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ABSTRACT

While initially heralded as the "magic bullet" for development, NGOs have come under increasing criticism for their failure to deliver "development" as promised. Despite the plethora of new critiques, little systematic work has theorized how NGOs actually operate within the least developed countries as economic and social institutions, and what structural conditions are necessary for NGOs to operate successfully. Drawing on existing theories of the nonprofit form in a functioning three-sector economy, the Article argues the absence of certain economic conditions has a negative impact on NGO efficiency and efficacy. For NGOs to succeed, they must exist in an economy with a functional state and private sector. Attempts to use NGOs as substitutes for private and public institutions damage the NGO sector and its objectives. The absence of functioning private and governmental sectors not only weakens NGOs but actually impedes the development of these other sectors and perpetuates institutional failures. The concentration of human capital in the NGO sector diverts human resources away from more economically productive forms of entrepreneurship. Additionally, the channeling of funding and human capital into the NGO sector weakens the state, limiting its capacity and credibility. By attempting to bypass weak institutions and create viable development partners, donors are actually contributing to the continued weakness of the organizations they are building and to those in other crucial sectors.

SUMMARY

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I. INTRODUCTION

By most measures the international community of "developed" nations has failed at the development business.[1] Large-scale development experiments have been mostly unsuccessful, leaving shattered economies and disillusioned populations in their wake.[2] With the failure of the structural adjustment programs of the 1980s, donors have come to accept the view that there might be more to development than macroeconomics—and that for any development policy to take hold, institutions within the country must take ownership both of its principles and its execution. Across continents, countries with good leadership have better track records of development, even when their policies have diverged from development orthodoxy. The Asian tigers, for example, rejected the development orthodoxy and have joined the ranks of the developed nations, not just in GDP per capita, but across a wide range of social indicators.[3] Botswana has distinguished itself among sub-Saharan countries with its record of good governance and sustained economic growth. In the 1990s and in the new century, the development focus has shifted from ends to means, as donors work to establish strong institutions to promote a broad range of economic and social goals—from creating macroeconomic stability, to reducing gender inequality, to alleviating poverty, and halting the spread of HIV and AIDS.

Institutional development has also proven difficult. Donors blame the failure of these programs on the administrative and political weakness, ineptitude, and corruption of recipient governments. Recipient governments place the responsibility on donors for weakening the capacity of the state in the name of structural adjustment and conditionality.[4] Left without viable institutional partners (and with new appreciation for their significance in the development process) international donors have come, in recent decades, to focus on indigenous non-governmental organizations (NGOs) as potential institutional leaders in development. Frustrated with the weak performance of recipient governments, donors have redirected foreign aid flows into the NGO sector, and the NGO sector in both donor and recipient countries has grown exponentially to meet the increased demand.[5]

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1. The United Nations Development Programme (UNDP) notes that "[s]ome 54 countries are poorer now than in 1990. In 21 a larger proportion of people is going hungry. In 14, more children are dying before age five. In 12, primary school enrolments are shrinking. In 34, life expectancy has fallen." U.N. DEV. PROGRAMME, HUMAN DEVELOPMENT REPORT 2003, at 2 (2003).

2. *See* Firoze Mangi & Carl O'Coill, *The Missionary Position: NGOs and Development in Africa*, 78 INT'L AFF. 567, 578 (2002) ("Today, most commentators agree that the neo-liberal reforms the IMF and the World Bank imposed under adjustment programmes in the 1980s actually caused much of the growth in poverty and inequality we have seen in Africa and Latin America over the past two decades.").

3. *See* U.N. DEV. PROGRAMME, *supra* note 1, at 237–40 (evaluating states based on life expectancy, adult literacy, education enrollment, and a number of other measures). This is not to say, however, that ignoring the advice of the international community is always a recipe for success. In most other regions, unorthodox development strategies, such as import-substituting industrialization, have also failed to produce conclusive economic progress. *See* PAUL R. KRUGMAN & MAURICE OBSTFELD, INTERNATIONAL ECONOMICS: THEORY AND POLICY 254–60 (4th ed. 1997).

4. Some observers have argued that structural adjustment was responsible for weakening the African state. *See, e.g.*, Mangi & O'Coill, *supra* note 2, at 579 ("The state's role in the social sector had been effectively gelded in the process of structural adjustment. State actors' decisive role in determining economic policy had been appropriated by the multilateral institutions and, instead, they found themselves the focus of blame for the failed neo-liberal policies that had previously been imposed upon them by their critics.").

5. *See* Michael Edwards & David Hulme, *NGO Performance and Accountability: Introduction and Overview*, *in* NON-GOVERNMENTAL ORGANIZATIONS—PERFORMANCE AND ACCOUNTABILITY: BEYOND THE

In their early years, NGOs found favor among development practitioners on both the political left and right, as institutional substitutes for the weak state *and* for a weak private sector. NGOs were believed to be "new agents able to compensate for the institutional weaknesses of the state and market" and non-state organizations able to "deliver[] services to the poor equitably and efficiently."[6] This institutional form was viewed as having a comparative advantage in the development business, due to its focus on "local growth, integrated interventions, mobilisation of the poor, and broader participation."[7] NGOs were "supposed to combine the best characteristics of businesses, governments, and charities."[8] In short, the development of the NGO sector was part of a broad attempt to bypass weak governments through the privatization of social services.[9] Lacking a functional private sector to which to delegate these functions, the donors essentially created a "third sector" by channeling funding to new and existing NGOs.

While initially heralded as the "magic bullet" for development, NGOs have come under increasing criticism for their failure to deliver "development" as promised. NGOs have been accused of perpetuating colonial dependencies,[10] infringing on the sovereignty of developing nations,[11] and co-opting and corrupting real community organizations.[12] Despite the plethora of new critiques, little systematic work has been done to theorize how NGOs actually operate within the least developed countries (LDCs) as economic and social institutions, and what structural conditions are necessary for NGOs to operate successfully. The Article attempts to fill this gap in the literature and to provide a framework for thinking about the relationship between operating conditions and outcomes for NGOs working in LDCs.

The Article proceeds as follows. Part II provides a general characterization of the institutional form and activities of developing country NGOs, drawing a parallel between developing country NGOs and developed country nonprofit organizations. In this section, I situate NGOs within the broader economic equilibrium of the developing country, drawing on existing theories of the nonprofit form in a functioning three-sector economy. I demonstrate that the absence of certain economic conditions can be expected to (and in fact does) have a negative impact on NGO efficiency and efficacy, and I argue that for NGOs to be successful in their objectives they must exist in an economy with a functional state and private sector. Attempts to use NGOs as substitutes for private and public institutions damage the NGO sector and its objectives. I support this thesis primarily with evidence from sub-Saharan Africa, home to most of the LDCs.

In Part III, I address the future consequences of continuing to funnel money into the

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MAGIC BULLET 3, 3–5 (Michael Edwards & David Hulme eds., 1995) [hereinafter BEYOND THE MAGIC BULLET].

6. William Muhumuza, *Unfulfilled Promises? NGOs' Micro-Credit Programmes and Poverty Reduction in Uganda*, 23 J. CONTEMP. AFR. STUD. 391, 391 (2005).

7. *Id.* (citations omitted).

8. Varun Gauri & Julia Galef, *NGOs in Bangladesh: Activities, Resources, and Governance*, 33 WORLD DEV. 2045, 2045 (2005) (Can.).

9. *See* Edwards & Hulme, *supra* note 5, at 4–6.

10. *See* Mangi & O'Coill, *supra* note 2, at 568 ("Today their work contributes marginally to the relief of poverty, but significantly to undermining the struggle of African people to emancipate themselves from economic, social and political oppression.").

11. *See* Michael Onyanyo, *NGOs: Pseudo Governments or Surrogates of Western Powers?*, NEW AFR., Aug.–Sept. 2005, at 20, 20 (U.K.).

12. *See* Mangi & O'Coill, *supra* note 2, at 578–79 (discussing how the negative popular response to the structural adjustment of the 1980s led to the "'good governance' agenda of the 1990s and the decision to co-opt NGOs and other civil society organizations to a repackaged programme of welfare provision, a social initiative that could be more accurately described as a programme of social control").

NGO sector rather than refocusing donor efforts on building capacity in the private sector and the government. I suggest that the continuation of present funding trends, in the absence of functioning private and governmental sectors, not only weakens NGOs but actually impedes the development of these other sectors, perpetuating these institutional failures into the future. I argue first that the concentration of human capital into the NGO sector impedes sustainable, equitable economic growth by diverting human resources away from more economically productive forms of entrepreneurship. Additionally, the channeling of funding and the diversion of human capital into the NGO sector weakens the state, limiting its capacity and credibility in the population. In their attempt to bypass weak institutions and create viable development partners, I argue, donors are actually contributing to the continued weakness of the organizations they are building and to those in other crucial sectors.

