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CONDITIONAL AID AND GOOD GOVERNANCE : EXPLORING THE LINKAGES

Abstract

Foreign aid has played an important role in world development since the 1940s. The prime argument in support of foreign aid is that it can eliminate poverty of the recipient countries by fostering development. However, the debate persists as to whether aid which almost inevitably is tinged with conditionality actually promotes development. Since 1980s a new conditionality of the aid package has been attainment of good governance. The main objective of this paper is to analyze whether conditional aid brings good governance or not. The findings based on cross-country evidence tend to suggest that conditional aid did not have expected impact on good governance.

Introduction

The origins of foreign aid can be traced back to the colonial links between imperial powers and their overseas territories, in general, and, in the case of the United States, to the Trumens' doctrine of the late 1940s.[1] Whatever its exact origins, aid began to

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be an important facet of international relations in the 1950s following the devastation of the World War II, on the one hand, and the growing struggle of influence in the world between the two superpowers – the USSR and the US – on the other. The rivalry of the superpowers became actually the main determinant of political alignments and the stimulus for early bilateral aid flows.[2] The widely accepted basic definition of aid, however, may be traced to the end of the 1960s, when the OECD's (Organistion for Economic Cooperation and Development) Development Assistance Committee (DAC) set aside a component of their financial resources flows that was to be called 'official development assistance' (ODA).[3] In the past and even in the present, governments of different countries have given various explanations to legitimise their granting or withholding of foreign aid to the Third World countries.[4] The reasoning behind aid is in assisting the recipient countries' to bring along economic and social transformations, *i.e.* 'development', through the provision of external resources. The inherent causal relationship may be specified as:

Aid ---> increase in domestic investible resources→ increase in domestic investment→ more rapid rate of economic growth.

If this proposition is correct, one can expect that increasing in aid flows to be positively
associated with rise in domestic investment, which will lead to promote higher rates of
economic growth in the recipient countries.[5]

Today, more than sixty years after the first traces of using foreign aid is still considered as a development tool but there is no

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[1] See for example, Riddell, *Foreign Aid Reconsidered* 1987: 85. Rist, *The History of Development* 1987:70-72.

[2] Browne (1990: 3)

[3] *Ibid*. p. 6.

[4] Riddell (1987: 85)

[5] *Ibid*. p.103

unanimous understanding of why some countries are more developed than others and how to achieve desired development. Furthermore, billions of dollars of foreign aid is given every year to the developing world, much of which in the last decade has had strict conditionality strings of policy changes – 'good governance'- conditionality being the latest of those. Since the late 1980s, 'good governance' as a condition has been written into the aid flows, and it is the time now, after more than a decade of such practices, to go beyond the theoretical discussions and to follow up on if these sums in practice have actually brought along the necessary and originally desired changes in the recipient countries, and thereby provided the basic material for the further discussions on how conditionality can become a better instrument of aid and development policy. The paper, for analysing the governance indicators of a large number of developing countries over a period of time, will use OECD data and World Development Indicators (WDI). Besides, the indicators of governance developed by Kaufmann, Kraay and Mastruzzi (KKM), will also be used. Conclusions will be drawn from the study results if the conditionality of 'good governance' has been working or not working on the aid recipients' policy reform.

Does Conditional Aid Bring Along Good Governance?

A number of research findings show that good governance – in the form of institutions that establish a predictable, impartial, and consistently enforced set of rules for investors – is crucial for the sustained and rapid growth of per capita incomes of poor countries.[6] Carlos Santiso in a series of articles has questioned the effectiveness of conditional aid in altering the institutions of governance in the borrowing countries. Santiso concludes that aid conditionality is not the most appropriate approach to strengthen good governance in

[6] See for example: S. Knack and P. Keefer (1997), pp. 1252-88

developing countries. What is rather needed is a more radical approach in which donors cede control to the recipient country, within the framework of agreed-upon objectives[7]. His views, regarding positive impact of conditional aid on good governance, are also supported by Craig Burnside and David Dollar findings, concluding that there is no direct relationship between aid flows and policy reform.[8] Based on a study of adjustment lending in South East Asia and Latin America for instance, Tony Killick also arrives at a similar conclusion, debunking the notion that conditionality can "buy" better policies and promote sound governance institutions.[9]

