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Working Paper

Shooting the messenger of good news: a critical look at the World Bank's success story of effective aid

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Kiel Working Paper No. 1103

**Shooting the Messenger of Good News:
A Critical Look at the World Bank's
Success Story of Effective Aid**

by
Peter Nunnenkamp

April 2002

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Shooting the Messenger of Good News: A Critical Look at the World Bank's Success Story of Effective Aid

Abstract

In a report presented at the UN Conference on Financing for Development in March 2002, the World Bank claims that the effectiveness of its financial aid has improved substantially by targeting aid at poor developing countries pursuing sound economic policies. However, the World Bank's success story rests on an extremely weak foundation: First, the institution's contribution to financial rescue packages for some emerging markets, rather than poverty concerns and policy assessments, dominated the distribution of World Bank financing. Second, the picture portrayed in the report takes a bad turn if only two outliers with extremely high per capita aid (Cape Verde and Honduras) are excluded from the sample. Third, according to our regression results, the allocation of World Bank aid did not improve in the course of the 1990s.

Keywords: financial aid, World Bank, International Development Association

JEL classification: F35

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I. WORLD BANK MARKETING FOR MONTERREY

A recent World Bank report on the role and effectiveness of foreign aid (World Bank 2002), presented at the UN Conference on Financing for Development in Monterrey, Mexico, in March 2002, seems to have turned the tide in favor of more aid. Prior to this conference, the US administration, notably treasury secretary Paul O'Neill, insisted on aid having helped little to spur economic growth and alleviate poverty in recipient countries; calls for more aid were sharply rejected (*The Economist* 2002a). The World Bank confronted the sceptics with empirical evidence showing that, in contrast to generalized verdicts, foreign aid has worked when allocated to poor countries with sound economic policies.¹

Yet, it came to almost everybody's surprise that President Bush, in his address delivered at the Monterrey meeting, outlined a new approach of the United States to foreign aid which is largely in line with the World Bank's reasoning. President Bush announced to increase US aid by US\$ 5 billion per annum (i.e., by 50 percent) until 2006, "exclusively for countries with good governance, investing in health and education and encouraging

¹ The report draws on earlier research, e.g. by World Bank (1998), Burnside and Dollar (2000) as well as Collier and Dollar (2001).

economic freedom" (*The Economist* 2002b). Shortly before, EU ministers had agreed to raise European aid from an average of 0.33 percent of GNP to 0.39 percent of GNP. The World Bank report appears to have prompted politicians to join in "a feast of giving" (*The Economist* 2002b).

Unexpected generosity of aid donors was probably not only because the World Bank could draw on previous findings suggesting that aid works under favorable circumstances. The report went an important step further and claimed that recent aid has actually been spent in accordance with these findings. It is pointed out that the donor community as a whole has improved the targeting of aid; in contrast to the early 1990s, countries with better policies received substantially more aid per capita (US\$ 29) in the late 1990s than countries with poor policies (US\$ 16). Moreover, the report portrays the World Bank as a shining example and frontrunner in allocating its own aid to where effectiveness is reasonably expected to be high:² "Even in 1990, much more IDA funding went to the good-policy countries (\$ 4.7 per capita) than to the poor-policy countries (\$ 2 per capita). By the late 1990s, targeting had improved still further: good-policy countries now

² Note that overall financing by the World Bank consists of highly concessional funding by the International Development Association (IDA) and of lending at market related terms by the International Bank for Reconstruction and Development (IBRD).

receive \$ 6.5 per capita, compared with \$ 2.3 per capita in poor-policy countries ... IBRD (nonconcessional) lending also goes primarily to countries with good policies and institutions" (World Bank 2002: xix).

The contention that "aid allocation has improved dramatically in recent years" (World Bank 2002: 70) may have convinced previous sceptics that it was high time to offer more aid. The World Bank's self-confident success story was widely quoted in the media. Few observers remained reluctant to take official numbers for granted. Republican Congressman Jim Saxton was one of these exceptions, announcing that the World Bank's allegations will be checked with scrutiny in US Congress (Elliesen 2002: 125). As shown below, this may jeopardize the World Bank's impressive marketing in Monterrey for three reasons: First, it is not too difficult to pour quite a bit of water into the wine by figuring out what the World Bank did not mention. Second, and possibly more damaging, the above mentioned and widely quoted figures are strongly misleading. Third, a more careful examination of the data reveals that little has changed in targeting aid at poor countries with good policies. In the longer run, the World Bank, by playing statistical tricks, may have weakened, rather than strengthened the case for more aid.

