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by

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Corrupt Governments Receive Less Bilateral Aid: Governance and the Delivery of Foreign Aid through Non-Government Actors

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Abstract

A core result of the aid allocation literature is that the quality of governance in recipient countries does not affect the amounts of foreign aid received. Donor countries may still give aid to poorly-governed countries because of a dilemma they face: those countries most in need typically also lack proper institutions. This paper argues that donors try to resolve this dilemma by delivering aid through non-state actors. Using aid shares as well as absolute amounts of aid allocated through different channels and considering different dimensions of governance, we provide evidence that bypassing governments via NGOs and multilateral organizations is indeed a response to weak recipient state institutions. The effect is stronger in aid sectors where donors can more easily switch between channels, and for the group of donors that have been dubbed ‘like-minded’ to indicate their specific focus on recipient need.

Key words: aid allocation, aid channels, governance

JEL: F35, D73, L31, F53

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1 Introduction

After a period of general pessimism regarding the effectiveness of foreign aid (e.g., Boone 1996), the World Bank's much-cited 'Assessing Aid' study (World Bank 1998) marked a turning point, suggesting that donors could contribute to economic growth in developing countries, but only if they focused their engagement on recipients with reasonable levels of governance. Even though the empirical results that underlie the World Bank's conclusion (Burnside and Dollar 2000) were later shown to be fragile (Roodman 2007), the donor community has recurrently stressed the importance of good governance for effective development cooperation (e.g., DfID 2011; Hout 2007). Yet, a core result of the aid allocation literature is that the quality of governance in recipient countries has hardly affected the amounts of aid actually committed and disbursed (e.g., Bueno de Mesquita and Smith 2009; Hoeffler and Outram 2011). This appears to hold most robustly for corruption, the element of governance that has been given particular attention by donors (e.g., Clist 2011; Easterly 2007; Nunnenkamp and Thiele 2013). Alesina and Weder (2002) even provide evidence that corrupt governments receive more aid.

The fact that aid flows do not seem to reflect recipient countries' quality of governance is consistent with at least two competing explanations. On the one hand, considerations of recipient merit may be dominated by other donor motives. There is ample evidence, for example, that donors pursue a variety of political self-interests when giving aid. These range from preserving ties with former colonies (Alesina and Dollar 2000) to influencing the voting behavior in the Security Council or General Assembly of the United Nations (Kuziemko and Werker 2006; Dreher et al. 2008) or the outcome of specific elections (Faye and Niehaus 2012). Foreign aid is also used to further trade links with recipient countries (Berthelemy 2006). On the other hand, donors may hesitate to withdraw support from badly-governed countries as a result of a dilemma they face: exactly those countries most in need of assistance also tend to lack proper institutions. One way of trying to resolve this dilemma is to combine government-to-government transfers with efforts to strengthen local institutions, an approach that has been applied in recent budget support programs (Tavakoli and Smith 2013).

Another way is to bypass recipient governments and deliver aid through non-state actors. While a sizeable share of aid by OECD donor countries is indeed channeled through non-state actors, the reasons underlying this pattern are not well understood. Some papers examine whether the conventional donor motives – need, merit and self-interest – differ between aid channels but take the existence of these channels as given and do not try to explain why aid is delivered through state or non-state actors. Dreher et al. (2010), for example, find that Swedish aid that is directly

transferred to recipient governments is targeted towards countries with lower GDP per capita whereas aid channeled through NGOs is not. Nunnenkamp and Öhler (2011) document that the various aid channels employed in Germany differ significantly in the extent to which need and merit are taken into account but that no aid channel is unambiguously superior.

This paper explicitly investigates the role of recipient governance for donors' decisions to channel aid through state or non-state actors. A similar argument has recently been made by Dietrich (2013) in the political science literature, according to which bypassing governments via NGOs, private contractors, public-private partnerships and multilateral organizations is a response to weak recipient state institutions.²

Our analysis proceeds in three steps. First, we analyze the relationship between institutional quality and the share of aid that is given to a recipient country as government-to-government transfer. In addition to conventional indicators of institutional quality, we use multiple dimensions of "bad" governance such as human rights violations, lacking representativeness of the government, or high levels of military expenditures. We are thus able to obtain a more comprehensive picture of the motives that might lead donors to circumvent governments. Second, we analyze the absolute amounts of aid allocated through different channels. While a higher share of foreign aid channeled through non-state actors would hardly matter for a weakly governed recipient country if overall donor engagement in that country was very low, higher absolute amounts would provide a much stronger indication of bypassing. Third, we check whether there is heterogeneity in the relationship between governance and the channel of aid delivery that is consistent with donors bypassing weak state institutions. We first test whether bypassing varies across aid sectors as it should be easier for donors to work with non-state actors in some sectors than in others. For instance, donors may be able to channel aid through NGOs in the case of emergency assistance or health interventions such as vaccinations, while this may be more difficult for larger-scale projects such as investments in road infrastructure. We then check whether the group of countries referred to as 'like-minded donors' to indicate their high regard of recipient need (Neumayer 2003) is more inclined to use non-state aid channels in countries with poor governance than other donors.

We obtain evidence for bypassing of governments in both relative and absolute amounts of foreign aid channeled through non-state actors. As expected, bypassing is more prevalent among like-minded donors and targeted towards aid sectors where the degree of substitutability between channels of delivery is high.

² An alternative donor response to weak governance is to bypass recipient aid management systems and to rely on parallel systems of aid delivery instead (Knack 2013).

2 Data and Descriptive Analysis

Data on the channel of delivery come from the OECD's Development Assistance Committee (DAC). Through its Creditor Reporting System (CRS), DAC documents all flows of Official Development Assistance (ODA) of DAC member countries (as well as some non-DAC countries and multilateral organizations) to developing countries. The CRS offers donors the option to report the channel of delivery for every aid transaction to a recipient country. The available channels of delivery include (i) the public sector of the recipient government, (ii) national and international NGOs, (iii) multilateral organizations such as UNDP or the World Bank, and (iv) other development actors such as private contractors.

