

Box 4 (cont'd)

The Rwanda case provides a clear illustration of the importance of a multi-sector approach even for attaining health outcomes. Rwanda is a country with important needs in terms of roads, water, sanitation, education and others. The aforementioned report prepared by the Rwandan authorities states that “spending on health has increased markedly in recent years (...). However, infrastructure and agriculture have been relatively neglected. Major investments in the road network are needed to support economic growth and poverty reduction. Major investments are needed in energy and in water and sanitation.”^{2/} Such multi-sector investments are also important determinants of health outcomes.

1/ Republic of Rwanda (2006). *Scaling Up to Achieve the Health MDGs in Rwanda*. A Background Study for the High-Level Forum Meeting in Tunis, June 12-13, 2006. Prepared by the Ministry of Finance and Economic Planning and the Ministry of Health.

2/ *Op. cit.*, p. 21.

IV. FRAGMENTATION OF OFFICIAL DEVELOPMENT ASSISTANCE

31. **The proliferation of aid channels has been combined with fragmented aid.** ODA fragmentation can be damaging to the effectiveness of ODA, particularly in recipient countries with low institutional capacity, as it may increase the transaction costs of aid. Fragmentation is manifested in different forms, such as the number of donor-funded activities and the financial size of aid commitments and the dispersion of small-scale free-standing technical assistance as a modality (instrument) of aid delivery (see also discussion in Box 2). This Section briefly describes ODA fragmentation trends and the transaction costs they engender (subsection A) and how these issues are being addressed in the context of the Paris Declaration on Aid Effectiveness.

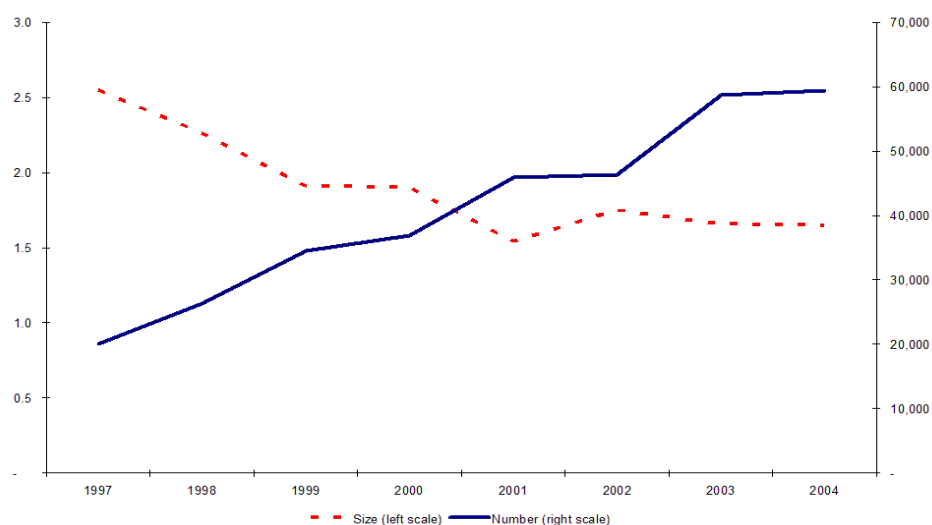
A. Aid Fragmentation and Associated Costs

32. **The number of donor-funded activities is large – particularly in the social sectors – and the average financial size of aid interventions/activities is small.** The average size of donor funded activities in developing countries is about \$1.5 million and total number of interventions/activities has reached almost 60,000 (see Chart 10).⁴⁹ The social sectors (including health and education) account for 48 percent of all activities recorded in the Creditor Reporting System for 2004. This average size of donor activity does not change substantially across sectors or across income groups except for infrastructure projects (about 3 times the average size), general budget support (13 times) and debt relief (16 times).⁵⁰

⁴⁹ In general, a "transaction" signifies allocation of funds to a specific activity (project or programme) in a given sector in a given recipient country. However, to improve the accuracy of CRS-based statistics, donors sometimes choose to compile CRS reports at a finer level, in which case a "transaction" represents a component of an activity. But there are also cases where it is preferable to report at a more aggregated level. A "transaction" can thus be the sum of several activities.

