



CHAPTER 11

Reforming Development Cooperation to Attack Poverty

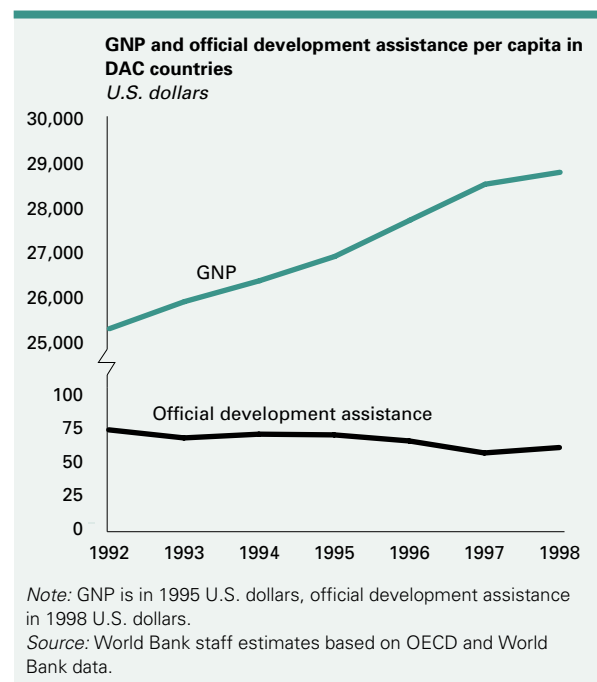
Development cooperation is being reformed. From the relationship between donor and recipient to the way in which aid is delivered and the framework for debt relief for the poorest countries, many of the old ways of assisting development are beginning to be replaced by new forms.

Much of this is due to a reaffirmed commitment by the international community to fight poverty. The World Summit for Social Development in Copenhagen in 1995 set forth the goal of eradicating poverty in the world through decisive national actions and international cooperation. Donors have included halving poverty between 1990 and 2015 and other targets among their international development goals (see box 2 in the overview).¹ In the 12th replenishment of the International Development Association (IDA) in 1998, donors reaffirmed their mission to support programs to reduce poverty and improve the quality of life in IDA's poorest member countries.² The Jubilee 2000 movement helped put deeper debt relief at the heart of development cooperation strategies for poverty re-

duction. And donors are working to resolve differences in approaches to poverty reduction through the OECD's Development Assistance Committee (DAC), which expects by mid-2001 to agree on guidelines for poverty reduction to help donor agencies make their programs more effective.³

But while the international community's commitment to attack poverty was strengthened in the 1990s, official development assistance shrank. This, despite the optimism at the start of the 1990s that development cooperation would reap a post-cold war "peace dividend" from cutbacks in military spending.⁴ Indeed, after peaking in 1992 (in real terms), official development assistance fell consistently over the decade—despite the robust economic growth of DAC countries—rebounding only slightly in 1998 during the global financial crisis (figure 11.1). Sixteen of the 21 DAC countries spent a smaller share of their GNP on development assistance in 1997–98 than in 1988–92.⁵ The regional distribution of this aid remained roughly constant between 1987 and

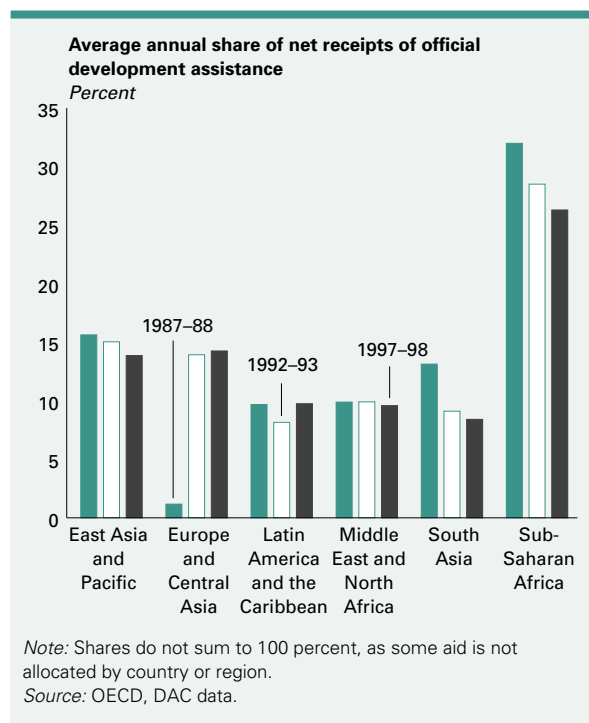
Figure 11.1
While donor countries' economies grew after 1992, their development assistance shrank



1998, apart from an increase in the share going to Europe and Central Asia (figure 11.2). But total development assistance fell in every region except Latin America and the Caribbean after 1992–93 (figure 11.3). Preliminary estimates show that official development assistance rose again in 1999, by about 5 percent, though it is too soon to know whether this reflects more than the response to the Asian crisis and indicates a much-needed real and sustained reversal of the downward trend in the 1990s.

The decline has been costly for many countries. Although it has coincided with massive inflows of private capital to developing countries, very little of that capital goes to the poorest countries. Net private capital flows to low- and middle-income countries reached \$268 billion in 1998 and now dwarf aid flows in some countries. Overall, private flows to developing countries surged during the 1990s, from 43 percent of total resource flows in 1990 to 88 percent in 1997, just before the East Asian financial crisis. However, inflows of private capital have been concentrated in relatively few countries; a large number of countries receive little or nothing. In 1997, before the financial crisis, the top 15 developing country recipients received 83 percent of

Figure 11.2
With the exception of Europe and Central Asia, the regional distribution of official development assistance remained roughly constant . . .



private capital flows to developing countries, leaving some 140 developing countries and territories (with about 1.7 billion people) to share the remainder. Almost entirely left out were the 61 low-income countries besides China and India.⁶ For example, all of Sub-Saharan Africa received only 1.2 percent of flows to developing countries in 1998. These are the countries that need aid most, and they are hit hard by its decline.

There is no single reason for the decline. Donors initially cited their fiscal deficits as a large part of the problem. Yet even as these deficits declined (from 4.3 percent of GDP in 1993 to 1.3 percent in 1997), official development assistance continued to shrink, dropping 14 percent from 1996 to 1997.⁷ A more likely explanation is that donors continue to view development cooperation through a strategic lens rather than a poverty lens, seeing other uses for their money as strategically more important. Historically, aid flows have been determined more by political and strategic interests than by poverty reduction goals.⁸

Perhaps more noteworthy is the decline in support from the traditional proponents of official development

Figure 11.3
 . . . while receipts fell after 1992–93 in all regions but Latin America and the Caribbean



assistance. The preeminence of geopolitical interests is not new.⁹ But what is new is the falloff in countervailing support from advocates for development assistance on humanitarian grounds. Many fell victim to “aid fatigue” and were far less vocal supporters in the 1990s than before.

Not every country was affected by aid fatigue—indeed, aid flows increased from some countries—but its symptoms were clearly evident. For example, in the United States a comprehensive poll found that an overwhelming majority of the population favored foreign aid in principle—and that only 35 percent thought it should be cut from current levels.¹⁰ Yet more than 80 percent of respondents believed that waste and corruption kept foreign aid from reaching the people who need it. This kind of public disillusionment may have made it harder for donor governments to maintain foreign aid, let alone increase it. If aid is not working, the sentiment goes, the money could be better spent elsewhere.

In contrast to the rise in aid fatigue in some places was a major upsurge in support and activism around debt reduction, most notably under the auspices of the Jubilee 2000 movement of religious organizations and other civil society groups. They rallied around the cause of

cutting debt for poor countries to support poverty reduction and human development. So there is clearly continuing support for the principle of providing resources for improving the lives of poor people in the developing world, but widespread questioning of the traditional mechanisms for providing such resources.

