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Development Effectiveness at the Country Level

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Abstract

While we know a lot about how countries become prosperous, we have only begun to understand how aid contributes to economic growth and poverty reduction. The development record is mixed and no robust association between the volume of aid and development performance has been discovered. The limits of cross-country regressions have become clear: they do not throw much light on the reality of aid. But the novel mix of qualitative and quantitative methods fashioned by independent evaluators constitutes a serviceable approach to the assessment of aid effectiveness both at project level and at country level. In particular, a new brand of country assistance evaluations (CAEs) has demonstrated that success at project level matters even if it does not automatically translate into success at country level—the 'micro-macro paradox'. Evaluations confirm that well-managed aid, using instruments that are tailored to specific country contexts, works. They show that budget support mechanisms and programme aid instruments have a role to play in certain circumstances while projects are the aid vehicles of choice in others. The popular notion that development effectiveness can be ensured through the targeting of aid towards countries classified as good performers by idealized sets of indicators has been discredited. Recent policy research suggests that, despite the risks

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involved, aid does the most good when it benefits the weakest and poorest economies and those most vulnerable to shock. But to achieve development effectiveness at country level, coherence of interventions is critical, as is judicious sequencing. Development operations should be (i) selected to fit within coherent country assistance strategies; (ii) aligned with the priorities of the country and (iii) coordinated with other policies and actions of partners. Ultimately, this is because the quality of aid matters as much as its quantity: aid is a transmission belt for ideas, a device to train development leaders, an instrument to build state capacity and a platform for policy experimentation and dissemination. The final proposition offered by this paper is that professionally administered aid works, but that it would work even better in concert with reforms of rich countries' policies geared to levelling the playing field of the global market and to peace building and human security in the zones of turmoil of the developing world.

Author's note

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Acronyms

CAEs	country assistance evaluations
CPIA	World Bank's country policy and institutional assessment index
DAC	OECD's Development Assistance Committee
IEG	World Bank's Independent Evaluation Group
NGOs	nongovernmental organizations
ODA	official development aid

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Each project may not look formidable on its own but the combined impact of hundreds of coordinated projects could far outweigh empty words and rhetoric.

Junichiro Koizumi, Prime Minister of Japan (2005)

1 Introduction

What makes countries rich or poor? Why are some countries prime movers of economic expansion while others are mired in stagnation? How do resources, technology and social arrangements interact to generate development? These questions are being widely debated in this 'year of development' (Birdsall, Rodrik and Subramanian 2005) but they have preoccupied economists since the eighteenth century. Malthus viewed the discovery of the causes of the wealth and poverty of nations (as) the grand object of all enquiries in political economy'.[1] Adam Smith laid the foundations of classical economics in order to elucidate the 'progress towards opulence and improvement' of nations. Since then, we have learnt a great deal about how economies grow.

By contrast, we know far less about how aid contributes to development. The notion that rich countries have an interest (indeed an obligation) to help alleviate poverty reduction in faraway lands is only half a century old. In international relations, the aid industry is the 'new kid on the block'. Public support for aid is still volatile and fragile. This is because we live in a world of states (rather than a world state) and 'the people for whose benefit aid agencies work are not the same as those from whom their revenues are obtained'.[2] Along the chain that links rich countries' taxpayers and the poor citizens of developing countries slippages inevitably occur. Without the accountability provided by the voting booth, the construction of an effective feedback mechanism is central to the legitimacy of aid (Martens 2005).

This is why aid agencies exist. They mediate between the preferences of donors and recipients and they manage the risks inherent in the transfer of resources. To this end they have had to design elaborate institutional arrangements in order to justify to the taxpayers of rich countries that the funds they have provided through their taxes have been put to good use. The poor citizens of recipient countries are equally keen to know that the funds provided for their benefit by rich countries have not been diverted towards nonproductive uses. To this end, a wide range of controls (auditing requirements, competitive bidding, supervision missions, etc.) has been put in place.

Fiduciary controls are necessary to guarantee development effectiveness. But they are not sufficient. Auditing may confirm that the funds are used for the intended purposes but such purposes can be misconceived; the means used to achieve them may be poorly selected or the aid administration may be incompetent or inefficient. Ultimately, what

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[1] Letter to Ricardo dated 26 January 1817, from J. M. Keynes, quoted in Landes (1998).

[2] The principal-agent problems associated with aid (multiple principals, incoherent objectives, information asymmetries, monitoring costs, distorted incentives etc.) are explored in Martens et al. (2002).

the public wants to know is whether the benefits of aid have been commensurate with its costs and whether poverty was subsequently reduced.

Is development working? Does aid make a difference? Why do project and country level results differ? Does country level conditionality work? How do we know whether aid programmes are achieving their goals at the country level? Where is the aid enterprise going? What should be done to improve its effectiveness? These are the basic questions on the public mind. This paper reviews the evidence and draws the implications for development cooperation.

2 What has development achieved?

There are good news and bad news in development. During the periods of 1960-80 and 1980-2000, annualized per capita growth rates were 2.1 per cent and 3.6 per cent, respectively for developing countries compared to 3.3 per cent and 2 per cent for rich countries. This implies progress towards convergence and evinces hope. But if China and India are excluded,[3] per capita incomes in poor countries rose by an annual average of only 2.3 per cent and 1.2 per cent for the two periods (Bhalla 2002). This indicates growing divergence and induces gloom.[4]

Regional differences are large. During the period 1980-2000, East Asia achieved an annual per capita growth of 6.6 per cent, South Asia 3.4 per cent, Middle East and North Africa 1.2 per cent and Latin America 0.5 per cent while Sub-Saharan Africa regressed by 0.3 per cent annually. The differences are even more striking among countries: during 1990-2000, in China GDP per capita grew 9.2 per cent annually but declined by 12 per cent in Georgia. Such divergences in performance have massive implications for human welfare.

Growth has a cumulative impact on living standards. If, in John Lennon's words, we 'imagine, there is no country', the development narrative is positive (Bhalla 2002). Average social indicators have recorded major gains: life expectancy rose from 55 years in 1970 to 64 years in 2000; infant mortality rates dropped from 107 per thousand in 1970 to 58 in 2000; literacy rose from 53 per cent in 1970 to 74 per cent in 1998; the number of people suffering from chronic malnutrition declined from 35 per cent to 17 per cent of the population.

But here, too, there are major variations across regions and countries. In the 1990s, life expectancy actually fell in 32 countries because of the HIV/AIDS epidemic. Progress in infant mortality was much slower in Africa than elsewhere: from 116 in 1980 to 91 in 2000 while the undernourished actually increased from 168 million to 194 million. The impact on poverty has also been highly differentiated around the world.

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[3] If the two countries are taken together, per capita incomes grew by an average of 1.8 per cent per annum in the first period and by a hefty 6.1 per cent during the second period.

[4] In terms of purchasing power parities, the per capita incomes of rich countries rose by 3.3 per cent and 1.6 per cent in the two periods while they rose by 2.1 per cent and 3.1 per cent for all developing countries but by 2.5 per cent and 0.7 per cent if China and India are excluded.

