The Role of the Bank in Low-Income Countries

by Steven Radelet

This note makes four brief points about the role of the World Bank in low-income countries. The first point concerns mission creep, or lack of institutional discipline. The Bank is involved in too many activities in individual countries and does not have a particularly clear focus. This lack of focus and overextension transfers to the recipient country governments who are encouraged by the Bank and other donors to take on way too many issues and activities, leading to a lack of focus, no sense of priorities, and less progress on a small number of really critical issues.

The Bank does this partly because it has, in house, a wide range of expertise and a decentralized structure so that it tends to try to support all kinds of activities. The main concern is not necessarily that the Bank globally has expertise in too many areas and needs to narrow its focus as an entire organization, although that is an issue. The more important problem is that within individual countries it has difficulty focusing on the really key issues, deciding that some problems cannot be solved right away, and determining a small number of very high priorities. It needs to do a much better job of both setting its own priorities within countries and helping recipient countries think through their priorities.

As a result, the Bank and other donors also tend to encourage an attitude of trying to solve all problems at once. It is very easy to go into a low-income country and find 25 or 50 or 60 problems, and to tell the recipient country that X is not working very well, we've got to fix Y, we've got to change Z, and so on. While it is true that these may all be problems, there is no sense of priorities; the problem is that in developing countries, the scarce

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resource is strong government policymakers, meaning that there are only so many things that can be tackled. The real challenge in development policy is not finding problems, but determining which problems should be solved first, given limited resources, to get the biggest bang and set the stage for continued change.

The good news is that to achieve development, we do not have to solve everything at once. If you look at the countries that have been successful over the last 40 years, mostly but not exclusively in Asia, they have not solved everything at once.[1] Take China as an example. No one would argue that China has solved everything at once. Nor have Korea, Indonesia, Malaysia, Botswana, Mauritius or Chile.

These and other successful countries were able to set priorities and get a few critical things right, and really solve some of the most pressing problems, rather than attempt to solve a wide array of problems simultaneously. Unfortunately, the Bank and the donors do not do this very well. Most specifically, the World Bank's Comprehensive Development Framework is a mistaken approach, because it encourages the attitude of "let's try to solve everything at once and fix all of these problems because development is so complicated," rather than "let's set some priorities and try to make real progress on the most important issues first, and follow on with others later."

Second, the Bank and other donors have to do a better job of recognizing that not all developing countries are alike, and it is necessary to differentiate the strategies that are used within developing countries. Here I am not making the point that the substantive development priorities differ across countries, which they obviously do, but rather that the quality of governance, commitment to development, and institutional capacity differ widely across countries, so the approach the Bank takes should recognize these differences, and the Bank should more clearly vary the way it provides its assistance across the spectrum of countries. There has been a lot of talk in the last few years about selectivity, the principle being that we give more aid to countries with better governance and institutions and less to countries that don't perform as well. This is a sensible starting point, but we need to go beyond that and actually *deliver* aid differently to countries that have different capabilities and qualities of governance.[2]

For example, in recent years there has been a lot of talk surrounding the issue of budget support, about country ownership, about longer-term commitments, about all kinds of things, as if these are the right solutions for *all* developing countries. But they are not. The principle of country ownership may not be appropriate under certain circumstances. Zimbabwe, with its current destructive government, is a perfect case in point—no donor should give more ownership of the development program to the government of Zimbabwe, and none really does. But our rhetoric about improving aid effectiveness does not take these differences into account, and implies that changes that make sense in some countries are a good idea for all. Donors, including the World Bank, need to move beyond the general rhetoric and shift toward thinking about how to employ different kinds of approaches and modalities in different countries. In countries that have better governance, better institutions, and have shown some commitment toward progress—countries such as Ghana, Honduras, Mongolia, Mozambique, Senegal, and Tanzania—it makes sense to have more country ownership, to provide longer-term commitments, to send more of the money through the budget as budget support, and otherwise change the ways that we deliver assistance.

In countries with weaker governance, we should stick with more project support, look for a narrower set of activities, and have a mix of donor priorities and country priorities. In countries with the weakest governance, there should be a much narrower set of activities, much less government ownership and involvement in setting priorities, a shorter time frame, shorter time commitments, much tighter oversight in what is done, a different way to measure results and different ways of delivering money, with less of it through the government and more of it through non-governmental organizations.

We have to shift toward creating these more distinctive strategies for different countries. Donors are beginning to move a little bit in this way, in some cases implicitly and in others more explicitly. The United Kingdom's DFID and some other European donors are providing budget support in some countries but not in all (although the criteria they use to make these distinctions are not clear). The United States has set up the Millennium Challenge Account, which very explicitly distinguishes among recipient countries. And there is some welcome movement within the Bank along these lines, but it needs to go further in providing its assistance in different ways across countries. The Bank's increased use of grants opens many new possibilities that it has not yet begun to explore about to whom and how it provides financing under different circumstances.

