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AID EFFECTIVENESS IN EDUCATION:

SETTING PRIORITIES IN A TIME OF CRISIS

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**Aid Effectiveness in Education:
Setting Priorities in a Time of Crisis**

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Preface

The eighth meeting of the High-Level Group on Education for All (EFA-HLG) (Oslo, December 16 - 18, 2008) presents a crucial opportunity for world leaders to reassert the importance of education and drive home key messages for global audiences pertaining to the achievement of the Education For All (EFA) goals. The EFA-HLG serves as the focal point for political commitment, as well the technical and financial resource mobilization, needed to achieve the EFA targets.

This year is pivotal for the EFA movement - it is the midpoint between the year 2000, when developing and donor countries alike reinforced their commitment to the six goals of EFA, and the year 2015, the target year for the achievement of these goals. It is also the midpoint for the education Millennium Development Goal (MDG): universal primary school completion. Most importantly, it is the last chance to begin first grade for children expected to complete sixth grade by 2015. And finally, the current financial crisis poses new risks in terms of shifting priorities and budgets away from education at a time when resource mobilization for education is the most critical.

The World Bank welcomes the partnership with the Norwegian government in preparing for the Oslo event and appreciates the collaboration to deeply examine issues concerning the financing of education and aid effectiveness. “Aid Effectiveness in Education: Setting Priorities in a Time of Crisis” discusses the need, in the present difficult environment, for donor countries to maintain aid efforts while revisiting aid allocation, and for developing countries to continue to protect the most vulnerable while sharpening their education priorities. The paper also urges a focus on aid effectiveness calls for donors and developing countries to work together to overcome the various barriers to the effective use of aid, as identified in aid research.

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Executive Summary

The economic environment for education progress has worsened sharply over the past year.

- **The world economy has swung from boom to bust.** From 2003 to 2007, developing countries achieved their strongest GDP growth in decades, with annual growth rates peaking at nearly 8 percent. But the current global financial crisis has caused an abrupt global deceleration. The World Bank forecasts that the OECD economies will contract in 2009, while developing economies will see GDP growth rate fall sharply, to an average of 4.5 percent.
- **The economic slowdown will place new pressures on education systems in developing countries.** Slower growth could lead to expenditure cuts if governments are unable to arrange additional financing as private capital inflows drop sharply. Slower growth in household incomes will also reduce the ability of parents to contribute to their children's educations.
- **These strains will be compounded if donors fail to meet their commitments to provide development assistance to education.** In the past, aid levels have depended strongly on donor-country income levels; experience from the 1990s shows that domestic banking crises in particular can lead to sharp declines in aid.

The more difficult environment suggests new priorities for both donor and developing countries:

- **It will be important for donor countries to:**
 1. **Maintain aid effort.** It would be a mistake for donors to suddenly back off on commitments that they have made—especially to governments that are doing their part to remain focused on access and quality goals despite the economic crisis. Making aid budgets procyclical risks backtracking on the education progress of recent years.
 2. **Revisit the allocation of aid.** Donors should make sure that aid is allocated in ways that are most likely to advance education goals, as discussed in a companion paper for this conference entitled “The Evolving Allocative Efficiency of Education Aid: A Reflection on Changes in Aid Priorities to Enhance Aid Effectiveness” (Fredriksen 2008).
- **Developing countries will need to do their best to:**
 1. **Protect the most vulnerable and disadvantaged.** The greatest long-term costs of the crisis will be students who are forced to drop out or who are prevented from enrolling in school—often ethnic minorities, girls, or students from very poor families.
 2. **Consider carefully where to prioritize efforts.** Where cutbacks in resources for education are necessary, governments should consider carefully the evidence on costs and returns to different levels of schooling.

For both sets of countries, the crisis underlines the importance of focusing on aid effectiveness and, more generally, on development effectiveness of all programs.

- **Recent years have seen major progress toward international education goals, with aid likely contributing to this progress.** For example, net primary enrollment in sub-Saharan Africa has grown by more than 2 percent annually since 1999—a very rapid rate by historical standards. Although the macro debate on the effects of aid is still unresolved, recent research on the education sector provides evidence that aid to education does on average increase enrollments in recipient countries.
- **But there is still room for greater effectiveness.** While effectiveness of resource use is always important, it is particularly important during a crisis—both to make sure that limited resources go as far as possible, and to maintain support for aid.

