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Aid and good governance: Examining aggregate unintended effects of aid

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ABSTRACT

Although donors generally aim to improve governance in recipient countries by various means, critics claim that the aggregate effect of large aid flows is the deterioration of governance. Aid is said to weaken domestic accountability, sustain authoritarian regimes, increase political instability, weaken government capacities, and increase corruption. Conducting a systematic search in Web of Science, this paper reviews the empirical evidence for these unintended aggregate effects of aid on the political, administrative, and judicial dimensions of good governance. It finds that the negative effects of aid on governance are much exaggerated. The aggregate effect of aid on democracy has become more positive after the Cold War, and the effect of aid on government capacity and on reducing corruption has also improved over time. Furthermore, most studies show a positive effect of aid on political stability. These findings imply that donor intentions matter: donors that are serious about their *intended* effects on governance are able to mitigate the possible negative unintended effects of their aid.

1. Introduction

From around 1990 onwards, good governance has increasingly become an important objective for development cooperation. First, the end of the Cold War reduced the need for aid propping up dictators like Mobutu in Zaire or Marcos in the Philippines, in order to keep them outside the communist sphere of influence. Donors began to expect recipient countries to respect human rights and to set up institutions for democratic accountability, and were willing to provide aid for supporting these goals (Hoebink, 2006). Second, while in the 1980s donors – in particular the IMF and World Bank – had promoted a neoliberal agenda of deregulation and privatization as means toward economic growth, they have subsequently come to realize that a well-functioning market requires well-functioning state institutions (Fukuyama, 2016). The World Bank and other donors began to promote public sector reforms as well as anti-corruption policies. While donors on the one hand aim to support good governance by different aid modalities such as projects, technical assistance, or through the policy dialogue around budget support and debt relief, on the other hand they have also used good governance criteria for the aid allocation. However, the implementation of this criterion has varied by donor and by period (Dollar & Levin, 2006; Hout, 2007).

Yet, the sum of all aid to a particular country may also have effects on governance, and these aggregate effects of aid are usually unanticipated and often unintended. Large aid flows are often said to weaken domestic accountability in recipient countries because executive governments are no longer dependent on the consent of parliaments or of the population at large (Moyo, 2009; Moss, Petterson, & Van de Walle, 2008; Sogge, 2002). Aid may also strengthen authoritarian regimes directly by providing them resources for increasing repression or for buying off potential opposition. Through the weakening of domestic accountability, aid is often said to increase corruption. And finally, the presence of many donors and large aid volumes in a country may also have unintended negative effects on governance. The many different projects with different implementation and reporting requirements distract the attention of government officers from their regular planning and implementation activities, and weaken state capacities (Acharya, De Lima, & Moore, 2006). Donors have increasingly recognized these problems and this has led, for example, to the 2005 Paris Declaration on aid effectiveness, which expresses commitments to increase recipient country ownership, increase alignment to local priorities and local systems, and improve donor harmonization and coordination (High Level Forum, 2005).

On the other hand, there can be positive unintended effects of aid on governance, for example when aid improves the education level in a country or promotes international exchanges that lead to the adoption of higher accountability and integrity standards. Ultimately, the aggregate effect of aid on good governance is therefore an empirical issue. This paper aims to give an overview of the evidence on these aggregate effects of aid on governance. It reviews the findings of empirical studies published between 1995 and 2016, and gives particular attention to possible changes over time. As such, it is the first systematic review to examine the possible influence of the end of the Cold War (around 1990), the increased attention for state institutions and anti-corruption

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policies (starting in the early to mid-1990s), and the increased awareness of the negative effects of aid fragmentation and proliferation (from around 2000 onward).

The paper focuses on aggregate effects of aid, which means the effect of all aid in a particular recipient country. Good governance outcomes are also analyzed at the country level. The possible aggregate effects of aid to a country are unintended by individual donors, and are expected to appear or to become more serious when aid flows are "large." The size of aid flows must be considered in relation to the size of the population or the economy of recipient countries.

In practice, most low-income countries, i.e., countries with an average income per capita of less than US $1025, do receive large volumes of aid. On average, they received US $60 per capita during 2011–2014, which is higher than in previous decades. The average share of aid in Gross National Income of this group of countries decreased in the past decade due to high economic growth rates, but is still high, at 9% in 2014.

While several authors stress the unintended negative aggregate effects of aid, these effects are often just postulated. This means that it is important to examine the evidence. To what extent are the aggregate effects of aid indeed negative for governance, or is it possible that the aggregate effects are positive? This paper examines the evidence, and concludes that the picture is not as negative as many aid critics and aid observers claim. In addition, donor intentions and donor behavior matter for mitigating these negative effects. While there have been improvements over time, there is certainly room for further improvement.

The review analyzes the effects of aid on three dimensions of good governance, namely the political, administrative, and judicial dimensions. Before discussing the empirical evidence, the paper first defines these three dimensions and discusses the hypotheses regarding the aggregate effects of aid on these dimensions. This is followed by a presentation of the methodology for this review. The final section summarizes the evidence and discusses some policy implications.

