 4: 2SLS Regression: Bypass, Governance and Infant Mortality

<i>Bypass</i>	0.34 (0.21)
<i>Governance, All Inst.</i>	-0.25** (0.07)
<i>Bypass</i> * <i>Governance</i>	0.19* (0.09)
<i>Log(GDP per capita)</i>	-0.02* (0.01)
<i>Civil Conflict</i>	0.122 (0.16)
<i>Log(Aid per capita)</i>	-0.03 (0.02)
<i>Economic Growth</i>	0.114 (0.121)
<i>Pretreatment IMR</i>	0.87** (0.05)
F-stat ( <i>bypass</i> )	7.1
p-value	.00
F-stat ( <i>bypass</i> * <i>governance</i> )	6.8
p-value	.00
Hansen's J	0.35
p-value	.54
N	337
+ $p < 0.10$ , * $p < 0.05$ , ** $p < 0.01$	

To identify the effects of bypass across different levels of governance, I calculate the full range of conditional coefficients and standard errors and graphically illustrate them in Figure 3. The figure graphs the expected marginal change in infant mortality (logged) associated with a two-standard-deviation increase in the proportion of bypass, at various levels of governance. I draw a 90% confidence interval around the conditional coefficients to see whether they are statistically significant. At the lowest levels of governance (below -1.5) as in the Democratic Republic of the Congo or Guinea, bypass decreases infant mortality by a little over 2 percent. This effect decreases to 1.5 percent in countries with governance levels around 1.5, as in Equatorial Guinea, Togo, Belarus, and Ecuador. For aid recipients with governance levels greater than 2.5 bypass, as in Mexico, Mauritania, Maldives, and Fiji, while associated with an increase in infant mortality, becomes statistically insignificant. Overall these findings suggest that bypass behavior reduces absolute poverty levels in the recipient.

Figure 3: Marginal Effect of Bypass on (log) Infant Mortality Rate



## 4. Conclusion

Does aid channeled through non-state development actors cause better infant health in countries at low levels of governance? Based on my tentative findings the answer to this question is: yes. The evidence suggests that there is a positive, statistically significant average causal effect of bypass on infant health in poorly governed countries.

The findings have implications for the study of aid effectiveness as well as donor policy. With regard to the former, I show that modeling donor interests and expectations is key to understanding the selective nature of donor decision-making, and its effects on infant health. In the last few years it has become fashionable to be a critic of aid, and in particular donor aid policy. Most recently, for instance, Moyo (2009) calls for the elimination of all aid flows to Africa. In her view, foreign aid largely serves as cash handouts to the leaders, with detrimental effects for the poor. The limits of such popular brush-stroke critiques become apparent as one takes a closer look at the aid allocation pattern of donors in sub-Saharan Africa. Western aid to sub-Saharan Africa only contains a small portion of budget and program support (which would qualify as cash handouts). If Moyo's advice to cut these types of aid were followed, the aid flows to the region would only modestly decrease. As Figure 1 in Section 1.3 above shows, however, donors channel much of their aid to Sub-Saharan Africa through non-state development actors, bypassing the very leaders that Moyo claims pocket the aid.

Given the complex interactions between donor interests, recipient institutions, and aid success it is important to move away from oversimplifying the nexus between aid flows and outcomes. While foreign aid is no panacea for underdevelopment, it does produce good outcomes, most certainly at the micro-level. To detect effects of aid at the macro-level it is important to test models that explain aid effectiveness by taking into account donor interests, expectations, and delivery mechanisms. I offer such a model in Section 2. In Section 3.1, I show that there is systematic evidence of endogenous aid: donors condition the aid delivery mechanism on the quality of governance in the recipient. Section 3.2 shows evidence that non-state aid is more effective at reducing

infant mortality in countries that are poorly governed.

From a policy perspective, the implication of this paper's findings is straightforward. Donors possess alternate means for increasing aid effectiveness, which are more insulated from threats of failed aid contract enforcement by recipient governments. By increasing the amount of aid delivered through non-state development actors in poorly governed states, donors increase the chance of aid reaching and improving the livelihoods of the poor. While there is evidence of outcome-orientation among donors, Section 3 also shows that room for improvement remains. Aid allocation from several donors, e.g. France and Germany, still remains largely government-to-government and not selective in terms of delivery mechanisms.

More broadly speaking, bypassing recipient government structures can offer immediate relief for the poor but bypass is also a double-edged sword. It might hamper or even undermine long-term efforts to build-up a state capable of managing its own development.<sup>30</sup> Underlying this donor dilemma are differences in the nature of short-term and long-term development assistance. Donors often fund countries where there is need for short-term relief and development. The question of "how many lives can be saved right now" might get answers that are difficult to reconcile with strategies related to long-term development. Should development assistance focus on providing antiviral drugs to people infected with HIV/AIDS or should they invest in setting up health care systems in a sustainable way? Donors often offer a combination of short- and long-term approaches in countries where capacity building is possible. If it is not, then bypassing government might be the only option.