Poverty, as a share of the total population, dropped between 1981 and 2001, from 67 per cent to 53 per cent for the two-dollars a day benchmark. But once again, the improvement is almost entirely due to China's extraordinary growth performance and, in per capita terms, China received very little aid.[5] Elsewhere, the increase in the number of the absolute poor has exceeded the reductions. Based on the two-dollars a day benchmark, the number of poor people worldwide *increased*—from 2.5 billion in 1981 to 2.7 billion in 2001 (Chen and Ravallion 2004). Tragically, in Sub-Saharan Africa, overall poverty rates have been rising instead of declining and this is a region that has received a great deal of aid.[6]

3 Does aid make a difference?

The fortunes of aid recipients vary. Some aid recipients have experienced growth rates that are unprecedented in world history. Whereas the United Kingdom took more than 60 years to double output per person (1780-1838), Turkey did it in 20 years (1957-77), Brazil in 18 years (1961-79), and China and Korea in 10 years (1977-87). Between 1966 and 1990, Thailand tripled its real per capita income and India doubled its per capita income (Dollar 1998).

By contrast, Ethiopia and Zambia saw no income per capita growth at all[7] and both countries received vast amounts of aid. In 2001 four countries (Malawi, Niger, Honduras and Kyrgyz) received aid averaging 15 per cent of gross national incomes but experienced negative per capita income growth while six other developing countries with GNP per capita growth rates in excess of 7 per cent (Angola, Azerbaijan, China, Latvia, Moldova and Turkmenistan) averaged aid dependency rates of only 3 per cent.

Aid pessimists may surmise that aid can be a curse while aid optimists will retort that, given the long lags between aid flows and development results, little can be concluded from one year data. Aid advocates also point to Eritrea, Uganda, Ghana, Mozambique, Tanzania with GNP per capita growth averaging 4.8 per cent, probably arguing that such performance would not have materialized without the aid which averaged 22 per cent of their gross national incomes. Evidently based on other corroborating evidence, these are the countries where aid appears to be working.

Thus, it seems that aid does not always work, nor does it always fail either. Development is not a simple process and generalizations about aid are hard to come by. The literature points towards a positive association between aid volumes, growth and poverty reduction but the relationship is weak and contested. A systematic review of cross country correlations suggests that the effect of aid volumes on growth is small and statistically insignificant in the aggregate (Roodman 2004). This is in part because the

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[5] In per capita terms India received modest levels of aid and yet it has been growing rapidly since the 1991 reforms.

[6] Sub-Saharan Africa's share of the developing world's population is about 10 per cent, but it received in 2004 a third of all aid—U$26 billion out of a total of US$78 billion (OECD/DAC 2006: Table 25).

[7] Relative to the US, Thailand's real per capita income rose from 10 to 20 per cent, India's from 5 to 7 per cent, while Ethiopia's and Zambia's dropped from 2.4 to 1.8 per cent and from 8.5 to 3.8 per cent, respectively.

econometric studies that underlie this conclusion do not distinguish between aid channels, instruments or modalities.[8] Nor do they take account of the social and institutional environment within which aid activities are embedded.

The quality of market institutions appears to be a significant antecedent of growth. For example, the ‘rules of the game’ governing the investment climate in developing countries—measured by the ease of starting a business—are strongly correlated with labour productivity (World Bank 2004).[9] The weaker the property rights regime and the rules-based governance practices, the poorer the country. Banking sector penetration—measured by the ratio of bank deposits to GDP—is far lower in low-income countries (21 per cent) than in upper middle-income countries (49 per cent). Macroeconomic policy is an important factor as well. Low-income countries that experienced relatively good growth (higher than the median rate) had unsatisfactory fiscal, public spending and macroeconomic policies in only 16 per cent, 38 per cent and 16 per cent of the cases, respectively, compared to 51 per cent, 59 per cent and 29 per cent for countries with growth lower than the median rate.

Does this mean that aid always works better in environments where policies comply with all the strictures of the development establishment? So far, the evidence does not confirm that aggregate aid volumes give better results in countries where policy indicators (e.g., as measured by the World Bank) are good (Roodman 2004). This could simply mean that we do not know exactly how to measure the quality of policies in different country environments. Alternatively, the resource transfer dimension of aid may not be all that relevant, i.e., aid is less about money than about ideas, linkages and demonstration effects, what have been labelled ‘the centrality of side effects’ (Hirschman 1995).

Unfortunately, policy research has concentrated on the volume of aid. Yet, practitioners know that the quality of aid (the efficiency of its delivery, the choice of instruments selected, the adequacy of aid terms, etc.) is as important as volume. They note that the conclusions reached by aid pessimists are based on studies that have examined the impact of aid over too short a period and/or included humanitarian aid negatively correlated with growth because it is given in times of crisis. Recent work at the Centre for Global Development (Clemens, Radelet and Bhavnani 2004) shows that once these distortions have been corrected, aid has a large and positive impact on growth.[10] Every dollar of aid raises output by 1.6 dollars in present value terms and the authors of the study assert that the correlation is highly significant and robust. It is not sensitive to the quality of policies or the level of incomes.

Rigorous evaluations combining qualitative and quantitative assessments are rare in the development system but when such evaluations are conducted professionally and independently they deliver robust judgments about aid quality. Of course, aid quality is relevant on both sides of the aid relationship. A large number of organizations of

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8 A study (Sawada, Kohama and Kono 2004) that decomposes development grants and loans finds that loans to countries with good development policies promote growth whereas grants do not.

9 All statistics in this paragraph are from World Bank (2004).

10 The study refers to aid designed to have a positive impact within four years (whether in the form of budget support or the lending for infrastructure, industry, or agriculture). It accounts for more than half of all aid flows.

varying competence, and pursuing diverse agendas, channel aid to poor countries. Even for a single donor, aid is often saddled with multiple objectives (e.g., poverty reduction, democracy promotion, security concerns, commercial interests, etc.). Most damaging perhaps is the frequent misalignment of goals and practices in relation to the recipient country, especially in the poorest and most aid-dependent countries where aid administration 'on the ground' is weak.

In brief, aid quality has four dimensions: (i) the consistency of ends and means within a project or programme (in terms of its relevance, effectiveness, efficiency and resilience to risk); (ii) the congruence of aid and non-aid policies within the donor country; (iii) the degree of harmonization and coordination of aid programmes among donors; and (iv) the alignment of aid goals and practices with the country's own. Performance in terms of all four dimensions is important for aid effectiveness. This is why aid effectiveness is so hard to achieve. Similar considerations underlie the agenda on 'policy coherence for development' that has become a central focus of 'whole-of-government' approaches in many OECD countries (Picciotto 2005).

4 From projects to country programmes

Until recently, development evaluation was concentrated on the first dimension: the linear connections between aid inputs and development outcomes. Projects were perceived as the main unit of account. Obviously, development effectiveness is far easier to evaluate at this primary level because projects connote clear objectives, well defined features and a systematic approach to getting things done. They specify the shared goals, distinct accountabilities and reciprocal obligations of the partners. While shunned by macroeconomists who look at aid as a resource transfer, they are popular with politicians keen to fly the national flag on successful projects. They also appeal to social scientists who perceive development as microeconomic in nature and embedded in society. For them, the transformation processes associated with development are local phenomena that take place at the community level where social relationships are forged.[11]

Thus, and until macroeconomists captured the commanding heights of the development profession, projects were 'where the action was'. For Albert Hirschman (1995), projects 'have much in common with the highest quests undertaken by human kind'. They are 'privileged particles of development', 'units or aggregate of public investment that, however small, still evoke direct involvement by high, usually the highest, political authorities'. They produce visible results that taxpayers in rich and poor countries alike can understand and appreciate. For all these reasons, projects have long been (and are likely to remain) essential vehicles of development assistance.

