Center for Global Development

Working Paper Number 102
December 2006

Payments for Progress: A Hands-Off Approach to Foreign Aid

By Owen Barder and Nancy Birdsall

Abstract

There are significant differences of opinion about the merits of additional aid in meeting the MDGs, including whether and how aid should be given in 'fragile states', whether additional aid on the scale envisioned can be effectively used even in well-managed economies, and whether the aid system, particularly in highly aid-dependent countries, undermines instead of strengthens local institutions. We discuss an approach to scaling up foreign aid that would explicitly be aimed at strengthening local capacity and institutions, including in fragile states. "Payments for progress" would link additional aid to clear evidence of progress already achieved on the ground. This approach would give flexibility and autonomy to local institutions, providing an opening for local institutional experimentation, while at the same time ensuring that aid pays only for real, measurable achievements. Donors would bind themselves as a group to pay a specific amount for clear evidence of progress against one or more agreed goals in low-income developing countries. Developing country governments would present an independently audited statement reporting their progress on the measures, and donors would pay the agreed amount. Payments would be determined as a function of the outcomes, and not linked to the implementation of any particular policies, any other intermediate outputs, or "tied" to purchases from particular suppliers or companies. Governments that found ways to provide services efficiently and so reduce the costs of providing them would benefit from a larger surplus. We discuss the issues such an approach raises—in setting the benchmarks against which progress is measured, in avoiding cheating, and in managing unintended negative consequences of an incentives-based approach. We conclude with a summary of the advantages for donors and recipients.

Payments for Progress: A Hands-Off Approach to Foreign Aid

Owen Barder and Nancy Birdsall[1]

November 28, 2006

[1] Barder is Director of Global Development Effectiveness at the United Kingdom Department for International Development (O-Barder@dfid.gov.uk) and was Senior Program Associate at the Center for Global Development, Washington D.C. when this paper was first drafted. Birdsall (corresponding author) is President, Center for Global Development (nbirdsall@cgdev.org). We are grateful to John Williamson, Ruth Levine, and participants in a Center for Global Development research seminar for useful and insightful comments on an earlier draft, and to Kate Vyborny, Special Assistant to Birdsall, for her enormously smart inputs to the thinking and drafting of this draft.

At the start of the millennium, the international community committed itself to help developing countries to achieve the Millennium Development Goals, including through major increases in foreign aid spending – on the order of doubling, and in the case of Africa, a tripling of annual aid flows[2]. But there are significant differences of opinion about the merits of additional aid in meeting the MDGs, including whether and how aid should be given in 'fragile states', whether additional aid on the scale envisioned can be effectively used even in well-managed economies, and whether the aid system, particularly in highly aid-dependent countries, undermines instead of strengthening local institutions. In this paper, we discuss an approach to scaling up foreign aid that would explicitly be aimed at strengthening local capacity and institutions, including in fragile states. The approach, simply stated, is to link additional aid to clear evidence of progress already achieved on the ground. The approach would give flexibility and autonomy to local institutions, providing an opening for local institutional experimentation, while at the same time ensuring that aid pays only for real, measurable achievements. We believe that "payments for progress", though it needs further exploration and testing, has the potential to command support from aid enthusiasts and skeptics.

In Section I of this paper we discuss the twin challenges of scaling up aid and using aid resources to support rather than undermine local capacity and institution-building. In Section II we describe how "progress-based aid" or "payments for progress" would work. In Section III we discuss the issues such an approach raises – in setting the benchmarks against which progress is measured, in avoiding cheating, and in managing unintended negative consequences of an incentives-based approach. In Section IV we conclude with a summary of the advantages for donors and recipients.

Section IA. Dealing with the challenges of scaling up aid

The OECD estimates, based on existing commitments, that aid transfers will increase by about 60% in real terms between 2004 and 2010, from about $60 to 100 billion.[3] In many countries, especially in sub-Saharan Africa, planned increases in aid would mean increasing the proportion of all government spending that comes from donors from up to 30 percent now to as much as 60 percent or more.[4]

Three issues have arisen. The first is whether additional aid can make any make any difference in states with poor governance. On the one hand, it is clear that the MDGs cannot be achieved in some countries without more money from donors. Some views emphasize that a substantial increase in funding would enable at least some developing countries to move more quickly toward the goals.[5] For example, annual public spending on health in the 25 poorest developing countries is below $10 per capita, including

[2] Rough estimates of the cost of meeting the MDGs beyond what aid-recipient countries could finance were on the order of $50 billion more per year in 2000. The Commission on Africa chaired by Prime Minister Tony Blair recommended in 2005 that donors triple aid to Africa starting in 2010 assuming progress in Africa on use of aid by then.

[3] OECD DAC (2006).

[4] Moss and Subramanian (2005).

[5] Sachs (2005), chapters 14 and 16.

government revenues and foreign aid.[6] That is almost certainly too low to deal effectively with current disease burdens, let alone reduce infant mortality and make progress against malaria and AIDS.[7] On the other hand, in most aid-dependent countries there are many other constraints on delivering the MDGs, including weak institutions, poor governance and conflict, and it is not clear that additional money will help as long as these constraints obtain..