2. Good governance and expected aggregate effects

There is no universally accepted definition of what good governance entails (Fukuyama, 2016). Sometimes, good governance refers only to the effective implementation of policies, and not to elements like democratic accountability or civil liberties. This would imply that there can be good governance in dictatorships. Rothstein and Teorell (2008) make a similar distinction between two dimensions of good governance, namely elements that concern (citizen's) *access to* authority of a state or nation, which would include democratic accountability, and elements that concern the *exercise of* authority, thus referring to the implementation side. Empirical research on good governance usually distinguishes three dimensions: political, administrative, and judicial, where the first corresponds to access to authority and the latter two refer to exercise of authority (Kaufmann, Kraay, & Mastruzzi, 2010; Kwon & Kim, 2014).

In this paper, I follow that practice. The political dimension includes issues like protection of civil rights, institutionalized checks and balances, press freedom, the possibility of replacing governments by elections, and also political stability. Administrative governance is about the capacity of governments to formulate and implement policies effectively, often also called "bureaucratic quality." While Kaufmann et al. (2010) present two indicators for this dimension, government effectiveness and regulatory quality, I consider the latter to be more an indicator of regulatory *policies*, and not of governance. Judicial governance is about respect of citizens and the state for the institutions that govern economic and social interactions, such as laws, property rights, and the judiciary itself. This can be measured by the indicators "rule of law," "law and order," and "corruption" or "control of corruption."

Aid dependence implies that governments are more accountable outward, i.e. to donors, than inward, i.e. to parliaments or domestic constituencies in general (Boekestijn, 2009; Moss et al., 2008; Sogge, 2002). This may weaken the political dimension of governance. Furthermore, large aid flows may have the perverse effect of reducing tax efforts, which may further undermine state building. Historically, taxation has been important in increasing the accountability and legitimacy of executive powers. Increases in government revenues were usually needed in times of war, inducing Charles Tilly to articulate his famous saying, "the state made war, and war made the state" (quoted in Moss et al., 2008, p. 272). Several authors claim that foreign aid plays the same negative role as the availability of highly valued resources such as oil (Djankov, Montalvo, & Reynal-Querol, 2008; Morrison, 2009). Countries with a resource curse, be it due to oil or aid abundance, tend to have lower levels of democratic accountability. With respect to the effect of aid on political stability, Grossman (1992) has argued that aid makes control of the state and aid resources more valuable and therefore increases the number of coup attempts and domestic conflicts in general.

Yet, there may also be positive aggregate effects of aid on democracy and political stability. When aid leads to higher education levels or more socio-economic development in general, it can be expected that people will be more interested in and capable of participating in political decision making, and will be less inclined to solve their disputes in a violent way. Furthermore, aid may also reduce civil conflict by increasing state capacity for repression, which acts as a deterrent.

Aid may reduce the administrative capacity in recipient countries, especially if provided in high volumes and by many different donors. Morss (1984) has observed that the increase in the number of donors since the 1970s and the change toward more project aid instead of program aid[1] led to "institutional destruction" in developing countries and especially in Sub-Saharan Africa. This conclusion was based on qualitative evidence from Lesotho, Malawi, and Zambia. More recent authors have also highlighted the adverse effects of government officials' having to deal with many donors and projects, all with their own reporting and evaluation requirements. This not only means high transaction costs but also leads to a fragmented development policy. Donors are often only interested in the success of their own projects, and not in the quality of governance in general or the success of other donors' projects (Acharya et al., 2006). They provide technical assistance in the form of training and seminars for relevant government staff, within the country or abroad, leading to high absenteeism among government officers. Or, donors may set up separate implementation units for the execution of their projects, hiring the best government staff and thus poaching staff away from regular ministries (Acharya et al., 2006; Wuyts, 1996). As O'Connor and Soludo wrote, "The aid relationship can get stuck in a high aid-weak institutions equilibrium in which institutions remain weak and graduation [i.e. from aid dependence – gd] never occurs." (O'Connell & Soludo, 2001, pp. 1548).

On the other hand, if donors manage to avoid aid fragmentation and succeed in harmonizing aid practices under government leadership as recommended by the Paris Declaration and subsequent high-level fora on aid effectiveness, this may mitigate the negative effects of aid on governance or even improve state capacities.

As in the other dimensions of governance, the theoretical aggregate effects of aid on the judicial dimension of governance can go both ways. Aid can improve the rule of law and reduce corruption by setting rules and conditions and by providing a good example, for example in procurement activities for projects. Aid may also help reduce corruption by allowing increased salaries of civil servants. On the other hand, aid may reduce domestic accountability, and as a result it may disappear into the pockets of high-level government officers. Furthermore, aid may foster patronage and clientelism by facilitating the growth of public employment and of public subsidies (Chabal & Daloz, 1999; Van de Walle, 2001).

[1] Morss's study defines program aid as aid to a sector *and* to large infrastructural projects. The latter, however, is no longer part of the current definition of program aid.

3. Methodology

In order to find relevant papers, I conducted a search in the Web of Science database with the following search terms: a combination of "“aid” or “foreign aid” or “development cooperation“ on the one hand, and many different terms for good governance on the other: governance, good governance, regime, authoritarian, democracy, dictatorship, accountable government, accountability, bureaucratic quality, institutions, institutional quality, institutional capacity, political stability, conflict, civil war, rule of law, corruption. The search included studies published between 1995 and 2016.

