Abstract:
World Bank Rules for Aid Allocation:
New Institutional Economics or Moral Hazard?

This paper considers whether the World Bank has adequately justified its metric for distributing international aid to the poor. The International Development Association (IDA) is the part of the Bank that helps the world’s poorest countries, 1.5 billion of whom live on less than the equivalent of US$2 a day. In 2008, the IDA gave official development assistance worth 6689.24 million. It provides basic health services, primary education, clean water and sanitation, environmental protection, business support, infrastructure, and help with institutional reforms. This paper argues, however, that the Bank has failed to justify its claim that this metric gives enough weight to aiding the poor. Although it may turn out that some good justification is available, this paper suggests that there is ground for concern. This is an important conclusion for those who care about international economic justice. For, the World Bank is one of the largest aid donors and similar metrics guide many other development organizations’ aid efforts. Many countries, including the United Kingdom and Canada, also use similar metrics for distributing aid.
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1. Introduction

This paper considers whether the World Bank has adequately justified its metric for distributing international aid to the poor. The International Development Association (IDA) is the part of the Bank that helps the world’s poorest countries, 1.5 billion of whom live on less than the equivalent of US$2 a day. In 2008, the IDA gave official development assistance worth 6689.24 million (OECD, 2010). It provides basic health services, primary education, clean water and sanitation, environmental protection, business support, infrastructure, and help with institutional reforms (IDA, 2009a). This paper argues, however, that the Bank has failed to justify its claim that this metric gives enough weight to aiding the poor. Although it may turn out that some good justification is available, this paper suggests that there is ground for concern. This is an important conclusion for those who care about international economic justice. For, the World Bank is one of the largest aid donors and similar metrics guide many other development organizations’ aid efforts (ADB, 2009). Many countries, including the United Kingdom and Canada, also use similar metrics for distributing aid (Tarp, 2006).

The IDA’s aid allocation system is based largely on the Country Policy and Institutional Assessment (CPIA) index, a measure of "institutional quality" and its governance criteria, in particular (IDA, 2009a). The IDA’s metric also takes into account countries’ gross national product per capita (GNIPC). See the Appendix I for more information on the index.

The next section considers and rejects a few preliminary arguments the Bank gives in defense of its metric. Section 3 considers two different interpretations of what I believe is the IDA’s most promising attempt to justify its metric. First, the Bank may be insisting that aid to countries with good institutions is good for the poor. This section argues that there are a host of conceptual and empirical problems with the evidence the IDA relies on to support of this thesis. Second, the Bank may be insisting that aiding on the basis of poverty alone creates a moral hazard. It may argue, for instance, that if we aid on the basis of poverty alone, we create an incentive for rulers to keep their countries poor. So we should consider institutional quality in aiding poor countries. This paper suggests that one problem with this argument is that assumes the negative incentives aid creates will be efficacious. More generally, the paper suggests, arguments based on incentives require empirical substantiation. Another problem with the Bank’s argument is that even if the negative incentives aid creates are efficacious, we may be required to aid in some circumstances. Finally, even if we should not aid on the basis of poverty alone, it does not follow that we should consider institutional quality in aiding poor countries. Rather, empirical evidence is necessary to support the contention that we would do better to consider institutional quality in aiding poor countries. The requisite evidence is, however, precisely the evidence necessary to support the first interpretation of the Bank’s argument.
This inquiry is important for several reasons. First, it engages in the international debate, initiated by anti-globalization activists, over the World Bank's policies and whether they are poverty-focused enough. The paper comes down strongly on the side of the critics. Second, its arguments may indirectly challenge the relevance of a broad class of economic arguments about public policy. For, it suggests that theoretical arguments invoking potentially problematic incentive effects do not generally provide firm ground for public policy on their own. Third, this inquiry illustrates how philosophers can contribute to a largely neglected area of study. Most work in the philosophy of economics looks at the foundations of game theory and welfare economics. Philosophers have paid very little attention to public and development economics. There are many important questions about development policy that desperately require analytic examination of the sort philosophers are well placed to offer.

2. Moral Framework and Preliminary Arguments

This section considers a few ways the Bank (especially in the IDA 14) has responded to one criticism of its index for aid allocation: Namely, that one of the primary objectives of international development aid should be to help the poor and the IDA has failed to justify its metric in light of this objective. This paper will examine the Bank’s response to this criticism on the assumption that aid’s primary objective should be to help the poor. The Bank might deny that aid’s primary objective should be to help the poor. Its primary aim may just be to foster growth and good institutions. Nevertheless, this paper will suppose that the disagreement is not about the ends of good development but about the best means of achieving this objective. For it would be easy to argue that aid’s primary objective should be to help the poor. A lot of the philosophical work on international development would support this contention (Crocker, 2008; Pogge, 2005; Nussbaum, 2000; Sen, 1999; O’Neill, 1986; Singer, 1973). Further, there is reason to believe the IDA is committed to this objective. The Bank bills itself as an institution deeply concerned about poverty and does not articulate or defend an alternate moral framework (World Bank, 2010; IDA, 2010). The IDA also seems to believe that it is important to give preference to at least poor countries in allocating aid. For, it says GNIPC is supposed to provide a proxy for poverty and the IDA gives less weight to GNIPC as it rises (each increment of income yields less aid) (Kanbar, 2005, 11). Though, even with this weighting, the IDA acknowledges that GNIPC is an aggregate statistic that may not track poverty rates (IDA, 2004a, 6). A country with many poor people and a few very rich people may be richer than a country where everyone fares equally and moderately well.