The share and absolute amount of ODA delivered via different channels to a given recipient country is based on the bilateral aid disbursements of all DAC member countries in 2008.³ For almost a third of the 181,852 bilateral aid transactions recorded by the CRS in 2008, however, the channel of delivery is not readily coded. This is because the channel of delivery is no mandatory item in the CRS. We code these missing cases by determining whether the implementing organization (whose name is mandatory to provide) belonged to the public sector, was an NGO, a multilateral organization or another non-state development actor.⁴

The focus of our analysis is on whether aid is channeled through state or non-state actors. In the following, we therefore only distinguish between aid channeled through the public sector (henceforth bilateral aid) and aid channeled through NGOs or multilateral organizations (henceforth non-bilateral aid). Our main outcomes of interest are the share of bilateral aid as well as the absolute amount of bilateral and non-bilateral aid in 2008.

Figure 1 plots the share of bilateral aid, overall and by donors. Overall, 75 percent of aid given in 2008 was disbursed in the form of bilateral aid. In other words, an important share of aid is delivered through non-bilateral channels. There is considerable variation across donors. The share of bilateral aid exceeds 90 percent for donors such as Germany, Japan, and France, but is only between 40 and 60 percent for the Netherlands, Sweden and Norway, who all belong to the group of like-minded donors.

The share of bilateral aid varies considerably over aid sectors, too. As Figure 2 shows, humanitarian assistance stands out as being predominantly channeled through non-state actors.

³ As of 2008 DAC member countries include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and the United States. In case aid disbursements were not reported, we used aid commitments instead.

⁴ We take the most recent year for which a fairly complete data set could be compiled and refrain from adding a time dimension to the analysis because this would provide little additional explanatory power given the highly persistent governance indicators.

Among the remaining sectors, the share of bilateral aid ranges from 55 percent for governance, via 77 percent for health and education to almost 95 percent for infrastructure (see Table A1 in the appendix for a definition of the sectors). This pattern is consistent with the notion that it should be easier for donors to bypass the recipient government in sectors where the degree of substitutability between state and non-state actors is relatively high. Hence, bypassing should be more prevalent in sectors such as governance or health where donors can run relatively small-scale projects that do not require much coordination with the recipient government (e.g., support to advance civil and political rights, female empowerment, feeding programs or basic health care including vaccination campaigns). Bypassing should be less prevalent, however, in sectors such as infrastructure where donors typically run relatively large projects that require strong and continuous high-level support from the recipient government and where little support may be provided by non-state actors such as NGOs (e.g., roads, dams or electricity supply). In fact, most development NGOs including Feed the Children, World Vision, Food for the Poor, Catholic Relief Services, Care, or Amnesty International focus on sectors like food security, health, education, or advocacy (Werker and Ahmed 2008) where bypassing is relatively easier.

Does the quality of governance in the recipient country matter for a donor's decision to choose state or non-state actors as implementing partners? To answer this question, we consider four measures that aim to capture different dimensions of governance. Our first measure is the control of corruption index that is published as part of the Worldwide Governance Indicators by the World Bank. It captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests (Kaufmann et al. 2009). It ranges from -2.5 to 2.5, with higher scores corresponding to better governance. The control of corruption index is a broad measure of institutional quality that has been widely used in the literature on aid allocation. As corruption increases the risk of a recipient government's capture of aid, we expect more corrupt countries to receive relatively less bilateral aid.

The other three measures cover more specific dimensions of the quality of governance. Our second measure is the physical integrity rights index that comes from the Cingranelli-Richards Human Rights dataset (Cingranelli and Richards 2010). It captures a government's respect for internationally recognized human rights by documenting incidences of torture, extrajudicial killings, political imprisonment and politically motivated disappearances. The physical integrity rights index ranges from 0 to 8, with higher scores corresponding to better outcomes. To ease understanding, we refer to the physical integrity index as human rights score in the following. As the respect for human rights reflects the integrity of a recipient government, we expect countries with more human rights violations to receive less bilateral aid.

Our third measure is the size of the powerless population as a share of the overall population that comes from the Ethnic Power Relations dataset. The size of the powerless population is defined as the percentage of the population who belong to an ethnic group whose representatives hold no political power at the national or regional level (Cederman et al. 2010). As the recipient government may be more likely to exclude people with no political representation from the proceeds of aid (Hodler and Raschky 2014), and donors may care about the distribution of aid, we expect countries with larger parts of powerless population to receive less bilateral aid.

Our fourth measure is the size of military expenditures that comes from the World Bank's World Development Indicators. The size of military expenditures is defined as the percentage of overall government expenditures that is spent on the military. As bilateral aid may at least to some extent be fungible and allow the recipient government to spend more resources on less desired purposes such as the military, we expect countries with larger military expenditures to receive less bilateral aid.

These four measures arguably cover different aspects of a recipient country's quality of governance. The risk of capture of aid, respect for human rights as well as the distribution and utilization of aid in the recipient country may all affect a donor's decision to channel aid through bilateral or non-bilateral channels, but their effects may well work independently. Indeed, as Table 1 shows, the correlation between our four measures of governance is relatively low.

By contrast, control of corruption is highly correlated with the other five measures of the World Bank Governance Indicators (voice and accountability, political stability, government effectiveness, regulatory quality, rule of law). The correlation coefficients for the different indicators are between 0.70-0.88 in our sample. The high correlation clearly suggests that these indicators capture similar institutional structures. Our analysis therefore focuses on the four dimensions of governance introduced above, taking control of corruption to be representative of a set of similar measures of institutional quality. All our results are, however, robust to using other measures of the World Bank Governance Indicators or the Freedom House Scores (results are available upon request).

Figure 3 plots the share of bilateral aid against our four measures of governance. In line with our hypothesis, it clearly shows that countries with a better quality of governance receive more aid through bilateral channels. For example, for countries such as Somalia or Sudan with relatively low levels of control of corruption the share of bilateral aid received in 2008 was only 4 and 16 percent respectively. By contrast, for countries such as Bhutan or Namibia with relatively high levels of control of corruption the share of bilateral aid was 90 percent. The same holds true for the other measures of governance, even though the relationship is less pronounced for the size of

military expenditures. This may be due to confounding military and strategic motives on behalf of some donors that could affect both the share of bilateral aid and the size of military expenditures in the recipient country. Pakistan is a case in point where a high share of bilateral aid is associated with high military expenditures (see Figure 3; lower-right panel), which arguably reflects the specific geo-political interests of its principal donor, the United States.