Finally, in Part IV, I conclude with a series of recommendations for remedying the distortionary impacts of donor funding. I suggest generally that institutional substitution is a flawed strategy and that donors should refocus their attentions on building up the private and governmental sectors, which in turn will strengthen the third sector. Recognizing, however, the significant role that NGOs can (and sometimes do) play in LDCs, I offer several strategies by which donors can mitigate the negative effects of current NGO funding structures.

II. SYSTEMIC CONSTRAINTS ON NGO EFFECTIVENESS

There is no single, all-encompassing model of a developing country NGO. The substantial expansion in the number of NGOs has also resulted in increasing differentiation and categorization among developing country NGOs. Generally, NGOs are conceived as "legally constituted, non-governmental, nonprofit organisations working in areas of relief, development, and advocacy."[13] These organizations engage in the production of international public goods, by which I mean both standard public goods, like environmental protection, as well as goods that do not meet the traditional definition of a public good, but that have a strong collective component and significant positive externalities.[14] Most of the services provided by NGOs in the least developed countries can be considered international public goods within this definition. These include human rights activism, environmental protection, democracy promotion, microcredit services, agricultural development, public health, and education.

As the increased flow of funds has professionalized the NGO sector, its constituent organizations have begun to be categorized by their "social composition, institutionalization and accountability."[15] Intermediary development NGOs now constitute the majority of third sector organizations in the LDCs and are the subject of the most optimism and criticism in the development community. They are usually staffed by middle-class, educated, and professional citizens who choose to work on the behalf of the less fortunate in their communities.[16] These organizations tend to rely heavily on donor funds, and are more formal and professional in their operation.[17] In the literature, these types of NGOs have

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13. Muhumuza, *supra* note 6, at 392 (citation omitted).

14. For example, HIV counseling would typically not be considered a public good since each additional client increases the cost of provision and the benefits of counseling can be made exclusive. There is, however, a strong collective component to HIV counseling, as the spread of AIDS poses health, economic and social risks nationally and globally.

15. Jenny Pearce, *Between Co-Option and Irrelevance? Latin American NGOs in the 1990s*, *in* NGOS, STATES & DONORS: TOO CLOSE FOR COMFORT? 257, 259 (David Hulme & Michael Edwards eds., 1997).

16. *See* Pearce, *supra* note 15, at 259–60.

17. *Id.*

also been referred to as: BINGOs (big NGOs), GONGOs (government-organized NGOs), DONGOs (donor-organized NGOs), and briefcase-NGOs.[18]

This type of NGO has become more prevalent in recent decades as financial flows from developed country donors have increased, and "volunteered" money from local populations has dropped proportionally.[19] By the 1990s, NGOs *not* dependent on official aid for the majority of their budgets had become the exception rather than the rule.[20] The composition is not all that has changed in response to the dramatic increase in available funding—the absolute number of NGOs in developing countries has also exploded. During a three-year span, registered NGOs increased from 220 to 1210 in Nepal and from 1886 to 5186 in Tunisia.[21]

These developments in the international foreign aid business have transformed a population of small indigenous NGOs and community organizations into a comprehensive third sector in many of the LDCs. A large body of theoretical work exists on the third or nonprofit sector in industrialized countries. By applying the concepts developed in the industrial context, I argue that increasing funding to developing country NGOs is weakening rather than strengthening the recipient organizations and impeding rather than encouraging the desired outcomes. In this section, I review the theoretical framework behind the emergence and competitiveness of the nonprofit sector to demonstrate that the success of the nonprofit sector is heavily dependent on the economic environment in which it operates, and that these important structural characteristics are lacking in the LDCs.

A. Identifying the Economic Prerequisites for a Functional Third Sector

A normative theory of the nonprofit sector suggests that the nonprofit emerges as a solution to the under-provision of public goods.[22] Governments supply the quantity and quality of any public commodity that is determined desirable by a political voting process. But the result of this kind of allocative process does not enable individual consumer-citizens to equate the value of the tax they pay with the marginal utility received from an additional unit of that good or service. The consumer-citizen can turn to the private for-profit sector for a substitute for the public good that she feels the government is undersupplying, but these alternatives are often expensive and in some cases ineffective.[23] Unsatisfied consumers, in this model, have an incentive to collectively subsidize a higher level of public goods through the nonprofit sector—as long as they gain more utility from jointly subsidized public goods than individually purchased private sector substitutes.

While useful in explaining why markets will emerge in response to consumer desires

18. CARRIE A. MEYER, ECONOMICS AND POLITICS OF NGOS IN LATIN AMERICA 84 (1999).

19. *See* Alan Fowler, *Distant Obligations: Speculations on NGO Funding and the Global Market*, 55 REV. OF AFR. POL. ECON. 9, 12–16 (1992) (U.K.).

20. *See* Edwards & Hulme, *supra* note 5, at 1, 5.

21. Michael Edwards & David Hulme, *Too Close for Comfort? The Impact of Official Aid on Nongovernmental Organizations*, 24 WORLD DEV. 961, 962 (1996) (Can.).

22. The discussion below draws from Weisbrod's theory of nonprofit sector development. *See* Burton A. Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three Sector Economy*, *in* THE VOLUNTARY NONPROFIT SECTOR 51–76 (Burton A. Weisbrod ed., 1977).

23. Weisbrod offers the following examples of private sector substitutes. A home security system may substitute for an inadequate police force; a sprinkler system may substitute for the services of the fire department. While these represent fairly adequate private substitutes for a public good, there are other public goods that cannot so easily be recreated in the private sector. For example, owning a gun is clearly not an adequate substitute for national defense. *See id.* at 58–59.

for public goods, the Weisbrod model fails to explain why the private sector does not simply pool consumers unsatisfied by the level of government provision and create a profitable collective alternative. An example will help to illustrate the gap in the Weisbrod model. A local government provides a certain level of security through the taxpayer-funded police force. Certain individuals, however, desire an increased level of home security. The traditional private sector alternative would be the purchase of a home security system, but that might be too expensive for individual homeowners. Weisbrod suggests that the set of disappointed consumers in such a community would turn to the nonprofit sector to purchase the incremental amount of security, perhaps through subsidizing some kind of neighborhood watch program. The other alternative, however, would be for the community to hire a private security officer to patrol the neighborhood. Weisbrod's model fails to recognize the possibility of collective purchases of private substitutes for public goods.

A second set of theories of nonprofit sector development, which focuses on the problem of contract failures, helps to explain why the private sector will fail to provide certain types of services that consumers find desirable, or will provide them inefficiently as compared to the nonprofit sector. They explain why a private security company may emerge to compensate for the less than optimal level of security provided by the local police, but why a private sector company will not emerge to provide an increased level of human rights advocacy, for example. The contract failure models focus on nonprofits as a more "trustworthy" alternative to the for-profit sector in providing services that, for various reasons, are difficult or costly to monitor.

Professor Hansmann's model of contract failure demonstrates how the trustworthiness of nonprofits allows them to compete effectively with private sector providers.[24] Hansmann argues that nonprofits emerge when there is a need for greater trust in the provision of services. He observes that efficiency in the market requires that:

> consumers can, without undue cost or effort, (a) make a reasonably accurate comparison of the products and prices or different firms before any purchase is made, (b) reach a clear agreement with the chosen firm concerning the goods or services that the firm is to provide and the price to be paid, and (c) determine subsequently whether the firm complied with the resulting agreement and obtain redress if it did not.[25]

When these conditions are not met, there is a contract failure, and consumers have to put a greater level of trust in their supplier.

Hansmann describes three general kinds of contract failure that give rise to nonprofit activity. First, there are situations in which there is a separation between the purchaser and the recipient of the service. Hansmann uses the example of the delivery of food aid by CARE as an example of a service in which the person paying can do little to check that the service was rendered as agreed. Second, there is the public goods case. Public goods are defined as those that cost no more to provide to multiple persons than to a single person, and whose benefits cannot be limited once they are produced.[26] Air pollution control is a typical public good because "it costs as much to clean up the air for one citizen of Los Angeles as it does to clean it up for the whole city, and once the air has been cleaned up it is

24. The following discussion is drawn from Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835 (1980).

25. *Id.* at 843.

26. *See* RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY & PRACTICE 7–10 (2d ed. 1976) (using the term "social goods").

hard to prevent any individual from enjoying it."[27] Because there is no way to measure the value that each citizen receives from a public good and to extract the proportional contribution, there is again a contract failure. Finally, Hansmann notes the presence of contract failure in the provision of certain kinds of services: "the complexity of these services, their nonstandardized character, and the circumstances under which they are provided make it difficult for the consumer to determine whether the services are performed adequately."[28] In situations of contract failure, provision by a nonprofit organization is desirable because the nonprofit is more trustworthy than a for-profit organization.

