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Three Steps Towards More Effective Development Assistance

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Abstract

There are three steps New Zealand can take to make its bilateral development assistance more effective in reducing poverty. These steps are unilateral: they improve the effectiveness of development assistance without requiring changes in the politics or policies of developing countries.

By far the most important of these three steps is to focus New Zealand's bilateral aid on those poor countries that are democracies pursing policies of market-led growth. One of the major findings of recent research is that development aid only reinforces what is already there. New Zealand should accept the developing countries as it finds them and pick and choose so that it helps those already helping themselves.

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Preface

This working paper is a by-product of Treasury research into development economics.

That research arises out of managing New Zealand's relationships with the World Bank and the Asian Development Bank, overseeing Vote Ministry of Foreign Affairs and Trade, and contributing to the recent ministerial review of New Zealand's official development assistance.

This working paper is designed to inform the current debate about how to make New Zealand's development assistance more effective.

THREE STEPS TOWARDS MORE EFFECTIVE DEVELOPMENT ASSISTANCE[*]

1. Introduction

> *Some of us, at least, believe that five decades of development experience since the end of the second world war has shown that policies for poverty alleviation are not mysterious or new, but mundane, tried and tested. They are policies that bring about rapid and labour-intensive growth based on a better-educated and healthier labour force, participatory democracy and fuller integration with the world economy*
>
> T. N. Srinivasan (1999)

> *If we have learned anything from the history of economic development, it is that national governments shape national outcomes.*
>
> Larry Summers (1999)

Everyone knows what the developing countries need to do to grow faster. The debate is litigated and re-litigated every ten years or so for similar results (Bhagwati 1996). Economists and aid donors then return to earnestly lecturing the developing countries about what they are doing wrong and what they should do to make things better. The suggested reforms imply changes in democratic accountability, bureaucratic integrity, economic and trade policy and the state sector that are often quiet but real revolutions.

This essay is about next to none of that. This is because the World Bank's research on aid effectiveness has redefined how to make development assistance more effective. Some of the old questions are redundant; others were badly posed. A new politics of development is emerging:

> Until the end of the cold war, many corrupt and incompetent governments of developing countries played one superpower off against the other to extract the most aid. Independent inter-national institutions became entangled in the game. Countries knew that if the politics were sensitive, the conditions attached to the aid by the World Bank or the International Monetary Fund would not be enforced rigorously. Bilateral aid, often tied to trade, would also flow freely. The effectiveness of aid plummeted, particularly in strategically important areas. Terrible governments, such the Mobutu regime in Zaire, were able to cling to power for far too long (*The Financial Times* 2001*)*.

Looking back over the last 50 years of foreign aid and nearly US$ 1 trillion in aid expenditure, the World Bank looked for insights in improving the effectiveness of aid in reducing poverty. The World Bank was also conscious that aid levels had fallen as a result of the end of the Cold War, and the increased focus by OECD governments on containing fiscal deficits and reining in government spending. Aid has also been overtaken by the dramatic increase in private capital flows to (a few largely middle income) developing countries. Not only must aid effectiveness be improved to actually reduce poverty, but also it needs to be seen to be effective to so that donors will continue to maintain aid levels against competing domestic concerns.

The World Bank rethinking of aid produced the following main findings:

- Financial aid works in a good policy environment;
- Improvements in economic institutions and policies in the developing world are the key to a quantum leap in poverty reduction;

[*] Our thanks to Peter Martin, John Wilson, Lewis Holden, Stuart Prior, Grant Scobie, Wayne Stevens, Peter Adams and Joe Grossman for comments on drafts of this paper.

- Effective aid complements private investment;
- The value of development projects is to strengthen institutions and policies so that services can be effectively delivered;
- An active civil society improves public services; and
- Aid can nurture reform in even the most distorted environments – but it requires patience and a focus on ideas, not money.

As the World Bank is the first to admit, none of these ideas are new, and to many the research confirmed what had been hinted anecdotally for some time. There is no quick magic fix for economic development. While this is all well and good, the question for a small aid donor like New Zealand is what do these findings mean for aid policy? How can they help New Zealand make a difference to developing countries?

This essay is about what unilateral steps that a donor country such as New Zealand can take to make its official development assistance (ODA) more effective in reducing poverty that assumes no change in the policies of recipient countries.

None of the proposed steps, three in all, require individual recipient nations to develop country poverty reduction strategies and/or show genuine ownership of those strategies. The steps do not depend upon political reforms and electoral re-alignments in developing countries. They do not require a turn-around of corruption, cronyism and personal services politics or the emergence of a mass constituency for market-led economic policies. The steps are all unilateral. They offer major gains in the effectiveness of development assistance without requiring changes in the political systems or politics of developing countries.

The plan of this paper is as follows. The next section will provide an overview of New Zealand's aid programme. Section three will review the empirical literature on the effectiveness of ODA. Section four will discuss the paramount importance of governance in economic development. Section five will discuss the first step: choosing the right countries to aid. Section six will discuss the next step: better donor co-ordination. Section seven will discuss step three: improved management of fungibility risks. Section eight will discuss the decisions implied for New Zealand.

2. NZ ODA Today and Yesterday

New Zealand's aid programme largely dates from the Commonwealth Colombo plan established in the 1950s to assist economic development in South/Southeast Asia, and to head off communist agitation. In New Zealand's case, a major focus of the aid programme was in the provision of mainly tertiary scholarships, a focus that continues to this day. New Zealand's aid programme steadily increased in the late 1960s from 0.15 per cent of Gross National Product (GNP) in 1965 to 0.18 per cent of GNP in the early 1970s. This was more than doubled with the election of a Labour Government in 1972. There was a dramatic increase in aid to 0.51 per cent of GNP and an increased focus on the South Pacific in New Zealand's aid programme.

Following the oil shocks and throughout the liberal market economic reforms of the 1980s, New Zealand's ODA declined as a percentage of GNP to a low of 0.21 per cent in 1991. However, from that point, New Zealand's ODA slowly increased throughout the 1990s to 0.27 per cent of GNP in 1998. Scheyten and Overton (1995) note that in real terms New Zealand's ODA is roughly double what it was in the 1960s and has actually remained relatively constant in the last 2 decades.

Today New Zealand has an aid programme of just under NZ$ 250 million, of which about NZ$ 226 million is in aid grants, with another $17 million allocated to programme management. The South Pacific continues to remain the core focus of New Zealand's aid programme. In total, New Zealand allocates aid to some 93 recipients, including 19 main bilateral recipients and just under 75 countries receiving less than US $1 million (OECD 2000). New Zealand also contributes to about 40 multilateral organisations.

