



Making U.S. Foreign Aid More Effective

By Philip I. Levy

For the next fiscal year, the George W. Bush administration has requested over \$20 billion for bilateral foreign assistance. How should that aid be allocated and how should its effectiveness be measured? Perhaps surprisingly—given the cost and range of foreign aid programs the United States administers—there have been few comprehensive attempts to answer these questions.

In 2005, the United States spent \$11 million on “Child Survival and Health” programs in Guatemala. Was this the right thing to do? Guatemala ranks 134th among countries in infant mortality, with almost 37 deaths per 1,000 live births. It certainly seems that it could use the help.

Eleven million dollars was an amount clearly insufficient to solve the problem. Should more money have been spent? Should the United States have used that money in a different country with greater child health needs? Haiti’s infant mortality rate, for example, is 74 deaths per 1,000 live births. Or perhaps the money could have been better used in Guatemala for other purposes, such as improving education or reforming the criminal justice system. How should U.S. policymakers decide among competing priorities for foreign assistance? And how can they tell whether the money has advanced U.S. interests?

These questions have traditionally been avoided in discussions of U.S. foreign assistance. One reason for this is that there is not a single pot of assistance money from which administrators fund programs. Assistance flows through distinct accounts such as “Child Survival and Health,” “Development Assistance,” or “International Narcotics Control and Law Enforcement.”

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Congressional earmarks heavily influence the allocation of funds. The difficulty of moving money between accounts keeps administrators from having to ask whether the last million dollars of aid funding is best spent on nutrition or on combating drug gangs. This structural constraint can be a disincentive to a rigorous, evidence-based decision procedure for aid allocation.

When a program’s value is questioned, the most common response is that it addresses a clear need. This is a necessary—but not sufficient—condition for making good aid allocation decisions. Foreign aid will never be capable of meeting all the needs of poor countries. To be effective, aid administrators must choose the most important from among many urgent needs. Instead of simply asking whether a program has a positive effect, administrators should ask whether it has enough of a positive effect to overcome the high opportunity cost of those funds.¹

Enhancing the efficacy of foreign assistance and making sure it serves U.S. interests are key problems facing the State Department and the U.S. Agency for International Development (USAID), through which the bulk of U.S. foreign assistance flows. After a 2005 review, there was a consensus among policymakers and legislators that U.S. foreign assistance could be allocated more efficiently.

This *Development Policy Outlook* offers some ideas for how to achieve this. How to meet

apparently limitless needs with limited resources is a classic problem in economics. The economic approach of “constrained optimization” can serve as a guide to improving the efficacy of U.S. foreign assistance.² There is no simple mechanistic solution to improving U.S. aid programs, but this analytic approach can ensure that some of the necessary questions are posed: What is the right prioritization of the objectives of U.S. foreign assistance? How can progress toward these objectives be measured? What happens when the impact of aid is ambiguous or impossible to measure?

Prioritizing the Objectives of U.S. Foreign Assistance

The first step in making aid as effective as possible is to prioritize the competing objectives that foreign aid seeks to address. Weighting the competing objectives would then allow for comparisons such as whether the payoff to the United States from an extra million dollars for democracy promotion in a given country was greater than or less than the payoff from an extra million spent on education. Ideally, with money optimally allocated, the payoff to the last dollar in each program would be equalized.³

This prioritization is a fundamentally political task that must be accomplished by senior policymakers; there are no easy formulas to determine the payoffs from assistance. There are a number of public goals for assistance, but they are not prioritized and they do not match up with U.S. interests. Perhaps the most prominent set is the United Nations Millennium Development Goals (MDGs), which focus on poverty reduction.⁴ Although reducing poverty is a central objective of U.S. foreign assistance, the MDGs do not include other important objectives, like ensuring security and promoting the rule of law.⁵

A broader set of indicators used by the U.S. Millennium Challenge Corporation (MCC) assesses countries’ progress in three broad categories: economic freedom, investing in people, and ruling justly. But these indicators are not ideal. They were selected in part because publicly available objective indicators exist to measure them. There could be important goals excluded because they are difficult to measure.⁶ Further, the MCC governing board neither weights nor aggregates the component measures.