Is aid working? Can it work better? What is the role of debt reduction in concessional support? Developing countries themselves will largely determine through their own policies whether they achieve the international development goals. But aid and debt relief can provide crucial support. So finding out how to make these more effective—and then doing what it takes—remains vital.

In answering these questions, this chapter outlines a vision for a better system of development cooperation, one based on new thinking and new practices. This vision includes a reformed framework for country-focused aid and debt relief for the poorest countries—underpinned by a renewed emphasis on the policy and institutional environment and the fundamental priority of poverty reduction. Donors would work in partnership with countries, directing aid and debt relief along the lines of a broad-based poverty reduction framework (as advanced by many donors and laid out in this report), supporting countries that can put these resources to good use for poor people.

Supporting good policies and institutions is important, but it is not enough. We learned in the 1990s that process is as important as policy in foreign aid and the management of unsustainable debt burdens. The way donors and recipients interact strongly influences the effectiveness of development cooperation. Relationships have tended to follow the preferences of donor countries, leaving recipient countries with little sense of ownership of the aid-financed activities. Along with advancing a broad-based poverty reduction framework, this report emphasizes how much local realities matter in development. That aid relationships have too often failed to take local realities into account, undermining ownership, is an important flaw.

If development cooperation is to attack poverty effectively and efficiently, donors will need to:

- Pay more attention to local conditions and country ownership.
- Deliver aid in ways that intrude less on government functions, including greater use of sectorwide approaches and a movement away from old forms of aid conditionality.

- Provide sustained support for policy and institutional environments that are strongly conducive to poverty reduction, in preference to ones that are not.

The chapter begins by exploring how these new approaches can make aid more effective. It then examines the issues associated with relieving the debt problem of poor countries.

Making aid more effective in reducing poverty

Recent studies confirm what anecdotal evidence has long hinted: the experience of aid has been mixed.¹¹ Early predictions that aid would close the financing gap that prevented developing countries from moving ahead have not come to pass. If all the aid that went to Zambia between 1961 and 1994 had gone into productive investment, and if investment had been as important to growth as initially predicted, the country's per capita income would have been more than \$20,000 in 1994, not \$600.¹²

And yet there have been many aid successes. The Onchocerciasis Control Program is but one example (see box 10.1). Aid was important, in different periods, in East Asia's extraordinary success in poverty reduction over the past few decades. The rapid progress in Vietnam in the 1990s is another example. So aid can work. The challenge for the international community is to understand how to make it work consistently—and then to do what it takes.

The key problems with aid

Aid's difficulties in reducing poverty go deeper than the sway of geopolitical interests over development interests, which has often directed aid to countries whose policies were not focused on reducing poverty. Aid has been hindered by the frequent differences in donors' perspectives on development policies, even though the past 50 years have been punctuated by times of relatively wide consensus on the best way to pursue development.¹³ Donor differences have played a key role in preventing aid from achieving full effectiveness. Donors have often failed to coordinate their efforts, countries have not taken ownership, and there has been heavy use of conditionality both at the project level and economywide.

In the first two decades after World War II state-led industrialization was generally seen as the best way to pursue development, a consensus undone in the 1970s by world events, including the demise of the fixed exchange rate system and two oil shocks, which had devastating im-

pacts on developing countries. It was widely believed that government interference in the economy had prevented developing countries from adjusting to these shocks. Subsequently, a new consensus began to form, eventually to be known as the "Washington consensus" (see box 4.1 in chapter 4).¹⁴ To many, including staff at the World Bank and other multilateral financial institutions, fiscal prudence, free markets, and outward orientation had clearly demonstrated their superiority as the most efficient way for countries to grow and develop.¹⁵

But it has become clear that simple strategies for development and poverty reduction are elusive. While markets are a powerful force for poverty reduction, institutions that ensure that they operate smoothly and that their benefits reach poor people are important as well. As the 21st century begins, donors are coalescing around a development strategy that includes investing in people through health and education services, promoting inclusive and equitable growth, supporting good governance, and protecting the environment.¹⁶ This strategy also recognizes the centrality of local conditions: that the most effective development policies will vary by situation.

Despite this growing consensus on the broad development framework, agreement on the right policies in particular conditions has tended to elude donors and recipients. Donors come to development problems with their own mandates, histories, ideologies, and political realities and often do not see situations in the same way as other donors or the recipient countries. Even in health and education, which all donors agree are essential, the right reforms are open to debate. As an analyst commented, there is "a bewildering multitude of national systems and experiences, with varied (and hotly debated) advantages and disadvantages associated with each."¹⁷ So while the days of adhering strictly to either state-led or market-led solutions are over, between these extremes lie a host of options, and the debate on them is far from over.

The lack of consensus on the broad outlines and the details of national and local policies and projects has reduced the effectiveness of development assistance.¹⁸ This effect is especially evident in problems of ownership, donor coordination, fungibility, and conditionality—the four main issues affecting aid in the 1990s.

Ownership. Because donors and recipients often disagree, donors have looked for ways to ensure that their money is spent as they intend. They have run their own projects, required detailed reports from countries on projects, and attached conditions—usually policy oriented—

to the use of funds. A major study on relations between donors and African recipients found that “in spite of some improvements, donors still tend to dominate the project cycle and pay inadequate attention to the preferences of the government or project beneficiaries.”¹⁹ These efforts to ensure that aid is spent effectively, evidence now shows, have often had the opposite effect by diminishing ownership by the recipient country.

Analyses show that ownership is a key ingredient of aid effectiveness.²⁰ How strongly a country believes that a project or reform will bring benefits affects the effort put into the activity, the domestic resources contributed, and the commitment to the activity after the donor has left—all substantial determinants of success. To succeed, reforms and projects must foster ownership by the people for whom the policy or project is ostensibly being implemented.

Donor coordination. When different donor priorities and project-related conditions (including donor-specific reporting and procurement requirements) are multiplied many times over, they can create an unworkable environment for a recipient government. Just the sheer number of donors and donor projects can be challenging. At one point there were 405 donor-funded projects in the Mozambican Ministry of Health alone. In the early 1990s in Tanzania there were 40 donors and more than 2,000 projects. In Ghana during the same period 64 different government or quasi-government institutions were receiving aid.²¹ Coordinating these efforts to support a coherent development strategy—even at the sector level—is nearly impossible.

Fungibility. Studies show that aid funds allocated to a particular sector tend to free up for other purposes money that the government would otherwise have spent in that sector.²² This means that in funding specific projects or sectors, donors may actually be helping to increase spending on sectors they do not want to finance, such as the military. This has profound implications for development cooperation. Project-level evaluations will not reflect the true impact of aid, since aid is likely to be freeing up resources for other activities.²³

Even where resources are fungible, donor support can still have some impact, from the design of certain policies to institutional development. Moreover, in countries highly dependent on aid, donors as a group could lead to shifts in government resource allocations, because of the sheer size of flows. A potentially important part of this is the preference of donors to support development budgets, which can lead to a net shift in resources out of the recurrent budget—not always a good thing for develop-

ment because of the importance of recurrent spending in maintaining basic social and economic services.²⁴

Conditionality. Donors know that even properly implemented projects will have limited impact in poor policy environments.²⁵ A well-built school will be useful only if money is budgeted annually for teachers, books, and supplies—and if the economic environment enables children to go to school. The role of good policies and institutions in ensuring sustainable results suggests that aid should flow more to countries with a good overall policy environment and good policies for poverty reduction. But the relationship between good policies and aid flows has not been strong.²⁶

This finding would be understandable if aid were spurring policy reform by influencing countries to change their policies or by helping them do so. This has been the intention of many donors, and it is one reason (fungibility is another) that many of them have reduced the share of their portfolio allocated to projects and increased the share allocated to program and policy-based aid.²⁷ Most program and policy-based aid has been tied to the enactment of certain policy reforms. But studies in the 1990s showed little systematic relationship between conditionality and policy changes, though case studies do find positive effects under some conditions, especially where conditionality supports the hand of reforming groups.²⁸

The dynamics between aid donors and recipients explain why conditionality fails. Recipients do not see the conditions as binding, and most donors are reluctant to stop giving aid when conditions are not met.²⁹ As a result, compliance with conditions tends to be low, while the release rate of loan tranches remains high.³⁰ Thus aid has often continued to flow despite the continuation of bad policies.