For New Zealand the focus on the small states of the South Pacific is a particular challenge. Several of these island economies receive significant expatriate remittances. The smallness of these states creates the risk that ODA and remittances will jointly or severally constitute a significant proportion of the local economy, leading to aid (and remittance) dependency.

While the Pacific Islands receive relatively large inflows of aid per capita than other larger low and middle income developing countries, aid has not always been effective in generating a good growth performance in those islands. The World Bank (2000b) notes that the economic performance of the Pacific Islands compares very unfavourably with that of other small island states outside the region, partly due to the relatively large size of the public sector, further aggravated by poor policy settings.

3. The Results of ODA are Often Disappointing

Development assistance from the industrialised countries and the multilateral agencies together account for a significant share of the national income of the least developed countries — countries with average annual per capita incomes below US$ 885. Official resource transfers, mostly on concessional terms, accounted for 8 per cent of their combined GDPs in the 1990s (World Bank 2001). ODA accounts for a third to a half of the GDPs of several Pacific islands. ODA is almost 100 per cent of the GDP of Niue.

Outside of the sub-Sahara and the Pacific islands, aid accounts for an average of less that one per cent of their GDPs. A third of aid goes to middle-income countries, whose GDP per capita averages six times that of low-income countries (World Bank 2000c).

A large share of bilateral and multilateral development aid is ostensibly delivered through specific projects such as for children, nutrition, schools, hospitals, emergency relief and scholarships abroad. Since aid may be directed to projects that the country would have financed in any event, its real impact may be to permit the country to pursue other activities, which may have no impact on poverty (World Bank 2001).

Recent studies by the World Bank (1998) of the effectiveness of official development assistance have confirmed what anecdotal evidence has hinted at for a long time. In many countries, ODA simply does not work all that well in helping to reduce poverty.

When aid is effective in fighting poverty, increases in aid flows, like increases in private capital inflows, are closely associated, perhaps dollar-for-dollar, with increased domestic investment (World Bank 2001). This is how aid ultimately works when it is working-well.

One reason for the modest record of ODA in fighting poverty is that colonial pasts, political alliances and geo-politics have been major determinants of foreign aid (Alesina and Dollar 2000). Poverty reduction became the international goal of development co-operation only after the end of the cold war. Previously, aid was an arm of diplomacy; a servant of geopolitics. Many say that it still is.

U.S. ODA follows the changing tides of geopolitics. Europe immediately after the war. North Asia in the 1950s. South East Asia in the 1960s. The Middle East in the 1970s and after. After controlling for a special interest in Egypt and Israel, recent U.S. ODA is targeted to poverty, democracy and openness (Alesina and Dollar 2000).

Most European ODA, and especially French foreign aid, reflects their individual colonial legacies. Japanese ODA is provided mostly to other Asian countries. Some bilateral aid donors, notably the Nordic countries, simply target the poorest countries, and within that grouping, reward good policies and institutions in receiving countries (Alesina and Dollar 2000).

At the margin, countries that democratise receive more aid from most donors. French and Japanese ODA is largely unaffected by democracy (Alesina and Dollar 2000).

New Zealand's ODA has followed a mix of strategic and humanitarian aims. South Asia in the 1950s. Southeast Asia in the 1960s. The South Pacific from the early 1970s, with increasing amounts to Asia from the mid-1980s. In 1999/2000, approximately NZ$ 90 million, or just over 40 per cent of New Zealand's annual ODA went to the South Pacific.

New Zealand is one of the principal aid donors in the South Pacific, contributing 15 per cent of all bilateral aid to the region between 1987 and 1994 (ADB 1996). Within the Pacific island region, New Zealand aid has been concentrated on four Polynesian states closely associated with New Zealand: Samoa, Cook Islands, Niue and Tokelau, which is a New Zealand Trust Territory.

There have always been problems with a lack of ownership of development projects by countries receiving assistance and poor co-ordination among donors (Kanbur and Sandler 2000). Recipients have their own national histories and ideas on development strategy, which influence how they wish to act and their willingness to follow-up on the projects established by aid donors. The donor countries themselves have contrasting histories, experiences, expertise, and ideas, and these influence the types of projects and programs they are willing to support (World Bank 2000c).

At no point in the last 50 years has everyone agreed on the best development strategy and the methods for pursuing it. When there has been consensus over policies, there has been disagreement on how best to implement them. When there has been consensus on how best to pursue development — such as state-led or market-led development — there has been disagreement on what particular policies should make-up the agreed development strategy (World Bank 2000c).

Nonetheless, disagreement over the right development strategy is not the main hurdle to effective ODA. The key hurdle is beyond the control of the donor countries.

4. Good Governance is Almost the Only Thing that Matters to Development

4.1. ODA reinforces whatever is there

Major reviews of the literature by the Congressional Budget Office (1997) and the World Bank (1998, 2000c) suggest that ODA will play only a modest role in promoting development. There were simply exaggerated expectations about what ODA could achieve in isolation from the background political and policy conditions.

> Aid has been shown to be effective in promoting growth and poverty reduction in poor countries with sound economic policies and sound institutions — ineffective where these are lacking. Aid driven by political and strategic interests rather than by the recipient country's development policy environment is largely wasted from a poverty reduction perspective (World Bank 2000c, p. 196).

Reviews by the Congressional Budget Office (1997) and by the World Bank (1998) have found that the quality of a developing country's government and the policies it pursues are far more important than is the quantity, quality, or type of ODA that a country receives. Essentially, ODA reinforces whatever is there:

- If a country has an honest government and good economic policies, the result of ODA is likely to be more honest government and good economic policies; and
- If a country has a corrupt political system and pursues counterproductive economic policies, the result of ODA is usually more of the same.

Aid has a positive impact on growth in developing countries with good fiscal, monetary, and trade policies, and institutions. When these background policy conditions are absent, the World Bank (1998) found that ODA has no positive effect on growth. Right now, the quality of national policies has only a small impact on aid allocation (Burnside and Dollar 2000).

4.2. Aid is not a catalyst for change

An aspiration that ODA can be a catalyst for policy change has little empirical support. The World Bank (1998) found that the quantity of ODA received has no systematic effect on the quality of national policies. National policies can be explained by underlying country characteristics, such as the rule of law, which are associated with poor policies, or political instability, which is also linked to poor policies.