3 Empirical Strategy

We estimate equations of the following type to analyze the relationship between bilateral aid and the quality of governance:

$$bilateral\ aid_{ij} = \alpha + governance'_i\beta + X'_{ij}\gamma + \varepsilon_{ij} \quad (1)$$

where $bilateral\ aid_{ij}$ is the share or the absolute amount of bilateral aid that recipient country i received from donor j . Hence, we estimate bilateral aid flows for any (potential) donor-recipient country pair in a joint model.⁵ Depending on the specification, the vector $governance_i$ contains one or all of the four measures of the quality of governance in recipient country i that we introduced above. If better governance increases bilateral aid, we expect β to be positive. Since it has been shown that the allocation of aid also depends on factors other than governance, we add a vector X_{ij} of control variables.

We use different dependent variables to capture both the relative and absolute importance of state and non-state channels of aid delivery. Our first dependent variable is the share of bilateral aid that recipient country i received from donor j . This variable is bounded between zero and one and takes on the extreme values of zero and one with positive probability (i.e., a donor may give all its aid to a recipient country bilaterally or non-bilaterally). We therefore estimate the model employing the fractional logit method as proposed by Papke and Wooldridge (1996) for the case of proportions as dependent variables.

Donors may not only adjust the proportion of aid that is given bilaterally to bypass the government of a recipient country. They may also lower the absolute amount of overall (bilateral and non-bilateral) aid to that recipient country. To consider this possibility, our second set of dependent variables includes the absolute amount of (i) overall, (ii) bilateral and (iii) non-bilateral aid that recipient country i received from donor j . As many donors only give aid to a subset of potential recipient countries, these variables have many zero observations. We therefore estimate (1) using the poisson pseudo maximum likelihood (PPML) method. Santos Silva and Tenreyro

⁵ Alternatively, one could also ignore donor heterogeneity and aggregate bilateral aid flows from all donors at the recipient country level. Changing the level of observation from donor-recipient country pairs to recipient countries would leave our results qualitatively unaffected (results are available upon request).

(2006 and 2011) show that PPML outperforms OLS and Tobit models in the presence of heteroskedasticity and many zero observations.

In choosing our control variables, we follow the aid allocation literature and distinguish between recipient need and donor interest. To proxy recipient country i 's need, we include its GDP per capita, population size and the number of people who died as a result of natural disasters in the preceding period (2000-2008). It should be noted, however, that this interpretation only applies for the specification using aid amounts as dependent variable. When it comes to explaining aid shares, recipient country i 's GDP per capita and population size rather signal the economic importance of a recipient country. Donors can be expected to favor direct engagement with governments, i.e. to distribute a high share of aid through bilateral channels, in recipient countries they regard as economically important. The number of deaths from natural disasters controls for the exceptional role of non-state actors in humanitarian assistance (see above), with more deaths giving rise to a higher non-bilateral aid share.

To proxy donor j 's self-interest, we include the amount of exports from donor j to recipient country i , the amount of proven crude oil reserves in country i , and a dummy indicating whether donor j and recipient country i have had a colonial relationship in the past. We also control for how "close" donor j and recipient country i are by including the geodesic distance between the two countries and the number of migrants from recipient country i who live in donor country j as a share of country j 's population. We expect a donor to deliver more aid, and also a larger share of its aid budget, through bilateral channels when its self-interest and "closeness" to the recipient country is high as government-to-government transfers may be more effective in reaching non-development goals of the donor.

Table A2 in the appendix contains a detailed description of all variables used in the analysis including their data sources, while Table A3 provides summary statistics. In addition to the control variables, the regressions include a set of donor and continental dummies.⁶ Standard errors are clustered at the donor country level in order to take into account that donors' decisions to allocate bilateral aid to a given recipient country are likely to be correlated.⁷

All explanatory variables are lagged to mitigate concerns of reverse causality (for details see Table A2). To address remaining endogeneity concerns, we additionally perform a robustness test where we use an instrumental variable for each of our four governance indicators. The

⁶ Continental dummies are defined for the following regions: East Asia, Pacific and Oceania; Europe and Central Asia; Latin America and Caribbean; Middle East and North Africa; South Asia; Sub-Saharan Africa.

⁷ Standard errors could alternatively be clustered at the recipient country level, which does not affect the regression results.

instrument is taken from the literature that links governance to cultural traits such as individualism (e.g., Licht et al. 2007; Tabellini 2008). It is specified as a dummy variable that takes on a value of one if a country's primary language permits the speaker to drop a pronoun when it is used as the subject of a sentence, and zero otherwise.⁸ In languages that do not allow pronoun drop, the subject stands apart from the context of the rest of the sentence, pointing to an individualistic culture. Licht et al. (2007) show that individualism as proxied by the dummy variable for pronoun drop is correlated with various governance indicators including corruption. Following Spolaore and Wacziarg (2013), we argue that pronoun drop, a culturally transmitted trait, accounts for some deep-rooted and persistent variation in institutional development and therefore correlates with each of our four different governance measures. At the same time, pronoun drop can reasonably be assumed to be correlated with aid only through its effect on governance. There could be a direct association dating back to colonial times, with persistent language and aid patterns that were shaped by former colonial powers. However, as mentioned above, we do control for colonial relationships and also include donor dummies. Therefore our identifying assumption is that, conditional on these control variables, the exclusion restriction of the instrument is not violated.

4 Results

4.1 Recipient governance and the share of aid channeled through state actors

Table 2 presents our main results with the share of bilateral aid as dependent variable. Columns 1-4 show the results of single specifications for each of the four governance measures, column 5 the results of a joint specification with all four governance measures included as simultaneous regressors. Consistent with our hypothesis, the quality of governance is significantly and positively associated with the share of bilateral aid in all specifications. This finding is in accordance with Dietrich (2013), who documents a similar relationship between the share of non-bilateral aid and aggregate World Bank governance indicators. The size of the marginal effects is substantial. A one standard deviation increase in the control of corruption index (which corresponds to the difference between Kenya and Ghana) is associated with an almost 4.3 percentage point increase in the share of bilateral aid. Likewise, a one standard deviation increase in the human rights score (which corresponds to the difference between Laos and Vietnam) is associated with a 3.5 percentage point increase in the share of bilateral aid, while a one standard deviation increase in the share of the powerless population (which corresponds to the difference between Botswana and Mozambique) and military expenditures (which corresponds to the

⁸ This dummy variable was originally compiled by Kashima and Kashima (1998) and later extended by Davis (2012).

difference between Tunisia and Egypt) is associated with a 2.1 and 2.8 percentage point decrease in the share of bilateral aid, respectively (all marginal effects are based on column 5).