In addition to performing poorly in influencing policy reform, policy-related conditions, often combined with project-related conditions, severely burden developing country administrators—a problem that has become more pronounced as conditionality has expanded. Conditions on World Bank adjustment loans, having mushroomed in the 1980s, continued to grow in the 1990s along with the expanding development agenda.³¹ As one recent assessment put it: “Although much has been added to the conditionality menu since 1981, nothing has been taken off.”³² The time government officials spent negotiating and monitoring these conditions is time they could better have spent analyzing development problems and designing development strategies. Ownership has been shown to be

central to the sustainability of both projects and policy reform, and the fact that the delivery of aid weakens it is a fundamental flaw of current development cooperation mechanisms.

Solutions that accommodate different perspectives

While the dominant forms of donor-recipient relations have allowed donors to pursue their own priorities, the result has generally been a fragmented system that undermines their efforts. The challenge in reforming international development cooperation is to accommodate different perspectives on development without overburdening the recipient or undermining ownership.

Achieving global uniformity in development strategies might be one solution, but history shows that uniformity is undesirable. Development is determined to a great extent by local conditions, including social institutions, social capability, ethnic fragmentation, inequality, and geography.³³ In studies these variables significantly explain the variation in growth rates over the past 30 years.³⁴ Studies also show that external shocks—and the ability to respond to them—can have as much effect on growth as policies do.³⁵ The approach to designing development strategies should therefore be flexible enough to adjust to both internal and external conditions.

This perspective began to take hold in the development community in the late 1990s. Combined with new thinking on aid effectiveness, it has prompted proposals to address the problems of aid. Three prominent themes are ownership and partnership, less intrusive aid delivery mechanisms that focus on the overall policy and expenditure framework, and selectivity. Together, they form the agenda for the international community to improve development cooperation in the coming decade.

Ownership and partnership. Recognizing the importance of ownership and the problem of donor coordination, most donors have embraced partnership as a guiding principle in interactions among donors, governments, and citizens in developing countries.³⁶ Most partnership frameworks have two parts. The first is a partnership between the recipient government and its citizens, who share responsibility for developing their national development strategy. This strategy can take shape through a consultation process involving government, civil society, and the private sector. The second is a partnership between the government and donors, with donors designing their assistance strategies to support the government's strategy. In the new thinking the focus is on how to shape this external part-

nership, or contract, in a way that provides the incentives for country-driven, long-term poverty reduction strategies while also strengthening the internal partnerships necessary for social stability and economic development.

Consultations between governments and civil society and between governments and donors have been carried out in a number of countries piloting the World Bank's Comprehensive Development Framework, the European Union's partnership approach, and other such approaches. The consultations under the Comprehensive Development Framework have proved fruitful in several countries—such as Bolivia, the Dominican Republic, and Ghana—but have also highlighted the need for government commitment and for capacity as key ingredients of successful consultations (box 11.1).

This emerging approach to development cooperation has been incorporated into the new initiative by the World Bank and International Monetary Fund (IMF) to link their support of low-income countries to nationally designed poverty reduction strategies, working within the principles of the Comprehensive Development Framework (box 11.2). Concessional funds and debt relief from the World Bank and IMF will be linked to the goals of poverty reduction strategies prepared by governments in consultation with civil society organizations, the private sector, and donors. Based on a good understanding of the poverty situation in the country, the strategies will identify actions with the greatest expected impact and set up monitoring and evaluation processes. The goal is for these strategies, described in poverty reduction strategy papers, to form the basis for assistance not only from the World Bank and IMF, but from other assistance agencies as well.³⁷ Similar initiatives are under way in the regional development banks.

Less intrusive aid delivery mechanisms focusing on the overall policy and expenditure environment. Donors have used many means to influence recipient country policies. Old forms of policy conditionality have often had disappointing results, depending on country circumstances and how the conditionality was used. Policy review processes also have had limited success. Public expenditure reviews, for example, have evaluated the level and composition of countries' expenditures and identified ways to improve expenditure policy and use donor funds more efficiently (see box 9.2 in chapter 9). But several studies have found this type of intervention to be ineffective in many cases, largely because recipient countries have not been closely involved in the reviews—and so have felt little inclination to comply with the findings.³⁸

Box 11.1 Learning about the consultative process through the Comprehensive Development Framework

In 1999 the World Bank announced its Comprehensive Development Framework, a tool for improving country ownership and donor coordination in development cooperation. The framework is based on four principles: country ownership of the policy agenda, partnership with all stakeholders, attention to social and structural concerns as well as macroeconomic and financial issues, and a long-term, holistic approach built on national consultations.

The country develops its national strategy in consultation with civil society and the private sector—and then, with donors, designs a matrix linking development goals and development actors. The activities of actors in support of each goal are listed in the matrix, revealing any gaps or overlaps.

The framework is being implemented in 13 countries, encouraging wide consultation between governments and their citizens and enhancing partnerships with donors in the design of comprehensive national development strategies. But progress has been varied, reflecting different starting dates and country circumstances.

Bolivia is an early case. In late 1997 the new government embarked on an analysis of the country's development challenges and the preparation of a national action plan to address them. A key part was a national consultation with a wide range of representatives of civil society—NGOs, unions, religious organizations, opposition parties, and academics—and the private sector to discuss development constraints and propose solutions. The results of this national dialogue were presented to the government as input to the national action plan.

Source: Wolfensohn 1999; World Bank 1999d, 1999u.

All discussions with donors now take place in the context of the national action plan. At a consultative group meeting in April 1998 donors pledged 45 percent more than they had in 1997. Donors have also been encouraged to formulate their strategies in support of the national action plan. The World Bank recently redesigned its country assistance strategy to align it with the plan, choosing to support three of the plan's four pillars. The government continues to lead donor coordination, chairing the consultative group meeting in Paris in 1999, where it presented its version of the Comprehensive Development Framework. It has also agreed with donors on intermediate indicators for monitoring outcomes.

Other countries have not progressed as far. The difficulties of some highlight potential problem areas. For example, it is clear that country ownership depends largely on national capacity. The country must be able to hold broad consultations with all elements of society and to conduct the complex analysis necessary to design national strategies that balance macroeconomic and financial issues with social, structural, and institutional concerns. And, of course, the country must be able to implement the strategy.

Without this ownership—and the country leadership from it—donor coordination will remain difficult. While there is some evidence that some donor countries are gradually aligning their strategies with those of recipient countries, stronger leadership by the recipient government will be required to accelerate progress.