The positivist assumptions underlying projects are that (i) national leaders can be influenced through the visible impact of specific investments; (ii) societies can learn from experience and (iii) development interventions can overcome the legacy of

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[11] This perspective underlies the participatory development doctrine, the fruit of disappointment with centralized, top-down initiatives, and highlights the information advantages of local actors. However, these may be offset by the risks of elite capture and misappropriation of funds in weak states (Roland-Holst and Tarp 2002).

conditions over which decisionmakers have little or no control (e.g., geographical handicaps, lack of skills or limited natural resource endowments). But projects are not implemented in a vacuum. Just as they impact on the institutional environment, their beneficial impact varies according to the country context. Conversely, projects are not ends in themselves. They are levers of country development, symbols of international cooperation, metaphors for modern management, platforms for social learning and incubators of national leadership.

Besides, from the very start of the development enterprise, nation-building was an explicit objective of development cooperation. Then as now, bilateral aid frequently aimed at diplomatic leverage. Politically, projects were justified by considerations of national security or commercial advantage. Economically, they were conceived as slices of country investment programmes and their justification was measured in terms of their net contribution to the country's GNP measured by a rate of return. Once the role of good policy came to light, the project instrument was reshaped to promote explicit reforms and fashioned to generate development knowledge (Rondinelli 1993). Later, as governance emerged as a critical determinant of country performance, the institutional development impact of projects became a notable criterion of aid effectiveness.

In short, projects have always been used as policy tools and their designs have gradually adapted to changing conceptions of development. But they involve substantial transaction costs and have no comparative advantage in countries that have acquired the institutional strength to manage effectively large-scale poverty reduction programmes. In such countries, budget support makes sense. Instrument selectivity is critical to aid effectiveness.

By now, it has become an article of faith within the aid establishment that the success of development operations (project as well as programme aid) should be measured in terms of their cumulative effects at the country level. Up-scaling of operational results has become a major preoccupation of aid managers. For the development community today, what matters is the direct and indirect impact of the portfolio of externally funded operations (along with the other services funded by aid) rather than the aggregation of benefits from individual operations measured case by case. The country has become the privileged 'unit of account' and this is all to the good.[12]

The realization that development requires a sound policy framework and sound institutions rather than simply more and better aid-funded public investment has had a major impact on the aid industry. All aid agencies now shape their operations and sequence their interventions to achieve strategic results at the country level. Thus, the design and implementation of country assistance strategies have stepped into the centre stage of aid management. Typically, the design of a country assistance strategy involves the judicious structuring of operational portfolios combined with technical cooperation and explicit dialogue with country authorities about the policy objectives of donor involvement.

[12] While serving at the World Bank in the 1950s, Paul N. Rosenstein-Rodan advocated a broadening of the project approach to encompass the entire economy, through investment in country development programmes. Only when macroeconomic policy conditionality took centre stage did his vision prevail. By then, however, the growth theory driven by 'big push' public investment which he had consistently promoted was discredited.

In this context, it no longer suffices to measure development effectiveness by individual projects or programmes. Individual operations must now be conceived as the building-blocks of the country assistance strategy. They are expected to fit within a coherent design: the country programme edifice is expected to rest on sound institutional foundations; to be buttressed by the beams and pillars of good policies and to be held together by the cement of partnership. Only then do aid projects and programmes contribute to large-scale social transformation and sustainable development. Most development agencies are equipped with evaluation systems that track the results of individual projects and programmes. While not all of these systems are reliable, the most rigorous confirm that 'aid works', as long as success is measured on the basis of individual operations (Cassen and associates 1994).

5 The micro-macro paradox

For reasons elaborated above, the shift in focus towards country assistance strategies has moved the goal posts of the aid enterprise to a higher plane. This is why the micro-macro paradox (which holds that project results and country results diverge) has proved exceptionally damaging to the aid industry. It first came into existence when the debt crisis of the early 1980s unfolded and development economics gave way to the neoclassical resurgence. Suddenly, basic questions about the premises on which aid had been provided emerged.

A cottage industry of cross-country studies came into existence. Unfortunately, it failed to establish meaningful correlations between aid volumes and growth at the country level. A recent review of this literature (Doucouliagos and Padalm 2005) draws three overarching conclusions (labelled as 'sad' by the authors):

i) aid has a small impact on savings and investment behaviour;

ii) aid and growth are positively correlated in the aggregate[13] but the effect is modest, volatile and of dubious statistical validity; and

iii) the hypothesis that good policy generates good aid outcomes has not been proven: multiple regressions and attempts to replicate the positive results with new data have failed to achieve statistical significance.

Several explanations have been offered. Each contains a grain of truth. While none are totally convincing on their own, they add up to a formidable set of potential obstacles to aid effectiveness.

— First, it has been asserted that aid funds are fungible and that donors, therefore, are not financing the activities they intend to finance: at the margin, domestic resources liberated through aid are applied to other purposes (e.g., prestige projects or military expenditures) by recipient governments. The counterargument is that projects are not neutral channels of funds. They invariably embody 'trait making' characteristics, e.g., capacity-building

[13] Disregarding statistical significance, the authors conclude that the studies they reviewed point to an average increment of 20 per cent in the standard of living of poor countries' citizens attributable to aid.

features, technology transfers or improved management methods. These aid effects are not fungible. Furthermore, diversion of domestic funds to low priority uses can be restrained by sound aid management that ensures that funds are used for the intended purposes and that public expenditure programmes are adequately managed.

— The second explanation of the micro-macro disconnect concentrates on the macroeconomic consequences of aid and suggests that in highly aid-dependent countries, aid harms the economy by creating volatility in public revenues, contributing to inflation and raising the real exchange rate so that export competitiveness suffers.[14] Thus, research by the IMF (Rajan and Subramandian 2005) finds that the impact of aid on growth reaches diminishing returns when the intensity of aid becomes excessive. But there is no mystery about how to control this phenomenon through competent monetary and fiscal policies, and judicious economic management advice can be provided along with the aid.

— The third and closely related explanation deals with the political economy dimension. Allegedly, aid in large amounts creates a 'resource curse'. Competition for control of rents aggravates social tensions. Aid becomes addictive, reduces the incentives to reform, undermines the social contract between public authorities and citizens, hinders budget discipline and substitutes donor preferences for country priorities. Some studies even purport to show that excessive aid weakens economic[15] and political[16] institutions. But it stands to reason that in most cases the volumes of aid are too small to have such a pervasive and insidious effect.

— The fourth explanation of the micro-macro paradox has to do with the fact that many aid agencies and nongovernmental organizations do not have credible aid evaluation systems so that the paradox may be illusory. This highlights the need for independent and rigorous aid evaluation systems.

— The fifth and most plausible explanation has to do with quality of aid on the supply side. Transaction costs are high: administrative costs absorb 6-7 per cent of aid flows. Tying of aid generates needless mark-ups for goods and services that reduce the aggregate value of the aid.[17] Developing country

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[14] This phenomenon has been labeled the Dutch disease: it refers to the negative economic impact that rapid exploitation of a natural resource may have on the rest of the economy by triggering an abrupt rise in the value of the currency that makes other export products uncompetitive. The phenomenon was first observed in the Netherlands in 1634-37 when over-reliance on tulip exports diverted resources away from other productive pursuits. The discovery of large natural gas reserves in the North Sea in the 1960s evinced a similar phenomenon.