The second issue is whether even well-governed developing countries can make effective use of the proposed substantial increase in aid. For a range of reasons – microeconomic, macroeconomic and political economy – it is possible that additional aid would not bring the intended benefits and could actually do harm. Major inflows put pressure on exchange rates, risking the competitiveness of the aid-receiving economy, and tend to divert some of the best local talent into administering increased aid – raising wages of skilled workers and, some evidence suggests, leading to slower growth of tradable, job-intensive private manufacturing.[8] Many other problems are direct or indirect results of inefficiencies in the global aid system.[9] Fragmentation, high transactions costs, skills bottlenecks, poorly-judged conditionality and lack of predictability all make it difficult for developing countries to make good use of extra aid. Donors have committed themselves to an agenda of aid reforms which would go a long way towards relaxing these constraints.[10] But in practice, progress on aid reform has been slow. Individual donors find it difficult to subsume their contributions into a collective effort while at the same time remaining accountable to their domestic stakeholders for the contributions they make.[11]

The third issue arises as a consequence of donors' legitimate desire that aid be properly used and accounted for. Developing countries tend to have weak systems for budgeting, procurement, performance management and accountability. Some official donors and many nongovernmental groups that provide aid therefore manage projects separately, so that they can be sure that aid delivers the intended results. But this approach often ends up emphasizing short-term results and accountability at the expense of long-term institutional development. Resources that are channeled outside the government's own financial systems risk undermining whatever local political

[6] World Bank (2006a) and author's calculations. 2003 data for the twenty-five countries with lowest per capita GDP for which this information is available.
[7] Estimates of the full cost of meeting the MDGs suggest that aid would need to double if the targets are to be met by 2015.Zedillo Panel 2001, Devarajan et al. (2002) UN Millennium Project 2005
[8] Ragan and Subramanian (2006) emphasize the latter. For a discussion of Dutch disease and other macroeconomic problems associated with aid inflows see Heller, 2006.
[9] Discussed in detail in Barder (2006).
[10] See High Level Commission on Aid Effectiveness (2005) and International Conference on Financing for Development (2002).
[11] "At the political level, the efforts and commitment of senior managers in aid agencies to "spread the harmonization gospel" have sometimes been undermined by such external political factors as donor country politicians concerned with visibility, NGOs and private sector lobbies, and lack of commitment and leadership on the part of partner governments." OECD (2005)

mechanisms of accountability and feedback that do exist.[12] Where many official and nongovernmental programs are active, the proliferation of multiple donor systems is even more likely to erode existing domestic capacity and accountability – a result with respect to scores on effective bureaucratic systems reported by Knack and Rahman (2004).

Section IB: …while supporting not undermining recipient country institutions

In short the challenge for donors, especially but not only in fragile states, is to find ways to provide support for progress on the MDGs in ways that will be used effectively despite the weakness of local governance and institutions (even in states with relatively good performance given their low income), and at the same time will help improve governance and strengthen local capacity and accountability – contributing positively to the evolution of sound, stable and effective "institutions".

The governance problem: conditionality forsaken. Over the last 25 years, the donor community has sought to deal with the problem of inadequate institutions and poor governance in recipient countries in a variety of ways. In the 1980s and much of the 1990s, bilateral donors followed the lead of the IMF and the World Bank by linking lending and major grants programs to policy change in recipient countries – for example trade opening, privatization, and financial sector liberalization as well as greater fiscal and monetary discipline to reduce macroeconomic instability. By the late-1990s, there was mounting evidence that this policy conditionality was not having a significant effect on improving the policy environment.[13] The debt problems of the very poor countries, many in Africa, were embarrassing evidence that structural adjustment programs supported by the IMF and the World Bank had not helped countries grow, and indeed by adding to their debt had possibly undermined their growth prospects.[14] Nor was there compelling evidence that policy conditionality had encouraged governments to address the needs of the poor. Many observers concluded that it was not effective to use conditionality to try to impose from the outside policy changes that governments were otherwise unwilling or unable to implement.[15]

In the mid-1990s donors began to shift to what is now called "process conditionality". They required that recipient governments demonstrate and ensure local "ownership" of reforms, through extensive involvement ("participation") of NGOs and local communities in discussions of government policies and strategies. For the poorest and most aid-dependent countries this was generally in the form of Poverty Reduction

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[12] Moss, Pettersson and van der Walle (2006) refer to this problem as the "aid-institutions paradox." Bräutigam and Knack (2004) provide evidence that aid has weakened bureaucracies in many countries over the last several decades.
[13] Killick (1998) and Devarajan, Dollar and Holmgren (2001).
[14] Easterly (2002).
[15] Another view holds that conditions were inappropriate and pushed countries into reforms that were not growth-enhancing. See Killick (1998). This view is, however, hard to reconcile with the evidence that in most cases countries continued to receive loans and grants whether or not they were honoring promises made. This was the case in the late 1980s and early 1990s even for countries that were already deep in debt and had very "poor" policies according to the World Bank indicator (Birdsall, Claessens and Diwan, 2003)

Strategy Papers which were prepared for and with donors as a precondition for receiving support. Process conditionality has evolved in the last decade toward an emphasis by donors on minimum levels of corruption, respect for human rights, adherence to the rule of law, and greater accountability of government to its citizens. Indeed, donors began to categorize as "fragile states" those countries which fell below particular thresholds on one or more of these and other political and institutional characteristics. In what is now called "selectivity", the U.S. Millennium Challenge Account aid program is by design targeted to the least fragile of the poorest countries; similarly the World Bank's limited IDA funds are allocated in part as a function of low-income countries' scores on these kinds of characteristics (as well as according to their policies). Other donors use these characteristics to determine which way they will deliver aid: that is, for less "fragile" states donors will be more willing to provide support directly to government budgets and to sector-wide programs; in more "fragile" countries donors provide aid through stand-along projects, NGOs and other non-government channels.

But this emphasis on process conditionality and selectivity created two new problems. First, selectivity by definition (and process conditionality, were it comprehensively implemented) excludes from support many countries with poor governance, including some with enlightened leaders who are stymied not by lack of will but lack of institutional capacity to tackle corruption, enforce the rule of law and implement their vision. Second, process conditionality, with its emphasis on "participation", is intended to strengthen the hand of civil society groups; but it in practice it has led donors to make quite intrusive and difficult judgments about whether a recipient government is "open" and "democratic". In practice, process conditionality may be harder to measure and enforce than policy conditionality was before it.[16] At its worst, it may weaken indigenous institutions of transparency and accountability, including local governments and civil society organizations, in favor of internationally-visible non-government organizations.

