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Book Review

Book Review: The Institutional Economics of Foreign Aid

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**Bertin Martens, Uwe Mummert, Peter Murrell and Paul Seabright (2002):
The Institutional Economics of Foreign Aid**

Cambridge University Press, 201 pages, ISBN 0-521-80818-9 (hardback),
GBP 40.– (USD 60.–)

In this book BERTIN MARTENS and his co-authors analyse the institutional set-up in which foreign aid is delivered. The view put forward is that—rather than just being due to inefficiencies in recipient countries – the perceived failure of many aid programmes is often the result of institutionalised weaknesses in the aid delivery process. Due to inherent informational asymmetries and incomplete contracts, the incentives of the various actors are not necessarily consistent, which then leads to various inefficiencies. The research project started in the foreign aid Evaluation Unit of the European Commission. The proclaimed aim was to improve the delivery of European aid by explaining “the causes of persistent problems and behavioural patterns in EC foreign aid” (p. 29). One aspect repeatedly emphasised in the book is that aid delivered to improve policy and/or institutions – as compared to more traditional project aid – has its own specific problems.

The analysis is almost entirely theoretical and based on agency theory. The stylised process of aid-delivery envisaged in the book comprises several actors and/or stages and looks roughly as follows:

- (1) Voters and politicians in donor countries decide on the amount and type of aid.
- (2) The responsibility for disbursement of funds and overall implementation is delegated to an official aid agency. This could be a branch of government in the donor country or a multilateral development agency.
- (3) The actual implementation is carried out by private or semi-private contractors in the recipient country. Their output is typically delivered to a government agency or some other public organisation in the recipient country.
- (4) This agency/organisation has the task of delivering the benefits of the aid project/programme to the wider population in the recipient country.

At each stage there are potential conflicts of interest between the parties involved, leading to a standard principal-agent problem. Of particular importance is the fact that – in contrast to domestic aid programmes or, for that matter, any tax-financed public expenditure – there is no direct feedback mechanism between the taxpayers financing aid and the final recipients of aid (i.e. the recipient country’s population).

The book has six chapters: a long introduction that also summarises the main results of the book, four analytical chapters and a final chapter in which some policy conclusions are drawn. Each chapter is clearly associated with a single author, with BERTIN MARTENS responsible for the introduction, chapter two and the policy conclusions. The other three authors contribute one chapter each. Each of the four main chapters analyses a specific stage of the aid delivery process in more detail.

Chapter 2 (by PAUL SEABRIGHT) takes a closer look at aid agencies, focusing in particular on two aspects: the problems associated with multiple principals (in the European case the various nations financing EU aid), and the so-called ‘input bias’, i.e. the emphasis on inputs into the development process rather than final outputs, which results from the fact that inputs are easier to monitor and evaluate. Chapter 3 (by PETER MURRELL) analyses the three-way relationship between donor, intermediate contractor and recipient.

ent, with an emphasis on institutional reform programmes. Chapter 4 (by UWE MUMMERT) focuses exclusively on institutional reform projects, distinguishing carefully between *de jure* and *de facto* reforms. Whether aid leads to *de facto* reforms also depends on the socio-economic environment, in particular the nature of the informal institutions already in place and the extent of segregation in society. Chapter 5 (by BERTIN MARTENS) examines the relationship between donor country taxpayers and the suppliers of aid services, with the donor country aid agency as intermediary between the two. Due to lack of feedback from aid recipients to aid donors, the chapter stresses the role played by evaluation.

The four authors demonstrate that agency theory can be successfully applied to shed light on the delivery of foreign aid. Practitioners are probably familiar with many of the problems highlighted, but the book deserves credit for putting them on a sound theoretical footing. Nevertheless, it makes fairly demanding reading and will be of interest mainly to an academic readership. What is missing most is an equally thorough empirical analysis to back up the theoretical findings. A systematic evaluation of the relevance of the theoretical results would have been extremely interesting. In fact, there is hardly anything empirical at all, apart from a few intermittent examples. While this shortcoming is readily acknowledged by MARTENS at the beginning, one is left wondering how pervasive the problems are in practice. Adding more empirical data and observations would have also made this interesting book a more captivating read.

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