Stephen Knark, in analyzing the relationships between aid dependency and good governance, argues that more aid can reduce government's accountability to its people as proportionately it does not rely on citizens' taxes as much as on aid money. He concludes that aid dependence can actually potentially undermine institutional quality, by weakening accountability, encouraging rent seeking and corruption, fomenting conflict over control of aid funds, siphoning off scarce talent from the bureaucracy, and alleviating pressures to reform inefficient policies and institutions.[10] Carlos Santiso argues that the quality of governance (*i.e.* good governance) is ultimately attributable to its democratic content. In other word, neither democracy nor good governance is sustainable without the other[11], which in turn, allows us to interpret that good governance is achievable only in case of existing democracy. Gwin and Nelson in their study, come to the conclusion that "aid is only effective in promoting changes in a good policy environment, and on the whole,

[7] C. Santiso (2000: 1-23),(2001: 154-180)
[8] C. Burnside and D. Dollar (1997)
[9] T. Killick, "Aid and the Political Economy of Policy Change", Overseas Development Institute, London, 1998
[10] S. Knark (2000), p. 1
[11] C. Santiso (2001), p.1

it has not succeeded in leveraging good policies".[12] Göran Holmqvist brings out more specific findings on conditional aid and the type of policy reforms. He concludes that conditional aid only promotes better short run policies while contributing to the postponement of more fundamental home-grown reform efforts.[13] Burnside and Dollar in their study examine the determinants of policy, and find no evidence that aid has systematically affected policies, either for good or for ill. Through their aid allocation equation they show that any tendency for aid to reward good policies has actually been overwhelmed by donors' pursuit of their own strategic interests.[14]

The previous studies do all tend to support the assumption that conditional aid cannot bring about good governance. However, it is difficult to substantiate why it is so. As no previous statistical analyses are known to have been conducted in this field of research, we can only presume that conditional aid does have a positive impact on good governance. This is simply because conditional aid reduces the costs of reforming policies. Also, followed by Stephen Knack's reasoning that more aid reduces government's accountability to its people, we assume that it then in contrary increases government's accountability to foreign donors, who in turn, via conditionality pressure for policy reforms. The present paper is intended to explore if there is a straightforward positive relationship between conditional aid and good governance, based on analysis of statistics from 117 developing countries. The paper will focus on analysing the average changes with respect to good governance that the governance related conditional aid has brought along in the developing countries during the time period of 1996-2002. If our assumption that conditionality can 'buy' better policies is right, the statistical analysis on such a

[12] C. Gwin and J. Nelson (1997), p. 22
[13] G. Holmqvist (2000), p. 7
[14] C. Burnside and D. Dollar, *op. cit.*, p. 32

significant number of countries should show clear trends in positive changes towards 'better governance' among the most aid receivers in comparison to those of the least aid receivers. The study assumes that there exists a positive relationship between conditional aid and changes in governance indicators; that is, we assume that those countries that have received more conditional aid have also experienced a policy reform towards better governance in comparison to those countries that have received least aid.

Specifying the Concepts

(a) Conditional Aid

Different ways of thinking about development and beliefs in reaching development have at different times brought along the attachment of different strings called conditionalities, to the amounts of given development assistance. From the historic perspective, during 1980s, the conditions were aiming at reforming the economic policy, while those of the 1990s focused at policy reform of the recipient governments. In the social science discourse these varying conditions on aid are called respectively the first and second-generation conditionalities. The first generation conditionality, reforming the economic policy of recipient governments mainly via structural adjustment lending. It had strong neo-liberal roots and focused on boosting the market and reducing the role of the state. The second-generation conditionalities are being labelled 'structural conditionality' by the IMF, and 'governance conditionality' by the World Bank. The second-generation conditionality is aimed at political and administrative reform in recipient countries, promoting democracy, human rights and administrative accountability.[15]

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[15] *Ibid.*, p. 1

We know, currently US provides assistance to the countries which are divided into three categories: (i) sustainable development countries or countries where there is a clear commitment on the part of the host government to democratisation and economic reform; (ii) transitional countries, or countries that have recently experienced a national crisis and where timely assistance is needed to reinforce institutions and national order; and (iii) countries "where USAID's presents is limited, but where aid to non-governmental sectors may facilitate the emergence of a civic society, help alleviate repression, meet basic humanitarian needs, enhance food security, or influence a problem with regional or global implications".[16]

However, conditionality is not an aim in itself but an instrument by which other objectives are pursued.[17] The terms conditional aid and conditionality do not carry a single meaning. One meaning of 'conditionality' is tied to conditions on purchases from the donor country. This meaning of conditionality is used by the OECD, defined as "The amount of the transaction (grant or loan) which is tied to procurement of goods and services from the donor country."[18]

In this paper, however, we are going to talk about the conditionality on policies and policy changes that the aid donors set to the recipient countries, aiming to nurture development of the latter.