Box 11.2 The new poverty reduction strategy initiative

The poverty reduction strategy initiative of the World Bank and International Monetary Fund seeks to link external support to domestically developed, results-based poverty strategies. It is also intended to improve the effectiveness of World Bank and IMF relations (and those of other donors as well) with recipient countries. As important as the recipient country strategy is the process leading up to it. A broad, participatory dialogue with representatives of civil society and the private sector is expected to:

- Help national authorities develop a better understanding of the obstacles to poverty reduction and growth—and devise good indicators of progress in poverty reduction.
- Deepen a shared vision of desired poverty reduction goals across society.
- Lead to formulation of priorities for public actions to achieve the desired poverty reduction outcomes.
- Encourage the development of participatory processes for setting poverty reduction goals and monitoring implementation and progress.

The results will be periodically reported in poverty reduction strategy papers expected to reflect a broadly owned development strategy. The strategies will generally focus on three-year cycles, with annual progress reports in the intervening

Source: IMF and IDA 1999; World Bank and IMF 2000a.

years, all embedded in a long-term framework for poverty reduction. While the actual form of the strategy will be decided by the country—there is no single blueprint—most strategies would likely include:

- Long-term goals for key poverty reduction targets, and the macroeconomic, structural, and institutional framework for achieving them (see, for example, Uganda's goals in box 1.7).
- Mechanisms for monitoring and evaluating progress toward the poverty reduction targets, linked to public actions.
- A consistent policy and institutional framework that includes the underpinnings for rapid, sustained growth and poverty reduction (including macroeconomic policies, institutional reforms, sector strategies, and associated domestic and external financing needs).

Donors can help by providing technical assistance in some areas. Initial experience in Africa and Latin America indicates that countries are strong in laying out a poverty profile and a general poverty reduction strategy but weaker in preparing quantified targets, costing the strategy, and evaluating tradeoffs under limited resources. As in other aspects of development cooperation, the country should determine its own need for assistance—to maintain ownership of this important process.

Perhaps more surprising, donor compliance has been weak as well. A recent evaluation found public expenditure reviews to have had little effect on either recipient country policies or donor lending practices.³⁹ So donors are searching for new mechanisms for strengthening policy environments that encourage country ownership rather than undermine it. They have begun, for example, to encourage countries to participate fully in the public expenditure review process, and they are experimenting with new instruments.

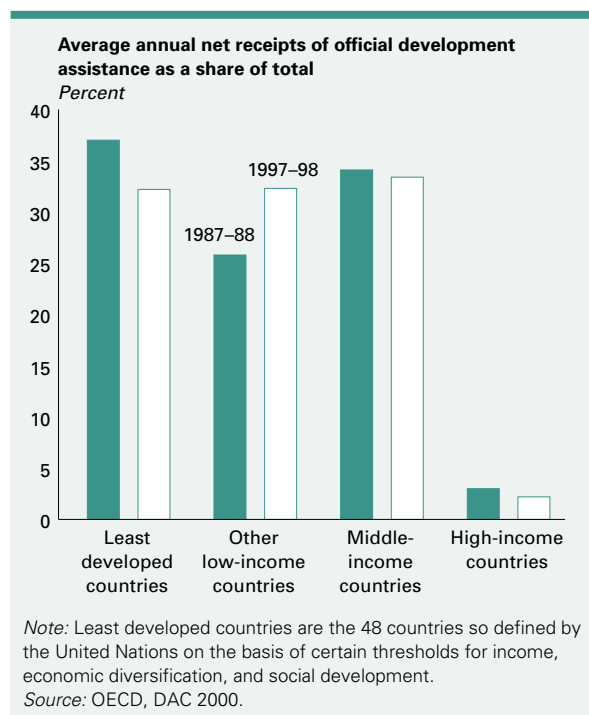
One new instrument that has received much attention is the sectorwide approach: the government designs an overall sector strategy, and donors sign on to fund the sector, not individual projects. This resolves the problem of donor coordination by eliminating the need for it: all activity in the sector is conducted by the recipient country, using its own funds in addition to those of donors. This instrument responds to a broader policy environment while also ensuring ownership. Although the approach is too new to have a track record, some early experiences are promising (box 11.3).

Some proponents have suggested applying the principles of the sectorwide approach to all development cooperation (box 11.4). Others consider project-based lending to be desirable and consistent with the new thinking on development cooperation for poverty reduction. Project support can be effective for results-based sector development—if it falls within a sector framework that systematically links investments and policy and institutional development to poverty outcomes (and to intermediate indicators for tracking and interpreting progress). The choice of instrument will depend on the policy and institutional conditions of particular countries (or sectors within countries) and the preferences of individual donors. But a premium should be placed on putting the country in charge and ensuring that the mechanisms of aid delivery do not compromise its ownership.

Selectivity. For aid to be most effective at reducing poverty, it must be well targeted. If all aid money were allocated on the basis of high poverty rates and reasonably effective policies and institutions, a recent study estimates, even today's small aid flows could lift 19 million people out of poverty each year—almost twice the estimated 10 million now being helped.⁴⁰

Currently, about a third of aid goes to middle-income countries, whose average GNP per capita is roughly six times that of low-income countries (figure 11.4). While only a few major donors target more of their aid to mid-

Figure 11.4
Aid does not go only to poor countries



dle-income countries (most donors target aid to the poorer countries), that still means that global aid is not heavily targeted to areas where the incidence of poverty is greatest. Aid, and especially nonconcessional development flows, still has a role in reducing poverty in middle-income countries, when the policy environment is sound and the resources are well targeted.

In addition to targeting poverty, donors should allocate aid on the basis of the policy environment. Aid has been shown to be effective in promoting growth and poverty reduction in poor countries with sound economic policies and sound institutions—ineffective where these are lacking.⁴¹ Aid driven by political and strategic interests rather than by the recipient country's development policy environment is largely wasted from a poverty reduction perspective. Several instruments have been developed to assess the policy and institutional environment in recipient countries, generally covering macroeconomic management, structural policies, policies for social inclusion (poverty, gender), and public sector management (box 11.5).

Factoring in the level of poverty and the quality of policies should make aid much more efficient in reducing poverty, and there is evidence that donors began to do this in the 1990s.⁴² In replenishing IDA in 1998, for

Box 11.3 Sectorwide development cooperation

To address problems of ownership, donor coordination, and fungibility, donors are experimenting with pooling their resources to support sectorwide strategies designed and implemented by the recipient government. The country, in consultation with key stakeholders, designs a sector strategy and a budget framework extending several years forward, and donors put their money into the central expenditure pool for the sector. The approach encourages country ownership of sector strategies and programs. It also links sector expenditure with the overall macroeconomic framework. And it ensures coordination of donor and recipient activities.

Some benefits of a sectorwide program are evident in the Zambian health sector. In 1994 the government presented its national health policy and strategy to donors and—to ensure equitable distribution of services and coherent implementation of the strategy—asked them not to fund specific provinces or projects but to fund the Ministry of Health centrally. Hesitant at first, donors began to comply. An independent evaluation in 1997 found that “health workers are better motivated; clinics are functioning; funds are flowing to the districts; some modicum of decentralization is in place; [and] an important part of the private sector has become formally involved.”

The approach ensures full ownership by the country and eliminates problems of donor coordination. With the country having more ownership and control over what happens, the use of resources can be much more efficient. But it also means great changes in donor-recipient relations and perhaps greater difficulties in implementation. Several sectorwide programs have stumbled because of the recipient country’s inadequate institutional capacity. Lack of consistency with the macroeconomic program has been another problem. And donors often have too many requirements and thus too much of a problem (or too little interest) in harmonizing them (Harold and associates 1995). Furthermore, these arrangements greatly diminish donor control and monitoring of exactly how money is spent.

