
What to Do?

Foreign aid has been the primary instrument with which the international community has sought to jump-start the economies of the stagnant low-income states (SLIS). Although it is recognized that a successful economic strategy will require the full harnessing of the private sector, these economies are currently unable to attract significant private investment and generally unable to benefit much from the international trading system. For the foreseeable future, their main link to the global economy is foreign aid. Yet aid has been least effective in the stagnant low-income states. Doubts about its effectiveness have led to a wave of aid reform in the last decade. The previous chapters argued that two facts have undermined the impact of sometimes quite promising donor reforms. First, external pressures on and dynamics within donor organizations lead them to fail to fully implement these well-intentioned reforms. As a result, many of the key issues, such as donor coordination, have never been properly addressed. Second, specific governance characteristics in the stagnant low-income states continue to undermine the effectiveness of foreign aid.

The biggest difficulty is not that the policy analyst does not know what to do. The previous chapters suggest a number of desirable reforms. The real difficulty is finding the political and institutional actors who will fully implement these reforms because it is in their interest to do so. A central argument of this book is that the last two decades suggest that the absence of a constituency for reform has been the primary constraint on positive change in the stagnant low-income states.

How should one think of an approach to positive change in stagnant low-income states? The World Bank's Low Income Countries Under Stress

(LICUS) group recently attempted to put together a strategy (LICUS Task Force 2002). The group focused on a slightly different and more varied set of countries than the ones addressed in this book. LICUS includes countries in civil war, for instance, as well as those recovering from civil war. But LICUS is an attempt to put together a strategy and thus worth examining. LICUS starts with much the same diagnostic about its categorization of low-income states as that made in this book. If anything, the LICUS group's understanding of the governance deficiencies of these countries is even more negative than the understanding in this book, since LICUS includes states that have entirely collapsed. The LICUS prescription for these countries is simple: Donors should focus on delivering services to populations and develop pragmatic institutional solutions for doing so. The LICUS report (LICUS Task Force 2002) recognizes that in the long run, it is desirable to have strong and effective state institutions spearheading the development process; but in the short run, these states are weak and thus donors should create and rely on "independent service authorities" (ISAs) to provide developmental goods and services to populations. The report adds that donors should simultaneously work on developing state capacity so that the ISAs can eventually be turned over to the state. Nonetheless, the LICUS approach is to promote economic growth first, with the assumption that governance deficiencies will be easier to address in the future, once growth has resumed.

LICUS is refreshingly forthright and pragmatic. Clearly, recipient-government weakness is the central conundrum of aid to low-income countries. But how is the LICUS strategy different from what donors have always done? For the last 40 years, donors have sidestepped the state with their own aid-driven institutions for short-term practical reasons and simultaneously sought to build capacity within the state, often at great expense. The report is usefully candid about the problems of implementing aid in these countries, but its advocacy of ISAs appears to ignore the many evaluations that have for many years pointed to the ISAs' relatively high cost, mediocre performance, and poor records of sustainability (e.g., see Cassen et al. [1986] for evidence). Although LICUS voices all of the right concerns for ownership and selectivity, it is terribly vague about how the Bank will avoid the past pitfalls in this strategy's implementation. The fact that it advances the use of ISAs as an original and novel approach does not inspire confidence.

The diagnostic offered by LICUS (and this book) does point to the key issue: How can outsiders promote development in countries with governments not particularly interested in development? To answer this question, several broad principles have to be part of any reform strategy:

Create the right incentives. It seems axiomatic to me that reforms that require exceptional leadership, or that do not take into account the incentives individuals and organizations face, are unlikely to succeed. It is

true that there is no real substitute for visionary leadership, so that a small number of poor economies will emerge because of great leaders, despite various structural constraints and the dysfunctional relationships described in the book. More prosaically, in a small number of cases, selflessly dedicated public officials, foreign experts, or NGO leaders can advance development and poverty reduction against great odds. But obviously such individuals are a rare luxury, and policies that require exceptional individuals to succeed will fail most of the time. Instead, reform should promote institutions that create incentives to improve the behavior of individuals in both donor organizations and recipient countries, even when these individuals are not exceptional. This may seem obvious, but a striking number of proposed reforms advanced in the development business appear to count on extraordinary individual behavior.

Conditionality and selectivity are both necessary but for different purposes. Any solution will necessarily involve some form of external conditionality by donors. Giving a blank check to all low-income governments with systematic governance problems is almost inevitably likely to prove counterproductive, as indeed the recent past has demonstrated. Even if it is true that traditional forms of conditionality are probably inappropriate in countries that have demonstrated their ability to effectively manage their economic affairs, the stagnant low-income states require an external push, given their governance deficiencies.

Conditionality came under much fire in the 1990s and was pronounced a failure by an odd combination of NGO and academic critics who viewed its application as excessively harsh (e.g., Cornia, Jolly, and Stewart 1987) and by development-community insiders who viewed its application as excessively lenient (e.g., Collier 1997, Killick 1998). I argue that conditionality has often been applied in a flawed manner: It has undermined local ownership over economic policymaking and has proved difficult to reconcile with need-based allocation of aid. Nonetheless, some form of performance-based allocation of aid resources is a *sine qua non* of reform. The past two decades show clearly that poorly performing states are more likely to pursue policies that are unfavorable to economic development if they know donors will nonetheless continue to provide them with the same level of resources. Carefully implemented donor conditionality is useful because it provides incentives to governments to change their behavior, and it strengthens the hand of reformers within these countries.

How can donors reconcile performance-based allocation of aid with other considerations? I argue that both selectivity and conditionality should be applied to aid. On the one hand, donors should strictly enforce a simple and highly explicit form of selectivity in the political realm as well as over a small number of macroeconomic criteria. On the other hand, donors should engage in a policy dialogue with governments in

most areas of sectoral policy using more traditional forms of project conditionality.