(b) Good Governance

In 1990s, the term good governance became a buzzword in the development discourse, carrying the thought that it is good governance that leads to development. It is, however, to note that good governance might help some countries towards development but by no means does the term automatically entail development. In order to examine the shift in the policies of international aid

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[16] USAID 1994,p.5 in Hadenius edt. (1997),p.386.

[17] O. Stokke, (1995), p. 2

[18] OECD, CDE Corporate Data Environment, Creditor Reporting System

community towards good governance both as an objective and a precondition for development aid, we should try to define the concept of governance. There are varieties of definitions are used to describe the concept governance. Simply, governance means from one side the process of decision-making, and from the other, the process through which decisions are implemented.[19] The concept of good governance thereby just refers to the qualitative dimension of governance. Marie Besançon defines governance as the delivery of political goods – beginning with security – to the citizens of nation-states. Good governance then according to her, results when nation-states provide a high order of certain political goods – when the nation states perform effectively and well on behalf of their citizens.[20]

Strong arguments have been put forward that without good governance structures, the poor and the developing countries cannot reduce poverty. And contrarily, bad governance is being viewed as the main cause behind the ills confronting these societies. The analysis of good governance would remain incomplete though, without acknowledging the prominent role of neo-liberal economic policy package, known as Washington Consensus. It is not a coincidence that the concept gained popularity when market-oriented structural adjustment programs pushed by the international financial institutions in the developing world were increasingly coming under public criticism. Good governance agenda is actually deeply embedded in the neo-liberal Washington Consensus. Pushed actively by powerful international financial institutions, good governance became the cornerstone of development co-operation and the main governance conditionality of foreign aid.

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[19] K. Singh, (2003), p. 4

[20] M. Besançon, (2003), p. 1.

But despite that the concept of governance has gained popularity in the development debate throughout the world at different levels among political leaders, donors, developers, reformists, experts etc. the interpretation of the concept of 'good governance' still differs between development agencies, *i.e.* there does not exist an unambiguous and operational definition of the concept, making measuring the results of aid conditionality also complicated and dependent on each donor's individual definition of the concept.

Carlos Santiso writes on World Bank definition of good governance in this way: "Good governance puts requirements on the process of decision making and public policy formulation. It extends beyond the public sector to the rules that create a legitimate, effective, and efficient framework for the conduct of public policy. It implies managing public affairs in a transparent, accountable, participatory and equitable manner. It entails effective participation in public policy making, the prevalence of the rule of law and an independent judiciary, institutional checks and balances through horizontal and vertical separation of powers, and effective oversight agencies."[21] World Bank and the International Monetary Fund (IMF) stress the importance of sound macro-economic policies and the fight against corruption, while some bilateral donors and non-governmental organisations (NGOs) put more emphasis on democratisation and human rights. The leading promoter of good governance, The World Bank, defines the concept as the ''manner in which power is exercised in the management of a country's economic and social resources for development'' (World Bank, 1993).[22] Kavaljit Singh, in the Discussion paper for the Reality of Aid, proposes to even broaden the concept of good governance, and to include all formal and informal actors who play a role in decision-

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[21] C. Santiso, *op. cit.*, pp. 1-23

[22] World Bank, (1992), p.1.

making or in influencing the decision-making process. The notion of governance should according to his reasoning encompass all non-state actors including also markets and civil society.[23]

OECD, on the other hand, limits 'good governance' clearly only to the level of public sector, stating that "Good governance is established when public institutions act efficiently, providing an enabling environment for economic growth and development. Good governance requires the improvement of accountability and transparency of public sector agencies, concomitant with the effective fight against corruption. The effective performance of democratic institutions, including legislatures, and the fight against corruption, are central elements of good governance."[24]