> A generally consistent finding, however, is that economic policies and governance structures rarely respond to increases in aid inflows. Indeed, more aid can encourage aid dependence or even predatory behavior, with perverse effects on policy and governance (World Bank 2001, p. 94).

The World Bank (1998) also found that generally donors have not successfully anticipated political turning points and increased their assistance in advance of reform. In fact, reform is more likely to be preceded by a decline in ODA than an increase.

4.3. Even more conditionality is not the answer

Conditionality — linking aid and loan disbursements to specific reforms — makes little difference. Dollar and Svensson (2000) found that the success or failure of the 220 World Bank structural reform programmes they studied hung on domestic politics.

In the 1980s and 1990s, the IMF and World Bank made 958 conditional loans. In the 1990s, three dozen poor countries received 10 or more conditional loans. Government mismanagement usually continued and the conditions were not enforced.

> Unfortunately, with some exceptions, multilateral and bilateral agencies had incentives to continue lending even when recipient government actions destroyed any hope of economic growth. Sometimes donors and multilaterals gave aid and loans only because the function of donors and multilateral agencies is to give aid and loans. Sometimes aid lenders gave loans to enable old aid loans to be repaid. Sometimes donors gave aid because the recipient countries were political allies of the donor countries. Recipient governments promised the multilateral agencies that this time they would reform, like alcoholics promising never to drink again (Easterly 2001).

Adding more conditions to loans makes little difference. Dollar and Svensson (2000) found no relationship between any donor-effort variable and the success or failure of reform. They found that donors have had little success in cajoling governments into doing things for which there is no domestic political support. Dollar and Svensson (2000) described the experiences of the World Bank, the International Monetary Fund (IMF) and bilateral aid donors with governments that are not democratic and have been in power for a long-time in ethnically fragmented countries as "dismal".

The World Bank has been refreshing in its candor about the failure of conditionality:

> Recipients do not see the conditions as binding, and most donors are reluctant to stop giving aid when conditions are not met. As a result, compliance with conditions tends to be low, while the release rate of loan tranches remains high. Thus aid has often continued to flow despite the continuation of bad policies (World Bank 2000c, p. 193).

The World Bank (2000c) considers that if all the aid that went to Zambia between 1961 and 1994 had gone into productive investment, and if those investments had been as important to real economic growth as initially predicted, Zambian per capita income would have been more than US$ 20,000 in 1994, not US$ 600. If ODA was all that it said it could be, Zambia should be richer than New Zealand on a per capita basis.

5. Step 1: Successful ODA is About Supporting the Right Countries

5.1. Help for self-help

The first step towards more effective development assistance is New Zealand must identify and help countries that are already helping themselves grow. The strong message from the recent literature is that aid only reinforces what is already there:

> Until a country commits seriously to reform, the best that donors can do is to provide technical assistance and policy dialogue without large budget or balance of payments support. If donors pour large amounts of aid into poor policy environments, they are likely to sustain poor policies longer. When the country finally commits to reform, evidence shows that finance should be increased as policies improve (World Bank 2000c, p. 199).

Aid donors need to build on the insight that democracy and the rule of law are essential to the prosperity of developing countries. This proposition needs some justification.

There is a large and inconclusive empirical literature on the effect of democracy on economic growth. The positive effect that democracy may have on economic growth that has been identified is for the poorest countries (Barro 1996). There is strong empirical support for economic development leading to more democracy (Barro 2000). However, it is fair to say that evidence of better economic performance among democracies than dictatorships has been found, but the relationship is not very robust.

5.2. Democracy or development — the 'cruel dilemma'?

The link between democracy and faster economic growth is clouded because some autocratic regimes have experienced episodes of high growth.

Bhagwati (1998) described the suspicion that democracy may not help development as the 'cruel dilemma'. Bhagwati pointed to soft authoritarians who wrote of the exuberance of democracy leading to indiscipline and disorderly conduct that is inimical to development. Our contention is that it is more likely that development assistance will be more effective when provided to democratic countries than autocracies.

The economic systems of autocracies vary enormously, as do the ways to account for their rates of economic growth, good and bad:

> Those who believe that there is some simple formula for distinguishing the economy of dictatorship from that of democracy should compare, for example, the economies of Nazi Germany, Apartheid South Africa, Papa Doc's Haiti, Pinochet's Chile and the former Soviet Union (Wintrobe 2001, p. 41).

The notion that insulating economic policy from democratic processes is good for growth has support among theorists of development from economics and political science. These theorists point to the capacity of the authoritarian states in South-East and North Asia to resist distributional pressures as the key to their high growth rates (Wintrobe 1998). However, they over-look the negative correlation between political repression and growth in Africa and Latin America (Grier and Tullock 1989).

The extraordinary post-war growth of Hong Kong, Singapore, South Korea and Taiwan were not productivity miracles. Their rise was fueled by an unusually rapid growth of capital and labour inputs. Labour force participation rates, educational levels and, with the exception of Hong Kong, investment rates rose rapidly in all four economies. There were large intersectoral reallocations of labour, again excepting Hong Kong, favouring non-agricultural and manufacturing industry. The growth of output per effective worker in the non-agricultural sector of these four economies has been only three to four per cent per annum. Allowing for the doubling, tripling and even quadrupling of the investment to GDP ratio in the 'Asian Tiger' economies, total factor productivity growth rates, both for the non- agricultural economy and for manufacturing in particular, are well within the bounds of those experienced by the OECD and Latin American economies over equally long periods of time (Young 1995). There were also large differences in how the four 'Tiger' economies strove for higher growth. Although Singapore ploughed twice a large a share of its GDP into investment as Hong Kong for thirty years, the growth rates of per capita GDP were about the same (Young 1992).

Similarly, accepting national economic statistics at face-value can still transform the recent growth experience of the People's Republic of China from the extraordinary to the mundane. Systematic understatement of inflation together with rising participation rates, improvements in educational attainment, and the transfer of labour out of agriculture, results in a productivity performance of the non-agricultural economy during the reform period since 1978 that is respectable, but not outstanding (Young 2000).

5.3. The transition from communism was the grand experiment in ODA

The transition from communism was the grand experiment in ODA to countries that were not stable democracies. The transition from communism is a case-study in whether countries that are autocracies and oligarchies can benefit from ODA.

Of the successor states to the former USSR, only the Baltics have consolidated into democracies. A few of the newly independent states of the former Soviet Union have become straight-forward autocracies. The remainder, including the Russian Federation, are hybrids. They have some democratic and free market characteristics and limited institutional development in company with a high degree of authoritarianism, corporatism, cronyism, and state involvement in economic life (Freedom House 2000).