Why are nonprofits more trustworthy? Primarily, Hansmann argues, because of the non-distribution constraint under which they operate. Unlike their for-profit counterparts, the officers of nonprofit companies cannot "take home" or distribute to shareholders any profit that is realized. Therefore, the incentive to maximize profit by cutting costs and degrading the product or service does not drive nonprofit organizations. Officers in nonprofits have no reason to fundraise above and beyond what they can use in their programs, or in Hansmann's terms, to "milk" their customers since, theoretically at least, they cannot benefit from the increased revenues. While non-distribution provides Hansmann's primary justification for the increased trustworthiness of the nonprofit organization, he recognizes that opportunistic officers can benefit from increased revenues in nonprofit situations by rewarding themselves with larger salaries and additional non-monetary perks. Hansmann suggests that this kind of opportunism is minimized by legal constraints supported by social norms that reject profiteering and by the self-screening phenomenon described above. The result is a pool of staff and officers more committed to the social goals of the nonprofit and therefore less likely to abuse their powers.

The empirical evidence on nonprofit entrepreneurship in developed economies supports Hansmann's theory of self-selection. While classical economic theory posits that entrepreneurship is generally motivated by residual ownership claims to the firm, and the right to sell these claims, nonprofit entrepreneurs seem to have a variety of other motivations.[29] A series of case studies of nonprofit entrepreneurs suggest that the motivations driving entrepreneurs in the nonprofit sector are varied: they are artists, professionals, believers, searchers, independents, conservers, power seekers, controllers and income seekers.[30] The underlying constant that Professor Young proposes is that "people care about many things besides money and may start nonprofit organizations to pursue their non-pecuniary goals."[31] In developed countries, nonprofit entrepreneurs face tough competition from profit-making organizations in raising venture capital, as evidenced by the concentration of the nonprofit form in labor-intensive service industries with low capital requirements[32] and a substantial opportunity cost associated with choosing nonprofit sector work. Therefore the entrepreneurs and workers who self-select into the nonprofit sector seem to be compensated by a variety of non-pecuniary benefits. They choose the nonprofit sector because they "believe" in the work.

27. Hansmann, *supra* note 24, at 848.

28. *Id.* at 862.

29. *See* Susan Rose-Ackerman, *Introduction*, *in* THE ECONOMICS OF NON-PROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY 3, 10–11 (Susan Rose-Ackerman ed., 1986).

30. Dennis Young, *Entrepreneurship and the Behavior of Nonprofit Organizations: Elements of a Theory*, *in* NONPROFIT FIRMS IN A THREE SECTOR ECONOMY (Michelle White ed., 1981), *reprinted in* THE ECONOMICS OF NON-PROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY, *supra* note 29, at 161, 165–68.

31. ESTELLE JAMES & SUSAN ROSE-ACKERMAN, THE NON-PROFIT ENTERPRISE IN MARKET ECONOMICS 52 (1986).

32. *See id.* at 51 (discussing nonprofit organizations in the United States).

While both of these models address the choices of individual consumers, they can be extended to address government allocations as well. Professors James and Rose-Ackerman suggest that:

> constraints on the government's ability to use market-clearing prices and wages make it cheaper to delegate production of quasi-public goods to the private sector and monitoring problems frequently make it politically expedient to choose nonprofit rather than for-profit organizations for this delegation and subsidy.[33]

In highly fragmented industries, the cost of government monitoring would be very high relative to expenditure with each service provider. Therefore government is more likely to provide services through a grant or subsidy (a one-way transaction) rather than through a contract (a two-way transaction). Significantly, James and Rose-Ackerman state that:

> [n]onprofit status of the recipient may then reassure the government and substitute for monitoring; at least, the subsidies will not be distributed by NPO's as pecuniary profits. Politicians may have a high preference for avoiding scandal, and subsidies to NPO's may be considered "safer" than payments to PMO's in industries where output cannot be readily observed.[34]

The inherent trustworthiness of the nonprofit organization therefore makes it competitive with a for-profit organization when consumers, whether individual or governmental, have difficulty monitoring the outcome of their financial contributions.

The provision of international public goods through the nonprofit form is consistent with Hansmann's contract failure model. In the United States, foreign development assistance is a service provided primarily by the government through contributions to the World Bank and IMF, and through the United States Agency for International Development (USAID). U.S. taxpayers supplement these donations by supporting nonprofit organizations that target more specific developmental concerns: human rights, reproductive health, environmental protection, and disaster relief, for example. While some of the government money that is not given directly to a recipient government is channeled to private service contractors and developing country governments, much is also given to support the work of development NGOs.

The contract failure theory demonstrates why NGOs are perceived as desirable recipients of private and government contributions in the context of providing international public goods. Services are usually paid for on one continent and delivered on another. The kinds of services provided are extremely complex, and outcomes and efficacy are difficult to measure, so that purchasers of these services must, to some extent, trust that the organization is dedicated to its cause. Human rights promotion is an example of the kind of complex service that is almost exclusively handled by nonprofit organizations. Even the most committed individuals cannot promise that their work will result in tangible improvements in human rights conditions, so generally, donors must believe that the organization is making its best effort rather than relying on the measurement of outcomes. The selection of the nonprofit form for the provision of development services is thus consistent with the normative models of nonprofit behavior. The NGO form emerges as the most desirable because of the contract failure problems inherent in the provision of these services.

33. *Id.* at 20.
34. *Id.* at 31.

The Hansmann model demonstrates that when the trustworthiness of the nonprofit organization is challenged, this organizational form loses its comparative advantage vis-à-vis the for-profit form. As this presumption of trustworthiness is grounded primarily in the self-selection process that Hansmann proposes, the absence of the opportunity cost that drives this process presents a fundamental threat to the competitiveness of the NGO. While there is little systematic data on developing country NGOs, the available anecdotal evidence strongly suggests that the crucial self-selection process is indeed absent in the LDCs due to the absence of competing opportunities with more substantial rewards in other sectors, including the governmental sector. If the Hansmann theory holds for developing countries, then the failure of self-selection will mean that developing country NGOs will be less efficient and effective than their developed country counterparts because of missing incentives.

B. The Failure of Self-Selection in the Least Developed Economies

Professor Hansmann's theory of nonprofit competitiveness relies upon the presence of an opportunity cost for nonprofit work, which ensures that those who self-select into the sector are committed to their cause. This opportunity cost does not exist in many developing countries. The situation facing entrepreneurs in developing countries differs dramatically from that in industrialized countries in that the rewards of nonprofit sector work are often higher than those in the public or private sectors, and the barriers to entering the private sector are arguably higher than those faced in the NGO sector. This difference is particularly pronounced within the least developed countries, in which private sector opportunities for educated professionals are limited or virtually nonexistent. The result is that government and donor-funded NGOs provide much of the available capital and most of the "good jobs" for educated workers. While systematic data in this area is lacking, case study and anecdotal evidence tend to support the contention that the NGO sector is the most attractive (and even the only) source of financially rewarding, stable, and fulfilling employment for educated workers.

In sub-Saharan Africa, this phenomenon is particularly pronounced, given the generalized weakness of the public sector and the huge challenges involved in raising capital for private sector entrepreneurship. The private sector has never been a large employer of educated professionals in most African nations. Tertiary education developed slowly in Africa.[35] Graduates of early African universities were trained for the only real employer in town, the colonial administration. This trend continued after independence, with most new governments offering guaranteed positions in the civil service to any university graduate.[36]

The civil service positions, once highly coveted and lucrative, have lost their value as a result of economic reforms designed to reduce government spending.[37] In the 1970s and 80s, real wages fell dramatically and while non-wage benefits helped to ease the blow, "there is little doubt that all but the highest level public sector employees underwent a sharp reduction in their purchasing power in most countries in the region."[38] This has not, however, resulted in a significant rush to the private sector. Instead, NGOs have emerged

35. FREDERICK COOPER, AFRICA SINCE 1940, at 111 (2002).

36. NICHOLAS VAN DE WALLE, AFRICAN ECONOMIES AND THE POLITICS OF PERMANENT CRISIS, 1979–1999, at 134 (2001).

37. *See id.* at 134–35.

38. *Id.* at 135.

as the new desired employer, a phenomenon discussed in more detail in the next section. The trend is not limited to sub-Saharan Africa, although it is most pronounced in the LDCs because of the continuing lack of a viable private sector alternative to public or NGO sector employment. Even in Latin America, where economic development has been much more successful, "salaries and working conditions [in NGOs] are often superior to those in the public sector, and the prestige attached to NGO leadership may be substantial. Particularly because professional opportunities are limited in developing countries, these incentives are important . . . ."[39] In Peru, for example, salaries at the Center for the Study and Promotion of Development (DESCO) were $500 per month, compared to only $60 per month at a public university.[40] The result was that "professionals and academics fled to NGOs."[41] The problem has been compounded by the fact that barriers to entry have made entrepreneurship in the private sector less available and attractive than the NGO sector.