Paul O'Neill, US Treasury Secretary, has defined the term in a similar fashion. In his own words, "Good governance means ruling justly, enforcing laws and contracts fairly, respecting human and property rights and fighting corruption."[25] Transparency, rights and the rule of law also turned out to be central in the G8 Final Communiqué from 2001 Genoa Summit. The document stated: "Open, democratic and accountable systems of governance, based on respect for human rights and the rule of law, are preconditions for sustainable development and robust growth. Thus, we shall help developing countries promote:

- accountability and transparency in the public sector
- legal frameworks and corporate governance regimes to fight corruption

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[23] K. Singh, *op. cit.*, p. 21

[24] OECD, Country and Regional Programmes, Latin America, at <http://www.oecd.org/document/47/0,2340,en_2649_34691_18605359_1_1_1_1,00.html>

[25] "O'Neill says good governance can attract US investments", *The Hindu Business Line Internet Edition,* Nov. 23, 2002

- safeguards against the misappropriation of public funds and their diversion into non-productive uses
- access to legal systems for all citizens, independence of the judiciary, and legal provisions enabling private sector activity
- active involvement of civil society and Non Governmental Organisations (NGOs)
- freedom of economic activities."[26]

The World Bank (WB), the first promoter of good governance since late 1980s, touches best upon the multiple essences of the term, combining the core notions of the definitions of 'good governance' of the many international organizations, and providing a wider reaching and broader definition of the term. As 'good governance' is a concept with mutual aspects, it is vital for the actual policy makers to have the definition concrete instead of being vague and too narrow. The six WB aspects of 'good governance' include:

1. Voice and accountability, which includes civil liberties and political stability;
2. Government effectiveness, which includes the quality of policymaking and public service delivery;
3. The quality of regulatory framework;
4. The rule of law, which includes protection of property rights;
5. Independence of the judiciary; and
6. Curbing corruption.[27]

[26] G8, Genoa Summit, Final Communiqué, July 2001

[27] See: D. Kaufmann, A. Kraay, and P. Zoido-Lobaton, "Aggregating Governance Indicators," *Policy Research Working Paper*, No. 2195, World Bank, Washington DC, Oct. 1999; and D. Kaufmann, A. Kraay, and P. Zoido-Lobaton, "Governance Matters," *Policy Research Working Paper*, No. 2196, World Bank, Washington DC, Oct.1999.

Methods and Data

The main objective of the paper has been to explore if conditional aid promotes good governance in the aid recipient countries. For testing the conditional aid impact on good governance, we will look at the recipient countries that have received governance-related conditional aid and their good governance indicators over time. This, however, would require a data set containing governance conditionality in aid flows. Since there is no major international financial institution from which we can get such data on all the developing countries, and the OECD DAC-database is obsolete for this particular study due to their definition of 'conditionality' through purchases and not policy changes, so we take an alternative method for conducting the research.

For the data on the dependent variable, we are going to use the data set that produced by Kaufmann, Kraay and Mastruzzi (KKM).[28] The KKM governance indicators are an update and expansion of the same team's (KKZ) earlier work. Their good governance measure seeks to maximise the use of a broad range of available indicators on good governance through a data reduction technique called 'unobserved components model' (a variant of factor analysis). The greatest strength of this method, due to the multiplicity of indicators being used, is in an increased validity and reliability of those indices, and in the ability to reduce simultaneously the chances for systematic measurement error.[29] Their indicators are perfectly suitable for our study, as according to the authors, they are potentially informative about changes in countries' relative positions over time.[30]

KKM research presents estimates of six dimensions of governance covering 199 countries and territories of four time periods: 1996, 1998, 2000 and 2002. The indicators are based on several hundred individual variables, measuring perceptions of

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[28] D. Kaufmann, A. Kraay, M. Mastruzzi, (2003), p. 1