No reform can succeed without donor coordination. Any reform program has to have the broad adherence of all the major donors. Any policy not adopted by a majority of the big donors will be ineffective, because the actions of other donors will serve to undermine that policy and send ambiguous signals, at best, to recipient governments. Unless a majority of donors are coordinating their conditionality, one donor's bilateral conditionality is likely to be little more than a passing annoyance to a recipient country that receives hundreds of millions of dollars from two dozen donors. Thus, donor coordination is essential to any successful reform program. It might be added that this coordination increasingly has to take into account the views and actions of leading NGOs, since their lack of adherence to a consensus among official donors will dilute conditionality and the incentives for reform.

In many donor discussions, the need for donor coordination is viewed as justifying a greater resort to "common pool" financing, where donors put their funds into a common pool of resources, which is then available to the government for its developmental activities (Kanbur, Sandler, and Morrison 1999). The World Bank's Poverty Reduction Strategy Papers (PRSP) approach is designed with a common pool logic. I agree that such an approach is long overdue in well-performing countries that have effective governments with a long-term development strategy and the public administration to carry it out. In those countries, uncoordinated, project-driven assistance is unnecessarily obtrusive and inefficient. However, in the stagnant low-income states, where poor performance is in large part due to governance problems, a common pool approach amounts to giving the government a blank check and will not promote development. I agree that even the least effective governments need to be given more responsibilities in the managing of aid resources. I highlight later several such mechanisms that serve to build government ownership and institutional capacity. However, I do not believe the goal of building government ownership and institutional capacity implies the implementation of common pool approaches. Instead, donor agencies should promote coordination with limited pooling of resources, resorting more often to a "lead donor" model in which one donor is designated for a sector and put in charge of the policy dialogue with the government. Similarly, donors need to promote coordination mechanisms to limit the number of projects and donors present in any single country.

Institutional improvements require economic stability and vice versa. The biggest challenge in the stagnant low-income states is that it is equally hard to imagine economic growth without prior improvements in the institutional landscape and improvements in institutional capacity without

a prior period of sustained macroeconomic stability. First, it is hard to imagine progress on enhancing institutional capacity without macroeconomic stability, since economic crisis causes or exacerbates many of the problems associated with low capacity. The erosion of real civil service salaries in countries under more or less permanent fiscal crisis has been devastating for state capacity and has encouraged rent-seeking and corruption that now militate against successful economic reform (van de Walle 2001). In periods of extended economic crisis, economic agents shorten their time horizon in their investment decisions, whereas the kinds of organizational and economic investments needed most for growth require relatively long-term decisions. Institution building probably requires a stable macroeconomy, with minimum uncertainty. Similarly, government ownership of the development process is much less likely if recipient governments are engaged in the kind of crisis management that has existed in most low-income states over the last 20 years. Second, the last several decades at the same time suggest that institutional constraints have hampered macroeconomic stability and sustainable growth in the stagnant low-income states. Political instability, predatory state officials, and a haphazard regulatory environment all undermine private investment. Nondevelopmental state structures driven by clientelism are likely to face endemic fiscal imbalances.

Faced with such a classic chicken-or-egg question, should reformers focus on institutions or on economic stability first? Moreover, what should donors do that they are not already doing in the stagnant low-income states? After all, the last few years have already witnessed a growing focus on governance issues, in addition to the last two decades' focus on macroeconomic stabilization. These questions do not have easy answers. A renewed attention to both economic growth and central-state capacity issues does seem desirable. Again, the contrast with the LICUS approach and its twin focus on social-service delivery by nonstate actors should be clear. So should the donors' recent emphasis on promoting local government and NGOs as alternatives to the central state.

From experience, one knows there are no magic bullets to getting the SLIS economies back on track. In the following paragraphs, I discuss a number of approaches that will help promote the change these countries need to benefit from economic growth and the role that the Western donors could play in advancing these changes. Nonetheless, these countries have highly problematic structural features and historical legacies, and it bears repeating that positive change will not be easy to engineer. As argued in the previous chapter, reform of the aid business has typically been stalled because of the absence of a powerful constituency for change in both the West and the developing world. Aid reform is likely to be least tractable in the stagnant low-income states. Some clearly desirable reforms may be impossible to implement, for a combination of political and capacity reasons. Progress is likely to be slow and discontinuous,

and the solutions offered here will not be without their own contradictions and problems.

Promote Democracy in the Stagnant Low-Income States

Democracy is no panacea, *yet liberal political reform that increases political participation and competition has to be part of the equation that brings economic growth and poverty alleviation to these countries.* This is true, first, because the balance of empirical evidence suggests that democracies outperform nondemocracies; for a long time, economists posited a “cruel choice” between democracy and growth, arguing that political participation prevented governments from deferring consumption in favor of the long-term investments that spur growth (Przeworski, Stokes, and Manin 1999). A new round of empirical studies in the last decade has, however, not upheld the authoritarian advantage hypothesis, concluding instead that there is probably a small but significant “democratic advantage” (for an excellent literature review, see Gerring, Barndt, and Bond [2003]).

Second, as argued earlier, the poor economic performance of the stagnant low-income states is hard to disassociate from their authoritarian politics. Even if some authoritarian countries have managed to engineer significant economic growth, this is clearly not the case for these states, where the political status quo seems dysfunctional from an economic point of view. In particular, the political patterns I identified as “presidentialism” appear to be inimical to growth.

In fact, recent World Bank–sponsored research (Kaufmann 2003) suggests that governance improvements can have a positive impact on the level of economic growth. As suggested earlier, the traditional donor approach—most recently embodied by LICUS—suggests a causal mechanism that goes from growth to governance, so that donors can ignore governance issues, which will tend to improve over time as the local economy gets richer. This research suggests the opposite: The causal arrow goes from governance to growth, and a higher income level will have much less of an impact on governance than the reverse.