The aid-insitutions paradox. The difficulties with conditionality serve to highlight the fundamental problem that outsiders cannot be effective and can actually do harm if they try to design the "software" of an economy.[17] Good software, i.e. the rules, habits, arrangements that support sustained growth and development, are apparently the result of a process by which societies experiment with and continually fine-tune the political, social and economic institutions that are appropriate to their evolving needs, constraints and opportunities. As a result, good institutions come in many forms, ranging from the European Union's independent central bank to the ingenious Chinese experiment with the village enterprise system.[18] In some societies it can take less tangible forms, such as the

[16] World Bank (2004): "Tensions in the Initiative's design have caused problems during implementation. There is inherent tension in a Bank/IMF–driven initiative involving conditionality that is also meant to foster a country-driven process. This has led to two problems during implementation…Countries have focused more on completing documents, which give them access to resources, than on improving domestic processes."

[17] See Rodrik (2000). On the centrality of institutions, see Acemoglu, Johnson and Robinson, 2004; and North, 1990.

[18] The system created market incentives without providing private property rights. Rodrik, 2003 cites other examples from China, to help explain its success outside the boundaries of conventional wisdom.

longstanding trust that exists between private contracting Chinese parties that fueled growth in Malaysia. In other societies, it takes the form of legally-enforceable property titles and contracts and an uncorrupted court system. The only generalization is that there is no universal recipe – and outsiders are unlikely to help if they try to push institutional forms and norms that have worked for them, in one place and time, as the solution for others at another place and time.

What is clear is that a common characteristic of effective political institutions and good governance is accountability. Governments that are accountable to their citizens are more likely to make effective use of resources. At the same time, donors legitimately expect that the resources they provide will be used effectively, and they set restrictions and conditions that they intend will increase the probability of this. These conditions require governments to respond, at least in part, to the priorities and expectations of donors; and this in turn can make them less accountable to their own citizens.[19] Some scholars worry that more outside aid will reduce the need for recipient governments to tax their citizens, and so weaken the 'social contract' between government and its citizens which lies at the heart of accountable and effective governments.[20]

Compounding the dilemma for donors is their need to respond to reasonable demands from their legislatures and public to show that aid funds have been well spent. For the purposes of their own domestic accountability, they create the separate arrangements referred to above (such as project management units) for accounting, measuring and evaluation and these tend to be based on their own trusted and recognized systems. With each donor introducing its own reporting and monitoring arrangements, and with dozens of donors operating in the poorest countries, individual donors' separate approaches to their own accountability creates an enormous administrative burden on recipient countries in addition to undermining their governments' accountability to their own citizens.[21] That not only adds to transactions costs for donors and recipients, but diverts scarce administrative and human resources from the planning and management.of the countries' own resources.

The results – institutions paradox. Conditionality is now yielding to "results" as the mechanisms to ensure effectiveness and accountability in aid programs. The singular example is the emphasis in the Millennium Development Goals on targets to be achieved by 2015. On the one hand that invites a longer planning horizon and a focus on building local institutions now to sustain the needed long-term programs. On the other hand, the targets are too ambitious for many countries (if applied at the country level) and risk turning success into apparent failure. For example, countries that by historical standards

[19] Easterly (2006) and Easterly (2006b) elaborate on the lack accountability due to the absence of mechanisms of citizen feedback in aid programs.
[20] See Moore (1998). Moss and Subramanian (2005) report contradictory evidence on this point: in the poorest countries, most taxes are indirect (trade and sales taxes) so tax systems do not currently build in much direct accountability anyway.
[21] Knack and Rahman (2004) provide evidence that donor fragmentation has undermined bureaucratic quality in aid-dependent countries.

are enjoying unprecedented success, such as Burkina Faso, Mali and Uganda,[22] are currently characterized as "off-track" on such measures as education and infant mortality in UN reports (e.g. the Human Development Report of 2003, which uses a simple linear measure of trends), and unless they can accelerate progress even more dramatically will not meet certain of the goals by 2015.[23] The MDGs thus highlight the tradeoff between a focus on measurable results and the need for patience with the long-term, unpredictable dynamic by which institutions get built. Impatience to demonstrate progress has led donors to monitor inputs (such as purchase of goods and or the agreement of contracts), and intermediate outputs (such as an increase in government spending on social programs). Ironically it is still rare to see donor interest in actual results that can be attributed to new programs or inputs, such as a reduction in infant mortality, an increase in what students are learning in school, or a decline in the cost of transportation as a result of the provision of an adequately-maintained road.[24]

Output- and performance-based aid. A more promising avenue is the effort of some donors to experiment with performance-based and output-based aid.[25] The Global Alliance for Vaccines and Immunization (GAVI) and the Global Fund to Fight AIDS, TB and Malaria have started to base new rounds of funding on past performance – including reducing grants to countries that under-perform. An evaluation of GAVI's immunization support services program, which links payments to the number of children vaccinated, found it produced a modest increase in vaccinations, and at the same time greatly benefited from the flexibility accorded to local decision-makers when they had stronger incentives to deliver results.[26] In Cambodia NGOs are being paid for services provided through contracts that require demonstrated results.[27]

Separately, a small number of programs financed by a fund for "Output-Based Aid" at the World Bank, primarily in the water sector, pay private contractors or concessionaires only upon demonstration of their "output" – for example, household water connections made. The concept is enormously promising in terms of ensuring

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[22] See Clemens (2004) on education, and Clemens, Kenny and Moss (2004) on education, infant mortality and other goals.

