6

A New Aid Architecture

Debt relief is not a magic bullet for getting the development process in poor countries back on the rails. Indeed, elementary arithmetic tells us that—if the estimates of the cost of achieving the Millennium Development Goals are anywhere near the mark—even complete debt cancellation would not come near to sufficing. Any campaign directed to achieving those goals needs to focus on the issues of trade and aid, not just on debt—as does Bono's new campaign leading up to the 2002 Group of Eight summit.[1] There is also, of course, a whole agenda of domestic reforms that developing countries themselves need to pursue, spanning governance, macroeconomic discipline, the institutional infrastructure of a market economy, public expenditure on basic social services, and other priorities, as emphasized in the Monterrey consensus.[2] But this is not the place to explore that agenda.

In this chapter, we turn to the issue of how development assistance might be reformed to provide a more propitious financial environment for the poorest countries and to make sure that debt problems do not recur. We argue that a ''new aid architecture'' implies both fundamental reform in the way aid is delivered and a substantial increase in the volume of aid to the world's poorest countries for the next decade and beyond. Fundamental reform entails creating new incentives not only for recipients but for donors as well to focus on and be accountable for their perfor-

1. For a similar view, see also Serieux (2001).

2. We refer here to the United Nations conference on Financing for Development, held in Monterrey, Mexico, as this book went to publication in March 2002.

mance. That is the key to making the aid process more effective and ultimately to sustaining the necessary increase in aid flows.

We begin by discussing two incremental changes in the aid architecture, in HIPC procedures, and in the composition of aid between concessional loans and grants. We then turn to recommendations to build in incentives for more donor efficiency, selectivity, and additional aid in the future. The most important proposal is that the donor community move toward a "common pool" approach: to create a clear framework with incentives for both donor selectivity and recipient-country ownership of their development strategy.

The HIPC Procedure

The design of the enhanced HIPC Initiative is a first but modest step in building a new architecture. The idea is to make sure that money released from debt service actually gets devoted to basic social programs or is otherwise deployed to reduce poverty, as well as to ensure that this happens in a way that is chosen by the country itself. To reach the HIPC completion point where its debt stock is reduced, a country has to develop a Poverty Reduction Strategy Paper, in consultation with its own population, that lays out a national strategy to promote development and thus reduce poverty (see box 6.1).

The PRSP represents a new version of traditional conditionality in two senses: because the focus is on poverty reduction rather than structural adjustment (privatization, trade liberalization, etc.), and because donors hope that greater citizen participation will result in political "ownership" of the strategy and thus more sustained and effective implementation. The approach is based on experience in Uganda, which went through a 5-year participatory process that culminated in agreement on a Poverty Eradication Action Plan in 1997 (Mijumbi 2001). Because it is recognized that a truly participatory process is bound to take time, though it is urgent to provide highly indebted countries with relief, a country is allowed to obtain debt-service relief on an interim basis at a "decision point." This requires an interim PRSP, which covers much the same ground as a full PRSP but without the same elaborate requirements for public participation. The intent is nonetheless that the country should "own" the strategy.

Announcement of the requirements for the PRSP process provoked a fair amount of cynicism on the part of development professionals. Many recalled that (for example) Letters of Intent to the IMF and Letters of Development Policy to the World Bank are also supposed to be documents produced by the borrowing government, but that in practice they have long been written by IMF and World Bank staffers and presented to the would-be borrowing government to sign. In addition, concern was raised that the emphasis on poverty reduction via increases in social expendi-

Box 6.1 The PRSP challenge: Avoiding business as usual

The Poverty Reduction Strategy Papers, announced in 1999 as part of the enhanced HIPC Initiative, were hailed by the World Bank and IMF as a way both to address the contentious issue of conditionality versus ownership and to ensure that the proceeds from debt relief were spent to benefit the poor—especially by increasing education and health budgets. The PRSP envisaged a process whereby governments (aided by World Bank staff) would convene extensive consultations with civil society and nongovernmental actors, and prepare holistic, country-owned strategies that would form the basis for both HIPC and future donor assistance. One complaint in some countries is that parliaments have been largely bypassed in the process of popular consultation.