To defend its use of GNIPC as a proxy for poverty, the IDA originally says a few things. First, it says “statistical studies suggest a high correlation between headcount poverty and per capita income for most countries” and aberrations may “arise from errors in the household surveys, which are in general less reliable than national accounts” implying that scaled GNIPC is better for measuring poverty in at least some respects than the headcount index (which relies on household data) (IDA, 2004a, 6). The IDA also argues that “up-to-date direct poverty measures, such as headcount poverty or poverty gap, are difficult to obtain because they are based on household surveys which..."
are conducted periodically – in some countries at ten-year intervals. Variations in the
determination of the poverty line and in the methodology for poverty assessment also
make the comparison of poverty levels among countries unreliable” (IDA, 2004a, 6).

These responses are not sufficient to support the Bank’s choice of scaled GNIPC as a
proxy for poverty. First, the Bank might decide on a particular way of measuring poverty
and collect more data about poverty rates (e.g. provide funding for better surveys).
Second, if this proves too difficult, there are other widely-available proxies for poverty
that would be better than GNIPC from at least 1980 (UNDP, 2009b). Infant mortality rate
is probably a better proxy for poverty, for instance, since most of the gains on this front
accrue to the poor.

The IDA also considers an equally easy improvement that would certainly not alleviate
the problem with using GNIPC but might help a bit: giving more weight to the poorest
countries in their calculations. The IDA says it does not give more weight to the poorest
countries for a few reasons. First, it says its aid allocation “system is the most poverty
focused among development agencies” (IDA, 2004a, 7) citing David Dollar and Victoria
Levin’s 2004 study “The Increasing Selectivity of Foreign Aid: 1984-2002.” Further, to
ensure that aid helps the poorest countries, the IDA says that it only helps countries with
incomes of less than US$865 per capita (IDA, 2004a, 6).

It is precisely because the IDA only helps countries with incomes of less than US$865
per capita, however, that it does so well in Dollar and Levin’s study. When Dollar and
Levin look at aid only to IDA eligible countries, the IDA is 12th, rather than 1st (out of 80
or so agencies) (Dollar and Levin, 2004, 10). Further, the study basically just looks at
how aid agencies do on the components of the IDA’s formula. So even the authors
acknowledge that “it should not be surprising that the World Bank allocates a lot of
assistance to the countries that it ranks highly in its annual CPIA rating exercise” (Dollar
and Levin, 2004, 11). Further, Dollar and Levin specify that they mean by “poverty-
focused,” aid that is focused on the log of GDP per capital (Dollar and Levin, 2004, 6).
So, this fact cannot count as a justification for using (scaled) national income as a
measure of poverty!

Perhaps the IDA could argue that its system is the most poverty focused on a better
measure of poverty. For, its allocation rule suggests giving aid in a way that is highly
correlated with the amount of poverty in developing countries. Although I have not seen
any reports by the Bank addressing this issue, this seems to be the case. Looking at a
sample of 35 countries for which data was easily available, it is clear that estimated
disbursements according to the IDA allocation rule would be highly correlated with
poverty rates (as well as child mortality, malnutrition, lack of primary education, and
adult illiteracy rates).
In fact, disbursments according to the allocation rule would be much more highly correlated with poverty and so forth than actual IDA allocations or official development assistance (ODA) in general.

It is not clear, however, that the correlation between poverty (etc.) and disbursments according the IDA’s allocation rule can justify the rule. Even if aid from the IDA is the most highly correlated with poverty, it may not be poverty focused enough. Another way of giving aid may reduce poverty more. Taking into account the incentives aid creates, it may be best to give aid in the way the IDA does. The next section will consider a few arguments along this line.

4. The Bank’s Most Promising Argument

What may be the IDA’s most promising argument is that “increasing the poverty weight in the allocation among the poor countries would de facto reduce the weight put on the quality of policies and institutions. Management is of the view that this would lead to less effectiveness in fighting poverty” (IDA, 2004a, 7). There are a few ways of understanding this claim.

The first way of understanding the claim that increasing the weight given to poorer countries in the formula will reduce aid’s effectiveness in ameliorating poverty is as a gesture towards existing empirical evidence. The second way of understanding the claim that increasing the weight given to poorer countries in the formula will reduce aid’s effectiveness in ameliorating poverty is as an appeal to the moral hazard argument: If we aid on the basis of poverty alone, we create incentives for rulers to keep their countries poor. So we should aid in other ways (support good institutions or whatnot).
should aid in other ways (support good institutions or whatnot). The next sub-section (a) considers the empirical evidence, the subsequent sub-section (b) considers the moral hazard argument.

(a) The Empirical Evidence and Critique

There is some reason to interpret the claim that increasing the weight given to poorer countries in the IDA’s formula will reduce aid’s effectiveness in ameliorating poverty as a gesture towards an existing body of empirical evidence. For, after making this claim, the IDA goes on to say:

One research paper has estimated the allocation of aid that would have the maximum effect on poverty, under a certain set of assumptions. This ‘poverty efficient’ allocation actually rises with per capita GNI up to a level of about $800, because of the fore-mentioned increasing need for public investment and increasing ability to absorb aid. However, to implement this ‘poverty efficient’ allocation would require a complex formula. Still, it makes the useful point that the ability to absorb aid productively increases as GNI rises from an extremely low level. Beyond a certain level of per capita GNI, countries can turn to private markets and their own savings. The IDA approach roughly fits this pattern, with little distinction based on per capita GNI among the poorest countries, and then graduation to IBRD beyond a similar income level (currently $865) ((IDA, 2004a, 7) citing (Collier and Dollar, 2002)).

It is not clear that the Bank would do well to rely on this study, in particular. To estimate the ‘poverty efficient’ allocation Paul Collier and David Dollar assume that growth will reduce poverty by a certain amount and that there is a set budget for reducing poverty. Neither of these claims is well justified. They simply assume, for instance, that the effect of aid is distributionally neutral and then adopt an estimate for the poverty elasticity of growth given mean income based on just a few research papers (Collier and Dollar, 2002, 17-18).

