LOCALISING AID

Sustaining change in the public, private and civil society sectors

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EXECUTIVE SUMMARY

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This report examines the proposition that by localising their aid – by which we mean transferring it to national rather than international entities – external donors can play a part in strengthening three sectors of society: the public sector (state); the private sector; and civil society. In a previous paper – 'Localising aid: can using local actors strengthen them?' – we set out the framework for our research, and a forthcoming series of shorter papers will discuss what our research findings may mean for donors facing complex constraints. This paper sets out our research findings and conclusions based on extensive literature analysis supported by three country studies: Guatemala, Liberia and Uganda.

A core element of the Paris Declaration on Aid Effectiveness, and subsequent fora, is that donors should progressively increase their use of host country systems. ODI's "Localising aid" work evolves this approach in four key ways.

First, we define a new category of aid delivery: 'localised aid' is aid money that is transferred directly to, or through, national entities. This concept is very much in the same spirit as the "using country systems" popularised by the Paris Agenda, but has a number of advantages, including being easier to define and count.

Second, we set the scope of our research to cover three pillars, the three main sectors of society: state, private and civil society. This scope is in line with the spirit of Busan which sought to expand the vision of development practitioners beyond strengthening the state to include a concern for the private and civil society sectors as well.

Third, acknowledging that the Paris agenda has been criticised for focusing on stable low-income countries, we analysed three categories of country to determine the relevance of localising aid: stable low-income, middle-income, and fragile states.

Finally, we decided to focus on system-strengthening and sustainability rather than other possible development objectives, namely improving short-term results and reducing costs.

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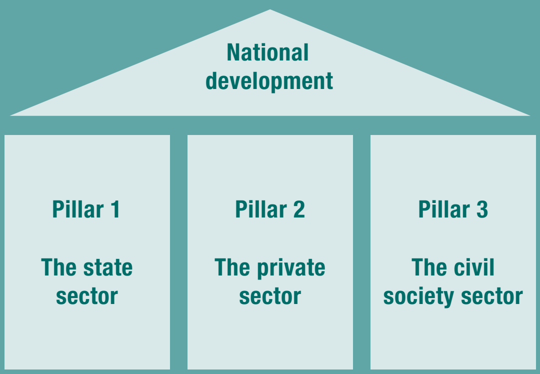
The three research pillars



After a brief introduction, the report is structured around the findings of the three pillars of our research with a few final conclusions which span each of the pillars. Looking first at the state sector (section 2), our literature analysis and country studies suggest that localising aid is associated with improvements in state capacity. We identified two main reasons that localised aid packages were considered to actively help strengthen state systems. First, they incentivise increased technical and political engagement from donor agencies, civil society and domestic accountability bodies. Second, they can buy donors “a seat at the government’s table”, enabling them to apply pressure for specific systemic changes (among others) via policy dialogue and aid conditions.

The literature is mixed on the impact localising aid can have on state accountability. Our research suggests that, on the one hand pressure from donors that do localise their aid appears to have brought accountability actors, such as parliament and civil society, more into play. It has also encouraged state actors to be more open to vigilance. On the other hand, the deeper involvement in state processes implied by localising aid has led to accountability moving more towards donors than domestic stakeholders.

There are good grounds to believe that in most cases localising aid will mean more information about the activities of major external actors in the hands of the host government, enabling accountability. The crucial accountability link between aid providers and international citizens (i.e. those that fund aid with their taxes) is one that many donors fear will be weakened if aid is localised.

There are three reasons to be cautious about this evidence associating localised aid with state capacity strengthening. First, there is a causality problem to do with the lack of a counterfactual: we do not know whether the improvements in systems which occurred at the same time as aid was localised were caused by such localisation, or otherwise. Second, there are other well-evidenced means to build capacity and strengthen systems, and the evidence that using alternate aid modalities undermines the gains from localised aid is weak. And third, the evidence base is confined to quite a limited group of fairly aid dependent countries. As countries rely less on aid and more on domestic resources, the theory of change behind a decision to localise aid will necessarily alter.

