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DEVELOPMENT EFFECTIVENESS, PARTNERSHIP, AND CHALLENGES FOR THE FUTURE

Attached for the April 21, 2002 Development Committee meeting is a report entitled "Development Effectiveness, Partnership and Challenges for the Future" prepared by the staff of the World Bank. This subject will be considered under item I.A of the Provisional Agenda.

DEVELOPMENT EFFECTIVENESS, PARTNERSHIP, AND CHALLENGES FOR THE FUTURE:

AN ISSUES PAPER PREPARED FOR THE DEVELOPMENT COMMITTEE

APRIL 21, 2002

I. INTRODUCTION

1. The world has seen growing international commitment to work together to fight poverty and promote development. The adoption of the Millennium Development Goals (MDGs) at the United Nations in September 2000 and the recent Monterrey conference on Financing for Development were important landmarks. The past two decades have witnessed major improvements in economic policies in many developing countries. And the World Trade Organization meeting in Doha in November 2001 demonstrated a commitment to a “development round” of trade negotiations and agreements.

2. At the Development Committee meeting last October, there was a recognition of both: (i) the opportunities being created by better policies and more open trade, and (ii) the magnitude of the challenge of fighting poverty and attaining the MDGs. Mr. Wolfensohn called then for a deeper partnership between developing and developed countries to respond to that challenge. Many Ministers saw increased volumes of aid as a crucial part of that partnership. Accordingly, there were requests that the Bank examine the record on development, including the differences among countries. Further, Ministers asked that the Bank prepare an assessment of the role and effectiveness of development assistance, as well as draw lessons for the future.

3. Accordingly, the Bank has undertaken a detailed evaluation of these questions, drawing on its extensive research and the work of the Operations Evaluation Department. The results are reported in the Bank’s research paper, *The Role and Effectiveness of Development Assistance: Lessons from World Bank Experience*.[1] Broadly, that paper finds that there has been strong progress in health, education, and poverty reduction over the past 50 years, driven in substantial measure by better policies. It shows that many countries and groups have nevertheless been left out of that progress, in large part because of weaknesses not only in policies but also in institutions and governance. And it shows that, while there have been failures as well as successes, development assistance has played an important role in the strong overall progress. The development community has learned from both successes and failures; to take two important examples, it is now allocating more aid to countries that can use it better, and it has begun to come to grips with the difficult challenge of improving governance and institutions. This paper includes

[1] The paper is available on the Bank’s research website at http://econ.worldbank.org/.

a summary of that longer research paper, while also drawing on other recent research papers on trade and development.[2]

4. ***The Monterrey consensus:*** The discussions of the Development Committee last fall, as well as the conclusions of the research paper on development assistance, contributed to the *Financing for Development* conference held in Monterrey in March 2002. That conference ratified strongly the theme of a partnership between developing and developed countries that is based on results and mutual accountability. This paper elaborates on the key elements of that partnership: better policies, institutions, and governance in developing countries; more rapid economic integration and increased market access; and greater effectiveness and higher levels of development assistance. It closes by identifying some areas of continued challenge for the development community.

II. SOURCES OF DEVELOPMENT PROGRESS

5. ***Development progress has been rapid but unequal.*** There has been considerable overall development progress during the past 50 years. Indicators of both income and human development for the developing world as a whole show this: since 1960, average life expectancy has increased by 20 years; since 1965, per-capita incomes have more than doubled; since 1970, the illiteracy rate among adults in the developing world has dropped by nearly half, from 47 percent to 25 percent; and since about 1980, the absolute number of people living on less than $1 per day has begun to fall, after increasing for much of the previous two centuries. As discussed below, development assistance has accelerated this progress by supporting governments committed to growth and poverty reduction.

6. Nevertheless, progress has not been uniform, and many people are being left behind. Most notably, Sub-Saharan Africa as a region saw no increase in its per-capita incomes between 1965 and 1999, even with some improvement in the 1990s. Although Africa did make steady progress on health and education indicators over much of that period—despite the lack of income growth—the AIDS epidemic has reversed the increases in life expectancy. Numerous countries in other regions too have failed to share in the increased prosperity; and many of those in countries that have been growing rapidly have not participated in the benefits of growth. Governments and donors share responsibility for these failures, and have worked to learn from them. Continued development progress, and in particular achievement of the Millennium Development Goals (MDGs), will depend on ensuring that prosperity is shared more widely. This in turn will require not only immediate action, but also further learning about how to address the most difficult development issues.

7. Vast challenges remain. Nearly a quarter of the developing world lives on less than $1 per day, and more than half on less than $2 per day. Despite gains in education, an estimated 100 million children of primary school age do not attend school. Some 5 million people become infected with HIV each year, and an even larger number contract tuberculosis. On many of these

[2] *Global Economic Prospects 2002: Making Trade Work for the World's Poor* (Washington, DC: World Bank, 2001); *Globalization, Growth, and Poverty: Building an Inclusive World Economy* (Washington, DC: World Bank, 2002).

dimensions, the world as a whole is falling behind the path that is necessary to achieve the MDGs by 2015.