Donors and developing countries will need to work together to overcome the various barriers to the effective use of aid, as identified in aid research:

- **Fungibility of aid.** If increased education aid allows recipient governments to shift their own resources to non-education sectors, improvements in education outcomes may be weakened. To combat this problem, donors need to help recipients: (1) *focus on education results*; (2) *improve the overall management of public expenditures*; and (3) *maintain their own efforts* in the sector.
- **Aid fragmentation.** The sharp growth in the number of aid donors, both overall and in education, has increased administrative burdens on developing-country governments. *Donors therefore need to continue to strengthen their harmonization efforts*, while recipient countries should take the lead on harmonizing country goals.
- **Volatility of aid and expenditures.** Excessive volatility of aid makes it difficult for governments to make education investments that require a long-term commitment. What ultimately matters even more is the volatility of overall education expenditures in recipient countries. *Donors should make aid as countercyclical as possible* to help reduce volatility caused by external shocks.
- **Poor-quality service delivery in education.** If aid does not translate into more and better service delivery at the school level, it is unlikely to lead to much progress in education. Donors and recipients alike will need to *focus on identifying and fixing these breakdowns in service delivery*, such as leakage of funds, high levels of teacher absenteeism, ineffective pedagogy, or too little expenditure on important non-salary inputs.
- **Lack of monitoring and evaluation of results.** There remains too little good M&E on education, although the situation is improving rapidly. Serious impact evaluation should be part of any major aid-financed initiative. Donors also need to encourage recipient governments to *make M&E an integral part of their domestically financed programs*.

Aid Effectiveness in Education: Setting Priorities in a Time of Crisis

This note sketches the dimensions of the sharp downturn in global economic prospects resulting from the financial crisis that began in fall 2008, raises cautions about the effects of the downturn on developing-country education systems, and suggests priorities for both donor and recipient countries in responding to the new circumstances.¹

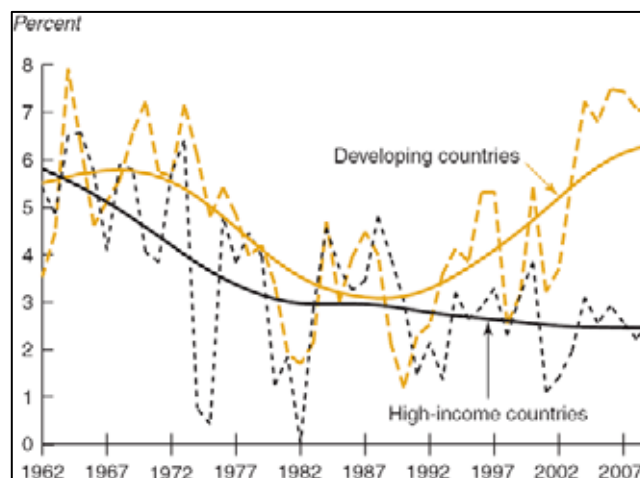
The new global economic context and its implications

The world financial landscape has changed dramatically over the past year, especially since September 2008. These changes will mean tectonic shifts in the economic landscape over the medium term, as the real economy adjusts to increasing unemployment and slowing growth after a five-year period of rapid global expansion. For developing countries, these changes will translate into a greater need for aid at precisely a time when there may be greater domestic pressure on aid budgets in donor countries.

The era of rapid growth, 2002–2007

The period from 2002 to 2007 was characterized by strong global growth—in the case of the developing world, the strongest in decades. Developing countries entered the decade in a relatively strong macroeconomic and structural position, with low inflation rates, more sustainable fiscal situations, and better integration with the global economy. These circumstances predisposed them to more rapid growth, but developed economies also benefited from expansionary monetary and fiscal policy. As a result, the GDP of the developing world rose by more than 5 percent each year between 2003 and 2007 (see figure 1), with growth rates peaking at nearly 8 percent (Lin 2008; World Bank 2008b).