[15] Foreign investment confidence indicators (related to the quality of economic institutions) appear to be negatively correlated with large aid flows (Knack 2000).

[16] Since the 1960s, the ten countries suffering the biggest deteriorations in democratic institutions received large aid inflows while the ten countries with the largest improvement in democratic institutions received modest amounts (Djankov, Montalvo and Reyanal-Querol 2005).

[17] According to Oxfam (2005: 8) 'too often domestic interests take precedence: almost 30 per cent of G7 aid money is tied to an obligation to buy goods and services from the donor country. The practice is not only self-serving, but highly inefficient; yet it is employed widely by Italy and the USA. Despite

policymakers have been especially critical of the quality of technical assistance funded by aid and the high cost of resident expatriates imposed by donors. On the one hand, the economic returns on well targeted and well managed technical cooperation can be astronomical since knowledge transfers can have multiplier effects and contribute to greater effectiveness of the overall financial assistance package. On the other hand, much of the technical assistance funded by aid has been provided as a *quid pro quo* for the assistance and it has not always been effectively used.[18] The same considerations explain why alternative measures of the value of aid that discount its value have been proposed (Box 1).

Box 1
The debate about the true value of aid

ActionAid International has released a report[a] that points to questionable aid-accounting assumptions and massive aid-delivery inefficiencies connected to distorted donor policies. These distortions are alleged to translate into hidden charges and costs that bring the true value of aid down to 39 per cent of the amounts reflected in the official statistics of the Development Assistance Committee (DAC) of the OECD.

In response, DAC has argued[b] that the adjustments estimated by ActionAid for debt relief, excessive transaction and administrative costs, misdirected aid, tied aid, overpriced and ineffective technical assistance, and hosting of refugees were based on misunderstandings about DAC statistics, and arbitrary judgments regarding the value of technical assistance as well as multiple counting of discounts. However, DAC acknowledges that debt relief where debt repayments are not being made does not create fiscal space or allocation of real resources by donors.

On the other hand, DAC maintains that debt relief has substantive value since repeated rescheduling imposes needless burdens on recipients and donors. Furthermore, DAC notes that the debt relief bubble of recent years will gradually disappear as the need for debt forgiveness declines. Similarly, DAC shared some of ActionAid's concerns about the development effectiveness of technical assistance but considered the discount excessive and noted that DAC had issued guidelines in 1991 to help remedy the problem.

Similarly, the problems of tied aid, high transaction costs, and other effectiveness issues raised by ActionAid had been fully discussed by donors and partner countries at a March 2005 conference that had led to substantive agreements on mutual accountability mechanisms under the Paris declaration. Finally, DAC pointed out that DAC members had made public commitments that by 2010 could add up to at least US$36 billion more aid than the US$79 billion that was provided in 2004.

[a] Source: www.actionaaid.org.uk/wps/content/documents/real_aid.pdf

[b] Source: www.oecd.org/document/29/0,2340,en_ 2649_33721_34990749_1_1_1_1,00.html - 72k-

donors' agreements to untie aid to the poorest countries, only six of the 22 major donor countries have almost or completely done so'.

18 According to a recent review carried out by the IEG (World Bank 2005b), the internal watchdog department of the Bank, the organization 'does not apply the same rigorous business practices to its capacity building work that it applies in other areas. Its tools—notably technical assistance and training—are not effectively used, and its range of instruments—notably programmatic support, Economic and Sector Work, and activities of the World Bank Institute—are not fully utilized. Moreover, most activities lack standard quality assurance processes at the design stage, and they are not routinely tracked, monitored, and evaluated'. (See also Epstein 2005.)

Geopolitical factors continue to influence aid flows. The poorest countries get less than 30 per cent of aid, and the share of aid allocated to basic social services is about half of that recommended by the United Nations (20/20 principle). Excessive aid flows can overwhelm the domestic administration.[19] Aid fragmentation through numerous channels and multiple projects may siphon skills away from core government functions through the use of salary supplements, vehicles and other perks. Poor aid coordination further contributes to the inefficiency of aid delivery.[20] Here again, aid policy reform and prudent aid management could limit the damage.[21]

To summarize, while the micro-macro paradox has been used to discredit aid, a sober review of research results suggests that well-managed aid does work, albeit with diminishing returns once absorptive capacity constraints are reached. Thus, sound aid administration and effective aid delivery could overcome most of the obstacles that stand in the way of bridging micro and macro results.

The greatest value of the micro-macro paradox theme is that it has helped to focus on the need to reform the aid industry. The task is multifaceted: (i) to reduce the fragmentation of aid; (ii) to rely on domestic processes of aid coordination centred on poverty reduction strategy papers; (iii) to favour pooling of aid for sector wide programme and budget support where country performance warrants it; and (iv) to avoid political interference in aid management.

The other useful contribution of the aid effectiveness debate has been the rediscovery of some important truths about the reality of aid. First, it is less about money than about ideas and institutions. Second, it requires sound aid policies and efficient administration. Third, it calls for effective coordination. Fourth, it needs proper alignment with country needs and priorities.

In contradiction with the policy-based aid allocation protocols that favour countries with positive ratings as measured, for example, by the World Bank country policy and institutional assessment (CPIA) index, aid seems to work best in economies vulnerable to external shocks (Guillaumont 2005) and in the poorest countries, even though their policies are weak (Roodman 2004).

The common sense proposition that aid works best in a good policy environment may be unconfirmed for the simple reason that the development community has had a hard time in defining precisely what good development policy means in diverse country environments, how to measure it and what levers to pull to get economies moving forward and societies to change for the better. As stated at the beginning of this paper, we still have a lot to learn about the impact of aid on development. The evaluation of country assistance strategies is still new. We now turn to this topic.

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19 Tanzania alone receives funding from 80 donors for 7,000 projects.

20 The Development Gateway, an independent foundation sponsored by the World Bank, provides internet services and information to development practitioners. It includes information on 340,000 projects.

21 Ninety-one countries, 26 donor organizations and partner countries, representatives of civil society organizations, and the private sector met in Paris on 28 February–2 March 2005 and committed their institutions and countries to harmonization, alignment, and managing for results.

6 Can country assistance strategies be evaluated?

Major shifts in doctrine have characterized the history of aid, with major consequences for development. Geo-economic considerations, geopolitical interests as well as development ideas have influenced the design of country assistance strategies. The numerous swings in the authorizing environment of aid and the evolving conceptions of development that these have generated have had a major impact on country development. Is it possible, in this charged context, to assess objectively the development impact of country programmes funded by aid? On the one hand, workman-like evaluation instruments have been designed and tested with credible results for individual country assistance programmes (Conway and Maxwell 1999). But on the other hand, independent and professional evaluation is still the exception rather than the rule within the aid system.

Evaluation arrangements are weakest in the nongovernmental organizations (NGOs) that have been most critical of the international financial institutions (Kruse et al. 1997). Yet the share of aid flowing through them is substantial, e.g., UK's Department for International Development gives more aid through British NGOs than through the World Bank Group (£233 million versus £206 million in 2004-05). Aid to NGOs is growing: the share of total official development aid (ODA) channelled through NGOs rose from 2 per cent in 1998-99 to 5.2 per cent in 2003-04 (OEDC/DAC 2001, 2006: table 8).