[23] For example, Burkina Faso is "off-track" from meeting the goal of universal primary schooling by 2015. The net primary enrollment rate was just 35 percent in 2000, and by one estimate (extrapolating from historical experience of more than 100 countries which takes the form of a logistics curve; see Clemens, 2004) would reach "only" 59 percent by 2015. However, compared to the historical performance of today's rich countries, that rate of progress would be impressive. It would roughly match South Korea's progress between about 1945 and 1955,[23] but far outpace the progress of the U.S., which, starting at Burkina Faso's current enrollment rate of 42 percent, took 30 years to increase its rate to 57 percent

[24] See Savedoff, Levine and Birdsall (2006), for evidence of the resulting lack of evidence of attributable impact of development programs. Some programs to improve health are notable exceptions; see Levine (2004). Ironically, given the rhetoric about "results", impatience on the part of donors and the nature of incentives within donor agencies lead donors to monitor inputs but not actual outcomes, and have meant limited interest in investing in long-term development of institutions and capacity for effective budgeting, personnel management, auditing, accounting, and other administrative functions.

[25] This type of mechanism has been suggested, among others, by the Meltzer Commission (Meltzer 2000, p.86)

[26] Chee et al. (2004).

[27] See Kremer, 2005. A CGD working group is completing a report on other performance-based incentives, including to potential clients as well as to providers.

funds are disbursed against clear objectives, and ideally will lead public water utilities and other public and quasi-public institutions to institutionalize habits and mechanisms for more effective public-private partnerships with greater accountability of private contractors to the public purse.[28]

Section II. How payments for progress might work

What we call progress-based aid or "payments for progress" would build on the idea of linking aid to specific results, while at the same time specifically providing an opportunity for institutional learning. It would allow donors to scale up aid against specific goals agreed with recipient country governments, and compel (in the best sense of the word) donors to act together in providing flows that countries could count on – predictable as a function of a country's own progress. Most important it would contribute to broader understanding of the elusive processes through which better local institutions (rules, habits, organizations) that are accountable to citizens, actually evolve.

Donors would bind themselves as a group to pay a specific amount for clear evidence of progress against a set of agreed goals (such as any of the Millennium Development Goals) in low-income developing countries. For example, donors could promise to pay governments $20 for every child that is vaccinated; or $100 for every child that completes primary school beyond the number that completed school in 2000, or $200 for every primary school graduate who passes a competency test. In contrast to output-based aid, payments would be made against "progress" toward a goal (even if relatively limited), not against a pre-specified "result" or "goal" *per se*.

Each year, developing country governments taking part in the scheme would present an independently-audited statement reporting their progress on the measures for which the donors had made pledges. The auditors would be chosen by the developing country from a list of independent auditors pre-qualified by the donors, and the costs would be borne by the donors.

On receipt of the audited statement of progress, the donors would pay the agreed amount. The payments would be unconditional transfers to the Finance Ministry, to be used by the recipient government in accordance with its priorities. Payments would be determined by the achievement of the outcomes, and not linked to the implementation of any particular policies, or any other intermediate outputs. Nor would this aid be "tied" to purchases from particular suppliers or companies. The only criterion would be the audited statement of progress.

We envision that the "price list" for each measure of progress would be the same for all countries. The payments would be correspondingly more valuable in least developed countries, where wages and costs are typically lower. In the richer developing countries, the payments would subsidize but not pay in full the cost of delivery. In the poorer countries, the payments would be sufficient to provide the service, perhaps with

[28] Brook and Smith (2001).

some left over to meet the overhead costs of government. Governments that found ways to provide services efficiently and so reduce the costs of providing them would benefit from a larger surplus.

The commitment would be binding on donors. It would need to be sufficiently predictable for developing countries to be able to enter into contracts with third party suppliers on the basis of the expected revenues from donors. For example, a government could arrange for an NGO or private sector firm to deliver health services, and pay the bills for that service with the funds provided by donors. Alternatively, some governments might choose to borrow money from capital markets or international financial institutions, against the promise of payments for progress, to invest in increased government provision of services.

Because the donors' pledge would translate future social benefits (*e.g.* increased schooling) directly into a stream of revenues, a government with a good record of delivery and with credible business plans would be able to secure the confidence of private investors and scale up the provision of those services.

In practice, governments would be likely to choose a mixture of increased private and public provision of services. The exact mixture in each sector would depend on political priorities in that country and on the effectiveness of existing institutions. In the case of education, for example, some governments might use new funds to finance transfers directly to poor households when children finish school, or to establish a voucher-like system to enhance a decentralization effort (see text box). Or governments might choose to use progress-based funds at the central level: to train more teachers, pay higher salaries, build new schools, or buy new books. These decisions would be for the governments themselves to take, for which they could be held to account by their own citizens.

Under this system, donors as a group would recognize a very different standard in terms of attribution of results on the ground to their inputs. They would be able to demonstrate to their own taxpayers and legislatures that they were increasing aid only in circumstances in which it was effectively used and resulting in measurable progress. However, they would have to eschew the ability to link the aid they give to particular activities or particular results. Some donors have already taken that step since they provide budget support in selected countries, and much aid is fungible anyway (whenever it finances activities the government might have financed itself).

Payments for progress as we outline it here is thus similar to budget support insofar as participating donors would not be earmarking transfers (say against specific progress in health or education or road-building) to the sector in which progress is being rewarded – though of course the government might choose to do so. On the other hand in contrast to budget support there is a much clearer link to measurable progress on the ground.

Free technical assistance would be available from donors on demand; but no recipient country would be obliged to accept it. De-linking technical assistance from resource flows would enable recipient countries to decide for themselves how much advice they needed, in what form and from whom.

This approach could be but need not be a substitute for other development aid, and would not be a substitute for humanitarian and emergency aid .Donors could make additional grants or loans to recipient countries, on top of the agreed progress-based aid, for humanitarian, strategic, commercial or other reasons, if they chose to do so.

We next describe how progress-based aid might be applied to education.

