New Development Thinking

Consensus Building, Knowledge, and Conditionality

Paul Collier

Progress in poverty reduction depends primarily on policy and institutional changes in low-income countries. The World Bank's previous approach to inducing these changes relied on negotiated conditions on loans, or conditionality. The empirical evidence suggests that this approach was largely ineffective—where change occurred, it was chosen by governments rather than induced by conditions on loans. Various countervailing pressures undermine the effectiveness of loan conditionality. An alternative approach to inducing change is to empower, through knowledge and participation, domestic constituencies to make change. This approach is likely to be more effective in promoting policy change—and essential in promoting institutional change, now usually the frontier of economic reform. This shift in focus is part of the rationale for the Bank's Comprehensive Development Framework.

Our understanding of why some countries stay poor and what donors can do to reduce poverty has evolved over the past 30 years. I start by looking briefly at how our ideas about why countries stay poor have changed, but focus primarily on how our ideas about the role of the World Bank and of donors have changed.

Why Poverty Persists

Thirty years ago the diagnosis of persistent mass poverty was pessimistic. People feared that the poor would stay poor even if growth could be achieved. The evidence for the Kuznets curve appeared to suggest that growth in poor countries was intrinsically biased against the poor: as low-income countries grew richer, inequality increased. In this view poverty reduction would require active, large-scale redistribution policies to offset the forces that seemed to systematically exclude the poor from the benefits of growth.

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In contrast to the assumption about mass poverty, the diagnosis of slow growth was highly optimistic. Slow growth was initially seen as a result of low savings, which in turn were seen as a result of low incomes. Sufficiently large aid flows, it was argued, would spring a society from this savings trap. Analysts soon realized that low savings could not be the primary cause of slow growth because in much of the developing world the capital stock was much lower than savings rates indicated. For example, by 1990 about 40 percent of the private wealth of Africa and the Middle East had shifted offshore (Collier, Hoeffler, and Pattillo 2001). These regions evidently were short of capital domestically at least in part because they had hostile environments for economic activity. The diagnosis of slow growth therefore changed from the savings trap explanation to an explanation of what made these environments hostile to investment, but it remained optimistic. The culprits were a shortlist of dysfunctional economic policies—high inflation, trade barriers, overvalued exchange rates, and restrictions on private activity—all of them readily fixable.

We now think that these positions on poverty and growth were wrong.

The Effect of Growth—and Pro-Growth Policies—on Poverty

Our analysis of mass poverty was too pessimistic. Although growth does not necessarily help the poor, it does not necessarily exclude them either. With reasonable care, we can make growth sufficiently broad based to eliminate *mass* poverty (Li, Squire, and Zou 1998; Dollar and Kraay 2000). Pro-growth policies have received an undeservedly hostile response from the development studies community. This response must be contested because it undermines, and is intended to undermine, the political basis for growth.

Take the example of Uganda, clearly the testing ground for pro-growth policies in the 1990s. A recent so-called "participatory assessment" of how poverty had changed in Uganda, using the standard methods of development studies, concluded that "the rich are getting richer and the poor are getting poorer" (Uganda 1999, p. 27). This message would normally have been used to discredit the pro-growth policies that the Ugandan government had pursued so effectively. Was it correct?

Fortunately, in this case the participatory assessment results could be challenged by objective evidence. Large, national, random sample consumption surveys had been conducted annually throughout the decade. The results of these surveys showed precisely the opposite of what the assessment had concluded: consumption poverty had fallen in every year of the survey, and the cumulative reduction in poverty was very substantial (Appleton 2001). Moreover, inequality had been reduced. The poor had benefited disproportionately from Uganda's growth, although 80 percent of the reduction in poverty came from growth rather than redistribution.

If we broaden the definition of poverty to include not only consumption but also education and health services, the evidence is even more positive. During the 1990s school enrollment increased dramatically and infant mortality declined sharply. If we go further and include the notion of empowerment in our definition of poverty,

we find that during the 1990s the Ugandan population acquired meaningful electoral power, gained access to competing sources of information through a free press and radio, and was liberated from monopoly crop marketing. Thus the claim that the rich were getting richer and the poor were getting poorer grossly mischaracterized the Ugandan experience.