Presumably, however, the Bank would not rest its case on one study. So, perhaps the Bank is making a vague gesture towards a large body of empirical evidence (Burnside & Dollar, 2000; Burnside & Dollar, 2004; Dollar & Levin, 2004; Collier & Dollar, 2002). The Collier and Dollar study they cite extends the Craig Burnside and Dollar results that received a lot of attention in development circles (Burnside & Dollar, 2000; Burnside & Dollar, 2004). Further, the IDA says there is “broad consensus that among low-income countries, large-scale financial aid has more impact in an environment of sound institutions and policies” (IDA, 2004a, 6). They suggest that this is why the CPIA is “the dominant factor” in the formula (IDA, 2004a, 6).

Consider the empirical evidence that is supposed to support the Bank’s argument. Perhaps the seminal article on the topic is “Aid, Policies, and Growth” (first put out as a working paper in 1997) by Burnside and Dollar. This paper argues that aid works only in
countries with “good policy” using a measure of policy that contains budget surplus, trade openness and inflation weighted by their correlation with growth rates (Burnside & Dollar, 2000). Collier and Dollar (2002) and Burnside and Dollar (2004) extended this work using other measures of institutional quality including the CPIA index. This research was also picked up by the World Bank report Assessing Aid edited by Dollar and Prichett (1998) and Collier and Dollar have taken on leadership roles within the Bank’s research department greatly influencing public opinion and probably economic policy (Easterly, 2009).

Unfortunately, the Burnside and Dollar study has been roundly criticized and its successors suffer from many of the same problems (Lensink & White, 1999; Dalgaard & Hansen, 2000; Dalgaard, Hansen, & Tarp, 2004). These problems undermine the evidence that distributing aid to countries on the basis of CPIA ratings is an effective way to increase growth rates. Many researchers have had trouble replicating the results in Burnside and Dollar’s study and its successors (Lensink & White, 1999; Lu & Ram, 2001). The results are at least quite fragile, they depend greatly on the particular theoretical assumptions (model specification) and data used (Lu & Ram, 2001; Dalgaard & Hansen, 2000). The measures of institutional quality used may well be endogenous and aid may not have a linear relationship to growth (though the studies suppose otherwise) (Deaton, 2009; Dalgaard & Hansen, 2000; Arndt, Jones & Tarp, 2009). Some of the studies depend on a few crucial (country and year) observations (Easterly et. al., 2004). Some suggest that good institutions are not a precondition for aid to work, though good institutions increase growth (Dalgaard & Hansen, 2000). Some researchers argue that other features of countries besides their institutional quality may explain why aid works in some places but not others (Dalgaard, Hansen, & Tarp, 2004) Some even find that good institutions may hinder aid’s effectiveness (Dalgaard & Hansen, 2000).

Both Burnside and Dollar (2004) and Dollar and Levin (2004) try to defend the evidence in favor of aiding countries with good institutions. They point out that, “common to many of these criticisms is a change in specification, either in terms of estimation technique, or in terms of which variables are included in the regression that explains growth” (Dollar & Levin, 2004, 2; Burnside & Dollar, 2004, 6). But the complaint about their studies was precisely that they use the wrong theoretical specification. As to data sources, Dollar and Levin admit that it was for a long time literally impossible for other researchers to access their data. So the most other researchers could do was show that the evidence in favor of aiding countries with good institutions was not robust. (What Dollar et. al. do not mention is that this is because the Bank’s research department, in which Dollar and Collier have both taken leadership positions, had not released it.) Furthermore, even when researchers were eventually given access to the original data, they were unable to replicate the results (Dalgaard & Hansen, 2001). So there is little reason to believe these studies’ conclusions (Dollar & Levin, 2004, 7).

An equally important critique, however, is that the main studies supporting Burnside and Dollar’s results use GDP per capita as a measure of poverty. So they do not support the Bank’s claim that it gives enough weight to poverty (as opposed to national income) in its metric. If the Bank wants to establish that it is helping poor people (or even poor
countries) enough, these studies are of little use. At best there is a large gap between the studies’ results and the Bank’s justification for the weight it gives to the components of its index.\textsuperscript{xvii}

Perhaps the Bank can appeal to the much more general and extensive evidence that good institutions are good for growth (Rodrik et. al. 2002.; Acemoglu et. al., 2001).\textsuperscript{xviii} They might endorse a simple story about the causes of development - that domestic institutional quality accounts for most, if not all, of the success in development.\textsuperscript{xix} Mathias Risse says, for instance, that the evidence suggests that:

\begin{quote}
Growth and prosperity depend on the quality of institutions, such as stable property rights, rule of law, bureaucratic capacity, appropriate regulatory structures to curtail at least the worst forms of fraud, anti-competitive behavior, and graft, quality and independence of courts, but also cohesiveness of society, existence of trust and social cooperation, and thus overall quality of civil society.\textsuperscript{xx}
\end{quote}

If the institutionalist thesis is correct, it may support the IDA’s formula for distributing aid. For, if institutions are the primary determinant of development, there may be reason to ensure that countries have good institutions before giving them aid. Without these institutions, aid may not really impact development.\textsuperscript{xxi}