Unfortunately, there is an inherent tension between the focus on participation and the connection between the PRSP and release of HIPC debt relief proceeds. the second representing a form of donor-mandated conditionality that hinders the first. Though few argue that increased spending on education and health is a bad idea, many Southern NGO and civil society advocates caution not to confuse the preset goals of the PRSP process with country ownership. In May 2001, a group of 39 regional networks in 15 African countries argued that the PRSP is simply "window dressing" (Ranis and Stewart 2001).

Further, the long list of hoops that countries need to jump through to have a PRSP approved by the World Bank and IMF (and thus receive the proceeds of debt relief) has forced countries to sacrifice a participatory approach in the face of time constraints. Indeed, the detail and breadth demanded of the PRSP (detailed in Easterly 2001) has, to date, been beyond the capacity of nearly all of the HIPCs.

As of this writing, the World Bank and IMF had approved PRSPs from only four countries (Bolivia, Mozambique, Tanzania, and Uganda). It was to enable countries to start gaining the benefits of debt relief before they were able to complete the requisite participatory process for a full PRSP that Interim PRSPs were authorized as a sufficient condition for reaching the HIPC decision point. An Interim PRSP must cover the same ground, but it does not carry the same obligations for public participation in preparation.

Another danger is that PRSPs are not adequately addressing the task of monitoring, and that even if countries buy into the new donor conditionality, it will be impossible to tell where the proceeds of debt relief are really going. The World Bank and IMF (2001a) found that only two of the HIPCs will have the capacity to track spending related to debt relief transactions within the next year.

tures was primarily a donor-owned view, and would not necessarily be the optimal path for a country to attain sustainable growth and thus sustainable reductions in poverty.[3]

Why, then, should we expect PRSPs to be a step in the right direction? A possible answer is that the Bretton Woods institutions either have learned about the importance of country ownership and public participation or they finally believe their own propaganda about their importance. Another possibility is that the requirement for public participation makes it far more likely that countries will develop pro-poor policies and pro-

3. Addison and Rahman (2001); Burnside and Fanizza (2001).

grams and that vested interest groups will find it far more difficult to get away with business as usual. This applies to the preference of many HIPC governments for ignoring their own civil societies, and even parliaments, as well as the relationship between the World Bank and IMF and the countries involved.

In any event, some observers of early PRSP processes have concluded that the exercise is not just a charade, but is encouraging a degree of public involvement and a depth of citizen involvement and national ownership that were lacking in the past. For example, a Bread for the World case study on Zambia lauds the ''unprecedented citizen participation in economic policy making'' that the I-PRSP galvanized (McCarthy 2001). Booth (2001) is also fairly positive. Other observers are skeptical, raising the legitimate concern that citizen participation via a handful of public forums does not really embed the policy process within functioning institutions and may forestall rather than enhance real democratic politics—that is, the empowered legislature and regular free and fair elections that bring substantial accountability and ownership.[4]

Still, on the whole, we are inclined to the view that the PRSP process, imperfect as it may be, can make a difference, and if subsequent evidence confirms this, it is a gain not to be squandered. However, we see no need to delay debt-stock relief for years after a country has reached its decision point until a participatory PRSP has been completed. The decision point itself is conditional on a country's satisfying the traditional requirement for an IMF program—a reasonably sound macroeconomic regime. There is something of a contradiction between the notion that a country and its citizens need to own the PRSP strategy if it is to be sustainable and the additional conditionality of completing a PRSP by a set date.

As was argued above, some of the benefits of debt relief, notably those of enhancing national ownership and reassuring the private sector, are dependent on reducing the overhang of debt stock, and are not yielded simply by reducing the flow of debt-service payments. And it has been reported that pressure to bring HIPCs to the completion point is already leading to a rush to finish PRSPs, undermining the very process of participation and creation of political ownership that the PRSP is meant to encourage.

Moreover, the additional delays and the requirement to meet certain ''standards'' in a PRSP[5] elide the point that the debt to be canceled is

4. Marshall (2001) is skeptical about PRSPs. See also Van de Walle (2001).

5. World Bank staff have produced guidelines and recommendations for PRSPs, which are laid out in a 1,000-page sourcebook, covering such details as how to do household surveys, organize participatory processes, and design social service delivery mechanisms. (On the World Bank's mission creep, see Einhorn 2001). Of greater concern may be that PRSP conditions will work less well than traditional conditions because they apply to the political process, making them less realistic than ones on economic policy. It is difficult to imagine success in imposing democracy, as desirable as that might be.

