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Mutual Interest Development Cooperation: Aligning Incentives in a Fragmenting World

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Executive Summary

We propose Mutual Interest Development Cooperation (MIDC) as a new template for development cooperation that aligns incentives between donor countries and partner countries, restores political legitimacy, and improves long-term effectiveness. MIDC is a high-level governance model, not a one-size-fits-all instrument. It sets out a coherent set of principles and rules that governments and institutions can apply in ways consistent with their institutional structures and political contexts. The core elements of this approach are summarized below.

Background

- Development cooperation will not remain politically viable unless it delivers visible, credible returns for both partner countries and donor societies. Aid has improved lives, but it has often not succeeded in fostering structural transformation and sustained economic growth for recipients while providing donor-side benefits visible to voters.
- The central failure of past aid models is misaligned incentives, not insufficient spending or knowledge. Previous approaches have all failed to create durable reform incentives for governments at scale and have received fragile political support in donor countries.

Proposal

- MIDC introduces mutual interest as a rule-based organizing principle for development cooperation. Every program is assessed for its developmental value to the partner country's population and its tangible return to donor country citizens. A transparent mutual interest filter determines which partnerships are eligible, how deep cooperation can go, and how scarce resources are prioritized.
- MIDC replaces ad hoc conditionality with an opt-in, tiered partnership model linked to verified reform performance. Partner governments opt in when their own reform trajectories align with MIDC's principles and demonstrate this through observable signals such as transparent governance. Donors, in turn, commit to predictable multi-year support once those signals are verified. Governments advance through tiers based on observable reform efforts, with adjustments governed by pre-announced rules and applied to future commitments.

How MIDC works

- Scarce concessional finance is allocated by joint returns and marginal impact in partner countries. Reform-oriented countries in the highest tier are prioritized. Global public goods are protected across tiers as they create mutual benefits even under weak governance. Basic human development investments such as childhood immunization are also eligible; they often generate high long-run developmental returns, while providing indirect donor-side benefits. Humanitarian assistance remains fully separate from MIDC incentives to guarantee a basic safety net

- A pooled Mutual Interest Fund anchors MIDC financially and enables scale. Pooling allows like-minded donors to overcome coordination failures. Collectively, they are less limited by regional or political focus and can back a larger set of reform-oriented partner countries. It also enables donors to provide predictable multi-year support to reformers and reduces exposure to short-term political cycles.
- Transparency plays a central role in MIDC. Published rationales, documented donor and partner benefits, and publicly visible tier status limit discretion, expose exceptions, and strengthen accountability to citizens, markets, and other governments.

What MIDC offers

- MIDC builds on existing reform-oriented approaches such as the Millennium Challenge Accounts and the Compacts with Africa. By creating long-term incentives for reforms and taking donor-side benefits into account, it provides a more coherent, scalable, politically sustainable model of cooperation.
- MIDC is not a new objective for development policy, but a systematic response to its most persistent failures. By aligning reform incentives with political sustainability and mutual benefit, it makes development cooperation more effective, defensible, and durable in a more contested global environment.

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Chapter 1: Why We Need a New Aid Model

Aid has delivered important improvements, but little transformation

Development assistance has always reflected the priorities of global politics. During the Cold War, it was mainly used to secure allies. In the 1980s and 1990s, it became an instrument of structural adjustment, tying support to market reforms and fiscal discipline. From the 2000s onward, development cooperation shifted toward a more altruistic frame and a focus on more effectively achieving improvements in human development, in particular reducing poverty, made transparent and measurable through the Millennium Development Goals.

The achievements of past aid efforts should not be dismissed. Human development outcomes have improved markedly in many areas. One example of a widely agreed-upon indicator is maternal mortality, which has declined substantially: globally by roughly one-third since 1990, and in Africa by more than half from a much higher base. Access to basic services such as primary education has improved significantly (UNESCO 2024). These gains demonstrate that development cooperation can be effective in improving key outcomes.

At the same time, these achievements have often not translated into structural transformation. Recent trends in food security illustrate the fragility of progress. In Sub-Saharan Africa, the share of undernourished people increased from 17.8 percent to 23.2 percent between 2013 and 2023 (FAO et al. 2024). With population growth, this corresponds to an additional 146 million undernourished people, most of them in countries that received large aid flows but failed to achieve sustained per capita growth.

This pattern is widely acknowledged in the academic and policy literature. Hundreds of studies converge on the finding that while aid improves specific outcomes such as health and education, it rarely triggers the productivity growth, diversification, and institutional change required for lasting prosperity (Burnside and Dollar 2000; Rajan and Subramanian 2008). Recent work further argues that aid design itself has contributed to this by systematically favoring short-term delivery over the foundations of growth (Wantchekon 2026). The core challenge is therefore not whether aid can work, but whether it can support the deeper transformation that helps countries grow beyond aid.

The Core Failure: Misaligned Incentives

The limited transformational impact of aid is closely linked to a misalignment of donor and partner country incentives. For much of the 1980s and 1990s, donors relied heavily on policy conditionality, tying disbursements to reforms in fiscal policy, trade, or regulation. In theory, conditionality was meant to induce reforms by allowing donors to enforce compliance through conditional tranches. In practice, conditionality often led to formal commitments with limited follow-through. Political constraints in partner countries, combined with weak donor enforcement and competing priorities, made reforms costly, while donors frequently failed to sustain enforcement when reforms stalled or proved politically inconvenient (Dercon 2022, 2025).

As confidence in conditionality eroded, donors increasingly turned to unconditional or weakly conditioned transfers. While these approaches reduced conflict and improved short-term delivery, they also weakened reform incentives. Resources flowed without necessarily strengthening domestic accountability or supporting politically difficult reforms. In neither case did aid reliably align incentives on both sides of the relationship.

Attempts to improve effectiveness through better design and monitoring at the project level did not resolve this problem. Instead, by improving one program at a time, the system became increasingly fragmented. Thousands of small, siloed projects emerged, each with their own objectives and reporting burdens and frequently disconnected from recipient countries' broader national reform agendas. The resulting system is administratively busy but brittle.

When Development Cooperation Works: Aligned Incentives and Mutual Interest

Historical experience shows that when incentives are aligned, assistance can contribute to lasting transformation. Post-war South Korea offers a clear illustration. Devastated in the early 1950s, South Korea combined long-term external support, initially mainly from the United States and later through multilateral channels, with domestic reform, export orientation, and institution building. Over two decades, aid financed reconstruction, human-capital investment, and infrastructure that enabled rapid industrialization.