As the benefits of the NGO sector pull in skilled entrepreneurs, so the formidable challenges to private sector entry continue to push them away. The regions that are least developed generally also have the highest barriers to entrepreneurship. In sub-Saharan Africa, starting a new business requires, on average, eleven administrative procedures, which take 63.8 days, and cost over 215% of gross national income (GNI) per capita. In Latin America and the Caribbean, there are 11.4 procedures, which last approximately 63 days and cost 56.2% of GNI per capita. This is in contrast to the OECD countries, which require an average of 6.5 procedures, lasting 19.5 days, and costing less than seven percent of GNI per capita. Disaggregating these averages produces even more stunning results. In Niger, for example, the 13 required procedures last 35 days and cost over 465% of GNI. In Chad, 19 procedures last approximately 75 days and cost over 360% of GNI per capita. In Paraguay, 17 procedures take an average of 74 days to complete and cost approximate 147% of GNI per capita. For purpose of comparison, the United States has five procedures, which take approximately five days and cost less than one percent GNI per capita. The United Kingdom has six procedures, which take 18 days and cost less than one percent of GNI per capita.[42] In short, the barriers to starting a for-profit business in the LDCs are significant.

While there is no comparable empirical evidence about the resources needed to register an NGO, there is at least some indication that the requirements for establishing NGOs have traditionally been significantly less rigorous and costly. Government regulation of the NGO sector is considered more suspect than similar constraints on the private sector because of the possibility that increased monitoring may be abused, for example, to stifle political opposition.[43] Increased government monitoring is also seen to conflict with constitutional guarantees of freedom of association and religion.[44] The

39. MEYER, *supra* note 18, at 89.

40. DANIEL C. LEVY, LATIN AMERICA'S PRIVATE RESEARCH CENTERS AND NONPROFIT DEVELOPMENT: BUILDING THE THIRD SECTOR 295 (1996).

41. MEYER, *supra* note 18, at 41.

42. World Bank Group, Starting a Business, http://www.doingbusiness.org/ExploreTopics/StartingBusiness (last visited Apr. 10, 2006).

43. In Ghana, for example, as of the early 1990s, nonprofit organizations were not required to register with the government "provided that the activities of the association are not aimed at the acquisition of gain for the association or its members." Atingdui et al., *The Nonprofit Sector in Ghana*, *in* THE NONPROFIT SECTOR IN THE DEVELOPING WORLD 179 (Anheir & Salamon eds., 1998). However, to be eligible for government funding and contracts, NGOs must register under the Trustees Incorporation Act of 1962 (Act 106), by providing the appropriate government ministry with an application that "clearly specifies the organization's purpose, and identifies the names and addresses of its trustees, the proposed name . . . the description of the property of land owned or held by the organization, as well as the regulations governing the custody and use of the organization's official seal." *Id.*

44. Botswana, Kenya, Mozambique, Tanzania, Uganda and Zimbabwe all have constitutionally protected

suspicion accompanying proposed restrictions on indigenous NGOs likely acts as a counterweight to government attempts at increased regulation, which may have the unintended effect of favoring the NGO form over the for-profit form.

The difficulty of starting a for-profit business and the large, relatively accessible financial rewards available in the NGO sector make private sector entrepreneurship a comparatively unattractive or inconceivable option. The result is that the NGO sector is highly attractive to educated entrepreneurs, regardless of their level of social commitment. The absence of the self-selection process in this context results in a pool of NGO employees that is less committed to the organization's goals, and arguably less effective. Paradoxically, the funding designed to strengthen third sector institutions may actually be contributing to their failure. In the next part, I explore the evidence that suggests that over-funding of developing country NGOs is having this unintended impact.

C. *Weakening the NGO Sector*

In the last section, I demonstrated that the incentives in the economic context of the LDC described above differ from those that characterize nonprofit entrepreneurship in developed economies. The self-selection process that works to ensure an increased level of commitment among nonprofit workers in developed economies does not operate in the same way when the private and public sectors do not offer more financially lucrative positions. There is increasing evidence to suggest that lack of commitment is an increasing problem facing developing country NGOs. One critical observer has claimed that evidence suggests that "levels of corruption in donor-funded NGOs . . . certainly rivals corruption within the state."[45] A study of third sector organizations in Uganda found that:

> [m]any intermediate NGOs are composed of elites, often bureaucrats or professionals who have discovered NGOs as an alternative and lucrative source of income. Many civil servants are unable to make even a living wage at their government jobs, and given the flood of donor money some have turned to the NGO sector for personal profit. Since the private sector is still very weak, and because the state has lost its former lucrative offerings, many have switched to NGOs instead to further their ambitions. The extent to which NGOs are characterized by self-interest and greed varies, although the number operating almost strictly on the basis of personal gain is increasing.[46]

At the extreme, the NGO is merely a front for the corrupt entrepreneur's personal gain. However, even generally honest nonprofit workers may make choices that maximize their personal benefits because working at an NGO is not a vocation (as it would be in a developed economy), but rather a way to make a living. This problem of uncommitted decision making is often reflected in unusually (or unnecessarily) high overhead costs. A study of NGOs in East Africa demonstrated that even local NGOs receiving donor funds

rights to free speech association, but also have laws that give government the power to regulate and restrict the activities of NGOs. WORLD RES. INST. ET AL., REPORT SERIES: WORLD RESOURCES 2002–2004: DECISIONS FOR THE EARTH: BALANCE, VOICE, AND POWER, *available at* http://pubs.wri.org/pubs_description.cfm?PubID=3764 (last visited Mar. 31, 2006). These regulations "allow[] governments to act against interest groups that challenge them." *Id.*

45. VAN DE WALLE, *supra* note 36, at 165.

46. SUSAN DICKLITCH, THE ELUSIVE PROMISE OF NGOS IN AFRICA: LESSONS FROM UGANDA 128 (1998).

demonstrate a high level of bureaucracy.[47] A survey of these organizations showed that despite donors requiring, in some instances, that seventy-five percent of project funds be used directly for beneficiaries or projects, in actuality, salaries and operational expenses often took up as much as sixty percent of the budget. A proposal from TANGO, an umbrella organization for NGOs in Tanzania, demonstrated that from the total budget for a three year training program, only twenty percent of the funds were allocated for training.[48]

While higher overhead costs are not necessarily evidence of corruption, they may point to organizational decision making that is not commitment-driven. Syed Hashemi notes this phenomenon in Bangladesh:

> Some of the larger Bangladeshi NGOs, with their fleets of air-conditioned four-wheel drive vehicles and plush offices, were easy targets for accusations of lavish lifestyles, particularly since such "luxuries" are antithetical to the spirit of service that poor people in South Asia have historically associated with organisations working with the poor.[49]

While a comparative study of NGO and government functionaries determined that Bangladeshi NGO entrepreneurs earn less in terms of pay and perquisites than high-level government officials,[50] the spending patterns of Bangladeshi NGOs can seem quite sumptuous, especially when compared to their Indian counterparts, who are described as "more modest, down-to-earth and resource-scarce."[51] Hashemi suggests that difference reflects "the general abundance of foreign funds in Bangladesh."[52] The thesis presented here offers an alternative explanation: India's more developed economy presents a greater set of choices for entrepreneurs, thus allowing the self-selection process described above to occur and ensuring that those individuals who do join the nonprofit sector are committed to their mission and more likely to allocate funds accordingly.

Donors and other observers are not unaware of the problem of uncommitted decision making. The extensive literature on NGOs emphasizes increased accountability, both to donors and to the local populations that the NGOs are meant to serve. In some ways, however, the "solution" has exacerbated the condition. Donors' reporting requirements have placed a heavy burden on ill-equipped southern NGOs, further increasing administrative and overhead costs and ensuring that only the elite are able to access donor funds. This in turn reinforces the negative perception among the general population that NGOs are the province of the wealthy and diminishes their credibility among and commitment to the indigenous populations they serve. In Uganda, "NGOs are increasingly headed by bureaucrats and members of the middle class, reflecting an understanding by many Ugandans that the way to make money is to set up your own NGO."[53] Because Hansmann's theory suggests that part of the credibility of the nonprofit form is tied to an internal culture of commitment, as this culture changes to one of expected opportunism, NGOs can be expected to become less rather than more effective. Increasing funding to these NGOs would therefore decrease, rather than build, their capacity.

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47. Zie Gariyo, *NGOs and Development in East Africa: A View from Below*, *in* BEYOND THE MAGIC BULLET, *supra* note 5, at 131, 134.

48. *Id.* at 134 ("Salaries and consultants' fees were allocated 14.2 per cent and 29.2 per cent respectively; equipment and travel 19.6 per cent; rent 3.0 per cent and other miscellaneous charges 15.5 per cent.").

49. Syed Hashemi, *NGO Accountability in Bangladesh: Beneficiaries, Donors and the State*, *in* BEYOND THE MAGIC BULLET, *supra* note 5, at 103, 104–05.