There are several problems with this suggestion. First, the evidence that good institutions are good for poverty reduction may have some problems (Rodrik, 2004; Easterly et. al., 2003). Even if it is correct, however, further evidence is necessary establish that aiding countries with good institutions will contribute to good institutions that ameliorate poverty. Some causes of institutional improvement may not contribute to poverty relief. Alternately, aid may not improve or even corrupt good institutions.\textsuperscript{xxii} Risse says, for instance, that “the sources of wealth rest in [domestic] institutional quality… While foreigners can destroy institutions, they can often do little to help build them.”\textsuperscript{xxiii} The general form of argument -- x reduces poverty so we should give to countries with x – is not a good one. Even if it were, there are a significant number of studies arguing that many other things besides good institutions contribute to poverty reduction.\textsuperscript{xxiv} So, the Bank might do better to target aid in other ways.\textsuperscript{xxv}

\begin{quote}
(b) The Moral Hazard Argument and Critique
\end{quote}

Recall the second way of understanding the IDA’s claim that increasing the weight given to poorer countries in the formula will reduce aid’s effectiveness in ameliorating poverty: The moral hazard argument. The Bank might suggest that if we give to countries that are poor, simply because they are poor, we create an incentive for their rulers to keep them poor. For, their (often bad) rulers can extract more rents from aid by keeping their countries poor. So, we should instead give to poor countries that have good policies.

It is important to be clear here that the claim underling the moral hazard argument is not that if we aid on the basis of poverty alone, rulers \textit{will} keep their countries poor. The
claim is that if we aid on the basis of poverty alone, we create an *incentive* for rulers to keep their countries poor. An incentive, at least as most economists use the term, just provides a reason for action. An incentive is like a reward or penalty. Rewards or penalties may or may not be efficacious. Sometimes incentives do not work. Nevertheless, many incentives have motivational force. The version of the moral hazard argument above says that if we aid on the basis of poverty alone, we give rulers a reason to keep their countries poor - they can get more aid. So we should not just give to poor countries, we should consider the quality of their institutions.

There are many different version of the moral hazard argument that posit different mechanisms by which giving aid on the basis of poverty alone creates potentially counter-productive incentives. The IDA seems to embrace a different version of the moral hazard argument, for instance, when it says: “While it is natural to focus on how the allocation formula distributes aid across poor countries, it should be kept in mind that it also affects how poor countries are treated over time. The negative coefficient on per capita GNI is essentially a tax on growth” (IDA, 2004a, 7).

Nevertheless, this paper will consider the version of the moral hazard argument sketched above. For, the problem with the moral hazard argument is quite general – empirical evidence is necessary to support most claims about incentives. Further, the requisite evidence to support the above version of the moral hazard argument is the (woefully inadequate) evidence examined in the previous section.

Recall the version of the moral hazard argument at issue: If we give to countries that are poor, simply because they are poor, we create an incentive for their rulers to keep them poor. For, their (often bad) rulers can extract more rents from aid by keeping their countries poor. So we should not aid on the basis of poverty alone. We should, instead, give to poor countries that have good policies.

Consider an analogy that illustrates the problem with this argument -- a variation of philosopher Peter Singer’s famous pond case. Suppose that, on your way to work, you see a small child is drowning in a pond. You can save the child by a process that involves giving the child’s mother one hundred dollars. Even though it will cost you something to do so, if no one else can help the child and the child will otherwise drown, it is clear that you should save the child. Some have pointed out that if you save the child, you create incentives for mothers of small children to throw their children into ponds. For, a similar process might allow other mothers to get a hundred dollars from you to save their children. The proper reply to this kind of case is “so what!” That is a silly objection. There is no reason to think other mothers will throw their children into ponds for one hundred dollars. Sometimes, we should (simply) aim to ameliorate poverty even if we create bad incentives in the process.

Even the moral hazard argument may not always be silly. In some cases there may be reason to think many mothers will throw their children in ponds (or do other things to harm their children) if we create incentives for them to do so. After all, some parents probably do maim their children so as to make them better beggars. It is less clear that
this is because people will help those who are maimed. Some mothers might maim their children only because they do not have a better means for helping their families survive.

In general, however, the claim that we should not create incentives for some to keep others in poverty requires defense. Consider an expansion of the (first part of the relevant version of) the moral hazard argument:

P1) If we give to countries that are poor, simply because they are poor, we create an incentive for their rulers to keep them poor. For, their (often bad) rulers can extract more rents from aid by keeping their countries poor.

P2) We should not create an incentive for rulers to keep their countries poor if we are concerned about poverty reduction.

C) We should not aid on the basis of poverty alone, we should instead give to poor countries that have good policies.

The complaint is that we need some reason to accept the second premise, for it is not always true. Bad rulers may not act on the incentive aid creates for them to seek rents and perpetuate bad institutions. Giving to countries with good institutions may not decrease rent-seeking or spur poverty reduction. (Though, this paper will also suggest that the move from the second premise of the moral hazard argument to the conclusion that we should take institutional quality into account requires defense.)

More generally, we may be wrong about any posited incentive effect. Other incentive effects may be present and counter the posited effect or the posited effect may fail to materialize. Consider an example from a different domain. Many people believe that decreasing what people are paid gives them an incentive to work less hard. Few seem to recognize, however, that decreasing what people are paid also gives them an incentive to work harder (to make up for lost income). If some people do not work for money, decreasing what they are paid may not influence their behavior at all.

Pointing to the existence of an incentive effect might give us reason to consider (empirically) whether or not the incentive will be efficacious, but then again it might not. Especially when we think the inquiry a waste of time because the incentive is not likely to be efficacious, there is little reason to alter our behavior to accommodate the incentive effect. The point here is that, though we may have reason to worry that giving aid on the basis of poverty alone will exacerbate poverty, the moral hazard argument does not always give us reason to worry. (We may worry because there are often reports of bad governments stealing aid to the detriment of their people etc.)