II. WHAT THE WORLD BANK DOES NOT TELL

The World Bank is rather imprecise in spelling out the statistical details of its calculations. The sample of countries is not given, and it is not specified whether the report refers to (gross) disbursements or net flows (disbursements minus principal repayments) of concessional IDA financing and non-concessional IBRD lending. In the following, we principally use net flows. In addition, we present calculations based on gross disbursements where net flows may provide a distorted picture. This applies to IDA in particular. Various developing countries which are relatively advanced and, hence, no longer eligible to IDA financing, report negative net IDA flows due to principal repayments of earlier IDA loans. These countries are excluded from the sample when assessing the distribution of gross disbursements. We follow the World Bank in taking its Country Policy and Institutional Assessment (CPIA) as a yardstick of good versus poor policy.³ The income status of recipient countries and the incidence of absolute poverty is measured by GNP per capita (purchasing

³ The range is from 1 (very poor) to 5 (very good). We use the classification as published in Collier and Dollar (2001: Table 3). The fact that only one CPIA observation was available to us limits the subsequent evaluation in some respects (see below).

power parity) and the share of the population living on less than US\$ 2 per day, respectively.⁴

The World Bank considers aid flows to recipient countries in per-capita terms, in order to show that its financing patterns have increasingly been shaped by poverty concerns and policy assessments. Before returning to this issue in section III, we portray the distribution of absolute aid flows in the 1990s. This exercise reveals that, in contrast to what is suggested in the report, recent changes in the distribution of World Bank financing were primarily due to the institution's involvement in providing emergency loans to some major emerging markets in financial distress, rather than poverty concerns and policy assessments.

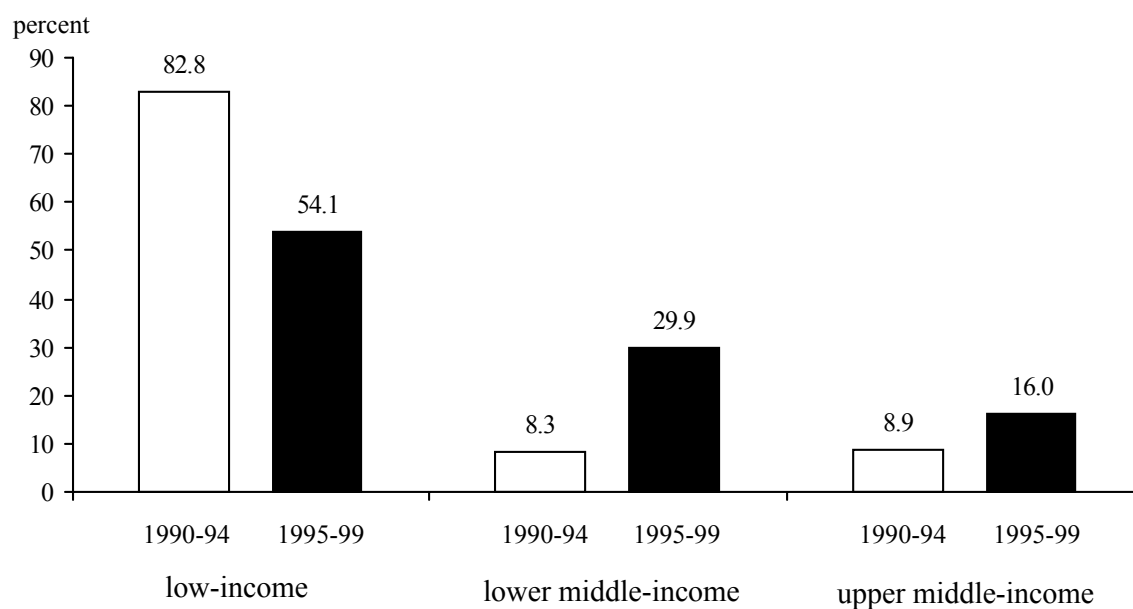
Instead of comparing somewhat arbitrarily selected annual observations, as in World Bank (2002),⁵ calculations in this section refer to annual averages of the first and the second half of the 1990s. Figure 1 shows that low-income countries received a substantially **lower** share of total (net) World

⁴ GNP per capita is from World Bank, World Development Indicators, CD-RoM; poverty incidence is taken from Collier and Dollar (2001: Table 3).

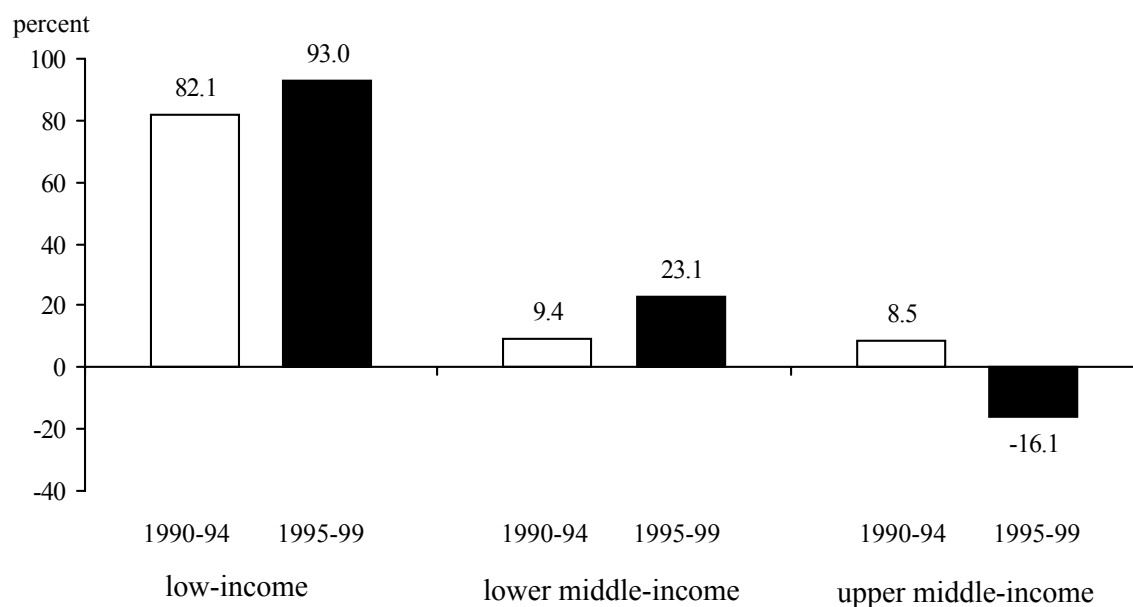
⁵ The World Bank mostly (but not always! Why not?) refers to 1990 and "the late 1990s".