How could the participatory assessment method produce such an erroneous finding? The authors of the report breezily mention in a footnote the sharp fall in consumption poverty and offer no explanation of the contradiction between this finding and their own results. The author of a later attempt to defend the results of the assessment is forced to admit that data collection was politicized—some people were paid to participate—and that the improved environment in Uganda has raised expectations and empowered people to complain more about unsatisfactory social services than they might have before (McGee 2000). While the author reassures us that the participatory method deals with these problems in a holistic way, some might conclude that a method that represents an improvement as a worsening, without even acknowledging this severe limitation, is suspect.

The theory of fads and information cascades gives us an insight into why the participatory assessment method is liable to produce such misleading results (Bikhchandani, Hirschleifer, and Welch 1998). False opinions can become dominant when people assume that the collective opinions of others contain more information than their own limited experience: the idea that growth leads to worsening poverty becomes accepted through a cascade of gossip. In effect, the participatory assessment method allows development practitioners to hold up a mirror to their own prejudices while interpreting the results as if they were hard data.

Of course, pro-growth policies can be more or less effective in reducing poverty. Recent research in the World Bank has explored the impact of various pro-growth policies on the poor. Dollar and Kraay (2000) show, for example, that low inflation disproportionately benefits the poor relative to other groups in society. This implies that a macroeconomic policy package that seeks to reduce poverty—rather than simply to promote growth—should give more weight to preventing inflation.

While growth will eliminate *mass* poverty, and well-designed growth policies will eliminate it quite rapidly, growth will not be enough for some groups. That is why all developed societies have evolved sophisticated public welfare, health, and pension programs.

The design of redistribution systems, and especially of quick-acting social safety nets, in low- and middle-income countries requires a great deal of skill. The modernization of society inevitably weakens traditional family-based systems. There is also some evidence that the introduction of public safety nets further undermines traditional systems (Cox and Jimenez 1995). These are not arguments for continuing to depend on family-based assistance, but indications that a rapid transition to public systems may be necessary because traditional systems and public systems do not cohabit successfully. The rationale for combining policies to build these transfer systems with a pro-growth strategy is not to mitigate the ill effects of pro-growth policies, but to make these transfer systems more affordable.

Constraints on Growth

While our analysis of poverty was too pessimistic, our analysis of growth was too optimistic. The constraints on growth are not just a matter of macroeconomic policies. We increasingly recognize that while open market economies outperform closed, planned economies, markets need institutions and infrastructure.

Institutions matter. Surveys of African manufacturing show that firms across the continent are reluctant to do business with new clients because they lack effective means of contract enforcement. This reluctance evidently reduces competition and dynamism: firms are locked into their existing client base. Infrastructure matters too. A study in Uganda found that the most important constraint on private investment was unreliable electricity supply through the grid (Reinikka and Svensson 1999). Another study found that deficiencies in the telephone system were more detrimental to African growth than poor macroeconomic policies were (Easterly and Levine 1997).

Once gross macroeconomic misalignments are corrected, growth is generally constrained by the weakest point in a long list of factors. But governments cannot tackle all potential problems at once. Efforts across a broad front spread limited government implementation capacity too thinly, and priorities must be chosen. In the integrated development projects of the 1970s development agencies recognized that many factors might constrain development and tried to work on everything at once. These projects failed. Even when development agencies have been willing to prioritize, their choices of priorities have often reflected the latest fads in development thinking. For a time the most important constraint on growth was considered to be lack of openness, then it was lack of education, and then lack of transport infrastructure.

We need a diagnostic procedure that steers us toward more realistic conclusions. Every country must first work through an exhaustive checklist of the factors that might be the binding constraint on growth. Does the power work? Do the phones work? Do the courts work? Does the financial system work? Does health care work? Once the country determines the important constraints on growth, it should do a critical path analysis of efficient sequencing. If the courts don't work the banks won't work, because assets will not function as collateral. Until recently courts in Uganda would not transfer to banks control over assets pledged as collateral by defaulting borrowers. Defaulters could persuade the courts to delay decisions indefinitely. Not surprisingly, a survey of Ugandan banks found that their most pressing need from the government was a fast-track court procedure for collateral (Atingi-Ego and Kasekende 1997). Until the courts improve, Ugandan firms will inevitably be short of credit.

Another example of sequencing: if public sector employment reflects cronyism, staff will not be motivated to deliver services. Among Ghanaian public sector workers wages are 25 percent higher for those belonging to the locally dominant tribe, yet wages are unrelated to workers' numeracy and literacy skills (Collier and Garg 1999). Until hiring and promotions are skill based, the Ghanaian public sector will be unable to deliver such services as education and health care efficiently. A third example: if markets are not competitive, privatization will not work. In the Russian

Federation privatization has produced rapacious monopoly and in the process undermined the political constituency for private-led development.

