

*Department of Agricultural &
Resource Economics, UCB*
CUDARE Working Papers
(University of California, Berkeley)

Year 2003

Paper 982

Beyond Bono: Making Foreign Aid More
Efficient in Putting into Place the
Development Fundamentals

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**Beyond Bono:
Making foreign aid more efficient in putting into place
the development fundamentals**

(The Challenge of increasing aid efficiency)

Rich countries' levels of foreign aid as a share of their GDP have fallen dramatically over the last thirty years. The United States' current aid spending of one tenth of one percent of GDP pales in comparison to the UN's 0.7% goal, a level met today by only a few good world citizens such as the Danes, the Dutch, and the Swedes. Following September 11, there is, however, some hope that foreign aid budgets may rise again among delinquent countries. At the UN's March 2002 Monterrey Conference on Financing for Development, President Bush announced a \$5 billion increase in U.S. spending, raising U.S. foreign aid by no less than 50%. Under the influence of his guide, U2 rock star Bono, then Treasury Secretary Paul O'Neill returned from his tour of Africa better disposed toward higher foreign aid budgets. This, however, under the condition that use of funds be made substantially more efficient, a legitimate stipulation in the face of the ineptitude, waste, and corruption often associated with foreign aid and recently exposed by William Easterly. Showing how efficiency can be increased is thus an unavoidable challenge for advocates of higher aid budgets.

(Education and the fundamentals of development)

Education has increasingly been recognized as a fundamental pre-condition for economic development. In a May 2, 2002, New York Times editorial, Alan Kruger proposed using Bush's additional foreign aid to boost expenditures on education, taking inspiration from Mexico's Progresas program. This \$1 billion a year program pays poor rural mothers to send their children to school from the fourth year of primary to the third year of secondary school, conditional on regular attendance and health check-ups.¹ The UN's Millenium Development Goals also stress the importance of raising educational levels, proposing to achieve universal primary education by the year 2015. Indeed, improving the quality of education and assisting poor rural parents in sending their children to school seems like an effective strategy to break the inheritance of poverty. The theory is that poor people do not have the means of investing in the education and health of their children, thus creating a vicious circle of poverty. With some 65% of the world's poor located in rural areas, and with rural poverty finding its way into urban poverty through the migration of individuals unprepared for urban employment, focusing on rural education seems like a good move indeed. Progresas demonstrated the remarkable result that when cash transfers are made to poor parents conditional on school attendance and health visits, the educational achievements of their children can be raised to the same levels as that of the non-poor. The success of this approach has inspired similar programs in Honduras, Nicaragua, Costa Rica, Jamaica, Brazil, Colombia, and Turkey.

¹ Under President Fox, this program has been renamed "Oportunidades" and is being extended to semi-urban areas and to a full six years of secondary education, increasing in 2002 the budget to \$1.8 billion.

(Good policies for efficiency)

The problem in building support for these programs, and in enticing higher foreign aid budgets in general, is meeting the efficiency condition. There are two ways of achieving this goal. One approach is the credo increasingly endorsed at the World Bank and by the U.S. government that aid can only be effective in countries that follow good economic policies. This includes control over inflation, budgetary balance, and open trade. Time and again, however, we have seen that such policies cannot be imposed by donors as a condition for receiving aid, as they can too easily be faked. The logical conclusion is that good policies have to be in place before aid is granted. Unfortunately, given that underdevelopment is precisely synonymous with bad policy, this is a pre-condition that very few countries meet. Therefore, the dilemma of the “good policy approach” is that it disqualifies the majority of the world’s poor, leaving them in the purgatory of development. Fortunately, for programs that seek to put into place the basic fundamentals of development – education, primary health care, nutritional needs of mothers and children, and family planning – aid may not need have to wait for good policies to be in place.

