# Domestic Political Outcomes of Foreign Aid*

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**Abstract**

Development aid often has domestic political consequences—both intended and unintended. This chapter reviews the literature on the effect of aid on political outcomes in recipient countries. These consequences can result from mismatched priorities between aid agencies and recipients, the need to accommodate various actors within domestic governments at the national and local level, and strategic attempts on either side to manipulate aid projects for their benefit. We argue that those effects can arise due to salient features of foreign aid that lead to the introduction of new actors in domestic politics, the introduction of new incentives for leaders and an increase in available resources. Those can affect the strategic decisions of voters and local leaders with a range of potential consequences from institutional changes and strengthening state capacity to corruption, political capture and distortions.

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# 1 Introduction

Although development aid is often justified on moral and economic grounds, it can also have intended or unintended political consequences in recipient countries. Understanding those effects is critical as they could either reinforce or go against some of the stated of goals of providing aid. For example, aid could help strengthen institutions which would then improve government budgetary allocations and thus have further positive effects on economic outcomes. Conversely, by temporarily lifting the government budget constraints, aid could delay important political transitions.

This Chapter discusses, both theoretically and empirically, a number of mechanisms that could explain how aid affects domestic politics and whether they interact with regime type. We take as a starting point common foreign aid modalities (delivery mechanisms, conditionality and targeting) and discuss how they might affect domestic politics by introducing new actors in domestic politics, new incentives for leaders and by increasing available resources.

We first review studies on the impact of foreign aid on political institutions, focusing on institutional change and effects on state capacity. Then we move to the effects of foreign on political incentives, focusing on corruption, political capture and distortions.

# 2 Definition of Development Aid

Development aid is generally understood as financial and in-kind assistance to recipients for the purposes of improving economic welfare in low and middle income countries. In the development policy community, development aid refers specifically to Official Development Assistance (ODA), which is "government aid that promotes and specifically targets the economic development and welfare of developing countries." (OECD).

At the same time, all development aid is not the same, and different features of development aid might have important implications for subsequent economic and political outcomes. In particular, for understanding potential political consequences of aid, it is especially important to consider the following design features:

1. **Type of aid**, especially whether it is project-based aid, general budget support, or issued in response to emergencies or other extraordinary circumstances; and also whether it is channeled through governments (national or sub-national), NGOs or private enterprises.

2. **Conditionality,** or whether the aid comes with specific requirements that the recipient is obligated to do in order to receive the aid;

3. **Targeting**: which specific actors are receiving the aid and the subsequent process through which aid resources are distributed.

In addition, a common concern about foreign aid is the degree to which it is **fungible**, or whether aid given can be used for other purposes. We now discuss those features in greater detail before linking them to potential domestic political effects in the next section.

## 2.1 Types of Aid

### 2.1.1 Project vs General Budget Support

Aid comes in different modalities. These modalities describe how aid enters recipient countries, the terms of financing, procurement requirements, and the monitoring conditions (Tilley and Tavakoli 2012; Tavakoli 2013). Aid can be a grant or a loan, can enter through or bypass the recipient government's financial management, can be cash or goods, can be sourced locally or from the donor, can be subject to close tracking of funds or can be highly discretionary. Two key aid modalities for consideration in this chapter are general budget support and project (or program) level aid.

Budget support directly enters the recipient's budget and passes through the country's financial management systems. It is a more discretionary form of aid (and thus linked to debates on fungibility, discussed below).

Project aid is typically much more targeted, focusing on a specific project within a given sector. Such aid allows donors greater control but can be costly to monitor and implement (Clist et al., 2011). Despite these strictures, much of the literature on how local politicians use aid to target specific voters analyzes programmatic aid.

Aid modalities have come into greater focus since the Paris Declaration on Aid Effectiveness (2005) and the Accra Agenda for Action (2008), where donors have been encouraged to let recipients specify their preferred aid modalities and respond to these preferences. Donors, however, appear to condition their choice of aid modality on specific recipient characteristics, often bypassing the government and reducing discretion in countries with poorer governance (Clist et al., 2011; Dietrich, 2013; Bermeo, 2017, 2018).

### 2.1.2 Channels of Development Aid

Aid flows through different channels. Donors can implement their own aid projects, but, typically because of the sheer volume of aid, they also utilize implementing partners such as NGOs, private enterprises, universities, and national and sub-national government. Because channels serve as conduits for aid, implementers can shape and direct aid in ways unanticipated by donors. Consequently, donors face a principal-agent problem when choosing the channels through which to implement aid.

Even so, donors typically have a choice between different agents to implement aid. In contexts with weaker political institutions, fragile states, or high levels of corruption, non-government aid channels become more attractive as a means of bypassing political institutions and actors in the recipient country.

Such non-state actors have emerged as increasingly important development partners in the last fifty years as the number of NGOs has grown tremendously (Clarke, 1998). Dietrich (2013) argues that donors have outsourced aid implementation to third-parties such as NGOs to avoid aid capture and boost aid effectiveness in weak institutional environments. In other cases, some aid channels may be chosen to allow donors to deliberately take advantage of the principal-agent problem: this is likely to occur when donors wish to appear to be pursuing strong measures, but would actually prefer a weaker implementation of the policy. Bush (2015) theorizes that this paradigm explains "tame democracy assistance," because donors espouse strong rhetoric about the virtues of democracy but want to avoid politically destabilizing their strategic allies. Similarly, NGOs working in politically-sensitive environments want to achieve reform, but do not want to risk being expelled from the country. This means it is in their interest to adapt programs to be more compatible with the current regime, which increases the chances of the organization's survival in the country. Thus, Bush (2015) suggests that donors intentionally choose to implement governance aid to strategic allies through NGOs, because NGOs are more likely to pursue "regime-compatible" "tame" democracy assistance.