Crucially, this support was embedded in a strategic relationship based on mutual interest. For South Korea, external finance complemented domestic reform incentives and supported a long-term development strategy. For donors, assistance contributed to the emergence of a stable economic partner and a geopolitical ally. The result was not only a dramatic rise in living standards but also durable political and economic ties. While South Korea's trajectory was in part context-dependent, it illustrates a general principle: When domestic reform incentives are reinforced by external finance that is part of a broader, mutually beneficial relationship, development cooperation can yield enduring economic and political benefits for both sides.

However, experiences like South Korea's remain rare. In the absence of aligned incentives and visible mutual returns, aid has come under political pressure.

Lack of Political Sustainability in Donor and Partner Countries

The incentive failures and lack of transformative impact of traditional aid models have translated into political vulnerability. Large shares of donor-country publics question the use of funds for ODA, perceiving a lack of sustainable impact.

Survey evidence underscores this erosion of confidence. Data from the Development Engagement Lab shows persistently low perceptions of aid effectiveness across major donor countries. In mid-2025, only 19 percent of respondents in Great Britain, 22 percent in France, and a third in Germany and the United States consider ODA to be effective or very effective. In Germany, just 16 percent believe German ODA gets to where it is needed (Development Engagement Lab 2025). At the same time, broader domestic pressures have intensified. At times of economic stagnation and increased security needs in most donor countries, large shares of voters want to focus spending on domestic priorities (Bruder et al., 2024). Support for maintaining or increasing aid budgets has declined markedly in all four countries. In France and Germany, where support remained above 65 percent through 2022, support dropped to 56 percent and 53 percent respectively in 2025 (Development Engagement Lab 2025).

Criticism is not limited to donor countries; partner country publics also take a critical view of aid. While acknowledging the benefits aid can have, the overall view of development aid in partner countries is mixed. At its core, the current system is still perceived as reflecting a structural asymmetry where donors finance and set priorities, while recipients implement them. This limits ownership, can weaken incentives for sustained reform, and undermines the durability of cooperation. Other significant criticisms that frequently get noted in partner countries are the risk of fostering corruption and perceived intransparency. In a survey experiment of public attitudes towards foreign aid in seven developing countries, Kim et al. (2025) show that people have a strong preference for democratic and transparent donors.

In this environment, development cooperation is perceived in many countries either as a charitable transfer or as a form of elite diplomacy that does not benefit ordinary people. Neither provides a politically sustainable foundation. Without demonstrable and visible returns that resonate with domestic constituencies, development assistance becomes highly vulnerable to budget cuts and policy reversals, particularly during crises.

A More Demanding Global Context

These domestic pressures coincide with a far more challenging international environment. The post-Cold War consensus around the Millennium Development Goals (MDGs) and Sustainable Development Goals (SDGs) has fractured. Multilateral institutions that once structured cooperation are gridlocked. The United States has stepped back from its leading role. China has expanded its influence through large-scale finance and infrastructure, offering an alternative model much more focused on self-interest as well as the economy-related investment that partner countries are seeking. Regional powers such as the Gulf states deploy aid and investment to pursue economic diversification and geopolitical ambitions.

Meanwhile, long-term global challenges such as climate change, the risk of pandemics, and displacement have intensified. Taken together, these pressures do not merely add complexity; they also raise the bar for political sustainability. In a world of competing offers and constrained budgets, development cooperation must be credible, incentive-aligned, and defensible, if it is to endure.

The Response So Far

Recognizing the limitations of conditionality, some donors have already shifted toward more incentive-compatible approaches. Rather than attempting to induce reform through ex ante policy conditions, these initiatives direct support toward governments that demonstrate reform commitment. This reflects a recognition, prominently captured in the World Bank's Assessing Aid report (Dollar and Pritchett 1998) and related academic studies (e.g., Burnside and Dollar 2000), that aid tends to be more effective in countries with stable macroeconomic policies, institutional reform momentum, and the political commitment of ruling elites that has been termed a "development bargain" (Dercon 2022).

This logic underpins more selective models. The U.S. Millennium Challenge Corporation created a formal entry system based on governance and policy performance indicators. The G20 Compact with Africa aimed to align investment support with national reform agendas. Germany launched bilateral Reform Partnerships that tied additional funding to investment in climate or fiscal governance improvements. These approaches shared a core idea: Aid should reinforce reforms and set incentives for additional countries to undertake them.

Yet this selectivity remained partial and inconsistent. Donors apply different criteria, at times with limited transparency. Coordination across funders is weak, while safeguards against political reversals and exit mechanisms are underdeveloped. Most importantly, selective approaches remain niche within a broader system still dominated by traditional modalities. As a result, their incentive effects remain limited so far.

What Is Missing and Why We Need Mutual Interest Development Cooperation

What has been missing is a system that aligns incentives on both sides of development cooperation. Partner governments need assistance that supports their reform priorities and offers predictability over political cycles. Donor governments need a strategy and evidence of returns they can credibly explain to parliaments, taxpayers, and the broader public.

These returns do not have to be uniform. For partner countries, they include revenue gains, institutional consolidation, and resilience. For donor countries, they can take the form of economic opportunities, geopolitical or security and stability-related benefits, and reduced spillover risks. The Mutual Interest ODA framework developed by Heidland, Schularick, and Thiele (2025) formalizes this insight by classifying aid relationships according to benefits for recipients and donors and identifying where interests overlap most strongly.

Mutual Interest Development Cooperation (MIDC) builds directly on that foundation. It makes mutual interest an organizing principle that guides allocation and delivery. Aligning support with verified reform orientation and embedding cooperation in a framework of shared gains, MIDC aims to maximize developmental impact while maintaining broad political support in donor countries by lowering the political cost of sustaining effective, long-term cooperation. In doing so, it does not introduce a new goal for development cooperation. It rather provides a systematic response to the incentive and legitimacy failures that have become impossible to ignore.

Chapter 2: What Mutual Interest Development Cooperation Is and How It Works

Development cooperation systems differ widely across donors. The approach set out below therefore does not offer a full operational blueprint. Instead, it proposes a high-level governance model and a set of principles that countries and institutions can apply in ways consistent with their institutional structures and political contexts. The aim is to provide a coherent framework that can guide reform discussions and choices.

2.1 The Core Rationale and Logic: Mutual Interest as a Filter

Mutual Interest Development Cooperation (MIDC) starts from a simple proposition: Cooperation becomes politically stable only when it creates visible, verifiable gains for both donors and partners.

Three issues have kept traditional aid from achieving this stability. The first is the lack of a transformative impact. While decades of assistance improved living standards, few countries managed the sustained productivity growth, diversification, and institutional capability that underpin durable prosperity. Evidence from multiple studies (e.g., Rajan and Subramanian 2008) shows that long-run growth correlates less with the amount of aid received than with the consistency of domestic reform and policy credibility. Recent work highlights that aid design itself contributes to this gap, arguing that development assistance has systematically underinvested in higher education, innovation systems, and research in partner countries, prioritizing short-term delivery and goals over the foundations of productivity growth (Wantchekon 2025).