Table 6.1 Continued aid dependence of post-completion point HIPCs

Country	Net official transfers (1997-99 annual average)	Debt service relief (2000-04 annual average)
Bolivia	482.3	125.8
Mozambique	926.3	119.3
Tanzania	907.0	77.0[a]
Uganda	647.0	50.8

a. Tanzania's completion point document is not yet publicly available. Therefore, this estimate relies on data from Tanzania's decision point document.

Source: World Bank *Global Development Finance* CD-ROM, 2001, and HIPC completion point documents.

fundamentally uncollectible—and thus seem to liberate donors and official creditors from recognizing and reforming whatever procedures or incentives led to the problem in the first place. If the donors were unlikely ever again to have the leverage needed to persuade these countries to go through the PRSP process, then it would make sense to delay the completion point in the interest of maintaining that leverage. But in fact there is no need for such leverage. On the contrary, all the existing HIPCs (though admittedly not all the additional candidates we have suggested) are heavily aid dependent and will remain so after debt reduction, even after the deeper debt reduction recommended above.

The reductions are in fact small relative to recent aid inflows. Table 6.1 displays the annual projected savings in debt service as a result of HIPC debt reductions and average annual net transfers in recent years for the four countries that have reached the HIPC completion point. In Uganda, the debt-service relief provided by the HIPC Initiative is only 8 percent of net official transfers. Recall also (at the end of chapter 3) that of our rough estimate of $25 billion a year in donor spending for the 42 HIPCs to achieve the Millennium Development Goals, our estimate of annual debt-service savings for those 42 countries (were all to reach the HIPC completion point) is a mere $4.2 billion a year.

If the donors announce that as from year 200x they are going to require that the Consultative Group be presented with a PRSP or else a country must expect aid commitments to be severely cut back, they will have ample pressure to ensure that the PRSP process continues to be taken seriously and continuing incentives for improving policies and building sound institutions. In other words, this consideration really does not provide a convincing case for delaying the full benefits of assured debt reduction. And it undermines the very notion of ownership.

Accordingly, we recommend the consolidation of the decision point and completion point. We recognize that this puts us in the paradoxical position of advocating aid selectivity, but only after a process of relatively nonselective debt cancellation (based only on macroeconomic stability but not an apparent dedication to a poverty strategy). Here is a case, however, where consistency in fact is nonsensical.

Grants, Not Just Loans

In a speech at the World Bank on 17 July 2001, US President George Bush suggested that IDA should convert about half its lending into grants. In this proposal, he echoed one of the few unanimous recommendations of the Meltzer Commission (2000). We strongly endorse this proposal, and we believe its endorsement by all the shareholders of the World Bank would clarify that for the poorest countries, where institutions are weak, disease burdens are high, geography is unpropitious, and civil conflicts and exogenous shocks frequently create havoc, it is perverse to demand repayment. Large resource transfers to countries where good leadership is committed to change will be necessary for a substantial period. A move to grants would also reflect official creditors' recognition that there was too much lending with too little selectivity in the past.

There are two principal arguments against IDA providing grants, but neither of them strikes us as any longer compelling. The first is based on incentive effects. The fear was that grants would be treated as easy come, easy go; loans, in contrast, were supposed to motivate recipients to use the resources well, for programs that encourage private-sector growth, yield increased tax revenue, or to build up human capital and strengthen institutions. But the evidence of the past 20 years is that this incentive effect does not necessarily provide sufficient discipline to restrain irresponsible borrowing. Governments are often prepared to accept loans without thought of the burden it will impose on future governments and future taxpayers. Moreover, nowadays a much larger proportion of aid goes to projects that are not expected to pay their way directly in financial terms (to schools and nutrition programs rather than power stations or dams).

The second argument was that IDA loans would in due course lead to a return flow of repayments that could then be recycled. It is surely good that in the 1960s South Korea received loans rather than grants, and is now repaying these and providing funds that IDA can lend to other countries that still have low incomes today. But even though 50 years were not enough to get development started everywhere, one has to be a real pessimist to expect the same need for supporting a large bloc of low-income countries in another 30 years time. And there is no point in having IDA loans repaid if, as became true in at least some HIPCs, this is financed by donor grants that are then not used for development investments.