The binding constraints on growth are not only country specific. Constraints evolve as policy interventions succeed: when one problem is fixed, another replaces it as the binding constraint. Thus governments need to update the entire checklist regularly.

Both governments and donors should understand the evolving constraints on growth. The ideal diagnostic procedure would therefore be collaborative.

How Donors Have Tried to Reduce Poverty

Coordinated action based on a common diagnosis would be a major change in the aid relationship, more likely to achieve donor objectives than previous approaches. Until now most donors have attempted to reduce poverty through project aid and aid for reform.

Project Aid

Thirty years ago donors tried to reduce poverty by delivering projects with a high rate of return. This approach encountered three problems. First, a project might be good in itself but not replicable, and a project that would not "scale up" was irrelevant in the larger context of economic growth. Second, projects were fungible: donor support for a project that a government would otherwise have financed itself freed resources for the government to use in other ways. In reality, the donor financed not the project it appeared to pay for, but the marginal project the government chose to undertake. Donor care in selecting among intramarginal projects thus made no difference to the overall portfolio of implemented projects (Feyzioglu, Swaroop, and Zhu 1997). Third, a project's success or failure depended less on its design than on the environment in which it was implemented. Just like other investments, donor-funded projects failed in hostile environments (Isham and Kaufmann 1999).

Aid for Reform

Because good project design was not enough to achieve donor objectives of poverty reduction, in the 1980s donors developed a new approach—conditionality. They provided aid in return for explicit negotiated commitments to policy reform. The theory underlying this approach was that aid could be an incentive for policy change. But this theory implied that governments would undertake policy change that went against what they considered their interests, except for the receipt of aid. Policy change was the price governments would have to pay for aid. Put another way, donors would buy policy change with their aid.

The implications of using aid to induce reform were uncomfortable: if donors "bought" the reforms, they clearly "owned" them. When one African head of state became sufficiently annoyed with donors for complaining about the lack of political

rights in his country, he threatened to reverse the reforms unless they stopped complaining. The threat of reversing a reform program was intelligible only if both parties understood that the reforms belonged to the donors and not to the government (Collier 1997).

The implications of using aid as an incentive were so uncomfortable that donors came up with an alternative "fig leaf" theory: the notion of costs of adjustment. This theory held that policy change, because it was initially costly, was like an investment. Aid could finance the up-front costs.

Neither of these theories was completely wrong—sometimes the incentive of aid was enough to induce governments to implement policies they otherwise would not have undertaken, and sometimes such policy changes had up-front costs—but as general propositions both were dysfunctional. The lure of aid led governments to promise more than they intended to deliver and to implement more than they could sustain. For example, the government of Kenya sold the same agricultural reform to the World Bank five times in 15 years. The same condition has appeared in seven of the past eight policy framework papers prepared by the Bank for Malawi. The cumulative effect of such behavior was to destroy the credibility of governments, not only with donors but also with private investors.

Why Aid for Reform Has Not Induced Policy and Institutional Change

Adjustment costs are largely mythical. Most reforms, if they are sensible, lead to a rapid improvement in the economy. The emphasis on adjustment costs encouraged governments to exaggerate the difficulties of policy reform. The negotiating framework allowed rational governments to exaggerate the costs of policy change to maximize its price. Moreover, since donor negotiating teams saw their role as extracting the maximum reform for a given amount of aid, governments were always reluctant reformers at the margin, refusing to implement reform urged on them by donors.

Aid has not, on average, speeded policy change. A study of 220 reform programs shows that the success of such programs is systematically related to domestic political economy factors, such as how long the government has been in power, but is unrelated to donor behavior (Dollar and Svensson 2000). There is no overall relationship between aid flows and policy change. This is not as surprising as it might seem. While the incentives argument is elementary economics—the offer of aid for reform should induce a supply response—it ignores four offsetting effects.

Pressures Undermining the Effectiveness of Loan Conditionality

First, because aid alleviates governments' fiscal and payments crises, it reduces the urgency of policy change. Economists would describe this as the income effect of aid offsetting the substitution effect. A recent study in collaboration with a team of African economists looked closely at 10 reform programs to see how the aid relationship affected the propensity to reform at different stages (Devarajan, Dollar, and

Holmgren 2001). In no case was sustained reform initiated by aid-for-reform packages. Reform was sustained only when initiated by governments, often in response to a crisis. In poor policy environments aid for reform thus paradoxically tends to delay reform—the income effect dominates the substitution effect.