8. ***Progress has three main sources:*** Experience and analysis reveal three key elements that promote increases in living standards:

- Country policies, institutions, and governance
- Economic integration through trade and investment flows
- External assistance to support country policies

Together, these three elements represent an agenda for progress—the partnership between developed and developing countries that is at the core of the Monterrey consensus. The remainder of this section explores each of these elements in greater detail.

A. Country actions: Policies, governance, and institutional capacity

9. The experience of the past several decades makes it clear that the country itself is the lead agent of development progress. To be successful, a development approach has to be country-driven, country-owned, and country-specific; no single approach will work across all countries. Countries that have grown and reduced poverty rapidly have done so in their own way, responding to their own particular reform needs and making their own choices. When the primary impetus for reform has come from outside, the result has generally been failure due to lack of country commitment and to the ignorance of local conditions embodied in outside prescriptions. This lesson about the importance of country commitment motivated the creation of the Poverty Reduction Strategy Paper (PRSP) process, a country-managed exercise that now provides the framework for coordinated assistance to low-income countries by the Bank and their other partners, as well as for mutual accountability. *[The joint IMF/World Bank **Review of the Poverty Reduction Strategy Paper Approach** provides details and identifies areas for improvement.]* But while any approach must be tailored to country circumstances, experience shows that country actions are most likely to be successful if they reflect certain broad principles. In terms of broad approaches, the government and the private sector need to play complementary roles. The private sector is typically the primary engine of growth and job creation, while the public sector makes this possible by providing the framework for development—specifically, by promoting human development and creating an environment for opportunity, entrepreneurship, and growth. Both roles are essential: for example, where privatization of state-owned enterprises is often advisable for both efficiency and equity reasons, a strong government regulatory capacity will often be necessary to ensure that privatization does not create a private monopoly and thus harm consumers.

10. ***Two pillars of development.*** Specifically, public action will need to focus on building two key pillars of development:

- Creating a good investment climate—one that encourages firms and farms, both small and large, to invest, create jobs, and increase productivity.
- Empowering and investing in poor people—by providing or enabling access to health, education, and social protection, and by creating mechanisms for participating in the decisions that shape their lives.

The investment climate generates opportunities for private investment, while the empowerment pillar ensures that poor people can participate in growth. These two pillars support each other: growth is essential for sustained poverty reduction, and investing in poor people can pay off in higher rates of growth. In addition, the measures taken to build up these pillars are also essential in reducing vulnerability of both economies and poor people to economic disruptions—providing the security that is also an integral part of poverty reduction.

11. ***Improving the investment climate.*** Creating a climate for investment and growth requires progress in a number of areas: macroeconomic stability and trade openness; governance and institutions (including an effective legal and judicial system, the rule of law, a professional and non-corrupt bureaucracy, a strong and well-regulated financial sector, a good education system, and vigorous competition); and adequate infrastructure.

12. While foreign investment often contributes to development—by providing access to capital, technology, and marketing channels—sustained growth depends primarily upon domestic investment and entrepreneurship. The best indicators of the state of the investment climate, therefore, will be the investment and productivity performance of the *domestic* private sector. And because most poor people work in small firms and microenterprises, including family farms, countries need to pay special attention to improving the investment climate in the rural, informal, and small-business sectors.

13. ***Investing in poor people.*** Poverty reduction depends heavily on sustained economic growth. On average across countries, income distribution does not worsen during periods of economic growth, so on average the incomes of poor people rise at a similar rate to those of wealthier people. But this is simply an average, across countries and across people, and this outcome is not guaranteed in a particular country during a given period. Countries need to take steps to ensure that as many poor people as possible will participate in growth. This requires policies and institutions that provide or enable poor people to have access to education, health, and social protection. It is particularly important to keep in mind the gender dimension of development. Investment in women and girls is often not only an important tool of empowerment, but also the most cost-effective way of achieving development goals; for example, educating women substantially improves the health outcomes of their children. Participation of poor people in the decisions that most affect their lives—for example, parental involvement in school management, or participation by beneficiaries in project design—also fosters the involvement of poor people in growth. So too does an administrative and legal structure that allows them to build, protect, and borrow against their assets.

14. Policies and investments aimed directly at reducing non-income dimensions of poverty can be highly effective. Income growth can lead to significant improvements in health and education, but countries can greatly accelerate health and education progress through direct measures, which in turn stimulate growth. Globally, we see the powerful effects of policy in the dramatic reductions in infant mortality, which has fallen steadily *at each level of income* as a result of improvements in technology, knowledge, and policies and institutions. For example, in 1950 an average upper-middle income country had an infant mortality rate of 45 per 1000 live births; by 1995, an average country *at the same real income level* would have had an infant mortality rate of just 15 per 1000 live births, a reduction of two-thirds. Countries at all income levels saw similarly large reductions.