Figure 1 — Better Focus on Poor Countries?
(distribution of total net World Bank flows according to per-capita income^a)

a) all sample countries



b) excluding 7 emerging markets with financial crises



^aPeriod averages of net flows; classification of low-income, lower middle-income and upper middle-income countries according to World Development Indicators.

Source: World Bank, Global Development Finance 2001, CD-ROM; World Bank, World Development Indicators, CD-ROM.

Bank flows (IDA plus IBRD) in the second subperiod than in the first. The corresponding increase in the share of middle-income countries is mainly because of heavy IBRD lending to some crisis countries.⁶ It is only when net flows to seven emerging markets suffering financial distress in the 1990s⁷ are excluded from the sample that the bulk of World Bank financing (93 percent) was allocated to low-income countries in 1995–1999.

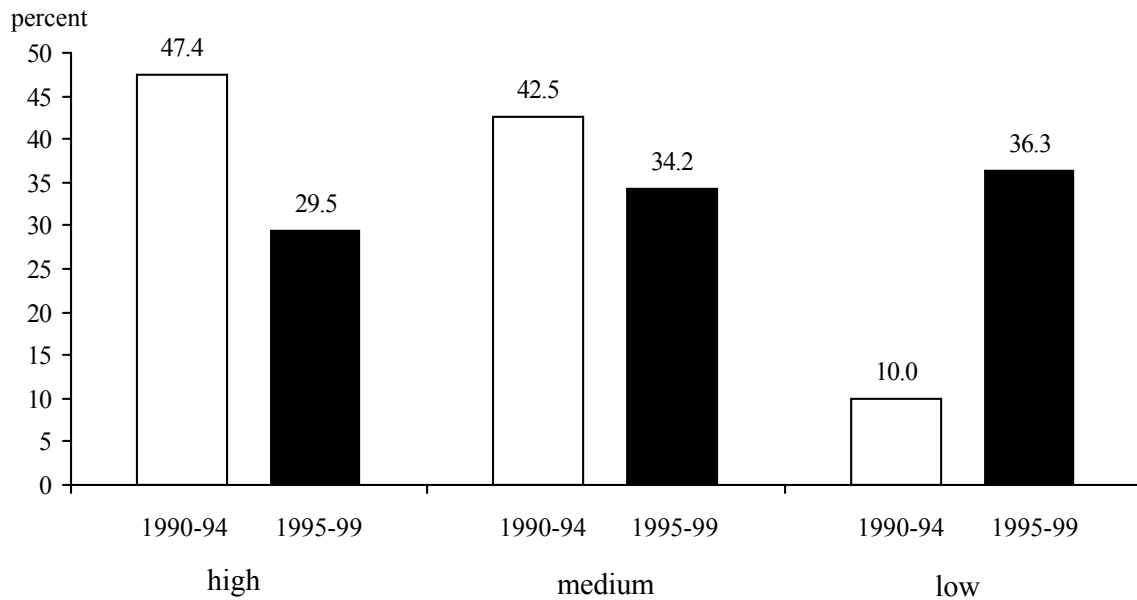
The latter finding may provide some comfort to the World Bank. But even if recent crises were exceptional, the fact remains that World Bank financing was driven by these events in the first place. Moreover, it would be fairly heroic to assume that similar "exceptions" are unlikely to occur in the future. Finally, World Bank financing in the second half of the 1990s hardly reveals a stronger focus on recipient countries with high incidence of absolute poverty, even when the above mentioned crisis countries are left out of account. According to Figure 2, countries with pervasive poverty

⁶ For example, IBRD lending (net flows) to Russia in 1995–1999 summed up to US\$ 6.2 billion. Korea received US\$ 6.5 billion in 1997–1999.