Once reform was seriously under way, conditional aid was useful, although the key conditions were those chosen by governments. The usefulness of the aid resulted not from the substitution effect, but from governments' ability to signal priorities to their own bureaucracies by committing to two or three vital changes. Long lists of conditions diluted such signals and so were dysfunctional. As the reform process proceeded, the reforms became more complex and needed support from a wider constituency to be implemented effectively. By this stage conditionality served no purpose because the substitution effect could not be translated into effective incentives for such a large group of actors.

Second, aid for reform faces what economists call a time-consistency problem. If the government does not want the reform, it has little incentive to maintain it once the aid has been delivered. If it does want the reform, however, it normally does not need the aid to carry it out. The on-off pattern of Kenyan reforms noted earlier is an example of this time-consistency problem.

Third, aid for reform faces a moral hazard problem. The agencies that should enforce the conditions of aid for reform also happen to have an interest in seeing their loans repaid. Enforcing the conditions will reduce the probability of repayment. Svensson (1999) shows that loan disbursement has depended more on indebtedness than on adherence to conditions. Moral hazard has mattered.

Finally, while development agencies might have wanted to use conditionality to induce policy reform, other OECD interest groups with their own agendas tried to subvert conditionality to induce different behavioral change. Thaker (1999) claims to show statistically that loan approval by the board of the International Monetary Fund (IMF) in the early 1990s was significantly associated with a country's voting record at the United Nations. The more a country's voting pattern shifted toward the U.S. position, and the closer its voting was to the U.S. position, the higher the probability of loan approval. Although Thaker interprets this association as causal, other interpretations are equally possible. In any case we should not dismiss out of hand the possibility that political objectives subverted the economic objectives of conditionality.

Thus while aid for reform seems at first to be a straightforward application of economic incentives to promote behavioral change, such aid has encountered major obstacles in practice. The income effect has offset the substitution effect. Even when the incentives have been effective, they have induced policy oscillation rather than sustained reform. The agencies tasked with enforcing the bargains have had an incentive not to do so, and other interests have tried to hijack the bargaining.

Damage to Government Credibility

Although ineffective in achieving sustained policy improvement, aid for reform was effective in undermining the credibility of governments. Bad governments destroyed

their reputations by reneging on the spirit of agreements, but even good governments faced a problem: when governments implemented and sustained policy reform, donors claimed the credit. This claim had some credibility because even reform-minded governments visibly resisted reform at the margin, while donors visibly pushed it.

Thus even governments that implemented reforms because they believed in them found it difficult to establish their claim to ownership with the investor community. The only policies governments were seen as truly owning were those that failed, because no one else claimed them. In the language of economics, governments need to be able to signal their true intentions to investors. Aid for reform made this signaling more difficult.

Misallocation of Aid

Aid for reform also diverted aid from countries where it could have been most effective in reducing poverty. We now know that poverty-efficient aid allocation takes into account three factors: the level of poverty, the level of policy, and diminishing returns. The level of poverty is straightforward: the more severe the poverty, the more effective aid is in reducing it. Thus for a given level of policy and institutions, the greater the poverty, the larger the aid program should be.

The second factor, the level of policy and institutional performance, is also fairly straightforward: the better the policy and institutional environment, the more effective aid is in increasing growth and reducing poverty. Thus for a given level of poverty, the better the policies and institutions, the larger the aid program should be. Fortunately, about 75 percent of the world's poor live in countries with policy environments good enough for aid to be effective in reducing poverty.

The third factor is the diminishing returns to aid. Even in environments with good policies and severe poverty, the amount of aid that can be effectively absorbed is limited—although the limit is high, about 20 percent of GDP.[1] But even in environments with poor policies, the first few million dollars of aid are worthwhile. Diminishing returns simply set in much sooner if policies are poor.

If donors had followed these three simple allocation criteria of poverty, policy, and diminishing returns, they could have helped considerably more people emerge from poverty (Collier and Dollar forthcoming).

Poverty-efficient aid allocation involves a straightforward relationship between policy and aid: for a given level of poverty, the amount of aid should be greater when policy is better. In other words, donors should condition aid on the level of policy. In contrast, aid for reform conditioned aid on *change* in policy. Because there is clearly more scope for improvement in policy when policy is worse, aid for reform would tend to bias aid flows toward weaker policy environments. This is indeed what happened in the 1990s (figure 1).