## 2.2 Conditionality

Aid comes with varying conditions, strings, and stipulations, either explicit or implicit. These requirements attempt to reduce recipient discretion and the misdirection of funds and 'tie' recipients to using aid for specific reforms or for the purposes intended by the donor. Conditionality has been criticized by some scholars as ineffective (Collier, 1997), as structured to "buy" reforms or as paternalistic. Both the Paris Declaration on Aid Effectiveness (2005) and Accra Agenda for Action (2008) advocated for fewer conditions on aid and a shift to more untied aid. This emerged in tandem with a focus on country ownership and participation in aid. Even so, arguments for and against conditionality continue and another chapter in this handbook is devoted to the topic.

Relevant to this chapter are the arguments in favor of conditionality that hinge on the political impact of aid, and the potential political consequences of aid once implemented. Yuichi Kono and Montinola (2009) argue that donors should condition the time horizons of aid according to regime type, because long-term aid may unintentionally extend the tenure of autocrats otherwise. As a result of these effects on political survival, the authors suggest that democracies should receive longer-term assistance conditioned on policy while autocracies receive emergency assistance rather than systematic aid.

Similarly, Radelet (2003) argues that "aid delivery mechanisms should differ significantly between well-governed and poorly governed countries." For example, Dietrich (2013) explores the phenomenon of aid in weak institutional environments and "bypass aid", observing that significant quantities of aid bypass central government actors across these scenarios. Donors may prefer direct bilateral transfers, but they also seek to minimize aid capture and ensure development by delivering aid through channels which "mitigate institutional failure". While good governance positively and significantly predicts loans received from the IDA, it does not translate into greater discretion and more programmatic aid. In fact, the IBRD grants a greater proportion of programmatic loans to recipients with good governance than the IDA does (Winters, 2010).

## 2.3 Targeting

Outside of general budget support, foreign aid programmes and projects specify either recipients directly or the criteria that will be used to select recipients. Those decisions are made in discussions between the donors and the recipient governments and range from needs-based targeting to resources being sent to politically important constituencies.

## 2.4 Fungibility

Fungibility describes the fluidity of aid and the ease with which it can be redirected. Fungibility is a potential concern because it can change the fiscal behavior of recipients by relaxing budget constraints and leading to substitution effects. If aid is given for health purposes, but domestic actors can redirect some of that aid towards infrastructure, then the aid is considered categorically fungible because resources can be shifted from one category of aid spending to another. Alternatively, domestic actors may use health aid for health purposes, but reduce government spending on health and redirect that portion of the domestic budget to other projects—this is general fungibility, where aid substitutes for and perhaps entirely replaces government spending in a sector.

Fungibility exists along a spectrum, where full fungibility allows recipients to treat aid as income and direct it wherever they prefer while zero fungibility allows the recipient no flexibility in deviating from the donor's directives. Scholarly debate about how much fungibility matters has followed two broad waves. The first wave occurred in the 1990s and focused on concerns that aid might not be spent in the ways that donors desired and the fiscal implications for recipient countries. Given the rising percentage of ODA as a share of recipient's budgets, several papers in this period explored the extent of fungibility and whether this altered expenditure and tax effort in recipient countries (Cashel-Cordo and Craig, 1990; Pack and Pack, 1990, 1993; Feyzioglu et al., 1998; Franco-Rodriguez, 2000). If the fungibility of aid displaces government investment (in developmental and non-developmental sectors) with consumption and dampens incentives to collect domestic revenue, it could compromise state capacity and economic growth.

Cashel-Cordo and Craig (1990) detail how the fiscal behavior of the recipient depends on the structure and conditionality of the aid received, both of which also impact the extent to which aid is fungible. Looking into specific cases, Pack and Pack (1990) conclude that aid is partly fungible yet does not reduce tax effort and domestic revenue in Indonesia, but is more fungible, not spent in alignment with donor preferences, and may reduce tax effort in the Dominican Republic (Pack and Pack, 1993). Franco-Rodriguez et al. (1998) find that aid affects investment positively and tax effort negatively in Pakistan while Franco-Rodriguez (2000) finds little effect of aid on fiscal behavior in Costa Rica. On the categorical front, Feyzioglu et al. (1998) analyze fungibility in five sectors of aid, identifying higher fungibility in agriculture, education, and energy than in transportation and communication. Echoing a World Bank analysis on the topic, they underscore that recipients seek to reallocate aid when their preferences diverge from those of donors, but they consider these arguments a distraction from how donors can increase domestic spending in desired sectors given that aid will continue to be treated income by recipients.