Without a ready-made solution for assessing the payoff from assistance, what would factor into a custom-built one? Here are some likely objectives for U.S. aid programs:

- alleviating poverty
- fostering economic growth
- minimizing environmental damage
- mitigating security threats
- improving public perceptions of the United States
- strengthening bilateral relations

There is no reason why the United States cannot pursue one objective in one country while pursuing a different objective in another (e.g., transboundary migration is likely to be a bigger concern for our dealings with Mexico than it is for our dealings with Bangladesh). And there is no reason to have only one objective for U.S. aid in a given country; there will normally be several.

In a well-designed aid allocation process, top policymakers would assign weights to competing policy objectives. To date, this has been rare.⁷ The nearly twenty different accounts and countless earmarks that constitute the foreign assistance budget do not make it easy.⁸ The most effective means of demonstrating the costliness of earmarks, however, is to develop a clear plan for how funds *should* be spent if they are to do the most good. Prioritizing goals is the first step in this process.

Measuring the Objectives

After objectives are prioritized, the next steps are to measure progress toward each objective and then link that progress with the corresponding assistance program. Neither is an easy task. It is not difficult to determine economic growth rates or measure public opinion; it is harder to assess the quality of the rule of law or quantify how well-disposed other countries are toward the United States in international organizations.⁹

Where such measurements have been attempted, as with the MCC’s indicators on ruling justly, some of the measurement challenges have been avoided by looking at relative prowess (comparing countries’ performance to that of peers) and by requiring progress in only a fraction of the indicators. But in order to accurately measure progress, one would need to rely on absolute levels and there would need to be some way of aggregating progress across all relevant indicators.

Even with a precise measure of progress in each area, the level of progress does not matter as much as the extent to which it is valued for U.S. foreign-policy purposes. Even within a well-defined objective like economic progress, which should be valued most highly: a 1 percent increase in the growth rate, a 1 percent drop

in unemployment, or a 1 percent drop in inflation? All are valid indicators of progress. An objective measure of aid success will inevitably contain some subjectivity.

The aid administrator is left with only two choices: to try to overcome these technical hurdles and construct objective measurements, or to accept some subjective measures (for example, U.S. representatives to international organizations could assign “helpfulness” scores to other countries, relying upon information that is not publicly available). Before grappling with this choice, it is worth considering two additional technical obstacles that any serious attempt to measure the efficacy of foreign assistance needs to confront.

Which Program Goes with Which Effect?

A key condition for efficiency as described above is that the return on the last dollar spent on democracy equal the return on the last dollar spent on education. The implicit assumptions underlying this condition are that programs targeting democracy and education are distinct and that progress in one does not depend on progress in the other.

The effects of programs are sometimes distinct, but not always. A rule-of-law program is one example of an assistance program with effects across multiple areas. A direct impact of improved rule of law might be a decrease in crime. At the same time, the improved court system might spur economic activity by enhancing contract enforcement. Failing to account for these interdependencies would throw off the optimization of assistance allocation. The true marginal payoff on rule-of-law spending includes the effects both on crime and on economic activity. If the latter is not accounted for, there will be underinvestment in rule-of-law programs. This interdependence works in reverse, too. Investment in a dam could spur economic growth but set back environmental protection efforts. In that case, ignorance of the latter link would lead to overinvestment in dams.¹⁰

A second problem in determining the effect of an assistance program occurs when multiple donors operate in the same country. It might be possible to disentangle effects with statistical methods if there is good information about the extent of other countries’ assistance activities and if aid flows from different sources do not move in tandem. But in practice, such comprehensive information is scarce.

In addition to the problem of attribution, there is the problem of observability. In order to compare the payoffs from different aid programs, one needs to observe the effects of a “marginal dollar” spent on each, but this may

not be easy. Some effects take time to appear. For example, additional primary education this year will almost certainly have no positive effect on economic growth. In the long run, though, primary education is essential for economic growth.¹¹

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“Latent variables” represent a different example of unobservable effects. These are factors that go unobserved until crossing a particular threshold and causing visible effects. Democracy-promotion aid in Ukraine was linked to an unobservable variable that one might call “strength of civil society.” As civil society was steadily being built up there, observable indicators were unchanged. Then, after a critical point was reached, a strong civil society propelled the Orange Revolution. Up to that point, however, it would have appeared to the observer as if democracy-promotion spending was having little or no effect.