50. *See id.* at 105.

51. *Id.*

52. *Id.*

53. DICKLITCH, *supra* note 46, at 159.

Because the "trustworthy" nonprofit is competitive with a for-profit enterprise when monitoring costs are high, the removal of the "trust" relationship creates a fundamental flaw in this organizational form. The trust relationship is based in the self-selection process among workers, which is not occurring in the least developed countries. Arguably, the self-selection process could be reintroduced—donors could set pay levels below or on par with those available in the civil service or academia—to recreate an opportunity cost. In some countries, where these positions are relatively well paid, this is a plausible, if incomplete solution. In other countries, where the majority of publicly funded positions barely pay a living wage, this is less of an option. If donors were to match or undercut the public service salaries, they would be in the uncomfortable position of forcing indigenous entrepreneurs to pay themselves less than a living wage. The wage differential between local and foreign staff of NGOs is already a source of tension because "keeping local hires' wages and salaries low can convey an unintended message that local people are less valued than international staff."[54] Further exacerbating the disparity could send a negative message about the inequality of donor-recipient relationships and would likely be counterproductive to the success of the partnership and its goals. The self-selection mechanism is thus unlikely to be reintroduced solely through the manipulation of NGO salaries; its absence is, however, a problem that requires attention.

Despite the failure of incentives, there are many NGOs in developing countries doing useful and productive work. In the next section, however, I will argue that donors should not continue their strategy of pouring increased funding into developing country NGOs in the hopes of channeling some money to the effective NGOs because the attractiveness of the third sector is exacerbating the structural failures of least developed economies and perpetuating them into the future. Development researchers have noted that the opportunities in the NGO sector are attracting the best and the brightest of the developing countries. In Uganda, "[l]ocal staff [in NGOs] were better paid than they would have been in most other jobs, but there was so much competition for NGO posts that they were for the most part highly qualified and motivated . . . ."[55] Similarly, in Costa Rica, "[t]he financial incentives reinforced the commitment of some of the finest talent available and encouraged them to put that talent to work in the provision of international public goods."[56] While in this section I have demonstrated how systemic conditions have caused donor funding to undermine the development of successful NGOs in the present, in the next section, I will show how the economic distortions created by NGO employment attractiveness help to perpetuate these conditions into the future, impeding the achievement of both economic and social development goals.

III. EXAMINING THE FUTURE CONSEQUENCES OF NGO DOMINANCE

In the previous section, I proposed that the existence of functioning private and public sectors is a prerequisite to the success of the institutions of the third sector. In this section, I argue that the channeling of skilled human capital into the NGO sector is actually impeding the development of these other sectors, perpetuating the institutional failure of all three sectors into the future and thus limiting the possibilities of development (particularly given the newly recognized importance of strong institutions in development). In the first subpart, I argue that the attractiveness of the NGO sector is impeding economic growth

54. MARY B. ANDERSON, DO NO HARM: HOW AID CAN SUPPORT PEACE—OR WAR 44–45 (1999).

55. E.A. Brett, *Voluntary Agencies as Development Organizations: Theorizing the Problem of Efficiency and Accountability*, 24 DEV. & CHANGE 269, 297 (1993).

56. MEYER, *supra* note 18, at 95.

because the market for public international goods that NGOs serve is not one that can expand to support a developing economy, and because the skills required by NGOs are not easily transferable into more productive sectors. In the second, I review the evidence that NGO attractiveness is diminishing the responsibility and capacity of developing country governments. I hope, in doing so, to demonstrate that the current donor strategy of institutional substitution is not just ineffective in the short term—because some NGOs are clearly doing good and useful work—but also counterproductive to the long-term development agenda.

A. *The NGO Sector Cannot Generate Economic Growth*

In the last section, I demonstrated that the NGO sector has become the most desirable source of employment in the LDCs. In this section, I argue that the overwhelming attractiveness of the NGO sector to entrepreneurs and skilled workers is a problem for sustainable economic growth. The world's least developed economies[57] all have comparatively low rates of tertiary education.[58] The absorption of this limited and important resource into the third sector should be a source of concern for developing countries and donors.

Some observers have suggested that the NGO sector might provide a new locus for economic growth in developing countries. Professor Meyer has made the claim, in a case study of environmental NGOs in Latin America, that developing country NGOs can contribute to economic growth as exporters of international public goods. Meyer observes that:

> Like exporters of private goods, [the NGO exporters of public goods] bring in foreign exchange, new technology, ideas, and international contacts. They contribute to economic production, employment, and increased human capital. They are also a flexible base of entrepreneurial talent and contribute innovations in both public goods and the institutional arrangements to provide them.[59]

Extending Meyer's argument, developing countries could be seen as having a comparative advantage in the provision and export of some international public goods. For example, Costa Rica (Meyer's case study example) is in a unique position to catalog biodiversity. Similarly, a donor concerned about stopping the spread and minimizing the impact of the HIV/AIDS virus could reasonably feel that investing in programs in sub-Saharan Africa would bring the greatest return on investment. Classical international trade theory, which encourages specialization by countries in their areas of comparative advantage, would therefore suggest that the concentration of entrepreneurial talent in the production of international public goods would lead to gains from trade for developing economies.

A closer examination of this position points to some problems with this thesis. Providing international public goods seems intuitively different from specializing in agricultural production, or in high technology manufacturing. The markets for agricultural

57. In this paper, I refer to the LDCs defined as having "low human development" by the UNDP. In addition to economic indicators such as GDP per capita, the UNDP human development index takes into account social factors such as life expectancy, literacy, and education levels. The nations with "low human development" are those ranked from 142 to 175 on the index and with the exceptions of Pakistan, Nepal, Yemen, and Haiti, all of these nations are located in sub-Saharan Africa. U.N. DEV. PROGRAMME, *supra* note 1, at 239–40.

58. In sub-Saharan Africa, the rate of tertiary education is about five percent of the population in the region, the lowest in the world. David Bloom et al., Higher Education and Economic Development in Africa 3 (Feb. 2006), *available at* http://www.worldbank.org/afr/teia/pdfs/Higher_Education_Econ_Dev.pdf.

59. MEYER, *supra* note 18, at 97.

or manufactured products are made up of many individual consumers. While changes in consumer tastes for those products will occur over time, they are likely to occur more gradually as individual preferences change, giving producers time to adapt. The market for international public goods, in contrast, is generally limited to a few large donors and shifts in donor "tastes" can be dramatic, and based on domestic political changes that recipients can do little to impact. Producing international public goods subjects a developing country to the whims of a market made up primarily of a few developed country donors, whose willingness to provide additional funding will, if history is a guide, have no relation to the country's success in producing the desired good.

Developing country NGOs receive most of their funding bilaterally from developed country government donors and NGOs, which means that amounts fluctuate as political priorities and economic conditions change. For example, bilateral aid from the United States has declined sharply in real terms since 1965 (although increases in assistance from other donors made up the difference until 1992)[60] with particularly sharp cuts following the Republican sweep of the U.S. Congress in November 1994.[61] Even when official development assistance levels remain constant, development priorities change. Certain countries and regions become more prominent on the world scene and allocations shift to reflect these geopolitical changes.

Donor interests change as well. While "human rights and popular education were the key issues [in Brazil] during the 1970s, civil society, democracy and ecology appear the dominant issues of the 1990s."[62] In Bangladesh, as Hashemi notes:

> [T]he emphasis on non-formal education, immunisation and diarrhoeal disease control, are all due to donor pressure. Conversely, the dropping of adult literacy from NGO agendas is due to the lack of donor interest in such programmes. Now that donor interest has turned to HIV/AIDS, it is only a matter of time before large numbers of NGOs begin to integrate HIV/AIDS into their activities.[63]

While some skills and organizational structures are doubtlessly fungible, other organizations must become defunct when funding moves out of their area of expertise—or indeed out of the country.

The fluctuations and unpredictability of donor giving reflect the reality that in some sense, international public goods are luxuries for the donor economy, even when they are essential for the recipient economy. In all markets, preferences will change over time, but in few is the consumer base as limited and the fluctuations as significant and rapid as in the market for international public goods. Even if, however, donor giving was relatively stable, the overall demand for international public goods is restricted, which limits the potential of this market to generate economic growth that reaches beyond the elites.

While the major donors seem unlikely to end their development funding anytime in the near future, they also seem reluctant to expand it beyond certain levels, regardless of the success or failure of their development agenda in any given country. In 1968, at the first United Nations Conference on Trade and Development (UNCTAD), donor countries committed themselves to reaching an Official Development Aid (ODA) level of 0.7% of

60. *Id.* at 8.
61. *Id.* at 13.
62. *Id.* at 44.
63. Hashemi, *supra* note 49, at 109.