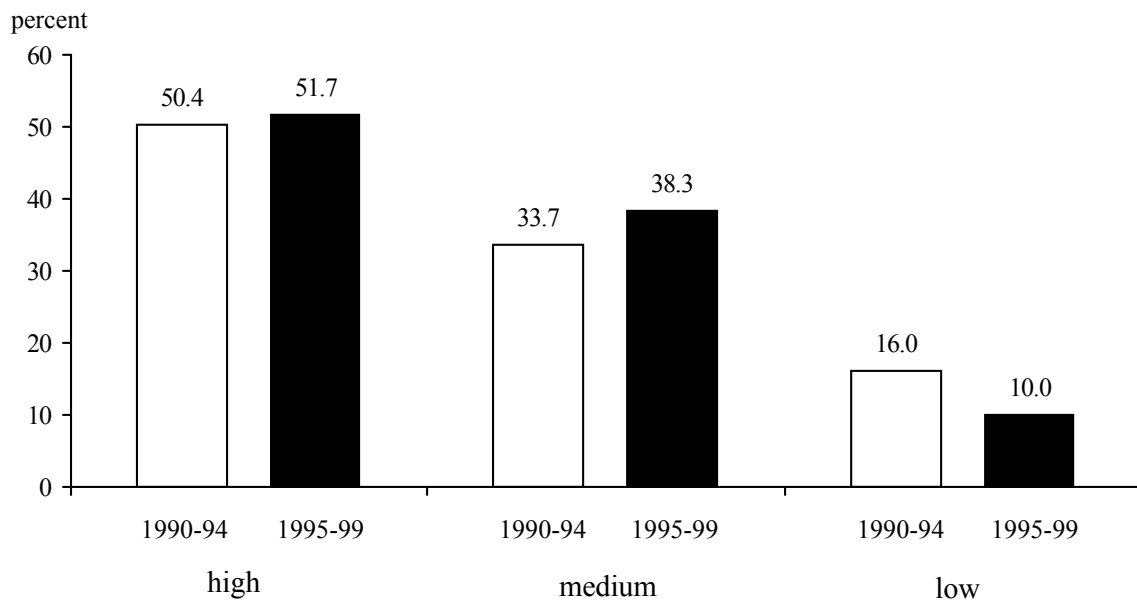
⁷ In addition to Korea and Russia, the list includes Argentina, Brazil, Indonesia, Mexico and Thailand; Malaysia is not considered here as no significant crisis financing was provided.

Figure 2 — Better Focus on Absolute Poverty?
(distribution of total net World Bank flows according to poverty incidence^a)

a) all sample countries



b) excluding 7 emerging markets with financial crises



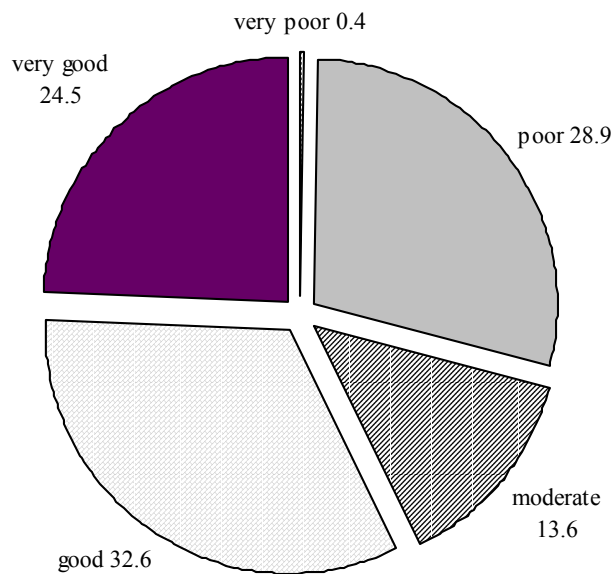
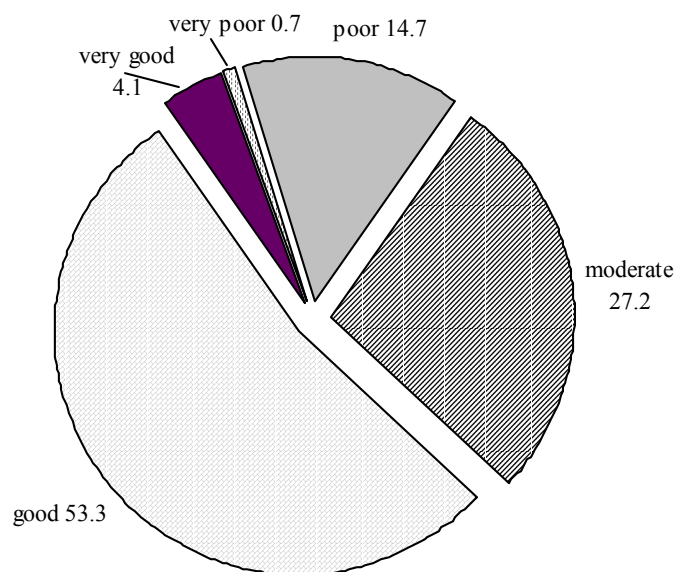
^aPeriod averages of net flows; poverty incidence, i.e. percentage of population living on less than US\$ 2 per day, as in Collier and Dollar (2001); low: up to 33 percent; medium: 34-66 percent; high: more than 66 percent.