The second is the deficit of incentive alignment. Traditional conditionality required governments to reform before receiving support, but donors rarely maintained their commitments when reforms proved politically costly and were delayed. Conversely, unconditional grants offered resources without strengthening reform incentives (cf. Dercon 2022, 2025). MIDC replaces both approaches with opt-in reciprocity: Governments that demonstrate reform gain access to deeper cooperation under pre-announced rules. This provides incentives for reform and allocates scarce funds to where they have the strongest impact.

The third deficit concerns legitimacy. In many donor countries, citizens perceive aid as either moral charity or political favors for elites in the partner country. Both narratives weaken the public mandate for international cooperation. For sustained, broad-based support, donor governments must be able to demonstrate tangible domestic returns (economic, political, or security and stability-related) that voters can recognize. Without such benefits, fiscal and political backing for ODA may erode quickly at times of crisis, despite widespread support for some goals such as reducing child mortality.

MIDC addresses these gaps by applying mutual interest as the filter for cooperation. Every engagement must deliver real developmental value to the partner country and tangible returns to the donor. This approach transforms aid from a discretionary transfer into a rules-based investment partnership. Reciprocity replaces conditionality, predictability replaces discretion, and shared outcomes replace unilateral objectives. By grounding cooperation in measurable common benefits, MIDC aligns political realism with developmental purpose and restores credibility to a field that has lost both momentum and trust.

This is a break with previous aid models, which have swung between two poles. The needs-based aid approach of the 2000s achieved clear returns for partner country populations in terms of human development outcomes, e.g., in health, education, and poverty reduction, but rarely delivered the structural transformation required for countries to grow beyond aid, nor were many of the returns appreciated by a broad coalition of voters in the country. Politically driven aid, in turn, often secured temporary alliances (Bau and Dietrich 2025) but these at times came at the cost of developmental returns. The same is true for self-interested, economically motivated forms of aid.

2.2 Core Principles

MIDC regards **structural transformation** as the explicit long-term objective of development cooperation, while also securing **human development** and providing humanitarian relief when necessary. These elements complement one another: they protect lives, sustain progress, and create the foundations on which transformation becomes possible. MIDC therefore embeds all three purposes in its logic, even though the instruments and scope differ by partnership tier (see below).

Since development cooperation is (mainly) concessional and purpose-bound, donor self-interest must not override developmental value. Where donor objectives, such as the pursuit of strategic, commercial, or migration-related objectives, conflict structurally with developmental purposes, other foreign policy, trade, or security instruments– not ODA –should be used. Development cooperation that fails to address local needs is also unlikely to generate lasting mutual benefits. Only when it strengthens partner economies, institutions, and resilience do the direct and indirect gains for donors become durable (Heidland et al. 2025). As concessional finance is not grounded in reciprocity but in an assignment of purpose, it remains politically vulnerable when citizens perceive it as ineffective, poorly targeted, or captured by other interests. Purely strategic or elite-focused uses of development cooperation tend to weaken, rather than strengthen, the soft power and trust that development cooperation is meant to foster. A credible model must therefore satisfy two requirements: it must produce substantial developmental benefits for partner populations and be publicly defensible in donor countries.

Mutual Interest Development Cooperation rests on **three interlocking principles**: the mutual interest filter, its transformative purpose, and opt-in reciprocity. Together, these distinguish MIDC from earlier aid paradigms that relied on either needs-based allocation or conditionality without credible commitment.

The first principle, the **mutual interest filter** (Section 2.3), ensures that cooperation generates measurable benefits for both sides. Every program is assessed for its developmental value to the partner country's population and its tangible return to donor country citizens. Developmental value refers to gains in human development, income, institutional strength, or resilience. Returns to donors include enhanced economic links, diplomatic or geopolitical benefits, and greater stability or security (cf. Heidland et al. 2025). Projects that yield high returns to both sides are prioritized. Projects with weak or one-sided benefits are redesigned or phased out. This filter operationalizes the political economy insight that sustained cooperation requires visible domestic legitimacy in both donor and recipient countries.

The second principle, **transformative purpose**, means using development cooperation to achieve greater productivity growth, stronger institutions, and build resilience to shocks such as climate change, pandemics, or displacement so countries can grow out of aid over time. The objective is not to provide perpetual support or to deliver isolated sectoral gains but to help reforming countries achieve structural change that makes external assistance unnecessary over time. Under this logic, aid serves to support and de-risk domestic reform rather than to substitute for it. The desired endpoint is self-reliance, with countries becoming stable economic and political partners rather than recurring aid recipients. Hence, making countries independent of ODA is the aim and a clear benchmark for success, with graduation from aid dependency something to celebrate for donor countries and partner countries alike. While achieving structural transformation is the ultimate goal of development cooperation, many partner countries fall far short of meeting the necessary preconditions but still qualify for emergency relief or for interventions in education, health, and nutrition that foster human development.

The third principle is the **tiered, opt-in character of MIDC** (Section 2.4). Rather than conditioning disbursements on ex ante promises, MIDC functions as a standing offer with different levels of partnership. Partner governments opt in when their own reform trajectories align with MIDC's principles and demonstrate this through observable signals such as fiscal discipline, transparent governance, or investment climate reforms (cf. Dercon 2025). Otherwise, they can choose levels of partnership that imply fewer funds. Donors, in turn, commit to predictable, multi-year support once those signals are verified. Otherwise, they only conduct arm's-length work, which may in some countries even largely avoid the central government. This approach clearly prioritizes limited development funds to be used mainly in the most promising partnerships while creating an incentive for partner countries to qualify for the more reform-oriented partnership tiers. This provides a transparent strategy that donor country governments can easily explain to their voters. The opt-in character of MIDC replaces traditional conditionality with earned partnership.

2.3 The Mutual Interest Filter

At the core of MIDC is a mutual interest filter. No cooperation qualifies unless it delivers substantial benefits for both recipient and donor governments. The concept originates in the Mutual Interest ODA framework suggested by Heidland et al. (2025), which classifies aid across three axes: domain (economic, political, security), timing (short vs. long-term), and directness (direct vs. indirect). Donor benefits fall into three domains:

- **Economic**: Increased trade, procurement linkages, and future investment opportunities (e.g., aid-for-trade programs that expand export markets while enabling industrial upgrading in recipients);
- **Security and Stability**: Prevention of fragility and spillovers (e.g., post-conflict stabilization programs that reduce displacement and transnational threats);
- **Global Public Goods and Soft Power**: Pandemic preparedness, climate mitigation, and effective aid that increases donor legitimacy (e.g., vaccination infrastructure with high benefit-cost ratios for both sides).