Concerns about fungibility resurfaced in the wake of the Millennium Development Goals (MDGs) in the 2000s. As donors targeted broad outcomes set by the MDGs, such as increasing primary education and maternal health and decreasing child mortality and the spread of HIV/AIDS and malaria, donors increasingly poured aid into the health and education sectors. Yet if recipients simultaneously offset this increase by decreasing their own budget commitments to health and education, this substitution effect would jeopardize the attainment of the MDGs. Early work from Pettersson (2007) suggested no adverse economic effects due to fungibility in a cross-country analysis of fifty-seven recipients and a specific study on a World Bank health-sector project in Vietnam similarly indicated little negative impact of fungibility on reductions in infant mortality (Wagstaff, 2011).

However, Lu et al. (2010) argued that health aid is highly fungible, particularly in Sub- Saharan Africa where they calculated that every dollar of health aid reduced government spending on health by forty-three cents. This re-ignited the debate over fungibility and sparked a series of sparring articles. This second wave of arguments concentrated primarily on the health and education sectors. In response to Lu et al. (2010), Van de Sijpe (2013) emphasized the importance of distinguishing between aid which directly enters public sector accounts and aid which bypasses the public sector (harking back to McGillivray and Morrissey (2000) and linking to arguments about aid modalities). Van de Sijpe (2013) differentiated off-budget aid such as technical cooperation from on-budget aid like sector program aid, ultimately reporting lower levels of fungibility in education and health than found by Lu et al (2010). Dieleman et al. (2013) responded to both papers by extending analyses by Lu et al. (2010) and Van de Sijpe (2013) to include an additional twenty-three countries and four years of data, reporting that health aid is highly fungible.

# 3 Sources of Political Effects of Aid: how can aid have political effects?

In this Section, we discuss mechanisms through which aid can affect domestic politics. We focus on how the characteristics of aid highlighted in the previous section can affect domestic political outcomes. The discussion will help us interpret the empirical literature discussed in Sections 4 and 5.

Most of the traditional literature on political effects of aid tend to focus on the effects of aid on institutions. One concern in particular is the concept of *aid dependency* (Brautigam and Knack, 2004). In Brautigam and Knack's framework, development aid can have harmful effects on politics, through five different mechanisms: (i) Reducing incentives for reform, (ii) Creating moral hazard, (iii) Distorting budget constraints, (iv) Fostering a "tragedy of the commons" mentality, and (v) Reducing accountability.

To help organise the empirical findings discussed in the next Sections we take a slightly different approach and focus on how aid can affect domestic politics through the introduction of new actors in domestic politics, an increase in available resources and how those combine to affects leaders' incentives. We discuss those in turn.

## 3.1 Introduction of new actors to the domestic political scene

Foreign aid introduces new actors into the domestic political scene in the recipient country, whether these be donor representatives stationed in the country or local and international NGOs. Even if not explicitly political, these new domestic actors may modify civil society, impact perceptions of the domestic government's legitimacy, or directly challenge the existing political institutions. In addition, countries often have to deal with a number of donors, among whom there is persistent lack of coordination in aid efforts of major donors (Aldasoro et al., 2010). This can lead to fragmentation and reductions in bureaucratic (Knack and Rahman, 2007).

**Donor representatives and NGOs** Both NGOs and donor representatives have proliferated in the last few decades (Clarke, 1998; Knack and Rahman, 2007; Van de Walle, 2001), introducing numerous additional actors into the domestic political scene. Donor representatives and aid officials may increase technical capacity and "learning by doing" in the domestic environment, but their presence may also lead to the "poaching" of qualified staff from the civil service and a substitution effect whereby agencies and NGOs begin to function in place of government ministries (Knack and Rahman, 2007; Van de Walle, 2001). This provides one backdrop for the discussion of aid and state capacity later in this chapter.

Clarke (1998) traces the tremendous growth of NGOs operating around the world since the 1970s, proffering four reasons for their proliferation. First, NGOs act as a non-government channel for non-government actors. Second, NGOs also operate as an important channel for bilateral and multilateral donors. Third, economic hardship prompted domestic governments to outsource social and economic agendas to non-state players. Fourth, NGOs have adopted a role for themselves in social mobilization.

Despite their non-governmental status, Clarke argues that their 'associational' nature and participation in development processes and civil society makes NGOs "intrinsically political" actors. In later work, Rubenstein (2015) categorizes humanitarian international NGOs (INGOs) similarly, as somewhere between Samaritans and states—actors with political influence because of their global profile and whose operation is necessarily tangled up in domestic political institutions because of the contexts in which they operate and the nature of their relief work. Both authors highlight that even if NGOs are not intentionally political, their work still creates political impact.

Clarke posits five ways in which NGOs might reshape the political environment, citing some specific examples for the first three mechanisms and theorizing about the latter two as avenues of future research. NGOs may impact domestic politics: (i) By strengthening the opposition (ii) By strengthening civil society (iii) By strengthening activism (iv) By creating political contestation and (v) By fostering democratization.

Brown et al. (2008) adapt Clarke's framework and suggest the following mechanisms. They differentiate between ways NGOs might foster reform and ways the same organizations can stifle political change.

NGOs can cultivate political change by creating social capital and by acting as interest groups. NGOs can build social capital by generating associational activity and "horizontal linkages," which in turn can ease collective action and the provision of public goods. Alternatively, NGOs can effect political change by behaving as interest groups, leveraging their own resources to lobby for reforms.

NGOs may prevent political change or reinforce the status quo by responding to elite interests or by being demobilized. NGOs can be "captured" by an interest group or coopted by elites seeking to prevent change. Finally, NGOs can be demobilized and reinforce the status quo as they compete for resources, conform their agenda to satisfy key development actors, or distort cycles of political feedback by eliminating grievances.

