

KNOWLEDGE IN DEVELOPMENT NOTES

Overview

Development and Aid Effectiveness: What have we learned, what are we doing, where are we going?

While the developing world as a whole has made huge strides against poverty over the last 20 years, progress has been highly uneven. The persistence of poverty in many countries is a source of both concern and impatience in the policymaking and development communities. After 50 years of experience and effort, the argument goes, why have we not made greater progress in all developing countries? Why is sustained growth elusive and aid effectiveness uncertain? Tempering their impatience, these same communities recognize that economic development is a poorly understood phenomenon. So a key part of development policy is not only to implement effectively reforms that work, but also to discover what those reforms should be.

The Bank, through pilot programs, through the analysis and evaluation of operational experience and through research has made great progress on the knowledge agenda. Knowledge, lending, and learning have proven to be mutually reinforcing activities, and the Bank is the leading development institution in exploiting these synergies. Knowledge generated by research is a key input into the design of Bank programs and lending, and the Bank's knowledge itself a key selling point to clients. Through lending, we learn more about what works in development, and through research, this learning adds to the Bank's knowledge base.

But important gaps remain in our understanding of how the policies of both developed and developing countries affect development goals. This note offers a brief outline of key policy insights from the knowledge-lending-learning cycle and of some of the important gaps that remain. These insights relate to how the policies of developing countries could be improved to accelerate development, whether specific interventions to reduce poverty are really effective, what policies best address the unique disadvantages that many developing countries confront, and how the policies of developed countries could best be reformed to promote development. For each of these four areas, this note summarizes key findings in past research and the current efforts to understand remaining puzzles.

DEVELOPMENT AND THE POLICIES OF DEVELOPING COUNTRIES

Development advice focuses mainly on steps that developing countries should take to improve their development chances. From macroeconomic, trade, and environmental policies to social services and firm and financial regulation, we know much more about the contribution that developing country policies make to growth and poverty than we did 15 years ago. Recent discoveries have influenced the Bank's policy advice in a wide range of areas.

What we have learned

Liberalization and regulation

- Agricultural liberalization—more than trade liberalization—has driven poverty reduction in China, though health damage from excessive use of pesticides and rising inequality threaten the gains to the poor from China's robust economic growth.¹
- Increased openness to trade has led developing countries to reduce dramatically their reliance on commodity exports. More than 70 percent of developing country exports are now manufactures.²
- Unilateral and multilateral trade reforms interact in important ways: unilateral trade reforms have been the most important contributor to the rapid increase in openness in developing countries and facilitate subsequent multilateral commitments, but multilateral commitments help lock in unilateral reforms and yield more positive outcomes for poorer countries.³
- Financial development is a key driver of growth but neither deposit insurance nor government ownership should be used to promote it: the first introduces excessive moral hazard with few offsetting development advantages; the second leads to excessive politicization of financial intermediation.⁴
- Restrictions on foreign ownership of financial institutions impede productivity growth and financial development and increase risk in the financial sector.⁵
- Infrastructure investments can make crucial contributions to growth and development, but for some types of infrastructure appropriate regulation is required—and appropriate regulations in poor and rich countries look very different.⁶
- Government regulation of firms significantly limits the ability of countries to recover from crisis.⁷

Securing property rights and improving governance

- The security of property rights and good governance are keys to the growth of national income.⁸
- Greater political accountability increases the quality of public services and reduces corruption (for example, transparency about government transfers to local spending units reduces leakage of those funds by as much as 90 percent).⁹
- The security of property rights in land is a precondition for economic development. How rights are defined and administered and how land is distributed can have far-reaching implications for the cost of financial intermediation, conflict, governance, and corruption. For example, tenure insecurity in land leads to significant underinvestment and substantial income differences across rural households.¹⁰
- The environmental resources that many of the world's poorest people rely on—water, grazing land, fisheries, forest products—exhibit poorly defined and insecure property

rights and are subject to degradation and exhaustion. But under certain social and environmental conditions, local institutions can manage these resources sustainably.¹¹

Direct assistance to the poor

Well designed policies for human development and social protection can reach the poorest people, expand their opportunities for advancement, and help reduce their vulnerability to economic and environmental risks.