Progress-based aid in the case of education. The Millennium Development Goal for Education is that by 2015, all boys and girls should complete a full course of primary schooling.[29] In 2005, an estimated 100 million children were out of school, of whom about two-thirds were girls. Most girls out of school come from households that are members of social minorities or socially excluded groups in their countries.[30] Other out-of-school children come mostly from poor, usually rural, families. Though some children, including in South Asia, never attend school at all, in many developing countries it is common for children to begin school but to fail to complete the five or six years of primary school that are generally believed to provide a minimum level of literacy and numeracy.[31]

Estimates of the total annual costs of putting every child in the world in primary school range widely – from $7 to $17 billion. Assuming developing countries increase their own spending by 1 percent a year, the conventional estimate is that bilateral and multilateral donors would need to contribute at least $10 billion annually in external assistance, compared to the $1.2 billion a year actually disbursed by donors for basic education in 2001-2002.[32] If about $10 billion has to be provided by donors from a total cost of between $7 and $17 billion, then in many countries most of the resources for education would be externally provided. One estimate is that African countries would need more than three-quarters of all donor resources provided.[33] Aid increases on this scale, within the existing aid architecture, raise the specter of exactly the dilemmas described above.

An alternative way to estimate the resources required is to sum up the estimated costs of the inputs needed to provide education – teachers, books, desks, subsidies for poor children and so on – in specific settings. This is not without controversy, as it

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[29] The corresponding progress indicators are (a) the net enrolment rate; (b) the proportion of pupils starting grade 1 who reach grade 5; and (c) the literacy rate of 15-24 year olds. None of these addresses the true goal of learning (as opposed to attending school) (see Filmer, Hasan and Pritchett, 2006)
[30] See Lewis and Lockheed, 2006.
[31] Filmer, Hasan and Pritchett (2006) report results of various competency tests that suggest average learning in most developing countries is shockingly low, even for children who complete primary school.
[32] See UN Millennium Project report, pp. 78-81 on financing the education MDG.
[33] Bruns, Mingat and Rakotomalala (2003).

requires consensus on the minimum inputs needed and their costs, and the difficulty of estimating the likely costs for large numbers of children, given uncertainty about the likely effect on marginal costs of a large increase in numbers. Despite these uncertainties, the Millennium Project has estimated the annual cost of putting every child through primary school in five developing countries would be between $50 and $100 per child.[34]

Suppose that donors pledged to pay developing country governments $100 for each child who completes six years of schooling, over and above the number that completed schooling in 2000. This cash amount would be the same for all developing countries. In the very poorest countries, it might constitute two to three times annual spending per child that had already reached the final year of primary school. In better-off countries, it would meet only part of the cost of expanding or improving primary school education.

Donors have gone further in education than in other sectors to establish and implement a framework for undertaking their heretofore separate and disparate programs, thus making education a good sector for a pilot test of a hands-off, progress-based approach. Under what is called the Fast Track Initiative, donors are committed to increasing and pooling their education financing in a select group of countries that have developed “credible education plans” (see text box). Among the challenges the initiative, announced in 2002, originally faced was the difficulty donors had in reconciling this tendency for imposing priorities from the center rather than country-specific planning, and the resistance of recipient countries ("partners") to the appearance of “conditionality” involved in the selection process and the donor judgment of "plans". Four years on, the FTI has made progress in sorting out these problems and has received new pledges of support from donor governments, though what might be measured as new or additional financing for education in any of the countries is still hard to assess. In any event, the FTI provides a framework and a forum where a mechanism for progress-based aid in education could be discussed, given that donors are already committed in principle to pooling and to aligning their financing with recipient countries’ own programs.

Box 1. The Education Fast Track Initiative

In 2002, the major bilateral donors and the multilateral development banks agreed on a joint strategy to “fast track” selected poor countries in ramping up progress on primary education. The idea is to coordinate large long term and predictable financial support of countries own national education plans in countries in which leadership and commitment to education have already produced visible progress. The program is premised on mutual accountability: donors need to be held accountable for their financial

[34] The UN Millennium Project (2004) estimates an average annual cost of $86 for Ghana $56 for Cambodia; $59 for Tanzania; $67 for Bangladesh; and $53 for Uganda. See tables pp. 97, 120, 141, 165, 187. Estimates are average annual costs from 2003 to 2015 in 2000 US dollars.

commitments and national leaders for reforming their education systems, with financing and reforms going hand in hand.[35]

FTI currently supports 22 countries and is set to expand to over 30 over the next two years. Initially, the FTI faced challenges including developing country resistance to the appearance of any "conditionality", bureaucratic and political pressures to include more countries (the initial group was seven countries; there are now twenty countries deemed eligible, with eleven more slated for 2006 approval), and the donors' reluctance to firmly commit new money where existing aid was available, but for one reason or another, not being disbursed. However, recent funding commitments by Britain and general commitments by the Dutch and Japanese governments have demonstrated new support for the initiative.[36]

If donors introduce progress-based aid in primary school completion, what kind of resources would they have to commit? The following table provides estimates of the approximate cost to donors of such a commitment. In this policy experiment, if these five countries successfully reached the MDG of 100% primary completion in 2015, donors would be required to make additional annual transfers of about $207 million over and above current aid and domestically financed spending, an increase equal to about half the current aid earmarked for education in those countries.

Cost to Donors of Progress-Based Aid for Education

Transfers of $100 per Additional Primary School Completion

Country	*Total Aid for Education in 2000 (millions)*	*Total Aid Earmarked for Basic Education in 2000 (millions)*	*Completion Rate in 2000*	*Annual Transfers for 80% Completion in 2015 (millions)*	***Annual Transfers for 100% Completion in 2015 (millions)***
Ghana	$15.8	$8.0	64%	$16.5	**$29.4**
Bangladesh	$53.7	$38.5	70%	$15.5	**$65.3**
Tanzania	$29.3	$13.6	59%	$38.2	**$61.4**
Uganda	$83.1	$12.1	65%	$25.3	**$42.1**
Cambodia	$12.1	$2.0	70%	$3.1	**$9.1**
TOTAL	$194.0	$74.1	67%	$98.5	**$207.3**

[35] This segment draws from United Nations Millennium Project (2005).
[36] World Bank (2006b).

