Can Indicator-Based Competition Make Foreign Aid Work?

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The World Bank
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Questions to the Panel

- Are indicators a good idea for aid allocation?
  - absolutely yes
- Does indicator-based aid create incentives for reform?
  - maybe
- What kind of indicators should be used?
  - will focus mostly on governance indicators, but many points are more broadly applicable

Allocating Aid Based on Indicators – Surely a Good Idea

- aid works in a good policy environment
  - debates over the evidence but let's not forget (i) common sense, and (ii) fungibility, both suggest aid works better in a good environment
- World Bank has been doing this for over 20 years
  - Performance-Based Allocation System (PBA) allocates concessional loans and grants to poor countries based largely on the Bank's own "official" Country Policy and Institutional Assessment (CPIA) ratings
    - extra weight on "governance" components of CPIA
    - Big money is involved, around $10b/year, well over $100b cumulatively from International Development Association (IDA)

Does Indicator-Based Aid Create Incentives for Reforms?

- main rationale for indicator-based aid is to get a more efficient cross-country allocation of aid *conditional on existing policies/institutions*
- but will it *also* trigger reforms?
  - "old-fashioned" conditionality: aid first, reforms later
  - "indicator-based aid": reforms first, aid later
  - if domestic political forces are the main driver of reforms, hard to imagine this small difference in timing will make a big difference in terms of "buying" policy reforms
- an important caveat – the *public advocacy* role of indicators surely is strengthened by their use in aid allocation

Which Indicators To Use?

- Use the right tools for the right jobs
- Be transparent about unavoidable margins of error
- Avoid artificial distinctions:
  - subjective vs. objective
  - actionable vs. actionworthy
- Worry about incentives of indicator producers
- Go beyond indicators of “technocratic” competence

Right Tools for the Job

When you hold a hammer every problem looks like a nail

- Different types of indicators for different purposes
  - “broad” indicators with large cross-country coverage to allocate aid across countries
    - e.g. CPIA, 16 MCC eligibility criteria
  - these are *not* the indicators you want to use to (i) design country reform strategies, or (ii) evaluate the effectiveness of country-level aid programs
  - cross-country indicators are no substitute for
    - local country-level diagnostics
    - carefully designed evaluation strategies built into individual aid projects