Regarding the control variables, there is evidence that donors deliver a higher share of aid through bilateral channels in richer and more populous recipient countries. As argued above, these countries are likely to be economically more important to donors. Besides, bilateral aid shares are robustly related to the number of deaths from natural disasters, with the expected negative sign. Other factors such as trade links and closeness between donors and recipients do not appear to affect the choice of aid channels.

We perform three checks to assess the robustness of these results. First, to account for potential reverse causality, we apply the instrumental variable approach described above for each of our four measures of governance. Results are reported in Table 3. With the possible exception of corruption (column 1), the first-stage F statistics indicate considerable strength of the instrument. Regression results for the governance indicators of interest remain qualitatively as before: bilateral aid shares are shown to rise with the quality of governance, irrespective of how the latter is measured. The estimated effects turn out to be larger than those reported in Table 2, pointing to a possible downward bias of the un-instrumented estimates. This is in accordance with the notion that government institutions may deteriorate when having to deal with large aid inflows (e.g., Bräutigam and Knack 2004; Djankov et al. 2008).

Second, we exclude recipient countries from the sample if they fall into the lowest or top percentile of the governance measures. This is to test whether our results are driven by recipient countries with extreme values in their governance measures. As shown in Table A4 in the appendix, restricting the sample leaves our results unaffected. Given that the sample size is more than halved, however, the marginal effect of the human rights score is no longer precisely estimated in the joint specification (column 5).

Third, if absolute amounts of aid flows to a given country are small in magnitude, donors may well give the total amount either bilaterally or non-bilaterally to minimize transaction costs. It may hence be the case that our results are merely driven by small aid flows and that the relationship between governance and bilateral aid is much weaker for larger aid flows. To address this possibility, we weight observations by the share of aid a recipient country receives from the total amount of aid disbursed across the globe.⁹ Table A5 in the appendix shows that using these weights does not affect our results. If anything, the marginal effects become even larger.

⁹ In a similar vein, our results are also robust to limiting the sample to countries that do not belong to the bottom decile in terms of absolute amounts of aid received or population size (results are available upon request).

To further substantiate our main finding, we now investigate whether there is heterogeneity in the relationship between institutional quality and the channel of aid delivery that is consistent with donors bypassing weak state institutions. As argued above, bypassing should be more prevalent in sectors that exhibit a high substitutability between state and non-state actors. Table 4 therefore uses the single specification for each of the four governance measures as reported in Table 2, but replaces the overall share of bilateral aid with sector-specific shares of bilateral aid (see Table A1 in the appendix for a definition of the sectors). Indeed, the marginal effects of the respective governance indicators vary considerably across sectors. Institutional quality is of no importance at all when aid is given for infrastructure projects (the point estimates are virtually zero; column 1) and of little importance for aid projects related to improving production activities (column 2) or education (column 3). By contrast, institutional quality seems to matter much more for aid disbursed in the health (column 4) or governance sector (column 5) where non-state actors are relatively more prevalent. These findings are in line with our argument that we should primarily observe bypassing in sectors in which donors have a real choice of delivery through state or non-state actors.

The remaining aid sector of Table 4 is emergency aid. By definition, emergency aid is typically granted in times when recipient countries require immediate assistance to cope with disasters. Emergency aid can arguably be expected to be driven by the desire to assist as quickly and effectively as possible. Compared to structural aid that follows long-term objectives, considerations of governance should hence be less relevant in case of emergency aid. One illustrative example is the cyclone Nargis that hit both Myanmar and Sri Lanka in 2008. Overall, better governed Sri Lanka received 80% of its aid bilaterally, whereas the share for poorly governed Myanmar was only 20%. However, when it came to emergency aid in response to the cyclone, both countries received about the same share of their emergency aid bilaterally (26%). Therefore, if donors do not consider good quality of governance as a general justification for aid flows to recipient governments vis-à-vis their electorates, we expect governance to play no role in the bilateral share of emergency aid. Indeed, the marginal effects of all four governance measures are practically zero and mainly insignificant (column 6).¹⁰

Another way to detect heterogeneity in the relationship between governance and the channel of aid delivery that is suggestive of bypassing is to analyze aid flows by donors, not sectors. Bypassing should be more common among donors whose aid allocation is motivated less by

¹⁰ There were 656 disasters in 154 countries with a total of 249,137 deaths recorded in 2008. As a consequence, 22 donors delivered emergency aid to 133 recipient countries. A disaster is defined as meeting at least one of the following criteria: (i) ten or more people reported killed, (ii) hundred or more people reported affected, (iii) declaration of a state of emergency, (iv) call for international assistance.

strategic (self-)interests, but more by consideration of recipient need and aid being effective in promoting development. We therefore split the sample into two groups of donors. One group comprises the five so-called ‘like-minded donors’ Canada, Denmark, the Netherlands, Norway and Sweden. These countries have a particularly high regard of recipient need and poverty reduction. Their aid allocation has also been viewed as not following self-interests and giving a prominent role to human rights and good governance of recipient countries (Tomasevski 1993, Gillies 1999, Neumayer 2003). The other group comprises all other donors for which self-interests play a relatively more important role in the allocation of aid. Indeed, as Tables 5 and 6 show, ‘like-minded donors’ are more inclined to use non-state aid channels than other donors in countries with poor governance.

4.2 Recipient governance and the absolute amount of aid channeled through state and non-state actors

In the previous section, we have shown that donors channel aid through non-state actors in recipient countries with weak governance. However, bypassing state actors would hardly matter for a recipient country if overall donor engagement in that country was low. Arguably, channeling lower absolute, not relative amounts through state actors (and higher amounts through non-state actors) would provide an even stronger indication of bypassing. In this subsection, we therefore investigate the absolute amounts of aid that are delivered through bilateral and non-bilateral channels.

We start by following the general literature on aid allocation and use the logged amount of total aid including both bilateral and non-bilateral aid as dependent variable (and the same set of explanatory variables as introduced above). Table 7 reports the results. As before, columns 1-4 show the results of single specifications for each of the four governance measures, and column 5 shows the results of a joint specification. All explanatory variables have the predicted relationship with total aid and are consistent with the results of previous studies. Aid flows increase with population size, exports and colonial relationship and decrease with GDP per capita, distance and oil reserves. Our first governance measure, control of corruption, reproduces the result of Alesina and Weder (2002) that more corrupt countries receive more aid (column 1). However, the other governance measures, in particular the human rights score (column 2) and the share of powerless population (column 3), indicate that recipient governance is taken into account when determining the overall amount of aid, with better governed countries receiving more aid.