Another problem with many versions of the moral hazard argument is this: Even if aiding on the basis of poverty alone creates some efficacious incentives for poor rulers to keep their countries poor, we may still be required to aid in some circumstances. Suppose that some countries will not escape poverty on their own and aid may do them very little good. Their leaders may keep them poor in order to receive more aid. Suppose, further,
that there is no other way to aid. It may, for instance, be impossible to tell which countries will continue to support themselves after receiving aid and which will remain poor. Further, there may be very few countries that will remain poor and many that will escape poverty permanently. In this kind of case, it is not clearly acceptable to stop giving aid. Aid may be required even if aid creates some efficacious incentives for some rulers to keep their countries poor.

Nevertheless, there may be something important underlying the moral hazard argument. So, consider just one revised version of this argument that avoids the problems outlined above: Giving on the basis of poverty alone creates an efficacious incentive for rulers to keep their countries poor. So when we justifiably have some concern for how much poverty we alleviate (etc.), other criteria should enter into our decisions about how to aid.\textsuperscript{xviii} This argument is much more promising than the original moral hazard argument because it appeals only to efficacious incentive effects. Further, it does not rely on the controversial claim that we need never aid desperately poor countries when some will remain poor because of the incentives aid creates.

Even the revised version of the moral hazard argument gives nothing like the kind of justification necessary for the IDA’s formula for distributing aid. For the revised version of the moral-hazard argument to be well-justified, the premise that aiding on the basis of poverty alone creates an efficacious incentive for rulers to keep their countries poor requires defense. (Though there may, of course, be other arguments that make use of something like moral hazard as well.)\textsuperscript{xxix}

Finally, even if some of the negative incentives aid creates do drive behavior, what we should do about that is still an open question. Even if giving aid to poor countries creates an efficacious incentive for their rulers to keep them poor and concern with how much poverty we alleviate (etc.) is justified, it does not follow that we should give to those countries with good policies. For it is possible that giving to countries with good institutional quality would be no better or even worse for the poor than giving on the basis of poverty alone. Rather that claim depends precisely on the evidence for the conclusion that it is best to aid to countries with good institutions criticized above.

5. Conclusion

This paper argued that the World Bank has failed to adequately justify its metric for distributing international aid to the poor. At best the moral hazard argument provides reason for empirical inquiry but it cannot, on its own, justify the IDA’s aid allocation formula. The requisite empirical evidence is lacking. This is not to say the Bank’s metric is unjustifiable. At least as long as the Bank remains committed to using aid primarily to relieve poverty, however, it must do more to justify its metric for aid allocation.

In arguing that the Bank has failed to justify its metric for distributing international aid to the poor, this paper illustrated how philosophers can contribute to a largely neglected area of study. Most work in the philosophy of economics looks at the foundations of game theory and welfare economics. Philosophers have paid very little attention to public and
development economics. There are many important policy arguments that desperately require analytic examination of the sort philosophers are well placed to offer.

In any case, the fact that the World Bank has failed to adequately justify its metric for distributing international aid to the poor is incredibly important. For, the World Bank is one of the largest aid donors and similar metrics guide many countries’ and development organizations’ aid efforts.

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Appendix I:

The IDA’s Formula for Aid Allocation and the CPIA Index

Very roughly, the IDA’s Formula for Aid Allocation is this:

\[ f(\text{PR}^{2.0}, \text{GNIPC}^{-0.125}) \]

GNIPC stands for Gross National Product Per Capita. The IDA gives less weight to GNIPC as it rises so that each increment of income yields less aid (Kanbur, 2005, 11).

PR stands for Performance Rating and the Country Policy and Institutional Assessment index (CPIA) index makes up 80% of the PR. The Annual Review of Portfolio Performance (ARPP), the Bank’s rating of projects in a country, makes up the remaining 20%.

This sum is then scaled by a measure of countries’ governance quality. This measure is taken from the six governance criteria in the CPIA and one in the ARPP (weighted equally, divided by 3.5 and raised to the power of 1.5). In effect, governance gets a lot of weight in the formula. There are also many exceptions.

Although the exact formula changes over time, the IDA14 formula was:

\[
\text{Allocation Country } i \text{ (3-year)} = \text{SDR3.3 million} + \text{Performance-Based Allocation } i \\
\text{(PBA } i) \\
\text{where:} \\
(\text{IDA rating } i)^2 \times \text{Population } i \times (\text{GNI/cap } i)^{-0.125}
\]
The CPIA index is based on a questionnaire filled out by World Bank personnel. It contains 16 indicators in four equally weighted groups – structural policies, economic management, public management and institutions, and social inclusion/equity policies. CPIA scores for each criteria are between 1 (low) and 6 (high).

To come up with the ratings, evaluators rate a small number of countries in each region and provide narrative guidelines to country staff who then rate countries on each criterion. The scores are modified by the chief economists in the region. Sector experts review the new scores, and modifications are reviewed by the chief economists again. An arbitration panel resolves disputes. Below are the CPIA Index Rating Categories.

A. Economic management
1. Monetary and exchange rate policy
2. Fiscal policy
3. Debt policy

B. Structural policies
4. Trade
5. Financial sector
6. Business environment

C. Policies for social inclusion
7. Gender
8. Equity of public resource use
9. Building human resources
10. Social protection and labour
11. Policies and institutions for environmental sustainability

D. Public sector management and institutions
12. Property rights and rule-based governance
13. Quality of budgetary and financial management
14. Efficiency and equity of revenue mobilisation
15. Quality of public administration
16. Transparency, accountability and corruption in the public sector

The country allocation norm is subject to a maximum of $20 per capita per annum. (IDA, 2004b).
Here is some further information about CPIA “governance criteria” which receive a good deal of weight in WB analysis of countries’ institutional quality:

1. Property rights and rules-based governance: a good score requires, inter alia, that property rights be protected in "practice as well as theory"; laws and regulations affecting businesses are "transparent and uniformly applied"; obtaining licences is a small share of the cost of doing business; police force functions well and is accountable.