(Good programs for efficiency)

The alternative approach to meet the efficiency condition is to look for good programs instead of good policies. This is a less stringent demand since programs can use delivery mechanisms such as semi-autonomous agencies, decentralized levels of government, and NGOs that can be effective without having to wait for overall good policies. While programs will rarely be effective for income generation without good policies, they can at least save time in putting into place the fundamentals of economic development, education in particular. Donors’ increasing appreciation for the social fund approach (an autonomous distribution mechanism) to alleviate the welfare costs of economic crises is precisely due to this. Special educational programs for the rural poor in Nicaragua, Colombia, and Honduras also follow this approach. Designing good programs has the advantage of allowing aid to reach the poor even under conditions where good public policies may not be in place. The efficiency challenge is thus to find ways of improving the performance of such programs.

(Making educational programs more efficient)

Educational grants programs targeted at the poor are quite expensive. The educational component of Progreso is an annual \$418 million that reaches 2.4 million children in 2.6 million rural households. Transfer per child is \$100/year in primary school and \$200/year upon entry in secondary school. Expanding this program to the children of the 17 million extreme poor in Mexico (people who live on less than 1\$/day) would require \$2.7 billion, half of Bush’s incremental aid increase for the whole world. And Mexico’s poor are only 1.4% of the world’s extreme poor, a population that numbers 1.2 billion. Clearly, O’Neill was right: aid is minuscule to meet existing challenges at current efficiency levels. While Bono was effective in helping him see the need for more

foreign aid, the question of how to meet the efficiency challenge remains unanswered. It is up to development experts to take the baton from rock stars in completing the task. Of particular importance is to explore whether the efficiency of cash transfer programs in support of setting up the development fundamentals could be improved by redefining the way the beneficiaries of these programs are selected and the transfers calibrated.

Targeting for program efficiency

(Targeting to induce a change in behavior)

There are two fundamental principles that should guide the efficient targeting of any program intended to induce behavioral responses among recipients. One is to only pay people to make them do what they would not otherwise be doing. The other is to calibrate the transfers to give them the necessary incentive to alter their behavior and nothing more. Cash transfers to induce more rural parents to send their children to school should follow these principles.

(Targeting on poverty is inefficient)

Take what can be learned from Progresas as a laboratory. As in most other educational programs of the same vintage, cash transfers are targeted to poor households in poor communities, using secret formulas to define eligibility in order to avoid the imitation of poverty by those who would like to qualify but do not. Those who are thus categorized as poor receive cash transfers in exchange for sending their children to school and to health care visits. Using poverty as a criterion for educational cash transfers is, however, highly inefficient in boosting educational achievements in rural areas.

(No need to pay the poor for primary school)

In Mexico, primary school attendance among the rural poor is already virtually universal. This is vividly displayed in Figure 1 (dotted line for control villages) where 98% of poor children in poor rural communities start primary school and 91% complete it. The continuation rates all exceed 97%. Enrollment gains from Progresas transfers to primary school children are at most 1% point per year (plain line for Progresas villages in Figure 1). Hence, 99 children have to be paid to get one more child into school, clearly a highly inefficient approach in helping the few at risk of not attending primary school. While each child receives \$100/year to attend primary school, the cost per child effectively induced to go to school due to the transfer is no less than \$9,600/year, almost as much as the cost of a year of undergraduate education at UC Berkeley, complete with fees, room, and board. Abandoning payments for primary school on the basis of poverty would help save 55% of the program's educational budget, freeing resources for where real problems exist.

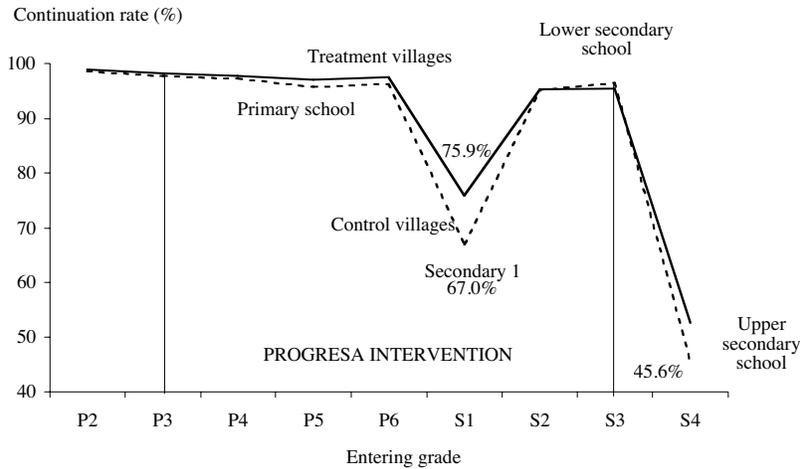


Figure 1. School Continuation Rates in Poor Rural Communities
 (---- Control village, — Progresa treatment village)

(How inefficient is targeting on poverty?)