**Strengthening civil society** Aid may strengthen civil society by increasing the resources available for civil society organizations (Kalyvitis and Vlachaki, 2010) and free and independent media (Knack, 2004; Dutta and Williamson, 2016).

Civil society promotion has been an important component of democracy promotion (Carothers, 2004). Examining NGOs in Brazil, Brown et al. (2008) report that NGOs can strengthen civil society and increase social capital. In Kenya, Gugerty and Kremer (2008) do not find that funding strengthens community organizations who receive it, but do detect a change in the composition of membership toward those who are "younger, more educated, and better off". Dutta and Williamson (2016) conclude that aid can increase freedom of the press in democracies, but not in autocracies.

## 3.2 Introduction of new or additional resources to the domestic political scene

Aid is also a resource, a source of unearned foreign income or goods. As such, aid may create aid dependence (Brautigam and Knack, 2004) and change electoral incentives, as discussed. Further, aid is a "politically useful resource" that can be converted into goods and services (Briggs, 2019) and so can affect the political survival of the regime receiving it (Bauer et al., 1976; Yuichi Kono and Montinola, 2009; Ahmed, 2012; Knack, 2004; de Mesquita and Smith, 2009; Licht, 2010) or change the quality of political institutions (Tavares, 2003; Djankov et al., 2008; Jones and Tarp, 2016; Bermeo, 2017).

Consequently, just as with natural resources, some scholars have argued that aid may have a detrimental impact on development and institutions, suggesting a "'transferred' resource curse" analogous to the "natural resource curse" (Ahmed, 2012; Morrison, 2007). Bermeo (2017), however, argues that this phenomenon is limited to the Cold War period and that the fungibility of resources matters: donors prefer to give less fungible aid to non-democratic recipients; consequently, aid is not oil, because donors can limit its fungibility.

### 3.3 Introduction of new (or altered) incentives to the domestic political scene

Aid can directly change and distort both fiscal and electoral incentives in recipient countries. But it also important to note that donors and recipients may pursue different priorities which will need to be accommodated.

**Fiscal incentives** The perverse side of these fiscal incentives can be summarized by the concept of *aid dependence*. Brautigam and Knack (2004) develop a framework, specifying five different mechanisms, through which countries may become aid dependent, a "situation in which a government is unable to perform many of the core functions of government, such as the maintenance of existing infrastructure or the delivery of basic public services, without foreign aid funding and expertise."

Because aid can reduce incentives for reform, create moral hazard, distort budget constraints, foster a 'tragedy of the commons' mentality, and reduce accountability, this can fundamentally change the fiscal calculus of a government and over time render governments dependent on aid. Since aid can be a valuable resource for redistribution and donors may reduce the supply of aid as governance and development increase, there can be little incentive for recipients to undertake reforms which will jeopardize their aid packages.

Similarly, with aid as a revenue stream, recipients may expend less effort in collecting tax revenue or rooting out corruption within institutions. Aid as a source of unearned foreign income can further distort budgeting practices, because recipients are not limited to spending simply whatever revenue they raise. This creates problems for the government in the future as well when aid receipts cease and a hard budget constraint will be binding. In the meantime, politicians overdraw on resources, enacting a 'tragedy of the commons.' Finally, since governments tend to lower their tax effort when receiving high volumes of aid, this reduces their accountability to their own citizens, breaking feedback links between the governing and the governed (Moyo, 2010). At the same time as becoming less responsive to their own citizens, governments are becoming increasingly responsive to donor demands. Together, Brautigam and Knack (2004) speculate that these five mechanisms foster aid dependence, such that recipient governments lose their capacity to perform their core functions of governance.

**Electoral incentives** Aid can also alter electoral incentives when politicians shape in-country aid allocation to target votes or politically salient constituencies Briggs (2012, 2014); Dreher et al. (2019); Jablonski (2014); Öhler and Nunnenkamp (2014). Donors may similarly create "political aid cycles" by timing their aid to coincide with elections in which they have strategic interest (Faye and Niehaus, 2012).

Both the introduction of new actors, new resources and new incentives to recipient political environments foster political consequences of development aid. In the following sections, we discuss the effects on political institutions and political incentives.

# 4 Political Effects Part I: Political Institutions

Starting around the 1990s, development aid increasingly encompassed efforts to build and support political institutions, through the overarching framework of improving governance. The recognition that institutions were important for economic growth led to efforts to design development aid in ways that would support and strengthen political and economic institutions in developing countries.

Institutions appear to matter for economic development (Rodrik and Subramanian, 2003; Acemoglu et al., 2004) and so does the contextual framework in which aid operates (Burn- side and Dollar, 2000). But scholars remain divided over how aid impacts domestic institutions.

Several studies consider high volumes of aid problematic and observe that aid negatively impacts institutions (Knack, 2001; Busse and Gröning, 2009). Brautigam and Knack (2004) conjecture that, in the context of aid dependence, aid can weaken institutions in Africa. Djankov et al. (2008) argue that aid fosters rent-seeking and so is a "bigger curse than oil" to political institutions.

On the other end of the spectrum, Jones and Tarp (2016) find that aid positively impacts institutions and, after disaggregating aid by purpose, this effect appears to be driven by governance aid. Other studies also isolate governance or democracy aid to examine its effects. Scott and Steele (2011) find that "targeted democracy assistance" increases the chances of democratization while Savun and Tirone (2011) conclude that democracy aid "shelters" states from political violence internally as they transition to democracy.