This structure ensures that global public goods are not crowded out. Where cross-border benefits are large and verifiable, such as pandemic control or climate mitigation, programs pass the mutual interest filter even when domestic governance is weak.

Mutual interest does not imply that all donors weigh benefits in the same way. Donor countries differ systematically in how strongly they prioritize domestic benefits relative to partner-country development. MIDC accommodates this heterogeneity: It requires that both types of benefits be present and measurable for any program to qualify, while allowing donors to vary in how the balance between these dimensions shapes their allocation choices, sectoral priorities, and political justification at home. This flexibility makes the mutual interest filter applicable across donor countries with different preferences and political situations, while preserving the developmental integrity of cooperation.

The filter serves both as a gatekeeping and ranking tool. Programs must demonstrate measurable benefits for both sides and are ranked ex ante by the strength of joint returns. Projects below a defined threshold are redesigned or dropped. This turns the concept of mutual benefit into an allocation rule that prevents politically convenient but low-impact projects from crowding out reform-oriented ones.

To apply the filter credibly, each proposed program must make these benefits explicit. Expected donor benefits and supportive evidence for these expectations should be documented ex ante and updated during implementation cycles. At a minimum, this is a qualitative component of the theory of change, now covering the donor country as well. Where possible, it draws on rigorous quantitative evidence, thus enabling the specification of clear thresholds for passing the mutual interest filter, improving selectivity and contributing to greater program effectiveness. Requiring explicit documentation of both donor and partner benefits makes exceptions visible rather than implicit. This also follows the Development Assistance Committee (DAC) principle of mutual accountability by making both partner and donor-side rationales transparent so that cooperation can be jointly assessed against declared objectives.

2.4 A Menu of Partnership Options

A tiered partnership menu translates the principle of mutual interest into a structured and predictable framework for allocating cooperation according to reform commitment and shared benefit. It merges the analytical foundations proposed by Heidland et al. (2025) with the political-economy approach developed by Dercon (2025), which stresses that effective aid must align incentives, reward reformers, and avoid entrenching dependency. MIDC systematizes long-standing selectivity practices (e.g., the International Development Association's (IDA) performance-based allocation, Country Policy and Institutional Assessment (CPIA) anchored assessments, and EU budget support eligibility) into a single, shared framework that multiple donors can apply consistently. In operational terms, MIDC also builds on earlier G7 and G20 initiatives, such as the Compact with Africa, Germany's *Reform Partnerships* and the U.S. Millennium Challenge Corporation, which demonstrated that credible, rules-based selectivity can both strengthen domestic reform incentives and sustain donor legitimacy.

MIDC defines four partnership tiers reflecting reform orientation and institutional capacity. The system also safeguards investments in global public goods, which remain eligible for cooperation even in weaker governance settings. These tiers form a predictable pathway for movement: Reformers progress through verified performance, while regressions trigger transparent adjustments in the opposite direction.

Comprehensive Reform Partnerships (Tier 1) are available to countries whose governments have demonstrated sustained commitment to a "development bargain": credible fiscal management, stable macroeconomic policy, transparent budgeting, and institutional reforms that enhance accountability and investment. In these contexts, cooperation takes the form of long-term, multi-donor envelopes, typically lasting at least ten years, combining grants, concessional finance, and risk-sharing instruments. The mutual benefits are substantial. Reforming governments gain predictable financing that supports reforms across political cycles and allows investments with longer time horizons, while donors gain stronger partners, expanding markets, and reduced risks of negative spillovers.

Targeted Reform Partnerships (Tier 2) are offered to partners in the early stages of credible reform, where efforts are visible but still taking root and have not yet broadened or consolidated. In these settings, cooperation is more focused and operates over shorter horizons, with the mutual interest filter guiding project selection more tightly than in Tier 1. As reform efforts deepen and spread across institutions, governments can opt into more comprehensive forms of cooperation; if momentum weakens, engagement adjusts predictably. The aim is to reinforce emerging reform trajectories without presuming consolidation that has not yet occurred.

Limited Engagement Contexts (Tier 3) are designed for settings where governments show little reform intent, but where cooperation remains justified to address shared risks or to protect core development gains. Engagement is confined to narrowly defined, high-return areas such as health surveillance and vaccination campaigns. This avoids the inefficiency of large-scale transfers into settings where domestic political dynamics impede development progress, a lesson already emphasized in the World Bank's *Assessing Aid* report (Dollar and Pritchett 1998).

A central purpose of limiting engagement in Tier 3 is to ensure that resources flow where they can achieve the greatest developmental returns. In environments without complementary reforms, such as in labor markets, regulation, and investment climate, even well-designed programs often have sharply reduced impact. In such settings, a well-functioning program improving skills may not translate into jobs, infrastructure may not unlock investment, and local institutional constraints may mute long-run effects. Therefore, allocations in Tier 3 are deliberately smaller because development returns are far lower without complementary reforms and because limited engagement preserves incentives for governments to qualify for deeper partnerships.

The resources not allocated in Limited Engagement Contexts are used where the context achieves greater developmental returns. Concentrating most spending in Tier 1 and Tier 2 thus reflects both an effectiveness logic and an incentive logic: Dollars spent in reforming settings generate far higher and more durable benefits for partner countries' populations and, in turn, likely also greater benefits to the donor country.

Cooperation in Tier 3 thus concentrates on shared risks and targeted assistance, with the possibility of expanding engagement if credible reform signals emerge.

Finally, **Humanitarian Engagement** (Tier 4) applies in situations where political conditions or institutional collapse make a close partnership impossible or irresponsible. Cooperation is not based on reform signals but on humanitarian obligations. Assistance protects lives and rights through multilateral or non-governmental channels under strict "do no harm" principles. Tier 4 sits outside the incentive structure of MIDC. It preserves a humanitarian safety net that ensures populations are supported regardless of government behavior, while safeguards prevent assistance from reinforcing coercive or predatory elite practices. When conditions stabilize or reform signals emerge, engagement can shift toward more structured partnership forms within the MIDC framework.

Movement between tiers follows clear, pre-announced rules. Governments that strengthen reform commitments and performance "unlock" access to additional types of development cooperation, including a broader set of modes of financing and a longer-term orientation. Advancement depends on demonstrated reform progress, not political alignment with the donor country; regression leads to a predictable and potentially large reduction in future engagement.

Reviews are conducted on fixed cycles and independently verified by multilateral monitors. To keep tier decisions credible and shield them from political influence, MIDC should establish a panel hosted by a neutral multilateral institution instead of duplicating this institution in many donor countries. Eligibility is universal: Any government meeting the standards can qualify, independent of geopolitical alignment. The panel applies agreed criteria, recommends tier classifications, and publishes annual progress reports. A fixed, small indicator set that combines institutional, macroeconomic, and outcome metrics ensures that standards are comparable across countries. All results are published (ideally on a public dashboard) to reassure donor publics that allocations follow objective criteria and to also give reforming governments the ability to point to criteria that will unlock additional benefits that can support against domestic skepticism.