Sources: Current aid from all donors, OECD Development Assistance Committee CRS Database Table 2. Completion rates in 1999-2000 (for Tanzania, reference year is 1997): Bruns, Mingat, and Rakotomalala (2003), Tables B.3, B.9, and B.11. New transfers: author's calculations based on projections of school-age population in 2015 in Table A.5.

These estimates present the additional costs of providing education to additional children, over and above levels of education and their associated costs in 2000. We outline a pilot program in which a group of donors would use payments for progress in a few countries to fund the additional costs needed to move towards the Millennium Development Goals. This proposal constitutes a mechanism for spending a portion of the significant additional aid already pledged by donor countries to meet the MDGs. If successful, the mechanism could also be used to provide funding for existing levels of service.

Payments for competency on internationally comparable tests. Some countries, especially those where enrollment and completion rates are already high, might prefer to adopt a more challenging goal, such as increasing the number of children who attain an adequate score on an internationally-recognized competency test. In other words, they might define for themselves a "Millennium Learning Goal" over and above the Education MDG.[37] If donors were to link payments to the number of children that reach this standard, this would reduce the risk that incentives to meet the quantitative targets in the MDGs would shift focus away from quality, and perhaps erode the funding of relatively well-resourced schools. Such an approach might be used as a complement to payments linked to school completion rates. A combination of both incentives for countries in appropriate circumstances could produce progress towards both the quantitative and qualitative goals encompassed in the education MDG.

To the extent that countries agree to judge performance on the basis of achieved competency, governments and donors would finally have a tool for assessing quality – which has been recognized by UNESCO as the fundamental challenge and without improvement of which there seems little chance that students will complete primary cycle anyway.[38]

Box 2. Institution-building and the benefits of vouchers

One advantage of this progress-based approach is that it could provoke greater self-discovery on the part of public education officials, including at the local level, about where the bottlenecks are to "supply" of effective services. Is it that teachers are not adequately trained? Is it that they lack support on an ongoing basis? Or is the bottleneck books or lack of school meals? It might also encourage governments to address lack of demand – for example by reducing school fees – where that is a constraint on take-up.

This progress-based proposal shares many of the virtues of using vouchers to fund public services. In principle, vouchers can increase the power of consumers of services, by giving them choice of which services they want to use. They increase the incentives

[37] Filmer, Hasan and Pritchett, 2006.
[38] UNESCO (2003).

on the part of providers to deliver a good service at a low cost. They constitute a mechanism by which parents and consumers can make school systems and local governments accountable.

Many of the challenges that afflict education systems and constrain access to education might be addressed by changing incentives within the education system. For example, if poor household were given vouchers that could only be cashed by the Finance Ministry, that might encourage schools to find ways to attract more students – for example, through school feeding programs – in order to obtain vouchers which they could "sell" up the chain to district education offices, who would in turn sell the vouchers to the Education Ministry, who would sell them to the Finance Ministry. A school voucher system could thus complement the system of payments for progress that we describe here.

Further consideration would be need to be given to whether the benefits of creating an actual voucher system would be sufficient to warrant the transactions costs of implementation and monitoring that would be involved.

Incentives on the demand and supply side are likely to generate many different local responses, in a process that in effect constitutes the creation of home-grown institutions. Tracking changes could provide lessons relevant to other local settings and other countries – or not, since institutional arrangements, particularly for a service like education, will not necessarily be exportable.[39]

Section III. Caveats and concerns

Many issues with this approach need to be addressed, probably in the context of particular country settings and for particular sectors (or possibly particular Millennium Development Goals). In this section we review these issues for the case of payments for progress in education.

Choosing the benchmark. Ideally a single benchmark (and payment) would be announced by the major donors independent of any particular country's circumstances, to provide for transparency and minimize the risk of discussions of any benchmark becoming a setting for bargaining over amounts or conditions. In education, the tradeoff between quantity and quality noted above makes choosing a single benchmark difficult. Setting a goal of primary completion is politically less complicated and more transparent, particularly for civil society and parents to hold their governments accountable for providing education. A benchmark based on competency may ultimately be more appropriate in the long term, since the stated objective of formal schooling is learning (and indeed learning can be achieved without formal schooling). However, in most aid-

[39] Pritchett and Woolcock (2004) note that imposition of standard models of education in aid "led to schools with standardized curriculum, teachers with little training, low local commitment to the school (which was viewed as "the government's" school), excessive devotion of recurrent expenditures to wages, little real learning, and high dropout rates."

recipient countries, the institutional capacity to implement testing is not developed and political and bureaucratic resistance to testing is likely to be substantial.

One option is for donors to pay for each additional primary school graduate that simply takes an internationally comparable test of competency, independent of the result of the test.[40] That would require that countries wishing to benefit from progress-based aid would need to establish the arrangements for nationwide testing – while at the same time minimizing the likelihood of widespread cheating and of other unintended consequences, such as the diversion of central government resources to urban areas or certain regions where success on tests could be increased at relatively low cost.[41] In effect, the disincentive to evaluate (see Pritchett, 2002, "It Pays to be Ignorant" and Levine et al., 2006, "When Will We Ever Learn?"[42]) would be offset by the reward for the effort to evaluate and the creation of the institutional arrangements for doing testing and evaluation. Over time that might lead to increased access to the information and eventually to its constructive use by parents, school administrators and local and central governments. For example, given that testing occurs, some governments might set up their own incentives tied to test results – for example annually announcing "champion schools" in each district – for example the school with the best overall results and the school showing the most progress since the preceding year.