Figure 1. GDP Growth in Developing and High-income Countries, 1962–2007



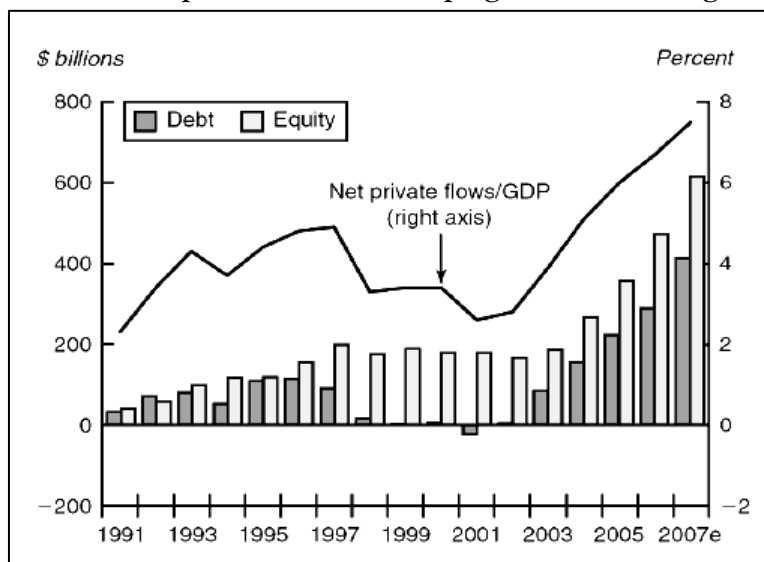
Note: Solid lines represent smoothed trend.

Source: World Bank 2008a.

¹ This paper was prepared by Halsey Rogers (DECRG, World Bank), under the direction of Robin Horn (HDNED, World Bank).

One feature of the expansion was a sharp rise in capital flows, both private and public, into emerging economies and the developing world more generally. Global expansion fueled exports, inflows of portfolio capital and foreign direct investment (FDI), and remittances—all of which rose sharply. In 2007 alone, for example, net private capital flows to developing countries increased by \$269 billion, reaching a record \$1 trillion (see figure 2). At the same time, flows of aid to these countries rose by two-thirds, from \$61 billion in 2000 to \$106 billion in 2005 (World Bank 2008a).

Figure 2. Private Capital Flows to Developing Countries during the Boom



Notes: Equity flows include both FDI and portfolio investment.
 “e” notation indicates estimates.
 Source: World Bank 2008a.

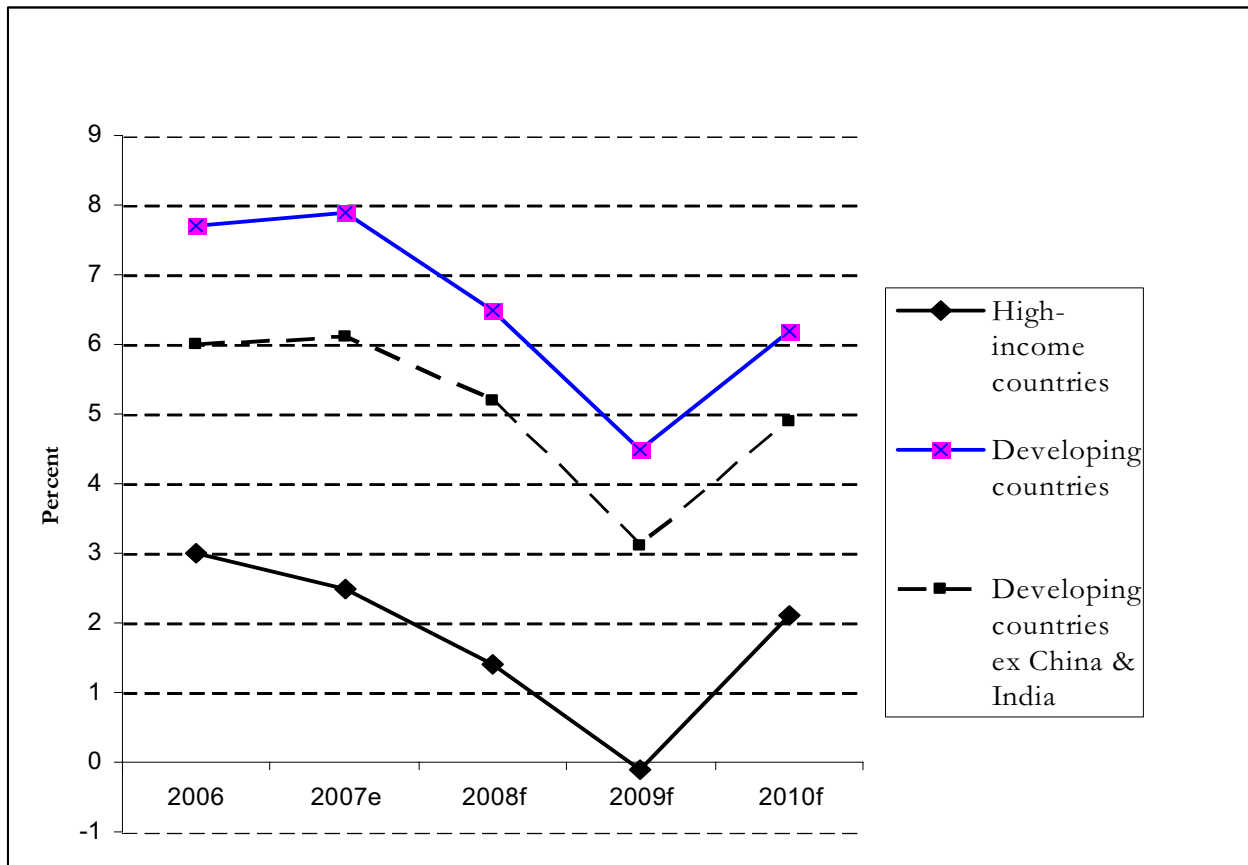
The medium-term future: More difficult times ahead