Donors continue to be ambivalent about making their aid programs compatible with national-level democracy. Economists and engineers have dominated the donor community, and perhaps as a result it has paid closer attention to economic policy and technical issues and inadequate attention to institutional issues. For many years, donors clung to the argument that aid allocation should not take into account the political orientation of the recipient country, because it was irrelevant to the donors’ work. That donors should not interfere in the domestic politics of recipient countries remains a deeply entrenched norm in many aid agencies. In fact, external support for a government is necessarily a profoundly political act, since it provides resources to the incumbent that the political

opposition does not receive. In addition, even on the donors' narrow technical terms, aid and politics are connected, since a number of studies have demonstrated that political factors have an effect on the ability of aid to promote development (e.g., Svensson 1999). Indeed, World Bank research in the 1990s (Isham, Kaufmann, and Pritchett 1997) makes clear that the level of political and civil rights in a country actually has had an effect on the rate of return of World Bank projects there. Even so, the Bank has only recently begun to involve itself in governance issues and continues to define them in the relatively narrow context of economic management.

To be sure, economic policy orientation is also important, and economic growth almost certainly cannot be engineered in these countries without the prior success of macroeconomic stabilization. Investors will not return until they are certain that the macro climate is healthy in a sustainable way after years of fiscal and monetary imbalances. Similarly, technical issues are also important. Some irrigation pumps really are better than others; scarce resources can be saved and productivity enhanced if certain technical choices are made rather than others. Having said that, the earlier analysis should have made it clear that governance deficiencies are a key economic constraint in stagnant low-income states.

Why would democratization help bring about economic growth and poverty alleviation in the stagnant low-income states? Presidentialism concentrates power in the executive and shields it from accountability. As discussed earlier, long-standing "strongmen" presidents who are virtually above the law tend to characterize the stagnant low-income states. Prebendal forms of clientelism are used to promote political stability, but they subvert formal political institutions, generate substantial inequalities, and undermine private-sector growth. The key benefit of democratization is that it engenders the vertical and horizontal accountability that is necessary to discipline the executive branch of government. Some will argue that donors have already assimilated this lesson and are using political conditionality to improve governance in developing countries. As argued earlier, however, the donors have been neither consistent nor persistent in their application of conditionality. In particular, the absence of donor coordination on political conditionality has served to diffuse the collective signal donors send to low-income governments. One donor's tough conditionality will have little impact if other donors have not followed suit. Cutting total aid by 50 percent to a country will not necessarily change a government's behavior if it still receives the equivalent of 10 percent of GDP in aid, or if the government is justified to believe that the larger aid volume will resume in 12 to 18 months, regardless of its behavior. As a result, it is important to realize that successful political conditionality will require much greater coordination than has been realized in the past.

Political selectivity should send a clear signal to governments that certain behaviors will no longer be tolerated. While all forms of clientelism

cannot realistically be eliminated, the worst kinds of governance breakdowns can and should be sanctioned systematically. Ideally, donors should in the short-to-medium term work to eliminate prebendal forms of clientelism and to circumscribe patronage to more reasonable levels in the medium-to-long term, since the former undermines economic growth much more than the latter.

Donors complain that they are poorly equipped to make precise judgments about the domestic governance of recipient countries. Certain regimes are nonetheless easy to evaluate. For instance, a small number of states still have military governments in power that came to power through the barrel of a gun or that do not hold regular elections. I believe these are easy calls: *Military governments should not receive a penny of donor assistance*, and a sharply reduced volume of aid should be directed to non-governmental actors, until the military return to the barracks and an elected government is formed. Cutting off these countries would send a clear message that old-fashioned authoritarian forms of government are no longer acceptable. They should certainly not receive loans from the international financial institutions (IFIs), as the recent past suggests this will inexorably turn into odious debt and saddle future generations with unfair obligations.

Such cases are few. Among the stagnant low-income states, only two governments could be defined as traditional military governments at the time of writing (Pakistan and the Central African Republic), though the military was playing a preponderant role in the politics of three others (Comoros, the Gambia, and Guinea-Bissau), and several others had long traditions of military involvement in politics. Comoros, for instance, has suffered through 19 coups since independence in 1975. Particularly today, authoritarian leaders have realized that they can get away with various rather superficial concessions to democratic governance that do not threaten their rule, such as regular elections they do not lose or the allowing of parliamentary oppositions that are never allowed to win more than a small minority of seats.

Most donors resist political conditionality or selectivity in a number of ways. First, they argue there is a real risk that the cutting off of aid will enhance political instability. As the World Bank's LICUS Task Force puts it, "Countries abandoned by the international development community show few signs of autonomous recovery . . . such countries are also at risk of state failure" (LICUS Task Force 2002, iv). To be sure, such a risk exists, but one would be hard-pressed to come up with many examples in which the termination of aid can be causally linked to the emergence of state collapse. Indeed, many countries that have undergone state collapse enjoyed a large amount of aid right before they collapsed. Donors provided Rwanda some \$356 million in aid in 1993, the year before the genocide, equivalent to \$47 per capita. Liberia, Sierra Leone, and Somalia received \$28, \$25, and \$69 in aid per capita, respectively, in

their last year of relative societal stability before state collapse. Even if one does not agree with Peter Uvin's (1998) harsh verdict that the aid system was in part to blame for state collapse in a country like Rwanda, it seems clear that large amounts of aid did not anticipate or prevent state collapse.

Second, donors resist political conditionality or selectivity by arguing that it is very difficult to make judgments about exactly how competitive and participatory formally democratic national processes are. Even here, however, the donors can use telltale signs to evaluate the true nature of governance. The absence of alternation in power is one clear sign. Leaders who have been in power for several decades are not presiding over democratic systems. As a result, I believe *donors should withdraw from countries in which the constitution does not provide for term limits or in which the leader has been in power for longer than, say, 12 years*, which would amount to three four-year presidential terms. In fact the 12-year cut-off point works extremely well. In 7 of the 9 stagnant low-income states evaluated as "not free" by Freedom House at the end of 2003 (see table 2.2), leaders have been in power more than 12 years.¹ A perceptive reader of an earlier draft of this book pointed out, however, that Seewoosagar Ramgoolam was prime minister of Mauritius from 1968 to 1982, while Seretse Khama was president of Botswana between independence in 1966 and his death in 1980. Would I recommend the termination of aid to these leaders, who in retrospect were exemplary developers? Clearly, these would have been tough cases to cut off, and perhaps both countries might have benefited from an exception. On the other hand, I suspect neither country's economic performance would have suffered all that much if either leader had left power a couple years earlier. In fact, in both cases, it was the democratic alternation of power at the end of the first leader's rule after independence that confirmed the regime's governance qualities.