The changes required imply that gaining support for the approach will be difficult. The recipient government has to be very confident, because strict adherence to a sectorwide approach means donors that do not participate in common implementation arrangements are not allowed to act in the sector (that is, they do not have their own projects). The result may be less donor funding for a sector. Governments might therefore opt for less strict sectorwide programs, choosing instead to allow donors to implement projects as long as they fit into the overall sector strategy.

Box 11.4 The common pool for development cooperation

Seeing the potential of the sectorwide approach, some propose extending the idea to the country level (Kanbur, Sandler, and Morrison 1999). Donors would cede complete control to the recipient country government—advancing their own perspective on development strategy through dialogue with the country and with one another rather than through specific programs and projects. Rather than fund their own projects, donors would give central budget support to countries with good development strategies (and the capacity to implement them).

A country would first develop its own strategy, programs, and projects in consultation with its people and with donors. It would then present its plans to donors, which would put unrestricted financing into a common pool of development assistance, to be used along with the government’s own resources to finance the development strategy. Earmarking would disappear. Donor monitoring and control of specific projects and programs would not be permitted. And no conditions would be placed on donor aid.

How much donors give would depend on their assessments of the country’s policy environment, including how the country came to agreement on the strategy and how capable it is of implementing the strategy and monitoring progress. In this way the common pool approach would be a more rigorous form of conditionality, because donors would need to evaluate the overall policy environment, direction, and capacity of countries. These assessments would be made known to the country and to other donors during the dialogue leading up to the financing decision.

This approach would entail many of the same challenges facing the sectorwide approach, including the need for recipient countries to have both the capacity to implement their strategy

and the confidence to follow through even if donors do not support it. In addition, donors might resist common pools at the national level because they would likely mean a reduction in donor staff, since donor agencies would no longer be developing and monitoring projects or negotiating and monitoring conditions.

However, like the sectorwide approach, the common pool approach would ensure full ownership by the country and eliminate donor coordination problems. It would also preserve two important benefits of the current development cooperation approach:

- The knowledge transferred in donor-implemented projects, an important side effect of aid. A road building project, for example, might transfer knowledge of engineering or even project accounting to local workers. This transfer would not be lost in a common pool arrangement. Recipient countries could still ensure knowledge transfer through their choice of companies and the terms of contracts.
- The support that conditionality gives to reform factions in governments. Support for reform elements in a country is perhaps the only effective part of the present system of conditionality. Donor-imposed conditions can strengthen the position of reformers in national debates or serve as a “self-imposed” constraint on government officials. The approach to conditionality in a common pool arrangement would be far different, but it would not sacrifice this benefit. Donors could strengthen the hand of reformers by publicizing the criteria used to assess country strategies and adjusting the volume of their assistance. This would form the basis for a more open and honest relationship between donors and recipients and preserve the benefits of the current conditionality while eliminating its problems.

Box 11.5 Assessing country policies and institutions

The World Bank has designed a measure of policy and institutional soundness—the Country Policy and Institutional Assessment, which gives equal weight to 20 components that have evolved as the measure has been refined. Each component is rated by country specialists on a scale of 1–6 using standard criteria. Although care is taken to ensure that the ratings are comparable within and between regions, the scores include an irreducible element of judgment. But when the measure has been included in regression analyses of growth along with other commonly used policy variables, it has had statistical significance, while other policy measures have not. It thus appears to be a good summary indicator of the overall policy environment for economic development. The 20 components:

Economic management

Management of inflation and the current account
Fiscal policy
Management of external debt
Management and sustainability of the development program

Structural policies

Trade policy and foreign exchange regime
Financial stability and depth
Banking sector efficiency and resource mobilization

Source: Collier and Dollar 2000; World Bank 1999h.

Competitive environment for the private sector
Factor and product markets
Policies and institutions for environmental sustainability

Policies for social inclusion and equity

Equality of economic opportunity
Equity of public resource use
Building of human resources
Safety nets
Poverty monitoring and analysis

Public sector management and institutions

Property rights and rule-based governance
Quality of budgetary and financial management
Efficiency of revenue mobilization
Efficiency of public expenditures
Transparency, accountability, and corruption in public services

Developing a consistent basis for rating economic and structural policies has been relatively straightforward, but doing so for social inclusion and public sector management has proved more challenging. Work to refine the indicators and reference points continues.

example, donors called for allocating funds on the basis of each country's policy performance.⁴³

How selectivity is applied will likely evolve as the international community continues to learn about the environments in which aid is most effective.⁴⁴ Some analysts stress that the level of poverty in a country is more important to aid effectiveness than the policy environment, though both are crucial.⁴⁵ Others show that external shocks—such as declining terms of trade, volatility in export prices, and even climate change—can impede countries' efforts in growth and poverty reduction (chapter 9).⁴⁶ It has been argued that aid can make a larger difference in these countries (and therefore be more effective) than in countries not experiencing shocks.⁴⁷ Refining the criteria for selectivity should continue. Adhering to the basic principle that aid should go where it is most effective in reducing poverty will be key if the international community is to achieve the international development goals.

Implementation difficulties and practical steps

These three components—ownership and partnership, aid delivery mechanisms that are less intrusive, and selectivity—

provide the framework for substantially improved international development cooperation. But progress toward that vision will not be easy. Each component of improved development cooperation brings great challenges in implementation.

For example, while almost everyone agrees that partnership is a good idea, there is no consensus on how to implement it.⁴⁸ Some analysts note that ownership is relative and that reaching consensus on strategies is essentially a political process, involving the same power relations that exclude poor people from discussions or discriminate against them (as seen in chapter 6).⁴⁹ Others voice doubts that donors will really come to terms with the implications of ownership and partnership for their actions: that donors should interfere less in recipient country policymaking.⁵⁰ Many donor practices—such as maintaining control over resource monitoring and tying aid to specific procurement requirements—run contrary to the idea of partnership.⁵¹ The recipient country's capacity to design and implement development strategies and its ability (and willingness) to hold broad consultations with all elements of society also pose significant challenges.

The combination of greater selectivity and a broader, less intrusive approach to delivering development assistance presents its own challenges. Determining how much support to give to a sector or national budget is difficult—and likely to prove contentious. Some country expenditures may not seem to fit into a “best” poverty reduction strategy, but donors will have to evaluate the poverty reduction impact of the overall program, not the individual expenditures.

A more fundamental problem arises when a country does not have an overall policy environment worth supporting, so that aid is largely ineffective. How should donors proceed?

Most important, they must understand that policies are driven primarily by the domestic political economy—and that donors are simply not very effective in influencing them.⁵² But donors can have some influence by tailoring their involvement to a country’s commitment to reform. Until a country commits seriously to reform, the best that donors can do is to provide technical assistance and policy dialogue, without large budget or balance of payments support (box 11.6). If donors pour large amounts of aid into poor policy environments, they are likely to sustain poor policies longer. When the country finally commits to reform, evidence shows that finance should be increased as policies improve.⁵³

In addition to this more nuanced approach to influencing policy reform, donors can address the challenges of the new development cooperation framework by taking several other steps:

- *Move the donor-recipient dialogue to the country and turn its leadership over as well.* Donor-recipient consultations—consultative groups or roundtables—have traditionally taken place in donor countries, chaired by the World Bank, the United Nations Development Programme, or another donor institution. Meetings are now beginning to be held in recipient countries and chaired by their governments, to foster ownership.
- *Continue to experiment with sectorwide approaches.* National capacity—and donor-recipient partnerships—can be built up sector by sector. While many countries will for some time not have the overall technical capacity, accountability, and transparency to monitor funds to the satisfaction of donors, these may be more advanced in some sectors than in others. The advanced sectors could be funded through the sectorwide approach as soon as possible, taking into account the lessons from experience with this approach.⁵⁴ And donors should continue to improve their

Box 11.6 How aid can help in countries with a weak policy environment

When a country has poor policies and no coherent political movement to change the situation, aid can have a limited but effective role, as Ghana, Uganda, and Vietnam all illustrate. In their prereform periods (before 1983 for Ghana, 1986 for Uganda, and 1991 for Vietnam), these countries received very little aid, probably reflecting their governments’ political estrangement from the West. But the aid was instrumental in laying the foundation for policy reform.