- Social policies matter in determining who benefits from growth. In India initial literacy rates at state level were a powerful factor in explaining the long-run gains to the poor from an expanding non-farm economy.¹²
- Interventions to increase tenure security (not always through formal title) encourage landlords to rent out and increase the access of the poor to land. More generally, policies that activate land rental markets provide an important and cost-effective way to increase productivity and improve access.¹³
- Redistributive land reform can have a positive long-term impact on poverty but need to be implemented in a cost-effective and non-politicized way.¹⁴

Issues under investigation

These lessons on the importance of policy have been internalized in the aid process. World Bank research and experience introduced to the development conversation the argument that aid is most effective in countries with good policies. Most donors, including IDA and the US Millennium Challenge Account, now condition aid on such factors as the governance environment, the allocation of public spending toward development priorities, and the extent to which countries conduct responsible macroeconomic policy.

Despite great progress in understanding the effects of policy on development, significant gaps remain that handicap the policy advice to developing countries. The Bank's research is targeted at bridging many of these gaps. For example:

How best to improve welfare and accelerate poverty reduction through growth?

Though we are confident that the effects of growth on poverty are significant on average, there is substantial variation in how much the rising tide of growth lifts all boats.

- Even as growth raises incomes, problems of vulnerability remain: the risk that some non-poor will become poor and that some poor people will become even poorer. Research is investigating these links and the appropriate policy response to problems of vulnerability. For example, researchers have been studying the potential for providing effective insurance to the rural poor through workfare schemes and other forms of safety net policies.
- The poor suffer disproportionately from unregulated pollution and natural resource degradation, but developed country regulatory models frequently fail in developing countries. Through pilot programs in a variety of sectors, research is evaluating possibilities for more cost-effective intervention under developing country conditions.¹⁵

- How can trade reforms reduce poverty more effectively? Current research focuses on the channels through which trade reform affects the poor, on the potential for particular groups to lose from reform, and on complementary measures that can reverse these losses (for example, by reducing costs of market access or lowering barriers between rural and urban labor markets).¹⁶

Which specific economic policies best promote growth?

We know that the policy and governance environment is crucial for economic growth, but we know much less about which specific policies should make up this environment. Nor is there evidence that identifies whether some specific constellation of policies and institutions is necessary to yield investment. Micro and macro research, at the household, firm, and country levels, is seeking to sharpen our policy advice on these issues.¹⁷

- We still know relatively little about precisely how access to finance promotes firm growth. The determinants of access to finance—and the effects of access—vary across countries and among firm and income groups. Our research is looking at these determinants and asking, for example, how important is access to finance for the growth of small firms and how do openness and foreign entry in financial markets affect access to finance, of both large and small firms?¹⁸
- The problems of infrastructure pricing and access are no less severe in developing than in developed countries. Unfortunately, research has shown that developed country models of regulation may actually be harmful in poor countries. Appropriate regulatory modes are still unclear, however. Multicountry work is under way to refine advice to developing countries on the regulation of infrastructure.

Which specific governance reforms work, and under what conditions?

- Research has found that transparency can have a profound effect on government behavior in specific instances, from reducing the leakage of funds to encouraging more environment-friendly industrial practices. There is little systematic evidence on the conditions under which transparency alone has such an effect, however, and there are many instances where transparency alone fails to trigger improvements in government policy. Research is exploring conditions under which transparency has the largest effects.¹⁹
- Assignment of property rights over environmental services, such as sequestering carbon and regulating water flow, has the potential to improve environmental and economic outcomes. Work is planned to evaluate such initiatives as they mature.²⁰

DEVELOPMENT POLICY AND THE EFFECTIVENESS OF SPECIFIC INTERVENTIONS TO REDUCE POVERTY

An important type of development assistance is the class of interventions meant to reduce poverty or improve the welfare of the poor directly. In many cases, competing models exist for the best way to structure particular interventions. Rigorous evaluation is needed to choose among competing models and, more broadly, to establish which types of interventions deliver the greatest benefits at lowest cost.

Such evaluations have been rare in the past. Now, expert attention and the application of new techniques have made them part of the basic development assistance toolkit. The evaluations allow us to ask which interventions deliver the greatest health benefits or fastest learning at lowest cost. Are all government goods and services usefully provided, even to the poor, or are development objectives better served if government resources go to other activities or if provision shifts to the private sector? Does the involvement of communities in the design and delivery of local services generate better and more sustainable services for the poor?