The proliferation of aid actors means that the sum of individual country-assistance programmes by diverse donors may be less than the sum of its part, another dilemma that may contribute to the micro-macro paradox. It highlights the need to carry out fully integrated evaluations of all ODA at the country level. This kind of evaluation has yet to be tested. But there is every reason to believe that it is feasible and that the time is ripe for carrying out such evaluations of the total impact of aid on individual countries. The experience with joint evaluation processes and products has been thoroughly examined and the lessons have been drawn and disseminated (Breier 2005).

There have been successful experiments in joint evaluations of country assistance strategies (involving two partners) (Edgren, Molund and Berlin 2005). Thus, in his 2003 Development Cooperation Report, the Chairman of the DAC of OECD outlined a fourfold evaluation hierarchy for aid effectiveness (impact of all aid on one country; effectiveness of the development cooperation system; evaluation of an individual donor contribution to the total system; and development effectiveness of an individual donor agency). Initial proposals for piloting evaluations focusing on the uppermost levels of this hierarchy are being reviewed by the DAC Network on Development Evaluation.[22] Finally, there is growing consensus within the profession on the basic approach to CAEs.

First, the quality of country assistance strategies should not be judged merely through aggregation of project results, despite their importance. High-quality country

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[22] The World Bank joined forces with the European Bank for Reconstruction and Development with (Kazakhstan); the African Development Bank (Lesotho); the Inter-American Development Bank (Peru and Rwanda) and the Islamic Development Bank (Jordan and Tunisia) while Norway and Sweden and Australia and New Zealand teamed up for reviews of their Malawi and Papua and New Guinea programmes, respectively.

programmes are more than a collection of disparate projects and the interaction of projects and other aid instruments must be taken into account. It is the impact of the full package of projects and services that needs to be identified, i.e., the difference between actual outcomes and outcomes that would have materialized without donor intervention. In principle, this requires the estimation of 'counterfactuals but the methodology of scenario building is not mature[23] and the generation of meaningful counterfactuals is still in its infancy. Therefore, the best that can be done within the budget constraints faced by evaluators is to use a mix of programme evaluation methods, including those that have long been in use in the assessment of social programmes in industrial countries.

This means judging country assistance strategies in the first instance against common criteria. First, high-quality country assistance strategies should be selective. Priority areas should be selected with care so that projects and other development services included in country programmes form a synergistic whole both relative to one another and to the interventions of other donors. The right instruments should be selected. The design of operations should be grounded in a constructive dialogue with country authorities and should take account of the interests and capabilities of other partners. Projects and other services should be competently managed in line with the operational policies of the donor and backed by professional analyses of development potentials, policy constraints and capacity-building needs (Ashoff 1999). Second, verifying the compliance of country strategies with the development doctrines currently in vogue is not a useful test: each developing country is unique and the track record of grand development theories has proven to be mediocre. The pertinence of country assistance goals must be judged case by case, taking account of country potentials and needs, implementation capacities and the determination of country authorities to address policy obstacles. Third, development results do not always equate with aid performance, not only because in most instances aid[24] accounts for a small part of the government's budget but also because country-level outcomes are ultimately shaped by a host of historical, geographical, political and policy factors.

In the absence of resilient hypotheses on the linkages between policy inputs and development performance, country assistance strategies cannot be evaluated by simple linear methods that examine the extent to which operations are geared to pre-ordained policy tenets. More reliable is the triangulation of evaluation methods focused on three major dimensions:[25]

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[23] Long-term growth models (not to mention large-scale econometric models) are expensive to construct and they are not very reliable. Country comparisons can provide useful pointers but the performance of one country cannot be used as a reliable benchmark for another because no two countries are alike in their factor endowments and their institutional frameworks.

[24] Aid accounts for less than 10 per cent of public expenditures in over 70 per cent of recipient countries.

[25] Whereas this approach reflects international financial institution experience, other development agencies use somewhat different approaches. For example, the European Union considers the impact of aid and non aid policy vectors in assessing the relevance, quality and size of its country programme and the resulting influence on the recipient country and its partners; the Swiss Development Corporation emphasizes participatory techniques and country involvement in its evaluation process, etc.

— the quality of individual operations, country dialogues, coordination with partners and analytical/advisory services;

— A development impact assessment, involving a ‘top-down’ analysis of the principal programme objectives and their achievements in terms of their relevance, efficacy, efficiency, resilience to risk and institutional impact; and,

— An analysis of attribution (or contribution) in which the evaluator assigns responsibility for programme outcomes to the various actors according to their distinctive accountabilities and reciprocal obligations.

In evaluating the expected development impact of an assistance programme, the evaluator gauges the extent to which major strategic objectives are relevant and are likely to be achieved without material shortcomings. Programmes typically express their goals in terms of higher-order objectives, such as poverty reduction or attainment of the Millennium Development Goals (MDGs). The country assistance strategy may also establish intermediate goals, such as improved targeting of social services or promotion of integrated rural development, and specify how they are expected to contribute toward achieving the higher-order objective.

The evaluator’s task is then to validate whether the intermediate objectives have produced (or are expected to produce) satisfactory net benefits, and whether the chain of results specified in the country assistance strategy is valid. Where causal linkages are not adequately specified upfront, it is the evaluator’s task to reconstruct the causal chain from the available evidence, and assess relevance, efficacy, and outcome with reference to the intermediate and higher-order objectives.

Evaluators also assess the degree of client ownership of international development priorities, such as the MDGs, at national and subnational levels, as appropriate. They examine compliance with donor policies, such as social, environmental and fiduciary safeguards. Ideally, conflicting priorities are identified in the strategy document thus enabling the evaluator to determine whether the tradeoffs adopted are appropriate. However, the strategy may gloss over difficulties or avoid addressing key development priorities or policy constraints, which inevitably affects the evaluator’s judgement of programme relevance.

The efficacy of programme implementation is judged by the extent to which programme objectives are expected to be met in ways that are consistent with corporate policies. Efficiency ratings concern the transaction costs incurred by donors and the country in connection with the implementation of the country assistance programme. Finally, sustainability has to do with the resilience of country assistance achievements over time and institutional development impact refers to the capacity-building benefits of the country assistance strategy.

7 What did country level evaluations find?

Based on these principles, the World Bank’s Independent Evaluation Group (IEG) compared the outcomes of Bank-financed lending operations with those of 55 country assistance programmes subjected to independent evaluation. As noted above, evaluation ratings of country assistance strategies give the place of pride to results and to the

principles of effective aid endorsed by the development community. It is therefore significant that a positive association exists between the ratings ascribed to project results and country assistance strategy outcomes. However, it is not strong. Box 2 represents a summary of the country assistance strategy ratings and of the project portfolio ratings.[26]

Box 2
Country assistance strategy and project portfolio outcome ratings

	Country assistance strategy	
Project performance	Satisfactory	Unsatisfactory
Satisfactory	Argentina 2000* Bolivia 1998* Brazil 2003 Bulgaria 2002* Burkina Faso 2000* Cambodia 1999* Cameroon 2000 Chile 2002 Dominican Republic 2003* Egypt 2000* El Salvador 2001 Eritrea 2003* Guatemala 2002 India 2001* Indonesia 1999* Jordan 2003* Kazakhstan 2001* Kyrgyz 2001* Lithuania 2003* Maldives 1999 Mexico 2001 (1989-91)* Mexico 2001 (1995-96)* Mexico 2001 (1997-2000)* Mongolia 2002* Peru 2003 Rwanda 2004 (1995-2001)* Sri Lanka 1999* Uganda 2000* Uruguay 2000 Vietnam 2002 West Bank/Gaza 2002 Yemen 1999 32 CASs	Morocco 1997* Bulgaria 2002* Costa Rica 2000 Ecuador 1999* Haiti 2002* Jamaica 1999* Lesotho 2002* Mexico (1992-94) 2001* Nepal 1999* Paraguay 2001* Peru 2003 Russia 2002 (1992-98)* Ukraine 1999* Yemen 1999* Zambia 2003 Zimbabwe 2003* 16 CASs
Unsatisfactory	Ethiopia 1999 Ghana 2000 Russia 02 (1999-2001) 3 CASs	Rwanda 2004 (1990-94) Guatemala 2002 Papua New Guinea 20000 Cameroon 2000 4 CASs

Note: The asterisk (*) connotes a marginally or moderately satisfactory (or unsatisfactory) rating rather than a fully satisfactory (or unsatisfactory) rating for one or both aspects of performance.