Establishing more distinct modalities could help create incentives for countries to strengthen governance and institutions. Budget support provides a good example. It makes sense for the Bank to provide budget support in countries that have better public sector finance institutions, stronger fiduciary standards, and better accounting and auditing practices, but not in countries with weaker systems (note that this is not the same as better governance more broadly). There are now many ways of ranking and grading public sector finance institutions, such as the budget office and the ministry of finance more generally. The Bank should use such grading systems, and provide a greater share of its funding as budget support to countries that score better on these standards. For example, as governments reach a certain standard on auditing, accounting, publishing their accounts, procurement, and other areas, they receive some share of their funding as budget support, say 20 percent. As their standards improve, they could receive 50 percent or 75 percent or more. Note the issue is not about how much money they would receive, but *how* they would receive it. The incentive would be built in for the countries to want to improve their systems, because by doing so they could receive more of the money in the way they want it—as budget support.

The third point is on accountability. The Bank currently does not reward results strongly enough, and too often it rewards failure. It needs to be much more results-oriented. To its credit, the Bank has begun to move in this direction in recent years. But it is a huge challenge to try to change incentives within an institution, and to try to reward success rather than failure. Part of the answer is in removing long-standing incentives for Bank staff that are focused on disbursing money, and creating incentives that are connected to the success or failure of the activity. But these changes will not just happen by people saying we ought to do a better job and we ought to focus more on results and by hoping staff respond. Instead, changes must come from the Executive Board and from senior management who must make structural and policy changes that create incentives that are focused on results. Management could make proposals to the Board for re-orienting staff incentives and promotion over time so that they are more linked to results, or to how projects are monitored and evaluated over time to focus on results. Similarly, Board members—both contributors and recipients—could demand more results-based approaches.

The United States has been pushing from the Executive Board to hook its IDA contributions to broad indicators of the Bank achieving results. I am generally supportive of this approach, although I have not agreed with all the details of how it has been carried out. It would be better if these kinds of initiatives primarily came from management rather than the Board. It will also be a challenge to translate these kinds of measures from an institution-wide focus to specific projects and programs.

President Wolfowitz has made the point about the need for the Bank to be more results-oriented, and hopefully he will be able to move the Bank in this direction. One key in focusing more on results, as proposed by my colleague Nancy Birdsall, would be the creation of a truly independent outside evaluation entity that can measure results on specific activities and for the Bank more generally.[3]

The fourth and last point concerns grants. From the Bank's perspective, providing more of its assistance to low-income countries as grants makes a lot of sense, but the way the Bank is allocating grants across countries doe not make much sense.[4]

When the shift to grants began in 2002, the Bank decided to allocate grants based on sector—certain activities, such as health education received more grants, while others such as infrastructure were financed by loans. It quickly became apparent that this formulation would not work, as countries would receive mixes of grants and loans, leading to incentives to move money and creating confusion.

More recently, the allocation rule was changed so that the share of grants a country receives is based on measures of debt sustainability. The rationale seems simple: grants were pushed by the United States and others partly as a solution to sustained debt problems, and giving grants to countries with the largest debt problems certainly helps reduce their future debt burden. But basing grants on debt sets up strong perverse incentives, because the more debt a country accumulates, the more likely it will be to receive grants, whereas the more a country manages its economy well and avoids debt problems, the more it will be told that it must continue to borrow. This rationale does not make a lot of sense, especially as we are about to forgive all the debts for countries that reach the HIPC Completion Point, meaning that those countries will be prime candidates for more loans, rather than grants.

Instead, grants should be based on a country's income. The poorest countries in the world should get grants, and as their incomes grow, they should receive more loans—first subsidized, and later not subsidized. That's the principle the Bank uses to distinguish between IDA and IBRD funds, and that's the way most donor flows work. As incomes grow and countries achieve higher incomes that demonstrably prove a greater ability to service debt, the level of concessionality should decline.

The poorest countries in the world are the ones that face the deepest development problems, so they face the greatest risk that they will not be able to achieve the growth necessary to repay loans, even if they establish good policies. They tend to be vulnerable to the greatest number of shocks and face the largest obstacles to growth. When they do achieve growth, the resources should be reinvested, not repaid to the Bank to be relent elsewhere.

Going forward, the Bank should set up either a third separate window or a window within IDA for grants only for all countries with incomes below $500 per capita. This would ensure that the poorest countries receive the most concessional money and do not face debt problems. As incomes grow in these countries and they begin to show some capacity to actually get returns on investments, they can go to IDA loan-financing. This approach will better match grant financing with the greatest needs, and avoid the perverse incentives of allocating grants based on debt.

Notes

1. See Steven Radelet and Jeffrey Sachs, "Reemerging Asia," *Foreign Affairs* 76, no. 6 (November/December 1997): 44–59.

2. Steven Radelet, "From Pushing Reforms to Pulling Reforms: the Role of Challenge Programs in Foreign Aid Policy," in *The New Public Finance: Responding to Global Challenges*, eds. Inge Kaul and Pedro Conceição, (Oxford: Oxford University Press, 2006). Also available as CGD Working Paper #53 at http://www.cgdev.org/Publications/index.cfm?PubID=196.

3. Nancy Birdsall, "Seven Deadly Sins: Reflections on Donor Failings," CGD Working Paper Number 50, December 2004.

4. See Steven Radelet, "Grants for the World's Poorest: How the World Bank Should Distribute Its Funds," CGD Note, June 2005, http://www.cgdev.org/content/publications/detail/2681.