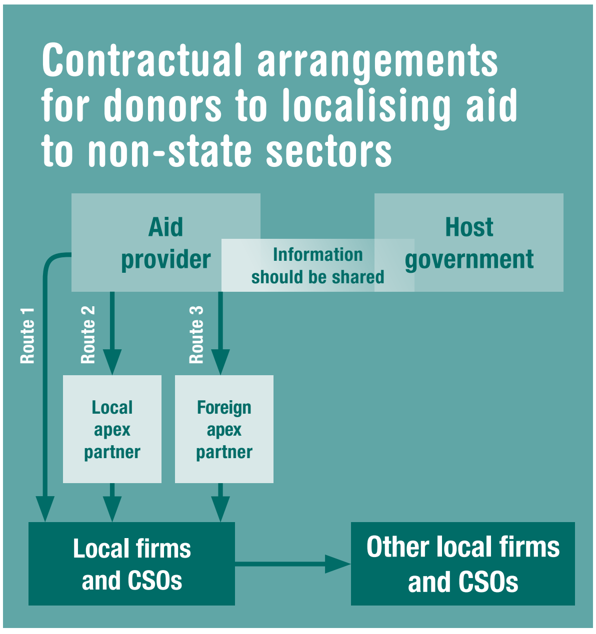
We conclude that while localising aid is not the only way to strengthen state systems, it is a crucial tool in the toolbox. This means that donors who are unable and unwilling to localise aid will be at a significant disadvantage to those that are willing and able. We also conclude that the main reasons for localising aid hold in all country contexts. Empirical evidence from highly corrupt or fragile countries demonstrates that localising aid, managed appropriately, can have strengthening benefits. And localising aid does not mean relinquishing control of donor monies, as is sometimes assumed. There is a spectrum of options that can cater to the risk-aversion of the donor and the analysis of the country context.

We open our analysis of the non-state sectors with a brief introduction (section 3). We define “local” private sector and civil society actors as those which a) plan to do their business indefinitely in the country and b) are required to be registered under companies, charities, NGOs or taxation laws. Donors can localise their aid through a variety of contractual frameworks and can use a variety of means to encourage aid-recipient governments to also prioritise local organisations.

We suggest three categories of benefit from localising aid to the private and civil society sectors. Firstly, to support the national economy in general via Keynesian multiplier effects, greater local employment and reduced distortion of the labour market. Secondly, to support national (and possibly sub-national) governments, via increased government revenues and better public finance and contract management. Lastly, for the strengthening effects on non-state systems and entities themselves - the subject of our enquiry.

The lack of empirical evidence on how aid affects the productivity of local firms presented a methodological challenge for our research into the private sector pillar (section 4). This led us to rely on broader research on the economics of the firm, in addition to our usual evidence base. We start with the propositions that private sector institutional capacity determines how effective firms are in achieving their goals and that strengthening the private sector means strengthening the productivity of firms, and/or the efficiency with which they can deliver outputs. Part of this involves factors that lie within the firm itself (such as the quality of its leadership); part involves the incentives provided by the environment in which the firm operates; while another part depends on the efficiency of the rest of the economy which provides factors of production like capital, labour and materials, as well as the incentives provided by markets for the firm's output.

The mechanism by which localising aid can increase a firm's productivity operates through the market for public goods and services. Aid can both increase the size of this market and strengthen incentives that increase the productivity of suppliers of goods and services which the market demands. An increased share by localised firms would create opportunities for existing firms to grow and for new entrants. We hypothesised that a greater share of aid flowing to localised firms would increase both the size of the local private sector (in number of firms) and the productivity of the local private sector, *providing* that there are incentives for efficiency operating across the market for goods



and services financed by localised aid. We found no statistical evidence for this hypothesis, but our fieldwork implied that it might hold.

Our review of the literature indicates that there are a number of key policies whereby government and partners can influence the way the market for public goods and services works: procurement policy; anti-corruption policy; preferences for locally owned firms; and "industrial" policies. We also identified aspects of aid that could be altered to promote the local private sector, including specification of technology requirements; size and complexity of bid packages; requirements for a supplier to qualify prior to submitting a valid bid; and efficiency of the payments system, which affects a contractor's working capital and cash flow.