For example, when Ghana was dealing with a macroeconomic crisis in the early 1980s, its well-trained economists found the policy dialogue with international financial institutions to be helpful in working out plans. A few years later, when Uganda’s leaders were trying to design new policies, donors financed helpful study tours to Ghana. In 1991 the United Nations Development Programme and World Bank organized a meeting for Vietnamese leaders with economic ministers from Indonesia, the Republic of Korea, and Malaysia, who laid out some key policies that had worked for them and also some of the detailed issues in stabilization, trade liberalization, foreign investment, and other economic policies.

In successful cases political leaders learn from other countries and from their own mistakes. Low-key assistance can help with this policy learning, which generally has to take place at a country’s own pace. Even in countries that do not reform for a long time, technical assistance can lay the foundation for policy learning. In Kenya, for example, donors are supporting the Institute of Policy Analysis and Research to help develop local capacity in research and policy analysis. This kind of capacity building is not going to have large benefits as long as vested interests resist serious reform. But it is an essential foundation if a political movement for change develops.

Source: Devarajan, Dollar, and Holmgren 2000; World Bank 1998b.

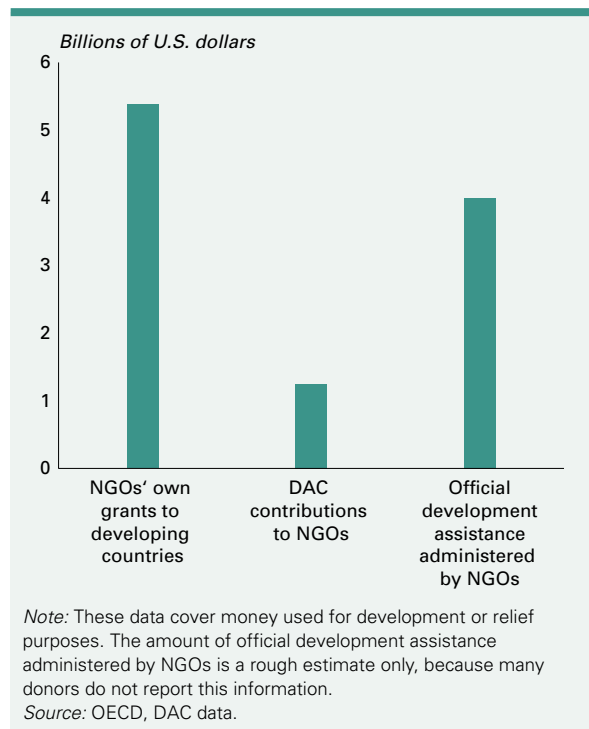
own practices—for example, by harmonizing procedures and reporting requirements among themselves—so that they can contribute effectively to these new aid relationships.

- *Strengthen monitoring and evaluation practices.* Donors’ systems of monitoring and assessing the impacts of their own projects have failed to focus on how poor people benefit.⁵⁵ But doing this will be even more important (and challenging) when looking at a sectorwide or nationwide program. Donors should encourage local monitoring by participants, to ensure ownership of the results. Furthermore, donors tend to be weak in disseminating information and incorporating knowledge

from evaluations.⁵⁶ Feedback and learning are essential to successful aid practices, and donors must ensure that they happen effectively. As part of this, donors and recipients should continue to strengthen their efforts against corruption, a major obstacle to economic performance that occasionally also affects donor agencies.

- *End tied aid.* In 1998 almost a quarter of official development assistance was tied, meaning that the procurement contracts were limited to the donor country or a group of countries. Driven by domestic political interests, this practice goes against the very free-market principles that most donors are trying to encourage in developing countries and results in inefficient use of aid. It has been estimated that tying aid reduces its value by 15–30 percent.⁵⁷ The practice should be ended as quickly as possible, and contracts should go to the best bids.⁵⁸
- *Make technical assistance demand driven.* Turning more responsibility over to recipient countries for designing national development strategies and leading consultation meetings will require rapid capacity development. Recipient countries will also need strong auditing and accounting skills if donors are to relinquish monitoring and control of projects. But technical assistance, the obvious choice for building capacity, has a spotty record at best, particularly in countries where capacity is already weak. The main reason is that it has often not been demand driven—it has often been tied aid and designed to develop capacity only in donor-supported activities.⁵⁹ Instead, technical assistance should be incorporated into a national strategy and expenditure plan, with the recipient government deciding what assistance it needs and who should provide it. This is likely to require initial support to countries on how to use the market for technical assistance.
- *Continue to learn about how to work effectively with NGOs.* Relationships between donors and NGOs are complex, with much room for improvement.⁶⁰ Good data on the extent and effectiveness of donor-NGO relationships are scarce, but an estimated \$5 billion in aid is now channeled through NGOs, either in subsidies to their activities or in contracts to implement donor activities (figure 11.5). NGOs appear to be an effective channel for aid when they are involved early in projects (at the design phase), when they are chosen for their proven capacity and experience, and when they are treated as partners rather than contractors.⁶¹ The long-term impact of NGO projects remains unknown, perhaps because so little money has

Figure 11.5
NGOs channeled some \$10 billion to developing countries in 1998, about half of it from the official sector



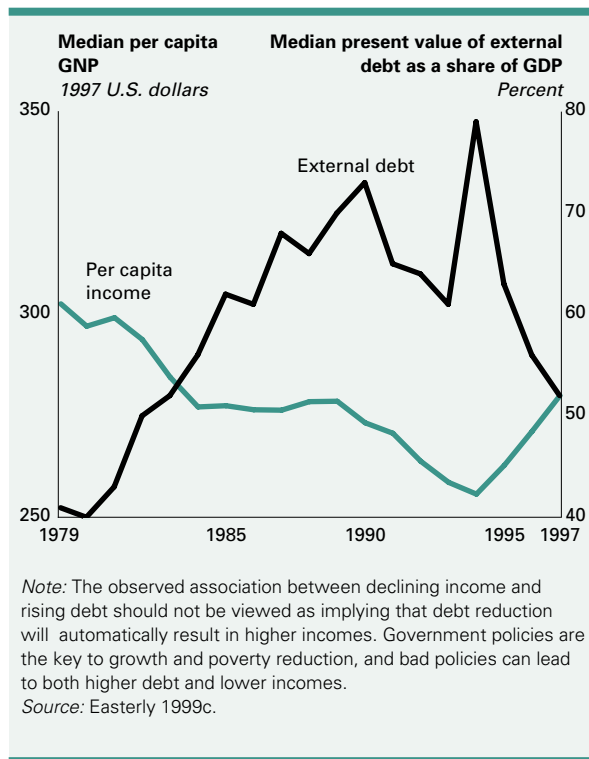
gone into funding their evaluation and monitoring efforts.⁶² Even with better monitoring, though, NGO projects face the same problems of fungibility as donor projects, and policy environments strongly influence their effectiveness. Donors and NGOs should continue to improve their working relationships, sharing best practices for making aid more effective in the long term.

- *Relieve more debt.* Debt relief for the poorest countries is essential for effective aid. Heavy debt burdens reduce incentives for policy reform, while debt negotiations and the constant circulation of new aid money to service old debt distract government officials from the needs of their citizens. The next section turns to this issue.