Donors also often resist pulling out of authoritarian countries, arguing that the recipient regime has begun a process of positive political reform, so external pressure would be counterproductive at best. Sure enough, in cases such as Ghana in the 1990s, an authoritarian government was able to undertake a phased process of political liberalization. Eliminating aid to former president Jerry Rawlings' government in the mid-1990s might very well have been counterproductive in terms of advancing political liberalization. But the donors have much more commonly erred in the other direction—of justifying the continuation of assistance to authoritarian rulers on the basis of vague promises of political reform. There are no doubt situations in which it is wiser to put discrete pressure on governments to change certain manifestations of poor governance and in which a withdrawal of aid can have negative consequences. However,

1. The exceptions are President Pervez Musharraf of Pakistan and President François Bozizé of the Central African Republic.

my main point here is that clear and explicit governance “triggers” for cutting off aid can be applied in a way that sends a clear signal to recipients.

A similar objection to the establishment of explicit rules cutting off nondemocratic countries from aid comes from a geostrategic perspective: Key allies need to be propped up, regardless of how distasteful the regime in place is. At the present time, such an argument is made for Pakistan, for instance, viewed as a key ally in the struggle against terrorism. True, the current regime in Pakistan is highly imperfect but is probably preferable to the likely alternative if it should fall and assists us in reaching various other objectives. There are two responses to this argument. First, propping up a dictator who does not enjoy domestic support is at best a very temporary solution, and if maintained for more than a very brief period, is almost always a self-fulfilling prophecy. For instance, three decades of generous Western support to Zaire did help to maintain in power an incompetent and extraordinarily venal government that enjoyed little support, but the aid did not prevent that country from collapse and warlord rule in the mid-1990s. Surely, one of the lessons of the last half-century is that it is naive and false to think that large amounts of aid will assist a process of governance reform in poorly governed countries. Assistance is far more likely to allow bad governments to remain bad.

In addition, if geostrategic pressures compel governments to assist unsavory regimes, it is very important that the assistance not involve traditional aid agencies. Governments balance different foreign policy objectives; insofar as possible, aid agencies should focus on only one objective—the development of the recipient countries. Donor agencies that adopt other objectives as their own, such as their governments’ security or commercial aims or both, are bound to lose both credibility and effectiveness as purveyors of development assistance. Instead, governments should use other agencies to provide assistance to advance security or commercial objectives. This would help make it clear to recipients that the donors were not exercising conditionality inconsistently.

Build a New Aid Relationship

The current relationship between donors and the stagnant low-income states does not promote the right kinds of incentives to low-income governments to use aid well and promote economic development, though some undoubtedly do so. Donor micromanagement of aid undermines local ownership, while the large volume of aid that donors give still does not take enough account of developmental performance, failing either to reward governments committed to good policies and sound governance or to withdraw or reduce aid to poorly performing states. The following

discussion seeks to change this in order to improve incentives for governments face to promote development.

Accept the Possibility of Lower Volumes of Official Development Assistance

Conditionality is not credible if donors are not willing to accept the possibility that aid volume will decline in specific countries, at least in the short-to-medium term. The selectivity model is right to argue that donors have to change the incentives for recipient governments. This means that fundamentally, donors have to find ways to clearly and unambiguously reward governments that are doing the right thing. Few observers in the aid community are willing to make explicit one virtually inevitable consequence of this critical principle: that aid volume to certain countries is likely to decline in the first phase of a real selectivity strategy. Yet it is probably the bureaucratic attachment to a given volume of aid being fixed ahead of time that is the biggest obstacle to the implementation of a real selectivity strategy.

Make no mistake, cutting off aid entirely is a harsh medicine, particularly in countries with high levels of poverty. But it is necessary, given the four decades of mixed messages that donors have given recipient governments. Having failed so miserably to enforce conditionality for so long, donors now have little choice but to implement unforgiving conditionality if they are to gain back credibility and leverage. The data presented earlier suggest that aid has become at best slightly more selective in recent years. Yet, to change the incentives for recipient governments, the allocation of aid needs to be unambiguously selective.

I am not necessarily advocating a decline in overall aid volume. If the application of conditionality does imply a sharp reduction in aid to certain low-income economies, it should also lead to increases in the flow of resources to well-performing countries, either in the form of aid or in the form of quicker and more generous debt relief. In addition, the donors could devote a larger share of resources to regional programs and for the provision of global public goods: They remain woefully underfunded, and their success does not require the developmental commitment of individual low-income governments.

Conditionality strategies have in many instances been undermined by the difficulties in calibrating the volume of aid that should go to countries that meet some but not all of the conditions. In practice, donors will often let governments slide and maintain the aid program despite governments' failure to meet some of the conditions because donors are hesitant to punish governments that are meeting most of the conditions. On the other hand, this leads donors to finally withdraw their aid from governments for relatively anodyne reasons, when a number of minor failures

to comply have added up over time. Monitoring compliance is not easy and imposes judgments over which reasonable people will disagree. But it seems better than the system with which the European Union is experimenting, notably in Uganda (Adam and Gunning 2002), where it calibrates its aid precisely to the number of conditions the government meets. In such a system, if the government complies with two-thirds of the conditions, it gets two-thirds of the aid. Such a system requires even more donor monitoring and appears to lead to the worst kind of donor micromanagement. Indeed, in the current situation, good performers that have a good track record of complying with the most important conditions tend to get more detailed conditionality over clearly secondary issues that involve more donor involvement rather than less in day-to-day policymaking. On the other hand, the bad performers get somewhat less money but also get more leeway on secondary issues, which makes little sense.