Dietrich and Winters (2022) analyze the empirical literature on aid and institutions, collating the potential mechanisms through which aid impacts institutions. On the positive side, aid may improve governance through conditionality, investment in human capital, in- creasing resources for government salaries, learning by doing, and increasing the chances

of survival of "reform-oriented" governments. On the negative side, aid might deteriorate the quality of governance through dampening tax capacity, accountability to citizens, and the growth of civil society and increasing transaction costs, rent-seeking, patronage, and conflict, poaching, and the chances of survival of "poor-governance" governments.

**Supporting state capacity** State capacity, particularly the ability to "collect taxes and enforce contracts" is a cornerstone of development (Besley and Persson, 2009). Aid has the potential to support state capacity by loosening budget constraints, increasing legibility improving technical capacity, and strengthening administrative capacity.

Aid can affect institutions by building or diminishing state capacity as new resources are added to the domestic environment and fiscal incentives are altered. In the arena of spending, revenue, and investment, Remmer (2004) documents that aid reduces revenue but increases spending while Chatterjee et al. (2012) find that certain types of aid, particularly providing infrastructure, can crowd out government investment. Cashel-Cordo and Craig (1990) argue that the structure of aid mediates these fiscal effects.

On the institutional capacity side, Blair and Winters (2020) conclude that aid reduces investment in institutions and Knack and Rahman (2007) that fragmentation of aid across many donors "erode[s] administrative capacity" in recipients.

Considering effects on state capacity and state legitimacy, Barma et al. (2020) develop a typology of interactions between donor and recipient governments that represents three dimensions of aid: level (or volume), design (donor or recipient led), and implementation (management of the project). Varying these three dimensions yields eight different types of aid: hollow, minimal, constrained, superficial, directive, facilitative, dominant, and supportive. They hypothesize that each of these could have differing impacts on state legitimacy and state capacity, which would explain the mixed results in the current empirical literature. For example, hollow aid, categorized as low volume, donor-driven in design, and recipient-managed—or "pro-forma attempt...without follow through"—would be the likeliest to negatively impact both state capacity and state legitimacy. In contrast, a cate- gory like facilitative aid, which is high-volume, recipient-designed -and-managed, is more likely to positively affect both state legitimacy and capacity. For the four donor-managed designations (constrained, superficial, dominant, and supportive), the effects on capacity and legitimacy remain ambiguous and further theoretical and empirical work is needed.

**Increasing legibility** Legibility refers to the extent of knowledge that a state has about its citizens, often considered a foundation for state capacity (Lee and Zhang, 2017; Opalo, 2013). This includes generating and gathering administrative and economic data, useful to the state in its functions, but unlikely to be readily provided through citizen sources.

Such data can range from detailing local GDP and earnings to primary school enrolment and vaccination numbers. Increased legibility may assist in collection of tax revenue or increased provision of health and education services.

Global summits such as the Marrakesh Action Plan for Statistics (2004), the Busan Action Plan for Statistics (2011), and UN's High-Level Panel on Post-2015 Development's call for a data revolution (2012) have highlighted the importance of building greater statistical capacity in developing contexts. Yet policymakers and scholars such as Justin Sandefur, Amanda Glassman, and Ken Opalo have criticized aspects of this focus—distinguishing between the type of aggregate statistics collected for donors and the "disaggregated, high frequency data linked to subnational units" useful to local policymakers (Sandefur, 2013). Data aimed at donors can overstate progress on desired goals, often due to incentives to misreport at the local-to-national or national-to-donor level (Sandefur and Glassman, 2015).

Whether foreign aid increases legibility then depends on type of data generated and the funding available to collect it. For 2012, Glassman (2014) noted that most data collection was highly aggregate or "micro-oriented survey fieldwork" and calculated that only 0.16% of official development assistance targeted statistical capacity building, on which many recipients were almost entirely dependent to finance their "core data collection".

**Strengthening bureaucracies and government agencies** Aid has also contributed to improvements in the bureaucratic capability of recipient countries (Brazys, 2015). In good institutional environments, Caputo et al. (2011) infer that budget support strengthened public management capacity, citing Mali, Zambia, and Tunisia as examples.

As discussed previously, aid also introduces new actors to the domestic environment. Campbell et al. (2019) consider the mediating role of international NGOs in contributing to state capacity in development contexts, concluding that INGOS can increase state capacity in democratic contexts.

**Improving technical capacity** Aid also has long term effects on state capacity and institutions through technical assistance. In addition to training and supporting bureaucracies and government agencies, technical assistance also takes the form of providing computing and accounting tools, and sharing best practices for recording and maintaining government records and data. Additionally, technical assistance is often the modality through which democracy promotion and judicial reform aid is delivered (Ariotti et al., 2021; Gibson et al., 2015).

Not all technical assistance succeeds in building technical capacity. Godfrey et al. (2002)

examine technical assistance in aid-dependent Cambodia (which Barma et al. (2020) might have classified as constrained in their typology due to its donor-design, donor-management, and low volume), concluding that under such circumstances technical capacity is not improved. Technical assistance may also alter political institutions because it increases donors' ability to monitor implementation of aid. Gibson et al. (2015) linked technical assistance to democratization in Africa.