Relieving the debt burden of poor countries

The most prominent issue in development cooperation at the end of the 20th century and the beginning of the 21st has been debt relief for the poorest countries. There has been a steady increase over two decades in the indebtedness of a group of poor countries now referred to as the heavily

Figure 11.6
As per capita income in the heavily indebted poor countries has gone down, debt has gone up—and vice versa



indebted poor countries (figure 11.6). Public attention has been drawn to their plight in large part through the tireless efforts of NGOs in developed and developing countries, whose campaign for debt cancellation by 2000 has captured the world's interest.⁶³ At the 1999 annual meetings of the World Bank and IMF, member countries agreed on an enhanced plan for debt relief, an acknowledgment of the detrimental effects of debt on country policy environments and overall expenditure frameworks (box 11.7).

The effects of heavy debt burdens

Many heavily indebted poor countries spent as much as a fifth of their annual budgets on debt service in the 1990s, and some spent much more.⁶⁴ Because this is often more than the amount spent on social programs, debt servicing is viewed by many as a severe impediment to improving the lives of the world's poor.

It has been argued, however, that debt servicing is not really a problem because heavily indebted poor countries receive more money from donor countries than they pay back. Actual debt service payments are

Box 11.7 **The Enhanced Heavily Indebted Poor Countries Debt Relief Initiative**

The Heavily Indebted Poor Countries (HIPC) Debt Relief Initiative was announced in late 1996. Realizing that the initiative did not go far enough, leaders of the Group of Seven (G-7) countries endorsed an Enhanced HIPC Initiative at a summit in Cologne, Germany, in July 1999. The enhanced initiative was approved by the full membership of the World Bank and International Monetary Fund in September 1999 as an integral part of the new poverty reduction strategy initiative (see box 11.2). The Enhanced HIPC Initiative changed the eligibility requirements for debt relief and the timing of relief.

Eligibility

To be eligible, a country must be very poor, have an unsustainable debt burden, and pursue good policies.

- *Poor* is defined as both eligible for support under the IMF's Poverty Reduction and Growth Facility (the reformed and renamed Enhanced Structural Adjustment Facility, or ESAF) and eligible only for concessional financing from the World Bank, through the International Development Association.
- An *unsustainable debt burden* is defined as a stock of debt that is more than 150 percent of exports in present value terms after the full use of traditional debt relief mechanisms or (for countries with certain structural characteristics) a ratio of debt to government revenue of more than 250 percent.
- *Good policies* are interpreted to mean macroeconomic, structural, and social policies consistent with poverty reduction and sustained growth.

These new eligibility criteria increase from 26 to 33 the number of countries likely to qualify for relief.

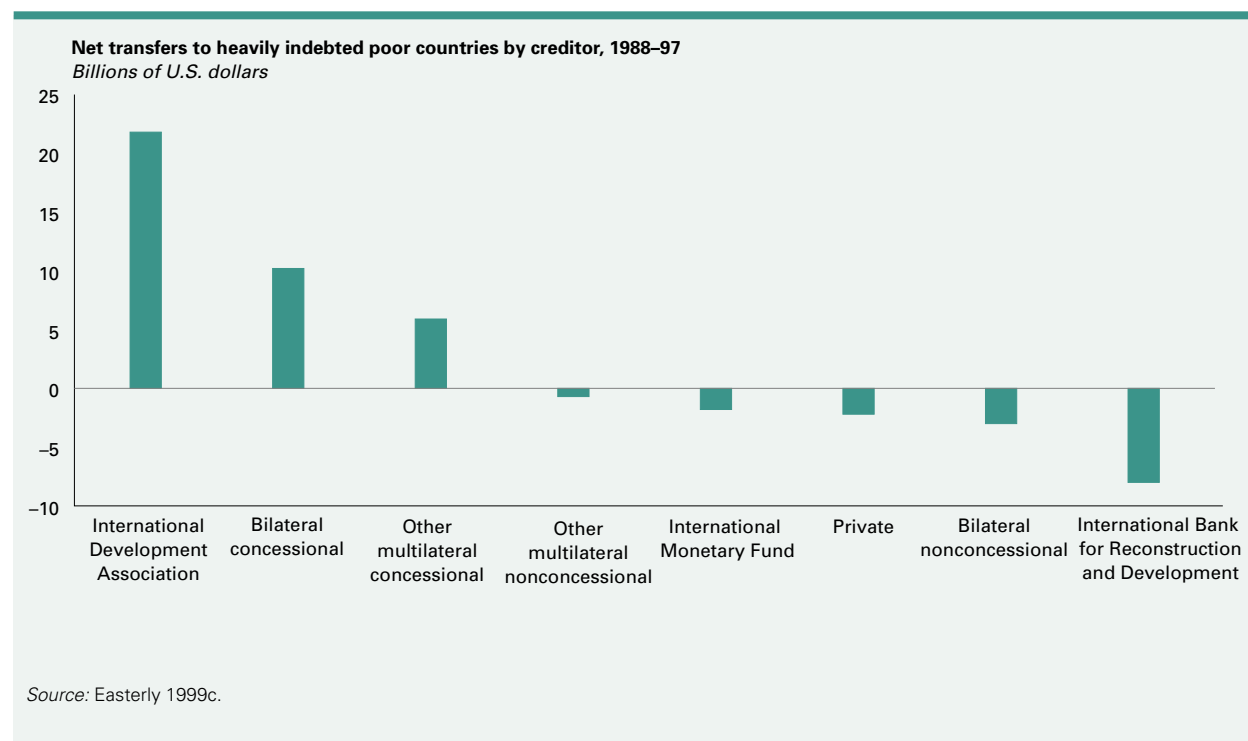
Timing of relief

The Enhanced HIPC Initiative provides for the possibility of interim relief for countries after they pass the decision point, when the World Bank and IMF determine a country's eligibility. A reduction in debt service payments is therefore possible even before a country reaches the completion point, when the stock of debt is reduced. Under the earlier HIPC agreement the debt stock was reduced only after completion of two full ESAF programs—a minimum of six years. Now the completion point can be moved up if the country's performance is particularly good. Relief is intended to be front-loaded as much as possible.

Combined with traditional debt relief arrangements, the Enhanced HIPC Initiative is likely to cut by half the net present value of public debt for the 33 countries likely to qualify. As many as 20 countries may reach a decision point on debt relief by the end of 2000, depending on progress in developing their poverty reduction strategies and on how much financing is available from donors.

Source: World Bank (www.worldbank.org/hipc).

Figure 11.7
Concessional transfers largely compensate for negative net transfers of nonconcessional resources



almost always far less than scheduled payments, because the countries cannot make the full payments. The debts are serviced by rescheduling some loans and financing the rest through a combination of new loans and grants.⁶⁵ Overall, while net transfers of nonconcessional resources tend to be negative because new nonconcessional borrowing is strongly discouraged, transfers of concessional resources tend to more than compensate (figure 11.7).

However, heavy debt burdens bring additional problems that can affect a country's growth performance and ability to focus government action on social priorities. Debt service is financed largely by scarce domestic budgetary resources and thus competes with domestic recurrent spending, while concessional assistance goes to new investment projects. This mix can mean resources for new health centers and roads but not for nurses or maintenance. In addition, many grants go to donor-managed activities that are not included in the budget. These are subject to all the problems of ownership and donor coordination discussed above and can contribute to the further institutional weakening of an already weakened, insolvent state.⁶⁶ And debt negotiations and mon-

itoring take up much of the already stretched time and capacity of government officials.