Source: World Bank, Global Development Finance 2001 CD-ROM, Collier and Dollar (2001:Table3).

received about half of total (net) World Bank flows in both subperiods. It is no longer surprising that their share declined significantly, if the overall sample is considered.

Given the aforementioned constraints on data availability concerning CPIA, we cannot compare the second half of the 1990s with the first half when it comes to the distribution of World Bank financing among recipients in different policy categories. Nevertheless, the evidence presented in Figure 3 indicates that there still remains considerable room for improving the allocation of aid. Almost 30 percent of total (net) World Bank flows in 1995–1999 went to countries whose policies were rated poor or very poor. Substantial financing of Russia was largely responsible for this high share. However, the combined share of countries with good and very good policies is very much the same (about 57 percent) for total (net) World Bank flows on the one hand, and IDA disbursements on the other hand although Russia did not receive IDA funding.⁸

⁸ For reasons stated above, Figure 3 relates to gross IDA disbursements. Yet, the distribution of net IDA flows is very similar to gross disbursements. Countries with poor and very poor policies received 15.4 percent of net flows, countries with moderate policies got 28.8 percent, and countries with good and very good policies received 55.8 percent.

Figure 3 — Focus on Countries with Good Policies^a?a) distribution of total net World Bank flows, 1995-1999^b (percent)b) distribution of gross IDA disbursements^c, 1995-1999^b (percent)

^aPolicy categories as in Collier and Dollar (2001). — ^bPeriod averages. — ^cWe use gross disbursements, rather than net flows, for IDA, in order to exclude countries no longer eligible to IDA financing.

Source: World Bank, Global Development Finance 2001, CD-ROM; Collier and Dollar (2001:Table3).

In summary, the distribution of World Bank financing conveys two related insights that did not receive due attention in the World Bank report:

- The dominant factor shaping recent World Bank financing was neither poverty nor policy, but the institution's participation in funding rescue packages for some major emerging markets.
- Taking the World Bank's rhetoric on poverty and policy orientation seriously, the effectiveness of its aid could still be improved considerably by reallocating available funds.

III. PRETTIFYING RESULTS

As mentioned before, it is impossible to figure out exactly how the World Bank arrived at the result that "good-policy countries now receive \$ 6.5 per capita, compared with \$ 2.3 per capita in poor-policy countries" (World Bank 2002: xix) from IDA. Apart from not providing information on the sample and flow items on which calculations are based, it is unclear what exactly is meant by "the late 1990s". We interpret this as 1997–1999, and relate the annual average of IDA disbursements in this period to the recipient countries' population in 1998. In this way, we arrive at a sample

of 58 IDA clients, for which per-capita flows in 1997–1999 and the CPIA-classification are listed in the Appendix Table.

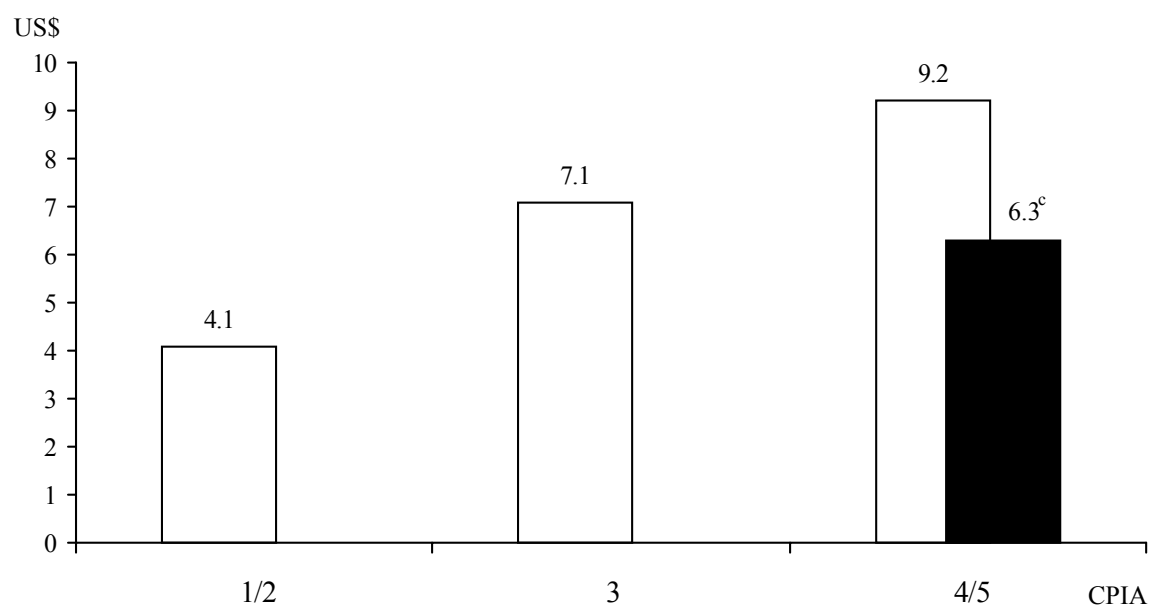
Average per-capita flows for countries belonging to different policy categories are presented in Figure 4.⁹ The averages given there are higher for both, poor-policy countries and good-policy countries than the averages in World Bank (2002).¹⁰ However, this difference has no major bearing for the World Bank's essential message that IDA financing favors good-policy countries by a wide margin over poor-policy countries.