My view is that a small number of clear conditions with unambiguous measurement criteria can be applied as part of a selectivity strategy. These should focus on the governance criteria outlined earlier and on basic macroeconomic policy issues, such as the size of the fiscal deficit or the basic parameters of monetary policy. Sectoral policy issues or, say, the pace of privatization should perhaps be the topic of policy dialogue with recipient governments in the context of traditional, project-level conditionality but should not be the subject of formal conditionality. Thus, for instance, the failure of a government to undertake price liberalization as promised might lead to the freezing of a big agricultural project but should not affect other donor lending. Instead, there should be only a small number of obvious conditions that could trigger a wholesale withdrawal, known to the public in the recipient countries, so that noncompliance is not controversial, does not require interference or donor micromanagement, and the incentives to comply are not ambiguous.

In addition, this new mixture of selectivity and traditional conditionality should be accompanied by other reforms of the way in which aid is carried out, outlined in the following paragraphs.

Adopt the Foundation Model

The only way to promote local ownership of the development process and to reward states that are committed to development is to adopt what has come to be known as the “foundation model,” though in fairness it does not appear that many foundations actually work in this manner. In this approach, the donor agency waits until the recipient government makes a proposal for support, and the agency does not have a set target for the volume of aid it wants to extend to any country. It also may establish broad, general priorities for its aid, but the extent and nature of

each individual country program are entirely determined by the quality of the proposals that the agency receives.

Current efforts to promote local ownership fall well short. As discussed earlier, policies to promote stakeholder participation remain micromanaged by donors and undermined by *ventriloquism*, in which governments are made to understand what policies they need to adopt in order to receive donor support, often with the assistance of long-term foreign experts provided by the same donors. Regardless of the rhetoric of local empowerment and participation, the current PRSP programs remains identifiably donor programs, with tangential relations to the governmental budget process, weak local constituencies, and a large-scale and costly donor presence to manage the process.

In the foundation model, the donors wait relatively passively until governments or other local actors come to them with proposals. The burden of coming up with good proposals is up to the governments. Clearly, there are dangers to the foundation model, and it is not a panacea. It, too, favors the governments that least need aid, since they are more likely to have the wherewithal to make reasonable proposals that donors will find acceptable. Governments that do not value development, which is surely the case for some of the 26 stagnant low-income states, will generate fewer proposals. Perhaps, though this would have the advantage of dispelling any doubts donors can have about the absence of ownership in these countries. Governments in these countries would then be penalized for their absence of commitment to development and not continue to be spoon fed official development assistance (ODA). Moreover, donors could still accept project proposals from nongovernmental sources in the country.

Perhaps more problematically, it could be predicted that recipient governments would simply make the proposals they believe the donor wants to hear, leading to a new form of *ventriloquism*. Even relatively capacity-weak governments could employ intermediaries to generate proposals to gain funding for activities the government had little intention of carrying out. This would clearly be a danger, but the burden of having to put a proposal together and thus acquiring the capacity to do so would presumably partly integrate aid projects and programs into government decision making; the donors' evaluation of the proposals could emphasize issues such as local stakeholder participation and sustainability, which today too often get little attention.

This means eliminating donor-driven initiatives, of which the PRSP process is merely the latest in a long series. There is no reason the government's own budgetary and planning process cannot serve as the sole framework within which donors provide their aid. Such an approach would result in significant savings; the current system relies on high levels of investment in external monitoring and evaluation services to attempt to overcome the pervasive principal-agent hazards posed by aid's externally driven approach.

Promote Greater Donor Transparency

Experts in public management agree that bureaucracies that are not accountable to the publics they serve are less likely to perform well than those that are. The more bureaucracies are shielded from their clients, the more their behavior will be dictated by internal bureaucratic concerns that may be quite at odds with their official objectives. This kind of goal displacement is common in bureaucracies, and the literature has identified a number of cures, including greater transparency in bureaucratic decision making and increased competition across organizations.

Donor organizations have been increasingly willing to apply these lessons to the developing-country bureaucracies they have been seeking to reform. But aid bureaucracies have been largely unwilling to apply the same lessons to their own operations. Transparency has improved in recent years but rarely vis-à-vis the public in developing countries. Under political pressures, donors have opened up their books and, to a lesser extent, their internal decision making to Western NGOs operating in Western capitals or to their own national parliaments (Lancaster 2000). On the other hand, much less information is available to the public of recipient countries. Recipient governments, for their part, have accepted this situation, which typically conforms to their own lack of transparency and allows them to escape accountability to their own publics.

At the individual country level, there is little transparency concerning the details of donor projects, from the beneficiaries of grants to procurement decisions and hiring procedures. This needs to change in order to promote greater accountability for the donors vis-à-vis their primary clients, the citizens of the countries they assist. A detailed accounting of aid expenditures at the local level is long overdue; it would promote the accountability of aid agencies and of the organizations and activities they finance in these countries. The information provided to citizens would also facilitate public debates about the opportunity costs of different aid activities, a debate that is currently absent.

Strengthen the DAC

The Organization for Economic Cooperation and Development's (OECD) Development Assistance Committee (DAC) should be reinforced and made more independent of donor agencies. At present, it is too often a cozy club of retired and delegated bilateral aid agency officials, who compliment each other on the fine job their respective governments are doing in the aid field. Yet, it is a long-standing institution that has gained valuable experience in information sharing and data collection at the level of the donors. With greater independence and a mandate for constructive criticism of the donors, it could play a much more useful role than it does

today as the official cheerleader of the aid business. It could, for instance, promote donor coordination and greater consistency in donor procedures in areas such as auditing and procurement, where donor differences impose a substantial managerial burden on recipient governments.