In essence, MIDC and its tiered partnership menu multilateralize and systematize earlier selective approaches, such as the Millennium Challenge Corporation (MCC), the Compacts with Africa, and bilateral reform partnerships, while correcting their weaknesses of fragmentation and short-termism. The box below provides some examples of how the mutual interest filter applies in practice and why some activities qualify while others do not.

Illustrative cases of applying the mutual interest filter

The following examples illustrate how the mutual interest filter applies across different partnership tiers.

1. Trade corridors and customs reform (Tier 1 – Comprehensive Reform Partnership)
An aid-for-trade program that builds and upgrades ports, corridors, and customs systems can generate high mutual returns. It lowers trade costs, creates jobs, and raises revenues for partner countries while facilitating both regional integration and export market access for donor firms. Such programs typically pass the mutual interest filter and fit Tier 1 contexts since the benefits for donors are likely to be larger and more likely to materialize in Tier 1 countries, where investments in infrastructure coupled with credible reforms create expanding, reliable markets and stable partnerships.

2. Vocational training (Tier 1 – Comprehensive Reform Partnership)

Another example where the mutual interest filter suggests a focus on Tier 1 countries is vocational training interventions. Skills development can generate high returns when the surrounding economic conditions allow skills to be absorbed productively, such as where labor markets function, firms have an incentive to invest, and links to employment or entrepreneurship exist. In these settings, vocational training can raise productivity and employment and generate meaningful benefits, not least by providing an alternative to irregular migration.

In many contexts, however, these conditions are absent. Without sufficient labor demand or firm-level investment, improved skills often do not translate into jobs or higher productivity, resulting in weak and short-lived development effects and negligible returns for donors. Given that resources are scarce, funding vocational training in such environments crowds out more effective uses of funds.

3. Pandemic preparedness (cross-tier case)
A well-designed regional program that strengthens surveillance and border health systems benefits partners as well as donors through stronger disease control and reduced risks of economic damage, with possible additional donor-side benefits in terms of reputation (cf. Yamey et al. 2025). Such programs pass the mutual interest filter even in Tier 3 settings and therefore remain eligible across partnership tiers.

4. Cash transfer to reduce irregular migration (fails filter)
A stand-alone cash transfer program explicitly designed to deter irregular migration is likely to fail the filter if evidence suggests it primarily increases mobility or has unclear local effects. In such cases, donor benefits are uncertain, and benefits for recipients may be short-lived. If the program is not clearly embedded in broader local development and infrastructure, its alignment with mutual interest is weak. That does not preclude that cash transfers can be a very effective way of reaching other goals.

MIDC allows for some Tier 1 programs with mainly indirect or long-term donor benefits, such as investments in institutional resilience or regional infrastructure, if they are justified transparently and ranked accordingly. By contrast, programs with low or negative developmental value for partner countries, such as tied aid at inflated prices or symbolic diplomatic projects, typically fail the filter, even if they offer short-term benefits to donors.

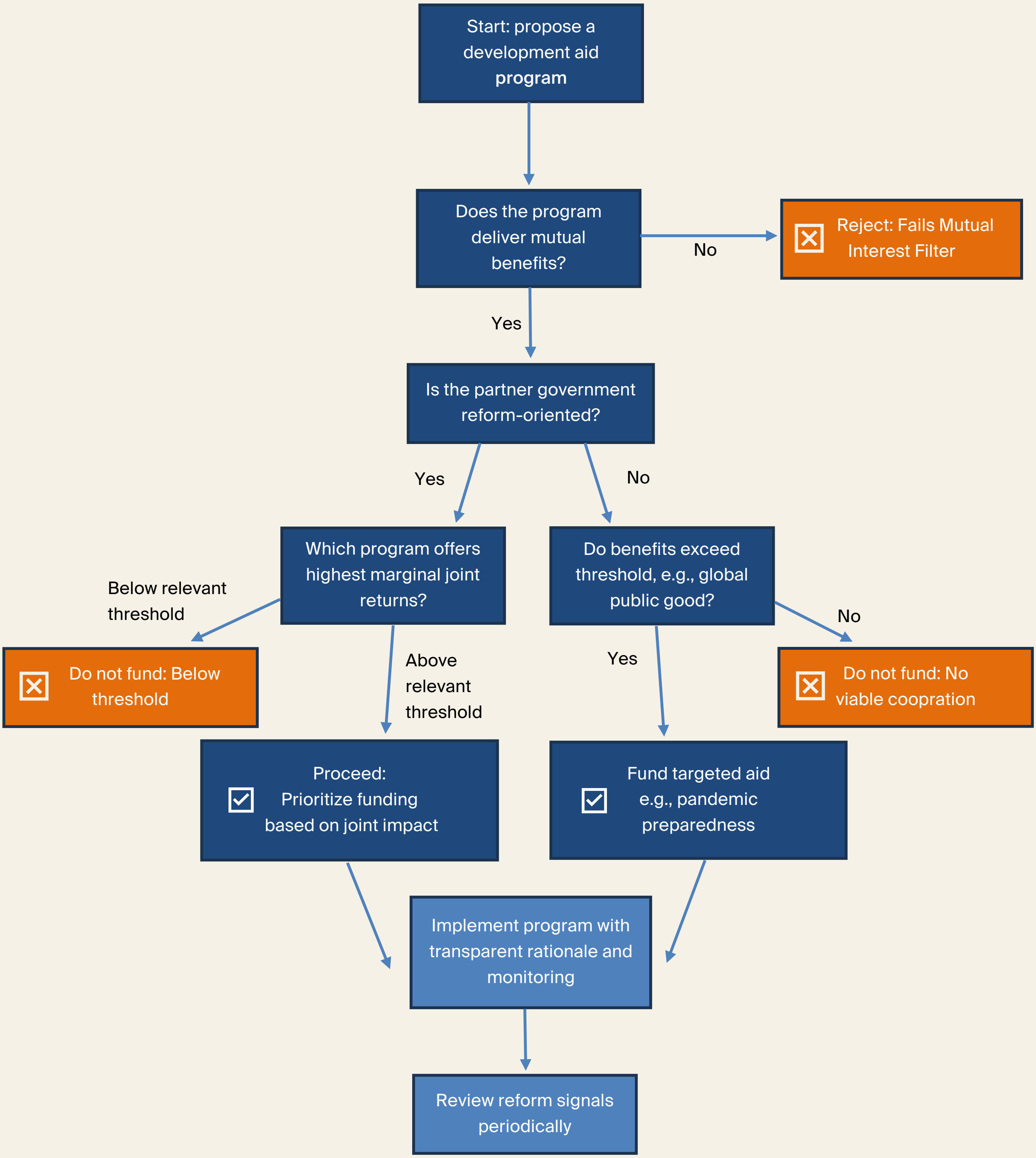
2.5 Prioritizing When Resources Are Scarce