The Europeans have resisted the Bush proposal in the run-up to the Monterrey Conference on Financing for Development, arguing for only limited use of IDA funds for grants.[6] They have spoken as though the loss of reflows to IDA was going to result in an equivalent reduction in the flow of financial resources to poor countries. This is not so. Most of the reduction in the reflow will be the counterpart to a reduced need to pay debt service and will therefore leave the countries just as well off as if they had paid the debt service out of money received in new IDA loans. Of course, there may be fewer jobs at the World Bank if IDA no longer has to make as many new loans to enable countries to pay it back, but we are surely not designing a job-creation program to benefit Washington.

The only benefit of receiving reflows would come from those countries that graduate from IDA and therefore repay money that can be recycled to other countries that are still poor. One has to ask whether there are likely to be enough countries in that category to outweigh the administrative costs of maintaining this recycling and the danger of pushing countries back into debt problems in the future. (And, diplomatically, it seems very silly of the Europeans to have picked a fight on this issue and thus diverted attention from the miserable US record on the volume of aid.)

The argument in favor of grants is of course that they will ensure that low-income countries do not again become overindebted, requiring a repeat of the HIPC exercise. The lack of reflows might increase the incentive for donors to insist on more selectivity on the part of IDA, so as to limit the use of large sums of grant money to countries truly able to absorb the resources effectively. For countries that are not performing well—for example, because they are run by crooks—IDA grants should be limited to much smaller sums designed to support policy dialogue, highly focused institutional reform, and so forth.

IDA grants, as is the case with loans, should still be made primarily to governments; policy dialogue and policy leverage with governments, especially regarding poverty strategies, is the comparative advantage of the World Bank's IDA. If country governments are not reliable or are simply unable to manage resources well, humanitarian, relief, training, and other institution-building programs would not go through IDA via governments but would be financed and managed by the United Nations specialized agencies, the bilaterals, and more and more by private sources, all of which have shown an ability to work with local NGOs.

Applying the principle of donor selectivity between the best-performing countries and the ones that are run by predatory governments is not very difficult. The problem comes in dealing appropriately with countries in the middle: ones with governments whose leaders mean well but are either following a misguided ideology (Tanzania under Julius Nyerere or

6. The debate as we went to publication was over specific amounts, with the United States proposing that 50 percent of IDA resources be in the form of grants, and the Europeans suggesting amounts in the range of 10 to 20 percent.

Zambia under Kenneth Kaunda come to mind) or else lack any competent administrative apparatus capable of putting their intentions into action. The problem also comes, practically speaking, in the constant stream of decisions that must be made about whether to enter strongly in support of a new government, and whether and when to withdraw major support. We turn to this issue of selectivity below; at this point, we simply note that in an environment where grant funding is disbursed on the basis of performance, it is likely to be easier to implement decisions about entry and withdrawal effectively.

Incremental Proposals to Increase Donor Accountability

We have emphasized that the donors and official creditors must take some responsibility for the buildup of unsustainable debt in the world's poorest countries. With the HIPC Initiative, they are taking some financial responsibility. But formalizing four new procedures would also contribute.

First, to create more visible, credible donor accountability, we recommend the modest additions to DAC reporting and changes in its accounting set out above (see box 4.1). Reporting the appropriate portions of official debt that is canceled as a loss would emphasize that at least some portion of the existing unsustainable debt of poor countries is truly uncollectible. Ending the practice of recording as ODA (uncollectible) interest arrears and cancellation of export credits would allow improved monitoring of official creditors' lending and of donors' overall commitments by development activists.

Second, we recommend that the PRGF be transferred from the IMF to the World Bank. Such a transfer would make the PRSP process, and the lending in support of it, the unambiguous responsibility of the World Bank.[7] The consolidation of the Poverty Reduction Support Credits already given by the World Bank with PRGF loans would presumably yield some administrative savings.