15. ***Improvements in developing-country policies and institutions.*** In recent years, many developing countries have improved policies and institutions, often with strong growth results. For example, macroeconomic stability and openness have improved throughout the developing world over the past two decades. The median inflation rate of developing countries was cut in half between 1982 and 1997, from about 15 to 7 percent. Average tariff rates have also declined sharply in all developing regions. In South Asia, for example, the unweighted average tariff fell from about 65 percent in 1980-85 to about 30 percent in 1996-98; in Latin American and the Caribbean, from about 30 percent to under 15 percent. Many of these improvements have been associated with extended periods of policy dialogue with, and support from, the international institutions. And although institution-building and governance reforms have often lagged policy reforms, governance has improved in a key respect: the share of the world's countries that are democracies increased from 30 percent to 60 percent between 1974 and 1998.

16. These improvements do not mean that all development problems have been solved. One major set of issues is the appropriate sequencing of policy and institutional reforms and how to build stronger institutions and better governance. No poor country has the capacity to move forward with equal vigor on all these fronts at once, and even though we know something about the ingredients, there is no single, universally applicable recipe that can specify the sequence of actions. Therefore it will be important for the country, with external support, to identify and grapple with the main obstacles to development. A second challenge is sustaining growth and poverty reduction. For example, many countries manage to achieve growth spurts of several years, but find it very difficult to achieve the two or three decades of sustained growth necessary for consistent poverty reduction.

B. The international environment: Trade integration and market access

17. Many poor countries are constrained in their development by their small domestic markets. Productive efficiency increases with access to larger markets, as does learning and innovation. For this reason, the ability to trade with other markets—including especially the large rich-country markets—greatly influences the rewards to other reforms aimed at improving the climate for investment and productivity. At the same time, integration depends on far more than market access. To take advantage of market opportunities, countries need to build infrastructure, improve trade-related policies and institutions, and smooth adjustment, with international assistance where necessary.

18. ***Trade integration and growth.*** The recent Bank policy research report *Globalization, Growth, and Poverty: Building an Inclusive World Economy* summarized the evidence on the importance of trade integration in growth and development. It identified the two dozen countries that integrated most rapidly with the international economy between the 1970s and the 1990s; on average, these countries doubled their share in trade relative to income over that period. The study found that for countries in this group (which have a total population of 3 billion people), the annual growth rate of per-capita GDP increased from less than 3 percent in the 1970s to 5 percent in the 1990s—a remarkable rate by historical standards. By contrast, developed-country incomes grew at only 2 percent per year in the 1990s, while incomes in countries that were less successful in integrating (with a population of 2 billion) did not grow at all on average.

19. The rapid growth in the fast-integrating economies was typically due in large part to broader policy reforms in the investment climate and in human development, not solely to trade integration. And it should be stressed that integration is not about applying a simplistic liberalization formula. Both China and India are part of this group because of their rapid trade growth and strong movement toward more open markets, even though their economic policies are not among the most open in the developing world in terms of import liberalization. Nevertheless, there is little question that for this group of countries—which also includes Malaysia, Mexico, the Philippines, and Thailand—export growth and trade integration helped accelerate growth. (The same is true in Uganda and Vietnam; these countries have also integrated and grown rapidly, although data limitations preclude their inclusion in the first group of countries.) The evidence of the past 20 years has been clear: faster growth has been associated with greater integration. Trade holds out even more promise for smaller low-income countries. But the effects of trade on growth can be greatly strengthened through measures to open markets and to increase the export supply response.

20. ***Market access remains a problem for poor countries.*** The first element in accelerating integration is greater market access for developing-country exports. The *Global Economic Prospects 2002* report (*GEP*) showed that although the past 50 years has seen strong progress in trade liberalization, the remaining global protection is still very large and hits poor countries the hardest. Progress in lowering barriers has lagged in two of the sectors with both the highest protection and with the greatest impact on poverty—agriculture and labor-intensive manufactures (such as textiles and clothing). Overall, the world's poor face tariffs that are, on average, roughly twice as high as those faced by the nonpoor. Recent moves by the European Union, the United States, and other countries to increase market access for certain groups of the poorest countries, while welcome, will need to be deepened and broadened if this pattern is to be reversed.

21. It is not only import barriers that reduce access to rich-country markets. In agriculture, government support for agricultural producers distorts trade by boosting rich-country production and reduces imports from developing countries. Rich countries' support to their own agricultural sectors in 2000 totaled more than $300 billion (or about six times total aid flows). These measures by rich countries raise major obstacles to development for poor countries, because agriculture is an important area of comparative advantage for many developing countries. Protectionism and subsidies also increase price volatility, which is particularly damaging to poor producers and consumers. Anti-dumping actions and other non-tariff barriers create further major obstacles to market access for poor countries.