⁵⁰ It is difficult to verify whether this situation has deteriorated over time as part of the growth in commitments may be a result of improved reporting from some DAC members.

Chart 10. Number and Average Size of Donor Activities included in the CRS Database
(US\$ million, 2004 prices)



Source: CRS Online (Table 1)

33. **Fragmentation is reinforced by the fact that the majority of aid activities allocated by modality is for free standing technical assistance.**⁵¹ The level reached by 2004 (i.e., over 20,000 free standing TA activities) was equivalent, on average, to almost one free standing TA activity – normally of very limited financial size – started each working day in each developing country. As noted in the 2006 *Global Monitoring Report*⁵², “technical cooperation is often criticized as being excessively costly because of the high cost of international experts, as exacerbating the problem of brain drain by training the best and brightest but not being able to retain them, and as being too fragmented and uncoordinated.”

34. **Fragmentation seems to be higher the lower is the institutional capacity of recipient countries.** This is suggested by Table 4 below, which links the public sector management capacity to selected features of donor activities. Where implementation capacity is very low, donors tend to finance a large number of small activities in a relatively reduced number of sectors.⁵³ As government capacity becomes higher, donors seem more willing to support larger projects in more sub-sectors and to increase the overall amount of aid resources to the country, as measured by commitments per capita.

⁵¹ "Activities financed by a donor country whose primary purpose is to augment the level of knowledge, skills, technical know-how or productive aptitudes of the population of developing countries, i.e., increasing their stock of human intellectual capital, or their capacity for more effective use of their existing factor endowment." From *DAC Directives*.

⁵² IMF and World Bank (2006). *Global Monitoring Report*, pp. 97-98, fn. 17.

⁵³ The figures in Table 4 do not control for the size or income levels of recipient countries.

Table 4. -Government Capacity and Donor Fragmentation in Low Income Countries (2004)⁵⁴

Government Capacity	IDA IRAI Rating	In each low income country:					No of countries
		No. of donors reporting to CRS	No. of transactions recorded in CRS	No. of subsectors where active	Average size of CRS activities (US\$ million)	ODA Commitments per capita (US\$)	
Very low	Up to 2.5	23	427	77	1.1	29.6	11
Low	2.6-3.0	23	300	78	1.5	42.9	15
Medium	3.1-3.5	25	502	97	1.8	65.7	19
High	>3.5	24	454	95	2.0	70.0	7

35. **Transaction costs of ODA affect both donors and recipients.**⁵⁵ In fact, “donors, recipients and independent observers all agree that the system is too complicated and imposes high transaction costs on all parties”. Such costs reflect a rising number of aid channels and donor activities/interventions; progressive earmarking of funding through multilateral and bilateral channels; and widespread use of uncoordinated technical assistance. While there is ample anecdotal evidence of the increase of transaction costs caused by aid fragmentation and donor proliferation, they have not been systematically quantified (see Box 5).

Box 5 -Examples of Aid Transaction Costs in Tanzania

A large share of aid to Tanzania is through more than 700 projects managed by 56 parallel implementation units. Half of all technical assistance provided to the country is not coordinated with the Tanzanian government. Tanzania received 541 donor missions during 2005 of which only 17 percent involved more than one donor.

Source: DAC, Progress report on the 2006 survey on monitoring the Paris Declaration .

36. **From the recipient countries’ perspective, transaction costs are directly and indirectly associated with the administrative burden placed on them.**⁵⁶ Acharya et al. (2006, *op. cit.*) distinguish between *direct* and *indirect* transaction costs. Direct costs refer to the diversion of scarce resources in recipient countries – notably the time and attention of politicians and government officials – away from domestic priorities in order to attend to demands associated with managing aid-related activities. Such costs are especially relevant in situations where aid is subdivided into many small “packets” with their own managerial and reporting requirements. Indirect costs result from the impact of aid proliferation and fragmentation on the incentive systems in recipient countries’ government bureaucracies. An example of such indirect costs is when donor-financed project implementation units lead to “brain drain” from line ministries where managerial skills are in short supply.