During the past decade aid tended to flow into policy environments that were too weak to use it effectively to reduce poverty—and tended to taper off in environments with policy good enough to use it effectively. This misallocation had serious

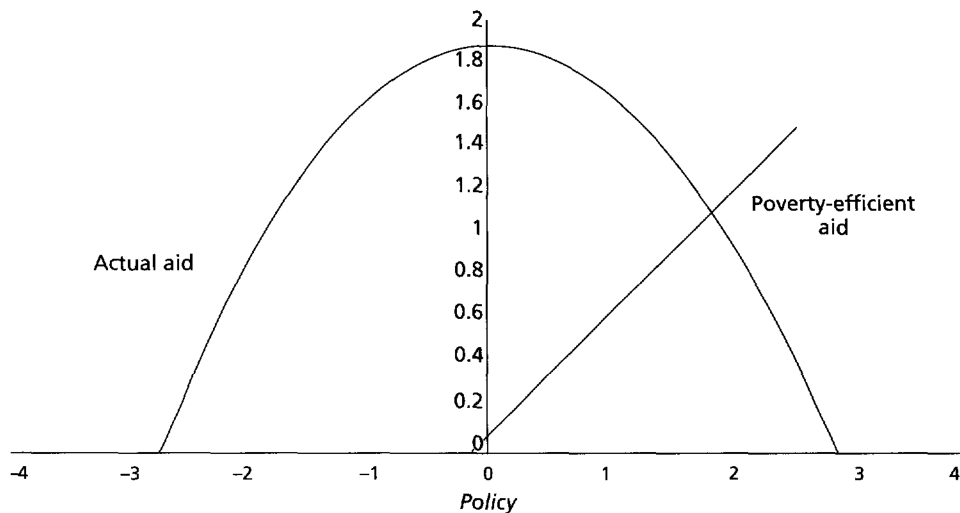
repercussions. Since there was only so much aid to go around, the people who paid the price for the large flows of aid to environments in which it was ineffective were those living in the better policy environments who could otherwise have been lifted out of poverty.

Conditioning aid on policy *change* rather than policy *level* leads not only to inefficient allocations between countries, but also to inefficient allocations over time. A democratic government that periodically faces an election typically will be more reluctant to change policies in the year before an election than in the year after an election. The cycle of elections thus creates a cycle of policy change. Aid flows conditioned on the rate of policy change become macroeconomically destabilizing: in the run-up to an election, just when a government is increasing its expenditures, its aid finance tends to be squeezed.

A Substitute for Government Commitment

Aid for reform may have weakened governments' capacity to work out and communicate their own strategies. Often governments had little real involvement in preparing the aid agreements they signed. The documents were sometimes prepared in Washington even before donor missions arrived in the country. Because governments knew that donor negotiators would try to coerce them into agreeing to do

Figure 1. Relationship between Policy and Poverty-Efficient and Actual Aid Allocation in the 1990s



Note: The figure measures policy using the World Bank Country Policy and Institutional Assessment Index (CPIA). This index measures a broad range of policy, including macroeconomic, structural, and public sector management. Most countries fall into the range of –2 to +2. The CPIA is measured on the range 1–6, here transformed into a series centered on zero.
Source: Collier and Dollar forthcoming.

more than they seemed to want to do, it was reasonable for them to seem to want to do even less than they really wanted to do. The incentives of aid for reform thus impeded rather than assisted even the reforms the governments believed in.

Governments also had little incentive to sell policies to their electorates. An entire doctrine evolved in Washington about the efficacy of international financial institutions as scapegoats: governments could blame these institutions for unpopular but necessary policy changes. The Zimbabwean minister of information commented to the media on his government's economic reform program in 1997, "It's the IMF's program; we had to go along with it" (IMF 1998, p. 35). There was some truth to the idea that it can be helpful for governments to have a scapegoat. The Zimbabwean government might not have initially reformed so quickly if it had had to carry the electorate with it.

As a general proposition, however, the scapegoat theory is surely wrong. The role of scapegoat has a corollary—the electorate is seriously misinformed about key aspects of policy. Repeated often enough by the government, the message "this policy is dreadful but we are being forced to do it by foreigners" produces suspicion, defeatism, and confusion. Perhaps if the Zimbabwean government had had to carry the electorate along, it would not have reversed the reforms quite so readily the following year.