22. ***Promoting integration requires complementary domestic reforms and institution-building.*** In many countries, greater market access will not be enough, and additional reforms and institution-building will be necessary to ensure an export supply response. These complementary measures may include: spurring the development of trade-related sectors such as transport, telecommunications, financial sector, and business services; upgrading customs administrations and other relevant public-sector agencies; adopting measures to cushion poor people from transition costs of trade reforms; and undertaking a phased lowering of trade barriers. Donors can contribute by providing "aid for trade," such as financial and technical assistance for behind-the-border trade-related investments and implementation of trade agreements.

23. ***Liberalization brings great benefits.*** How much would developing countries benefit from increased market access? The *GEP 2002* attempted to answer this question by defining an

integrated package of global trade reforms: further multilateral reductions in trade barriers, duty- and quota-free access to OECD markets for all low-income countries, and continued improvements in developing-country policies, together with "aid for trade" to help developing countries meet multilateral trade commitments. The report estimated that such a liberalization package would have large effects on poverty (defined here as the number of people living under $2 per day). Compared with the base case (which projects a decline in poverty of 600 million), trade reform would reduce poverty by an *additional* 300 million people by spurring economic growth. Lowering barriers to merchandise trade alone (again, supported by trade-facilitating domestic reforms) has the potential to increase developing countries' cumulative income by some $1.5 trillion over the 2005-2015 period; lowering barriers to services too could bring much larger gains.

C. Supporting progress: The role and effectiveness of development assistance

24. Well-designed development assistance accelerates growth and poverty reduction, by supporting and catalyzing country reforms. This section summarizes the findings of the research paper *The Role and Effectiveness of Development Assistance: Lessons from World Bank Experience,* which outlined not only the successes and failures of development assistance, but also evidence on how the World Bank and the development community have adapted to lessons learned. In looking at the overall effect of aid, the analysis groups together contributions from all countries and institutions; on specific projects and programs, the experience is primary that of the World Bank.

25. Development assistance contributes through a variety of instruments. Financial transfers are important, but are by no means the only or even the most significant form of assistance for many countries. Major successes have been achieved through international collaboration in agricultural and health technology and through capacity-building. The role of the international community in researching and sharing knowledge—so that we can build on successes and learn from failures—is also vital, although country specificity means that there is a need for constant assessment of and adaptation to specific situations. All of these instruments are appropriate for use in different mixes in different situations.

26. How effective has development assistance been at accelerating growth and reducing poverty? First, it should be noted that attempts to assess the contributions of external assistance face inherent difficulties, for several reasons. Successful development strategies and actions generally depend on strong country ownership, as well as deep partnership among donors; both make it misleading, and even counterproductive, for any external actor to claim full credit for a reform or project. Furthermore, the most successful development projects have effects that reverberate far beyond the project itself—either because the ideas in the project are replicated elsewhere, or because the intervention has helped institutionalize new approaches. This makes evaluation difficult.

27. To help overcome these problems, the paper presents four different types of analysis of development assistance: cross-country statistical analysis, country cases, program and project evaluations, and analyses of global programs Each of these approaches has its shortcomings, but separately and together they all lead broadly to one conclusion: *development assistance has made substantial contributions to development progress.*

28. ***Cross-country statistical analysis.*** Cross-country analysis is useful in identifying the typical economy-wide effects of aid for all developing countries.[3] The figures in this section come from cross-country regressions that isolate the effects of financial assistance on economic growth, investment, and poverty, after taking into account the effects of other factors such as domestic policies and institutions. All such regression results involve considerable uncertainty, so these figures should be taken as indicative rather than definitive; moreover, the results reflect averages, and the experiences of individual countries will vary. With those caveats, the research finds that when aid goes to countries with reasonably good policies and institutions—as the bulk of the Bank's lending typically does—then it has major benefits for the borrowing country.

- *Aid reduces poverty:* Aid has effects on incomes right across the economy, but if we focus only on its effects in lifting people across the poverty line, we see that its productivity has been growing strongly. Statistical analysis shows that in the late 1990s, an additional one-time infusion of $1 billion in official development assistance (ODA), allocated in the same way as overall ODA, would have lifted nearly 300,000 people *permanently* out of poverty (defined at the $1/day level). In the case of IDA lending, the figure would have been even higher, with close to 450,000 people lifted permanently out of poverty. Both these figures represented dramatic improvements over earlier figures, due to greater selectivity of lending and better country policies since the end of the Cold War. In 1990, $1 billion in ODA would have lifted only about 100,000 people permanently out of poverty—meaning that during the 1990s, the estimated poverty-reduction effectiveness of ODA tripled.
- *Aid promotes investment:* Poverty reduction is just one effect of well-allocated aid. Much IDA lending is targeted at improving the investment climate, by supporting improved policies and building the governance, institutions, and infrastructure necessary for private-sector productivity. As a result, every dollar of IDA flows on average leads to an increase in gross investment estimated at nearly two dollars. In good policy environments, aid also increases foreign direct investment (FDI) substantially—by some 60 cents for each dollar of aid. The recent Bank publication *Global Development Finance 2002* demonstrated further the strong relationship between FDI and the quality of the investment climate.
- *Aid promotes overall economic growth:* Because of the increases in investment, productivity, and human development that it can support and promote, the overall rate of return to IDA lending (in terms of increases in GDP) is estimated to be as high as 40 percent.