**Impacting state legitimacy** Given that aid has become an important source of finance for many recipients, concern emerged that high volumes of aid would delegitimize domestic governments because citizens might conclude that aid signals institutional weakness or a lack of state capacity. However, empirical investigations have revealed the opposite effect in many cases. Aid has not reduced perceptions of government legitimacy in India (Dietrich and Winters, 2015), Bangladesh (Dietrich et al., 2018), and Kenya (Dolan, 2020). Dolan (2020) suggests in the Kenyan case, this is because citizens do not expect their government to be self-sufficient and so receiving aid does not change their perceptions of state legitimacy. Also studying Kenya, Brass (2016) traces the proliferation of NGOs in the country, but finds this growth has not decreased state legitimacy.

Blair and Roessler (2021) find similar effects regarding Chinese aid throughout Africa. Sacks (2012) concludes that aid actually strengthens legitimacy in Africa. However, focusing on Uganda, Baldwin and Winters (forthcoming) conclude that "bypass aid" delivered through third parties may reduce legitimacy, as citizens may treat this as a signal about domestic institutions.

# 5 Political Effects Part II: Political Incentives

The most striking political effects of aid are the results of corruption or misallocation. However, even when there is no malfeasance involved in the allocation of aid, foreign aid can still affect politics in deleterious ways, by distorting political incentives.

## 5.1 Corruption and Theft

Alesina and Weder (2002) found that donors do not favor recipients with lower corruption with higher volumes of aid, but understanding how aid affects the prevalence of corruption in-country is more ambiguous. Tavares (2003) reported that aid decreases corruption in recipients while Svensson (2000) models increased corruption in more fractionalized or socially competitive conditions due to rent-seeking. Weighing the available data, Alesina and Weder (2002) cautiously intimate that aid may increase corruption.

Isopi and Mattesini (2008) extend the work of Alesina and Weder (2002) by differentiating between *endemic* and *aid-related* corruption. The authors suggest that where corruption is endemic and widespread, donors must accept this as a cost of operating. Aid-related corruption arises because donors need the support of elites to accomplish their objectives, but these same elites will attempt to capture some benefit from the project and cannot be easily monitored by the donors. Even so, donors will design contracts to limit aid-related corruption and enhance monitoring. Consequently, Isopi and Mattesini (2008) suggest that aid may not appear to respond to reduced levels of corruption, because donors treat endemic corruption as a necessary cost of doing business and design contracts to limit aid-related corruption.

Several studies explore aid-related corruption and elite capture. Boone (1996) addresses the concern posed by Bauer et al. (1976) and *Foreign Economic Aid* (1958) that aid will be captured and consumed by political elites. Boone demonstrates that this occurs primarily under certain extractive political conditions, what he terms "elitist" governments, but, in these cases, aid does increase the size and consumption of government. More directly examining the evidence for theft and economic capture, Andersen et al. (2022) analyzed twenty-two countries highly dependent on aid and demonstrate that a spike in transfers to offshore accounts in financial havens coincides with the receipt of aid disbursements from the World Bank. This suggests that in certain contexts economic elites can "capture" foreign aid—either directly or indirectly by substituting aid for other domestic resources, which are then stockpiled in offshore accounts.

## 5.2 Diversion, political capture, politically-motivated allocation

Aid can also alter electoral incentives when politicians can shape in-country aid allocation to target votes to win elections or maintain power Jablonski (2014). In such scenarios, donor fragmentation may assist domestic politicians in camouflaging their distributional agenda by spreading it across funders (Jablonski, 2014; Cooksey, 2012). Moreover, donors may encourage this kind of vote-targeting as a way to leverage aid to achieve desired political outcomes—timing their aid to coincide with elections in which they have strategic interest and thereby creating "political aid cycles" (Faye and Niehaus, 2012).

Studying Chinese aid, Dreher et al. (2019) document evidence of political capture by African leaders across 47 countries between 2000-2011. In general, leaders favor their birth region (Hodler and Raschky, 2014) and foreign aid amplifies this effect. Dreher et al. (2019) find that more aid is allocated to the leader's birth region, particularly in competitive election years.

Aid can also impact the political survival of incumbents. (The incentive-related aspects of this phenomenon are further discussed in section **5.3 Political Distortions**.) Yuichi Kono and Montinola (2009) determine that aid impacts political survival, but its effect depends on regime type: long-horizon aid supports autocrats (who can transform aid flows into slack resources amassed to lengthen their tenure), but current aid assists democrats. The role of aid in leader survival is further complicated by the reality that donors may strategi- cally time aid to assist or disadvantage incumbents (Faye and Niehaus, 2012; Kersting and Kilby, 2016). In such cases, Licht (2010) also validates that aid can prolong the survival of incumbent leaders, but, again, this effect depends upon timing and regime type. Ahmed (2012) finds that aid and remittances prolong the survival of autocrats.

### 5.2.1 Diversion

Aid can advantage incumbents and change chances of political survival. Even when aid is not politically directed, aid can still be diverted for political purposes. Briggs (2012) demonstrates that even under stringent supervision, political elites in Ghana under the NDC government directed infrastructure aid to supportive constituencies prior to the 2000 election and this increased their vote share in those constituencies.