Minimizing cheating through effective monitoring. There is a significant risk of cheating, since there are strong incentives for exaggerating completion rates (or number of students that score adequately on competency tests) at all levels: teachers, schools, local communities, and central government. How to implement an effective, independent monitoring and auditing system is a political as well as technical challenge. On the technical side, it almost surely requires not only standard auditing but a system of random spot checks at the local and school level, which could be expensive.

Several tools could be used to address these challenges. Unannounced random sampling could be used to monitor test sites or attendance, to reduce the costs of monitoring every school.[43] Or countries could be rewarded for the number of *teachers* passing competency tests, which would significantly reduce the cost and enforcement challenges of monitoring.[44] Alternatively, the payment structure could be set up in a structure that would promote competition between districts, such as designating a set number of vouchers or cash amount for the country as a whole. This would create an incentive for leaders to police each other.[45] To put such competition on a level playing field, the payments would have to reward progress, just as on the national level.

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[40] We are grateful to Barbara Bruns who made this suggestion.

[41] Cheating by school and other administrators has been a problem, for example, in the U.S., with the legislation called No Child Left Behind, under which schools can lose federal transfers if test results of enrolled children are below a standard. In Houston, Texas and other cities, there is evidence that high school students unlikely to do well on tests were encouraged to drop out, in order to raise average results.

[42] Pritchett (2002). Their model sets out why evaluation seldom happens. See also Levine, Savedoff and Birdsall, 2006.

[43] We are grateful to Michael Clemens for this idea.

[44] We are grateful to Jane Benbow and Janet Robb of AIR for this idea

[45] We are grateful to participants in a Center for Global Development research seminar for this idea.

At the same time, we note that an agreed, transparent benchmark of progress would be easier to monitor accurately, and verify, than the thousands (in some cases tens of thousands) of performance criteria on which current aid is based. With independent auditors investigating a smaller number of simpler measures of progress, donors should have much more confidence in these measures of success then they do in existing criteria for aid payments.

An important advantage of linking aid to audited performance is the new attention and priority it will bring to improving the local systems for data collection and auditing – which have not attracted the attention and support that they deserve. By shifting resources from collecting low-value information about inputs from a plethora of projects to a systematic approach to gathering information about the number of children in school across the country, payments for progress would create incentives for a much more valuable, comprehensive and potentially less expensive, monitoring framework. Gathering accurate data on these indicators is a desirable and necessary investment both for donors and recipient countries in future policy planning. It is a merit of the outlined approach that it would enable donors to shift resources from the largely unproductive industry of monitoring and appraising individual projects and performance criteria, to the much more important task of building effective national statistical and auditing systems.

Unintended consequences. The choice of benchmark and the systems and institutions implemented for monitoring progress would play a large part in determining the unintended consequences that progress-based financing could have. One question, alluded to above, is whether payments for progress in education would lead to suboptimal diversion of resources from other sectors with greater development impact for given expenditures in a particular region or country – be it health or roads or training judges and auditors. Similarly payments for progress in primary education could lead to suboptimal allocation of resources between primary and other levels of education. However, where the "price tag" committed by donors is high enough to cover or exceed the marginal costs of reaching the target, this should not present a major problem. In higher-income countries, the total amounts are likely to relatively small as a percentage of total government spending, also reducing this risk.

A serious risk in the case of education is that of a shift in priorities and resources towards quantity over quality. This would of course be partially addressed by the use of a competency test rather than school completion. Of course, using as a benchmark any level of performance on a test would probably mean setting a relatively low bar, possibly creating an incentive to get large numbers of children to only the bare minimum. To avoid this problem, a fixed amount could be paid per point on a test, summing across children who complete primary school, without setting a pass or fail standard.[46]

Another risk is diversion of central government resources to geographic areas where success on tests could be increased at relatively low cost; in different contexts this could mean urban areas, which are easier to reach and staff. It is possible that a middle

[46] We are grateful to Michael Clemens for this idea.

tranche of schools would receive disproportionate resources, because there would be no additional reward for improving schools with already high completion or pass rates, but the marginal cost of improving outcomes in the poorest and lowest-performing schools is likely high. Marginal urban schools and more accessible rural schools might then receive more resources, and the most well-funded schools no benefit at all. In general, the more challenging the benchmark, the more likely that schools with higher levels of existing resources and achievement would receive greater resources. This reflects the possible tradeoff between equity in the form of modest standards for a broad group, and efficiency in the form of maximum returns to limited investment via high investment among relatively well-off groups.[47]

We have discussed the issues in the case of education. However, it is hard to imagine a sector or subsector immune to these risks. Even immunizing children, with its simplicity in terms of measurable progress and its primacy as an objective given its high ratio of lives saved (disability-adjusted life years) relative to other health and non-health programs, has been criticized when done in "campaign" mode for crowding out attention and investments in sustainable health systems and infrastructure.[48]

Box 3. Reducing volatility

Many factors other than aid may affect a good performance (or a bad performance) in a given year, independently of a government's actions -- including natural disasters, unexpected growth due to a commodity boom, and political changes. To some extent, such shocks will be smoothed out by the use of outcome variables (as distinct from input conditions or linking aid to intermediate indicators which are likely to be more volatile). The predictability of the payments will also allow countries to make use of capital markets to smooth flows (e.g. by borrowing against future performance). The markets (including local banks) will be the judge of the likelihood of successful performance. If necessary, volatility could also be reduced by linking payments to a backward-looking, three-year moving average. This would also help to address the challenge to donors of planning for aid flows within the framework of existing budget cycles; in addition, beginning with a small pilot program of several countries as we suggest would create uncertainties of funding that would fit comfortably within the margin of error in aid budgets.