As a next step, to assess whether bypassing also occurs for absolute amounts of aid, we now use absolute amounts of bilateral and non-bilateral aid as dependent variables. The specification is the same as above, but additionally also controls for the amount of aid given through the respective

other channel. This is to avoid that an increase in the amount of aid given through the channel of interest comes at the expense of the amount of aid given through the other channel and may thus merely reflect a composition effect. Tables 8 and 9 present the results for bilateral and non-bilateral aid, respectively. There is strong evidence for bypassing weak recipient governments even in absolute amounts of aid. Poor governance, as captured by our four measures, is associated with significantly lower amounts of aid channeled through state actors. The marginal effects are large. A one standard deviation increase in control of corruption or the human rights score is associated with an increase in the absolute amount of bilateral aid by 3.9% and 10%, respectively. Similarly, an analogous increase in the share of powerless population and military expenditures is associated with a reduction in bilateral aid by 8% and 5.1%, respectively (all marginal effects are based on column 5). We observe the opposite effects for non-bilateral aid: Poor governance is associated with significantly higher amounts of aid being delivered through non-state actors.¹¹

5 Conclusion

We have shown that donor countries use aid delivery channels to discriminate between recipient countries with good and poor levels of governance when allocating foreign aid. In countries with poor levels of governance, donors bypass state institutions and deliver more aid through non-state actors in both relative and absolute terms. This finding qualifies the common verdict of the aid allocation literature that recipient merit is not taken into account. Our estimates corroborate Alesina and Weder's (2002) finding that more corrupt countries receive higher amounts of total aid, but show that the governments of weakly governed countries receive less bilateral aid, both as a share of total aid and in absolute amounts. Donors who bypass recipient governments are likely to be driven by developmental concerns because political and economic self-interests could be pursued much more easily through direct government-to-government contact.

When assessing the different aid channels from a development perspective, it is not donor motives per se that matter but rather how aid can be rendered effective in promoting growth and poverty reduction in recipient countries. Recent research (Dreher and Kilby 2010; Manoiu and Reddy 2010) has provided some evidence supporting the view that aid is most likely to raise growth if it is allocated according to developmental needs. This reasoning might also apply to the particular case of funds channeled through non-state actors. Another strand of the literature stresses the detrimental effects that large amounts of aid inflows are likely to have on institutional

¹¹ An exception is the joint specification where due to the smaller sample the marginal effect of the share of powerless population changes its sign.

quality, for instance by giving rise to rent seeking behavior (Djankov et al. 2008), which would also point to a higher effectiveness of foreign aid allocated through non-government channels.

The case for bypassing recipient governments is reinforced by the poor record of past efforts to use policy conditionality as a means of initiating reforms that are deemed necessary for aid to be effective (Oehler et al. 2012; Svensson 2003). Yet, in the donor community there is a strong opinion (Tavakoli and Smith 2013) that donors should remain engaged with local administrations in order to raise democratic accountability and strengthen administrative capacities. This is expected to be achieved by focusing on local ownership of reforms rather than relying on externally imposed conditions, but conclusive evidence that donors can indeed contribute to institutional improvements in recipient countries with weak governance is so far lacking. Given this insecurity, bypassing appears to be a rational strategy for donors who care for poor people in weakly governed countries.