Criteria for inclusion included that the studies should present empirical evidence on the relationship between aid and one or more governance indicators related to the political, administrative, and judicial dimensions as defined above. Since I was interested in the aggregate effects of aid, I excluded studies covering one donor or just one or a few specific aid modalities, like governance aid, project aid, budget support, or technical assistance. I also excluded studies dealing with the effects of aid volatility. While including the cross-country evidence on the effect of aid on political (in)stability, I excluded studies specifically dealing with the effect of aid in fragile states.

The empirical studies reviewed in this paper suffer from some common limitations and weaknesses, and this to some extent also affects the conclusions of the review. First, it is not easy to establish a causal relationship between aid on the one hand and good governance on the other. Aid is just one of many factors that may influence the quality of governance in recipient countries, and probably a relatively small factor. Econometric studies are to some extent able to control for other possible factors, such as the level of development, economic growth, and the presence of valuable natural resources. Yet there may be other country-specific historical or other factors that are not included in these studies, and this may create omitted-variable bias. Furthermore, it is very difficult to establish the direction of causality and to exclude endogeneity. Aid may be provided *because of* bad governance or *because of* improving governance. Both cases would distort conclusions on the effect of aid on governance, in different directions. Endogeneity would distort results if there were a third factor that influenced both the amount of aid and the good-governance outcome. This could be the rate of economic growth, for example. Simple ordinary least squares (OLS) regression analysis cannot deal with reverse causality or endogeneity. For this reason, many studies instrument for aid, meaning that they first estimate aid flows on the basis of factors unrelated to governance outcomes, and then use the results of this first regression to estimate the impact of aid on governance. Studies that attempt to deal with endogeneity and reverse causality can be expected to have more valid outcomes.

A second weakness is the quality and validity of the data on good governance. Most of the indicators for good governance are based on perceptions, and often these are expert perceptions (Arndt & Oman, 2006). In the political dimension of governance, these perceptions may have a more or less objective basis, for example if they assess the presence of institutions and procedures for citizens to express their preferences for policies and leaders, the presence of civil liberties, or the extent of institutionalized constraints on executive power, to mention a few dimensions used in the Polity IV index. However, expert opinions are much more subjective when it comes to assessing the bureaucratic quality of governments or the extent of corruption. Several authors argue that perceptions on governance are often influenced by western ideas, leading to lower assessment of government effectiveness in South Korea and Taiwan, for example (Kurtz & Schrank, 2007) and/or are mixed up with policy outcomes (Grindle, 2004; Rothstein & Teorell, 2008) or ideas on good policies–which, in turn, are often also influenced by western ideas (Van Waeyenberghe, 2009). These factors weaken the validity of results of virtually all presented studies, especially those for the judicial and administrative dimensions of governance.

Third, aid is provided for many different reasons and in many forms. We cannot expect all aid to have a development motivation. To the extent that aid is provided for strategic, commercial, or other reasons related to the donor's own interest, its effect on good governance will be more negative. It can also be expected that aid modalities matter for some of the negative unintended effects of aid. If donors provide closely monitored project aid for specific purposes, or only provide aid to non-government organizations, some of the negative unintended effects of aid on the political and judicial dimensions of governance can be mitigated. On the other hand, program aid is more likely than project aid to mitigate the negative effects on state capacities. These differences will prove to be important for the outcomes of the studies presented in this paper, and of course also for the policy implications.

4. Aid and the political dimension of governance

Goldsmith (2001) examines the impact of aid on democracy in Africa over the years 1975–1997, using the Freedom House's “Freedom Index.” He concludes that aid had a small but significant positive effect on democracy. Knack (2004) looks at a much larger sample of between 96 and 105 countries and examines the period from 1975 to 2000. He observes that, according to both the Freedom House index and the Polity IV index, many aid recipients experienced an increase in democratization. However, he finds that aid did not play any role in these improvements, and this finding was robust to various model specifications and to the use of exogenous instruments for aid.

Djankov et al. (2008) use the Polity IV index and an indicator for the existence of checks and balances to estimate the effect of aid on democracy. They control for oil income and apply many robustness checks including using instruments for aid. For a sample of 108 countries they find that aid has a negative effect on democracy during the period 1960–1999. The negative effect of aid proves even larger than that of oil. Kalyvitis and Vlachaki (2012) also conclude that aid has a negative impact on democracy in a sample of 64 aid recipient countries in the period 1967–2002. They use a binary dependent variable: a country is classified as democratic if both president and the legislature are elected. Their findings are also robust to using instruments for aid. They also examined under which conditions in the recipient country aid has a negative effect on democracy, and found that the effect was larger in countries with a low democratic status to begin with. On the other hand, previous economic liberalization helps to soften the negative effect of aid on democracy.