Margins of Error

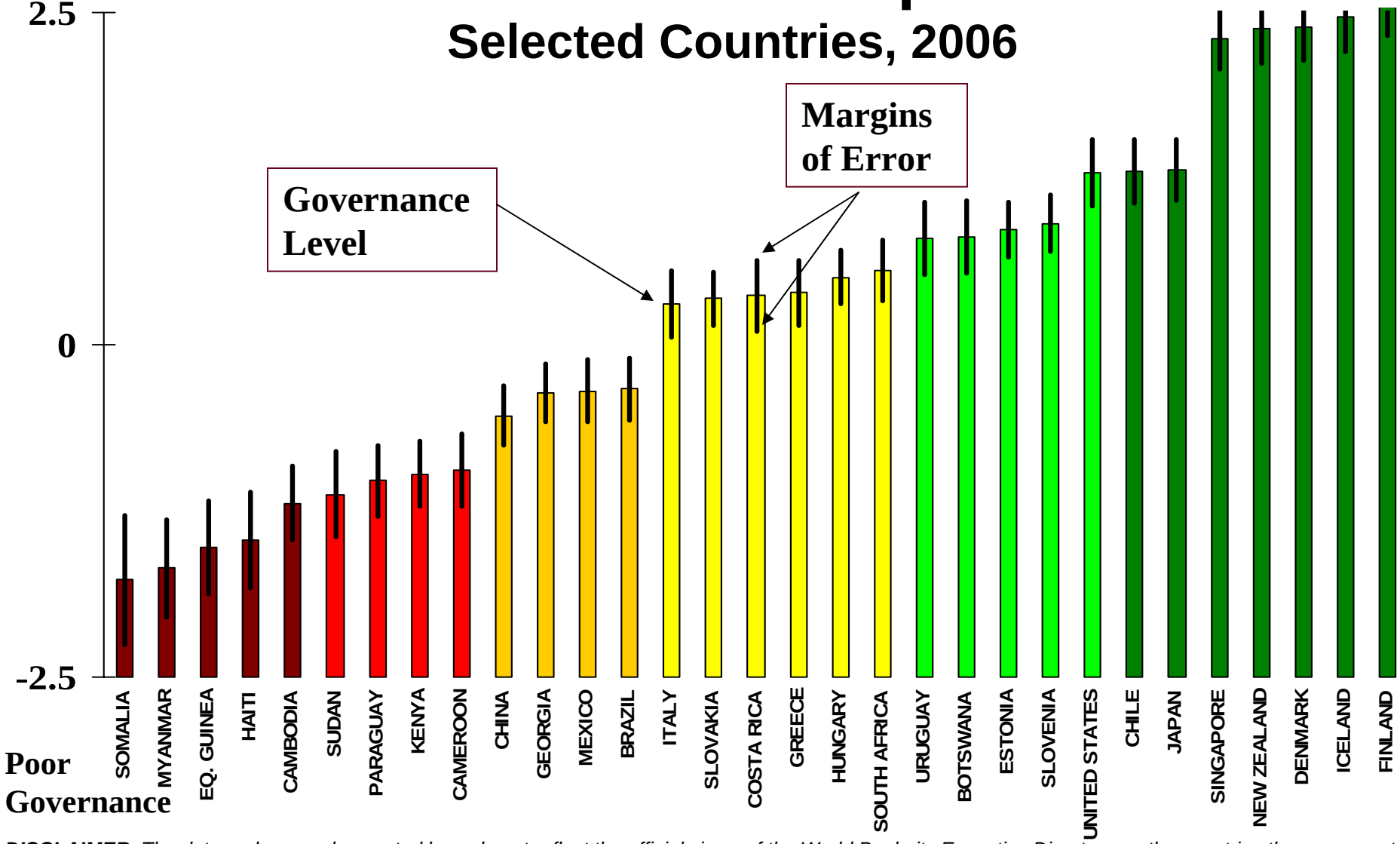
- Most indicators (and especially governance indicators) are proxies for broader concepts:
  - days to start a business -> regulatory environment
  - trust in courts -> rule of law
  - procurement corruption -> overall corruption
- Two types of measurement error in any indicator:
  - is the indicator well measured?
  - is the indicator a good proxy for what we care about?
- Unfortunately margins of error are almost universally ignored – *but they are present and matter when policymakers use indicators to make decisions*
  - Worldwide Governance Indicators are an unusual exception (next slides)

Worldwide Governance Indicators

- Data on six dimensions of governance covering 212 countries over 1996-2006
  - Voice and Accountability; Political Stability and Absence of Violence; Government Effectiveness; Regulatory Quality; Rule of Law; Control of Corruption
- Based on hundreds of underlying indicators taken from 33 different data sources
- Aggregate and individual indicators available at www.govindicators.org, largest publicly-available governance database