Such questions are asked in both rich and poor countries. But resource scarcity and the unique constraints confronting poor countries argue for dedicated research on the effects of poverty interventions in these countries. A significant and growing research effort has already uncovered suggestive and important findings.

What we have learned

Health care interventions and health care delivery

- Well designed, self-financed community water and sanitation projects significantly lower infant intestinal disease and mortality.²¹
- Widespread respiratory health damage from cooking and heating smoke in rural villages can be significantly reduced by simple, affordable changes in household construction and cooking practices.²²
- Nonprofit health care providers, particularly those with religious connections, can sometimes provide better quality health care at lower cost than government providers.²³
- Antiretroviral therapy for AIDS patients can save a year of healthy life in India for less than \$50, but only if treatment can be used to motivate improved HIV prevention.²⁴

Income support and labor market interventions

- Well designed workfare schemes can be highly cost-effective in reaching the poorest and helping them cope with adverse shocks and underpin their own efforts to escape poverty.²⁵
- By making cash transfers targeted to poor families contingent on their actions to help assure that their children are healthy and well educated, it is possible to reduce poverty both now and in the future.²⁶ Local control of decisions to allocate financial assistance to the poor can increase the fraction of resources intended for the poor that actually reaches them. But this depends critically on the local institutional context.²⁷

Agriculture and environment

- Rural extension services frequently fail to provide cost-beneficial advice to farmers, in part because extension services do not fully internalize the risks to farmers of adopting new technologies and the types of evidence that farmers look to before they take on such risks.

- Failure to account for collective action problems among farmers has limited the success of some programs, such as promoting integrated pest management to reduce toxic pesticide use.²⁸
- Extension programs intensely focused on small groups of farmers may fail to generate a national impact if the information they disseminate is overly complex and not easily diffused to other farmers.

Issues under investigation

Impact evaluation is an ongoing process that evolves to meet new policy priorities. It is addressing both new policies and new ways of conducting evaluations that encounter less political resistance and are more convincing to policy makers.

- An important new mode in delivering foreign assistance is community-driven development. Rigorous research is under way to assess the impact of programs structured around several possible CDD methodologies designed to provide local infrastructure and services. The roles of the socioeconomic and political context are being specifically assessed.
- Research is testing how the results of impact evaluation can be scaled up so that the impact of similar interventions can be rigorously assessed in different settings. New methodologies are also being developed that do not require randomization—an approach that, by using “chance” to exclude some potential beneficiaries, often generates political opposition that undermines the evaluation initiative.

DEVELOPMENT POLICY AND THE UNIQUE CONDITIONS THAT DISADVANTAGE DEVELOPING COUNTRIES

Developing countries often confront unique and troubling conditions that pose special challenges to growth, poverty reduction, and the effectiveness of donor assistance. This is especially so for the very poorest countries. For example, their disease environment is different than that of developed and middle-income countries: AIDS, malaria, and tuberculosis pose much greater challenges to human welfare and economic progress in developing countries than elsewhere. The poorest developing countries confront binding skill constraints—the inability to improve education because of the sheer absence of teachers, the inability to improve medical care because doctors have migrated, the inability to control dangerous pollution because regulators lack basic technical skills. Developing countries are also more likely to be threatened by conflict. And the demographics of developing countries, particularly the large fraction of children and young adults, are strikingly different from those in richer countries and pose unique development challenges.

Most of these areas are new in development research, and some have been addressed in recent research, with important implications for donor policy toward poor countries.

What we have learned

- Violent conflict is inextricably linked to the persistent, deep poverty of the neediest countries. Research has suggested that the development effects of intervention by rich

countries to halt conflict are huge relative to the costs. Recent research has also found that most participants fight for economic gain and that developed country assistance denying financial resources to the parties to conflict can be an effective way of ending it.²⁹

- Work on Ethiopia has quantified how the substantial effects that the current unavailability of teachers and doctors should condition both the amount and timing of donor assistance.³⁰

Issues currently under investigation

Ongoing and future research is focusing on other unique challenges confronting developing countries.