[29] T. Landman, *op. cit*, p. 17

[30] D. Kaufmann, A. Kraay, M. Mastruzzi, *op. cit.*, p. 11

governance, drawn from 25 separate data sources, constructed by 18 different organisations. The KKM team has constructed six aggregate governance indicators, motivated by a broad definition of governance, as the traditions and institutions by which authority in a country is exercised. These include: 1) the process by which governments are selected, monitored and replaced; 2) the capacity of the government to effectively formulate and implement sound policies; and 3) the respect of citizens and the state for the institutions that govern economic and social interactions among them. These separate six indices, having an equal value and virtually lying between ± 2.5, with the higher scores corresponding to better outcomes in a respective category, include: (1) voice and accountability, (2) political stability, (3) government effectiveness, (4) regulatory quality, (5) rule of law, and (6) control of corruption.[31]

Since we are looking at *general* trends between conditional aid and good governance, so for the purpose of the paper and for a simpler illustration of the results, we are going to combine indices and use the calculated average of the given six KKM indices in four points in time – 1996, 1998, 2000 and 2002. Then we look at changes between the calculated total average KKM indicators from 1996 to 1998, from 1998 to 2000 and from 2000 to 2002, we code the change in each of the three cases as P (positive) or N (negative).

For the independent variable, since there was no data available on all the countries' conditional aid, we instead look at the US foreign aid, as the US is the major player in the IMF and in the World Bank (WB), having thereby large powers in shaping the trends in foreign aid community. And although the US foreign aid in terms of percentage of their GNP has been the lowest of any

[31] *Ibid.*, pp. 2-4

industrialised nation in the world, though paradoxically in the last years, their dollar amount has been the highest.[32]

The data on aid flows, both in case of the independent as well as the dependent variable, are drawn from the OECD CRS-database. For our study we are looking at three sample years of ODA – 1996, 1998 and 2000, and assume that there is a time lag of two years between the ODA transfers and the actual policy changes, *i.e.*, between the independent and the dependent variables. For each of the year, 1996, 1998 and 2000 aid flows, in order to get a clear picture on the aid recipients, we do not look at the absolute amounts of aid but rather calculate the per capita aid amounts of each country. From the point of view of aid flows, we distinguish between three groups – the "A" group as highest aid receivers, "B" group as average aid receivers and "C" group as those receiving least aid from the US as the donor.

Findings of the Paper

For our study, from OECD DAC- database and the WDI we get 167 ODA receivers and 199 countries included in KKM governance indicators list, but we were able to utilise 117 countries. Some countries on the DAC list we had to exclude as they did not include corresponding KKM governance indicators, some other small island-countries were not suitable as including them in significant amounts might have produced faulty results, and some other countries on the KKM list did not suit as they were either developed countries or countries in transition, and not the developing countries which are the subject of our study.[33]

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[32] A. Shah, "The US and Foreign Aid Assistance", Global Issues web site, at <http://www.globalissues.org/TradeRelated/Debt/USAid.asp>

[33] In DAC list, aid to "traditional" developing countries counts as "official development assistance", for which there is a long-standing United

Table 1: Comparing the **total changes** between the KKM governance indicators **from 1996-98, 1998-00 and 2000-02**, across much (Group A), average (Group B) and least (Group C) conditional aid receiving country groups

Total changes in governance indicators from 1996-98, 1998-00, 2000-02	**Aid group**		
	Much aid(Group A)	Least aid (Group B)	Difference (%)
Positive change (P)	40	50	-10
Negative change (N)	60	50	10
Total changes in governance indicators from 1996-98, 1998-00, 2000-02	**Aid group**		
	Average aid (Group B)	Least aid (Group C)	**Difference(%)**
Positive change (P)	33.3	50	-16.7
Negative change (N)	66.7	50	16.7
Total changes in governance indicators from 1996-98, 1998-00, 2000-02	**Aid group**		
	Much aid (Group A)	Average aid (Group B)	**Difference(%)**
Positive change (P)	40	33.3	6.7
Negative change (N)	60	66.7	-6.7

The total results of the study are reported in Table 1. The total results include the total changes between the calculated average of

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Nations target of 0.7 per cent of donors' gross national product. Aid to the "more advanced" eastern European and developing countries of the list is recorded separately as "official aid". Other organisations have other definitions, like for instance the World Bank usually uses the term to refer to low and middle-income countries, assessed by reference to per capita GNP.

six KKM governance indicators at four points in time – 1996, 1998, 2000 and 2002. The possible changes we are measuring here from 1996 to 1998, from 1998 to 2000, and from 2000 to 2002.