Dutta, Leeson, and Williamson (2013) examine a similar hypothesis: that aid promotes democratic development in countries that are already democratic while the opposite is true in countries with dictatorial traits. They analyze 124 countries for the period 1960–2009 using the Polity IV index, and the results confirm their hypothesis. The authors conclude that aid has an “amplification effect”: it can reinforce certain paths, but cannot put the country on another path. Abegaz (2015), in a case study on Ethiopia, shows that aid focused on poverty reduction in a country with limited civil liberties and weakly accountable state institutions reinforces those tendencies.

Young and Sheehan (2014) examine the effect of aid on several measures for economic and political institutions for a large sample of 116 countries over the period 1970–2010. In simple OLS regressions they find a positive effect of aid on democracy, but after instrumenting for aid, the effect becomes negative.

Several studies examine the effect of aid on regime survival. Kono and Montinola (2009) distinguish between current and cumulative aid, where current aid is the annual aid flow, and cumulative aid is aid received over the period that a certain leader is in power. They find that cumulative aid is particularly beneficial for autocratic leaders because they can save aid resources to a larger extent then democracies can. Annual aid flows (current aid) are more beneficial for democratic governments because they will spend it in the same year. This means that aid provided over a long term helps to maintain autocratic leaders in power.

Morrison (2009) postulates that aid and other nontax revenues are important for regime survival of both democracies and autocracies. In democracies, nontax revenue helps to buy off the elites by reducing the need for taxation, while in autocracies aid can soften population protests by increasing social spending. He finds these hypotheses confirmed, implying that aid helps to maintain authoritarian regimes. Bueno de Mesquita and Smith (2010) conclude that both aid and other nontax revenue have a negative effect on regime change. Ahmed (2012) looks at the effect of aid and remittances on regime change in authoritarian states and similarly finds that both have a negative effect, and thus tend to sustain authoritarianism.

Overall, it seems that the conclusion is quite negative. Many studies conclude that aid has a negative effect on democratization, and some add that this holds even more in non-democratic countries. Aid tends to help autocrats to maintain their power. This is clearly an unintended effect of aid–at least for those donors that provide aid with a development objective.

However, as is also argued above, aid is not always given from a development perspective. Especially during the Cold War, many countries received aid for strategic reasons, no matter whether they were ruled by dictators. While strategic reasons have continued to play a role after that, benefiting, for example, Israel and Egypt, and more recently Pakistan and Afghanistan, it can be argued that during the Cold War the number of authoritarian regimes receiving large amounts of aid due to strategic reasons was larger than in the period after 1990. These larger numbers matter when assessing the average effect of aid on the political dimension of governance–which is what cross-sectional econometric studies do. Another factor that may have contributed to a more positive effect of aid on democratization after the Cold War is that democratization began to figure more prominently among donors' objectives.

Most of the above-mentioned studies cover a long period and include the Cold War years. And indeed, studies covering the period after 1990 often find a more positive effect. In addition, many of the above studies that found insignificant or negative effects of aid on democratization have been replicated in order to test whether the end of the Cold War makes a difference. The findings of these studies will now be presented.

Dunning (2004) specifically looks at the impact of the Cold War by reusing Goldsmith's (2001) data but now comparing two periods: 1975–1987 and 1988–1997. He argues that the Soviet Union's influence in Africa was already waning around 1987 and that this also influenced western donors' attitudes from that year onward. He finds that there was no significant effect of aid on democratic development before 1987, but that this relation became positive and significant in the second period.

Kersting and Kilby (2014) examine the long-run effect of aid in a cross-sectional study, replicating Knack's (2004) study while adding estimations for a longer time period (until 2007) and with a larger number of recipient countries. The exact replication yields the same insignificant coefficient for democratization as in Knack (2004), but the other models yield positive and significant effects of aid, showing that aid did play a role in democratization of recipient countries over the longer run. The results are robust for endogeneity and other tests.

Ear (2007) examines the effect of aid on the different World Governance Indicators (WGIs) for the period 1996–2004. He does not find any significant effect, but the coefficient on "voice and accountability" is most positive, pointing to a positive effect of aid on democracy. Heckelman (2010) investigates the effect of aid on democratization for Eastern European transitional countries and also finds a positive effect for most of the sub-dimensions of democracy, for the period 1997–2007. More recently, Askarov and Doucouliagos (2013) find a similar positive effect for the same group of countries, albeit with declining returns to scale: above around US $193 in aid per capita, the effect of aid on democratization begins to decline, and becomes negative above US $350.

Jones and Tarp (2016) use the Quality of Government (QoG) database for investigating the effect of aid on political and economic institutions, including democracy. They construct a synthetic measure of the QoG indicators for democracy, number of veto players, executive constraints, political terror, and judicial independence. They use several estimation methods for a sample of 104 countries for the period 1983–2010, and systematically find a positive effect of aid on this synthetic measure. When adding a dummy for the Cold War period, the effect becomes stronger.

Altunbas and Thornton (2014) also look at the effect of aid on several measures of democracy, including both the Polity IV and Freedom House measures. They instrument for aid and use system GMM as robustness test. Aid has a small but statistically significant effect on democracy over the period 1971–2010, and the size of the effect increases over time, pointing to a possible effect of the end of the Cold War.