The transitional economies received massive official development aid and technical advice. The share of Eastern Europe and Central Asia of global aid flows rose from 3.5 per cent in 1990 to 23.7 per cent in 2000 (World Bank 2001).

The Soviet-type economies were so inefficient that it should have been easy for them to outperform their communist pasts. Many transitional countries had reasonable infrastructures, ample natural resources and well-educated work-forces.

Ten years on, many of transitional countries have found it difficult even to maintain the level of output they attained in the last days of communism (Fischer and Sahay 2000).

The World Bank (2000a) and IMF (Fischer and Sahay 2000) concluded that despite their best efforts with the transitional countries, not enough was done about governance.

Sharp institutional breaks are often conducive to rapid economic growth. They destroy the existing network of distributional coalitions that are retarding growth (Olson 1982). These sharp institutional breaks simply did not occur in many of the transitional economies. By 1989, the Soviet-type economies had grown into a complex system of market restrictions and rent-seeking[1] opportunities for party members.

After 1989, in a number of the transitional countries, the Communist Party merely changed its name and continued to function. Ex-communists held most of the important jobs in all branches of government as well as in business.

By the mid-1990s, the former members of the soviet nomenklatura (the party hierarchy, managers, bureaucrats) had become major opponents to further reform paradoxically because they had captured the process sufficiently to become its main winners. The former nomenklatura had the most to gain if reform stalled halfway between the ancient regime and a well-functioning market economy. It quickly became clear to the nomenklatura in the partially reformed transitional countries that they could use their old status, connections and insider information to reap large profits in a system marked by continuing government intervention (Havrylyshyn and Odling-Smee 2000).

This turn of events — capture by the nomenklatura — was not entirely surprising. Venality, not ideology, drove the Soviet economy in practice. The reallocation of patronage positions was a strong under-current in the autocratic successions in the 1990s and the 1980s and after the deaths of earlier communist party leaders (Anderson and Boettke 1993). The Soviet system had evolved into a modern incarnation of the mercantilist economies of sixteenth- and seventeenth-century

1 Rent-seeking is the outlay of resources by individuals and organisations to compete for favours and rents created by government — it is the socially costly pursuit of wealth transfers.

France, England and Spain. Like these previous incarnations, the soviet economy was heavily restricted by state monopolies, with a specialised bureaucracy, ostensibly tasked with central planning, monitored the monopolist-franchisees. A powerful military as well as a large internal security apparatus was also required. The soviet system had become an elaborate revenue-raising device. The autocrat secured his position, wealth and central government revenues by mixing repression with the sale of privileges to carefully groomed and selected political supporters (Anderson and Boettke 1997).

After Stalin, the nomenklatura, having learned the cost of repressive excesses, adopted a policy that combined more co-option into the communist party with less intense political repression (Gershenson and Grossman 2001). It is likely that in 1989, more than a quarter of the people living in the Soviet Union were either party members or part of the immediate family of a party member. The cost of co-opting people into the communist party was a decrease in the standard of living of existing members of the nomenklatura (Gershenson and Grossman 2001). Soviet real growth from 1960 to 1989 was the worst in the world after controlling for investment and human capital, and relative economic performance worsened over time (Easterly and Fischer 1995).

Economic decline meant that the co-option into the party and patronage could not go on forever. Elements of the nomenklatura came to realise that their interests could be better served by ditching the command economy (Van Winden and De Wit 1993).

Olson (2000) considers that the capture of the transition has once again shown the importance of those in power having an encompassing stake in society. The bigger the group in whose interests the government rules, the larger the encompassing interest in the rule of law, public goods and rising incomes. Democracy is one of the guarantees of good government and insures that the general interests of society will usually (but not necessarily always) prevail. In a democracy, the majority will generally have a stronger focus on overall growth than on enriching particular interests.

After the collapse of communism, the old narrow interests remained powerful. The nomenklatura and its new business allies redistributed wealth in their favour without regard for the social cost. They either slowed privatisation or retained control of the privatised enterprises, continuing to divert resources to their own pockets. The fact that privatisation has made the former communist elite rich is the best evidence that they have been playing a major role in the institutional restructuring of Eastern Europe.

The contrast with the recovery of the former fascist countries after World War II is striking. There were dramatically different economic outcomes after the defeat of fascism versus after the collapse of communism. It was widely assumed that war-ravaged Japan and Germany would take decades to recover. Instead, there were unexpected economic miracles. The post-communist societies, where dramatic growth was expected, have struggled and performed well below expectations. Economic performance was so much better, especially in relation to expectations, after the defeat of fascism than after the collapse of communism because the victorious Allies swept aside all the old interest groups and imposed democracy.

> [Post-war West Germany and Japan] were ruled by majorities and therefore by relatively encompassing interests. Though these majorities made mistakes, their encompassing character gave them an incentive to try and make their societies work, and to a significant degree they succeeded (Olson 2000, pp. 169-170).

Olson attributes the rapid post-war growth of West Germany and Japan to the fact that markets of all kinds could operate freely and reliably and that the institutions representing the old special interests had been destroyed by the defeat.

The growth collapses in Latin America, East Asia and Middle East in the 1970s offer the same lessons as the transitional economies about the importance of domestic institutions for genuine mass-participation and effective conflict-management. The countries that experienced the sharpest drops in real economic growth after 1975 were those with divided societies, as measured by indicators of inequality, ethnic fragmentation, and the like. They were societies with weak institutions of conflict management, as proxied by indicators of the quality of governmental institutions, rule of law, democratic rights, and social safety nets (Rodrick 1999). Similarly, when there is ethnic diversity, such diversity is highly damaging to growth if there are limited political rights. Ethnic divisions explain a significant part of Africa's slow growth and African governments' choice of growth-reducing policies (Easterly and Levine 1997). However, ethnic diversity is not damaging to economic growth in democracies (Collier 2000).

Governments in polarised societies choose redistribution over development. Governments in many poor countries were torn by conflict over redistribution of the existing pie between regions, political factions and ethnic groups; or the landed and industrial elite, for whom power was more important than development, and who are afraid to invest in the masses that might demand their share of power (Easterly 2001).

5.4. Rent-seeking and democracies

The ability of people to participate in the benefits of the market economy is influenced enormously by the social arrangements for education, health care, credit, land reform, and other policies. The sharing of the benefits of the market economy depends on the other social institutions that are in place (Sen 2000a).

Our main contention is the power of special interests to capture rents from regulation and resist inclusive policies for market-led growth in developing countries is far less in democracies than in oligarchies and autocracies.