With respect to testing our hypothesis on that 'conditional aid has a positive impact on good governance', the findings do not show any clear evidence of such a positive impact. If our hypothesis had held true, those countries that received more aid would have exposed greater positive changes in governance indicators in comparison to those countries that received least aid. However, the study did not reveal any negative trends between amounts of aid and good governance either, in fact, based on the results of the study, there seemed to be no clear trends at all between aid amounts and good governance. In reference to the results, if conditional aid would have had a clear impact on the countries policy changes towards 'better governance', the positive change would have been noticeable the most between the comparisons of groups A and C (the most and least aid receiver countries respectfully). Table 1, however, shows that only 40 percent of group A countries did experience positive changes in governance indicators during 1996-98, 1998-2000 and 2000-02, in comparison to 50 percent of the countries in the C group which contained countries that had received the least aid in 1996, 1998 and 2000. So, the trend between the most aid receiving countries and the least aid receiving countries, in terms of the average changes in all the governance indicator years, is actually negative (-10 percent), instead of being positive as our hypothesis had estimated.

The trend between the second most aid receiving group (B), and the least aid receiving group (C) and their total changes in governance indicators are not pointing towards the direction of our hypothesis either. In Table 1, only 33.3 percent of the group B countries experienced positive changes towards better governance during 1996-02, while the respective percentage for the least aid receiver-group was 50.

Although the greatest contrast in case of an existing positive trend was expected between groups A and C, for the more strong possible evidence purpose we also did compare groups A and B. And surprisingly, although being only a 6.7 percent difference, in this case we did find a causal arrow pointing in the right direction between those receiving more aid, and those having greater improvements in governance indicators. But as we observe further, this was only a random figure pointing towards our established hypothesis.

Table 2 Comparing the changes between the KKM governance indicators **from 1996-98**, across much (A), average (B) and least (C) conditional aid receiving country groups

	Aid group			Aid group			Aid group		
Change I in governance indicators from 1996-98	Much aid (A)	Least aid (C)	Difference (%)	Average aid (B)	Least aid (C)	Difference (%)	Much aid (A)	Average aid (B)	Difference (%)
Positive change (P)	74.3	50	24.3	42.4	50	-7.6	74.3	42.4	31.9
Negative change (N)	25.7	50	-24.3	57.6	50	7.6	25.7	57.6	-31.9

Analysing now the three different change periods of governance indicators, by first starting out with looking at the change of governance indicators between 1996 and 1998, we do find the comparisons of two groups' causal arrows pointing at the right direction with respect to our hypothesis.

The first is the comparison between the two groups of A and C, being located in the different ends with respect to the US per capita aid flow amounts. Again the contrast between these groups should be the sharpest if our hypothesis would have held true. We do find a strong positive relationship with a difference of 24.3 percent here, for A group.

Also the comparison between the most and the second most aid receiving groups (A and B) is revealing a strong positive relationship 31.9 percent, percentage wise even greater than the difference between A and C groups. The third comparison between B and C groups however breaks the pattern, and in contrast to our hypothesis, shows a slight (-7.6 percent), but still negative trend between the amounts of aid and changes in governance indicators.

Table 3 : Comparing the changes between the KKM governance indicators **from 1998-2000**, across much (A), average (B) and least (C) conditional aid receiving country groups

Change II in governance indicators from 1998-00	Aid group			Aid group			Aid group		
	Much aid (A)	Least aid (C)	Difference (%)	Average aid (B)	Least aid (C)	Difference (%)	Much aid (A)	Average aid (B)	Difference (%)
Positive change (P)	45.7	56.8	-11.1	48.5	56.8	-8.3	45.7	48.5	-2.8
Negative change (N)	54.3	43.2	11.1	51.5	43.2	8.3	54.3	51.5	2.8

The second governance indicators' change period from 1998 till 2000, does not provide any proof to our hypothesis either. Instead of the expected positive trend between the most aid receiving countries and their change towards 'better governance', this time period changes are showing an overall negative trend. The negative trend between the two opposite independent variable groups – A and C–is actually even the greatest (11.1 percent), followed by a bit smaller negative trend between groups B and C (8.3 percent), and the smallest between A and B (2.8 percent).