An Incentive for Governments to Reverse Reforms

Another possible effect of the attempt to coerce reform is the psychological phenomenon known as reactance. According to clinical psychologists, if someone tries to force you to do something, unless that person has total power over you your natural reaction is to do the opposite. Only by doing the opposite can you reestablish your freedom of action. Governments may have found it more attractive to reverse reforms because such action reestablished this freedom. Electorates may have gone along with the reversal because they had been told so often that the reforms were not a national choice.

What Is Needed for Sustainable Improvement in Policies and Institutions

Aid for reform was well intentioned, but it was based on a misunderstanding of how policies and institutions can be changed sustainably. At the risk of oversimplification, I suggest that we now know within reason what constitutes a good macroeconomic policy environment but have less idea about what constitutes good institutions.

Good macroeconomic policies are fairly generic. An overvalued exchange rate has qualitatively the same damaging effects in India as in Peru, and this is why such policy variables are significant in growth regressions (Burnside and Dollar 2000). Some high-profile issues are still in dispute, of course. For example, most scholars now probably accept that unrestricted capital accounts may be unwise on balance in many developing countries. But even this doctrine has nuances: despite controls, there has been so much capital flight in Africa that open capital accounts may need to be part

of the strategy to attract capital back. Good institutions are much more historically specific. We know, for example, that the design of legal institutions is much less important than their operation (Berkowitz, Pistor, and Richard 2000). Reforming institutions may require a different process than reforming macroeconomic policy.

Policy Reform

Policies depend largely on the balance between domestic political constituencies. Countries with very poor policies have large latent constituencies for policy change because poor policies inflict poor outcomes. Policy reform depends on strengthening the constituencies that suffer from the poor policies. The 1990s brought greater empowerment of these constituencies. As one example, the visible failure of the Soviet model stimulated a wave of democratization and provided a wealth of information for the debate on development policy.

Governments were pressured into improving their country's economic environment, though fitfully. Even benevolent leaders learned from having to listen more closely to their population. For example, when President Museveni of Uganda went out to rural areas to campaign for votes in the country's first fair presidential election, he discovered that what people wanted was free primary education for their children. This demand became so pressing that Museveni announced a massive change in policy in the middle of his campaign. The abolition of primary school fees led to a doubling in school enrollments the following year. We now know that pressure from civil society is effective in improving government performance. For example, civil liberties such as freedom of the press raise the return on public investment (Isham, Kaufmann, and Pritchett 1995).

It was easy for the Ugandan electorate to understand that they needed a policy change in primary education. But in many areas of policy electorates have too little information to discipline leaders effectively. Ironically, the slogan "It's the economy, stupid!" has described political debate in the poorest countries less accurately than in the richest. There are four major knowledge bottlenecks: lack of information, lack of a way to turn information into knowledge, lack of capacity for analysis, and lack of capacity for policy design.

To be effective, democracy needs the disclosure of *information.* Recently there has been a great deal of emphasis on the need for transparency in the banking system so that depositors can assess solvency. But the lack of transparency in government is a much larger problem. Electorates often lack basic information with which to assess the performance of their government.

Electorates often also lack a basis for comparison. Especially when neighboring governments perform just as badly as their own, electorates have no way to judge whether their government's performance could be better. This is why regional role models have been so valuable. The "gang of four" economies in East Asia, and Chile in Latin America, fostered a transformation across their regions. Africa and the Middle East have had no such models. Electorates need a window onto the world to turn information into knowledge.

The effects of many policies can be understood only through analysis. For example, an economist usually finds it fairly straightforward to work out the true effects of trade restrictions. But these effects are not obvious to electorates unless they have a remarkably sophisticated understanding of the economy or, more realistically, trusted authorities to explain the effects. Many developing countries lack such authorities. The consequence: supported by economic myths, poor policies persist. In a trivial but revealing example, the largest denomination of currency in Nigeria is barely worth a dollar, because people imagine (wrongly) that introducing higher-denomination notes would be inflationary. Moreover, the lack of high-denomination notes increases the costs of transactions because firms must buy note counting machines. It also increases the government's costs of printing money—the Nigerian government pays the equivalent of a real interest rate of more than 20 percent a year on its currency supply. Seigniorage—government revenue from supplying currency—far from being the government's cheapest form of debt, is its most expensive (Teriba 1998). The country needs a Nigerian think tank to puncture the myth that high-denomination notes are inflationary and a Nigerian press campaign to spread the message. More generally, the society needs to develop a *capacity for analysis.*

Many governments themselves lack the capacity to work out and communicate a coherent program of reform. As discussed above, under the aid-for-reform strategy governments may even have learned techniques of passive resistance to reform. Governments need a *capacity for design* of reform programs.