⁵⁴ See discussion in footnote 49.

⁵⁵ In Burall, S. and S. Maxwell, with A.R. Menocal (2006), *op. cit.*, p. 1.

⁵⁶ There is a small but growing literature on the costs created by aid proliferation and fragmentation. Recent examples include: Easterly, W. (2002). “The Cartel of Good Intentions: The Problem of Bureaucracy in Foreign Aid”. *Journal of Policy Reform*, Vol. 5 (4); Djankov, S., J.G. Montalvo, and M. Reynal-Querol (2005). “The Effectiveness of Foreign Aid in a Donor Fragmented World”. World Bank, Washington, D.C.; T. Harford and M. Klein (2005). “The Market for Aid”, *Public Policy for the Private Sector*, Note No. 293, June; Acharya, A., A. De Lima and M. Moore (2006). “Proliferation and Fragmentation: Transactions Costs and the Value of Aid”. *Journal of Development Studies*, Vol. 42, No. 1; and Roodman, D. (2006). “Aid Proliferation and Absorptive Capacity”. *Center for Global Development Working Paper*. No. 75, January.

B. The Paris Declaration Agenda

37. **The Paris Declaration on Aid Effectiveness is a significant step forward towards addressing the complexities of the existing aid architecture.**⁵⁷ Signed on March 2, 2005 by 35 donor countries, 26 multilateral donors, 56 recipient countries, and 14 civil society observers, the Declaration put forward an agenda supported by a broad spectrum of development actors. As noted in the 2006 *Global Monitoring Report*, “a distinct feature of the Paris Declaration is a mutual commitment undertaken by partner [recipient] countries and donor countries to an international monitoring process.”⁵⁸

38. **The Paris Declaration is based on the key principles of ownership, alignment, harmonization, managing for results, and mutual accountability.** These principles underlie the partnership commitments between recipient or partner countries and the donor countries, as follows:⁵⁹

- *Ownership.* “Partner countries exercise effective leadership over their development policies and strategies, and co-ordinate development actions.”
- *Alignment.* “Donors base their overall support on partner countries’ national development strategies, institutions and procedures.”
- *Harmonization.* “Donors’ actions are more harmonized, transparent and collectively effective.”
- *Managing for Results.* “Managing resources and improving decision-making for results”.
- *Mutual Accountability.* “Donors and partners are accountable for development results”.

39. **The five principles of the Paris Declaration are translated into 12 monitorable global targets for 2010.** On the side of recipient or partner countries, these targets emphasize the importance of operational development strategies and reliable procurement and public financial management systems. On the side of donor countries, the targets aim *inter alia* at aligning aid flows to recipients’ national priorities, strengthening recipient country capacity, increasing predictability of aid, increasing the proportion of untied aid, using common arrangements or procedures, and sharing analysis. To ensure mutual accountability, all partner countries should have mutual assessment reviews by 2010.

40. **Some of the Paris Declaration targets are directly aimed at addressing aid fragmentation.** They include: (i) 50 percent of technical co-operation flows should be implemented through coordinated programs consistent with national development strategies; and (ii) 66 percent of aid flows should be provided in the context of program-

⁵⁷ See *Paris Declaration on Aid Effectiveness. Ownership, Harmonisation, Alignment, Results and Mutual Accountability*. It was signed on March 2, 2005 by ministers of donor and recipient countries responsible for promoting development as well as by heads of multilateral and bilateral development institutions.

⁵⁸ IMF and World Bank (2006). *Global Monitoring Report*, p. 79.

⁵⁹ Definitions extracted from *Paris Declaration, op. cit.*