Majorities make their mistakes, but their encompassing nature gives them an incentive to make their societies work. In a democracy, the majority will generally have a stronger focus on overall growth than enriching particular interests.

The tendency for compact, well-organised groups with relatively intense common interests to benefit at the expense of broad groups with relatively diffuse interests is not denied. However, any group can win from lobbying — the interest-group theory of government has always accepted that no one group gets all it wants (Tollison 1998).

A government desiring re-election is constrained to make trade-offs among a variety of interests, including those of ordinary voters. Elections are infrequent. However, political competition constrains parties to be sensitive to the characteristics of those that voted for them and those that did not. Parties tend to appeal to different incomes, educations and occupations and draw contributions from different groups. Party platforms bundle many policies. To win a majority, platforms will tend to converge to the middle of the distribution of voter preferences. The platform of each party is not identical. Each party serves a hinterland to the left or to the right of the middle by offering platforms that compete for this middle (the median voter) but are distinctly preferred by voters in their respective hinterlands (Peltzman 1998).

On political issues that are largely one-dimensional and voters correctly perceive their own interests at little or no cost and vote accordingly, such as the rule of law or the overall amount of government spending and taxes, the outcomes are likely to reflect the desires of the median voter (Peltzman 1998). The median voter theorem is the basis of Director's law: redistributive democratic politics tends to favour the middle classes at the expense of both the rich and the poor (Stigler 1970).

Voters reward income growth and punish unemployment and inflation and, albeit with less success, growth in spending that is faster than they wish (Peltzman 1998). The success of the median voter in getting the public sector they want is often under-rated:

> When this century began, governments all over the world were small by any measure. The [U.S.] federal government of that day, for example, was little more than a small army and a post office. As the century ends, governments everywhere are very much larger than they used to be. ... My resolution to this apparent paradox lay in the nature of that growth. It has been concentrated in a few very specific programs. Without universal education and social insurance, government would still be a post office and a (somewhat larger) military. I argue that these "mega-programs" could not succeed without broad-base agreement about their desirability, and such agreement required the growth of a large and articulate middle class (Peltzman1998, pp. xiii- xiv).

An important fraction of the growth of government during the twentieth century must be attributed to the growth of spending that benefited mass voting blocs such as families and the elderly. On broad issues, a poor macroeconomy may cost a voter his or her job or erode their savings with inflation. Rational ignorance cuts more sharply on narrow issues. It is at the information intensive operational level of government, such as regulation, where special interests come into their own because of advantages in obtaining information and organising effective pressure groups (Peltzman 1998).

Voters want a mix of private and public goods. In the industrialised countries, most parties invest heavily in brand-names. Each brand signals to the mass-electorate that the party's leader and each candidate stands-behind a balanced standard portfolio of public and private goods that encompass the interests of the great majority of society.

In a number of developing and transitional countries, political candidates prosper by promising elaborate arrays of mostly private goods to amass networks of voters loyal to them personally. The sale of regulatory favors and government contracts to interest groups and cronies finance expensive candidate-specific campaigns. The brand-name value of political parties and their leaders are weak.

What is important for the developing countries and their aid donors is that democracy is a crucial social safety net against famine, social strife, and the emergence of a truly enduring under-class; racial, sexual, ethnic and sectarian discrimination; and the serious under-provision of public goods. The fact that no severe famine has occurred in a democratic country (even in very poor ones) with a free press and regular elections is a rudimentary illustration of this nexus (Sen 2000b).

5.5. Rent-seeking in autocracies

The proposition that democracy is vital to rapid economic development starts with Tullock's (1986) contention that rents from regulation and wealth transfers in autocracies are shared disproportionately and rather generously among a restricted group close to the ruler. This narrow generosity is necessary because autocrats are fundamentally insecure. A palace coup by high-ranking officials can occur at anytime.

The problem facing any autocrat is knowing how much support he has among the public, as well as among the smaller groups with the power to depose him. Autocrats need to cultivate loyalty as well as use repression to survive. It is advantageous for the dictator to buy-off some of his constituents, especially those who may be too powerful to repress, and those whose demands are easily satisfied (Wintrobe 1998).

Autocrats divide the population into two. The first group is taxed and repressed. The second group is subsidised at the expense of the taxed group (Wintrobe 1998).

The politics of autocracies and oligarchies are manifestations of kleptocratic rivalry. There are many examples of kleptocratic ruling elites: all-powerful landlords, parasitic aristocracies, indolent royal courts, and over-privileged militaries (Grossman 1999). Wealth is freely taken from the taxed group because kleptocratic rulers are preoccupied with avoiding (often violent) overthrow by elements of the subsidised group. The prize is the power to exploit the productive members of society.

> Democratic political competition, even when it works very badly, does not give the leader of a government the incentive an autocrat has to extract the maximum attainable social surplus from the society to achieve his personal objectives. … Examples of confiscations, repudiated loans, debased coinages, and inflated currencies perpetrated by monarchs and dictators over the course of history are almost beyond counting (Olson 1993, p. 571).

A secure autocrat may develop an encompassing interest in his country and may provide law and order and other public goods that increases productivity and promotes investment. Any incentive an autocrat has to respect property rights comes from his interest in future tax collections and national income and increases with his planning horizon (Clague, Keefer, Knack and Olson 1996).

Whenever an autocrat expects a brief tenure, it pays for him to confiscate those assets whose tax yield over his tenure is less than their total value. This incentive plus the inherent uncertainty of succession in dictatorships imply that autocracies will rarely have good economic performance for more than a generation (Olson 1993).

When many groups have influence, such as in a democracy, the government they elect and lobby is more likely to have an encompassing stake in society. Indeed, voting institutions and the rule of law emerged in medieval times as mechanisms that allowed rulers to co-operate with their subjects, sharing power as genuine partners in mutually profitable projects (Barzel 1997, Barzel and Kiser 1997). Remember the slogan “no taxation without representation”. The right to vote was slowly extended in many oligarchies to co-opt opposition, encourage investment and prevent further unrest (Ramseyer and Rosenbluth 1995, Acemoglu and Robinson 2000).

In autocracies, many groups in society are systematically excluded from the trading of political support. These outsiders can be preyed upon by the privileged to extract the maximum available rents given the political security and time horizons of the ruler. Limits on rent extraction from the public in autocracies and oligarchies include a longer time period that the ruling elite expects to maintain power (which reduces rent extraction per unit time and gives incentives to provide public goods), hostile actions from the public, tax resistance, emigration and capital flight (Olson 2000).