Institutional Reform

Now consider the process of institutional reform. Even simple, specific issues of appropriate institutional design are unresolved. For example, economists commonly lump together Anglo-Saxon economic institutions and contrast them with continental European or Japanese models. But even within the Anglo-Saxon model they disagree radically about which bankruptcy procedure is better—the U.S. model that uses the courts, which seems to be gaining popularity, or the British model that bypasses the courts and uses the private sector, which may be preferable where the courts are weak. The best policy for regulating utilities is even less clear. OECD countries keep changing between price caps and profit rate caps, neither of which is better in all situations. Institutions seem to matter, but good institutional blueprints are more difficult to identify than good macroeconomic policy blueprints.

Because knowledge in such circumstances becomes a constraint on reform, creating an effective reform process is synonymous with creating an effective knowledge discovery process. The core is experiment and competition. We need enough variety and choice of institutions to find out which are better than others. Companies could be allowed to choose a legal system when specifying a contract. Local governments could be encouraged to adopt innovative institutional arrangements. We know, for example, that U.S. states with elected boards overseeing their electricity utilities have persistently lower electricity prices than those with appointed boards. But we do not know

whether an elected judiciary would improve the functioning of courts in Africa, and we will never know until some African courts experiment with such an institution.

Implications for the Role of Donors

The donor community can do a great deal to assist both policy reform and institutional reform. To encourage policy reform, donors can help pro-reform constituencies within the bounds of appropriate conduct. The international community can legitimately encourage standards of good practice for information disclosure. Donors are obvious conduits for information on how performance differs elsewhere, and can supply the analysis that shows the true effects of policy. To encourage institutional reform, donors can show governments the range of potentially viable options available and stress that diversity and experiment are legitimate responses to uncertainty. They can finance pilot institutional reforms that, if successful, can be scaled up through imitation.

But the international community cannot supplant governments in the reform process. Governments cannot abdicate responsibility for working out a development strategy. Still, there are good reasons why this process should be a partnership between governments and the international community rather than an exclusively government activity. Governments will usually start from limited information, limited knowledge, and limited analytic and design capacity—the ostensible reason for the international financial institutions' heavy involvement in drawing up reform strategies. What is the difference, then, between collaboration based on partnership and collaboration based on coercion?

Cooperation—for Greater Information Sharing

How governments and donors interact determines what can be achieved. As noted, negotiation and collaboration do not coexist well. In a negotiation the government has an incentive to conceal information and convey misleading signals, while the donor team has an incentive to extract government concessions. In contrast, in a collaboration where the prime purpose of government-donor interaction is to build a common strategy for development, both can reap gains from pooling information. Because governments, international financial institutions, and donors have such different information advantages, such gains can be large. Cooperation should produce better-informed programs.

Consensus Building—for Faster Reform

Except in the short term, the pace of reform is likely to be constrained by the electorate's willingness to accept change. In Africa there is evidence that policy reversals are a response to urban rioting following changes that disadvantage urban population groups (Morrisson, Lafay, and Dessus 1994). Such policy instability is to no one's advantage. Of course, no government can govern entirely by consensus. But industrial countries achieve much of their policy change through persuasion, accommodation, and co-option. What is needed is a mechanism for reaching agreement ex

ante. If every reform is placed in the larger context of a medium-term strategy, each social group can more readily accept that it will lose from some policy changes but gain overall. It then becomes rational to sustain the integrity of the strategy rather than to block each change from which the group loses. Consensus building should produce faster sustainable policy change.

Governments will not always be able to build such consensus, which requires skill and a belief in the possibility of mutual gains. But governments that disown their economic reform programs as externally imposed build a consensus against reform. For institutional reform, where the absence of international consensus makes domestic diversity of views desirable, it may still be possible to build consensus around the need to experiment and to try competing approaches.

Government-Donor Cooperation—for More Stable Aid Flows

Donors' participation in designing strategy will increase the flow of information to them and thus reassure them of government intentions and the viability of government plans. This reassurance is important in determining not only the scale but also the stability of public resource flows. Donor financial support should be a source of stability: the government, international agencies, and investors should all be able to perceive such support as reliable over the medium term.

