Toxic Aid: a review

Toxic aid: economic collapse and recovery in Tanzania, by UCLA Professor and former World Bank Chief Economist for Latin America Sebastian Edwards, is a fascinating and well told story of Tanzania’s economic history. It begins with a brief discussion of whether the recent economic progress in Tanzania is the success story often presented by those advocating economic reforms in Africa and then proceeds to summarise recent debates on foreign aid and whether aid really works on the ground.

The remainder of the book largely refocuses on the Tanzania story. It begins with a short discussion of how aid volumes evolved from independence to 2011 and then proceeds to drill down on what Edward’s identifies as three key periods of changing aid support. In subsequent chapters, with excellent analysis and convincing detail, he relates the economic performance that accompanies each period of aid. In the closing chapter he returns to the question of whether Tanzania should be considered a success.

For a variety of reasons this Tanzania story presents a particularly interesting case study. After his brief outline of the post-independence period, Edwards discusses in detail Tanzania’s turn to socialism in 1967 with the Arusha Declaration. Documenting well the steady economic decline that accompanied the move to socialism, Edwards contrasts this with the generous and increasing aid flows that Tanzania received through the 70s. Enthusiastic about Nyerere’s focus on rural development and addressing the needs of the poor, substantial support came from the World Bank and other donors, in spite of poor and declining economic performance. Indeed, this period provides a clear explanation of the title “toxic aid”; no one can credibly argue that the massive aid flows that marked this period had meaningful development impact, as poverty levels clearly increased.
Edwards then describes well the key areas of dispute that emerged with the IMF and World Bank in the late 70s, and devotes a chapter to the story behind the complete break in relations with the IMF in 1979. He also provides a useful summary of the broader changes that occurred in donor attitudes toward Africa’s development challenges, before returning to the Tanzania case.

Most of the remainder of the book focuses on the two periods of reform that marked the 1985-2011 period. After Nyerere retired and Ali Hassan Mwinyi was elected President in 1985, the government moved forward with a reform program that emerged from both internal Tanzania work and the support of the IMF and the World Bank. Edwards presents a comprehensive description of the reforms involved, and reviews the positive impact they had on the return to real economic growth. Pursuing reform also led to substantial new aid flows. Summarising this period of reform as “ambitious but incomplete” he then proceeds to discuss the waning appetite for reform in the early 90s and the resulting halt in economic progress.

Edwards then moves to the renewal and deepening of reform that commenced after the 1995 election of Benjamin Mkapa and continued under his successor, Jakaya Kikwete. In a detailed discussion of “the second wave of reforms” he describes both the depth of the reforms involved and the supportive donor environment that emerged around the reforms. Among other points, he notes the role played by the “Helleiner Report” that openly discussed issues in government-donor relations, the importance that was placed on government ownership of reform, and reviews some of the broader changes in donor approaches that impacted their work in Tanzania. He also summarises the substantial increase in donor flows that marked this entire period.

Professor Edwards concludes with a more detailed discussion of whether Tanzania is a success story. I will leave his
conclusions for interested readers to discover, but will say that as a professor he couldn’t resist giving grades for the three periods outlined above. Reading this book will also give readers an excellent summary of the issues surrounding economic reform and will, I am confident, spark a wide range of reactions on the appropriate role of aid agencies in supporting aid-dependent countries.

Private sector reservations and policies

My early years in the World Bank involved broad support for expanding the role of the public sector in Tanzania. The failure of that effort to generate robust growth, and the subsequent global emphasis on downsizing government and facilitating private sector-led growth, has clearly marked Bank priorities and policy interests, in particular during my tenure as Country Director for Indonesia. At a personal level I now recognise that there are real limits to the role of government and am convinced that in the future government will not be the major source of employment and income generation. The most effective way to do that today is clearly through facilitating a dynamic and robust private sector.

Having said this, I fully recognise that in most developing countries the private sector carries some baggage. In nearly all countries that lived through a colonial period, the private sector was closely associated with the colonial power; indeed in many instances there were formal restrictions on the involvement of local citizens in industry and commerce.

In Africa this situation was often complicated when minority groups dominated local industries by virtue of their financial
capacity and business skills. I typically saw that the consequence of this history has been real doubt among recipient governments about the priority of providing an attractive business environment. When confronted with donor efforts to support private investment, I have often been amused by the disconnect between the public assurances of governments of their support for the central role of the private sector (a view they know the donors want to hear), and the very poor policy environment that exists in reality.

Yet regardless of the reservations that remain, I now feel the need to underline the fact that a more effective private sector is increasingly critical to address the massive employment and income challenges facing developing countries. In fact, on reflection, I feel this is an area I underplayed in my work on PNG and the Pacific during my tenure at the Bank. If I had to do that job again, it is an area to which I would devote far more time and attention, reflecting its importance.

Given this view, there are two specific areas that I would underline as needing more attention in government work on the private sector.

The first is a tool, which I think credibly assesses the real private sector policy environment at the country level, the annual Doing Business reports produced by the World Bank Group. The recent 2015 report contains a comprehensive assessment of country-level performance across 11 areas that can have important impacts on private sector interest and performance. Among other issues, the report assesses the cost of starting a business, the ease of dealing with construction permits, getting credit and access to electricity.