These resource inflows can also be unstable, making it difficult for governments to manage their spending and maintain sound fiscal policies.⁶⁷ Furthermore, if resource flows are positive because countries have to rely on continuous reheduling and on grants and concessional lending, their access to private capital flows will remain very low. And where debts are not serviced in full, countries' debt stocks continue to grow, creating a potential disincentive to investment, since investors may fear that future profits will be affected by debt-related macroeconomic problems or higher taxes to service debt.⁶⁸

Debt is therefore as much a problem of how gross flows and debt management affect ownership, policy, and capacity as it is a problem of net flows. In this, it shares many of the problems that have diminished the effectiveness of aid. Debt relief can play an important role here by reducing the burden on recurrent budgets and allowing government officials to focus on sound spending strategies rather than continual renegotiation of debt. And it can be particularly crucial for countries emerging from civil conflict and war.

There is also some evidence that high debt service obligations (including those to international financial institutions) tend to weaken the link between concessional flows and the quality of the policy and institutional framework—and so the effectiveness in reducing poverty. This could be because donors try to avoid defaults on loans, and as countries become more indebted, donors give new loans to cover the old ones. (Between 1989 and 1997 debt relief for the 41 heavily indebted poor countries totaled \$33 billion and new borrowing \$41 billion.)⁶⁹ Not only does this compromise the ability of donors to target aid to where it will be most effective, but it may also deter reform in countries with poor policies, because they have less incentive to reform if they can expect relief and resources anyway.⁷⁰

Debt relief can ease all these problems by reducing the gross flows and, if structured correctly, encouraging a structure of new inflows that is more effective for poverty reduction.

An improved initiative for debt relief

To be effective, debt relief needs to be delivered in ways that encourage country ownership, using instruments that provide incentives to use the resources for poverty reduction. This is the same issue as for traditional aid flows, but in the context of a one-time decision to reduce debt. How much impact debt relief has on net transfers to a country depends, of course, on what happens to gross aid flows—on whether the resources for debt relief are additional or not. But even if the resources are not entirely additional, debt relief can ease policy and budgetary constraints for the recipient country, since it frees up resources from the recurrent budget. What will guarantee that these resources are used for poverty reduction? There are two related challenges:

- Linking resources from debt relief to results in poverty reduction.
- Strengthening accountability in the use of public resources, to minimize diversion to other uses (especially through corruption).

The lessons from the past—including those from the experience with aid outlined above—indicate that both are best tackled through their links to the overall policy and institutional environment, especially for public resource use. Experience also shows that debt relief alone will not improve policies. Twenty years of gradually increasing debt relief have not improved policies in heav-

ily indebted poor countries.⁷¹ That is why the principle is to grant debt relief on the basis of reputation—an established track record in using resources effectively for poverty reduction.

The design of the Enhanced Heavily Indebted Poor Countries (HIPC) Debt Relief Initiative incorporates these lessons. Debt relief will be granted to eligible countries with a viable and comprehensive poverty reduction strategy and a framework for linking public actions to monitorable results in poverty reduction. The strategy is to be defined through a participatory process involving government, the private sector, and civil society. The participatory process is important for the design of the strategy—and to help ensure good use of external (and internal) resources. Debt relief will be integrated with other sources of external finance in the country's overall budgetary framework for poverty reduction, rather than being earmarked for certain expenditures. The goal of the Enhanced HIPC Initiative is to contribute directly to poverty reduction and to ensure that countries that receive debt relief do not have policies that will lead them deeply into debt again.

In May 2000 Uganda became the first country to receive debt relief under the Enhanced HIPC Initiative (box 11.8). The relief was based on several years of progress in the participatory formulation of its poverty reduction strategy, results in key areas (getting children into school, reducing income poverty through agricultural and aggregate growth), and mechanisms to help increase accountability for public funds and reduce leakages.

The cost of the Enhanced HIPC Initiative is estimated at \$28 billion. If the debt relief is to be additional, financing must come from outside the normal aid and concessional lending budgets of donor institutions. Under current plans the cost will be financed roughly equally by bilateral and multilateral creditors. Although many donors have endorsed the Enhanced HIPC Initiative and made political commitments for funding, the mobilization of resources has been slow, and some donors have not yet committed to the initiative. Because a key principle underlying the initiative is that debt relief should be coordinated among all creditors, with broad and equitable participation, this lagging of resources and commitments seriously endangers the initiative. Donors need to give high priority to securing sufficient funding for the Enhanced HIPC Initiative.

Box 11.8
How debt relief fits into a poverty reduction strategy: Uganda's Poverty Action Fund

Fundamental in the fight against poverty is improving the overall allocation of resources, including those from debt relief, through more poverty-oriented and transparent budgets. There are many ways of achieving this end, and in Uganda a special fund to use the savings from debt relief is proving useful.

The government chose to create the Poverty Action Fund as a conduit for the savings from debt relief under the HIPC Initiative (about \$37 million a year; the Enhanced HIPC Initiative is expected to double this amount). The fund has been earmarked for priorities of the poverty eradication action plan adopted in 1997 to address poverty and social conditions. The plan emphasizes maintaining macroeconomic stability while increasing the incomes and the quality of life of poor people by developing rural infrastructure, promoting small businesses and microenterprises, creating jobs, and improving health services and education. The Poverty Action Fund focuses on schools, rural feeder roads, agricultural extension,

Source: UNICEF and Oxfam International 1999.

and district-level water and sanitation. Specific outcome targets have been identified, such as the construction of 1,000 additional classrooms to support the primary education program.

Two crucial features of the Poverty Action Fund are its integration into the overall budget and the Ugandan government's effort to create a transparent and accountable structure of management. Reports on financial allocations are released at quarterly meetings attended by donors and NGOs. The Inspector General's office monitors the use of funds at the district and national levels. This self-imposed conditionality reflects the government's strong commitment to tackling corruption. But it is also an attempt to address creditor concerns about the capacity of a debtor country to link debt relief to poverty reduction. Several measures have been proposed for improving monitoring, ranging from including district-level officials in the quarterly meetings to having local NGOs do community-based monitoring of the poverty fund's spending.

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Many questions remain about the implementation of debt relief and of the new development cooperation framework advanced in this chapter. Despite the financing difficulties of the Enhanced HIPC Initiative, some observers call for even deeper and faster debt relief, arguing that the debt deemed "sustainable" under the Enhanced HIPC Initiative is still too burdensome.⁷² How to move quickly to relieve debt while still allowing enough time to build country ownership of the poverty reduction strategy is another concern. Some countries wonder about their capacity to prepare their own poverty assessments and poverty reduction strategies. Others question whether donors can support the formulation and implementation of poverty reduction strategies without undermining country ownership. Questions also remain about the participatory process—how best to consult with poor people, how to fit consultative processes into the context of national political processes, and how to develop effective feedback and monitoring systems. And countries wonder how well donors will be able to realign

their procedures and interventions along the lines laid out in their poverty reduction strategies.⁷³ All these issues reflect the state of international development cooperation at the turn of the 21st century. There is profound, on-going change in the way developing and developed countries work together to fight poverty.

While many issues remain, the right direction for the international community is clear. Country-focused assistance should incorporate a greater emphasis on partnership between donors and developing countries. It should apply less intrusive mechanisms of aid delivery that focus on the overall policy and expenditure environment. And it should exercise greater selectivity in allocating aid where it will be most effective. More aid and debt relief need to be available to countries with effective poverty reduction programs. Donor evaluations of these programs must be informed by an awareness of the conditions each country faces and by the new approach to poverty reduction presented in this report. And to relieve the burden of the heavily indebted poor countries, donor countries should finance the Enhanced HIPC Initiative with money *additional* to their aid budgets.