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<sup>30</sup>Recently, the United States government announced a shift in aid policy toward Haiti. To improve the prospect of sustainable development, the U.S. government announced a move away from government bypass and towards state-to-state assistance. As Cheryl Mills, Hillary Clinton's chief of staff suggests: "We are now completely focused on how to build the capacity of the Haitian government effectively, to improve Haiti's long-term developmental prospects. That is something everyone has recognized as being one of the failures of aid in the past." Quote in "In U.S. plan for Haiti, Rebuilding Government is Key." The Washington Post, March 31, 2010.

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## Appendix

Figure A1: US Aid Flows 2008, Channels of Delivery

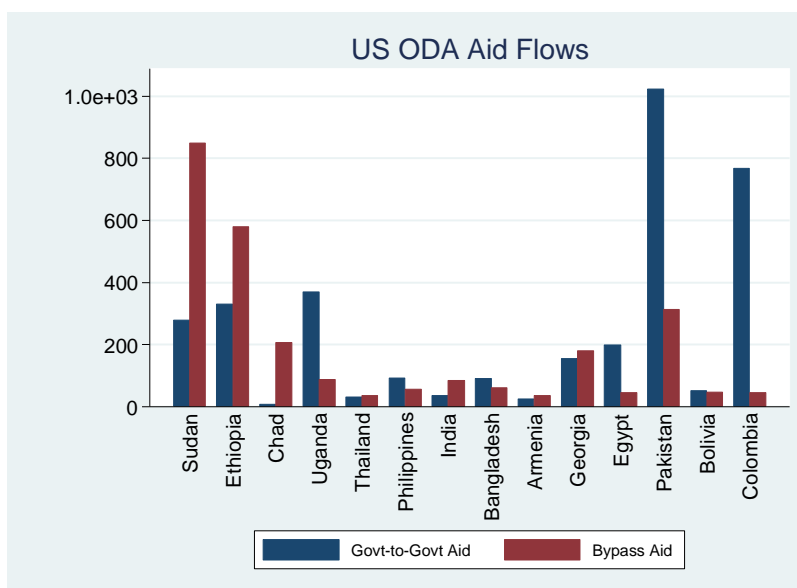


Table A2: Sample Selection Model for Donor Propensity to Bypass, 2005-2009

Outcome stage	Model 5A	Model 6A
	OLS	OLS
	Full sample	w/o 5 major economies
<i>Governance, Ec. Inst</i>	-1.549** (0.20)	-1.154** (0.26)
<i>Democracy</i>	-0.120+ (0.07)	-0.173* (0.08)
<i>Civil Conflict</i>	0.435** (0.12)	0.441** (0.14)
<i>Natural Disaster</i>	0.028 (0.07)	-0.226* (0.09)
<i>Distance</i>	0.829** (0.16)	1.183** (0.21)
<i>Former Colony</i>	0.203 (0.17)	0.291 (0.21)
<i>Trade Intensity</i>	-0.186** (0.05)	-0.252** (0.06)
<i>Security Council</i>	-0.556 (0.35)	-0.673 (0.43)
<i>Terrorism</i>	-0.001 (0.00)	-0.000 (0.00)
<i>Donor Welfare</i>	-0.910** (0.09)	-1.031** (0.10)
<i>Donor Growth</i>	-0.517** (0.08)	-0.347** (0.10)
Constant	161.962 (226.55)	695.030* (279.86)
(next page)		

(Continued)

Table A2: Sample Selection Model for Donor Propensity to Bypass, 2005-2009

Selection stage	Model 5A	Model 6A
<i>Governance, Ec. Inst</i>	-0.658** (0.03)	-0.597** (0.04)
<i>Democracy</i>	0.066** (0.01)	0.070** (0.01)
<i>Civil Conflict</i>	0.276** (0.04)	0.299** (0.05)
<i>Natural Disaster</i>	0.238** (0.01)	0.262** (0.01)
<i>Distance</i>	-0.449** (0.03)	-0.572** (0.03)
<i>Former Colony</i>	0.228** (0.03)	0.195** (0.04)
<i>Trade Intensity</i>	0.028** (0.01)	0.034** (0.01)
<i>Security Council</i>	0.217** (0.08)	0.156+ (0.08)
<i>Terrorism</i>	0.001** (0.00)	0.001** (0.00)
<i>Donor Welfare</i>	0.081** (0.01)	0.216** (0.03)
<i>Donor Growth</i>	-0.029+ (0.02)	0.044* (0.02)
<i>Donor Economy</i>	0.000** (0.00)	0.000** (0.00)
cons	-154.873** (40.06)	-166.921** (44.64)
$\rho$ (est.)	-0.014 (0.05)	-0.136* (0.06)
LR test of indep.	0.08	4.29
$p$	[0.77]	[0.03]
Wald $\chi^2$ (whole model)	3334.158	2210.508
$p$	[0.001]	[0.001]
N (Censored N)	10411 (3683)	8334 (3331)

+ $p < 0.10$ , \* $p < 0.05$ , \*\* $p < 0.01$

*Donor and region dummies, and year trend variable included but not reported*