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Figures and Tables

Figure 1: Bilateral aid share in 2008, overall and by donors

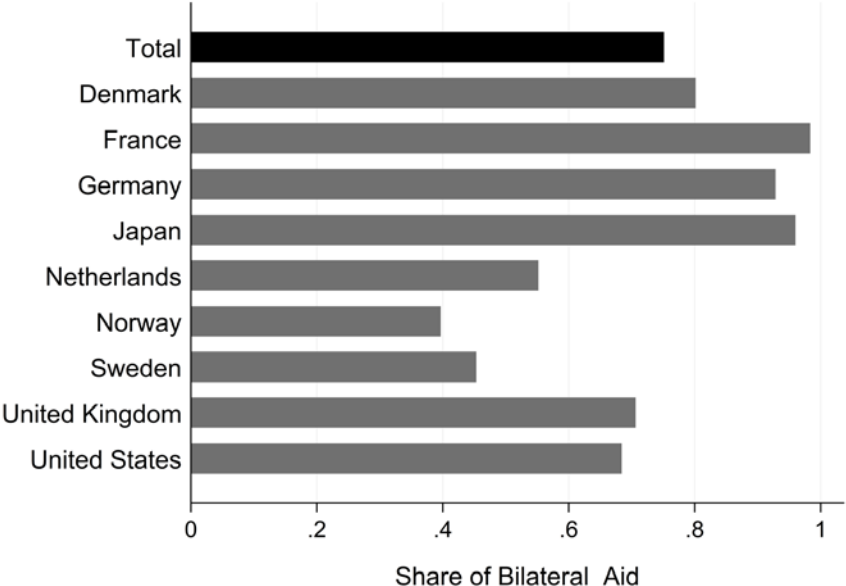


Figure 2: Bilateral aid share in 2008, by sectors

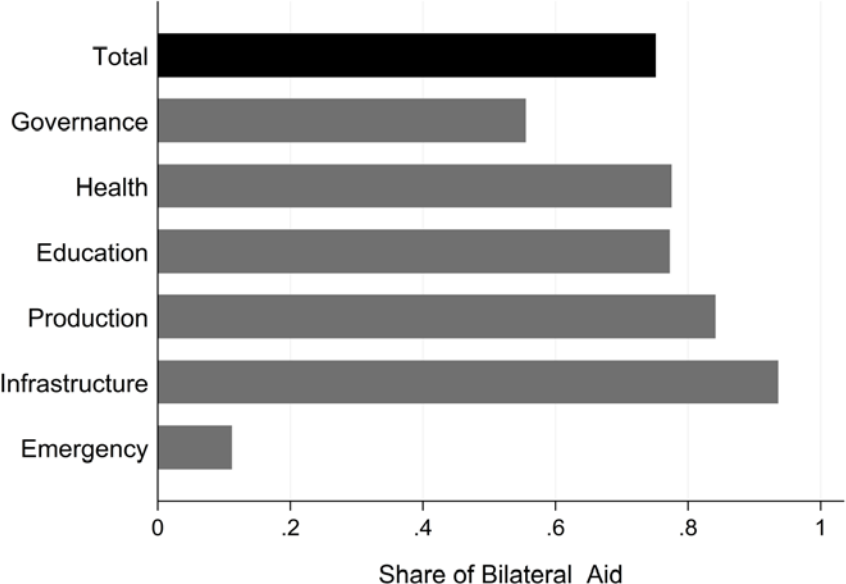


Figure 3: Governance and the bilateral aid share in 2008

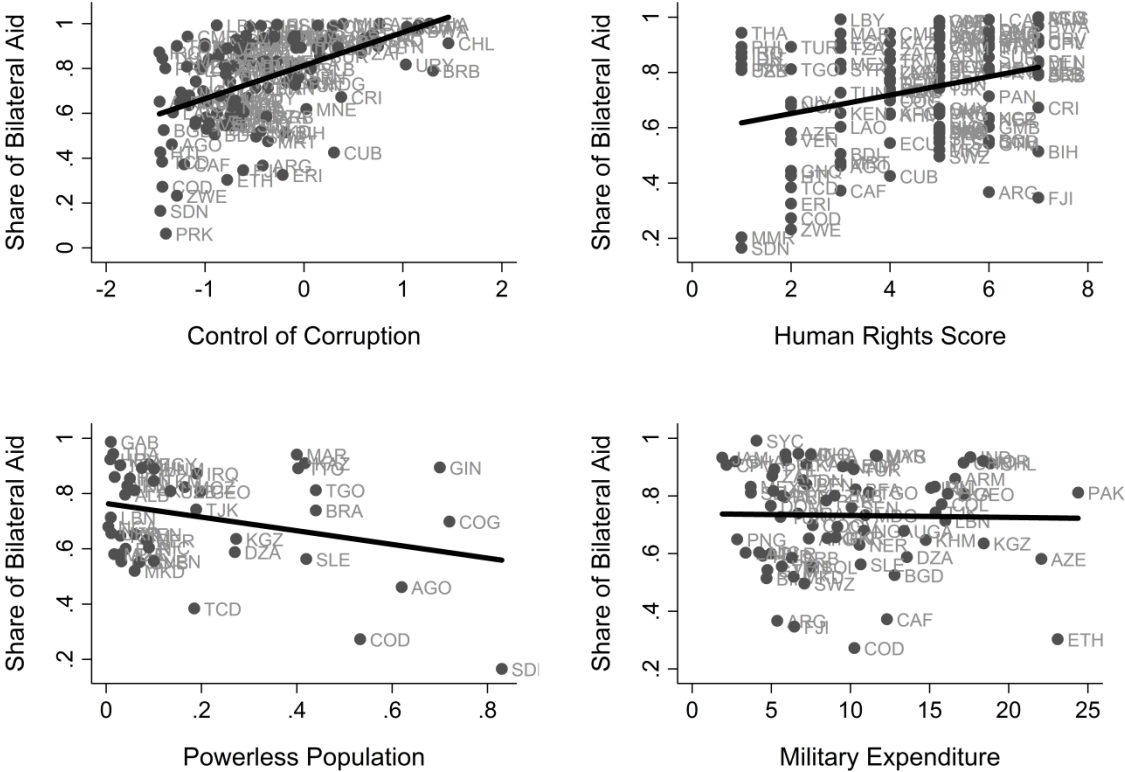


Table 1: Correlation matrix of governance indicators

	Control of Corruption	Human Rights Score	Powerless Population	Military Expenditure
Control of Corruption	1			
Human Rights Score	0.279	1		
Powerless Population	-0.243	-0.063	1	
Military Expenditure	0.103	-0.245	0.016	1

Table 2: Determinants of bilateral aid shares

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	0.118*** (0.024)				0.078** (0.031)
Human Rights Score		0.037*** (0.006)			0.017* (0.010)
Powerless Population			-0.146*** (0.052)		-0.147** (0.074)
Military Expenditure				-0.005** (0.002)	-0.005* (0.003)
GDP per Capita	0.036** (0.018)	0.075*** (0.021)	0.084*** (0.023)	0.100*** (0.028)	0.028 (0.027)
Population Size	0.007 (0.013)	0.037*** (0.013)	0.040** (0.016)	0.027 (0.017)	0.042** (0.018)
Natural Disaster Deaths	-0.025*** (0.008)	-0.029*** (0.008)	-0.031*** (0.008)	-0.020* (0.011)	-0.020* (0.011)
Crude Oil Reserves	0.033*** (0.011)	0.024** (0.010)	-0.003 (0.012)	-0.006 (0.014)	0.015 (0.017)
Exports	0.009 (0.006)	0.005 (0.006)	0.010 (0.007)	0.004 (0.010)	0.008 (0.010)
Colonial Relationship	0.047 (0.045)	0.076* (0.043)	-0.018 (0.067)	-0.036 (0.047)	-0.051 (0.045)
Distance	-0.040 (0.032)	-0.038 (0.032)	-0.029 (0.033)	-0.047 (0.039)	-0.045 (0.042)
Migrants	1.133 (7.184)	4.657 (7.816)	0.923 (7.155)	5.965 (8.198)	4.253 (7.800)
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	2151	2130	1933	1431	1394
Pseudo R ²	0.438	0.439	0.426	0.459	0.474
χ^2	98.618	120.578	65.882	85.017	101.625

The table reports marginal effects from fractional logit estimates. The dependent variable is the share of bilateral aid. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table 3: Governance and bilateral aid shares (IV regression)

	(1)	(2)	(3)	(4)
Control of Corruption	0.723* (0.336)			
Human Rights Score		0.093** (0.041)		
Powerless Population			-1.117** (0.482)	
Military Expenditure				-0.018*** (0.006)
Controls	Yes	Yes	Yes	Yes
Donor Dummies	Yes	Yes	Yes	Yes
Continental Dummies	No	No	No	No
N	851	851	851	744
R ²	0.266	0.416	0.414	0.484
F-statistic	17.91	36.75	37.72	45.92
<i>First Stage</i>				
F-statistic	7.90	30.67	80.15	177.04

The table reports results from two stage least squares estimates. The dependent variable is the share of bilateral aid. Each governance indicator is instrumented with pronoun drop license. Standard errors in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table 4: Governance and bilateral aid shares across sectors