Bermeo (2016) postulates that aid does not have the same effect on governments as oil, thus contradicting earlier authors such as Morrison (2009) and Bueno de Mesquita and Smith (2010). While oil income is always fungible for any type of regime, aid may be given in different modalities according to regime type. Donors will provide fungible aid to democratic governments or to governments that are strategically important, and non-fungible aid to autocratic regimes that are not strategically important. She expects that aid will have a negative effect on democratization during the Cold War, and a positive effect after that. Furthermore, aid may still have a negative effect on democratization when recipient countries are strategically important. Both of these hypotheses are confirmed for a sample of 129 countries over the period 1973–2000. Given that the results are so different from those of earlier studies, she also replicates the studies by Morrison (2009), Bueno de Mesquita and Smith (2010), and Ahmed (2012).[2] It turns out that both Bueno de Mesquita and Smith, and Ahmed, did not report their findings carefully enough: there proves to be a difference between oil and aid, and between remittances and aid, such that the effect of aid on regime change is not significant. For the Morrison study, the effect of aid proves to be positive in the post–Cold War period, while it was indeed negative in the earlier years.[3]

Yet, there are some (few) studies that do not agree that using data for prior to 1990 makes a difference, or that do not find positive significant effects for the period after the Cold War. For Brazys (2016), the main question is to examine whether there are diminishing returns in the relation between aid and governance. For the period 1995–2008, aid proves to have a positive but diminishing effect on the voice and accountability measure of the World Governance Indicators. However, this effect becomes insignificant under GMM.

In 2015, Askarov and Doucouliagos published a meta-regression analysis on the effect of aid on governance, covering studies examining its effect on democracy and on administrative governance. Among other things, they examined the effect of the end of the Cold War on the results. After an extensive search of published and non-published papers, they identified 25 quantitative studies on the effect of aid on democracy.[4] The 25 studies produce 564 estimated effects and, of these, 32% are positive and significant and 26% are negative and significant. However, when only including estimates based on analyses that control for endogeneity (instrumental variable analysis or GMM), only 10% of

[2] Bermeo tried to replicate the et al., 2008Djankov et al. (2008) study as well, but data proved to be unavailable (Bermeo, 2016, p. 21).

[3] Making this distinction by period proved to be impossible for the Bueno de Mesquita and Smith article due to the underlying structure of the data used.

[4] Unlike the present review, these authors included non-published papers and studies on specific types of aid, like technical assistance or project aid, and they excluded studies that did not disclose full statistical information like estimated coefficients, sample sizes, and standard errors or t-statistics. The search was finished by mid-2012. For all of these reasons the overlap between their selection and the selection in this review is limited.

the results are positive and significant and 63% are negative and significant. This confirms the overall somewhat negative conclusion as postulated above.

When examining the reasons for different results, Askarov and Doucouliagos (2015) find that studies using data from before 1991 are not more negative than studies using data after 1991. This contradicts many of the studies presented here. However, they do find that the results become more positive over time. Other reasons for the heterogeneity in results include: (1) using the Freedom House indicator leads to more positive results, using a binary variable as well; panel data produce more positive results than cross-sectional analysis; and (2) results for the transition countries are more positive than for Africa and Asia. This latter finding is confirmed in this review, as attested by the more positive results generally found for Eastern European and former Soviet transition countries than for Africa (below).

Dutta and Williamson (2016) examine the effect of aid on one specific indicator related to democracy, namely press freedom (from Freedom House). For the period 1994–2010, and when instrumenting for aid, they find that aid has no significant effect on press freedom. However, aid has a small positive effect on press freedom in democracies, but a small negative effect in autocracies (measured with the Polity II variable, the extent of checks and balances).

Asongu and Nwachukwu (2016) look at the effect of aid on all of the World Governance Indicators in 52 African countries for the period 1996–2010. They instrument for aid. In a panel regression analysis, they find no effect of aid on the voice and accountability indicator–-which is usually considered a measure of democracy. However, they include democracy (level of institutionalized democracy, from World Development Indicators) as a control variable as well. Not surprisingly, this effect is large and significant at the 1% level.

In another study on Africa, Asongu (2015a) compares the effects of tax revenues with those of aid, testing the hypothesis that tax revenues are important for improving domestic accountability while aid may have the opposite effect. Surprisingly, tax revenues do not have an effect on the voice and accountability indicator, while the effect of aid is negative and small in difference GMM, and neutral in system GMM. He does find a positive effect of tax revenues on political stability and concludes that this confirms the hypothesis. However, political stability is quite different from domestic accountability. The same author applies quantile regression analysis to examine whether the level of institutional development matters for the effect of aid in Africa. For the period 1996–2010 again, he finds that, at higher levels of democracy, the effect of aid is positive. However, this relationship only proves to hold for the variable "level of institutionalized democracy" (Polity V) and not for the WGI voice and accountability indicator.