After analyzing subnational World Bank and African Development Bank aid in Kenya between 1992-2010 across two regime changes, Jablonski (2014) concludes that aid does shape political incentives and politicians do use aid to target votes. For Kenyan elections, he models ethnicity as an important signal to politicians and clientelism as the channel through which redistribution occurs. He validates that aid goes to supportive constituencies and these districts receive more aid than swing districts. Coethnic constituencies also receive more aid—he calculates $ .80 per capita annually. Finally, he estimates that this redistribution of aid increases victory margins, by up to 16% if a constituency shifts from the minimum to maximum amount of aid. Briggs (2014) also analyzes the distribution of project aid in Kenya (1985-1999) and demonstrates that projects are directed toward the current president's political base. Öhler and Nunnenkamp (2014) similarly report that intra-country aid allocation favors the leader's home region. Masaki (2018) shows that when elections are competitive in Zambia, more projects occur in swing and opposition districts rather than supportive and coethnic districts. Given the incumbent government at the time of elections influences the distribution of aid, this advantages incumbents in retaining power.

Surprisingly though, targeting aid does not always increase incumbent support. Briggs (2019) tests whether aid increases incumbent support in Senegal, Nigeria, and Uganda between 2005-2012. While corroborating his initial 2012 finding that politicians use aid to target votes, surprisingly, Briggs finds that, in these contexts, increased aid reduces support for the incumbent. He suggests that a local project "exposes citizens to a range of pathologies" such as corruption and poor project management that decreases their willingness to support the incumbent party. This surprising result stands in contrast to much of the prior literature, yet Blattman et al. (2017) confirmed a similar result in Uganda for approximately the same period (2006-2012). The authors examine an economic development program aimed at Northern Ugandan youth, financed through a concessionary loan from the World Bank and monitored carefully to prevent patronage. In this case, aid may still be targeting votes but is not directly rewarding supportive constituencies and the authors find that the program reduced support for the incumbent party, likely through an income effect.

While aid may be targeting votes, the way in which aid can shape electoral outcomes may depend on regime type and state capacity. Several studies have analyzed aid, political outcomes, and credit-claiming in Uganda, with results sensitive to local political structure and varying depending on the level of analysis–ranging from the district level to the county and sub-county level and then to the parish and village level.

Briggs (2019) reported that aid reduced vote share for incumbent executives, examining 899 enumeration areas in his analysis (and thus working below the district level). Sim- ilarly, Horigoshi Reis (2020) estimates little effect of aid on vote share below the district level, unless local politicians have created new districts. She identifies this "administrative unit creation as a vote-buying instrument" at the county-level. Springman (2020) studies bypass aid at the parish level and finds that aid strengthens incumbent support (likely because citizens believe the president determines the location of projects). Baldwin and Winters (2023) conduct an experiment in Uganda, analyzing bypass aid implemented through external actors spanning the district, sub-county, and village level. They identify "aid oversight capacity" as a key component for constituents in assigning credit and in influencing incumbent support (further discussed in **Section 5.3.1**).

### 5.2.2 Budget Reallocation

Receiving aid may lead to a reallocation of the budget in recipient countries, linked to the fungibility of the assistance. The proportions of the budget may shift toward consumption or investment as spending sectors are adjusted. The 1994 UNDP Human Development Report flagged concerns by donors that aid enabled greater military spending.

In early work on this topic, Cashel-Cordo and Craig (1990) reported that aid increases general government spending but not military expenditure. Other sources suggest that even if expenditure increases, sectors receiving aid see budget cuts, such as health care (Yuichi Kono and Montinola, 2009) (IHME 2010). Swaroop et al. (2000) examine aid in India and find that aid “substitutes” for planned government spending, so that when aid is received government funds for the sector are then re-allocated to non-development spending. Khilji and Zampelli (1994) study U.S. assistance and conclude that, due to high fungibility, it drives increased consumption spending and tax relief to the private sector. Remmer (2004) likewise reports that aid increases spending.

Much attention has been devoted to military expenditure as an attractive outlet for non- development investment. Both donors and scholars have expressed misgivings that high levels of defense spending can be unproductive (Devarajan and Swaroop, 1998) and counterproductive (Collier and Hoeffler, 2007). Despite Cashel-Cordo and Craig (1990) ’s initial verdict that aid does not increase military spending, Collier and Hoeffler (2007) find a “regional arms race” effect from aid in Africa, estimating that “military spending is almost double its level in the absence of aid.” Further, these levels of defense spending do not lessen the risk of internal conflict and civil war (Collier and Hoeffler, 2007). Attempting to unify the different strands of the literature, Kono and Montinola (2013) separate spending by regime type and demonstrate that autocracies are more likely to reallocate aid to increase military spending than democracies.

## 5.3 Political Distortions

Last, foreign aid can still affect political incentives even in the absence of direct political capture or diversion. Politicians can still benefit electorally from aid even when safeguards are in place to prevent diversion of resources and interference with aid targeting and disbursement.

### 5.3.1 Credit-Claiming

Development aid also has unintended negative political consequences. Stories abound of politicians strategically directing development projects to their favored constituencies, or even lining their campaign war chests with stolen aid funds. At the same time, even absent blatant theft or corruption, development aid can have more subtle–but perhaps more pervasive–negative effects on political outcomes.

One example is credit claiming, which refers to situations where politicians attribute the receipt of development aid to their own personal efforts, regardless of whether this credit is deserved. This includes everything from re-branding bags of relief goods from international agencies with their campaign stickers to placing their names on large infrastructure projects.