	(1) Infrastructure Aid	(2) Production Aid	(3) Education Aid	(4) Health Aid	(5) Governance Aid	(6) Emergency Aid
<i>Specification 1</i>						
Control of Corruption	0.000 (0.003)	0.062** (0.031)	0.065** (0.027)	0.169*** (0.032)	0.192*** (0.034)	-0.001 (0.005)
N	698	988	1431	1251	1459	943
Pseudo R ²	0.417	0.400	0.511	0.416	0.409	0.466
<i>Specification 2</i>						
Human Rights Score	-0.000 (0.000)	0.008 (0.008)	0.014* (0.007)	0.048*** (0.010)	0.020** (0.009)	0.002 (0.002)
N	698	984	1421	1240	1446	924
Pseudo R ²	0.417	0.398	0.507	0.415	0.392	0.465
<i>Specification 3</i>						
Powerless Population	-0.003 (0.011)	-0.061 (0.063)	-0.072 (0.069)	-0.181*** (0.068)	-0.139* (0.081)	0.005 (0.010)
N	648	930	1329	1180	1372	911
Pseudo R ²	0.424	0.390	0.505	0.392	0.391	0.460
<i>Specification 4</i>						
Military Expenditure	0.000 (0.000)	-0.005 (0.005)	0.001 (0.002)	0.004 (0.004)	0.001 (0.003)	-0.002*** (0.001)
N	486	703	1001	863	1022	625
Pseudo R ²	0.461	0.423	0.507	0.437	0.405	0.482

The table reports marginal effects from fractional logit estimates. The dependent variable is the share of bilateral aid in each sector. All regressions include the full set of control variables, donor dummies and continental dummies. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table 5: Governance and bilateral aid shares for the sub-sample of like-minded donors

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	0.151*** (0.044)				0.105 (0.068)
Human Rights Score		0.054*** (0.015)			0.037** (0.016)
Powerless Population			-0.196* (0.112)		-0.220 (0.154)
Military Expenditure				-0.011** (0.004)	-0.012** (0.006)
Controls	Yes	Yes	Yes	Yes	Yes
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	446	441	420	305	300
Pseudo R ²	0.041	0.024	0.006	0.011	0.019
χ^2	26.779	58.182	1.076e+09	56.890	6.177

The table reports marginal effects from fractional logit estimates. The dependent variable is the share of bilateral aid. Like-minded donors include Canada, Denmark, the Netherlands, Norway, Sweden. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table 6: Governance and bilateral aid shares for the sub-sample of non-like-minded donors

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	0.100*** (0.028)				0.065** (0.032)
Human Rights Score		0.031*** (0.007)			0.009 (0.012)
Powerless Population			-0.119** (0.057)		-0.093 (0.081)
Military Expenditure				-0.002 (0.002)	-0.002 (0.003)
Controls	Yes	Yes	Yes	Yes	Yes
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	1705	1689	1513	1126	1094
Pseudo R ²	0.383	0.379	0.371	0.360	0.369
χ^2	117.260	206.726	50.596	227.920	144.052

The table reports marginal effects from fractional logit estimates. The dependent variable is the share of bilateral aid. Non-like-minded donors include Australia, Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, New Zealand, Portugal, Spain, Switzerland, United Kingdom and the United States. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table 7: Determinants of absolute amounts of overall aid (bilateral and non-bilateral aid; logged)

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	-0.087*** (0.029)				-0.096* (0.052)
Human Rights Score		0.037*** (0.010)			0.050*** (0.015)
Powerless Population			-0.131* (0.077)		-0.904*** (0.221)
Military Expenditure				-0.005 (0.003)	-0.002 (0.003)
GDP per Capita	-0.337*** (0.054)	-0.383*** (0.059)	-0.445*** (0.073)	-0.395*** (0.088)	-0.496*** (0.085)
Population Size	0.119*** (0.039)	0.141*** (0.044)	0.105** (0.043)	0.131** (0.053)	0.150*** (0.049)
Natural Disaster Deaths	0.016 (0.012)	0.019 (0.012)	0.036*** (0.013)	0.015 (0.017)	0.014 (0.017)
Crude Oil Reserves	-0.093*** (0.022)	-0.069*** (0.020)	-0.088*** (0.023)	-0.182*** (0.025)	-0.175*** (0.027)
Exports	0.107*** (0.035)	0.108*** (0.036)	0.116*** (0.037)	0.107** (0.050)	0.144*** (0.042)
Colonial Relationship	0.522*** (0.168)	0.514*** (0.179)	0.673*** (0.170)	0.511** (0.258)	0.437* (0.244)
Distance	-0.202*** (0.073)	-0.197*** (0.072)	-0.179** (0.075)	-0.240*** (0.076)	-0.143** (0.072)
Migrants	27.397*** (9.247)	24.775*** (8.994)	36.993*** (11.372)	32.120*** (10.851)	33.242*** (9.519)
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	2825	2803	2297	1693	1627
Pseudo R ²	0.306	0.308	0.266	0.275	0.277
χ^2	247.801	291.579	195.416	170.311	275.561

The table reports marginal effects from poisson pseudo maximum likelihood estimates. The dependent variable is the logged absolute amount of overall aid (including both bilateral and non-bilateral aid). Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table 8: Governance and the absolute amount of bilateral aid (logged)

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	0.120*** (0.039)				0.071* (0.037)
Human Rights Score		0.066*** (0.010)			0.051*** (0.013)
Powerless Population			-0.306*** (0.073)		-0.545*** (0.125)
Military Expenditure				-0.009*** (0.003)	-0.008*** (0.003)
Controls	Yes	Yes	Yes	Yes	Yes
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	2825	2803	2297	1693	1627
Pseudo R ²	0.369	0.377	0.347	0.357	0.365
χ^2	288.665	222.760	116.408	308.599	660.539

The table reports marginal effects from poisson pseudo maximum likelihood estimates. The dependent variable is the logged absolute amount of bilateral aid. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table 9: Governance and the absolute amount of non-bilateral aid (logged)

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	-0.152*** (0.021)				-0.112*** (0.028)
Human Rights Score		-0.012** (0.005)			0.004 (0.005)
Powerless Population			0.127*** (0.037)		-0.208** (0.082)
Military Expenditure				0.003 (0.002)	0.004** (0.002)
Controls	Yes	Yes	Yes	Yes	Yes
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	2803	2781	2297	1693	1627
Pseudo R ²	0.366	0.364	0.318	0.334	0.330
χ^2	589.071	830.770	250.723	304.686	243.824

The table reports marginal effects from poisson pseudo maximum likelihood estimates. The dependent variable is the logged absolute amount of non-bilateral aid. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Appendix