The expansionary era ended with the bursting of the U.S. housing bubble, the collapse of the subprime mortgage market, and the transmission of the crisis throughout the advanced economies. The dramatic and concerted response by authorities in the European Union, the United States, and Japan has helped prevent the collapse of the banking system, but it has not prevented a marked slowdown in the real economy. Economic forecasts for the medium-term future have steadily worsened in recent months. According to the latest World Bank Group forecasts, prepared for the November 15 meeting of the G20, the OECD economies as a group will shrink by 0.2 percent in 2009 (World Bank 2008b).

Developing economies are also expected to suffer a slowdown. This time, unlike during the East Asian financial crisis of 1997–1998 or other recent crises, the OECD economies are at the epicenter. But this situation does not shield developing economies from collateral harm. The slowdown in donor countries will (and has already begun to) reduce private capital flows to the developing world, as investors make a “flight to safety.” Many developing countries run sizeable current-account deficits: deficits exceed 5 percent of GDP in about half of developing countries and 10 percent of GDP in about one-third. These imbalances increase their vulnerability to a sudden fall in external financing (World Bank 2008b).

The World Bank now projects that developing countries' collective GDP growth will drop to 4.5 percent in 2009 (more than 3 percentage points less than in 2006–2007, see figure 3). While the forecasts project a recovery in 2010 in both developing and high-income countries, whether it arrives as projected will hinge on the effectiveness of the fiscal and monetary stimulus packages that are now being implemented. There are also risks of more severe slowdowns if emerging markets undergo their own financial-sector crises as a result of contagion (Lin 2008; World Bank 2008b).

Figure 3. Actual and Forecast Real GDP Growth Rates, 2006–2010



Source: Based on data from World Bank (2008b).

Notes: “e” notation indicates estimates. “f” notation indicates forecast.

Slower growth will likely mean a rise in education needs in developing countries. Even if these countries do not undergo financial-sector crises of their own, but merely economic slowdowns, there will be numerous pressures on education budgets. First, slower growth overall will translate into fiscal pressures on individual governments and perhaps expenditure cuts if these governments are unable to arrange additional financing. Second, slower growth in household incomes will reduce the ability of households to contribute to their children’s educations, so that education budgets may need to take up the slack. Third, evidence from past crises suggests that there could actually be an increase in enrollments at the secondary level, as students who would otherwise leave their studies decide to forgo the weak labor market and instead remain in school (Ferreira and Schady 2008).

Aid and the economic slowdown

What is likely to happen to aid flows? Despite greater needs in recipient countries—both to replace external private capital and, specifically, to support the education sector—donor countries will likely find it a challenge to maintain aid efforts in the current economic climate. In times of economic slowdown, policymakers are likely to be pressed to redirect aid funds toward domestic needs, such as their own schools. There is little research on how large these donor-country economic effects could be on aid levels. Preliminary calculations by the World Bank Education sector team (HDNED), based on panel data of donor countries over 1970–2006, suggest that an increase of 1 percent in donor-country GDP per capita is associated with an increase of aid per capita of 1 to 2 percent.² If this relationship holds in reverse, and if the recession leaves donor countries as a group 3 percent poorer in 2010 than they would have been had their economies kept expanding, aid flows might be expected to drop at least 3 percent. Compared to the large aid increases seen in recent years, this change would not be overly large, roughly translating into \$3–6 billion in forgone aid.