This concern also applies to crime-fighting. We do not observe the true level of crime; we observe reported crime. If aid dollars increase the effectiveness of the police force and the trustworthiness of the court system, it is possible that citizens who used to address problems informally will turn to the justice system. The result could be an increase in reported crime (the observable effect) at the same time the true crime rate falls (the latent variable).

Practical Implications

Assessment. The intricacies described above preclude a mechanistic approach to the optimization of foreign assistance. To the extent that objective measures of success or reasonable proxies are available, they are vital inputs to informed assessments. Gaps in measurement that require expert assessment and detailed knowledge of the recipient country will remain.

Given the subtlety of the assessment challenge, this argues for empowering officials to seek and then draw

the appropriate conclusions. The traditional structure of aid allocation in the U.S. government is not conducive to this. Most aid is allocated by geographic region (e.g., the Western Hemisphere Affairs bureau in the State Department and the corresponding Latin America and the Caribbean bureau in USAID). Funding plans are put forward by region, and reallocation within a region is substantially easier than reallocation across regions. Yet the development and foreign policy challenges of Haiti likely have more in common with those of Sierra Leone in Africa than with those of, say, Brazil.

Ideally, an office with oversight of post-conflict countries could develop the expertise to assess the most effective means of restoring stability, for example. It would have the power to propose reallocations from programs that are ineffective to those that are more effective. This would need to be balanced against political considerations to ensure that effectiveness is measured with respect to foreign policy, not just development. Furthermore, if the efficacy of U.S. aid is to improve, such an office should be able to propose experimentation across comparable situations. Such experimentation has traditionally been anathema in Congress, but this aversion fails to recognize the limits to current understanding of aid effectiveness.

The new Office of Foreign Assistance in the State Department has taken a step in this direction by classifying countries by their level of development and assigning staff to each level. Whether these individuals and the relevant functional bureaus are sufficiently empowered to enhance policy effectiveness remains to be seen.¹²

Prioritization. The most novel challenge is the systematic ranking of foreign assistance goals. As difficult as it may seem to choose poverty reduction over democracy promotion (or vice versa), the presence of budget constraints means that such choices are already being made implicitly.

The planning of foreign assistance programs should begin with a prioritization of U.S. objectives in a country. Past practice has been to select programs on the basis of whether they sound like a good idea. Is it worthwhile to promote biodiversity in South America? Sure. Is it worthwhile to combat drug trafficking? Absolutely. Is infrastructure important? Yes. Each program is funded without adequate consideration of whether moving a dollar from biodiversity to infrastructure would promote U.S. interests more. Given the scarcity of U.S. assistance dollars, there are programs that have a positive impact but that should nevertheless not be funded.

Making U.S. foreign assistance more effective will require reallocation within country programs. It will also require reallocation among countries. If the best use of a marginal dollar in South America is for infrastructure and the best use of a marginal dollar in Africa is for girls' primary education, which of those dollars goes further toward advancing U.S. national interests? That is a fundamentally political question which top policymakers must address.

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Eliciting policymaker preferences on prioritization is no easy task. It makes little sense to ask in the abstract whether democracy is preferable to poverty reduction. Instead, intensively prepared alternative scenarios should be made available to participants in high-level discussions, with each scenario depicting a different prioritization. Given the scarcity of top policymakers' time, this necessitates taking on a limited number of countries at a time. Those countries can then serve as examples for the rest.

For example, returning to the case of Guatemala on page 1, one scenario might focus on stemming the growing violence in the country. It could be argued that without public security, development is impossible. Few donors other than the U.S. government would provide aid for security. Under this scenario, programs to address child survival and health or other legitimate concerns would be reduced or eliminated, not because of failure, but because security needs would be more urgent, funds would be tight, and other funders would likely address health needs.

A second framework might focus on trade, subsequent to Guatemala's adoption of the Central American Free Trade Agreement. The top U.S. priority would be to assist Guatemala in taking advantage of the new trading opportunities. Such a program would focus on promoting economic development, building trade capacity, and ensuring that more of the population can benefit.

The case could be made that the purpose of U.S. assistance is to address humanitarian concerns. Thus, a third approach might focus on poverty alleviation and health concerns. This would have the added virtue of being visible and popular.