If one is going to consolidate in the interest of increasing accountability and efficiency, then clearly the World Bank should be in charge. The purpose of the PRGF is poverty reduction, which is the raison d'être of

7. Already there are differences in approach between the two institutions, reducing the accountability of either one. E.g., the IMF has approved many more interim PRSPs in order to resume lending; the World Bank, perhaps because it has the option of project lending independent of an approved PRSP, has not approved more than one or two Poverty Reduction Support Credits.

the World Bank. The IMF argues that its professional concern is macroeconomic policy and that disciplined macro policies are necessary for poverty reduction to have a chance, which is a viewpoint we endorse. However, an appropriate IMF role in ensuring macroeconomic discipline could perfectly well be secured by having the IMF monitor the macroeconomic component of each country's strategy. Macroeconomics is only one dimension, albeit an important one, that a country needs to get roughly right if it is to have a chance to grow rapidly and equitably, and all the other relevant issues except possibly the financial sector—from governance to the social sector—are primarily World Bank responsibilities. Hence it would be altogether more logical to conduct PRGF lending out of the bank.

It would be desirable for the IMF to transfer all those PRGF assets that remain after debt relief along the lines discussed above to the World Bank. The total assets of the PRGF at the moment, including its outstanding loans to HIPCs and other poor countries, amount to about $10 billion. Because about 70 percent of the loans are to HIPCs, and there will be more to other countries to which we suggested extending HIPC status, the assets coming with the HIPC Initiative would be fairly modest.

Third, we suggest that the donors, as shareholders in the World Bank and the regional development banks, instruct those institutions to encourage and be prepared to finance any initiative of borrowing countries to seek independent credit counseling. With independent advice, borrowers might resist the temptation to seek donor-guaranteed export credits for the purchase of unnecessarily expensive goods embodying inappropriate technology, as in the notorious case of the Tanzanian purchase of British radar in December 2001.

Fourth, the OECD's Development Assistance Committee might add to its mandate the development of principles on appropriate donor conduct, and then seek procedures to monitor how well donors measure up to those principles. One idea is for the donors' trade association, the DAC, to enlist an equivalent body representing the aid recipients. Although the administrative systems of aid recipients are already overstretched, so that one would not want to see them devoting the effort that would be needed to create a full equivalent to the DAC, it should be easy for the Group of 24 (say) to organize an annual discussion on these issues in the course of one of its regular meetings. A small number of the members could then be asked to convey the sense of the meeting to the donors' representatives in the DAC, allowing donors and aid recipients to discuss the issues in a less asymmetrical framework than arises in the typical one-on-one or Consultative Group setting. That could be complimented by the DAC's financing, on a pilot basis, borrowers' monitoring of the donors within their countries. For example, Ghana might receive a DAC grant to manage a 2-year program of in-country reporting on the costs and benefits of donor activities.

Donor Incentives for Selectivity

The reason for widespread skepticism about the effectiveness of aid is that so much of it has been given for the wrong reasons, notably to support diplomatic, strategic, or commercial goals rather than developmental ones. At its worst, aid has sometimes been used to support predatory governments run by tyrants interested primarily in looting the economy or building up their foreign bank accounts rather than in what happens to their citizens. In the past, even such villains often continued to receive foreign aid regardless of their failings, sometimes because of strategic concerns and sometimes because of a desire to preserve the fiction that debt was being serviced. A new aid architecture needs to make sure that aid is instead directed to where it can be most effectively used in curbing poverty by promoting economic and human development.

We have argued that debt relief can help in securing this reorientation, by getting rid of the pressure to lend so as to maintain debt service, and thus allowing for greater future selectivity by donors. But a new emphasis on selectivity also means the donor community holding itself to a standard of directing aid overwhelmingly to those countries meeting the twin criteria of the prevalence of poverty and the presence of policies that will make an effective assault on poverty.

Making the concept of selectivity operational is not straightforward (see box 6.2). What steps might take the donor community in the right direction?

The World Bank, in its IDA lending, has already shown a modest but important ability to direct more lending to countries that are "performing" better under its "performance-based allocation system." One way of improving the donors' ability to be selective would be to improve the information base available to them. In particular, it would be possible for the World Bank to publish the full details of the annual Country Policy and Institutional Assessment that it undertakes on all of its IDA borrowing members.

This information would enable donors to assess whether they believe that the numbers generated in the course of this exercise deserve to be taken seriously. To the extent that their judgment is indeed positive, it would then provide donors with the equivalent of an annual credit rating, one tailored to assessing the extent to which a country can be expected to profit from the use of external resources. Making the basis for the annual country index publicly available would also allow for the ongoing scholarly and public scrutiny from which country policymakers, citizens, and local and foreign investors, as well as donors, could benefit.