Moreover, it is possible that this analysis understates the effect of the crisis on aid. Experience from some OECD countries in the 1990s (Finland, Japan, Norway, and Sweden) suggests that donor countries hit directly by domestic financial crises often see their aid levels fall sharply (Roodman 2008). Bank rescues and recapitalizations place massive new fiscal demands on the public sector; donors may find it more difficult to continue giving aid during such crises than they would in even a normal downturn. Because the largest aid donor (in absolute, not relative, terms)—the United States—was hit first by the financial crisis, there is a risk that the crisis effect could reduce overall aid significantly. Education aid need not rise and fall in lockstep with overall aid, of course: in recent years, aid for education initially rose more rapidly than overall aid, then fell in 2005, even as overall aid was rising (UNESCO 2007). However, there is little reason to be sanguine about the prospects for education aid if overall aid falls as a result of the crisis.

In short, these are very different circumstances than those the world faced a year or two ago and the education and development communities need to prepare for a possible reduction in external private (and even public) resources available to developing economies.

Implications for donor countries

These new and more straightened circumstances suggest several priorities for donors:

- *Maintain aid effort.* There will likely be pressures to reduce aid budgets or, at a minimum, to postpone or eliminate planned increases in aid. Recent research on domestic voters' support for aid in the United States, for example, finds that higher levels of financial insecurity are associated with a reduction in voter support for foreign aid (Paxton and Knack 2008). But in a period when education needs will likely rise as developing countries' fiscal constraints tighten, it would be a mistake suddenly to back off on donor commitments to governments that are doing their part to stay focused on access and quality goals despite the economic crisis. Making aid budgets procyclical will simply add to the misery. The force of global education targets will,

² These results are preliminary and should be used with some caution. Although the finding that higher donor income leads to higher aid levels is reasonably robust, GDP *growth* rates (as opposed to levels) also appear to have an offsetting effect in the data, with more rapid growth at a given GDP level predicting *lower* aid. If this relationship holds in times of economic decline, it could mitigate or even eliminate the downward pressure of recession on aid. This effect seems counterintuitive, however, and analysis to better understand the statistical relationships is ongoing.

moreover, likely be lessened if they are not backed up by sufficient funding for deserving recipients. Over the past decade, more countries have abandoned fees and cost recovery in primary and secondary education. This is a welcome development, but it makes schools more vulnerable to budget cuts. The more schools have to rely on household contributions to make up for cutbacks in aid and public spending, the greater the inequality across schools. Sustained commitment by donors will be especially crucial in fragile-state settings, where even in the best of times, governments struggle to provide services. External actors, both governments and NGOs, will likely have to pick up the slack and provide an educational safety net during the downturn.

- *Reconsider the allocation of aid.* Donors should make sure that aid is allocated in ways that are most likely to advance education goals. In the 1990s, they focused on aid allocation across countries—that is, making sure that the largest amount of aid went to the countries that could use it most effectively. This type of allocative efficiency remains important; but there are other ways in which donors can improve their allocation of aid for development results. A companion paper for this conference (Fredriksen 2008) lays out these arguments in detail.
- *Focus on aid effectiveness and efficiency of public spending.* Effectiveness should always be a concern for donors, but tighter economic constraints should cause them to redouble their efforts to increase the returns to aid. It will also be more important than ever to provide evidence of aid effectiveness to electorates, given both cyclical pressures and the influential voices of aid critics (see, for example, Easterly 2001; Easterly 2008). The next section discusses aid effectiveness priorities.

Implications for developing countries

In a time of downturn, developing countries will face the toughest choices. Here are some suggested guidelines for education policy in these countries:

- *Protect the most vulnerable and disadvantaged.* The greatest long-term costs of the crisis will be on students who are forced to drop out of school, or who are prevented from attending school in the first place (rather than students who suffer a temporary reduction in the quality of their education as a result of cutbacks). One policy focus should be on keeping these children in school through such measures as conditional cash transfers, emergency scholarships, and cuts in school fees (for an excellent new survey of measures to cushion the impact of crisis on poor households, see Ravallion 2008). This goal is especially urgent in the case of the most marginalized populations—ethnic minorities and, perhaps in some cases, girls—who are likely to be the first casualties of a cutback in household and schooling resources.
- *Consider carefully where to prioritize efforts, using evidence on returns to education.* Despite the best efforts of donors and developing-country governments, some cutbacks in resources for education are likely. Governments should consider carefully which levels and types of schooling can best absorb the reductions. Different levels of schooling have different levels of private and social returns at the margin, as well as very different fiscal and economic costs. Cutbacks should come at the level that delivers the lowest marginal returns, per year of study, especially if this level is more expensive.
- *Redouble the focus on results and effectiveness.* The drying up of external private financing (and, possibly, public financing as well) will force tough fiscal choices on developing-country