A central problem with foreign assistance now is that it attempts all of the above. Without sufficient funds to

tackle these problems, such diffuse purposes risk failure on all counts.

Making foreign assistance more effective is a challenge for all donor nations. Despite a tendency in international discussions to stress quantity over quality, even the strongest proponents of quantitative increases recognize that without demonstrably effective assistance programs, public support for substantial aid programs will continue to wane.

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Notes

1. The opportunity cost of funds for a program would be the benefit derived from putting those funds to their next best use. That is likely to be greater than zero. This begs the question of how one defines the benefit of an assistance program, addressed in note 2 below.

2. Constrained optimization is a formal mathematical approach in which an objective function is coupled with constraints. For example, individuals might gain pleasure from the goods they consume (described by their objective functions), but the individuals' purchases are limited by their budget constraints. Constrained optimization yields conditions that describe the best possible outcomes. In the consumption case, this would determine the demand for each good. In foreign assistance, it could be the allocation of funds to different programs and countries.

3. If this condition were not met, one could do better just by shifting dollars from a category with a low marginal payoff to one with a high marginal payoff. The exception to this occurs when one reduces spending to zero. There may still be a difference in payoffs, but that is as far as one can go.

4. United Nations, *Millennium Development Goals*, September 2000, available at www.un.org/millenniumgoals/ (accessed February 21, 2007). For a concise description of U.S. activities in development assistance, see Center for Global Development, *U.S. Assistance for Global Development*, June 2006, www.cgdev.org/content/publications/detail/2852%20 (accessed February 21, 2007).

5. If the objective of U.S. foreign assistance were only to foster development or reduce poverty, there is already a substantial literature that discusses the efficacy of assistance in achieving this goal (or failing to achieve it). For a prominent skeptical view, see William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (New York: Penguin, 2006); for a positive view, see Jeffrey

Sachs, *The End of Poverty: Economic Possibilities for Our Time* (New York: Penguin, 2005). One central point of contention is whether it is unfair to look at politically motivated aid flows and then measure their effectiveness in fostering development.

6. Millennium Challenge Corporation, "Selection Criteria," available at www.mcc.gov/selection/index.php (accessed February 21, 2007). New indicators have been introduced over time as measurement problems have been overcome.

7. The new Office of Foreign Assistance in the State Department has created a framework that describes the goals of assistance for different types of countries but does not explicitly prioritize them. See U.S. Department of State, Office of the U.S. Director of Foreign Assistance, "Foreign Assistance Reform," available at www.state.gov/f/reform/ (accessed February 21, 2007).

8. Foreign assistance is provided through a number of channels in the U.S. government, including the Department of Defense. The bulk of assistance is overseen by the State Department and USAID. Budget requests for this assistance appear in the "International Affairs Function 150 Account."

9. In development assistance, the practice of project evaluation is relatively advanced. The World Bank's Independent Evaluation Group, for example, regularly assesses whether bank programs are effective in reducing poverty. This problem is more acute for political and security objectives.

10. Such questions of interconnection underlie academic and policy debates over the proper sequencing of economic liberalization that took place after the fall of the Soviet Union. Was it better to try everything at once or should legal and regulatory reform have preceded the privatization of state-owned enterprises? For a discussion of this topic, see Gerard Roland, "The Political Economy of Transition," *Journal of Economic Perspectives* 16, no. 1 (Winter 2002): 29–50.

11. One contribution to the literature on whether aid has been effective argues that it is this lag in aid's effect that critics often miss. When separating out aid flows that could plausibly have a short-run impact, the authors find a substantially greater effect of aid on growth. See Michael Clemens, Steve Radelet, and Rikhil Bhavnani, "Counting Chickens When They Hatch: The Short-Term Effect of Aid on Growth" (working paper 44, Center for Global Development, Washington, DC, July 22, 2004), available at www.cgdev.org/content/publications/detail/2744 (accessed February 21, 2007).

12. For the outlines of the country classification scheme, see U.S. Department of State, Office of the U.S. Director of Foreign Assistance, "Foreign Assistance Framework," January 29, 2007, available at www.state.gov/documents/organization/79748.pdf. The functional bureaus are those that address particular topics such as economic growth or international narcotics and law enforcement.