The reason why the World Bank's contention of an appropriate targeting of IDA financing is rather shaky is that group averages as reported above are seriously misleading, independent of whether averages are based on gross disbursements or net flows. Some outliers with extremely high per-capita aid from IDA in the late 1990s (see Appendix Table) distort the picture, a

⁹ Countries with very poor and poor policies (CPIA 1 and 2) are grouped together, as only three countries belong to CPIA 1. For the same reason, we combine CPIA categories 4 and 5 (see Appendix Table).

¹⁰ This difference may be because the World Bank considers net flows, instead of gross disbursements. However, we could still not reproduce the World Bank figures when we calculated averages on the basis of net flows. This suggests that our sample differs from the World Bank's. For example, the World Bank may have included countries with low or zero flows from IDA, which we had to exclude due to lacking observations on CPIA.

Figure 4 — Higher Per-capita Aid from IDA to Good-policy Countries?
 (average gross IDA disbursements^a per capita according to
 policy rating, 1997–1999^b)



^aBy considering gross disbursements, we exclude countries no longer eligible to IDA financing. — ^bPeriod averages. — ^cExcluding Cape Verde and Honduras.

Source: Appendix Table.

problem ignored by the World Bank. Cape Verde and Honduras clearly stand out with per-capita flows of US\$ 44 and US\$ 23, respectively.¹¹ If only these two countries are excluded from the sample, the group average for countries in CPIA 4 and 5 declines from US\$ 9.2 to US\$ 6.3. Countries with good policies (CPIA 4), except Cape Verde and Honduras, received only US\$ 5.2 on average in 1997–1999. This was significantly less than the average for countries with moderate policies (CPIA 3), and just 27 percent more than the average for countries with poor and very poor policies (CPIA 1 and 2).

Group averages are still more sensitive to the treatment of outliers, if calculations are based on annual observations (as done by the World Bank in some instances at least). The distribution of IDA disbursements in the latest available year, 1999, is in line with the World Bank's success story only if outliers are ignored: All recipients in CPIA category 4 (good policy)

¹¹ Due to Cape Verde's small population (0.4 million in 1998), per-capita aid was extremely high even though absolute annual flows hardly exceeded US\$ 20 million at the end of the 1990s. Aid to this country was mainly in three areas: energy and water sector reform, privatization and regulatory capacity building, and education and training (see the project documents on Cape Verde available from <http://www.worldbank.org/html/extdr/regions.htm>). Honduras received exceptionally high aid from IDA in 1999 (US\$ 273 million). This was primarily a reaction to the hurricane Mitch in October 1998, which hit Honduras particularly hard (see World Bank Report No. PID 7193 under the above internet address). It can safely be assumed that emergency relief to Honduras would also have been granted if the country's policies had not been rated good.

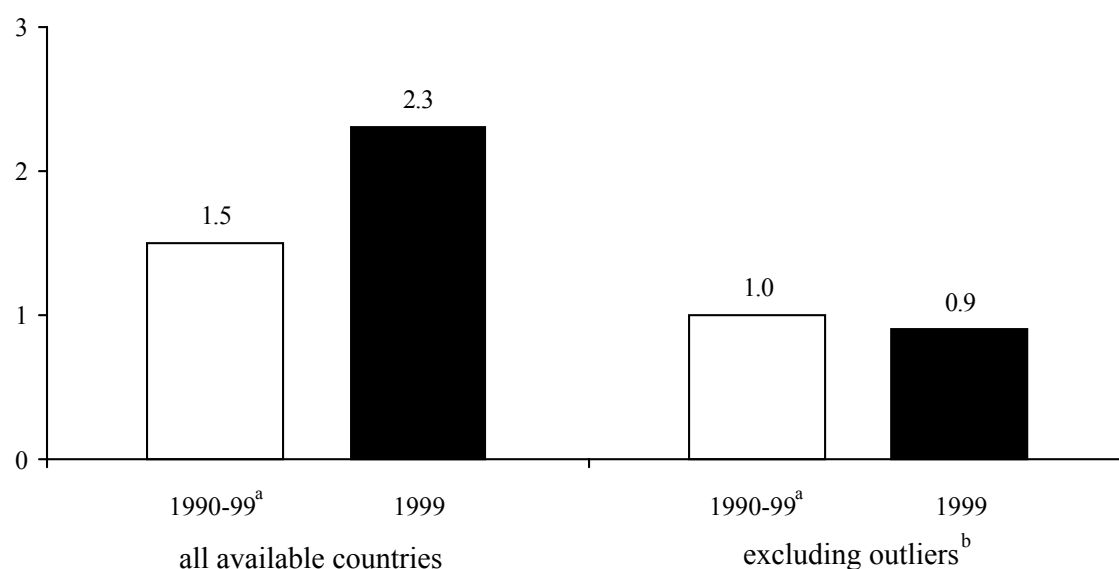
got 2.3 times as much per-capita aid as recipients in CPIA category 2 (poor policy). Once Cape Verde and Honduras are excluded, the remaining (13) countries with good policies, on average, received just US\$ 3.8 per capita in 1999. This was about half the per-capita aid granted to countries with moderate policies (US\$ 7.3), and even less than the average for countries with poor policies (US\$ 4.3).