In a first-best world, donor countries would provide sufficient resources to meet the major financing needs of all credible reform partners. In practice, fiscal limits and political constraints mean that MIDC must operate under scarcity. The allocation of limited resources must therefore follow rules that preserve incentives, maximize developmental returns, and remain politically defensible. Under scarcity, the mutual interest filter becomes the allocating rule: Concessional resources flow first to programs and contexts where joint returns are highest and demonstrable. For broad, concessional cooperation, eligibility almost always requires credible reform, because developmental returns depend on domestic policy. The threshold for being eligible depends on the severity of the budget constraint. MIDC separates *whether* cooperation is justified (mutual interest) from *how deep and concessional* it can be (reform orientation). When cross-border returns are high, such as in the case of pandemic control, mutual interest justifies engagement even where reform is limited. The difference is in scope: Mutual interest determines whether a rationale for cooperation exists, while reform orientation determines how broad, concessional, and long-term that cooperation can be. The flow chart below shows in a stylized way how decisions are made. Our approach implies four principles.

The first principle concerns **allocation between countries**. Tier 1 and Tier 2 governments have demonstrated credible reform intent and, in principle, all should receive substantial support. When resources are insufficient, MIDC allocates funding to those contexts where the marginal impact on structural transformation is highest. This requires weighing reform momentum together with the scale of potential development gains, because both dimensions determine the size of the returns on concessional finance. The logic is straightforward: A marginal unit of concessional finance should go where it shifts the development trajectory the most. This preserves incentives, because governments that sustain a genuine reform trajectory gain access to deeper and more flexible instruments. As countries grow and reforms consolidate, financing shifts gradually from grants toward concessional loans, guarantees, and eventually private capital. This is graduation in financing terms, not graduation out of cooperation. It ensures that scarce grant resources remain concentrated where they achieve the greatest payoff.

A second principle concerns **allocation within the group of Tier 1 and Tier 2 reformers**. When several countries meet reform thresholds and still exceed the available concessional budget, MIDC applies a transparent rule: Priority goes to those reforming countries where cooperation generates the strongest joint benefits for donor societies and partner populations, whether through market expansion, greater macro and political stability, or lower spillover risks.

Figure 1: Decision-making using MIDC principles



This rule operates only within the pool of eligible reformers. Geopolitical relevance can raise joint returns among reforming countries, but it can never compensate for insufficient domestic reform effort. To avoid a crowding-out of deserving but geopolitically peripheral reformers, donors should coordinate through pooled mechanisms that aggregate different regional interests and thus maintain incentives across all world regions. This creates a strong rationale for multilateral pooling of resources, which would reduce the risk that geopolitically peripheral but high-performing reformers are underfunded.

A third principle concerns **the place of global public goods in allocation decisions**. Some cooperation domains such as pandemic preparedness, disease surveillance, and climate mitigation generate exceptionally large cross-border benefits and must be protected from competition with bilateral envelopes. To prevent chronic underinvestment and ensure credibility, MIDC requires a ring-fenced share of resources for global public goods, so that funding for reforming partners does not crowd out high-return risk-reducing functions, and vice versa.

A fourth principle governs **sectoral allocation**. MIDC allocates resources based on marginal returns, recognizing that different sectors produce high returns in different reform environments. Some investments, such as infrastructure, higher education, or research capacity, yield the greatest transformation when positioned in more advanced reform settings. Others, such as primary health, basic education, or foundational public administration, deliver far greater benefits in early-stage reformers. An additional dollar for skills development, for example, has sharply different returns depending on whether functioning labor markets and a credible business climate allow those skills to be productively employed. MIDC therefore directs finance to settings and sectors where expected joint gains are highest, acknowledging that marginal returns vary significantly across contexts.

Human development investments deserve particular attention. Interventions such as malaria control, childhood immunization, maternal health, and basic education often generate some of the highest long-run developmental returns, while donor-side benefits are indirect and materialize through future growth, stability, and reduced fragility. Some of these investments pass the mutual interest filter because they create substantial benefits for partner populations and predictable long-run gains for donors. Moreover, donors differ in how strongly they weigh partner-country versus donor-country benefits. MIDC accommodates this by allowing countries with more altruistic preferences to allocate a larger share of concessional resources to high-return human development sectors, provided the developmental impact is demonstrably large. In early-stage reform contexts, these foundational interventions may be the most effective way to raise productivity and strengthen state capacity, whereas in more advanced reformers, higher education or research may exhibit higher marginal returns. More altruistic donors might also allocate funds to human development investments in non-reforming countries where expected long-run development benefits are low because they assign an intrinsic value to basic health and education.

However, analogous to humanitarian aid, this would no longer be captured by the MIDC logic.

Taken together, these principles ensure that scarce concessional resources flow to environments where they generate the most substantial developmental impact, reinforce credible reform incentives, and protect essential global public goods. This may mean that some reformers receive less support than their domestic progress alone would justify, but the rules are transparent, predictable, and defensible. Without such rules, limited resources would again be allocated through short-term political bargaining or historical ties, weakening fairness, distorting incentives, and undermining the credibility of development cooperation.

2.6 Operational Pillars

Mutual Interest Development Cooperation only works if its principles can be implemented in day-to-day governance. Four practical pillars make this possible. They are implementation rules, not new bureaucracy. They make MIDC predictable, politically realistic, and enforceable.

The first pillar is **clarity of purpose**. Development cooperation only works when everyone understands its purpose. MIDC treats aid as a temporary catalyst for self-sustaining growth, rather than a permanent transfer. Its purpose is defined by the transformative objective set out above, with a focus on helping countries “grow out of aid.” Clarity of purpose is enforced through the mutual interest filter, which defines what counts as meaningful cooperation and screens out activities with weak joint returns. Countries that pursue credible reform trajectories gain access to deeper and more predictable cooperation, while concessional resources remain focused on where they have the highest developmental returns. Clear purpose is therefore not just a statement of intent, it also determines what qualifies as cooperation under MIDC and what does not.

The second pillar is **political realism**. MIDC is rooted in the fact that development outcomes and the effectiveness of external financing critically depend on domestic political choices. Domestic political incentives determine what external finance can achieve. MIDC therefore deepens cooperation where reform incentives align and narrows it to high-return interventions where they do not. Political realism thus avoids the false comfort of programs that fail quietly because they ignore partner countries’ internal political economy and ensures that scarce resources are used effectively.