GNP,[64] a goal that was reaffirmed by most developed countries through the 1980s.[65] From the period 1991 to 2002, however, only Denmark, Luxembourg, The Netherlands, Norway and Sweden, of the Organization for Economic Cooperation and Development (OECD) countries, contributed upwards of 0.7% of GNI,[66] and the remaining donor countries generally fell far short.[67] Although aid levels declined in the 1990s, the trend reversed following a commitment by donors to provide an additional $16 billion a year by 2006 under the U.N. Millennium Declaration adopted in 2000.[68] However, even this increase would bring total official development assistance to just 0.26% of the gross national incomes of the twenty-three members of the OECD's Development Assistance Committee, falling far short of the 0.7% commitment towards which rich countries promised to work.[69]

The aid situation for the LDCs is even more dire. Funding to the LDCs as a subset of all recipient countries has fallen even more sharply—by almost one-third on a per capita basis.[70]

> Aid flows to LDCs, as measured by the share of net ODA disbursements in donors' GNP, have almost halved in the 1990s. . . . [I]n 1998 only five countries met the special targets for ODA to LDCs as a percentage of GNP which had been set in the Programme of Action for the LDCs for the 1990s . . . .[71]

This pattern of commitment and failure seems to suggest that the major donors generally perceive modern aid allocations more as a necessary demonstration of international charity than as a purchase of a desired outcome. In this context, increased funding is not tied to performance. Indeed, through the mid-1990s overall aid flows were correlated neither with economic performance nor to the level of need.[72] The bottom line is that the market for international public goods isn't really a market—aid contributions reflect a relatively fixed transfer payment that has not and probably will not increase enough to form the foundation for sustainable economic growth.

To summarize, when employed in the production of international public goods, the limited quantity of skilled human capital available to the least developed economies is going into a volatile, low-growth market. This essential part of the labor force is therefore less effective at creating broader economic opportunities that will generate income among the rest of the population. The argument has been made that the NGO sector is building capacity among entrepreneurs and skilled workers, who will then be better prepared to pursue other opportunities across sectors, should they emerge. Studies of African NGOs suggest that this is not the case—rather NGOs seem to replicate the conditions in other sectors. NGOs in East Africa, for example, are characterized by "limited absorptive capacity, inadequate delivery mechanisms, and a lack of technical expertise and managerial effectiveness, and poor resource mobilization . . . ."[73] Even if, however, the NGO sector is

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64. VAN DE WALLE, *supra* note 36, at 196 n.14.

65. *Id.*

66. This target level was to include development aid to all "developing" countries, not just the LDCs.

67. Org. for Econ. Cooperation & Dev. (OECD), *Aid Rising Sharply, According to Latest OECD Figures*, *available at* http://www.oecd.org/dataoecd/0/41/35842562.pdf (last visited Mar. 31, 2006).

68. U.N. DEV. PROGRAMME, *supra* note 1, at 146.

69. *Id.*

70. *Id.*

71. U.N. CONFERENCE ON TRADE & DEV., THE LEAST DEVELOPED COUNTRIES 2000 REPORT 60 (2000).

72. Craig Burnside & David Dollar, *Aid, Policies and Growth*, 90 AM. ECON. REV. 847 (2000) (demonstrating that economic performance depends on the presence or absence of sound fiscal, monetary, and trade policies in the country and not on aid, and that donors' pursuit of their own strategic interest has guided aid allocation).

73. A. Sat Obiyan, *A Critical Examination of the State Versus Non-Governmental Organizations (NGOs) in*

building capacity, the question then becomes whether the NGO sector provides the optimal training ground for for-profit entrepreneurship. Generally, it would seem that other potential capacity building strategies targeted at promoting private sector entrepreneurship would provide a more direct route towards reaching that goal. Certain model programs have already been launched both in developing and developed countries that could do more to promote entrepreneurship than funding additional NGOs.[74]

In addition to the loss of present day growth opportunities, there is some evidence to suggest that the desirability of employment in the NGO sector is having a distortionary impact on human capital development, perpetuating this loss into the future. University students are training for the most desirable (and extremely limited) jobs as NGO managers or consultants, thereby perpetuating the "brain drain" into the NGO sector. A study of universities in Bangladesh found that:

> Student enrollments over the last ten years have changed in response to the demand for consultants and the emphasis on particular economic and field survey skills. The best students are now increasingly likely to enter fields like economics, political science, anthropology, and business management, where [NGO] consultancy opportunities are perceived to be the most extensive and most lucrative.[75]

This preference has also been noted in Africa. In West Africa,

> few serious efforts have been undertaken to make study programs more relevant to the needs of the countries where they are situated. Stronger programs in such areas as agronomy, tourism, applied sciences, and technology, among others, would probably help support local economies. . . . But most students remain attracted to traditional long degree programs in the humanities, law and the social sciences—where high unemployment plagues graduates.[76]

Despite the extremely limited pool of skilled human capital, there are still high rates of unemployment among university graduates, particularly among those trained for highly desirable, but also highly limited white collar positions in the civil service and the NGO

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the Policy Sphere in the Global South: Will the State Die as the NGOs Thrive in Sub-Saharan Africa and Asia?, 4 AFR. & ASIAN STUD. 301, 316 (2005) (discussing findings in Alan Fowler, *NGOs and the Globalization of Social Welfare: Perspectives from East Asia*, *in* SERVICE PROVISION UNDER STRESS IN EAST AFRICA 62 (1995)).

74. For example, the Kigali Institute of Science and Technology (KIST) was founded in 1997 with a curriculum tailored to meeting the immediate needs of a community emerging from war. KIST's Centre for Innovations and Technology Transfer has developed products that meet local needs, including: low-cost hand and foot-powered water pumps; rainwater-harvesting systems for areas without adequate piped water; a dual crop dryer that uses either sunshine or biomass for fuel; solar water heating systems; and more efficient cooking stoves and other useful innovations. The school's Department of Entrepreneurship works with community development officers to modify tools commonly used in homes or local businesses. By creating a feedback mechanism between the community and the academy, KIST has been successful in providing innovations that have a demand in the marketplace. Increasing support to commercialize these products, domestically and regionally, could help strengthen entrepreneurial as well as technical skills. Burton Bollag, Improving Tertiary Education in Sub-Saharan Africa: Things That Work! 24–26 (Sept. 22–25, 2003), *available at* http://www.worldbank.org/afr/teia/conf_0903/final.pdf; *see also* KIST, Welcome to Kigali Institute of Science and Technology, http://www.kist.ac.rw (last visited Mar. 31, 2006).

75. Shelley Feldman & Itty Abraham, Notes on Field Development: The Case of Bangladesh, Items, Dec. 1995, at 94, 96.

76. Bollag, *supra* note 74, at 18.

sector.[77] The perception that success is in the NGO sector is leading to an investment in skills that carry high rewards, but which are in low demand.

There is also a strong indication that those countries that have been most successful with their economic development have placed a strong emphasis on education in math, engineering, and the sciences as a way to create a labor market attractive to foreign investors. The emphasis on universal education and particularly on math and science skills has been repeatedly mentioned as a key factor to the success of the Asian tigers.[78] India has also been cited as a country that has been able to jump-start economic growth through the creation of a labor pool with strong technical and English skills. In fact, India "has the largest pool of English-speaking doctors, scientists and engineering and technical graduates outside the United States, who are willing to work for salaries far less than those paid in the West."[79]

Eighty-two percent of large foreign companies investing in sub-Saharan Africa, surveyed in 2003, say that the presence of skilled, low-cost labor is a crucial factor in the location decision.[80] While the desired skill set was not specified in the study, the sectors currently most attractive to foreign direct investment are not likely to require the kind of training provided by NGO employment.[81] With the exception of financial intermediation, the kind of project development, management expertise and general office skills, which NGO employment is likely to build, are unlikely to be those desired by the investors currently most interested in Africa. Alternatively, a large pool of low-wage social scientists and business managers is unlikely to attract other types of investors in new industries (as has happened with India's engineers and scientists). Based on historical experience and current trends in investor demands, therefore, it seems that the educational incentives created by the desirability of the NGO market may be mismatched with those necessary to attract opportunities for long-term economic growth.

To summarize, the high desirability of employment in the NGO sector may, in fact, be crowding out private sector development in the LDCs. The attractiveness of the NGO sector means that entrepreneurship and skilled human capital—which might otherwise be employed in growth generating activities in the private sector—is channeled into the market for international public goods, which is low-growth (in terms of increasing overall employment opportunities) and volatile (due to the political nature of the market). The attractiveness of the NGO sector is also shaping human capital development by creating incentives to develop the expertise necessary to participate in this market. While some of the skills created both in those fields of study and in the NGOs themselves may be transferable to opportunities in the private sector, there is at least a strong question as to whether NGOs provide the most effective training to access economic opportunities in the

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77. *Id.* at 4.