The same study by Kersting and Kilby (2014), as discussed above, also includes a short-run analysis with annual panel data, in which the authors account for possible endogeneity in an original way. They first estimate whether the aid allocation by specific donors is influenced by the level of democracy and/or by the strategic importance of a country, measured as being a large recipient of US military aid. All major non-autocratic donors prove to reward democratization, although some do so conditionally on the country being of strategic importance. This latter finding is used as input in the regressions estimating the effect of different types of donors on a change in the democracy index one year later. The authors conclude that aid from DAC donors has a positive and significant effect on the change in democracy, while this effect is negative and significant for autocratic donors, and positive but not significant for multilateral aid. They also find that the positive effect of aid from DAC donors weakens if a country receives more than 33% of aid from donors that do not reward democratization if a country is strategically important. This means that there is an "incentive effect" when donors reward democratization no matter the strategic importance of a recipient country.

In a similar vein, Bermeo (2011) examines whether the type of donor matters for the effect of aid on democratization. She shows that aid from democratic donors has a positive effect on democratic regime change, while aid from autocratic donors has a negative effect. This is based on data from 87 countries and for the period 1992–2007. She concludes that donor intentions matter for the effect of aid on democratization.

All in all, it seems that the unintended aggregate negative effects of aid on democracy are much exaggerated. While the majority of studies covering the period until 1990 reveal a negative effect or no effect, the balance is on the positive side for the studies covering the period after the Cold War–although perhaps somewhat less so for Africa. Taking the more recent empirical studies into account, it is clear that donor intentions matter for the effect of aid on democracy in the sense that aid tends to weaken democratization in countries that are strategically important for donors.

4.1. *Aid and political stability*

There are a few case studies of African countries showing that donors have done unintended political damage and have contributed to civil conflict. In Lesotho, aid proved to strengthen bureaucratic state power at the cost of the poor peasants for whose benefit it was originally intended (Ferguson, 1990). In Rwanda, aid in the early 1990s proved to reinforce existing socioeconomic and ethnic inequalities. This contributed to the "structural violence" that later erupted as real racial violence, leading to one of the most brutal explosions of violence in history in 1994 (Uvin, 1998). Van de Walle (2012) shows that donors in the Mali of the years before the coup focused too much on the executive branch of government, gave too little attention to mechanisms of horizontal accountability, and turned a blind eye to already existing threats to democracy.

Collier and Hoeffler (2002) examine the effect of aid (and economic policy) on the risk of the outbreak of civil war. They do not find a direct effect, but do find an indirect positive effect of aid. Aid leads to an increase in economic growth and to a reduction in dependence on exports of primary commodities. Both have been found to reduce the risk of conflict. De Ree and Nillesen (2009) examine the effect of aid both on the onset of civil conflicts and on their continuation. In line with Collier and Hoeffler (2002), they do not find an effect on the start of conflicts, but they do conclude that aid has a negative and significant effect on the continuation of civil conflict. They control for endogeneity and use fixed effects to control for unobservable country characteristics.

Savun and Tirone (2012) examine the effect of aid in combination with economic shocks on the outbreak of civil wars. They hypothesize that economic shocks make civil wars more likely due to three possible channels: reduced government spending for social services, reduced military expenditure (hence lower repression of insurgent factions), and the reduced opportunity costs of civil wars. They measure shocks by looking at a large decrease in the global agricultural raw materials index in combination with high agricultural exports. On the basis of annual panel data for aid-eligible countries from 1990 to 2004, they find that aid (received in the previous year) reduces civil wars in general, while aid also reduces civil wars when there is an economic shock.

Kono, Montinola, and Verbon (2015) postulate that the effect of aid on civil unrest is different in democracies than in autocracies. Aid will have no effect on unrest in democracies but will reduce unrest in autocracies due to increased resources for repression and deterrence. Civil unrest is defined as the incidence of demonstrations, general strikes, and violent demonstrations–all of a certain minimum volume. In a panel regression analysis with a one-year lag for aid for 84 countries for the period 1970–2007, they find that aid reduces unrest in autocratic countries, while there is indeed no effect of aid in democracies. They also test the assumed causal mechanism, and it proves to be confirmed: aid increases military spending in autocracies and not in democracies, and increased military spending reduces unrest in autocracies and not in democracies.

While the original hypothesis was that aid increases political instability due to the higher value of state resources, the cross-country empirical studies do not support this claim. Some find an indirect mitigating effect of aid on civil conflict through socio-economic development or through reducing the effects of economic shocks; others find such an indirect effect through increased military spending and deterrence, especially in autocracies. Yet other studies find a direct effect on reducing the chance of civil conflict or on the continuation of civil wars. Overall, it appears that aid contributes to lessening domestic conflicts.

5. Aid and the administrative dimension of governance

Several authors have examined the effect of aid on the quality of governance. Knack (2001) finds for the period 1982–1995 that aid has a negative effect on bureaucratic quality, measured by the International Country Risk Guide (ICRG) of the Political Risk Services (PRS) Group. Knack and Rahman (2007) include a formal model showing that "poaching" leads to a lower quality of domestic governance. Their empirical tests confirm that more aid fragmentation leads to a lower bureaucratic quality in recipient countries. These studies instrument for aid in order to control for possible endogeneity: aid may be induced by low bureaucratic quality, or there may be another factor that causes both aid and low bureaucratic quality.