5.6. Efficiency in inclusive democracies

The inclusiveness of political systems matters to economic development and particularly in its earliest stages to the political sustainability of growth-promoting policies. These early stages of economic development are also the phase where development assistance can have its greatest impact on poverty.

What is important for present purposes is that a democracy contains rent-seeking and special interests better than an autocracy. In undemocratic states, political survival centres on providing wealth directly to a few influential groups strong enough to overthrow the ruler. There is a massive misallocation of talent in autocracies. A country's most talented people typically organise production by others. When they start firms, they innovate and foster growth. When they become rent seekers, they redistribute wealth and reduce growth (Murphy, Shleifer and Vishny 1990).

Countries' endowments of natural and human resources do not explain any significant part of the variation of their per capita incomes. The mobility of capital assures that it is impartially available to all countries. National differences in the quality of policies and institutions mainly account for differences in per capita incomes (Olson 1995).

Political systems are sensitive to waste. That sensitivity increases with inclusiveness. In a democracy, the losers can fight-back as things get worse. In democracies, few pressure groups can obtain very large subsidies, although many groups can obtain small subsidies, since those large subsidies stimulate countervailing pressure by those taxed to finance the subsidies. In autocracies, a few groups can become very wealthy because others are not permitted to form an effective opposition.

The main difference between Olson (1965, 1982) and Becker (1983) about social waste in the operation of government is the former stresses the adverse impact of growing differences in political access on the pace of growth. Becker stresses the efficiency of democracy when there is free competition among pressure groups.

Olson (1965, 1982) contended that the political struggle among the various groups in society is not symmetrical. Groups have trouble staying together because members are tempted to be free-riders. It is easier to keep a small group organised than to rally a large one. Small groups with concentrated interests will often triumph over numerically superior forces because the former are more likely to be organised and active.

Becker (1983) contended that the cost of some programmes may seem distressingly large, but they are cheap relative to the other programmes that could not muster enough political support. Cheap and expensive refers to their marginal deadweight cost, not the size of the taxes and subsidies. Becker contended that when groups had relatively equal access to the production of political pressure, public policies were likely to be efficient. No public policy that lowered social output could survive if all pressure groups were equally large and skilful at producing political influence.

Becker contended that Olson's general condemnation of interest groups was excessive and was much more justified when there is a lack of democracy:

> Democracies have competition among groups with relatively equal strength, while totalitarian and other nondemocratic systems have restricted competition among groups with highly unequal strength (Becker 1985, p. 344).

Becker (1983) contended that in a world of many pressure groups competing on some sort of equal footing, political processes should be drawn towards least-cost modes of redistribution and regulation. Neither the winners nor the losers will rationally oppose policy changes that reduce the waste of resources. The less waste, the more wealth that is available for distribution. Pressure groups that propose relatively wasteful policies are more likely to provoke resistance. As the waste from an actual or proposed policy rises, winners will be progressively enfeebled relative to the political losers. The political pressure the winners must exert for each extra dollar in wealth transfers must overcome steadily rising pressure from the losers to escape the escalating losses.

One of the functions of political parties and interest groups is to collect, process, and disseminate information (albeit of a self-serving quality) to voters. In a democracy with many interest groups, voters have more political information available to them. Voters are no longer confined to expressing their preferences as a package at the polls once every few years. Lobbying allows voters to articulate the content and the intensity of their preferences in greater detail.

Becker and Olson agree that when some groups have far greater advantages than others in organising political pressure, the policies that emerge from such a political system are likely to be far from desirable. The transition from communism, and the empirical evidence suggesting a positive effect of democracy on growth in the least developed countries, support these contentions. The governments of transitional and developing countries that are undemocratic are relatively indifferent to the social waste of the policies they pursue to further the interests of privileged few. Such governments are less sensitive to social waste because they lack democratic accountability.

Western democracies have their problems with special interests. So do the emerging democracies. These problems are far worse in autocracies and oligarchies.

As Olson (1982, 2000) has repeatedly argued, the dispersal of political power, and the emergence of representative government, has often been the trigger for faster growth. Stable, long-established democracy is good for growth because it creates a more encompassing interest in future prosperity. However, that same long-term stability also leads to a build-up of interest groups, which can retard economic performance. As these groups formed and developed, they would focus their energies on redistribution of income and wealth. Olson (1982) argued that democracies tend to decline in efficiency over time because special interests have more time to organise themselves.

The reliable enforcement of private contracts and the protection of individual rights depend on governments strong enough to guarantee these rights, yet is constrained enough not to undermine them. Fast economic growth depends on the emergence of an enduring market-augmenting government (Olson, Sarna and Swamy 2000).

The feature the poorest countries have in common is that contract rights and property rights are badly defined or weakly enforced. Markets involving time and uncertainty are stunted. If long-term contracts cannot be made with confidence, the corresponding markets and the rights-intensive production they enable will be retarded. The failure to provide these rights springs from the government's lack of an encompassing interest in the welfare of society. The absence of democracy, which narrows the government's interests to a minority, is at the root of the country's economic failure (Olson 2000).

ODA is unlikely to be used well when there are wide discrepancies in political influence across society — where governments are not accountable to the bulk of the public.

Svensson (1999) found that the data suggests that aid has a positive impact on growth in countries with an institutionalised check on the abuse of government power: in more democratic countries. However, when democracy is absent, the data suggests that aid will be used to satisfy the unproductive goals of unaccountable governments.

The empirical relationship between democracy and growth is not as clear in middle-income developing countries (Barro 1996). One reason may be that the network of distributional coalitions swept away with the establishment of democracy may have regained their traditional strength and/or strong new coalitions may have formed (Olson 1982). Such countries have less need for development aid relative to the least developed nations, so the issue falls to the margins of the focus of this essay.

5.7. New Zealand should pick and choose

The need for donors to be more selective in how they allocate development aid between countries is now widely accepted:

> For aid to be most effective at reducing poverty, it must be well targeted. If all aid money were allocated on the basis of high poverty rates and reasonably effective policies and institutions, a recent study estimates, even today's small aid flows could lift 19 million people out of poverty each year — almost twice the estimated 10 million now being helped (World Bank 2000c, p. 196).

New Zealand should accept developing countries as it finds them and pick and choose between them so that its overseas aid goes to those countries that already have the right background public choice conditions. New Zealand cannot and does not expect to influence to any great degree the policies of other governments and the openness of their political systems. However, New Zealand has a free hand in deciding how to allocate its aid budget between countries in the first instance and as their political systems change. Improving the effectiveness of New Zealand's aid programme in alleviating poverty is a matter of choice at the strategic level.