2. Quality of budgetary and financial management: assesses extent to which budget is linked to policy priorities in national strategies; effective financial management; timely and accurate fiscal reporting; and clear and balanced assignment of expenditures and revenues to each level of government.

3. Efficiency of revenue mobilisation: a good score requires that "bulk of revenues" be generated from "low-distortion" taxes such as sales/VAT, property, etc.; low import tariffs; tax base is free from arbitrary exemptions.

4. Quality of public administration: assesses "policy coordination and responsiveness, service delivery and operational efficiency, merit and ethics, and pay adequacy and management of the wage bill".

5. Transparency, accountability and corruption: a good score requires accountability reinforced by audits, inspections and adverse publicity for performance failures; an independent, impartial judiciary; conflict of interest and ethics rules for public servants.
Appendix II Correlation Between CPIA and Other Indexes
Unlike other “aid” ODA does not include military aid. Rather ODA primarily includes grants and loans to developing countries “which are: (a) undertaken by the official sector; (b) with promotion of economic development and welfare as the main objective; (c)
at concessional financial terms [if a loan, having a Grant Element (q.v.) of at least 25 per cent”
http://www.oecd.org/glossary/0,3414,en_2649_33721_1965693_1_1_1_1,00.html

ii The IDA makes this claim in the IDA 14 and this paper considers the defense it offers in this document although subsequent notes deal with other arguments that the Bank has offered and might use in defense of this point (IDA, 2007a; IDA, 2007b).

iii Over time the CPIA has changed slightly. It used to contain 20 indicators, for instance (Kanbur, 2005). Other changes to the formula include the fact that capital account convertability and privatization are no longer included in the guidelines for good policy (Minson, 2007).

iv There are, of course, some exceptions. See, for instance: (Brock, 2009; Wenar, 2008; Author, With-held). For discussion of philosophical work in the public economics literature see, for instance: (Subramanian, 2002).

v For examples, see: Ibid. More generally, I believe that many of the international institutions’ arguments are like this one in relying essentially on inadequately articulated and defended moral principles as well as empirical evidence and greatly impacting many individuals’ lives.

vi See, for instance: (Minson, 2007).

vii The Bank says: “Our mission is to fight poverty with passion and professionalism for lasting results and to help people help themselves and their environment by providing resources, sharing knowledge, building capacity and forging partnerships in the public and private sectors” (World Bank, 2010). The IDA website says: “The International Development Association (IDA) is the part of the World Bank that helps the world’s poorest countries” (IDA, 2010).

viii One response this paper will not consider at length is that it is by including the PR in its metric, the IDA it is able to account for the needs of the poor. After all, the PR looks at how countries perform on many criteria. For, this paper’s basic criticism should go through as there is little reason to think that this metric gives the right amount of weight to the needs of the poor. Few of the CPIA’s indicators, for instance, consider poverty at all. In the African Development Bank’s version of the metric, only two out of eleven indicators do so explicitly. They consider the poor in looking at the quality of financial and budgetary management and whether there is equity of public resource use but not even these indicators are primarily focused on how countries’ policies actually impact poor people (the first only looks at whether poverty reduction policies receive budgetary support, the second looks at whether countries monitor poverty levels and expenditures align with poverty reduction goals (ADB, 2009). Finally, the IEG’s report which attempts to argue that the CPIA does track the determinants of poverty via a literature review (besides being terribly sketchy and unconvincing), has this same problem (IEG, 2009, esp. 24-27). It falsely asserts that inequality neutral growth will reduce poverty to defend measuring growth as a proxy for poverty (IEG, 2009, 24). Inequality can remain stable or even decline if the poor get poorer as long as the middle class gains more than the poor lose.

ix More interestingly, almost all selectivity falls out of the sample once this change is made, though bilateral aid seems to take policy into account (Dollar and Levin, 2004, 10).

x What is surprising is that, even the Bank’s Independent Evaluation Group only looked at how components of the IDA’s metric correlated with similar metrics (see Appendix II)), though it did try to make the case that the index was responsive to the needs of the poor. See ft. nt. Xi for discussion.

xi Author’s calculations using the 2004 IDA disbursement formula and looking just at the subset of countries for which data was available from the following sources: (OECD, 2010; Baluch, 2004; Human Development Report, 2010).

xii Similarly, the fact that it only helps the poorest countries does not tell us whether or not it is sensitive enough to differences amongst these countries (Kanbur, 2005).

xiii The IDA also says the weight they give to need accords with donor preferences. It should become clear in what follows that, if this fact is not irrelevant, its link with something of significance requires defense. The IDA would have to argue, for instance, that if they changed the weighting they would do less good for the poor because donors would decrease the amount of aid they give.

xiv Since countries that maintain high enough growth rates tend to “graduate” from aid programs, it should not be surprising to find a negative correlation between aid and growth rates (Tarp, 2006). It would be more interesting if aid to countries with good policies were correlated with growth, though it would be a bit difficult to interpret the significance of this result.
xv Studies looking at the CPIA index are the most relevant since that is the index used in the IDA’s formula for distributing aid. But there are many problems with this and the other measures of institutional quality researchers use. Perhaps studies showing that distributing aid to countries on the basis of CPIA ratings is an effective way to increase growth rates would provide reason to distribute aid in this way. Even so, they would not support the Bank’s argument that institutional quality is the primary determinant of development. The problem is that the CPIA only measures investors’ perceptions of institutional quality. Recall that the CPIA index is based on a questionnaire filled out by World Bank personnel. So domestic institutional quality just ends up being a way of talking about the opinions of foreign investors about what constitutes a good investment climate. In any case, the CPIA might be appropriate for arguing that investor’s opinions are correlated with development. It is not clearly helpful for establishing that aid to countries with good institutional quality will be better for the poor. One could argue that World Bank personnel are good judges of institutional quality; that they are experts at measuring what matters for increasing growth and reducing poverty: a culture of trust, a reliable legal system, strong property rights etc. It is not clear, however, that foreign investors can reliably judge domestic institutional quality.