Control of Corruption

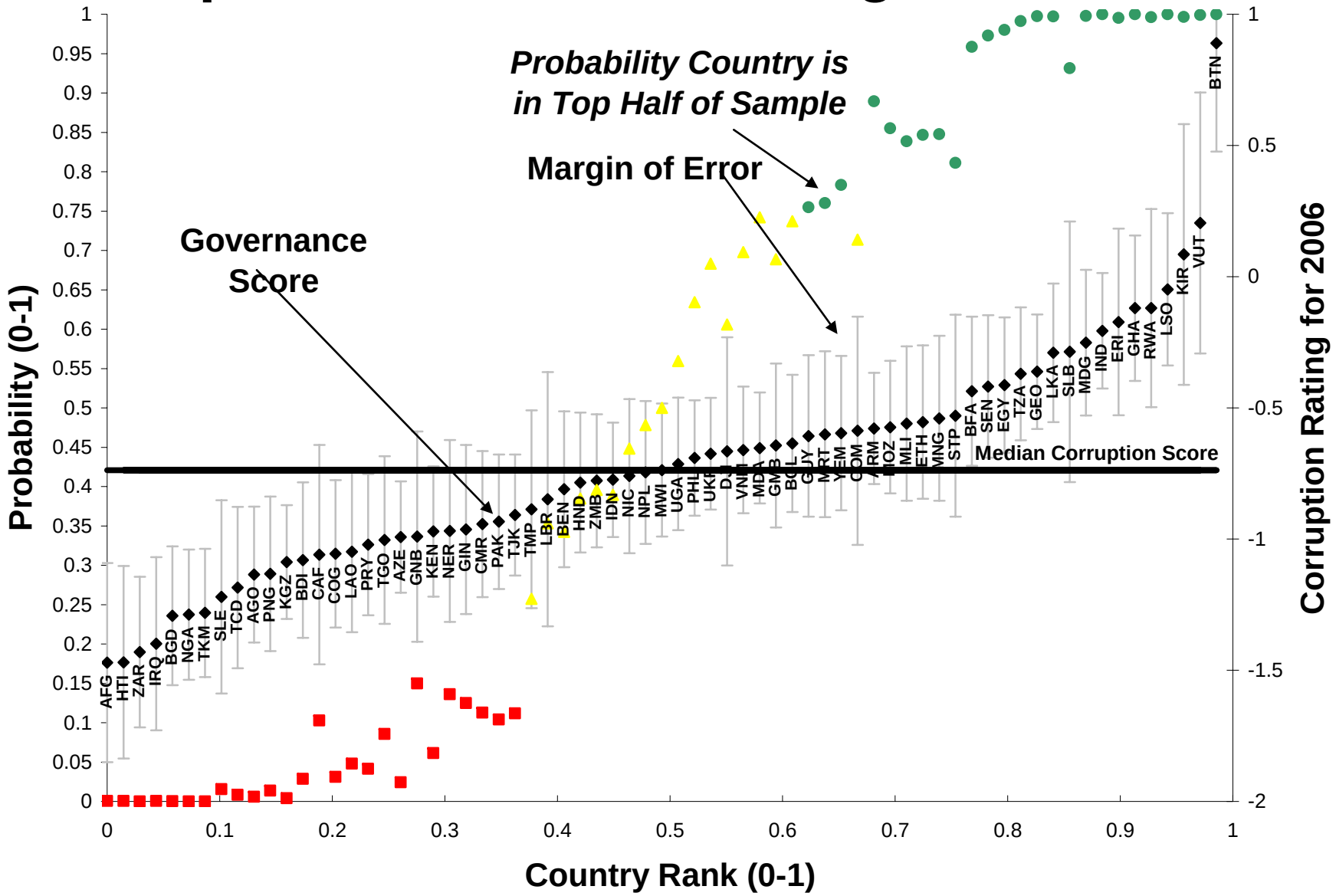
Selected Countries, 2006



***DISCLAIMER**: The data and research reported here do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources or for any other official purpose.*

Source for data: 'Governance Matters VI: Governance Indicators for 1996-2006', by D. Kaufmann, A. Kraay and M. Mastruzzi, June 2007, www.govindicators.org. Colors are assigned according to the following criteria: Dark Red: country is in the bottom 10th percentile rank ('governance crisis'); Light Red: between 10th and 25th percentile rank; Orange: between 25th and 50th percentile rank; Yellow, between 50th and 75th; Light Green between 75th and 90th percentile rank; and Dark Green: between 90th and 100th percentile (exemplary governance). Estimates subject to margins of error.

Margins of Error and MCC Eligibility: Corruption Threshold, 69 Eligible Countries