Aid for reform cumulatively undermined this perception of reliability. When governments breached their agreements on conditions, the continued flow of aid depended on donors' discretionary decisions to grant waivers. Aid flows were volatile and unpredictable as a result. One reason aid tends to taper off in good policy environments is that it is seen as so unreliable that people feel it is safer to learn to live with less of it. Associated with this is loose talk of the problem of aid dependence. As mentioned, the tapering off of aid denies it to precisely the environments in which it can be so highly effective in reducing poverty.

In fact, donors have not been unreliable over the past quarter of a century. In Africa aid has been less volatile than government revenue, so a large aid inflow has been a source of stability rather than instability (Collier 1999). But donor involvement placed in a cooperatively designed medium-term framework would be a firmer basis for donor commitment. In poor countries with reasonable policies and institutions, increasing aid flows will be desirable for poverty reduction for at least a decade. *Government-donor cooperation can produce larger and less volatile aid flows in environments where aid is most effective.*

Medium-Term Development Strategies—for Better Donor Coordination

Some governments are suspicious of coordination among donors because they see donors as ganging up on them to force through their own priorities. Agreement on objectives is therefore a necessary condition for coordination. The current lack of coordination reduces aid effectiveness. At the project level it results in duplication

of some interventions, omission of others, and occasional incompatible interventions. At the macro level it results in misallocation of aid among countries.

If all donors followed the poverty-efficient allocation rule of the International Development Association (IDA)—targeting aid based on a country's poverty and policies—they could substantially increase the number of people lifted out of poverty. But many donors do not (see figure 1). The Bank thus faces a dilemma. At one extreme it can stick to the rule for its IDA resources and encourage others to adopt it. At the other extreme it can use the rule as a guide for total aid resources, using IDA resources to smooth out the omissions of the rest of the donor community. Each of these extremes involves major difficulties. Medium-term development strategies can help to reduce the dilemma—by making aid provision more dependent on the total needs implied by a viable development path and less dependent on those implied by the provision of short-term incentives for policy change. *An agreed medium-term development strategy can improve donor coordination.*

Visible Political Consensus—for Reassuring Investors

Finally, private investors need reassurance. Africa is rated as the riskiest investment region in the world—even countries that have been strong reformers are rated as severely risky (Collier and Pattillo 2000). Aid-for-reform commitments have evidently failed to reassure private investors: the commitments lack credibility. A visible process of creating a medium-term social consensus around policy reform, if successful, would build investor confidence.

The Ugandan presidential election was the first substantial opportunity for Ugandan society to discuss a vision of the future, and it resulted in a large vote in favor of modernization. The election was followed by the largest improvement in investor risk ratings experienced by any African economy. In East Asia the opposite phenomenon occurred: the collapse in the risk ratings for Indonesia partly reflected the lack of political consensus. *Visible political consensus reassures investors more effectively than conditionality.*

Conclusion

Poverty reduction is now possible on a grand scale if donors and governments can navigate the policy and institutional changes needed for broad-based growth. In many social contexts this is likely to be easier if there is an informed constituency and if the government attempts to build consensus around the reforms. Because providing information and building consensus sound as wholesome as motherhood and apple pie, it is easy to dismiss them as decorative rather than functional parts of the development business. I have tried to show why this would be a mistake. In the past we may have paid lip service to information provision and consensus building within society, but we have neglected them in practice. Aid for reform tried to bypass consensus building and led to governments publicly disowning their own

programs. We should not be surprised that private investors regarded the reform process as lacking credibility under these circumstances.

Developed societies do not just happen to have good policies and institutions. They have them because governments are pinioned to them by informed and engaged social groups. Somehow the international community needs to encourage the formation of this equilibrium in developing countries. I have described steps the international community could take to do this—working with governments to identify a critical path of policy reform and initiating institutional experiments and competitions to discover which institutions work best. I have also described why ex ante social consensus would both speed these processes and enhance their credibility. What I have described is my understanding of the Comprehensive Development Framework.

Notes

1. Collier and Dollar (forthcoming) estimate the rate of diminishing returns to aid for different policy environments. They measure aid at purchasing power parity exchange rates, which differ from actual exchange rates in aid-receiving countries on average by a factor of around three. The 20 percent limit used here reflects an adjustment back to actual exchange rates, by which aid is normally measured.

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