There are both theoretical and empirical reasons to question this claim. World Bank personnel’s judgments may be influenced by other features of the economic environment besides institutional quality. They may even have an ideological bias that encourages them to judge institutional quality well when, for instance, a country is abiding by the World Bank’s proscriptions. Alternately, some argue that they give undue weight to certain institutional features (e.g. they may be unduly concerned about whether or not a country has embraced free market policies even if these do not ameliorate poverty). There is even some empirical evidence that the CPIA ratings may really be tracking growth rates rather than institutional quality (Dalgaard, Hansen, & Tarp, 2004; Dalgaard, Hansen, & Tarp, 2004, F210). In light of worries like these, researchers should provide the requisite empirical evidence to support the contention that the investors’ judgments of institutional quality map on to anything other than potential growth rates. It may even be the case that countries grow because investors report positively on countries’ prospects for growth (Rodrik, 2004). There are, however, many more objective measures of components of institutional quality (e.g. researchers might use the Sachs-Warner index or similar measures to evaluate trade openness). This paper will return to questions about measurement below, but it will set aside any problems with the measures of institutional quality in the studies for now.

xvi See: http://users.ox.ac.uk/~econpco/ and http://www.adb.org/Poverty/Forum/bio_dollar.htm

xvii Furthermore, even if growth (especially amongst poor countries) is really the IDA’s objective, perhaps it should reward countries directly for achieving this objective. If the IDA cannot defend this objective, perhaps it should follow others’ recommendations to reward countries directly for promoting development of a more defensible sort (e.g. achieving the millennium development goals), directly “incorporating an assessment of development outcomes in performance-based aid allocation” (Kanbur, 2005; Minson, 2007, 5). Doing this would reduce any pressure generated by moral hazard arguments. For incentives would be more directly aligned with success. The IDA would probably object that these proposals “contain no model for how aid money would support development outcomes… Outcomes-based allocations seem to eschew a causal link between the aid resources and development outcome. Aid would thus lose its instrumentality in the development process. Moreover, without looking at policy, the sustainability of any outcome is unknown” (Minson, 2007, 5). But, if the IDA has not “demonstrated a robust causal link between purported good policies and sustained development” maintaining the status quo does little better on this account (Minson, 2007, 5).

xviii Again there are many measures of institutional quality in the literature. It seems almost undeniable that, on some definition, good institutions have an incredible impact on development. But, because almost everything can be fit under the label “institution” or “policy” researchers may not only be able to cherry-pick the data they want to demonstrate the results they desire, but they may repack old results -- e.g. about how trade openness influences development -- and present them as new results. Further, there is little reason to think that there is a single plausible definition of “institution” economists could use in the short term to establish that good institutions in general promote development. The existing definitions are often too general and broad and even if they are appropriately limited, there are probably too many kinds of institutions for the hypothesis that good institutions promote development to be testable in the short term. For an introduction to the literature see: ((North, 1994; Glasser, 2004; Greif, 2006; Commons, 1931) cited in (Davis, Forthcoming)). It is easy to see how the thesis is too broad when it can be used to provide a good deal of evidence for hypotheses that are key to almost diametrically opposed political perspectives – some argue that good institutions (that secure land tenure) increase growth growth ((De Soto, 1989; Besley; 1995; Alchian and Demsetz, 1973) cited in (Davis, Forthcoming)). Others
argue that good institutions that redistribute wealth increase growth ((Rodrik 2000) cited in (Davis, Forthcoming)). And so forth. (Davis, Forthcoming) makes this point clear in providing a nice over-view of the literature.

One might worry that almost everything can be fit under the label “institution” or “policy.” Because these terms are so vague and broad, there is no shared definition. Worse, because so many things might fit in these categories, one might worry that researchers can cherry-pick the data they want to demonstrate the results they desire. In any case, given the lack of convergence on a single definition of “institution” it is important to pay attention to the precise measures individual studies use.

Risse does not distinguish clearly between the thesis that institutional quality is the primary determinant of development and the thesis that institutional quality is the sole determinant of development. He assert both theses.

Dani Rodrik, Arvind Subramanian, and Francesco Trebbi have tried to figure out how institutions impact growth by using instruments for institutional quality developed in Daron Acemoglu, Simon Johnson, and James Robinson’s famous article “The Colonial Origins of Comparative Development: An Empirical Investigation” (Rodrik et. al. 2002.; Acemoglu et. al., 2001). Acemoglu et. al. assume that where the Europeans settled during colonial times they were likely to bring with them good institutions and they were likely to settle where they could survive. So they use settler mortality rates as an instrument for good institutions today (Rodrik et. al., 2002). It seems, however, that more than a modicum of faith is necessary to accept arguments based on this instrument for institutional quality. Acemoglu et. al.’s instrument might be good for colonialism (or successful colonialism) but it does not clearly capture any kind of institutional quality. It is notable that this instrument has been used for many kinds of ‘institutional quality’ that have little to do with the most plausible stories about what institutions might have persisted since colonial times and nothing to do with one another (e.g. settler mortality has been used as an instrument for strong legal systems and property rights protection). Settler mortality may even be a better instrument for geography than it is for institutions (especially since the fact that today many Westerners can survive in what were deadly environments in colonial times is probably due to their access to new anti-malarials). Note: this is not general skepticism about instrumentation. But instruments have to be chosen carefully to correspond to exactly what is at issue. Consider Rodrik’s illustration of the distinction between an instrument and a causal factor (Rodrik, 2004). He suggests that longitude can be used as an instrument for differences in property rights in West vs. East Germany. Most of those in the East (but not the West) were under communism, though longitude did not cause any resulting differences in incomes there. If we are trying to isolate causation, however, we have to instrument for the right thing. Other features of communism may explain the income differences between East and West Germany besides differences in property rights. So longitude is only an appropriate instrument for communism, not property rights regimes. For more recent papers on the institutionalist thesis see (Rajan & Subramanian, 2007; Rajan & Subramanian, 2008; Arndt, Jones & Tarp, 2009).