Rajan and Subramanian (2007) conclude that aid has a negative effect on governance in an indirect way. They show that aid has a negative effect on the growth of those industrial sectors that depend on the quality of governance. Their study covers the period 1980–2000.

Coviello and Islam (2006) also examine the effect of aid on bureaucratic quality as measured by the ICRG. Contrary to the previously mentioned studies, they do not find a significant effect. They argue that it is necessary to include country fixed effects, and that this may be the reason for the negative effects found in other studies. Ear (2007) comes to a similar conclusion while using the six dimensions of the World Governance Indicators for a sample of 155 countries and for the period 1996–2004. When using pooled time series in a cross-sectional model, instrumenting for aid and taking into account fixed country effects, there is no significant effect on government effectiveness.

Selaya and Thiele (2012) distinguish between aid grants and aid loans. For the period 1995–2005, they find that grants have a negative effect on bureaucratic quality, while loans do not; the effect of both aid forms together is negative.

Brazys (2016) finds a positive but diminishing effect of aid on bureaucratic quality (ICRG) and government effectiveness (WGI). He examines the period 1995–2008. However, these findings are not fully robust, as the former is the result of an OLS regression alone, and the latter of system GMM alone. Yet, they would be fully in line with the assumptions underlying the Paris Declaration on aid effectiveness. In his quantile regression analysis for Africa, Asongu (2015b) finds that the effect of aid on government effectiveness is more negative at higher levels of government effectiveness. But this study does not address possible endogeneity. Asongu and Nwachukwu (2016) instrument for aid in their study on African countries and find a negative effect of aid on government effectiveness.

Askarov and Doucouliagos (2013) look at the effect of aid in transition countries (see above), not only on democracy, but also on other variables measured by the World Governance Indicators. They do not find a significant effect for any of these indicators.

All in all, the evidence of the cross-country empirical studies is not unambiguous. Most studies covering earlier periods (until 1995, or until 2000) show that aid, in particular aid proliferation and fragmentation, leads to a lowering of the quality of bureaucratic governance in developing countries, but some of these outcomes are contested by Coviello and Islam (2006). Most studies covering a more recent period, from around 1995 onward, conclude that there are no significant effects of aid on government effectiveness or bureaucratic quality. These latter findings may point to some positive effects of increasing donor awareness of the negative effects of aid fragmentation and proliferation.

6. Aid and the judicial dimension of governance

This section examines the cross-country evidence of the effect of aid on the two judicial sub-dimensions of good governance, rule of law and (control of) corruption.

Svensson (2000) develops a model showing that under certain conditions, in particular if countries' populations are ethnically divided, more government resources lead to less productive public spending due to rent seeking. In an empirical analysis and instrumenting for aid, he finds that aid increases corruption in countries with competing groups. In other countries, he does not find this negative effect.

Knack (2001) examines the effect of aid on ICRG measures of rule of law and corruption. When instrumenting for aid, aid proves to deteriorate the rule of law and to increase corruption. Alesina and Weder (1999) conclude that aid increases corruption. But they only look at bilateral flows and do not instrument for aid, so they cannot exclude a reverse relationship. Tavares (2003) uses the same indicator for corruption and finds for a longer time period that aid decreases corruption. He includes bilateral and multilateral ODA and does instrument for aid. Coviello and Islam (2006) also examine the effect of aid on the rule of law and corruption indicators of the ICRG and find no significant effects. As mentioned above, they include country fixed effects and argue that when this method is applied to the earlier studies of, for example, Knack (2001) and Tavares (2003), the significant (negative or positive) effects of aid vanish.

Braütigam and Knack (2004) look at the effect of aid on an average of the ICRG measures for bureaucratic quality, corruption, and rule of law in 32 African countries. They find a negative effect for the period 1982–1997. They also examine whether the effect is more positive for the period after 1990, assuming that donors began to allocate more resources and efforts in improving governance in recipient countries. However, they do not find any difference between the two periods. Busse and Gröning (2009) use a similar composite governance indicator, namely the average of ICRG scores for bureaucratic quality, corruption, and law and order. They take a somewhat longer time period into account, 1984–2004, and find a small but statistically significant negative effect of aid.

Two studies on this topic use Quantile Regression analysis. This allows for differentiating the effect of aid for countries with lower versus higher levels of corruption. Okada and Samreth (2012) find that aid reduces corruption and that the effect is stronger at lower levels of corruption. They examine the period 1995–2009 for 120 developing countries. When looking at groups of donors, they establish that it is multilateral aid in particular that reduces corruption; bilateral aid has no effect. Mohamed, Kaliappan, Ismail, and Azman-Saini (2015) look at Sub-Saharan African countries for the period 2000–2010 and do not find any effects of aid, multilateral or bilateral. However, in both of these studies it is not clear how the authors have dealt with endogeneity or reverse causality.

Young and Sheehan (2014) examine the effect of aid on one of the components of the Freedom House Index, namely the protection of property rights. This is an important aspect of the rule of law. When looking at the years 1970–2010, thus including the Cold War period, and instrumenting for aid, they find that aid has a negative effect on this indicator. The above-mentioned study by Ear (2007) uses the WFGI indicators for rule of law and control of corruption. It finds no effect on corruption, but a weakly significant (at 10%) negative effect of aid on the rule of law for the period 1996–2004.