Section IV. Potential benefits

The problems outlined in Section III can best be addressed in some sort of pilot of this approach, in which one or more aid-recipient countries and a group of donors would have to collaborate closely. We wish to conclude with a brief review of the potential benefits which make an experiment seem worthwhile, for both recipient governments and

[47] Behrman and Birdsall (1983) report higher wage returns to quality (measured in terms of teacher education) than to quantity (measured as years of school completed) for the case of Brazilian men in the 1980s, suggesting there is possible tradeoff between quality and quantity.
[48] Ask Ruth for citation to article that raises this issue

donors, beginning with the effect of this incentives-based approach on accountability of both recipient governments and donors – and thus on its potential to support the dynamic of institutional experimentation and strengthening within countries.

Increasing the accountability of recipient governments. A system which transfers accountability for use of aid resources within countries from donors to the country government is almost certainly a necessary if not sufficient condition for local institution building and thus the sustainability of any program scaled-up spending by donors supports. To maximize the contribution of the approach to accountability of recipient governments requires keeping the program simple and transparent. Simplicity and transparency and the incentives they create are at the heart of the institution-building role of the progress-based aid mechanism. If parents know that funding is unquestionably available for their government to meet the costs of providing primary education for all children, unencumbered by other conditionality, this permits them to hold the government accountable for whether they deliver the service. Responsibility is not diluted or distorted by the donors, nor can governments hide behind lack of resources as an explanation for failure.

If payments for progress are to translate into greater accountability, it is essential for the donor pledge to be transparent, widely understood, and couched in simple, unambiguous and consistent terms. Even a modest proliferation of additional conditions or complexity would greatly reduce the benefit of progress-based aid for improving the accountability of governments

Increasing the accountability of donors. A significant shortcoming in the aid relationship has been the difficulty of holding donors to account for their commitments. They have made individual and collective commitments on both quality and quantity of aid which have proven sufficiently vague or ambiguous for donors to be held to account.

Just as a transparent and simple pledge has the potential to improve the internal governance relationships in recipient countries, it also makes the aid commitment more binding on donors, because both recipients and civil society groups will be able to assess more readily whether they have kept their promises. If donors agree to be held jointly and severally liable for their commitment to pay for progress, they can exert peer pressure on each other to bear the costs as they fall due.

Other advantages for donors. These include:

- With payments linked directly to progress, the mechanism would provide full accountability to donor country taxpayers about where money has gone and what it has bought.

- Lower transactions costs for everyone: there would be no need for project milestones, benchmarks, performance criteria, appraisals, separate accounting mechanisms, etc. While there would be costs involved in auditing progress towards the specific indicators, these are the costs of improving systems and collecting information that is needed anyway for countries' policymaking and planning processes. The monitoring costs of progress-based aid would also be significantly less than the administrative costs of managing individual aid projects.

- No choices to make and defend about conditionality, selectivity, or adjusting aid in response to political or strategic interests. Aid would simply flow to those countries that are making progress towards delivering the internationally-agreed MDGs.

- Clarity of donors' commitments. Donors would be able to show that, if there is a shortfall in achievement, it is not because they have not made sufficient resources available. Accountability for making progress towards the MDGs would shift from the donors to the developing country governments.

- Resolution of the tension between the desire directly to fund service delivery, in order to produce results, and the desire to build up the institutions and systems that will enable governments to ensure the delivery of those services themselves in the future. By pledging a flow of funds, donors pay for the services that governments set up the institutions to deliver.

Other advantages for developing countries. These include:

- Greatly reduced transactions costs: the only requirement would be an annual audit of outputs delivered (which is information that they need to collect anyway, and which would be paid for by the donors).

- A less intrusive partnership with donors: there would be no interference in internal processes and priorities. Governments would be able to choose how best to prioritise service delivery in their own country.

- Predictable, long term funding against which governments could plan, invest, and if necessary borrow;

- Strengthening of the internal institutions of financial allocation and accountability. For example, finance ministries would allocate resources to those line ministries best able to deliver poverty reduction goals, and would have a reason to hold line ministries to account for performance.

- Enhanced internal political accountability. The transparent and guaranteed availability of finance would enable local civil society and media to hold the government accountable for what they deliver, and remove the excuse that insufficient resources were available.

- Discretion in whether and how to use a mix of public and private provision to address the MDGs. The donors would translate the social benefits ofprogress against the MDGs into financial flows which could be used either to finance public service provision, or to purchase goods and services from private sector suppliers.

- Automatic implementation of improvements in aid delivery so far promised but seldom delivered: untying aid, increasing predictability, avoiding establishing parallel project management mechanisms, linking aid to national priorities and plans, rewarding success, increasing the proportion of aid flowing to the poorest countries, and improving monitoring of indicators of progress.

Conclusion

The report of the UN Millennium Project correctly notes that "changing education systems requires political leadership and institutional reform, as well as additional investments and inputs". This is true for all the MDGs – the need for additional money is only one of the constraints on more rapid progress.

Some donors believe that the world should be more generous in its funding for development. They are right: the efforts of developing countries should not be allowed to fail through lack of resources. Other donors believe that aid funding should be clearly linked to results. They are right too. Increasing aid without linking it to progress is pushing on a piece of string.

We have outlined a mechanism for progress-based aid which seems to us to meet both these perspectives. It enables donors to make a serious commitment to fund the achievement of the MDGs, while ensuring that the resources flow only if the other constraints are actually lifted. It ensures that developing countries are more accountable to their own populations: no longer can they blame slow progress on lack of resources, when everyone will know that the funds are guaranteed for those governments that choose to deliver change. It reduces the costs of the aid business, and increases its transparency and effectiveness. Most important it creates the space for countries to develop and strengthen the local institutional capacity fundamental to sustaining progress.

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