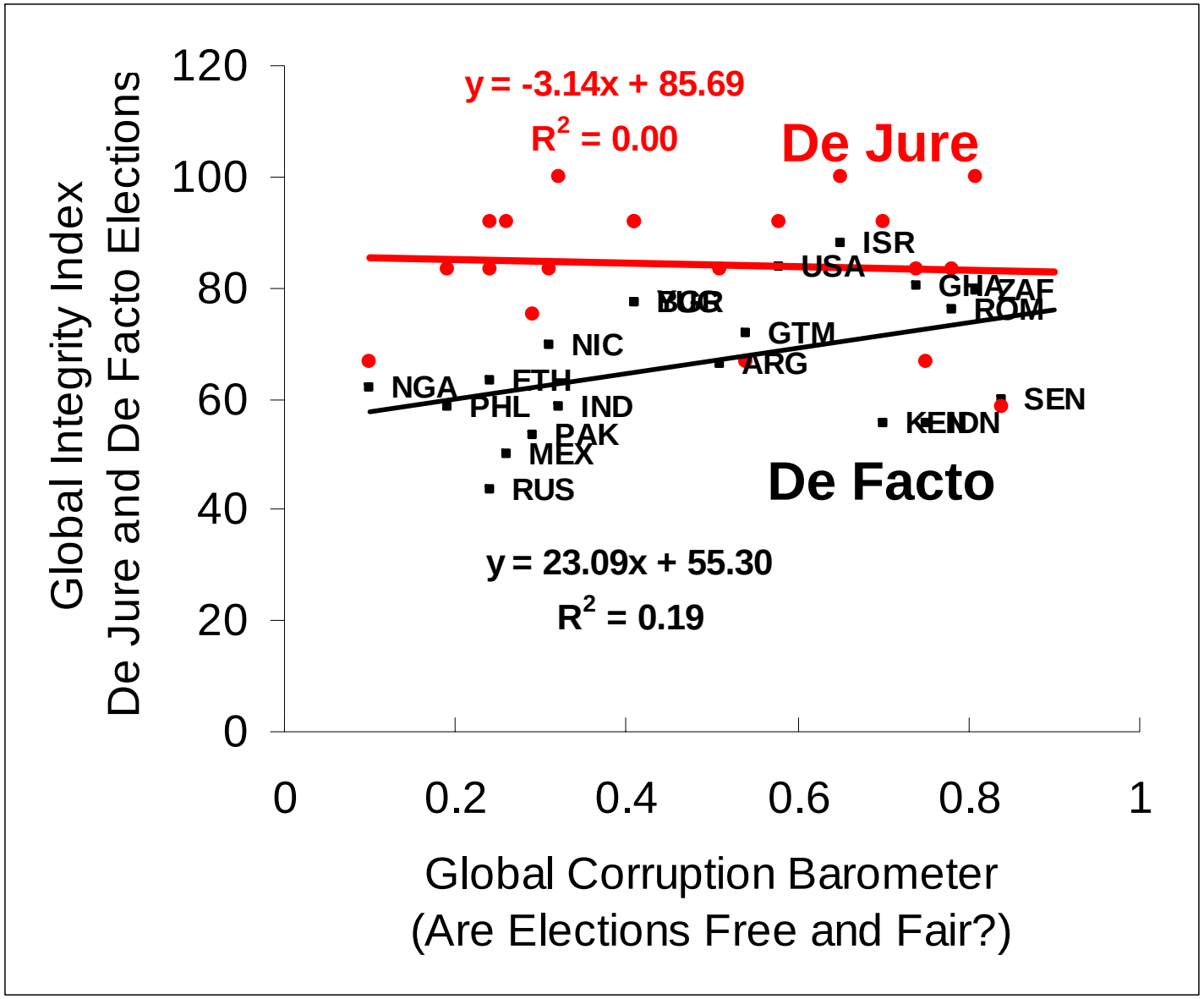
Artificial Distinctions 1: Subjective/Objective

- WB Executive Board and Development Committee called for the World Bank to develop and use "specific, disaggregated and *objective* indicators" to assess governance
  - trouble is, for most part *they don't exist!*
    - or if they do, very limited coverage
  - virtually all measures of governance require subjective judgment (*and this is a good thing!*)
- Think of problem of measuring prevalence of corruption using purely objective data.
  - can measure rules hopefully related to corruption: does ACC exist? is bribery illegal? asset disclosure?
  - can measure outcomes like prosecutions/convictions
  - none are likely to be very good proxies for actual corruption