Build State Capacity

A cornerstone of a new approach must be to create incentives for governments to increase their institutional capacity. Throughout this book, I have emphasized the importance of a greater focus on institutional capacity, and I have argued that donors need to get away from the projectization of capacity building, to see it as an end in itself rather than something that is done in the context of an aid project with other objectives.

Adopt the “Local” Model

The elements of the foundation model recommended earlier should be complemented by what Tom Carothers has called “localism,” based on his work with the Soros Foundations in Eastern Europe (Carothers 1996). This form of aid programming relies much more systematically on local capacities for developmental expertise in two distinct but complementary ways. First, the approach views the objective of aid not as the promotion of abstract objectives such as “economic growth,” “institution building,” or “democracy promotion” but as supporting and advancing the individuals and civic associations that are most likely to foster some local variant of these objectives. In Eastern Europe, Carothers argues that the Soros Foundations have been very successful at supporting a large number of individuals and small organizations with small grants to allow them to carry out activities that will advance democracy and capitalism in the long run.

This approach has the advantage of increasing the local demand for a more effective central state, since the historical experience suggests that a rich and vibrant civil society stimulates a more responsive and effective state apparatus (Putnam 1992). Carothers’ analysis does suggest it will work best in countries such as those of Eastern Europe, where the central state has relatively high capacity. On the other hand, a purely local approach may prove problematic in countries with extremely weak state capacity, which is true of most of the stagnant low-income states. Small associations may be extremely useful for the provision of critical social services, complementing the state in cost-effective ways. They may be necessary to pressure the state into better behavior by forcing accountability and undermining public monopolies. But they cannot replace the state, because they are much less useful for the provision of public goods and basic infrastructure. Thus, following the local approach

does not obviate the need to undertake a complementary direct effort at central-state institutional development.

Second, the local approach promotes developmental expertise by dramatically cutting down the role of foreign experts and relying instead on local expertise for different facets of the design, implementation, monitoring, and evaluation of aid activities. This has the advantage of being cheap. Despite some progress, the aid business remains overwhelmingly reliant on Western consulting firms, universities, and experts, who implement the vast majority of activities throughout the project cycle. Yet, as Carothers notes, a local NGO will implement a project for a small fraction of the cost of an American or West European consulting firm, which allows the Soros Foundation dollar to go much further: "A three-day conference with a group of visiting foreign experts may cost more than \$25,000. The same money could fund the entire operating expenses of a medium-sized local NGO for a year" (Carothers 1996, 21).

But the local approach also has the much more significant advantage of nurturing and developing local expertise in managerial and technical skills, which are important for long-term development. Donor agencies often protest that the local economy lacks professionals and organizations with the needed skill set. Surely, however, such professionals would emerge if a local market existed that increased the overt demand for such expertise, as more professionals would stay in the country rather than drive taxis in Western cities. Initially, the reliance on local actors might result in greater corruption, and no doubt inexperience might generate mistakes. But the emergence of a competitive market for local expertise would eventually help drive out the incompetent and help promote the more professional agents. Moreover, mistakes would be much cheaper than they are at present, given the much lower salaries that would prevail.

A side effect of the current prevalence of foreign experts and consulting firms is that their salary structure pushes up all salaries in the local aid business. Thus, local staff of Western aid agencies and NGOs tend to have extremely high salaries by local standards, thus distorting the local wage scale. Relying much more systematically on local professionals would almost certainly soon bring down local personnel costs within local NGOs and project units, as the demand would generate its own supply. Carothers gives the example of the Soros Foundation office in Romania, in which all the personnel were Romanian. The office had twice as much staff as the USAID office in the country, at least in part because of its more intense and hands-on management practices, but at a fraction of the cost of USAID, largely because the latter hired so many expensive American expatriates (Carothers 1996, 18). The aid business may well be justified in paying slightly higher-than-average wages to attract good local staff, but the current extremely large premiums are driven more by the comparison with the remuneration of foreign experts than anything else.

In sum, the current reliance on foreign expertise needs to be curtailed. In practical terms, it would not be unreasonable to recommend that *donors reduce the use of foreign staff and experts, as well as foreign consulting firms not based in country, by half within the next five years.*

Adopting more of the logic of the local approach would also move the aid business closer to the “capacity utilization” approach that experts of institution building have recently endorsed (Grindle and Hilderbrand 1995; Fukuda-Parr, Lopes, and Malik 2002). They argue that donors should undertake measures to better utilize the capacity that already exists within recipient countries, rather than focusing capacity-building efforts on creating capacity that then tends to be underutilized. Certain elements of the project cycle could easily be “localized.” Thus, I recommend that *donors make the evaluation of aid projects and programs a local responsibility.* Again, the comparison with how foundations work is instructive: They demand evaluations from their recipients, who know they must deliver a credible accounting of aid monies if they wish to receive further support from the foundation. It is striking that the vast majority of low-income recipient states currently undertake no evaluation of aid, which is considered a donor task. Indeed, few governments have more than a pro forma role in evaluation exercises, which are typically undertaken by and for the donors, and it is unusual for ministries to make use of donor evaluations for their own sectoral programming activities.

This recipient passivity and donor dominance of evaluation processes are perplexing. First, it would make more sense for the recipient to undertake the evaluation rather than the aid agency for which there is a clear conflict of interest. Local agencies, based in the country, are more likely to have the detailed field knowledge necessary to make a well-informed judgment about the project. Donor agency evaluators, on the other hand, are likely to lack that knowledge and will be under pressure from their employers to make a positive evaluation of their agency colleagues. Indeed, a recurring problem of aid evaluations has been that they tend to exaggerate project benefits and downplay problems. Second, involving more local staff in evaluation would be immensely useful to gaining local ownership of aid programs. Local evaluation would foster a debate about the project and its objectives and generate broader support for successful projects. Clearly, few low-income countries are capable today of taking over the evaluation process; it is nonetheless logical and desirable that efforts be devoted immediately to increase their ability to take over this function in the near future. Governments would, moreover, work to develop this capacity if aid resources depended on it.