29. ***Country cases.*** The cross-country statistical analysis is essentially a (somewhat) more sophisticated version of drawing graphs or producing tables comparing country experiences. It is not a substitute for looking in more detail at the experience of particular countries, projects, and programs, which will help us understand better how successes and failures occur. The study of country cases is a crucial and complementary part of our assessment of the effectiveness of development assistance. Uganda, Mozambique, China, Vietnam, India, and Poland are all examples of countries where, within the past two decades, policy and institutional reforms have

[3] This analysis was pioneered largely by the Bank, in its policy research report on *Assessing Aid* and other publications of the Development Economics Department. Further references are available in the full paper on *The Role and Effectiveness of Development Assistance*.

sparked an acceleration in development.[4] In each of these cases, the country and its government have been the prime movers for reform, and each country mapped out its own development strategy and approach. While their experiences share some common features—most notably an increase in market orientation and macroeconomic stability—none of these countries followed any formulaic external blueprint for development.

30. Yet in all of these cases, development assistance from many sources has supported the transformation. In some cases, advice was more important than lending. In the case of China, for example, aid flows have been dwarfed by inflows of private capital. But development assistance helped pave the way for private-sector growth and international integration—for example (and the World Bank played an important role in this part of the story), by providing analysis and advice to help China open its economy to investment, unify its exchange rate, and improve its ports early in the transition period. And advice without commitment of resources and people is less likely to be taken seriously.

31. In many other countries, development progress has been much less rapid, as noted above. The lack of progress has many causes, including most notably poor policies, institutions, and governance, as well as external circumstances such as declines in commodity prices. Yet donors also share some of the responsibility. For example, design of aid programs in many African countries (such as Zaire, Kenya, and Zambia) placed too little emphasis on institution-building and governance challenges. Nor was the problem unique to Africa. Development assistance in the former Soviet Union during the early years of transition was undermined by a lack of government commitment to laying the institutional foundations for a market economy, as well as by corruption and crime. In part, these problems in specific countries were associated with broader mistakes by donors in the design and implementation of adjustment lending. Especially in the 1980s and early 1990s, adjustment lending too often proceeded without key prerequisites—such as reform commitment by the borrowing country, attention to the distributional impacts of adjustment, and an understanding of the domestic political economy.

32. ***Evaluation at the program, sector, and project levels.*** The economy-wide analyses of effectiveness are complemented by more micro-level evaluation results. Here, we report only on data and examples from World Bank operations, as analyzed by the independent Operations Evaluation Department (OED); other agencies of course have their own evaluation results. While the results of individual projects have been mixed, the OED evaluations find that:

- *Bank operations have served in general to increase the economic productivity of borrowers*. The economic rates of return (ERR) that have been calculated on Bank-financed projects averaged 16 percent in the 1980s and 25 percent in the 1990s. (Note that these ERRs are fairly narrowly defined, as is conventional, and do not account for either possible fungibility problems or demonstration effects that could lower or raise returns. They are therefore useful primarily in combination with other types of analysis.)

- *Bank operations have helped to improve health and education outcomes*, both indirectly as a result of income increases and directly through projects and programs. The Bank is the

[4] The research paper on *The Role and Effectiveness of Development Assistance* provides details of these and other country cases.

world's largest external funder of education (with $30 billion in cumulative lending), as well as the world's largest external funder of health programs (with new commitments of $1.3 billion a year for health, nutrition, and population projects). And although it is difficult to summarize quantitatively the overall effect of Bank interventions in these sectors, project examples show large improvements of outcomes in many specific projects. In health, a project in China in the late 1990s dramatically increased the use of iodized salt, which will lead to average gains of 10 to 15 points in children's IQ levels in affected communities. In Mali, a project in the early 1990s raised the share of children fully vaccinated from 0 to 24 percent. And in Brazil, a project working through NGOs helped reduce the number of AIDS-related deaths by 38 percent since 1993. In the education sector, girls' enrollment in Bangladesh has increased dramatically—from 34 percent of secondary-school enrollment in 1990 to 48 percent in 1997—with support from a Bank project that helped finance stipends and cover school costs for girls. Beyond the direct benefits, expanded girls' education has contributed to a reduction in fertility, as well as higher female employment and earnings. And when Uganda used Bank support to create a system for public monitoring of funds going to primary schools and school districts, the share of non-wage allocations actually reaching the schools rose from less than 30 percent in the early 1990s to 90 percent by 2000—providing additional support for schools that have greatly increased enrollment since 1997.