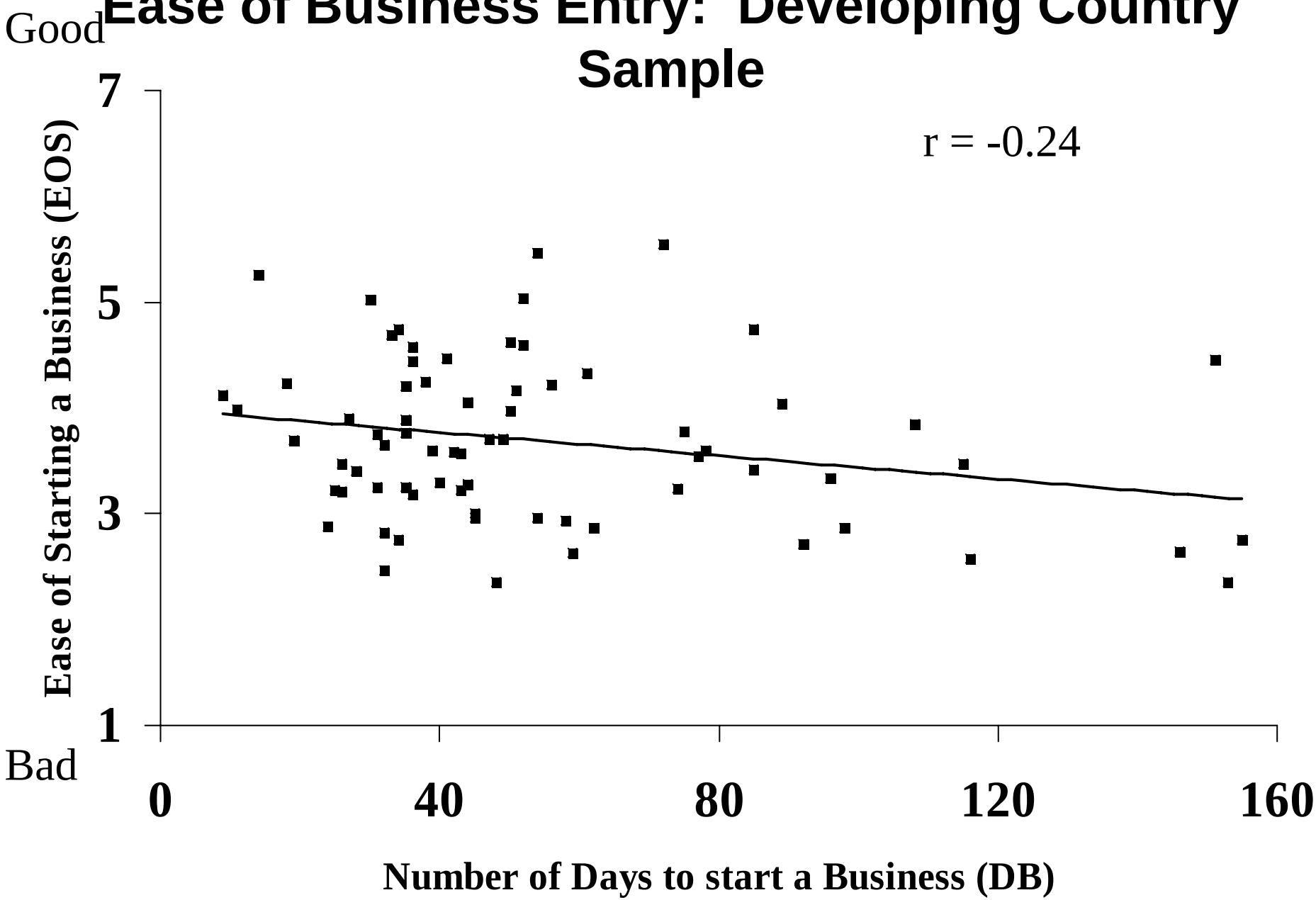
Artificial Distinctions 2: Actionable/Actionworthy

- Latest fad in governance measurement is “actionability”
  - does a governance indicator measure something that is directly under the control of policymakers?
- Obvious appeal, but obvious risk also: are “actionable” indicators also “*actionworthy*”?
  - actionable indicators tend to focus on very disaggregated and specific rules: is there an election monitor? promotion rules for civil servants? details of regulatory environment?
  - often they measure apparently worthwhile inputs
  - but what about links to outcomes?
    - do they matter at all? which matters more?
  - risk of “reform illusion”
- Important to measure broad outcomes in tandem, often subjectively, and try to link to specific policy actions

A Picture Worth a Thousand Words: Alternative Measures of Electoral Integrity



Subjective and Objective Measures of Ease of Business Entry: Developing Country Sample



Incentives of Indicator Producers

- Critics often point to alleged systematic ideological biases in organizations producing governance assessments
  - but actually not much evidence of this (see GMIV)
- Bigger risk is when “the raters” are too close to “the rated”
  - any governance assessment in which governments themselves play a big part in providing data and completing assessments,
    - e.g. Public Expenditure and Financial Accountability Indicators (PEFA), done by donors and govt’s in 70 countries, publicly available only for a handful!
  - CPIA assessments prepared by World Bank staff – could be “too close” to partners in government, risk of incentives for grade inflation
    - MCC gets this “right” by using external indicators
  - trends in indicators when organizations switch from a “pro-” to “anti-” government respondent