78. *See, e.g.*, World Bank, The East Asian Miracle: Economic Growth and Public Policy 133 (1993), *available at* http://www.worldbank.org. Another indication of the desirability of these skills in the world economy is the availability of international opportunities for those who have them. Developed countries, including Australia, Canada, and the countries of the European Union have opened recruitment offices in developing countries to compete for graduates in technical fields. France and Germany have loosened their visa regulations to attract foreign professionals in technology-related areas, and in 2000, the United States introduced an amendment to its immigration laws that made available 600,000 new visas for scientists and engineers. World Bank, Constructing Knowledge Societies: New Challenges for Tertiary Education 17 (2002), *available at* http://www1.worldbank.org/education/tertiary/documents/Constructing%20Knowledge%20Societies.pdf.

79. *India to Give 106 Million Dollars in Grants to Tech Colleges in 2003*, AGENCE FRANCE PRESSE, Dec. 31, 2003.

80. U.N. INDUS. DEV. ORG. (UNIDO), AFRICA FOREIGN INVESTOR SURVEY 46 (2003).

81. These include: food and drink; other chemical products; agriculture and tobacco; wearing apparel; wood, pulp and paper products; metal products; machinery; and financial intermediation, which together make up over sixty percent of all investment in the region. *Id.* at xi.

private sector. In addition, the inability of the government and NGO sectors to absorb the increasing number of university graduates with training in the humanities, social sciences, and law creates a disincentive for individuals to invest in higher education, as they are increasingly confronted with evidence that this investment will not guarantee them a position sufficiently well paid to compensate for the opportunity cost of education. The benefits that are created by continuing to fund the effective NGOs must be weighed against the negative effects of perpetuating these economic distortions.

B. Weakening Governments

In addition to the negative economic effects, the continued funding of NGOs in the LDCs has both direct and indirect effects on the strength of developing country governments. The most immediate and obvious impact of the focus on the NGO sector has been the reallocation of financial and human resources away from the state. The focus on NGOs resulted in a dramatic loss of funding for developing country governments. In the early to mid-1990s, NGOs were responsible for between ten and fifteen percent of all aid transfers to developing countries.[82] The United States government allocates an even larger proportion of its aid funding, nearly forty percent, through NGOs.[83] At a time when donor demands have increased, developing country governments are faced with diminishing resources with which to accomplish their goals. Responding to these budget constraints, government leaders "have preferred to spend their money to keep their elite coalition together rather than invest in mundane activities like building schools or undertaking vaccine campaigns, particularly given the donor predilection for such thankless tasks."[84] By redirecting funds to the NGO sector, donors have provided recipient governments both with the incentive and the excuse to abdicate their role as the primary provider of public services.

Skilled human capital has followed the flow of funds. Following the structural adjustment programs of the 1980s, NGOs have emerged as the largest non-state employer in most African economies, and many graduates now consider employment in this sector more prestigious than employment in the public sector.[85] NGO salaries have had a negative effect on government capabilities, as the most competent and qualified individuals have left the civil service for more lucrative positions.[86] One World Bank project in Kenya offered salaries of $3000 to $6000 per month, in comparison to a total compensation package of $250 for a senior economist in the civil service.[87] This kind of pay differential is "probably fairly common throughout the region and explains the substantial loss of senior decision makers from so many African government bureaucracies."[88] Drawn by increased autonomy and improved salaries, many career civil servants have left the government to start their own NGOs.[89] In Niger, "the majority of NGOs appear to be operated by moonlighting civil servants and ex-ministers of cabinet."[90] Draining the public sector of its most experienced

82. OVERSEAS DEV. INST., THE IMPACT OF NGO DEVELOPMENT PROJECTS (1996), *available at* http://www.odi.org.uk/publications/briefing/2_96.html.

83. Mangi & O'Coill, *supra* note 2, at 580.

84. VAN DE WALLE, *supra* note 36, at 164.

85. *Id.* at 58.

86. *See id.* at 204.

87. L.S. Wilson, *Kenyanization and African Capacity "Shuffling,"* 13 PUB. ADMIN. & DEV. 489, 493 (1993) (discussing the difficulty in retaining Kenyan civil service employees).

88. VAN DE WALLE, *supra* note 36, at 204.

89. *Id.* at 165.

90. *Id.*

staff, as well as the most skilled new graduates, has diminished governmental capacity and contributed to the weakening of state institutions. The result of this resource diversion is that "African states have increasingly lost authority to determine both the direction of social development and also the content of social policy."[91] Attempts by African governments to conduct aid oversight and monitoring, even of donor-funded projects associated with the central government, have generally failed.[92] The channeling of funds to NGOs has only exacerbated this problem, furthering marginalizing African governments in the development plan. In addition to the problems created by reallocating essential resources away from the government, funding NGOs is weakening the state by interfering with the development of a healthy indigenous civil society—a goal that the funding was intended to promote.

NGOs play a developmental role well beyond service provision. These organizations are expected to be (and in many cases are) essential participants in a developing country's civil society.[93] In weak democracies or semi-authoritarian states, NGOs provide a voice for local populations unable to speak through more traditional channels. Successful NGOs can "act as a counterweight to state power—protecting human rights, opening up channels of communication and participation, providing training grounds for activists and promoting pluralism."[94] Developing country NGOs' increasing professionalism and dependence on donors has become a cause of concern for development practitioners and theorists. Reliant on donor funding for survival, NGOs struggle to be responsive to the different demands of their funding sources and beneficiaries.[95] Growing dependence on official aid has also impacted negatively the willingness and ability of NGOs to take positions that are controversial or unpopular with governments.[96] Ironically, the funding that is intended to promote the development of a healthy civil society through strengthening its institutions is actually having the opposite effect.

This effect should be of particular concern to donors if the NGO sector is, as I have argued, currently monopolizing the services of the educated entrepreneurial class. If the NGO sector is focused on exporting international public goods to the satisfaction of international donors, it can no longer be responsive or accountable to the needs and preferences of the domestic population, except insofar as domestic and international desires overlap.[97] Without an active and independent civil society sector to represent diverse

91. Mangi & O'Coill, *supra* note 2, at 580.

92. *See* VAN DE WALLE, *supra* note 36, at 204–05.

93. M. Moore, *Good Government?: Introduction*, 24 IDS BULL. 1–6 (1993).

94. Edwards & Hulme, *supra* note 5, at 4.

95. Edwards and Hulme define accountability as "the means by which individuals and organisations report to a recognised authority, or authorities, and are held responsible for their actions." *Id.* at 9.

96. Michael Bratton, *Non-Governmental Organizations in Africa: Can They Influence Government Policy?*, 21 DEV. & CHANGE 87, 102–05 (1990) (discussing the dependence of Kenya's Voluntary Agencies Development Assistance (VADA) on USAID and its consequent limitations). This phenomenon has been observed in the U.S. context as well. The largest U.S. development NGOs, which are primarily dependent on government funding through USAID, generally avoid political activism or campaigning. *See* BRIAN H. SMITH, MORE THAN ALTRUISM: THE POLITICS OF PRIVATE FOREIGN AID 171–211 (1990); LESTER M. SALAMON & HELMUT K. ANHEIR, THE THIRD ROUTE: SUBSIDIARITY, THIRD-PARTY GOVERNMENT AND THE PROVISION OF SOCIAL SERVICES IN THE UNITED STATES AND GERMANY (1993) (report to OECD); STEVEN R. SMITH & MICHAEL LIPSKY, NONPROFITS FOR HIRE: THE WELFARE STATE IN THE AGE OF CONTRACTING 135 (1993).

97. The anti-democratic potential of international NGOs has been discussed at length by conservative commentators as part of the broader debate about the democratic legitimacy of international law. Kenneth Anderson notes that despite representing themselves as delegates of "international civil society," "'international NGOs' are not very often connected, in any direct way, to masses of 'people.' International NGOs, in virtue of their role to operate globally rather than locally, are fundamentally elite organizations." Kenneth Anderson, *The Ottawa Convention Banning Landmines, the Role of International Non-governmental Organizations and the Idea of International Civil Society*, 11 EUR. J. INT'L L. 91, 117 (2000). Concern about the transparency of international

voices, these needs and preferences may be hard to identify. As grassroots organizations scale up to access available donor funding, the "voice of the people" becomes increasingly more difficult to hear.

Impeding economic development also has important secondary effects on civil society development. A presence of an urban middle class has consistently been found to be an important force in democratic transition and consolidation because it "enjoy[s] a degree of independence vis-à-vis the traditional landed groups that often dominate the economic and political life of less developed societies, and [has] an interest in forming professional associations and other interest-based organizations."[98] The economic effect that I have described is therefore also contributing to the crowding out of an indigenous civil society sector, which is economically independent both from the state government *and* from donor governments. Donor efforts to create a functioning civil society may actually be contributing to the "democracy deficit" in the LDCs.