- *Bank lending has generally encouraged good economic performance.* Reviews of adjustment lending show that the Bank learned from its less successful programs of the 1980s, so that in the 1990s, such lending supported governments in maintaining their efforts in social areas and in poverty focus. Developing countries receiving Bank adjustment lending in 1990-97 maintained and in some cases even increased social expenditures, on average, more frequently than countries without such lending.
- *The measured outcomes of Bank lending have improved steadily.* Project outcomes, as measured by the independent Operations Evaluation Department, have improved sharply over the past decade. Despite the growing complexity and more demanding nature of the development agenda, the share of Bank projects rated as satisfactory (in terms of achievement of objectives) has increased from well below 60 percent in the late 1980s to above 80 percent today. Comparable data on evaluation of projects and programs in developed countries are less easy to come by, so it is an open question whether expenditure in those countries performs as well as in development projects or programs.
- *Evaluation has identified the factors most likely to lead to failure.* For example, analysis of Bank projects has revealed that failures are much more likely to occur in a weak policy environment; this finding motivated the Bank to offer programmatic support in addition to project lending. Similarly, better project preparation and additional resources for analysis are associated with lower rates of project failure. And evaluation has also shown that simplicity should often be a guiding principle in project design; complex, multi-component projects are more likely to fail in countries with weak administrative capacity. In these cases and others cited below, the Bank has improved its performance by learning from failures.

33. ***Analysis of global programs.*** Global development challenges—such as the spread of infectious diseases, the challenge of building an international trade and financial architecture, loss of biodiversity, deforestation, climate change—cannot be handled solely by individual countries

and therefore require multilateral action. There have been some notable successes of global or regional actions supported by the Bank. One is the Onchocerciasis Control Program, a collaborative effort of multilateral agencies, governments, NGOs, and the private sector, which eliminated riverblindness from an 11-country region of West Africa and thereby prevented an estimated 600,000 cases of blindness. Another example of great importance is the Consultative Group for International Agricultural Research (CGIAR), a network of research centers that has done much to generate the "Green Revolution" that helped increase yields in target grains by 75 percent over three decades. On the other hand, the world reacted slowly to the spread of AIDS, malaria has returned very strongly after being close to eradication, and we face the threat of further global warming. All of these are global problems that the world has not been able to work together to address quickly enough, and the global response now needs to be stepped up.

34. ***Lessons on increasing effectiveness.*** Lessons learned through experience and analysis have improved the effectiveness of development assistance over time. Because development is a vast and diverse field, and because development assistance is most effective when it is designed to fit country circumstances and needs, any generalizations should be made with caution. Nevertheless, examination of experience suggests broadly that development assistance is most effective when it follows certain principles:

- *Respect country ownership.* A major lesson of the early experience with adjustment lending is that loan conditionality cannot substitute for country commitment to reforms. As noted above, the Bank and the international community have launched the PRSP process to improve country ownership and donor coordination, by delivering assistance and promoting mutual accountability in the context of country-owned strategies. Together with its partners, the Bank is currently reviewing the early experience with the PRSP process and working to improve this approach. *[See Review of the PRSP Approach: Main Findings (DC2002-0003) for details.]* To sustain this momentum, an enhanced emphasis on results in the future should be managed in a way that does not undermine ownership.

- *Continue to improve aid allocation.* In general, substantial amounts of aid should go only to countries that have a track record showing a commitment to reform. Aid patterns did not reflect this principle in 1990, when Cold War politics still drove much of the overall allocation of aid; these considerations affected Bank assistance less than they did in the case of much bilateral aid, but even there they had some influence. As a result, countries with worse policies and institutions received $44 per capita in ODA from all sources (multilateral and bilateral), while countries with better policies received less (only $39 per capita). By the late 1990s, after improvements in aid allocation, better-policy countries received almost twice as much as the worse-policy countries ($28 per capita for the former, compared with $16 for the latter). It was this shift that led to the tripling of the poverty-reduction efficiency of aid over the period. There is still room for considerable improvement in allocation, however, especially in some bilateral programs.

- *Use instruments appropriate to the situation.* Better aid allocation is one element in tailoring assistance to the needs and capacity of a given developing country. For countries with poor policies and institutions, development assistance should focus on non-lending services—advice, analysis, and capacity-building—that will improve the productivity of eventual financial assistance. As noted above, countries fall along a continuum, rather than separating neatly into "good" and "poor" policy countries. As a result, the Bank and other donors need to vary the mix and nature of both lending and non-lending instruments to match the conditions of each country.

- *Harmonize aid.* The lack of coordination of aid programs overtaxes the scarce institutional capacity of recipient governments, causes duplication, and leads to projects that do not fit into local priorities. Coordination by donors in line with strategies that have been agreed through extensive consultation with countries—such as through the PRSP process—thus serves to increase the effectiveness of aid.