Restore Governmental Economic Planning

I have described how aid has tended to favor pseudo state actors such as project units and foreign experts. Such a bias is a mistake, as it both

favors the public sector, at the same time emasculating it, and fails to promote a sense of ownership by state agents. More aid can go to private actors than is the case now, as advocated by the local approach just discussed. On the other hand, aid directed to the public sector needs to be better integrated into the work of core state institutions. When resources go to the state, they should be included in national budgets and planning exercises. Parallel donor-driven exercises, whether in the form of the old by-pass model or in the new style of the PRSP, should be eliminated. Instead, all foreign aid should be integrated into national indicative planning exercises as was originally envisioned by the aid system and then progressively abandoned in the 1970s and 1980s. This is hardly a pitch for socialist planning. Instead, it is the recognition that the only way to build real ownership is to encourage governments to take command of their development process through a planning process that results in reasonable economic policies (which was all too rarely the case in the 1960s) and a participatory debate about development choices. I believe that even in the countries with lousy governance records, donors can use economic planning to empower technocrats and build state capacity.

The PRSP process is after all at least in part an attempt to fashion an aid-friendly economic planning structure within low-income governments. Ironically, the World Bank is trying to rebuild planning capacity in low-income countries, having spent much of the 1970s and 1980s trying to close down planning ministries and commissions. Though a step in the right direction, the PRSP is misguided in the sense that the main objective of economic planning should not be to please the donors and qualify for debt relief.

It should be noted that this implies a central role for the state in aid coordination. Much of the current effort to promote coordination is driven by donor concerns and is not compatible with local ownership. Donor attempts to coordinate their own efforts, notably at conditionality, are important, but donor coordination does not have the same function as aid coordination, which is best undertaken by the central state. In the context of a foundation approach, donors might still coordinate their own response to government proposals, but it is important that government aid proposals be integrated into a sustainable and coherent development program, which the government is best suited to develop and sustain.

Take Civil Service Reform Seriously

Perhaps the key institutional actor in the development of state capacity is the civil service. Civil service reform has been a central aspect of the economic recovery of countries like Uganda and Ghana. In such countries, forceful regimes were able to lay off a substantial number of civil

servants, provide significant salary increases to remaining employees, and pay them on time, all within a relatively brief period. Not surprisingly, their performance dramatically improved. Yet donors have long underemphasized the civil service in too many countries. In most of the stagnant low-income states, a high degree of politicization over hiring and promotions has weakened if not eliminated the civil service commission. The civil service has been sidelined by the increasing reliance on special implementation structure, often underwritten by the donors. Salary arrears have been allowed to accumulate over more than a decade, adding to the burdens of wage compression, low salaries, and ghost workers.

In sum, even as donors assign a growing number of tasks to these governments, they should provide resources and assistance for a rapid revamping of their civil services.

Beyond Aid

This book has argued that foreign aid will remain the central policy instrument to deal with the stagnant low-income states for the foreseeable future. Nonetheless, the international community can pursue other policies that will help make aid more effective and speed up the development process. Two are worth highlighting in the context of the themes I have explored: more effective promotion of the private sector and a greater attention to regional public institutions.

Promote the Private Sector

A view that has emerged during the last decade is that aid should promote the private sector more effectively. Aid to the stagnant low-income states has often served as a substitute for private capital, bailing out economies with policies that made them unattractive to private investors. Economists have suggested that aid should be designed instead to facilitate private investment. This is now being translated into policies that seek to use aid funds to promote mutually beneficial trade and investment opportunities in low-income states for Western countries through various subsidies to private agents in both sets of countries. This is notably the case with the African trade and investment promotion program—the African Growth and Opportunity Act (AGOA) in Washington in the late 1990s. The logic is impeccable: Aid should help African countries regain their international competitiveness, without which they will remain dependent wards of the donors. Rather than providing aid to governments, why not establish import-export credit facilities, loan guarantee systems, and so on? Such measures in effect subsidize the return of private

investors, who otherwise might view the region as too risky, and eventually result in the renewal of growth.

Initiatives to promote the private sector are important. At the same time, the prospects for private-sector growth in these countries are limited. As discussed earlier, the stagnant low-income states have received very little foreign direct investment in recent years. Unfortunately, most of these countries have neither the natural resources nor the internal market to attract investors. The new “trade, not aid” rhetoric is sustained by good old-fashioned commercial motives that, in conjunction with various budgetary pressures and the weakening of the aid impulse, are likely to result in both a smaller and a much less altruistic resource flow. One of the emerging mythologies of proposals such as AGOA is that what is good for Western business will necessarily promote development in the poor countries. In the current political climate, these initiatives may well evolve into boondoggles for the corporate sector of the developed countries and may not be all that different from the tied aid of the past. Moreover, even if well implemented, this approach has little to offer the region’s poorer countries, in which the private sector is unlikely to provide the critical investments in poverty alleviation, human capital, and better governance.

The policy community should devote more attention to several other issues, which could promote private sector-led growth more than these schemes to promote Western investment in low-income countries. First, donors tend to focus on “foreign” investment only and to devote much less time to “domestic” investment. Yet, many of the low-income countries have suffered many years of substantial capital flight, and a huge amount of capital now sits in offshore accounts. All investors, foreign and domestic, will respond to similar incentives, but special efforts could be made to discourage capital flight and encourage its repatriation. Banking-sector reform and financial-sector regulation have all been the focus of donor efforts, but the truth is progress has been slow and uncertain. Many stagnant low-income states still lack financial sectors that inspire much confidence, particularly for small local investors who lack political connections.

Second, faster progress on debt relief may well prove as important as investment promotion schemes to revitalize the private sector in the stagnant low-income states. Much evidence suggests that large debt-servicing obligations dampen investment because economic agents see these debts as future obligations for the government that will force it to increase revenue generation in the form of taxation (Birdsall and Williamson 2002, Elbadawi 1996). In addition, governments have less incentive to promote revenue generation when they know that additional revenues will simply return to the donor countries.