Source: World Bank, IEG.

[26] The year noted after each country listing refers to the publication date of country assistance evaluations (CAEs). Where different ratings apply to different periods they are noted in parentheses.

8 Frequent congruence between project level and country level results…

Remarkably, the country dialogue, the operations selected and the country's own priorities were found to be in appropriate alignment in 58 per cent of the country assistance strategies (32 out of 55), and the overall results were positive both at the project level and at the higher plane of country strategy.[27] In 14 of the 32 successful cases, where there was no disconnect between the performance of the strategy and the projects, fully satisfactory ratings were awarded for both performance aspects. Even hardened aid sceptics would be impressed by the major development influence of professionally selected and well-implemented projects documented in convincing detail at the country level in these objective and revealing evaluations.[28]

For example, in Brazil, the selective country assistance strategy is grounded in sound analytical work built on the successful stabilization programme of the Plan Real to attack root causes of poverty through human resource development, access to basic services and special attention to the depressed northeast region. This was complemented by a good support programme for environmental protection and by adjustment loans targeted to fiscal reform, social protection and energy sector reform that achieved mixed results. In China, the World Bank achieved excellent results through (i) workshops geared for the persuasion of senior policymakers; (ii) a trust-enhancing dual track approach that combined well-targeted investment lending and a gradualist approach to policy change; (iii) utmost care in the selection of partners; and (iv) systematic pursuit of demonstration effects whether technological, managerial or policy based.

In Tunisia, a well-crafted country assistance strategy and a judicious mix of investment and adjustment lending helped move the country towards early achievement of the MDGs through sustained growth (more than 5 per cent per annum during 1996-2002), economic diversification and patient support of market-oriented structural reforms. In Vietnam, the country assistance strategy emphasized poverty reduction based on extensive economic and sector work, and careful tracking of nationwide results in synergistic combination with project lending.

Marginally (or moderately) satisfactory ratings were awarded in another 12 cases for the strategy and fully satisfactory ratings for the portfolio. For example, the Burkina Faso strategy achieved a moderately satisfactory rating: economic reforms reduced inflation and triggered growth, but the majors reforms (including a lacklustre privatization programme) did not translate into poverty reduction despite aid levels being four times as high as the African average. The sluggish progress on social indicators was linked to severe natural resource constraints, high population growth, seemingly intractable land tenure problems and the HIV/AIDS epidemic. The top-down approach to participatory development (a legacy of its colonial and revolutionary past) contributed to the failure to trigger genuine social development.

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[27] A review of the CAEs contained in a recent publication by the World Bank's Evaluation Group (Chibber, Peters and Yale 2006) draws on 25 reports produced during 2001-03. They reach similar conclusions: the alignment between strategy and portfolio ratings is 60 per cent.

[28] All the CAE reports of the Bank's IEG (formerly known as the Operations Evaluation Department—OED) briefly summarized in this section are available on line at www.worldbank.org.

In another six cases, country strategy was rated fully satisfactory while project portfolio ratings were marginally satisfactory. For example, with a strong and well-managed World Bank and bilateral donor support, Uganda rose to achieve impressive results in economic stabilization, growth and poverty reduction despite the ravages of HIV/AIDS. However, chronic institutional weaknesses remain to be addressed (weak local governments, fiduciary assurance gaps, corruption). They have contributed to a less than a sterling record for project implementation while the halting progress towards democracy, the chronic insurgencies of the border areas and the turmoil of neighbouring countries threaten political stability.

Potential performance shortfalls or positive turnarounds are not fully captured by the ratings. Thus, the moderately satisfactory scores for the performance of Bolivia's assistance strategy for 1985-96 were accompanied by prescient warnings about the lack of progress on structural reforms—concerns that were dismissed at the time by policymakers, given the 'halo effect' of a highly successful macroeconomic stabilization programme.[29] Similar evaluation ratings for the Indonesian country assistance strategy of 1990-98 struck a balance between the remarkable poverty reduction achieved with World Bank support and the failure to address corruption issues and financial sector weaknesses. The latter proved to be the strategy's pitfall when the financial crisis swept over East Asia.

At the bottom of the performance ladder, ratings indicated similar results at both the macro- and micro levels (i.e., the IEG concluded that the World Bank failed to achieve its assistance objectives at both project and country levels) in four countries (Cameroon, Guatemala, Papua New Guinea and Rwanda 1990-94). These were instances where all aspects of the country assistance strategy had to contend with severe governance obstacles that proved impervious to country dialogue, analytical work or lending.

9 …but there is such a thing as a micro-macro disconnect

Nineteen cases involve a full micro-macro 'disconnect' with respect to country assistance strategy. In 16 of these, outcomes were unsatisfactory at the level of the country assistance strategy even though average project outcomes were satisfactory. In Costa Rica (1990-2000), for instance, strategy failed even though the economy performed well and poverty reduction results were impressive. This is because the World Bank had pressed for reforms that did not conform to the development strategy adopted by the country. Inevitably, country relations languished and the strategy objectives could not be met although the few projects that were implemented produced good results.

In 15 countries, projects in the country portfolios achieved most of the objectives efficiently while country performance was poor or mixed. The causes of the micro-macro mismatch vary considerably. In some cases, satisfactory outcomes were achieved on projects that had limited relevance because of poor governance (e.g., Paraguay) or rapidly deteriorating political situation (e.g., Zimbabwe). In Morocco, the Bank abstained from lending for relevant operations (and/or the borrower opted not to

[29] A more recent evaluation of the Bolivian programme (2005) rated the country assistance strategy as unsatisfactory.

borrow) in view of the critical but controversial policy issues that, according to the evaluators, might ensue, had these been attempted. In other cases, project outcomes were rated satisfactory but the government was slow in implementing reforms (e.g., Russia 1992-98) or backtracked on them (e.g., Peru).

In the remaining instances of a full micro-macro ‘disconnect’ (Ghana, Ethiopia, Russia 1999-2001), the World Bank achieved positive results at the country level through its analytical and advisory services despite project failures due to weak implementation capacity in the ministries concerned. All in all, a full fledged micro-macro paradox was found to prevail in one-third of the cases.

10 Agency performance and development outcomes do not always coincide

It is worth noting that outcome ratings are not necessarily equated with the performance of the World Bank (in terms of the quality of its country dialogue and its services) because other partners are also involved in generating development outcomes and exogenous factors (e.g., El Niño or the terrorist insurgency in Peru) often intervene. In fact, the aggregate results of development interventions are, above all, dependent on the role played by the country concerned. Other major donors may also contribute to the ultimate impact of a development programme. This means that quite apart from the possible existence of a micro-macro paradox, a disassociation between development outcome/agency performance is potentially present.