governments. To some extent, countries can loosen those constraints by using reduced resources more effectively. It will be necessary to monitor results in such a way that they can be linked to particular policies and projects. Measurement should cover not only enrollment and completion, but also intermediate inputs and the quality of schooling. As noted above, enrollments may not fall in many countries and governments are unlikely to close schools or lay off many teachers. Instead, the quality of inputs may suffer due to deferred infrastructure maintenance, lower levels of teacher effort, or reductions in non-salary inputs and supplementary programs—leading to lessened learning outcomes.

Promoting aid effectiveness and setting priorities

Given the importance of greater aid effectiveness on the priorities of all development partners, this section delves into the topic in greater detail. It offers evidence on the effectiveness of aid in spurring development, both in macroeconomic terms and within the education sector, and suggests priorities for removing barriers to greater effectiveness.

Progress in education outcomes and the role of aid

Recent years have seen major progress toward international education goals. Net primary enrollment ratios are estimated to have risen from 81 to 86 percent between 1999 and 2005. Even though many education systems are now having to pull in harder-to-reach populations as they approach universal primary enrollment, the increase in net enrollment rates more than doubled from 1991–1999 to 1999–2005. Sub-Saharan Africa saw the most dramatic progress, with net enrollment growing by more than 2 percent annually since 1999. As a result, the number of out-of-school children is estimated to have dropped from 96 million in 1999 to 72 million in 2005. There have also been some advances (often slower) toward other goals, such improved gender ratios in schooling in South and West Asia (UNESCO 2007).

How much of the progress in education can be attributed to aid? Much of the literature on the effects of aid has focused on *macro effects*: the link between aid and growth and between aid and poverty reduction. The debate heated up in the 1990s with the advent of statistical literature based on cross-country regressions, but as of yet, there is no consensus in the literature. For a time, evidence supported the view that aid was effective in spurring growth, but only in countries with reasonably good policies and institutions—those that least resembled Mobutu’s Zaire, for example (Burnside and Dollar 2000; World Bank 1998). And indeed, this view seems consistent with case studies and micro evidence (see, for example, Devarajan, Dollar, and Holmgren 2001). Other influential recent papers using expanded data sets and different statistical techniques have found a variety of conflicting results: that aid is generally ineffective in increasing growth, that aid is generally effective, or that certain types of aid (e.g., aid with developmental purposes) are effective (see, for example, Clemens, Radelet, and Bhavnani 2004; Dalgaard, Hansen, and Tarp 2004; Easterly, Levine, and Roodman 2004). On balance, these papers can be read as supporting the view that aid can accelerate growth (Doucouliagos and Paldam 2005), hence it is likely that it also increases education outcomes. Nevertheless, the effect is not large compared with domestic factors—the statistical relationships are often hard to replicate with different samples or econometric specifications (Roodman 2007). Moreover, aid effectiveness does not robustly depend on the quality of policies and institutions.

Much less specific research has been done on *how aid promotes education goals*, but some recent findings are encouraging. Because the link between education aid and enrollments is more direct than the macro link between aid and growth, there are reasons to believe that aid is more effective in this sectoral

context. One new study by aid researchers, for example, finds that over the period 1970–2004, higher levels of aid for education significantly expanded primary-school enrollment in recipient countries (whereas these governments’ self-financed expenditures on education did not) (Dreher, Nunnenkamp, and Thiele 2008). Other recent studies have also found positive effects on enrollment, although sometimes smaller in magnitude (Michaelowa and Weber 2007), and there is evidence that aid may have greater effects when it is targeted at the schooling levels appropriate for a recipient country’s level of development (Asiedu and Nandwa 2007). These results have not been subjected to the same degree of scrutiny as the aid-growth studies, however, and should thus be regarded only as suggestive at this point. Further research is also needed on how aid affects other education goals, including gender equity and student learning, which are goals desirable in and of themselves and have proven developmental effects (Hanushek and Woessmann 2007; World Bank 2001). The Bank has a research program aimed at filling some of these gaps.