Third, Western protectionism in certain sectors of great importance to SLIS economies also needs to be curtailed. The now notorious example

of US subsidies for US cotton producers is a great example of this protectionism, since it affects a number of stagnant low-income states. The direct cost of protectionism to low-income countries in the form of forgone exports is relatively high and apparently rising. The indirect cost, in the form of forgone investments by Western investors that are deterred by the possibility of protectionism, may be higher.

Promote Regional Institutions

Western governments need to promote regional organizations, such as the UN economic commissions, regional development banks, and various regional think tanks and research institutes, much more assiduously than they have so far. An advantage of such stronger regional institutions would be a larger role in the promotion of local policy learning and the creation of institutional capacity that would be transmitted to national institutions. Additionally, these institutions could play a role as regional agencies of restraint, establishing regional norms for policy and governance.

Many of the current IFI tasks should be transferred to regional institutions. For instance, these institutions should undertake much of the research currently done by the World Bank and the International Monetary Fund. One immediate advantage would be research of greater immediate concern to the recipient countries themselves. Another would be the development of a cadre of professional policy analysts in the region, which would improve both regional and national policy debates. Today, development research undertaken by the IFIs and the UN system is carried out almost entirely in the West. Indeed, more development research probably occurred in developing-country institutions two decades ago than does today, as economic crisis and structural adjustment resulted in a substantial brain drain from low-income countries (e.g., Eicher 2001). While it may be influential in shaping policy within the IFIs, current research in these international organizations has too little resonance within the developing countries, outside of a handful of individuals in technocratic positions. Since so much of this research appears to support the policy positions of the IFIs in their policy debates with recipient countries, it is in any event often viewed as tainted and not objective by the publics in low-income countries.

Regional organizations could also play a larger role in the form of aid that would promote global public goods (Ferroni and Mody 2002), such as research on tropical diseases and agriculture. These organizations should also promote revamping regional statistical offices to stop the progressive decline in the quality of national economic and social data, which has been observed in the last two decades. In many cases, it makes sense to undertake these activities at the regional level. By all accounts,

different global public goods are currently underfunded, given the benefits to be derived from their successful provision. Research on tropical diseases and HIV/AIDS provide good examples. These diseases currently exert an enormous cost on low-income economies, and private-sector investments in devising preventive medicines or improving treatments have been inadequate because of the low purchasing power of the populations most affected. There is little doubt that the social benefits of such investments dwarf the returns to most investments currently made by the aid business. Thus, there is a powerful logic for public intervention at the supranational level.

A Coalition for Change?

From where will the impetus for positive change come? Who will supply the reforms advocated in this book? If my assessment is correct, neither the donor organizations nor the recipient governments can be the main force for change. Internal and external pressures constrain donors, despite the existence of many officials of good will. Recipient governments, despite some well-meaning technocrats, are prey to clientelistic and other nondevelopmental impulses. Unfortunately, this question does not have an easy answer. In rich countries, even when the public supports foreign aid, it typically has an extremely traditional view of aid, with the dominant image being the dedicated Western expert, knee-deep in the rice paddies, implementing a technical assistance project. In all likelihood, the general public views the types of issues discussed in this book as “inside baseball,” much too arcane and probably of secondary importance to the success of aid. A sympathetic public (and not all Western publics are all that sympathetic to aid) may be educated to understand the need to lessen the amount of tied aid, for example, or it can be convinced of the need for conditionality, but it is less likely to soon understand the cost of donor proliferation or the relative advantages of moving to programmatic aid. For these reasons, I do not believe that the general public in the West will be part of the aid reform coalition that is needed to promote the views advocated in this book.

One important potential member of a coalition for change can be found in the Western NGO community. Their relatively recent rise to prominence has demonstrated their impressive potential to promote change. They have managed to significantly influence the policy agenda of the official donors in certain policy areas, such as the environment and poverty reduction. Their pressure in the 1990s led to a dilution of donor conditionality in the poorest countries and to greater debt relief. Yet, they have focused almost all their attention on substantive issues and have largely ignored procedural issues and aid modalities. Most have also exerted much more pressure on Western governments than they

have on recipient governments. Neither of these biases is inevitable. NGOs have always had a predilection for project-based aid, and the dominant values in the NGO community perhaps make them insensitive to the problems of donor proliferation. Nonetheless, NGOs that care deeply about aid could become more vocal about the need to change aid modalities as discussed in this book. There is no reason NGOs could not more effectively push donors to promote more meaningful donor coordination, for example. Similarly, the NGO community needs to become much more vocal about the governance failures of recipient governments.

The private sector has a long-term interest in promoting positive change as well, since improving the conditions for economic growth would benefit them directly. Businesses will benefit in the long run from improved governance, even if they tend to be suspicious regarding new rules about transparency and accountability. Current proposals to convince private companies to promote revenue transparency for their operations in developing countries, as a way to limit corruption, provide a promising start.

Finally, and most important, the public in the stagnant low-income states also needs to be part of this coalition for change. They have the greatest stake in more effective aid, since it would promote economic development and more effective and democratic governments in the low-income countries. There is a “looking a gift horse in the mouth” dilemma here, perhaps a reason why intellectuals in low-income countries have hesitated to criticize foreign aid in the past. But low-income country publics should become more vocal both to donors and to their governments to improve their performance and stop squandering aid resources.

In this respect, the emergence of more participatory and competitive politics in the stagnant low-income states is extremely encouraging. However imperfect, political liberalization has allowed the emergence of a lively press, various civic organizations and interest groups, and a new, better-educated politician. These new political actors are not satisfied with the old way of doing business and are trying to invent more productive politics for their countries. The public space that is growing, in however slow and halting a manner, holds the promise for more accountable and developmental governments that would use aid resources better. This prospect is just another reason it is so important for the West to nurture and protect this fledgling democratic space.