Thus, in Bulgaria during 1989-97, the objectives of the strategy were highly relevant and the Bank’s analytical, advisory as well as operational work was sound, but the reforms—the object of the strategy—stalled due to political opposition and the outcome was unsatisfactory. In Haiti, Bank and donor performance overwhelmed the administrative capacity of the country due to lack of selectivity during the 1986-97 period. Since then, donor performance has improved but governance dysfunctions proved insuperable and the Bank understandably reduced its involvement sharply through a cleanup of its project portfolio and a highly prudent stance.

In Rwanda in 1990-93 the Bank performed well overall, but its efforts to persuade the government to reform its policies, improve the quality of social services, undertake public enterprise reforms and give a greater role to the private sector failed to yield fruit. In Paraguay, the World Bank did good analytical work, promoted public debate on policy options and pursued a cautious lending strategy, but the political situation worsened and reform measures were not taken. Risks must be taken to capture development rewards. The challenge lies in assessing development risks, sharing them and managing them.

11 Where is the aid industry going?

The aid business is in rapid transition. The development challenge is as great as it has ever been. More than a billion people subsist on less than a dollar a day, while over 800 million people are malnourished. Global inequities are staggering. If the remarkable growth rates of China and India are excluded from statistics, the inequality *among* nations has been getting worse, and *within* some countries they are almost as serious.

Complacency is out of the question. The chances of survival of a baby born in Mali are almost twenty times lower than those of a baby born in the United States. Children's access to immunization among the richest fifth sector of Eritrean population is complete whereas this is possible for only half of the children in the poorest fifth.

At the turn of the century, the MDGs injected new energy into poverty reduction efforts. Aid flows are picking up again after a long and steep decline. Humanitarian activities and voluntary peacemaking initiatives are at an all-time high. After a long eclipse, development is back once again on the curriculum of elite universities. Development thinktanks are proliferating and the increase in the number of publications, conferences and workshops dealing with development issues does not seem to be abating. Development advocacy campaigns led by international NGO networks have become more professional, vocal and effective. Their aim has captured the imagination of the young: to 'make poverty history'. The aid industry still has life in it.

Unfortunately, doctrinal debates, while somewhat less strident, are still dividing public opinion and promoting aid pessimism. On the left, anti-globalization activists ascribe global poverty to deliberate mechanisms of natural resource extraction, social exclusion and cultural domination that consign the 'south' to isolation and marginalization (a 'containment' strategy directed *against* the poor). Yet, many developing countries have achieved poverty reduction by hooking onto the mighty engine of the global market. On the right, market fundamentalists argue that protectionist and 'statist' policies are to blame but many countries afflicted by weak institutions have gone through the rigors of structural adjustment without achieving poverty reduction. In both camps, democracy activists point to corrupt and tyrannical leaders that oppress their peoples and plunder natural resources—even as democracy is on the march.

The global war on terror and the Iraq conflict have generated a division among western countries but aid is gradually being 'securitized' on both sides of the Atlantic. This may be bad news since geopolitical aid is usually ineffective. But it may also portend good news if the convergence of security and development policies focuses attention on fragile states. Making progress towards the MDGs calls for special support to weak and conflict-prone states that have been bypassed by aid allocation practices which discourage risktaking and rely on indicators that confuse adverse initial conditions and weak institutions with poor performance. One can only hope that the emergence of human security as an overarching theme of international cooperation will create new dynamics that will facilitate the introduction of 'whole-of-government' policies that promote freedom from fear as well as freedom from want.[30]

Far from being a cartel (Easterly 2002), the aid industry has become ever more fragmented and competitive (Klein and Harford 2005). New entrants include official donors (India, China, Slovenia, Thailand, etc.) along with a bewildering variety of foundations and voluntary agencies. Within individual donor countries, development ministries, semi-autonomous agencies and specialized financial and investment guarantee institutions focused on the private sector compete for public support and rely on a vast network of contractors, consultants, think tanks and academic institutions.

[30] In Sweden, the 'whole-of-government' approach for global development has been endorsed by legislation, making all government departments accountable for the promotion of equitable and sustainable development and peacemaking in poor countries.

Multi-country collaborative programmes, public-private partnerships and specialized funds are being set up to address a host of increasingly severe global challenges (e.g., HIV/AIDS).

The nature of development cooperation is also changing because new mechanisms of resource transfer are dwarfing the 'money' impact of aid and creating new links between rich and poor countries (as well as among poor countries). The private sector is already vastly outpacing the public sector both as a source and as a recipient of loans and grants. Worker remittances are growing rapidly and are expected to exceed US$230 billion in 2005. Another injection of US$260 billion worth of foreign direct investment, equity flows and commercial loans is directed at poor countries. Thus, total private flows are at least four times as high as aid flows. The net welfare benefits that could flow from trade liberalization also represent a multiple of aid flows especially if restrictive tariffs against labour-intensive products are reduced, poor-country workers are allowed temporary access into rich countries, and food-importing countries are induced to generate successful agricultural supply response through 'aid for trade' schemes.

Knowledge flows need liberalization, too. The intellectual property rules imposed during the Uruguay Round involve a reverse flow of the same order of magnitude as current aid flows. Some relaxation of the TRIPS Agreement was introduced under the Doha Round for life-saving drugs, and technological development requires patent protection. But to level the playing field of the global knowledge economy, special provisions are warranted for encouraging research relevant to poor countries, for bridging the digital divide and for filling the science and technology gaps of the poorest countries. Finally, the environmental practices of rich countries and the growing appetite for energy of the Asia giants may induce global-warming costs for developing countries that are likely to exceed their value (4-22 per cent versus 7 per cent of national incomes) through losses in agricultural productivity (Birdsall, Rodrik and Subramanian 2005).

In combination, all of these trends mean that the relative importance of aid flows[31] compared to other policy instruments (trade, migration, foreign direct investment, etc.) has been reduced as a result of globalization. But aid will remain critical to attend to emergency situations and post-conflict reconstruction, as a midwife for policy reform, as a vehicle for knowledge, technology and management practices, as an instrument of capacity-building (especially for security sector reform) and as a catalyst for conflict prevention.

Programmatic aid and budget support are useful aid vehicles in well-managed countries. But wielded with skill and professionalism, the project instrument should regain the allure it lost when the neoclassical resurgence required a massive diversion of aid flows towards policy-based quick disbursing loans and budget support operations. Already projects for infrastructure development and natural resource extraction that are equipped with social and environmental safeguards are making a comeback, mostly through support to private enterprises and voluntary agencies, especially in weak states. Aid for

[31] Except for the smallest, poorest and most aid-dependent countries where coordination will continue to pose major challenges.

community-based social protection schemes is also rising, given the continuing public support for the notion that development is a bottom-up micro process.

In brief, through the revival of investment lending geared to the creation of institutions, the promotion of private investment and the mobilization of communities and voluntary organizations, the micro-macro paradox could be exorcised since it only haunts the money dimension of aid. Not that policy-based lending will disappear altogether. Many poor countries still need to improve their macroeconomic and structural policies, especially those related to trade facilitation and the enabling environment for private enterprise. But they may elect to do so through free standing advice and capacity-building assistance rather than repeated and addictive dollops of quick disbursing funds.