Furthermore, the World Bank's contention that the targeting of IDA financing has improved most recently rests on a weak foundation. True, the ratio of per-capita aid received by countries with good policies (CPIA 4) to per-capita aid received by countries with poor policies (CPIA 2) was significantly higher in 1999 than before, if group averages are not corrected for countries with exceptionally high disbursements (Figure 5). Once this correction is made, the ratio drops dramatically; and it is no longer true that the ratio increased in the course of the 1990s.

In summary, the World Bank's success story is extremely shaky. It comes to nothing if a few exceptional cases are excluded from the sample. To conclude the discussion of the World Bank's calculations on a sarcastic note, some US\$ 28 million of additional aid per annum in 1997–1999, i.e. 0.5 percent of total IDA disbursements, could have resulted in a still much "brighter" picture. Granted to two good-policy countries with a similarly

small population as Cape Verde, namely the Maldives and St. Lucia, this sum would have boosted the group average for countries with good and very good policies from US\$ 9.2 to US\$ 16.4 per capita, i.e. four times the per-capita aid to countries with poor and very poor policies. Obviously, success or failure in targeting aid should not be judged on such arbitrary averages.

Figure 5 — Good-policy Countries Favored at the End of the 1990s? (ratio of gross IDA disbursements per capita, CPIA 4-countries to CPIA 2-countries)



^aPeriod averages. — ^b1990-1999: Cape Verde and Guyana; 1999: Cape Verde and Honduras. All three countries belong to CPIA 4 and received exceptionally high IDA disbursements.

Source: World Bank, Global Development Finance 2001, CD-ROM; Collier and Dollar (2001:Table3).

IV. LITTLE HAS CHANGED

In order to assess the targeting of World Bank aid, it seems more appropriate to run some simple regressions in which both, the income status and the policy rating of recipient countries enter as independent variables. We use four different dependent variables: total net World Bank flows in per-capita terms and, alternatively, as percentage of the recipient countries' GNP, as well as gross IDA disbursements in per-capita terms and, alternatively, as percentage of the recipient countries' GNP.

For evaluating whether targeting improved in the course of the 1990s, the optimal approach would have been to run the regressions for the first half of the 1990s on the one hand, and for the second half of this decade on the other hand. We could not take this preferable route as the World Bank's policy rating (CPIA) in the first half of the 1990s was not known to us. This is why Table 1 compares regression results achieved for average flows throughout the 1990s with results achieved for average flows in the late 1990s (1997–1999). For both periods, we had to apply the CPIA rating as provided by Collier and

Table 1 — World Bank Aid, Per-capita Income, and Economic Policy of Recipient Countries: Regression Results^a

Dependent variable ^{b/} time period ^c	Constant	Income ^d	Policy ^e	\hat{R}^2	number of observations
total World Bank financing					
- per capita, 1990-99	3.67* (2.26)	-0.00038 (-1.55)	0.47 (0.87)	0.004	105
- per capita, 1997-99	2.00 (0.77)	0.00008 (0.21)	0.68 (0.75)	-0.007	104
- percent of GNP, 1990-99	1.59** (5.50)	-0.00027** (-6.13)	0.08 (0.79)	0.30	103
- percent of GNP, 1997-99	1.18** (4.15)	-0.00023** (-5.43)	0.14 (1.46)	0.24	104
IDA financing					
- per capita, 1990-99	2.34 (1.27)	-0.00028 (-0.96)	1.54* (2.42)	0.07	56
- per capita, 1997-99	0.96 (0.38)	0.00018 (0.46)	1.51 (1.66)	0.07	54
- percent of GNP, 1990-99	1.86** (3.70)	-0.00032** (-4.06)	0.32 (1.82)	0.21	56
- percent of GNP, 1997-99	1.31** (2.81)	-0.00027** (-3.84)	0.41* (2.48)	0.19	54
^a t-statistics in parentheses; ** (*) significant at 1 (5) percent level (two-tailed). – ^b Net flows in the case of total World Bank financing; gross disbursements in the case of IDA; both variables related to either the recipient countries' population (per capita) or the recipient countries' GNP (percent of GNP). – ^c Period averages. – ^d Per-capita income (PPP) of recipient countries in 1995 (for flows in 1990-1999) or 1998 (for flows in 1997-1999). – ^e According to the World Bank's Country Policy and Institutional Assessment as given in Collier and Dollar (2001); range from 1 (very poor) to 5 (very good).					