It is only in secondary school that dropout rates become alarming. As can be seen in Figure 1 (dotted line), only 67% of the children who finish primary school enroll in secondary. Here again, however, targeting on the basis of the poverty criterion is highly inefficient. Many poor parents in fact do send their children to secondary school because they value education and can afford public school, while many non-poor parents do not send their children to school because they have no appreciation for education or cannot afford the cost. In addition, because the cash incentive is a fixed amount (adjusted only to grade and gender, but not to other circumstances that characterize specific children), for many poor the offer of a Progresa transfer is insufficient for them to decide to send their children to school. The inefficiency of the poverty criterion used in targeting can be summarized in the following figure:

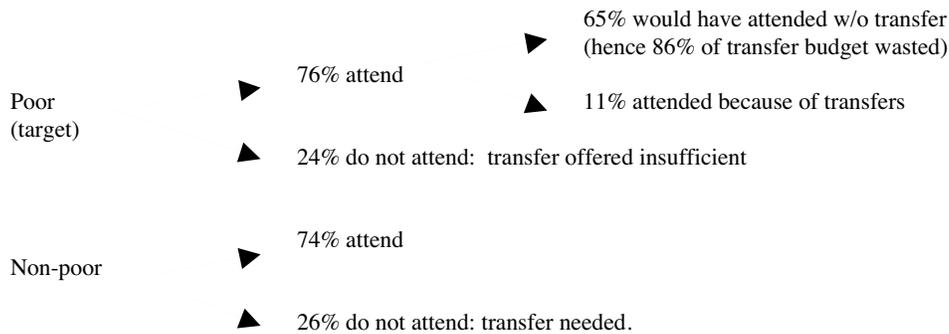


Figure 2. Why targeting educational transfers on the basis of poverty is inefficient

What we read in this figure is that 65% of the subsidized poor do not need a subsidy to send their children to school, 24% of the poor are offered a subsidy which is insufficient for them to decide sending their children to school, and 26% of the non-poor do not send their children to school which they might do if they received a subsidy. While every

qualifying child receives \$200/year, the effective cost of bringing an additional child to secondary school is \$1,360. Clearly, targeting uniform cash transfers on the basis of poverty is a highly inefficient criterion if raising educational achievements is the goal.

(Targeting for efficiency gains)

What could be done instead of uniform targeting on poverty is apply the two principles stated above. First, target transfers to children most at risk of not going to school, irrespective of whether they are from poor households or not. Second, calibrate the transfers to the minimum amount needed to induce parents to take the decision of sending a particular child to school. We can analyze these two options to see what efficiency gains they offer.

(Predicting which children are at risk)

Predicting who is at risk of not going to school is not more difficult, and in fact easier, than predicting who is likely to be poor. For a Mexican child in a poor rural community, the main predictors of risk of not going to school are age (positive), gender (positive for girls), rank of the child in the family (negative), educational levels of the parents and older siblings (negative), parents' poverty status (positive), quality of dwelling (negative), presence of a secondary school in the village (negative), and distance to a secondary school if there is none in the village (positive). For the same budget as currently used in targeting educational transfers on poverty, targeting on risk would raise Progresas's gains in educational achievements by 29%. If, in addition, transfers are, calibrated to the minimum amount needed to obtain the desired change in behavior, Progresas's gains in educational achievements could be raised by 100%, again for the same budget. With this approach, the cost per child effectively induced to attend secondary school drops by half, from \$1,360 to \$675.