12 What is to be done?

Once in a hole it is advisable to stop digging. A revised strategy is needed: development is moving forward but at a slow and decelerating pace and very unevenly. Since 1980, only one-third of the developing countries have grown faster than developed countries while another third have shown no increase in GDP per capita. In the same period, poverty decreased substantially only in Asia while it increased in Africa, Eastern Europe and Central Asia nor did it decrease materially in Latin America or the Middle East. To be sure, socioeconomic indicators have improved but not in Africa where they have regressed significantly. Poverty, violence and governance dysfunctions are self-reinforcing and must be addressed together. Since the end of the cold war, the spread of democracy has accelerated and the incidence of conflict has been reduced but not in the poorest quartile of countries (World Bank 2005a, 2005b). The front line of the war on poverty is in the fragile states of the world but also in the vast depressed and neglected areas of low- and middle-income countries, including China and India.

First and foremost, aid should no longer be viewed as the only tool in the development cooperation kit. Coherence among conflicting aims (OECD 2005) remains a major challenge for development cooperation.[32] The whole-of-government approach is needed to ensure that policy coherence for development becomes the driving force of donor countries' relations with poor countries. This means that trade, migration, foreign direct investment, intellectual property and environmental policies should all be shaped to benefit poor countries or at least to avoid doing them harm. From this perspective, aid should be viewed as the connecting thread between all policies that link the donor country to each developing country. This implies different kinds of country assistance strategies. To help support the reorientation, multilateral agencies should use their analytical skills to evaluate and monitor the quality of rich countries' policies towards poor countries.

Second, the downside risks of current development patterns should be acknowledged and conflict prevention, conflict management, post-conflict reconstruction, security sector reform, etc. should move to centre stage in country assistance strategies and

[32] In the US and among some of its allies, the war on terror has replaced the anti-communist crusade as a geopolitical rationale for development assistance and this constitutes a major threat to development effectiveness as well as a potentially destabilizing approach to international relations.

poverty reduction strategy papers. In parallel, multilateral agencies and regional organizations should use their convening power and their management skills to organize mission-oriented networks involving governments, the private sector and the civil society to design and implement collaborative programmes. They would aim at global or regional threats to peace and prosperity and they would be implemented at global, national and subnational levels. Already, major coalitions of donors are seeking to address such development challenges as HIV/AIDS that do not respect national borders. Increasingly, they will be mobilized to tackle the myriad illegal activities that constitute the dark side of globalization (e.g., the booming trafficking of drugs, arms and people) by combining law enforcement with development alternatives. In a nutshell, dealing with the downside risks of globalization will require adopting a human security model of development that continues to favour growth but with greater priority to economic equity, social inclusion and environmental sustainability.

Third, aid should no longer be conceived and evaluated as a resource transfer mechanism. Instead, it should be understood as a transmission belt for ideas, a device for training development leaders, an instrument for building state capacity and a platform for policy experimentation and dissemination based on good analytical work and sensitive advisory service. In the poorest aid-dependent countries, the convening power of the multilateral institutions would be used to help overcome the growing fragmentation of aid. Towards this end, the commitments made by donors to improve aid quality, eliminate tied aid, reduce transaction costs, harmonize policies across donor agencies and align aid objectives with country felt needs and public expenditures processes should be met. But this does not mean that the project vehicle should be jettisoned. Well designed and professionally implemented through donor coalitions, it can yield considerable benefits. Instrument selectivity is central to aid effectiveness.

Fourth, country assistance programmes should be tailored to the political economy. Human security considerations should be prominent in strategy design. Governance should be professionally assessed and conflict analysis should ensure that aid does no harm and that horizontal inequalities are taken into account in project designs. Standard, blueprint models reflecting doctrinal positions (e.g., with respect to privatization) should be abandoned and the transfer of good practices properly adapted to country context emphasized. Where government authorities are not committed to development, non aid instruments should be used and aid should emphasize infrastructure, the private sector and civil society channels as well as local government and community level organizations where good leadership can be identified and future leaders trained. Budget support has its place but not always and everywhere.

Fifth, given limited resources, selectivity is essential but the current aid allocation system short-changes fragile states. Policy research has established that they are currently receiving 40 per cent less than they should even if policy performance considerations are taken into account. If viewed in terms of the potential benefits achieved through conflict prevention and the satisfactory project level outcomes of almost 60 per cent (of World Bank projects in fragile states during 1998-2000),[33] as confirmed by independent evaluations, these would suggest that high risks can lead to

[33] Furthermore, current aid allocation rules do not take account of the benefits of conflict prevention and yet research by Collier and Okonjo-Iweala suggests that, on the average, preventing a single war would save US$64 billion a year.

high rewards. It is also notable that the performance of private sector projects funded by the International Finance Corporation has been as good in fragile states as elsewhere.[34]

The current system rests on three misconception, the first of which has to do with 'fungibility', an abstraction that ignores the institutional arrangements that have been demonstrated as being effective in minimizing its effects through project selection, fiduciary rules, public expenditures oversight and private sector/civil society involvement. Money is fungible but not money with strings.

The second misconception holds that policy and governance, as measured by the CPIA index, is a major factor of aid effectiveness. In fact, the index measures initial conditions more than policy performance. Furthermore, statistical tests cannot confirm that aid works better in good policy environments as measured by the CPIA whereas they do confirm that aid works better in countries with high economic vulnerability. This is why donors are on shaky grounds when they allocate aid on the basis of idealistic lists of governance indicators that have not been validated by robust econometrics. Nor is the results-based aid a panacea. A host of measurement problems, contractual dilemmas and principal agent constraints will have to be overcome to turn this abstraction into reality.

The third misconception holds that country policies cannot be improved through conditionality. Of course, conditionality should not be used in a coercive way to impose standard Washington consensus blueprints (whether in the original or enhanced forms) since it is now well established that reforms must be closely adapted and sequenced to the peculiar circumstances of individual countries. In any event, the evidence is overwhelming that one cannot 'buy' reform.

Yet, sensible conditionality is at the core of high quality aid. Experience confirms that with patience, professionalism and trust, sensible operational prerequisites that have been agreed through persuasion and country dialogue can do a lot of good and help to nurture broad-based ownership of good economic management principles, especially when combined with trade inducements (e.g., Mexico and NAFTA, Hungary and Poland before their EU accession) or long-term development partnerships, e.g., Bangladesh, Chile, Ghana, Uganda, Turkey and Vietnam (Branson and Hanna 2002).

Last but not least, development education should have high priority. The public in the industrial democracies should be exposed to the reality of aid, its inevitable challenges and its exciting opportunities. Currently voters vastly overestimate the share of government budgets allocated to aid.[35] Most are unaware that total aid flows have declined from about 0.65 per cent of the national incomes of OECD countries in 1967 to 0.25 per cent today[36] or that aid absorbs only a twentieth of the resources absorbed by

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[34] This conclusion is based on the degree of loss reserves, historic write-offs, default rates, equity investment measures and independent ratings of development outcomes, normalized for the class of investment (Collier and Okonjo-Iweala 2002).

[35] Americans are under the impression that the US spends 24 per cent of its federal budget on aid. They believe that 10 per cent should be spent in this way whereas, in fact, the US dedicates less than 1 per cent of the federal budget to aid.

[36] The US allocated 2 per cent of its national income to the Marshall Plan now but contributes less than 0.2 per cent for aid to poor countries, less than a quarter of what it spends on carbonated drinks.

the military. The self-interest rationale of development cooperation in the era of globalization should be clearly articulated. In an interconnected world the problems of others have become our own. There is no prosperity without peace, and there is no peace without justice.

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