Source: World Bank, Global Development Finance 2001, CD-RoM; World Bank, World Development Indicators 2000, DC-RoM; Collier and Dollar (2001: Table 3).

Dollar (2001: Table 3).¹² Consequently, we tend to underestimate the effect of CPIA on average flows in 1990-1999, if the rating changed during the 1990s. Such a bias would work in favor of the World Bank's claim that the policy orientation of its financial aid has become stronger since recently.

Nevertheless, the regression results in Table 1 do not support the World Bank's success story. They rather suggest that little has changed in the late 1990s as concerns the allocation of aid. The picture is particularly bleak for total World Bank financing:

- Measured in per-capita terms, all coefficients turned out to be insignificant.
- As percentage of the recipient countries' GNP, total World Bank financing favored lower-income countries. But this relation did not become stronger in the late 1990s. The policy variable CPIA is insignificant for both periods considered.

As concerns IDA disbursements, the coefficients of the income variable are very similar to results for total World Bank financing. By contrast, IDA disbursements have at least some relation to the policy rating of recipient countries. Two out of four coefficients of CPIA are significant at the 5 percent

¹² By contrast, per-capita income of recipient countries in 1995 entered regressions for 1990-1999, while per-capita income in 1998 entered regressions for 1997-1999.

level. The proposition of a stronger policy orientation of IDA aid in the late 1990s cannot be rejected, if disbursements are measured as percentage of the recipient countries' GNP.¹³ However, results achieved for IDA disbursements in per-capita terms are in conflict with this proposition. Taken together, the regression results underscore our earlier reasoning that the task of improving the allocation of financial aid is still lying ahead of the World Bank.

V. SUMMARY

In the report presented at the UN Conference on Financing for Development in Monterrey in March 2002, the World Bank contends that the effectiveness of its financial aid has improved dramatically by targeting aid at poor developing countries pursuing sound economic policies. A critical look at this report reveals that the World Bank's success story rests on an extremely weak foundation. First, the institution's contribution to financial rescue packages for some emerging markets, rather than poverty concerns and policy assessments, dominated the distribution of World Bank financing. Second, the picture portrayed in the report takes a bad turn if only two outliers with extremely high per-capita aid (Cape Verde and Honduras) are excluded from the sample. Third,

¹³ The coefficient of CPIA is smaller, and significant only at the 10 percent level, when the regression is run for 1990-1999.

according to our regression results, the allocation of World Bank aid did not improve in the course of the 1990s.

All this suggests that the "feast of giving" (*The Economist* 2002b), which the World Bank report appears to have prompted in Monterrey, may be followed by surprisingly generous donors feeling like the morning after the night before. In the longer run, it may turn out that the World Bank has weakened, rather than strengthened the case for more aid, by having provided "good news" based on a dubious reading of the targeting of aid in recent years.

Appendix Table — Gross IDA Disbursements to 58 Developing Countries, 1997–1999^a (US\$ per capita)

	CPIA	US\$ p.c.		CPIA	US\$ p.c.
Angola	1	2.85	Bangladesh	4	2.82
Congo, Dem. Rep.	1	0.00	Cape Verde	4	44.16
Equatorial Guinea	1	1.31	China	4	0.47
Burundi	2	2.58	Côte d'Ivoire	4	8.82
Central Afr. Rep.	2	0.71	Egypt	4	1.34
Chad	2	5.47	Ethiopia	4	1.58
Comores	2	5.21	Ghana	4	12.94
Congo, Rep.	2	0.11	Guyana	4	13.31
Guinea	2	9.61	Honduras	4	23.39
Guinea-Bissau	2	7.20	India	4	0.85
Haiti	2	4.04	Lesotho	4	5.85
Indonesia	2	0.02	Mongolia	4	8.35
Kenya	2	3.25	Philippines	4	0.11
Lao PDR	2	5.86	Senegal	4	7.18
Madagascar	2	6.62	Sri Lanka	4	3.97
Moldova	2	5.94	Kyrgyz Rep.	5	10.90
Nepal	2	2.40	Maldives	5	12.95
Niger	2	4.12	St. Lucia	5	8.11
Nigeria	2	0.81	Uganda	5	7.35
Rwanda	2	7.76	average (4+5)	–	9.18
Sierra Leone	2	3.95			
Solomon Islands	2	10.01			
Tajikistan	2	5.22			
Vanuatu	2	2.73			
average (1+2)	–	4.07			
Azerbaijan	3	5.75			
Benin	3	4.93			
Burkina Faso	3	4.86			
Cameroon	3	6.15			
Malawi	3	10.29			
Mali	3	5.65			
Mauritania	3	10.21			
Mozambique	3	7.05			
Nicaragua	3	19.15			
Pakistan	3	1.63			
Tanzania	3	5.02			
Togo	3	6.24			
Vietnam	3	2.58			
Zambia	3	12.69			
Zimbabwe	3	3.78			
average 3	–	7.07			

^a Annual average, divided by population in 1998.

Source: World Bank, Global Development Finance 2001, CD-RoM; World Bank, World Development Indicators 2000, DC-RoM; Collier and Dollar (2001: Table 3).

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