We end with suggestions for how donors could strengthen the market for public goods and services and promote a stronger local private sector. These include making strengthening the capacity of the local private sector an explicit objective in foreign assistance, including in contracts; taking a whole-of-market approach to facilitating the development of the local private sector; a new approach to managing economic rents and anti-corruption; and better measurement of the impact of aid on the local private sector.

Drawing analogies from the Paris Agenda, individual civil society organisations carry out many of the same institutional operations as state bodies, and we theorise that localising aid to the civil society sector will result in positive strengthening impacts following a similar logic (section 5). As with the state sector, we define a stronger civil society first in terms of its capacity (core organisational functions for delivering development programmes) and second its accountability (responsiveness to, and representation of, their constituent's needs). First we identify the main problems faced by donors seeking to strengthen national civil society. Then we assess whether localising aid might help to resolve them.

With regard to sector wide issues, there are two main challenges. First, the tension between seeking to support local leadership of the development agenda whilst holding the purse strings, which we term "aligning with NGO priorities". Second, there is the obvious but complex problem of deciding which organisations to support, which is often as much a political decision as a technical one.

As for strengthening individual organisations, there are four main challenges for donors. First, donor demands for quantifiable outcomes, often over very short periods, have increased the scrutiny and performance culture applied to development activities. They have been criticised for imposing models of evaluating change, and reducing attention on longer term development outcomes. Second, the way overheads are managed in a grant or contract can have significant impact on organisational strengthening. Too often donors are not adequately covering overheads in the support they provide to NGOs, which leaves these organisations struggling to strengthen their capacity. Third, short-term funding undermines organisations' attempts to plan better and leads to constant funding challenges. And fourth, flexibility once the contract has been signed is critical. The dominant experience of NGOs is one of limited flexibilities offered by donors in terms of the timing and nature of project activities.

Our research does not provide conclusive findings on whether localising aid will help solve these problems, and emphasises the context-specificity of these spending decisions. In most donor agencies the administration costs for a small grant are not significantly smaller than for a large grant. This means the use of apex organisations to manage large contracts or grants is likely to persist, both to save money and to target support to local NGOs more effectively. Some agencies, most notably USAID, are seeking to use local apex contractors instead of international ones in a bid to strengthen local civil society. Such an approach may help strengthen the large organisations managing the contracts/grants, but it is not clear whether other organisations, or the sector as a whole, will necessarily benefit. In fact, international organisations may be better placed to strengthen local civil society in some contexts, even if costs are likely to be higher. Our analysis of multi-donor funds also offers mixed evidence, with the challenge of reaching less formal NGOs and following local priorities still very much apparent. We end this section with a discussion of the importance of core support as opposed to project support, which can be important in targeting specific constraints and beneficiary groups but may be less effective at strengthening organisational capacity and ownership.

We conclude that while localising aid is no magic bullet in any of the sectors, it must be considered as a critical element in any aid strategy aimed at strengthening systems. We set out four findings that reach across the pillars and are worthy of further research. First, there are likely to be trade-offs between emphasising short term results and longer-term system-strengthening approaches. While this may seem obvious, it goes against the frequent assumption that aid effectiveness policies are win-win. Second, most of the issues and problems we looked at are political as well as technical, and need to be addressed as such. The failure to contemplate the political barriers to progress may explain why some practitioners have been over-ambitious for the impacts of new aid modalities. Third, the complexity of decision-making on these issues emerged throughout the research, with a realisation that, for all the directives made at an international level, it is the "human factor" of well informed decision makers on the ground that is often crucial. And fourth, there was an across-the-board consensus in the literature and in our interviews that better information sharing, which includes the now-popular principle of transparency, is one of the most critical factors of progress and one on which much still needs to be done.

There are many questions left unanswered, but we hope this report will be helpful to policy makers and practitioners engaged in the challenge of channelling scarce resources to maximum effect. In forthcoming papers building on this work, we will further explore some of these challenges from the perspective of aid donors seeking to strengthen local actors and systems from within political and technical constraints. Some of these challenges are perennial and possibly intractable; others are shifting in this changing era of development.

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