- The best predictor of new conflict is prior conflict, strongly indicating that a better understanding of how to prevent conflict is key to development. Research jointly financed by the Norwegian government and the World Bank is now focused on how best to address the challenges of development in post-conflict societies, including how to structure and sequence development assistance and which political and economic institutions are most appropriate and of highest priority.
- Death from infectious disease in developing countries is once again soaring, not only because of the AIDS epidemic, but because of the emergence of drug-resistant strains of such diseases as TB and malaria. Rapidly expanding international trade and travel increase the speed of transmission of new disease threats. Research is examining the economic impact of these new health dangers, assessing how some health care services—already failing to confront routine problems—can meet new health challenges and estimating the cost-effectiveness of specific interventions to prevent HIV infection, treat AIDS, and slow the national and international spread of potentially devastating new epidemics.
- Why do some countries develop and others not? The size of the development challenge is perhaps best highlighted by the simple observation that our understanding of how developed countries became rich is in its infancy. The role of policy and reform and the importance of idiosyncratic factors—such as good fortune—are still not fully understood. Even so, progress has been dramatic in understanding the immediate obstacles to development. In addition, aggressive efforts, both in operations and in research, are under way to further understand such issues as caste, social exclusion, political institutions, and political competition in the process of economic development.

THE POLICIES OF DEVELOPED COUNTRIES

Developed countries pursue a wide range of policies that have large direct or indirect effects on the development prospects of poor countries. Policymaking in developed countries—whether related to foreign assistance, trade, security, immigration, or finance—does not always take these effects into account, in part because their severity is only incompletely documented. Research has focused most strongly on developed country trade policies.

What we have learned

- Aid accelerates growth in countries that have adopted complementary policies, restrain corruption, and offer security to investors.³¹
- Trade strategies of developed countries that favor bilateral rather than multilateral trading regimes have significant, often negative, effects on poor countries. The accretion of bilateral and regional agreements may promote eventual multilateral agreement, but the evidence for this view is not strong.³²
- The agricultural policies of developed countries cost the developing countries approximately \$26 billion a year, or 60 percent of the cost to developing countries of all industrial country trade distortions.³³
- Empirical investigation has found high costs of compliance for developing countries in meeting certain WTO rules and in seeking to join the WTO, particularly the technical, procedural, and monitoring requirements that signatories to trade agreements must meet.³⁴
- The net economic benefits to developing countries of adopting strong intellectual property rights may be negative and not offset by corresponding benefits in increased innovation in developed countries.³⁵

This work has had a significant impact on international trade negotiations. For example, developing countries are increasingly vocal about the impact of some trade policies on their interests and the interests of developed country consumers—sometimes, unfortunately, to the extent of overlooking the need for sound trade policies in their own countries.

Issues currently under investigation

We know much less about the effects of policies in areas ranging from immigration to combating terrorism.

- The world's poorest countries are also countries that most often fall short in the policies they implement and for which traditional aid is least likely to succeed. Significant efforts are being made to identify new modes of interaction that will allow these countries to better use outside assistance for accelerating sustainable growth and reducing poverty.
- Financial sector and immigration regulations have a significant effect on remittances back to developing countries. Although evidence in some countries suggests that remittances can be a dominant source of foreign exchange, we know little about the poverty impact of remittances (the extent to which they are concentrated in the lower and middle classes, for example) and their use (whether for consumption, insurance against disaster, or investment). Research is addressing these questions.
- Although remittances benefit recipient countries, emigration may also have negative effects. This is especially true if the most skilled or most entrepreneurial are also the most likely to leave—though, if they return, they are likely to do so with enhanced

human capital. Research is investigating the costs of emigration for “source” countries.

- Developed country policies to control terrorist threats and drug trafficking may impose significant costs on developing countries. The economic costs of drug trafficking to developing countries are a function of the enforcement of drug laws and the vigor of interdiction practices. They include the costs confronted by developing countries when large slices of economic activity are illegal, including the effects on political institutions and the rule of law. The magnitude of these effects is unknown and the subject of research. Security measures by developed countries, such as those to control the contents of shipping containers, may also impose costs that fall disproportionately on developing countries. Again, such issues are the subject of research.

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Endnotes

Most Bank documents cited in this summary are available through the documents and reports portal of the World Bank <http://www-wds.worldbank.org/>. The word “processed” describes informally reproduced works that may not be commonly available through library systems.

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