Table 4 Comparing the changes between the KKM governance indicators **from 2000-02**, across much (A), average (B) and least (C) conditional aid receiving country groups

Change III in governance indicators from 2000-02	Aid group			Aid group			Aid group		
	Much aid (A)	Least aid (C)	Difference (%)	Average aid (B)	Least aid (C)	Difference (%)	Much aid (A)	Average aid (B)	Difference (%)
Positive change (P)	20	34.1	-14.1	39.4	34.1	5.3	20	39.4	-19.4
Negative change (N)	80	65.9	14.1	60.6	65.9	-5.3	80	60.6	19.4

Finally, looking at the changes towards 'better governance', we focus on the third change between governance indicators from 2000 and 2002. The comparison between most and least aid receiving groups – groups A and C, is showing a clear negative trend of –14.1 percent, and so does the comparison between C and B groups (-19.4 percent). The only positive trend in this period of indicator changes is between groups A and C, giving the difference figure of 5.3 percent.

As described in the above paragraphs and shown in the corresponding tables, not only could we find in the total figures any evidence to that 'more conditional aid receiving countries do have better governance', *i.e.*, that aid has a positive impact on good governance, but our analysis of each of the three periods of changes (1996-98, 1998-00 and 2000-02) between the governance indicators even more strongly supported our findings of the non-existent clear positive trends. An interesting pattern, which did not find any clear explanation, appeared though when analysing the changes between governance indicators from one year to another. Namely, the analysis between 1996 and 1998 as well as between 1998 to 2000, did reveal relatively more positive changes in good governance, while than the last change between 2000 and 2002 was overall very negative.

Conclusion

At the beginning of this study we were guided by the idea that good governance is crucial for the sustained and rapid growth in per capita incomes of poor countries[34], and which in turn promote right distribution, bring poverty reduction and development. Such an undermining thought of bringing along good governance, and thereby development, via setting conditions on aid, had been the reasoning of the international financial institutions and donor governments for over a decade already, which was the principal reason of being curious about the results of the first part of the 'chain' namely, if conditional aid had actually brought along the desired effects in changes towards better governance.

Being persuaded by the above reasoning, we set an optimistic hypothesis stating that conditional aid has a positive impact on good governance. The findings of the analysis, however, showed that conditional aid did not have the expected impact on good governance – at least not a clear and direct one. These findings raised a couple of issues and questions for further research.

Firstly, if improving the state of governance of the developing countries is the donors' aim, then it seems not to be enough to just

[34] See for example: S. Knarck and P. Keefer, *op. cit.*, pp. 1258-88

"give money under certain conditions and expect desired changes". The question is if conditional aid does not have a *clear* and *direct* impact on good governance, does it have an *indirect* one under certain conditions and in combination with other factors? Although some research in this area has been done[35] we still do not know enough, about which other variables acting together with conditional aid might bring along good governance.

Another deeper moral issue that arises from this study is how to interpret that conditionality written into aid with the aim of improving governance in the recipient countries' but tests show that at least directly it does not fulfil the goal. If from year to year dollars still keep going to the developing countries but no prospered changes in governance occur, the question of 'what are the motives and moral reasoning of the donors behind such aid flows' rises? Could it be that such acts actually make the recipients more aid dependent, preventing them from development and serve somehow thereby the donors' interests? Burnside and Dollar[36] have talked in their research about donors strategic interests in targeting aid flows, but in general this is an area that would still need a deeper studying. If it would hold true that donor's selfish strategic interests, rather than the ennobling thought of bringing along development to the developing countries is directing the aid flows, we might have to look at the whole concept of development from a totally different angle.

Despite the limitations, the results of this study are crucial in at least one aspect in comparison to the other earlier studies. In comparison to the other theoretical researches, this study did practically via analysing the performance of a large number of developing countries, test conditional aid impact on good

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[35] For example, see C. Burnside and D. Dollar, *op. cit.*, and C. Santiso, *op. cit*

[36] C. Burnside and D.Dollar, *op. cit.*, p.32

governance. Although we were let off by a more optimistic hypothesis than the results of the earlier studies, and we believed that conditional aid does have a positive impact on good governance, our did end up confirming the results of the earlier theoretical studies. We have no reason hereby to doubt that good governance is a must for in poverty reduction, but with this study we have found the confirmation to the earlier scholars, that at least the plain act of sending conditionality-dollars to the recipient developing countries is not the way of reaching good governance.

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