In addition, thought could be given to keying the index of country performance not to the relative allocation of IDA resources across countries but to the absolute amounts. That would imply that if more countries become more capable of using resources well, the total amount of aid

Box 6.2 Assessing country performance: Selectivity using what measures?

We have emphasized in this book that donors ought to be more *selective* across countries with their aid, that is, channel more resources to countries most in need and best able to use the resources well. The evidence has accumulated that linking aid to fulfillment of donor-specified conditions has not worked. This has not necessarily been because the conditions made no sense (though some argue that is also the case), but because the reforms they demanded need to be autonomously driven, or ''owned,'' by the societies benefiting from the aid transfers to be implemented effectively and sustained (Collier 2000; Ellerman 2001).

This is particularly true for reforms that cannot be implemented with the stroke of a pen (e.g., tariff cutting), but require the understanding and commitment of politicians, bureaucrats, customs officials, and others (e.g., customs reforms, property rights, strengthening an independent judiciary).[1] In other words, bribing governments or societies into good behavior (conditions as carrots) does not work, nor does refusing to disburse loans when governments fail to comply with conditions (conditions as sticks).

Conversely, there is also plenty of evidence that aid does work when governments are already in the process of developing the policies and institutions likely to induce long-run growth and poverty reduction. Then it makes sense for donors to commit large amounts of resources—to enable governments to accelerate the process, lock it in politically, and raise welfare more quickly. (Such a process of ''rewards'' might also help citizens in countries not so committed whose governments are not being supported to mobilize in favor of the same changes.)

But what are reasonable measures of a government in a particular country being ''in the process'' described (all too vaguely) above? Consider three familiar ones. The first is a macroeconomic policy mix that sufficiently minimizes inflation. There may be controversy about the optimal mix of monetary and fiscal policy and the limits of austerity in bad times. Certainly no country needs to run a budget surplus year after year; countercyclical deficits and deficits financed by manageable debt make sense. But no one resists anymore the need to take the measures necessary to prevent inflation rising above 10 percent, recognizing the difficulties of containing further increases and the burden imposed by inflation on the poor.

The second measure is a minimally ''liberal'' state, that is, one not so heavily engaged in productive and financial activities that emergence of a competitive, reasonably efficient economy is unlikely. There is plenty of controversy on the minimum depth and the right sequencing of the changes implied for some countries—privatization, financial-sector reform, trade liberalization. But no one argues anymore in favor of a state-managed, Soviet-style economy.

The third measure is a minimally corrupt state. Transparent budgets, checks on executive discretion, rule of law, respect for human rights including the rights of women, and the accompanying political and social institutions (a free press, contestable elections, etc.). Some would extend this farther, to include participation of citizens in political and community life, an active civil society of nongovernmental organizations, unions, faith communities, and even a particular form of liberal (Western) democracy.

1. Rodrik (2000) emphasizes this point.

(box continues next page)

Box 6.2 Assessing country performance: Selectivity using what measures? *(continued)*

The traditional conditionality of the IMF and the multilateral development banks has concentrated on the first two economic issues above. Even today, the decision point for eligible HIPCs is conditional on a minimum period of demonstrated macroeconomic stability, sufficient for the IMF to be satisfied. We have argued in the text for collapsing decision and completion points. That implies a nonselective approach for debt cancellation, except for the minimal macroeconomic conditionality. (It also implies eligibility of some postconflict countries for debt cancellation sooner than otherwise.)

We have also emphasized that the needs of the debtor countries for more post-HIPC transfers are huge. Debt cancellation will only reduce their current obligations by about 10 percent of the estimated costs to them of meeting the Millennium Development Goals. With our proposed debt-cancellation package, the poorest countries' debt will itself be sustainable. They will then be in a position to get ''into the process'' set out above, and donors ought to be in a position to support them—or not, depending on their performance.

We believe that as a community and in close partnership with borrowing and debtor countries, donors ought to develop and fine-tune a clear set of benchmarks for a country being adequately in that elusive process. Our own inclination would be to put much more emphasis on performance on the measures of minimal corruption, or ''governance.'' A minimum level of adequate governance might reasonably be made a precondition for new large transfers, independent of other measures, given the evidence that high levels of corruption inhibit growth and hurt the poor.