(Feasible programs)

Any effective cash transfer scheme must be easy to implement, transparent to all, and beyond possible strategic manipulation by would-be beneficiaries. If these qualities are met, then self-registration, the ideal approach to selecting beneficiaries, would be possible. If, to identify children at risk, we want to choose selection criteria that are easily observable and cannot be manipulated, we will exclude indicators such as age (parents could postpone sending their child to school to increase the likelihood of a transfer) and poverty (which is hard to predict). In this case, efficiency gains are lowered, but still remain 80% above current Progresas achievements, and the cost per child effectively brought to school is \$797. Finally, if aid purists say that the non-poor can help themselves, and that we should target transfers on children at risk only among the poor, then gains in enrollment due to the program can still be increased by a very respectable 64%, at an effective cost per child of \$846. It is hard to admit, however, that children at risk should be excluded just because their parents in these poor rural communities are classified as non-poor. Clearly, what should matter in deciding on targeting is the child's welfare and the likelihood of future poverty, not the current

income level of parents who may not be sending their children to school because they are uneducated themselves or live far away from a secondary school.

(Achieving self-registration)

Using these simple rules has the advantage that a program can announce the eligibility conditions publicly and let people self-declare as to whether they qualify. Registration of the specific features of each child that determine his or her level of risk of not going to school then imply the level of cash transfer. Community verification may be needed for declarations such as educational levels achieved by parents, but this is easy to arrange in small communities where gossiping implies that private information is public to all.

(Size of efficiency gains)

Altogether, combining savings on primary school and improved targeting in secondary school, the current gains in educational achievement induced by Progresa could have been obtained with only 25% of the initial budget, a good step toward meeting the higher efficiency requirement. Alternatively, 55% of the budget currently spent on primary education could be saved, and educational achievements in secondary school increased by 80% if the remaining budget is targeted on risk instead of poverty, calibrated to the necessary incentives, and uses self-registration. To achieve this efficiency gain, the available budget is allocated across all children in rural communities to equalize their chances of going to school, the true meaning of affirmative action. The higher the available budget, the lower this residual risk will be.

Why the fixation on poverty?

(Large efficiency gains are feasible)

The Progresa experience shows that significant efficiency gains can indeed be achieved in using foreign aid budgets to support development programs. The question, however, is why programs aiming at securing the development fundamentals have been targeted on poverty instead of risk of not achieving their specific objectives.

(Going beyond poverty at the program level)

By redefining the World Bank's overriding objective as poverty reduction, Jim Wolfenson has revolutionized the way the Bank selects projects for funding. Following the Bank's leadership, many other development agencies have similarly aligned their objectives toward poverty reduction. There is, however, confusion between the overriding objective of an organization and the objectives of particular projects, even when the projects do indeed serve the ultimate poverty reduction objective of the organization. Particular programs are designed to attack specific determinants of poverty, and they will be maximally effective not by targeting on poverty, but by targeting on where and how they can have maximal impact with the instruments they use,

for instance enhancing educational achievements among populations in poor rural communities.

At the program level, targeting on poverty needs to be replaced by targeting on risk of not achieving the program's desired purposes. Only when programs are aimed at relief for those currently in poverty is targeting on those observed to be effectively poor adequate. Even in this case, self-targeting through workfare programs or the distribution of inferior foods will be better than targeting through observable symptoms of poverty. It is thus high time to realize the efficiency gains that can indeed be achieved in anti-poverty programs that seek to put into place the development fundamentals. In these programs, targeting should be designed to equalize the population's residual risks of not acquiring these fundamentals. Going beyond Bono's convincing act that aid is important to meeting the Bush administration's request that it be made more efficient will require revisiting the fundamental practices in the targeting of social development projects. While poverty reduction is the ultimate objective, efficiency dictates that targeting rules for specific programs need not be the same as the organization's ultimate objective. It is only through the organization's entire portfolio of projects, coordinated in a comprehensive development framework, that the poverty reduction objective will be met, while each program should be designed for maximum efficiency in meeting its own particular objectives.

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