- *Concentrate on being agents of change.* In many countries, the resource flows from the World Bank—and even ODA flows more broadly—are not large enough for the money alone to make a major difference, relative to the scale of the challenge. ODA totaled about $54 billion in 2000; this was only one-third as much as foreign direct investment in developing countries, which itself was only a small fraction of total investment (nearly $1.5 trillion). Similarly the Bank usually lends $1 to 2 billion per year in direct assistance to the education sector (plus additional assistance through programmatic lending with education-related conditions), compared with annual public education spending in the developing world of more than $250 billion. Therefore when the IFIs and other donors have major effects on development, it is because their assistance has gone beyond mere resource transfer and has helped countries to make fundamental changes—for example, through building institutions or through demonstration projects that are replicated. Creating these long-lasting and far-reaching effects is the essence of "scaling up." Even where IFI flows are of major importance (for example in some small, very poor economies), supporting and generating change are essential for sustainability of poverty reduction. In working to be agents of change, it is essential that donors help meet the costs of change, rather than the costs of not changing.

- *Learn from failures.* Development is a risky business, and development assistance will inevitably lead to some failures. It is not simple, and circumstances and challenges change; there is thus a constant process of learning. The early mistakes in allocation and design of adjustment lending are one such example; another is the poor performance of power-sector projects in Sub-Saharan Africa in the 1980s and early 1990s. In both cases, the Bank responded by making major adjustments that sharply improved outcomes. More generally, the Bank responded to declining project success rates in the 1980s by successfully increasing the focus on quality at entry.

- *Build on successes*. At the same time, it is important to identify successes and scale them up where appropriate, either domestically or internationally. The CGIAR is one such example, in which the Bank and other donors worked to increase the scale and spread of "Green Revolution" technological innovation. Another example is Operation Flood in India, where the Bank supported the massive scaling-up of a homegrown dairy cooperative program; the effect was to increase the annual growth rate of Indian dairy production from 0.7 percent to 4.2 percent. These examples show that the Bank should build not only on the successes with which it is associated, but also on those of others.

35. To meet the Millennium Development Goals, the development community will need to continue to learn and improve effectiveness. Areas where learning is most needed are outlined in the Section III.

D. The partnership: Country actions, economic integration and market access, and aid

36. Growth and poverty reduction will be most rapid when there is progress on all three dimensions at once—country actions, economic integration and market access, and aid. There are powerful complementarities among the three. For example, as noted above, a major lesson of experience is that aid is most effective where policies and institutions are reasonably good. Similarly, market access increases the rewards to reform: in South Korea, for example, access to markets in the United States increased growth rates and doubtless made it easier to sustain the major improvements in policies and institutions in the 1960s. And the converse is also true: adequate domestic policies, institutions, and infrastructure are necessary if the private sector is to take advantage of access to foreign markets.

37. Realistically, most of the Millennium Development Goals (MDGs) will be met only with progress on all three of these dimensions. Knowledge of the complementarities among them is essential for estimating the costs of reaching the MDGs. One recent Bank paper has projected that although under current policies and trends there is some likelihood of meeting the MDG for income poverty, the poverty gains would come disproportionately in East and South Asia, with little or no decline in Sub-Saharan Africa and Eastern Europe and Central Asia. But the paper also develops an alternative framework—consisting of better aid allocation, significant further policy reform in Africa, and increased aid flows—that could lead to a reduction by half in poverty in Africa by 2015. Another recent Bank paper estimated the incremental aid costs of reaching both the income poverty and the human development MDGs. The dependence of aid effectiveness on policy reforms is central to this analysis. Among the countries that are currently off-track to reach the goals, many already have good enough policies that, with additional aid, it is projected that they could attain them. A rough estimate is that the incremental aid necessary might be on the order of $40 billion. But other countries have such poor policies and institutions that no amount of aid would be likely to suffice for them to attain the goals. If and only if these countries made sufficient policy improvements, then the incremental aid necessary for them to reach the goals could be some $15 billion.

38. These estimates are meant only to indicate orders of magnitude, not to provide precise costs or guarantees of meeting the goals. But what they indicate is that a substantial improvement in aid allocation, and a substantial increase in aid levels, is almost certainly a crucial part of any package of policies and actions for achieving the MDGs. Improved country policies and institutions and greater market access are essential; however, they are not likely to be enough. The longer we wait for this assertion to be confirmed, the more costly it will be in terms of poor people harmed and opportunities forgone.

III. ISSUES IN INCREASING DEVELOPMENT EFFECTIVENESS

39. This paper has outlined a number of development successes, and it has argued that improvements in country policy, greater market access, and development assistance have contributed to those successes. It has also identified areas in which, when development assistance has failed to achieve desired results, the Bank and the development community more generally have changed approaches and achieved better results—for example, in the case of structural adjustment lending following the problems of the 1980s.

40. The paper has also emphasized the importance of shifting aid allocations toward countries where assistance will be used most effectively, while simultaneously working to improve the policy and institutional environment in countries with poorer policies and institutions. Because in practice most countries do not fit neatly into either the "good-policy" or "poor-policy" boxes, it is essential in most cases to use both aid and advice to support change that will build better policies and governance.