The third pillar is **predictability and fairness**. MIDC replaces discretionary allocation decisions with clear rules that link the depth of cooperation to verified reform performance. Reforming governments can plan on support that extends beyond electoral cycles because tier status and financing terms change only at pre-announced review points and only in response to observable signals. Reformers can justify allocations to their publics because cooperation follows a transparent rule set rather than political favoritism or historical path dependencies. Predictability sustains mutual interest over time by fostering partner governments' ability to undertake politically costly reforms knowing that support will follow rule-based commitments. Meanwhile, donors can rely on a stable trajectory of joint returns rather than volatile, ad hoc allocations. This same predictability also governs disengagement. Exits or aid reductions are explained in advance as part of a standing offer, not as a form of punishment.

The fourth pillar is **credible delivery**. Who does what matters. In reforming contexts, governments take the lead. In fragile ones or contexts where the elites have little interest in reforms, multilaterals and civil society take over delivery to protect integrity and reach citizens directly. This tier-dependent division of labor prevents elite capture and ensures that the mutual interest filter is applied in practice, not only in program design. Across all settings, transparency is non-negotiable. Spending, results, and donor-side rationales are published in forms accessible to partner-country publics and donor taxpayers. In emerging reform contexts, basic data, evaluation, and accountability systems are standard components of support to ensure credible measurement over time if needed. Citizens in both donor and partner countries can see where the money goes and what it achieves. Credible delivery thus sustains trust on both sides and protects MIDC from the implementation failures that have weakened earlier aid models.

2.7 Financing

MIDC needs predictable, rules-based financing. Without it, reformers cannot plan and donors will revert to volatile, fragmented allocations. Mutual Interest Development Cooperation is designed as a policy framework that individual donor governments can adopt within their own development cooperation systems. However, its incentive effects and political credibility are strongest when like-minded donors pool resources and apply the framework jointly.

The Mutual Interest Fund

The Mutual Interest Fund is the financial backbone of MIDC. It translates the mutual interest logic into a pooled, rule-based mechanism that can mobilize sufficient resources to incentivize and support countries to undertake meaningful reform. Donors contribute to the fund not out of altruism alone but because pooling directs funds to programs with the highest joint returns. Pooling also solves a persistent coordination failure: Individually, donors tend to underfund reformers that fall outside their regional or political focus, but collectively, they can back a much fuller set of reform-minded partner countries. That also creates greater incentives for partner countries to become reformers. For reforming governments, the Fund provides what bilateral aid rarely delivers—predictable, multi-year support that survives political cycles and makes long-horizon reforms feasible. For donors, it offers a disciplined, politically defensible vehicle: resources follow transparent rules, concessionality reflects verified reform performance, and allocations cannot be redirected toward short-term political priorities. In this way, the Mutual Interest Fund anchors the credibility, scale, and durability of cooperation. This prevents discretionary reallocations and protects credible reformers from short-term fiscal pressures in individual donor states.

MIDC distinguishes clearly between what flows through the Mutual Interest Fund and what does not. The Fund finances development cooperation under the MIDC logic–policy and institutional reform support, long-term investment, and early-stage state capability building through investments in human development. It does not finance humanitarian assistance, which remains fully separate, nor can its resources be reallocated to humanitarian crises. Donor governments must retain dedicated fiscal space for humanitarian response. It complements existing and successful multilateral funding schemes for global public goods and the new type of coalitions proposed by Edenhofer et al. (2025), which do not have to be coordinated through the Mutual Interest Fund.

Comprehensive Reform Partnerships use the widest set of instruments: multi-year grants, concessional loans and guarantees for infrastructure and institutional modernization, and blended finance for areas where private investment can take over gradually. Predictable funding over at least 10 years allows governments to consolidate reform and undertake projects with long horizons. As reforms deepen and incomes rise, concessionality declines, but cooperation does not. Countries graduate in financing terms, not out of the partnership. This protects scarce concessional resources for settings where they achieve the highest marginal impact.

Targeted Reform Partnerships combine short-term, high-visibility grants and concessional loans with technical assistance and partial guarantees. Funding is linked to specific, verifiable outcomes, such as increased tax revenue, regulatory reform, or green energy transition. The focus is on building momentum and trust that early reform delivers tangible benefits to the partner country. Rolling three-to-five-year envelopes allow flexibility without locking either side into open-ended commitments. For reformers constrained by weak data or administrative capacity, MIDC can include targeted investments in core statistics, public financial management, and monitoring systems. Meeting MIDC standards thus becomes part of cooperation itself, not a precondition that countries must fulfill independently.

Limited Engagement Contexts narrow the toolset to small, carefully scoped grants for shared risks, such as regional disease surveillance, climate adaptation, or secure trade corridors. Large projects are excluded unless they directly reduce donors' short to medium-term risk or have a large investment return. Cooperation protects and invests in joint interests without shielding regimes whose policies obstruct development progress. A small window is reserved for low-visibility but high-need settings to build basic capacities required for eventual movement toward Tier 2.

Global Public Goods are by their very nature susceptible to the free riding behavior of individual actors. Their provision should therefore ideally be financed by multilateral institutions such as the established ones in global health and climate mitigation and promising, more recent initiatives like the World Bank's Framework for Financial Incentives (FFI). If for economic or geopolitical reasons key players decide to leave multilateral fora, it can still be highly beneficial to have smaller coalitions that provide global public goods. Edenhofer et al. (2025) show for the case of climate finance that such coalitions can become self-enforcing. That also implies that financing for global public goods does not depend on all participating countries applying MIDC. According to Edenhofer and coauthors, China, for example, could have an incentive to join a coalition that funds emission reductions in low- and middle-income countries.

Humanitarian Engagement relies entirely on grants delivered through multilaterals or vetted NGOs. Humanitarian financing is non-negotiable and reform-independent; it protects the ethical core of international solidarity and must be shielded from strategic or mutual-interest-based allocation. At the same time, the Mutual Interest Fund cannot be tapped for humanitarian needs. Financing humanitarian assistance follows strict "do no harm" rules to avoid reinforcing coercive regimes. This preserves a humanitarian safety net while maintaining separation from strategic or interest-driven aid.

A special category closely related to humanitarian engagement is post-conflict reconstruction. Recovery after war is often a direct mutual interest: preventing renewed violence, stabilizing regional trade, and managing refugee flows (cf. Heidland et al. 2025). Unlike humanitarian relief, which focuses on immediate survival, post-conflict support must rebuild fiscal institutions, infrastructure, and administrative capacity so that reform and private investment can resume. MIDC treats these settings as priority transition cases, helping countries move from humanitarian engagement to targeted reform partnerships.