Table A1: Definition of aid sectors based on the classifications of the Creditor Reporting System

Sector	CRS definition (based on CRS purpose codes)
Infrastructure	Transport and storage, Communication, Energy generation and supply
Production	Agriculture, Forestry, Fishing, Industry, Mineral resources and mining, Construction
Education	Education (level unspecified), Basic education, Secondary education, Post-secondary education
Health	Health (general), Basic health, Population policies/programs and reproductive health, Water and sanitation
Governance	Government and civil society (general), Conflict prevention and resolution, peace and security
Emergency	Emergency response, Reconstruction relief and rehabilitation, Disaster prevention and preparedness

Table A2: Description of variables

Variable name	Description	Data source
Share of Bilateral Aid	Aid that was channeled through the public sector of a recipient country as share of total aid that the recipient country received from a given donor in 2008	OECD's Creditor Reporting System
Bilateral Aid	Absolute amount of aid that was channeled through the public sector of a recipient country by a given donor in 2008 (in million USD, logged)	OECD's Creditor Reporting System
Non-bilateral Aid	Absolute amount of aid that was channeled through NGOs, multi-lateral organizations or other non-state development actors by a given donor in 2008 (in million USD, logged)	OECD's Creditor Reporting System
Control of Corruption	Perceptions of the extent to which public power was exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests in the recipient country in 2005	World Bank's Worldwide Governance Indicators (Kaufmann et al., 2009)
Human Rights Score (Physical Integrity Index)	Respect for internationally recognized human rights as measured by the incidences of torture, extrajudicial killings, political imprisonment and politically motivated disappearances in the recipient country in 2005	Cingranelli-Richards Human Rights dataset (Cingranelli and Richards 2010)
Powerless Population	Share of the population who belonged to an ethnic group whose representatives held no political power at the national or regional level in the recipient country in 2005	Ethnic Power Relations dataset (Cederman et al. 2010)

Military Expenditure	Share of overall government expenditures that was spent on the military in the recipient country, averaged over 2000-2008 (in %)	World Bank's World Development Indicators
GDP per Capita	Gross domestic product per capita in PPP of the recipient country in 2005 (logged)	Penn World Tables (Heston et al. 2012)
Population Size	Population of the recipient country in 2005 (in 1000, logged)	Penn World Tables
Natural Disaster Deaths	Number of deaths due to natural disasters in the recipient country, aggregated over 2000-2008 (logged)	EM-DAT: The OFDA/CRED International Disaster Database
Crude Oil Reserves	Crude oil proven reserves in the recipient country in 2005 (in billion barrels, logged)	U.S. Energy Information Administration
Exports	Value of exports from a donor to a recipient country in 2005 (in USD, logged)	IMF Direction of Trade Statistics
Colonial Relationship	Dummy for colonial relationship between a donor and a recipient country after 1945	CEPII GeoDist Database (Mayer and Zignago 2011)
Distance	Geodesic distance between a donor and a recipient country (great circle formula, logged)	CEPII GeoDist Database
Migrants	Number of migrants from the recipient country as share of donor country's total population in 2000	Global Migrant Origin Database of the Development Research Centre on Migration, Globalization and Poverty, Penn World Tables

Table A3: Summary statistics

	Mean	Std. Dev.	Min.	Max.	Obs.
Share of Bilateral Aid	0.541	0.405	0	1	2352
Overall Aid (logged)	1.462	1.773	0	8.365	3322
Bilateral Aid (logged)	1.016	1.563	0	8.137	3322
Non-bilateral Aid (logged)	0.83	1.233	0	6.751	3322
Control of Corruption	-0.473	0.686	-1.680	1.461	3146
Human Rights Score	4.543	2.186	0	8	3080
Powerless Population	0.095	0.197	0	0.85	2442
Military Expenditure (in %)	10.001	6.445	1.589	42.806	1716
GDP per Capita (logged)	8.061	1.063	5.335	10.26	3036
Population Size (logged)	8.584	2.106	3.012	14.076	3036
Natural Disaster Deaths (logged)	5.371	2.884	0	12.113	3322
Crude Oil Reserves (logged)	0.460	0.985	0	4.843	3036
Exports (logged)	15.542	4.182	0	25.106	3118
Colonial Relationship	0.03	0.171	0	1	3300
Distance (logged)	8.841	0.623	5.601	9.85	3300
Migrants	0.0003	0.0015	0	0.0399	3278

Table A4: Governance and bilateral aid shares excluding outliers in governance from the sample

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	0.110*** (0.025)				0.170* (0.094)
Human Rights Score		0.037*** (0.007)			0.003 (0.020)
Powerless Population			-0.334*** (0.090)		-0.249** (0.109)
Military Expenditure				-0.006*** (0.002)	-0.022*** (0.006)
Controls	Yes	Yes	Yes	Yes	Yes
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	2121	1938	811	1406	625
Pseudo R ²	0.438	0.439	0.387	0.459	0.407
χ^2	112.550	78.147	38.481	82.348	71.423

The table reports marginal effects from fractional logit estimates. The dependent variable is the share of bilateral aid. In contrast to our main results presented in Table 2, these results are based on a sample that excludes recipient countries with the lowest or top percentile of the governance measures. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.

Table A5: Governance and bilateral aid shares weighting observations by the share of aid flows

	(1)	(2)	(3)	(4)	(5)
Control of Corruption	0.210*** (0.031)				0.080* (0.045)
Human Rights Score		0.053*** (0.008)			0.028** (0.011)
Powerless Population			-0.322*** (0.060)		-0.213* (0.117)
Military Expenditure				-0.008*** (0.003)	-0.006** (0.003)
Controls	Yes	Yes	Yes	Yes	Yes
Donor Dummies	Yes	Yes	Yes	Yes	Yes
Continental Dummies	Yes	Yes	Yes	Yes	Yes
N	2151	2130	1933	1431	1394
Pseudo R ²	0.396	0.384	0.393	0.432	0.450
χ^2	96.534	103.732	58.906	49.092	75.505

The table reports marginal effects from fractional logit estimates. The dependent variable is the share of bilateral aid. In contrast to our main results presented in Table 2, these results are based on weighting observations by the share of aid a recipient country receives from the total amount of aid disbursed around the globe. Standard errors clustered at the donor country level in parentheses. *** denotes statistical significance at the 1 percent level, ** at the 5 percent level, and * at the 10 percent level.