Removing barriers to aid effectiveness

In short, there has clearly been substantial progress toward education goals and the limited evidence suggests that aid may have contributed to that progress. But education progress to date, while impressive by historical standards, still falls short of the goals set by the international community. To ensure that aid makes the greatest contribution possible to these goals, the broader aid literature and more limited literature on education aid effectiveness may provide insights into barriers to aid effectiveness and how to address them:

- *Fungibility of aid.* One possible barrier, often studied in the aid effectiveness literature, is the fungibility of education aid. If an increase in education aid allows recipient governments to reduce their efforts in the sector and shift their own revenues to other areas, improvements in education outcomes may be weakened. In that case, education aid would in effect be partially funding other sectors. Evidence from the 1990s suggests that historically, a substantial share of aid to education and other sectors has indeed proved to be fungible (Feyzioglu, Swaroop, and Zhu 1998; Swaroop and Devarajan 1999). More recent work confirms this finding for education and other sectors, finding that a substantial share of aid is in effect diverted outside the intended sector (Pettersson forthcoming).³ Because even new studies do not include much data from the current decade, they may not have captured work in recent years to ensure that recipient governments maintain their efforts in the sector, which might have reduced fungibility in education. Nevertheless, the advice that follows—which stems from a concern about fungibility—is likely to be broadly applicable. To combat potential fungibility problems, donors need to help recipients: (1) *focus on education results*, rather than input measures alone; (2) *improve the overall management of public expenditures* so that even fungible aid contributes to development; and (3) *maintain their own efforts* in the sector.
- *Aid fragmentation.* The 1980s and 1990s saw sharp growth in the number of aid donors overall, leading to a rise in aid fragmentation (as measured by a standard measure of industry concentration). If not accompanied by strong harmonization of efforts, however, the rise in fragmentation can increase administrative burdens on borrowers and even reduce their administrative quality (Brautigam and Knack 2004). Recent calculations suggest the same rise in

³ Surprisingly, Petterson also finds that in the area of health outcomes, fungible “pro-poor” expenditures reduce infant mortality as much as non-fungible expenditures do; however, the study includes no comparable evidence for the education sector.

aid fragmentation within the education sector in the 1990s as seen overall, followed by a recent leveling-off. To combat potential the pernicious effects of fragmentation, *donors need to continue to strengthen their harmonization efforts*, while recipient countries take the lead on harmonizing country goals.

- *Volatility of aid and expenditures.* Volatility of aid has been cited as a likely barrier to aid effectiveness. Excessive volatility makes it difficult for governments to make education investments that require a long-term commitment, such as hiring teachers. Some research has shown that aid flows are even more volatile than domestic fiscal revenues (Bulir and Hamann 2006; Eifert and Gelb 2005). What ultimately matters most, however, is the volatility of overall education expenditures in recipient countries. At a minimum, then, donors should ensure that aid is not procyclical—that is, that aid does not fall at precisely the time when domestically financed expenditures drop. To the contrary, *donors should make aid as countercyclical as possible* because evidence has shown that aid may be most effective when it helps recipient countries smooth economic shocks.
- *Poor-quality service delivery in education.* Although econometric evidence on how policies and institutions affect aid effectiveness remains controversial, there is little doubt that it must be true in extreme cases of graft and corruption. Even in less extreme cases, if additional aid does not translate into more and better service delivery at the school level, it is unlikely to lead to much progress in education. In certain systems, there are many broken links in the chain from finance to results, such as leakage of funds, high levels of teacher absenteeism, ineffective pedagogy, or too little expenditure on important non-salary inputs (Chaudhury and others 2006; Pritchett and Filmer 1999; Reinikka and Svensson 2005; World Bank 2003). Donors and recipients alike need to *focus on identifying and fixing these breakdowns in service delivery* in both aid-financed and domestically financed programs, thus increasing the returns to public education expenditures.
- *Lack of monitoring and evaluation for results.* One particularly important dimension of both recipient- and donor-government efforts in education is better monitoring and evaluation (M&E). Better M&E will allow governments not only to show results to donors and citizens, but equally important, improve education results over time. Serious impact evaluation should be part of any major aid-financed initiative; donors also need to encourage recipient governments to *make M&E an integral part of their domestically financed programs*.

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