To prevent MIDC from drifting toward purely strategic or commercially driven allocations, the Mutual Interest Fund will apply explicit limits and transparency rules. A dedicated inclusion window is reserved for contexts that meet requirements but lack strategic weight, e.g., small, peripheral reforming countries. All allocations must be published with a short statement of their donor-benefit category and their development rationale. Transparency thus becomes a core enforcement mechanism by informing publics in donor countries that allocations remain aligned with MIDC principles and informing partner-country publics about the principles and the incentives for their governments to reform.

2.8 Additional Incentives

To align reform incentives with mutual interest and crowd in private capital, MIDC tier status will be published annually. Countries in higher tiers will benefit from lower risk premia, longer loan maturities, and simplified approval procedures. Conversely, when a country is downgraded, its future MIDC financing automatically becomes less concessional, i.e., loans have higher interest or lower grant shares, and access to guarantees is reduced. Because changes apply only to new approvals within a known rule set, this mechanism avoids the discretionary cut-offs and retroactive sanctions associated with earlier forms of conditionality. This mechanism ensures that policy performance and financial terms move in tandem, translating institutional progress into tangible cost-of-capital advantages, and thus also reinforcing the mutual gains from reform.

Although this may appear harsh, it is not punitive. Tier adjustments are rule-based corrections of future engagement, not sanctions. This preserves credibility and aligns incentives on both sides. Higher-tier status signals institutional reliability, improves investor expectations, and lowers capital costs for domestic firms, amplifying the benefits of reform through private-sector channels.

To strengthen domestic ownership and align incentives further, MIDC could additionally benefit from introducing a **reform dividend**. This is a performance-linked top-up that rewards governments for achieving verified policy and institutional milestones. The dividend helps solve a well-known political economy problem: reform costs are immediate, while developmental gains accrue slowly. A visible, fairly rapid payout makes reform pay off early for governments, increasing the political durability of reform coalitions. Building on results-based financing models used, such as the World Bank's Program-for-Results-Financing and Gavi's mechanism, participating countries would receive additional disbursements once agreed reforms are independently confirmed.

Given the verification and fiduciary requirements, this mechanism should initially apply only to Tier 1 countries, where systems and transparency standards are strong enough to ensure credible measurement and timely payouts. For Tier 2 countries, the principal incentive remains the opportunity to graduate to Tier 1 status, which itself unlocks larger and more predictable envelopes. Experience from other results-based instruments suggests that effectiveness depends on clearly defined indicators, independent verification, and dividends that are large and fast enough to be politically meaningful. Otherwise, the incentive provided by the reward is lost and administrative costs make the reform dividend inefficient.

2.9 Global Context

In today's multipolar world, where Western leadership is increasingly contested, development cooperation has become a field of competing offers rather than coordinated effort. Emerging actors such as China, Russia, and the Gulf states blend aid, trade, investment, and security cooperation to pursue strategic goals, while Western donors face fiscal limits and declining public support. MIDC does not seek to restore the old consensus but to adapt to this reality. It turns competition into a guiding principle: Cooperation must be attractive enough to endure politically and deliver tangible benefits to both sides.

This shift requires acknowledging that development cooperation is no longer a monopoly of OECD donors. Many partner countries now have choices, and their governments evaluate offers based on a mix of predictability, financing terms, and respect for domestic priorities. In this environment, conditionality-heavy or fragmented aid loses appeal. A transparent, rule-based offer that links benefits to verified reform signals rather than donor discretion can therefore be a competitive advantage. MIDC positions Western and like-minded donors as partners that reward credible reform and provide stable long-term engagement, not just short-term transactions. For donor governments, this also means redefining success. The aim is not to outspend geopolitical competitors but to provide a more credible and incentive-compatible alternative.

Strategic competition also creates opportunities. When countries view cooperation with reform-oriented coalitions as a route to long-term investment and integration into global value chains, it can accelerate domestic reform. By offering predictable access to finance, guarantees, and technical support, MIDC helps translate political reform signals into tangible economic outcomes. In this sense, competition can foster good governance and shared prosperity.

Some partners may view the mutual interest logic as transactional, exclusionary, or as a new form of conditionality, especially where reforms are politically costly or where donor benefits appear to dominate. To prevent this, MIDC offers support that increases countries' ability to qualify for closer forms of cooperation and has a transparent allocation system that caps politically motivated spending. These features help MIDC maintain credibility even in contested environments. Instead of following geopolitical rivals and potentially diluting the effectiveness of their own resources, MIDC promotes a more self-confident approach that concentrates on the comparative strengths of donors' offers.

Chapter 3: Summary of Key Messages

Mutual Interest Development Cooperation offers a response to the two main reasons why development policy is facing a crisis: the lack of structural transformation in many partner countries and of political support in donor societies. The model starts from a simple premise: Cooperation becomes durable only when it produces visible, verifiable gains for both sides. The mutual interest filter operationalizes this by requiring that every program demonstrate substantial developmental value for partner populations and clear benefits for donors. Activities that fail to generate such joint returns should not be undertaken because the funds can create greater impact if used differently.

MIDC redefines how cooperation is structured. A tiered partnership system aligns the depth and form of engagement with verified reform commitment, replacing often discretionary conditionality with partnership tiers that governments choose to enter.

Movement between partnership tiers is governed by transparent criteria. The purpose of cooperation is explicit: to support reforms that allow countries to grow out of development cooperation. This long-term trajectory is itself a shared interest, since successful reformers become more resilient, more prosperous, and likely also more reliable economic and political partners.

At the same time, MIDC protects functions that generate large cross-border benefits. Global public goods such as pandemic preparedness remain prioritized through dedicated financing. These are not exceptions to mutual interest logic, but its strongest examples, as few investments offer clearer joint returns.

Under MIDC, funding should be allocated according to marginal impact. Concessional finance flows to settings and sectors where it can shift development trajectories most effectively, and—with the exception of global public goods or humanitarian assistance—primarily to countries that meet minimum reform conditions. If several reforming countries qualify but budgets fall short, priority is given to those where cooperation yields the strongest combined gains, not to those that merely carry geopolitical weight. This preserves fairness, avoids opaque bargaining, and keeps incentives intact across world regions. Multilateral pooling further reinforces these incentives by combining donors' differing strategic interests.

Finally, MIDC remains compatible with humanitarian obligations by providing a humanitarian safety net that sits outside its incentive structure. This ensures that essential, life-saving support continues independently of government behavior, while MIDC governs the rest of development cooperation in a rules-based, transparent, and politically defensible manner.

Together, these elements define a cooperation system that is incentive-aligned, impact-oriented, and politically sustainable. MIDC strengthens reform trajectories, protects global public goods, and provides donors with a credible and coherent strategy for long-term engagement in a fragmenting world.

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