41. Despite this record of progress and learning, there remain major issues with which the Bank and the rest of the development community are still grappling. These are cases in which outcomes have been disappointing, but the development community either has gaps in knowledge or has not been willing to take the steps necessary for improvement. Major examples include:

- *Institution-building:* Developing countries, with the help of the development community, have been much more successful at improving policies than at building institutions and improving governance. The East Asian financial crisis and the long transition recession in the former Soviet Union both underlined the vulnerabilities that poor institutions and governance introduce. Especially given the progress that so many countries have made on policy reforms, it is essential to learn more about how to make these institutional reforms. Some analysis of and guidance for these problems are set out in the most recent World Development Report, *Building Institutions for Markets.*

- *Halting epidemics:* The development community has not succeeded, at least on a global scale, in halting the AIDS, malaria, and tuberculosis epidemics that threaten decades of progress on human development. The challenges here are not just technical (developing effective vaccines), but also political, social, institutional, and financial.

- *Supporting the countries with the poorest policies, institutions, and governance:* The development community has no proven strategy for supporting low-income countries that are hampered by exceptionally poor policies, institutions, and governance. These countries are clearly not candidates for substantial financial transfers, but neglecting them is unacceptable, given the severe deprivation, the risk of further social damage, and the threat that they will become breeding grounds for terrorism and civil war. There are some approaches that may help in supporting such countries, such as capacity-building assistance; support for a narrow range of well-chosen institutional or regional reforms; and channeling of social-sector support through non-governmental actors. These approaches are currently under review within the Bank.[5]

- *Improving the growth response to reforms:* Even among countries that have undertaken reforms, the growth response has varied, often because of differences in historical conditions, informal institutions, or external circumstances. Some countries have worked hard to gain and preserve macroeconomic stability, have improved democratic governance, and have launched other reforms but have yet to see major payoffs in terms of growth and poverty reduction. In each country, it is possible to point to an unfinished agenda in governance and institutions. Nevertheless, the development community has a responsibility

[5] A report, *Low Income Countries under Stress (SecM2002-0140Rev1)*, has been circulated separately to Executive Directors.

to understand better the obstacles to growth—thus helping the country to prioritize reforms—while continuing to provide support.

- *Further improving aid effectiveness:* The development community needs to continue to work to improve the effectiveness of aid, in terms of both aid allocation and donor coordination. Here, the experience of the 1990s—and, more recently, the development of the PRSP process—gives hope for further progress, but continued attention is necessary.

IV. KEY CHALLENGES

42. The world has seen considerable development progress over the past half-century, in terms of growth, poverty reduction, and human development. This progress has been spurred by improvements in developing-country policies and institutions, by the integration of those economies into world markets, and by supportive development assistance. At the same time, many countries and groups have not shared in global growth; their lack of progress is attributable not only to poor policies and institutions in some countries, but also to a lack of market access and to mistakes in the design and delivery of development assistance. The Monterrey consensus is that to improve on the development progress of the past, partnership among developed and developing countries and a framework of mutual accountability are essential.

43. Implementing this partnership requires grappling with challenges in each of the three areas discussed in this paper—developing-country policies, institutions, and governance:

- First, developing countries will need to extend and deepen their reforms and institution-building, because country actions are at the root of development progress. Over the past two decades, developing countries have achieved major policy improvements in areas such as macroeconomic stability and trade, as well as pushing forward in the area of human development. Accelerated development will depend on similar progress in other areas of the investment climate, as well as in empowering poor people.

- Second, developing countries will need to accelerate their integration into global markets. This paper argues that more rapid trade integration of developing countries would promote their development. It recognizes that such integration depends substantially on behind-the-border improvements in trade-related policies, institutions, and infrastructure in the developing countries themselves, and on "aid for trade" from developed countries to support these improvements. At the same time, more rapid integration requires that developing countries gain greater access to rich-country markets, which account for 80 percent of the world's buying power in dollar terms. Access to some markets has improved recently for the poorest countries, but substantial barriers remain in areas of special importance to developing countries—including, but not limited to, agriculture and textiles.

- Third, the paper argues that aid has contributed to many development successes by promoting investment and accelerating growth, in partnership with recipient-country governments, and that it has been improving in effectiveness over the 1990s as a result of better policies and aid allocation. Yet despite these improvements and the growing knowledge about how to use aid well, aid could provide for still stronger reductions in poverty if it were better coordinated. Aid would also be even more effective if the allocation and delivery of large-scale financial aid—both bilateral and multilateral—were focused more tightly on supporting countries with good policies and institutions. (It is important to note that even in environments that can support large-scale aid, non-lending advisory and capacity-building services are essential for meeting the challenge of scaling up.) At the same time, donors will need to provide tailored assistance to support institution-building and targeted poverty reduction interventions in countries with poor policies and institutions, so that they can lay the foundations for growth and effective use of aid. Finally, as the wealth of donor countries and the ability of developing countries to use aid effectively continue to rise, further increases in the overall volumes of aid are essential.