New Zealand will get best value-for-money from aid allocations to democracies that are pursuing policies of market-led growth: help for self-help. The emphasis in New Zealand's development assistance on investing in human capital reinforces the need to aid the right countries. Over 40 per cent of New Zealand's bilateral aid, NZ$ 60 million, is allocated to education and training; 90 per cent of this is for tertiary scholarships, of which 85 per cent is provided in New Zealand. There is less value in providing aid to countries that are undemocratic or ethnically divided. Such aid is investing in capital that has an increasing probability of emigrating or not returning after studies abroad.

The highly indebted poor countries (HIPC) initiative is similarly centred on the belief that the least developed countries themselves must take the lead in poverty reduction efforts if lasting change is to be achieved. The HIPC initiative aims to build on the right background public choice conditions. The strategy of HIPC is to help poor countries that have shown that they want to help themselves. A country is not eligible for debt relief until it has achieved a series of targets for reform and economic progress. A country must show that it is investing in the necessary background conditions, which promote economic development, and which also make ODA worthwhile.

Allocating aid to countries that have proven they will use it well is the fastest way for ODA to reduce poverty in the least developed countries. Allocating aid to countries with political systems that are insensitive to the needs of the population and to the waste of the few indigenous natural and human resources they might have serves little purpose.

The key institution for development is an effective representative democracy. The defining democratic feature is that the public at large elects representatives, with each member of the public having a single, non-salable vote (Posner 2001). This last qualification does not always hold in some emerging democracies.

Voting is a method of control, not of administration. The people do not rule in a representative democracy; they control their rulers by voting them out of office.

For voting to work as a means of control, voters must have some minimum level of political sophistication, along with a measure of financial independence from others:

> The financial security of living in a prosperous society creates a citizenry that not only is reasonably well informed about political issues and candidates, but also is sufficiently independent economically not to be the pawn of the mighty; relations of patronage and dependence undermine the power-diffusing objective of equal voting (Posner 2001).

Any endorsement of democracy as an enabler of development cannot be blind. Some democracies have politicians who as a group are highly corrupt. Some democracies are not market economies, such as in South Asia, or have traditional land tenue and other cultural arrangements that inhibit borrowing to invest in growth. The type of aid provided to such countries will be different: it may by-pass national governments, relying on provincial governments or NGOs, both of whom should be easier to monitor.

6. Step 2: Better Donor Co-ordination/Less Donor Congestion

The coordination of aid donors has come under more scrutiny in recent years as a means to improve the effectiveness of foreign aid. Poor donor co-ordination can also be described less generously as donor congestion.

The sheer number of donors and donor projects can be staggering. At one point there were 405 separate donor-funded projects in the Mozambican Ministry of Health alone. In the early 1990s, there were 40 donors and more than 2000 projects in Tanzania. In Ghana during the same time period, there were 64 different government or quasi-government institutions receiving foreign aid (World Bank 2000c).

Some countries have a donor presence in many countries. Dutch ODA helps 80 countries (World Bank 2001). Irish bilateral aid is targeted at six least-developed countries in Africa: Ethiopia, Lesotho, Mozambique, Tanzania, Uganda and Zambia. Portugal has five bilateral aid partnerships, albeit all former colonies. Both countries have ODA budgets that are roughly similar in size to New Zealand.

New Zealand spreads its aid around. Three-quarters of the NZ$ 226 million in overseas aid is bilateral. The remainder is spent across 39 multilateral agencies. New Zealand has 63 bilateral development assistance relationships, nineteen of which are major partnerships in the Pacific,[2] South-East Asia[3] and South Africa. Other initiatives extend the global reach of New Zealand's overseas aid to a grand total of 93 countries, up from 49 a decade ago. New Zealand has over 300 bilateral aid projects in place which are worth an average of NZ$ 300,000.

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2 The Cook Islands, Niue, Tokelau, Papua New Guinea, the Republic of the Fiji Islands, Samoa, Kiribati, The Solomon Islands, Tuvalu, Vanuatu and the Kingdom of Tonga.

3 The Kingdom of Cambodia, the People's Republic of China, Indonesia, Lao People's Democratic Republic, The Philippines, Thailand, and the Socialist Republic of Vietnam.

Some recipient countries respond to the donor co-ordination problem by developing strategies that channel donors away from areas of marginal value. The strategy is an investment guide for donors. Any project that is financed must be in the plan, and the recurrent costs must be incorporated into the national budget. By encouraging individual donors to specialise in particular sectors, there is less duplication. By focusing on certain areas, donors have been able to learn from their experiences, and the national bureaucracy works with the same organisations from year to year.

The case for development banks arises out of donor co-ordination. Donors contribute to a common pool that supplements the resources of a range of recipients. When considering entry to a new country or an expanded presence in an existing recipient country, greater engagement with a development bank is a viable alternative for New Zealand to a new or expanded bilateral donor relationship.

Managing donor congestion affects New Zealand ODA in three ways. The first implication is New Zealand should pause before offering ODA to new countries when there are already a large number of donors and no integrated national plan to co-ordinate them. When there is donor congestion, it is more likely that the projects and strategies that a new donor may support will be of marginal value and subject to duplication. Focusing New Zealand's existing bilateral aid on the South Pacific and a few other countries is a possibility. Such prioritisation is not without precedent. For example, between 1995 and 1998, Denmark shed 18 countries to focus on 20.

The second implication of donor congestion is that New Zealand's ODA should focus on areas where donor co-ordination is more effective. This effectiveness can be due to the planning of the recipient country or because New Zealand is a lead donor.

When New Zealand is among the leading donors to a country, New Zealand is more likely to be supporting projects and programmes of high value. Lead donor status increases the leverage New Zealand's ODA may have to ensure that its goals are achieved. New Zealand is the third largest donor in the Pacific Islands.

The third implication of donor congestion for New Zealand is the vehicle chosen for delivery of ODA in new countries. Geographic and in-country donor specialisation can significantly improve the effectiveness of ODA. The global reach of New Zealand's bilateral aid almost doubled in the last ten years, from 49 to 93 countries. In a country where there many donors, and no New Zealand ODA presence but such a presence is desired, New Zealand may get better value for money by contributing through a third party, such as a multilateral development bank or an NGO. This approach ensures that there is a New Zealand contribution without any proliferation of donors.