In the development policy world, one of the most visible forms of credit claiming are large tarps or posters proclaiming the project or activity with the politician's name and photo prominently positioned. Meanwhile, if the name of the funding agency is included at all, it's often in smaller letters or in a corner of the poster. Other common forms of credit claiming for development aid include politicians visiting project sites to use groundbreaking and dedication ceremonies as opportunities for grandstanding.

Credit-claiming can be deserved, where politicians help secure funding and facilitate implementation, though more often it is undeserved, as politicians play no role in the project. Credit claiming can impact incumbent survival at the local or national level, because it may obscure accountability and "inflate" incumbent support through misattribution of credit (Baldwin and Winters, 2023).

**Deserved Credit-Claiming** Implementation of aid projects that deliver public or welfare goods can be a form of coproduction between state and non-state actors (Tsai, 2011), where politicians may be influential in fostering partnerships or forging links (Baldwin and Winters, forthcoming), especially in authoritarian contexts (Tsai, 2011). Politicians participating in these partnerships and coproduction may be deservedly claiming credit for such projects.

**Undeserved Credit-Claiming** However, in the absence of information, constituents frequently misattribute undue credit to incumbents (Guiteras and Mobarak, 2015; Springman, 2020). For example, studying bypass aid delivered through NGOs in Uganda, Springman (2020) reports, from survey data, that though respondents knew an NGO implemented particular aid projects, they still believed that the president was responsible for the allocation of projects to their locality.

Yet citizens also update their support and exhibit "sophisticated reactions" when provided information (Guiteras and Mobarak, 2015; Baldwin and Winters, 2023). As a result, information about the funding and implementation of aid projects can help constituents attribute credit more plausibly. Further, providing this information does not appear to disadvantage politicians deserving credit though it does reduce credit for undeserving politicians in an experiment in Uganda (Baldwin and Winters, 2023). Crucially, this effect relied on variation in political oversight capacity, where voters assess to what extent their local politicians are likely to have been able to be involved with an aid project and update their support for the incumbent accordingly.

### 5.3.2 Political Budget Cycles

Consistent with the political effects channel, there is evidence that donors, at least partly, provide aid to help align governments stay in power. Recent economic performance is an important determinant of incumbent vote share in competitive elections and the literature on political business cycle highlights that incumbents attempt to increase spending and improve employment outcomes in election years. Bilateral donors tend to provide more resources to recipient countries ahead of elections, especially if the countries are aligned (Faye and Niehaus, 2012).

# 6 Conclusion

It is abundantly clear that foreign aid impacts domestic politics; but the ways that aid can affect politics can vary not only in scale and scope but also in the types of effects—positive or negative—on political institutions and incentives. The aid-induced growing presence of development actors, local and international, can reconfigure the domestic political scene. These actors can galvanize civil society, act as interest groups (representing opposition or elite interests), attract resources, create social capital, and eliminate grievances against the ruling elites—all which can recontour domestic politics.

Further, foreign aid introduces additional resources, which can influence domestic politics and alter existing incentive structures for domestic politicians. The constellation of these effects depends on context. Under conditions of aid dependency or weak institutions, additional resources from aid appear less likely to improve bureaucratic or technical capacity and may have downstream effects on legitimacy and state capacity.

Because aid itself is a valuable resource, politically and financially, local political actors also have incentives to capture, direct, or claim credit for its flow. This may also accord with the interests of donors, who prefer particular incumbents or regime types, and can adjust the volume, volatility, and timing of aid flows accordingly.

Even well-intentioned donors are unlikely to be able to provide aid without any of the political effects of aid described in this chapter, many of which are context-dependent and the result of a complex interplay of factors. A few key takeaways for concerned donors include:

- **Improved design of aid programs:** donors should endeavor to design aid programs that create local political incentives for economic development. This requires a more nuanced understanding of the local political context to design programs that can: (i) engage with civil society and support their efforts to hold governments accountable; and (ii) enhance state capacity and promote inclusive economic development.

- **Attention to both fiscal and electoral incentives:** donors tend to focus more on aid dependence, distortions to financial planning, and incentives for reform, but understanding the effects of aid on political incentives is just as important.
- **Multifaceted approach to addressing diversion:** donors tend to focus efforts on mitigating corruption and large-scale misallocation of resources. While these are important, monitoring and oversight should also include more subtle forms of misuse, such as politically-motivated allocation of resources, undeserved credit-claiming, and the manipulation of aid timing for campaigning.

Although there is no one-size-fits-all solution, there is much reason for optimism. In most contexts, aid does not appear to reduce the recipient state's legitimacy in the eyes of citizens, except in cases where bypass aid may signal citizens about institutional quality. And while recipient governments will often attempt to use aid to secure political support, but their success in achieving this can be mixed. Aid can affect chances of political survival, but these effects depend on timing, channels, volume, and regime type. These features of aid can mediate the role of aid in domestic politics, but political effects of foreign aid, intended and unintended, will continue to arise as local and international actors respond to the changing incentives and fluctuating resources that accompany foreign aid.  At the same time, these potential channels for political effects of aid also point to important ways to minimize these effects. By addressing these considerations in the design and implementation of programs, donors can also foster improved political incentives and support strengthened political institutions in recipient countries, while reducing unintended political consequences.

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