Like Braütigam and Knack (2004), Charron (2011) also assumes that the time period makes a difference for examining the effect of aid on corruption. Around the mid-1990s, many international organizations, most notably the OECD, the World Bank, and the IMF, began an "anti-corruption movement." He argues that this may have changed recipient countries' behavior. He uses panel data for 82 developing countries for two periods, 1986–1996 and 1997–2007. With the same ICRG indicator for corruption, he finds that bilateral aid never has an effect on corruption, while for multilateral aid there was a clear difference between the two periods: after 1997 multilateral aid proves to have decreased corruption. He applies GMM system estimators and 2SLS to control for endogeneity (Charon, 2011).

Finally, Menard and Weill (2016) examine the two directions of possible causality between aid and corruption via Granger causality tests using a GMM dynamic panel system. They investigate the period 1996–2009 for 71 countries and use the corruption indicator from the WGI. They focus on short-run effects and find no significant effects of aid, either for multilateral or bilateral aid separately, or for aid to certain regions.

Overall, there is little proof that aid flows systematically lead to an increase in corruption. As with the other dimensions of good governance, it is very difficult to disentangle the effect of aid from the reverse effect, and results appear to depend largely on samples, data, time periods, and estimation methods.

7. Conclusion

The relation between aid and good governance is multifaceted. Donors usually are of the opinion that good governance is both an aim in itself and an instrument for enhancing development. As a result, they use good governance indicators as selection criteria in aid allocation and attempt to improve governance through specific projects or by having a policy dialogue with recipient governments. For all those reasons, one would expect that, on average, aid would improve governance. Yet, many authors claim that aid, and especially large aid flows in relation to the recipient economies, tends to cause a deterioration of governance. Aid leads to weakened domestic accountability and to more corruption. It tends to maintain authoritarian regimes and to promote political instability. The presence of many donors and projects undermines government capacities for policy making and policy implementation. This means that it is an empirical issue whether the intended positive effects or the unintended negative effects of aid on governance dominate.

This paper reviews the empirical evidence on the aggregate effects of aid on good governance. As with the relation between aid and economic growth, the empirical analysis of this relationship is riddled with problems. Aid is only one of the factors influencing governance, and it is very difficult to deal with possible endogeneity and reverse causation. In addition, aid is heterogeneous: it may be given for other than development reasons, and it is more or less fungible. Finally, indicators for governance may be subjective, especially for the judicial and administrative dimensions of governance. As a result of these problems, it is not unsurprising that we find many different and contradictory results for the effect of aid on governance. Nevertheless, some conclusions are possible.

In general, the negative unintended effects of aid on governance are much exaggerated for all three dimensions. For the relation between aid and democracy, the end of the Cold War seems to have had a positive influence on the aggregate outcomes. While before 1990 the effect of aid on democracy was negative or non-existent, after 1990 aid has, on average, strengthened democratization in recipient countries—with the possible exception of countries that are strategically important for donors. Most studies show that aid reduces the chances of domestic conflict, although sometimes through the channel of increased (threat of) repression.

The studies of the aggregate effect of aid on the administrative dimension of governance also point to slightly improving results over time. Studies covering a more recent period are more positive than studies dealing with periods until 1995 or until 2000. This may imply that increased donor awareness of the negative effects of donor proliferation and donor fragmentation has had a positive influence on governance outcomes. Finally, in the judicial dimension of governance, studies do not show consistent outcomes. Yet, there is no systematic evidence that aid increases corruption. In this area there is also some evidence that the time period and thus donor intentions matter for the outcomes. When, in particular, multilateral donors became more serious about combating corruption, the results become more positive.

From these conclusions, some policy implications can be drawn. In general, it is clear that donor intentions can make a difference for the aggregate effects of aid on governance. Donors that are serious about their *intended* effects on, for example, democratization, corruption, or mitigating the negative effects of donor proliferation are able to decrease possible negative *unintended* effects.

In order to enhance positive effects of aid on democracy, donors can reduce aid, and in particular highly fungible aid, to authoritarian regimes. However, there appears to be somewhat of a trade-off between the democracy and the political stability objective within this dimension, to the extent that aid to authoritarian regimes may help to maintain stability through increased military spending.

For the aggregate effects of aid for the administrative dimension of governance, it is clear that donor behavior can reduce the negative effects. For this reason, donors and recipients alike have agreed to principles like alignment and harmonization. Bigsten and Tengstam (2015) estimate the benefits from improved donor coordination and from providing more resources in the form of budget support, and they prove to be substantial. However, the evaluation of the implementation of these principles has shown that there is still a lot to be improved, especially on the donor side (Wood et al., 2011). More seriously, it seems that in recent years the situation is deteriorating. There is an increasing number of non-DAC donors such as China, Brazil, and Venezuela, as well as an increasing number of other aid agencies (vertical funds, private foundations) and NGOs, that are less committed to the Paris Declaration. At the same time, many DAC donors are backtracking from the Paris Declaration principles. These developments may increase the negative unintended effects of aid on governance again.

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