IV. CONCLUSIONS AND SUGGESTIONS

In this article, I have argued that donors should take a closer look at the strategy of institutional substitution and its effects on the overall development agenda. Through the discussion of a theoretical framework that links the economic conditions within which nonprofits operate to the ability of these institutions to operate effectively, I have demonstrated that attempts to bypass weak institutions by creating donor-sponsored substitutes is an ineffective and counterproductive strategy. By funneling increased funding into the NGO sector, donors are distorting the incentives that permit nonprofit organizations to provide goods and services more effectively than their state or private sector counterparts. Additionally, by making opportunities in the NGO sector attractive as compared to other career options, the development community is channeling skilled human capital into a sector that cannot and should not be the locus of economic growth. This impedes the realization of economic *and* social development objectives far into the future.

The problem is obviously multifaceted and cannot be solved unilaterally within the NGO and donor community. However, the NGO and donor community should not allow the complexity of the problem to serve as a justification for continuing on its current path. Ultimately, I have argued, for NGOs to be optimally successful in their numerous, more specialized goals (in human rights, education, public health and environmental protection, for example), a self-selection process that ensures the presence of committed individuals in this sector will have to be reintroduced. If I am correct that the overinvestment in the NGO sector is impeding economic growth and state development, then donors cannot afford to proceed with their current strategy and wait for the private sector and the state to catch up. Rather, the self-selection process must be instituted in the present to create the proper incentives for NGO operations. The overarching lesson for donors is that attempting to use NGOs as quick-fix substitutes for government and private sector institutions is likely to fail—and will impede the future development of these organizations.

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institutions led to the founding of NGO Watch. A project of the American Enterprise Institute and the Federalist Society, NGO Watch is dedicated to "[h]ighlighting issues of transparency and accountability in the operations of non-governmental organizations (NGOs) and international organizations (IOs)." NGO Watch, http://www.ngowatch.org (last visited Mar. 31, 2006). The anti-democratic potential of funding indigenous NGOs has received less attention, perhaps because building civil society organizations is viewed as inherently good for a developing democracy.

98. THE NONPROFIT SECTOR IN THE DEVELOPING WORLD, *supra* note 43, at 7.

Reintroducing the self-selection process requires both short and long-term adjustments in donor strategy. In some countries, this can be done by lowering wages of both developed and developing country professionals, so that nonprofit workers earn the equivalent of other professionals in their local communities. NGO jobs should not be a source of windfall profits, either to developing or developed country professionals. Generally, however, reducing incomes is not a strategy for development—a more holistic approach is necessary to create the three sector economy in which NGOs can occupy and fulfill their appropriate role. My suggestions, therefore, are based on the idea that for NGOs to work properly, equal or greater investments must be made into developing state and private sector institutions. In institutional development, as in economic development, a sequencing of development objectives is a necessary prerequisite to their success.

The donor community should reconsider its funding priorities to make private sector opportunities more accessible—and to make them *seem* more accessible to students selecting their career paths. There are a number of ways to pursue this strategy, most of which have been presented in other contexts, but the approaches take on new urgency given the thesis presented here. First and most obviously, governments and donors must streamline registration processes and increase investment capital for new businesses to encourage private sector entrepreneurship. Both this problem and the barriers to its resolution have been discussed extensively elsewhere.[99] However, by making aid funds for small and medium enterprise development contingent on the availability of more efficient registration processes, donors would create a strong incentive for recipient governments to prioritize reforms in this area. Working directly within universities to create demand for this kind of funding for entrepreneurs, and the ability to use it effectively rather than setting up new NGOs to disburse it, would improve the funding and institutional capacity of the university system and create other spillover benefits. Donors could help to create industry/university partnerships to improve the quality and applicability of education and to provide incentives for students to study those fields most likely to lead to productive employment after graduation.

These kinds of business development activities will clearly need time to take root. In the meantime, donors could limit the distortionary impact of their funding on the NGO sector by recognizing the profit motive of many NGO entrepreneurs and restructuring their relationship with these organizations accordingly. Some of the service activities currently provided by developing country NGOs, particularly those which are not "true" public goods NGOs, could be provided, at least to certain populations, by private for-profit organizations. Donors could create competitive markets for funds to provide these services, to encourage efficiency and to train NGO entrepreneurs to compete. As the theory suggests, this would require increased monitoring to ensure contract compliance. Donors could build administrative capacity in developing country governments by partnering with them to develop the capacity for regulating and monitoring, with the ultimate eventual goal of transferring control of these programs to the state.

Some services cannot be provided through a for-profit model. In these cases, donors should consider ways to strengthen the other factors that Hansmann argues help enforce the non-distribution constraint in the nonprofit organization: normative constraints and legal sanctions.[100] Donors should limit the direct funding provided to local NGOs, as well as the hiring of local entrepreneurs, to avoid corrupting true grassroots organizations and distorting the labor force. While increasing local participation was intended to improve accountability and performance, there is little evidence that it has done either. As suggested

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99. *See, e.g.*, Djankov et al., *The Regulation of Entry*, 117 Q.J. ECON. 1 (2002).

100. *See* Hansmann, *supra* note 24, at 873–75.

above, the evidence points in the other direction—donor funding tends to detach indigenous organizations from their grass roots and to encourage opportunism, rather than social commitment, among entrepreneurs. This cultural change is damaging to the NGO culture.[101] One possible strategy would be for donors to require that NGO recipients match donor funds (at least minimally) with funds raised domestically, and that local NGOs develop a plan for sustainability over time. This could help improve the problem of dual accountability by ensuring that those projects that donors want to fund have at least some local support, and it would encourage recipients to provide services that are desirable to the local population. This is not an impossible outcome—a recent study of Bangladeshi NGOs demonstrated that the majority of large NGOs now are funded mainly through payments from the local population for the services they provide.[102]

Hansmann also suggests that legal sanctions play a role, albeit a limited one, in discouraging abuse of the nonprofit organization. Donors and developing country governments should partner to put in place a more effective system for monitoring the expenditures of local NGOs. Requiring recipient NGOs to spend at least seventy percent of their funds on projects and limiting their administrative and overhead costs is not unreasonable, but is difficult to enforce remotely. Donors have generally been suspicious of government attempts to regulate the NGO sector because the rules can be used to target and harass organizations that criticize the government. Joint monitoring strategies would allow donors to have more legitimate input in the development of NGO regulation, while simultaneously involving the recipient country government more deeply in the allocation and use of aid funds.

The aforementioned matching strategy would also serve an informal monitoring function. Anecdotal evidence suggests that local populations are very aware of which NGOs are providing useful goods and services and which are primarily dedicated to enriching their employees. Often the situation is apparent simply from looking at the building in which the NGO operates and the vehicles driven by the staff. By requiring matching funds, donors could get a good sense not only as to what issues are prioritized by the community, but also which organizations are best fulfilling their mission.

The uncomfortable result of this suggestion is that some kinds of NGO activity would not survive in the short run because the perceived benefits are not important to (or at least not a priority of) the local population. While painful for well-intentioned donors, this is a good short-run outcome. Causes that lack domestic support are unlikely to be highly successful, regardless of the level of donor funding. Listening to local populations and calibrating funding to match their priorities and desires is more likely to lead to successful project outcomes and is more respectful of the ultimate donor goal of self-determination.

Increased monitoring is an inherently limited solution. As noted earlier, most attempts by African governments to create systems of aid monitoring have failed, in part due to limited managerial capacity and in part because the regulations went against patronage norms. Botswana is a notable exception in that "the government was able to institute and enforce a disciplined system in which all aid was carefully integrated into the

101. Several commentators have noted the predominance of informal norms over formal law within communities. *See generally* ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES 4 (1991) (claiming that large segments of social life are located and shaped beyond the reach of law). An established culture of opportunism incentives will therefore be difficult to counteract through monitoring and regulation.

102. Gauri & Galef, *supra* note 8, at 2046.

indicative planning process."[103] The implementation of the system led to good outcomes in aid-funded projects and to sustained economic growth that is unrivaled in sub-Saharan Africa.[104] Botswana's ability to run an effective monitoring system is attributed to the relatively strong institutional capacity of the state.[105] The Botswana example supports the thesis that I have presented here. Institutional substitution simply doesn't work as a development strategy. In countries with weak state capacity, new donor-funded NGOs replicate the existing institutional weaknesses in a new form. In countries with strong governments and growing private sectors, aid to NGOs can have a real positive impact. While I have offered a number of short-term policies suggestions to help correct the distortions created by current aid policy, fundamentally I have presented a case for shifting the focus back to developing state and private sector capacity. Institutional development is challenging, but essential, and attempts to bypass this stage will ultimately fail.

103. *See* VAN DE WALLE, *supra* note 36, at 206.

104. *Id.*

105. *See id.* ("Botswana has possessed effective leadership and a relatively stable and legitimate government genuinely committed to promoting economic development.").