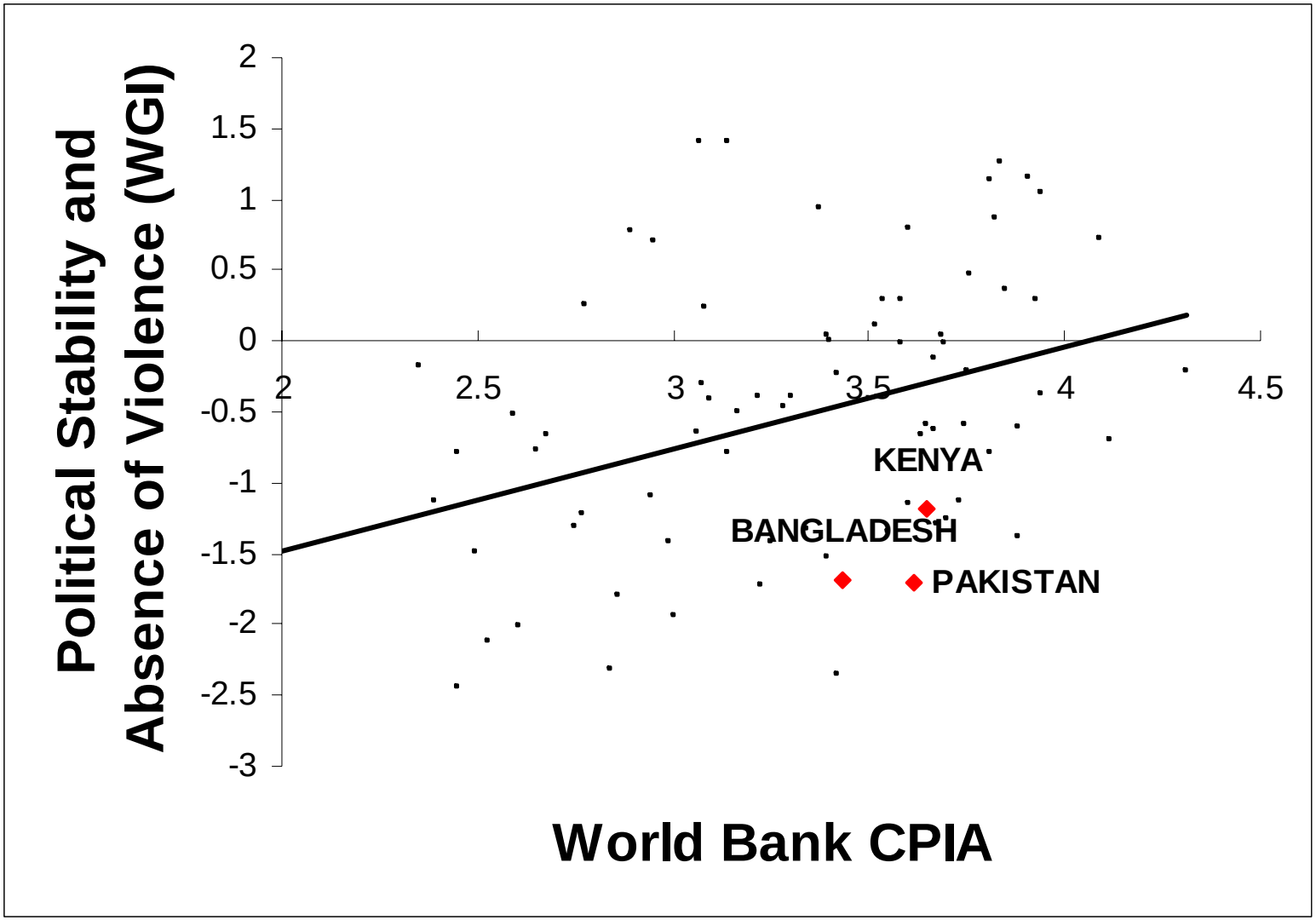
Beyond Technocratic

- Profusion of indicators measuring rich wealth of technocratic details: public debt management, civil service reform, details of judicial and regulatory procedures, etc.

- At same time should not ignore big political risks that can overwhelm all the technocratic details

- Political resistance to such indicators is necessarily stronger – especially in multilateral donors with ‘apolitical’ mandates
  - but is this precisely a sign of their relevance?
  - remember just over a decade ago corruption was considered a ‘political’ issue beyond mandate of WB

Alternative Governance Indicators 2006



Wrapping Up

- Indicator-based aid *allocation* almost surely a good idea
  - but very hard to “fine-tune”
- a “bonus” if it also promotes real, deep, and lasting policy reform
  - but be modest in our expectations of this given spotty history of all forms of conditionality
- principles for (governance) indicators
  - acknowledge margins of error everywhere
  - recognize links from policy inputs to ultimate outcomes of interest are very complex
    - rely on a range of indicators measuring (often subjectively) inputs *and* outputs
  - incentives of indicator producers
  - move beyond technocratic details
  - complementarity of various indicators – no “silver bullets”