Aid may help countries with bad institutions improve their institutions and reduce poverty

Although I am skeptical of many of many of the relevant studies, many economists argue that free trade reduces poverty, for instance. For a critical review of this literature as well as the theoretical arguments supporting it see: (Author b, With-held; Author c, with-held; Author d, with-held).

Even if the institutionalist thesis is true, it is so vague as to be unhelpful. It is not clear what components of institutional quality as measured by the CPIA index, for instance, are contributing to aid’s success (Rodrik, 2004). Very different institutional systems can also receive high ratings on different indexes. Even a legal system based on private property is not necessary for high ratings (e.g. China seems to do pretty well on some ratings). Some commentators argue against having a single formula for aid disbursement at all - context matters, there is no one-sized fits all approach. Perhaps we should look for contingent correlations between local economic conditions and success (Rodrik, 2004, 9). Still, there should be a point to saying “institutions rule.”

This paper’s criticism of the IDA’s formula is not exhaustive. Some worry, for instance, that it is “not informed by any substantial consultation or input from the recipient countries, nor does the Bank justify its scores publicly” (Minson, 2007, 4). Others argue that it is not sufficiently attentive to inter-country differences (Kanbur, 2005).

Some version of a moral hazard argument applies, any time we help poor people. For if we give the poor anything, they have an incentive to remain poor to get our assistance. Perhaps this is why some argue that “any performance-based allocation system, whether
based on policies or results, will be inherently biased against low-performers or countries with exogenous constraints” (Minson, 2007, 5).

This may be so, for instance, if resources are so scarce that we are unable to eliminate poverty and do all of the other things that matter. This is not clearly the case in the actual world, however. For, (1) we give very little aid globally and (2) we know a lot about what makes aid work. In recent years, the IDA has given an average of US$14 billion a year (IDA, 2009b). World GDP is US$69,697,642 million (World Bank, 2008). So, if we gave the average in recent years over all years, we would have collectively given only 0.0002 percent of our GDP in aid. The US, the IDA’s largest donor, has given about US$38 billion or 22 percent of IDA funds since its inception in 1960 (IDA, 2009b). This is 3.08 billion a year on average (22 percent of 14 billion). US GDP was US$14,204,322 million in 2008 (World Bank, 2008). So, if the US gave in 2008, what it gives on average in a year, it would also have given 0.0002 percent of its GDP to the IDA (IDA, 2009b). Even considering that there are other sources of official development assistance (ODA) and other foreign aid, there is little reason to believe that we could not give more. Foreign aid given to multilateral organizations and developing countries was US$61.5 billion in 2002 ((OECD, 2004) cited in (Tarp, 2006)). Still, few countries give even .7 percent of GDP in foreign aid (OECD, 2008). On average, citizens in OECD-DAC countries gave US$68 in 2002 ((OECD, 2004) cited in (Tarp, 2006, 14)). Furthermore, there is a lot of good evidence that some aid works. There are many experimental and quasi-experimental evaluations of health and education programs, for instance, that demonstrate their success (UN, 2006; UNESCO, 2006). There are also good examples of agricultural support, microfinance, school voucher, scholarship, and de-worming programs (Ashraf et. al., 2006; Cassen, 1986; Isbam et. al., 1994; Kehler, 2004; Oxfam, 2005; Duflo et. al., 2007). Many of these programs have been successfully replicated and scaled up (Duflo et. al., 2007; Zaman, 1997; Morduch, 1998; Pitt, 1999; BRAC, 2005; Center for Global Development, 2005). Though it may not be easy to do so, it is clearly possible to create such programs.

There may be other arguments for considering other factors besides development or poverty in aid allocation. We might be concerned, for instance, about how fast we can alleviate poverty. This paper will not explore other possibilities. See, however: (Chatterjee, 2004; Jamieson, 2005; Author, with-held).

There are, of course, some exceptions. See, for instance: (Brock, 2009; Wenar, 2008; Author, With-held). For discussion of philosophical work in the public economics literature see, for instance: (Subramanian, 2002).

For examples, see: Ibid. More generally, I believe that many of the international institutions’ arguments are like this one in relying essentially on inadequately articulated and defended moral principles as well as empirical evidence and greatly impacting many individuals’ lives.

The IDA’s formula continues to evolve over time. See, for instance: (IDA, 2007a; IDA, 2007b)

CPIA scores for each criteria are between 1(low) and 6 (high), 3.5 is the mid-point.

Post conflict countries get some precedence for IDA assistance but this is not reflected in the formula itself. Since there is a cap on how much aid countries can receive, there is also a bias in favor of small countries not reflected in the formula. A few years ago the Bank reported that “sixty-two per cent of IDA 14 resources will be allocated using the formula; another 14 per cent go to the capped wealthier countries (India, Indonesia and Pakistan); 10 per cent go to post-conflict countries and 8 per cent go to ‘special purposes’ agreed during the replenishment process’” (Brettonwoodsproject, 2007). The fact that small countries get more than their proportionate share of assistance (Tarp, 2006, 26) should probably be questioned, though this paper will not take on this task.

Excerpted from (Powell, 2004, Box 1).

Excerpted from (Powell, 2004, Box 2).