7. Step 3: Fungibility versus Additionality

Studies by the World Bank (2000c) have shown that aid funds allocated to a particular sector tend to free up resources for other purposes that the government would otherwise have spent in that sector in any event. Development aid for specific projects or sectors may actually be helping to expand spending on sectors donors do not want to finance, such as the military.

The intention of ODA is the exact opposite: to supply funds to projects and sectors in addition to those of the national government to support poverty reduction.

The World Bank (2000c) was right to observe that fungibility has profound implications for development cooperation. If funds are fungible, if aid cannot be targeted to particular services or sectors, and the recipient's public expenditure program is not satisfactory audited and controlled, then project lending may not be a cost-effective instrument. Project-level evaluations will not reflect the true impact of aid, since aid is likely to be freeing up resources for other activities. On the other hand, if the accountability of a country's public expenditure program is satisfactory, the donor might as well finance a portion of the national budget, rather than concentrate on projects.

The objective of ODA is to supplement poverty reducing national expenditure. Effective aid brings forward poverty reducing expenditure that the country was not able to fund now, but was planned as soon as revenue was available. Aid fails if it allows the government to substitute existing or planned expenditure away from poverty reduction.

Fungibility did not matter so much prior to poverty reduction becoming the main goal of ODA. In earlier times, ODA was driven by geopolitics and colonial legacies with some acknowledgement of humanitarian objectives. The realpolitik of ODA was to supplement the resources of friendly governments. Project-based aid had presentational advantages in-country and back home. Projects profiled in a concrete media-friendly way the efforts of donors to contribute to the political stability and economic development of friends and allies. In addition, project-based official development assistance was less likely to be directly tainted by local corruption. Project-based funding also allowed donors to tie their development aid to procurement policies that favoured, sometimes heavily favoured, tenders from their own nationals.

Fungibility is a major issue for New Zealand's aid efforts. Scholarship schemes may add no net funding to the education sector of developing countries. Over 40 per cent of New Zealand's bilateral aid, NZ$ 60 million, is allocated to education and training; 90 per cent is for tertiary scholarships, of which 85 per cent is provided in New Zealand.

New Zealand's official development assistance is directed towards a sector of developing economies (investment in human capital) where the capacity to free up resources for other purposes (fungibility) is large. Spending on primary education in developing countries is high. Any reduction would be easier to detect and would be unpopular with the bulk of the domestic electorate. Secondary and tertiary education is an emerging area of government expenditure in the poorer developing countries. In such circumstances, New Zealand's ODA could be taking over education responsibilities that the national government was planning to assume in the future. If so, resources may be released to purposes or sectors where poverty reduction is not as high a priority.

Confronting fungibility is a major operational challenge. Managing fungibility is the only step of the three proposed that has operational implications in-country. The other two steps are made at the strategic level: help democracies in a few given regions through scholarships, projects in specific sectors or budget support, as the case may be. Managing fungibility is about program delivery risks that may vary across countries.

Fungibility is an important reason to focus aid on the poorest countries. They may lack the infrastructure and resources to easily fudge spending priorities. The World Bank (2000c) considers that in countries highly dependent on aid, donors as a group could lead to shifts in government resource allocations, because of the sheer size of flows.

Resolving aid fungibility may be easier for New Zealand than for others. The challenge may be less in the Pacific islands than elsewhere. Some Pacific islands have unique problems, such as economic vulnerability; limited institutional capacity and poor export diversification. The small Pacific islands will often lack the size and scope to easily shift funds to other sectors. Their populations are too small relative to the start-up and fixed costs and the minimum efficient scale of key infrastructure. New Zealand is a leading donor in the region. Monitoring fungibility should be easier than in larger countries.

Ultimately, fungibility leads back to the first issue of providing aid to countries that are well-governed. Donor concerns about fungibility are largely alleviated when they can see that the recipient government is spending its own monies wisely. If a developing country is an effective democracy, and is pursing market-led policies for growth, donors cannot get away from simply having to trust aid recipients to use the money wisely.

8. Decisions for New Zealand

The paramount decision about the effectiveness of official development assistance is at the highest strategic level. It is made before any contact with a recipient country.

The most important step in fighting poverty in developing countries is identifying and only assisting those democracies that have a record of helping themselves grow.

Effective development assistance is not about how it is delivered; it is about to whom it is delivered. More than fifty years of development assistance has taught us that where national governments are truly committed to inclusive market-led policies for economic growth — international support can make a difference.

New Zealand should accept developing countries as it finds them and pick and choose between them so that its bilateral aid goes to those that already have the right background public choice conditions: democracies. Emergency disaster relief, which is a very small part of development assistance, may not come under this criterion.

The transition from communism demonstrated once and for all that no amount of development aid can make-up for poor governance. The transition was the grand experiment in institutionally unscreened development aid. It failed.

Donor congestion is the next major step towards more effective ODA. New Zealand should consider prioritising its development assistance budget towards countries where it is one of the leading donors, which are the small Pacific islands. If New Zealand is considering providing ODA outside of its existing areas, working through intermediaries such as the multilateral development banks may be the better choice. Direct entry as a donor into a new or congested country is unlikely to be value-for-money.

Once the right countries are chosen for support, fungibility is the major delivery risk for development assistance that New Zealand has significant unilateral control. The objective of aid is to supplement national poverty reduction efforts, not just expand the national budget without priority and free-up resources for poor quality projects. With growing populations, a national government can fudge spending simply by not meeting increased domestic demand from their national budgets, using ODA to fill the gap.

Focusing New Zealand's development assistance on the small Pacific islands, where New Zealand is a leading donor, and a few other countries, would help with the monitoring and the management of fungibility. New Zealand will need to review the balance between the current extensive funding of tertiary education scholarships and investing in-country in basic education and other social infrastructure that are of scale or have start-up costs that are beyond the fiscal capacity of a small Pacific island.

The three foregoing steps do not repeat the mistake of other strategies for improved development co-operation. Hoping for political reforms and electoral re-alignments in least developing countries in Africa, South Asia and elsewhere that turns-the-table on corruption and cronyism and ushers in an encompassing constituency for change.

Development assistance can only reinforce what is already there. Which developing countries have governments that have an incentive to make their societies work? In a democracy, the majority will generally have a stronger focus on overall growth than enriching particular interests. Majorities make their mistakes, but their encompassing nature gives them an incentive to keep-on trying to make their societies work. The larger the group in whose interests the government rules, the larger the encompassing interest in the rule of law, a prosperous society, and rising incomes.

Donors should direct their aid to where it will do the most good. Donors may have to wait for deep changes in some governments' behavior before giving money.

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