In any event, any such measures would need to be made more concrete and transparent. And even then, much would have to be left to the ongoing judgment of each donor.[2] The development of countries and people is not, after all, without risks—any more than is the development of defense missiles or new software businesses.

The people living in countries that do not meet the minimum thresholds for selectivity need not be altogether abandoned. Support for nongovernmental groups working to protect the environment, provide social services, and fight for democracy still makes sense, as does humanitarian and relief work with victims of repressive governments and civil conflicts. But large loans and grants to and through governments should be confined to countries that meet minimum criteria.

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2. The Country Policy and Institutional Assessment (CPIA) index of the World Bank does include assessment of governance arrangements, and we understand there is now consideration of giving governance greater weight in the overall index. But, as was noted, the country-by-country basis for the CPIA is not public.

would rise. It would also mean that were countries unable to absorb resources for one or more years, IDA resources could be used for additional financing of such global public goods as tropical agricultural research or the development of vaccines against infectious diseases.

Exploiting Multilateralism: The Common Pool

A second mechanism for donor self-regulation implies a more ambitious change in the way official aid is delivered. We argued in chapter 4 that there are various efficiency reasons for preferring debt relief to more ODA: ownership, transaction costs, fungibility, eliminating tied aid, and encouraging private investment. All those reasons except the last can also be cited in support of a proposal for reforming the process for granting aid called the *common pool proposal*. Note that a common pool would still allow different donors to give different amounts in different countries, allowing donors to back those countries where they like the program best.

The common pool idea was developed by Kanbur and Sandler (1999). They suggest that each aid recipient should go through a PRSP-like process to elaborate on its own development strategy, programs, and projects—primarily in consultation with its own population but also in a dialogue with donors. It would then present the plans to its donors, which would, to the extent that the plans meet with their favor, put unrestricted financing into a common pool of development assistance. This, together with the government's own resources, would finance the overall development strategy of the country in question.

The level of financing from each donor would depend on its assessment of both the strategy and the recipient country's ability to implement the strategy and monitor progress and expenditures. Donors' views would be made known to the country during the dialogue leading up to the financing decision, but earmarking of this or that donor's funds for this or that item, or donor monitoring and control of specific projects or programs, would not be permitted.

The international community has already moved toward this proposal by adopting the World Bank's Comprehensive Development Framework and the PRSP process. The recent statement by a dozen African heads of state adopting the New Partnership for African Development is also based fundamentally on the idea of a contract or partnership between donors and recipients, in which recipients ask donors to link the level of aid to recipients' performance in combating corruption, implementing the rule of law, and maintaining stable macroeconomic regimes.

This philosophy is also embedded in the agreed-on declaration of nations at the Monterrey Conference on Financing for Development. We suggest that the international community now make good on its own rhetoric by having all the bilateral donors channel their bilateral as well as multilateral assistance through recipient-country governments in this way. That would not only solve the nagging problem of poor donor coordination, it would place accountability for the selectivity with the donors, and for the success of the development program itself squarely where it belongs, with recipient-country governments.

Sovereign Debt: Building on the HIPC Initiative

One proposal of the debt campaigners does not seem to us to merit endorsement. This is the proposal mentioned in chapter 2 to set up an independent arbitration procedure, managed at the United Nations or another noncreditor agency, and including input from civil society groups, to handle a bankruptcy-like procedure for poor countries with unsustainable sovereign debt, including that owed to official international creditors and rich-country governments (Raffer 2001).

We agree that some sort of formal procedure for handling the debt of poor countries owed to official creditors does make sense.[8] But it would be pointless to force donors into debt relief that they were in a position to offset simply by cutting new transfers. It is unrealistic to think that donors would ever lock themselves into an arbitration proceeding that would coerce from them additional transfers, and we see no benefit in encouraging such an illusion.

In our view, the HIPC procedure itself represents an agreed-on bankruptcy-like procedure. It reflects the reality that official creditors have taken a serious measure of responsibility for their lending, which in retrospect has turned out to be unsustainable. We therefore believe that the most sensible and practical way to handle that debt is to build on the precedent set by the HIPC Initiative, by incorporating our proposals for ambitious but incremental reform recommended above.

8. The recent proposal of Anne Krueger of the IMF for a formal mechanism would apply to countries whose debt is primarily commercial, not official.