Reviewing Pacific performance overall, and PNG performance specifically, is not an encouraging read. The best performing country in the Pacific is Samoa, which is ranked 67 out of the 189 countries assessed; PNG is ranked 133. In addition, the
relative performance of the region has deteriorated over time. In the 2014 ratings, PNG was ranked 113 out of 189 countries. In sharp contrast to the Pacific, a number of African countries and most of the countries in Eastern Europe have made improved rankings on the index, a focus of reform efforts: Rwanda has moved up more than 100 places over the past decade, and Georgia now ranks just behind Germany in the 20 best performers group. These countries also perform well above regional averages in recent economic growth: Rwanda grew by 6 per cent and Georgia by 5 per cent in 2014.

An improved private sector environment is particularly important for the emergence of a robust domestic private sector. The simple fact is that larger, better endowed foreign actors can be discouraged by weak performance on the key areas of Doing Business, but they typically have the capacity to deal with slow and cumbersome processes and weak infrastructure, whereas these constraints can be devastating to a new local entrepreneur.

The second area requiring more attention is the need to more systematically develop a broader range of financing sources for private investment in the Pacific. In sharp contrast to Africa, the range of institutions involved in private sector finance in the Pacific is very limited. For Africa, nearly all European countries have established institutions that can fund private sector actors interested in investing in Africa.

Indeed, I just completed a review of the Finnish aid program and even that small country supports Finnfund, a well-established financial institution devoted to supporting private sector actors in investing in developing counties. This diversity does not exist in the Pacific.

Africa is also the home of booming growth of NGO-linked financing institutions. Again, this area appears much more limited in the Pacific. I do not think the public sector can fill this gap. Experience suggests that in most low income
countries, publicly owned and operated finance companies and banks have not been effective at supporting a dynamic and effective private sector.

To summarise, I want to underline the critical importance of both improving the policy environment for private sector activity, particularly for local actors, and providing appropriate incentives for the rapid growth and increased diversity of private funding sources.

Jim Adams is a former World Bank Vice President for East Asia and the Pacific. This is the fourth and final post in a series based on his keynote address delivered at the 2015 PNG Update at the University of Papua New Guinea on 18 June 2015. The full speech can be found here [pdf], and you can listen to the podcast here. Other posts in this series can be found here.

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Policy choices matter, even for the resource-rich

After spending 37 years at the World Bank giving advice to governments and ministries, I felt it might be interesting to focus on the major themes I would give priority to if I was made a senior technocrat in a low-middle income developing country.

Not surprisingly, my first priority would be economic reform and the need to continuously review key economic challenges. I am firmly of the view that all countries need to constantly assess the impact of global shifts and be prepared to continuously assess the impact of key developments on policy choices. Indeed, this is no longer a challenge for developing countries alone. Looking at recent EU performance, countries
that have undertaken needed structural reforms over the past decade have performed far better than those that have resisted reform.

The story of Germany’s successful labour market reforms is well known, but Sweden is a case where the government undertook far-ranging financial and budgetary reforms to address stagnant economic performance, and it has clearly seen a positive impact on economic growth and lower inflation. After the global financial crisis, Ireland took aggressive reforms to address the collapse of its banking system and its economy is now growing at above 3.5 per cent. This is in sharp contrast with the reluctant reforms in Greece and the resulting very weak economic performance.

Turning to developing countries, and Papua New Guinea specifically, I am worried that the recent resource boom in relation to Chinese demand has created a level of confidence in ongoing policies that is not justified. While increased resource revenues are always appreciated, the importance of sensible structural policies to longer term growth is key.

Having worked on Indonesia and Nigeria during my Bank career, I was always struck by the differences in policy they each adopted after the early 1970s boom in oil prices. In Nigeria, fiscal discipline was set aside, the exchange rate allowed to strengthen, and domestic industry was protected. In Indonesia, the importance of fiscal discipline was maintained, the exchange rate was carefully managed to sustain agriculture performance, and the trade regime was far more open. The patterns of growth that followed were dramatically different. Although Nigeria began the with per capita income that was double that of Indonesia, its income fell dramatically over the 1980s and 1990s, and today it is approximately half that of Indonesia’s.

Perhaps nothing reflects the impact of different policy choices better than what has happened to the oil palm industries in these two countries since the 1970s. In Nigeria,
the leading oil palm producer globally in the 1950s and ‘60s, the industry has declined dramatically. Today it is a marginal global producer. In Indonesia, macroeconomic, agricultural and exchange rate policies provided a stable and supportive environment for oil palm. Today, combined with Malaysia, it produces 85 per cent of global oil palm output.

The message to me is clear: policy choices matter, even to the resource-rich. It is clear to me that ensuring policies are in place in PNG to manage the emerging situation of lower resource prices will be critical to long-term growth and poverty reduction.

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Capacity building: how to do better

In my previous post, I argued that efforts by the donor community at capacity building had not in general succeeded, but that the endeavour was too important to give up on. In today’s post, I provide a number of suggestions on how the recipient government, the donor community, or both acting in concert, can increase the probability of success in this area.

First, there is no question in my mind that serious institution building requires more time to evolve than is possible in the traditional five-year project. I would argue
that ten years be set as a new standard for this area; this would ensure that the government involved has access to reliable long-term support.

Second, I would suggest that the government be required to have a clear, time-bound strategy for any agency being proposed for the new approach to serious institution building. It needs to own the strategy and ensure that its obligations are fully delivered. In parallel, governments need to work harder to identify and support better leadership for the institutions selected for reform.

Third, the approach should preclude the typical pattern of donor fragmentation. While multiple donors might be involved, there should be only one institution building program, which all donors involved would commit to. There should be a clear commitment that no funds would be provided outside the agreed program.

Moreover, any urgent technical assistance requirements should be fully incorporated into the program. In addition, my preference would be that one donor should be assigned the coordination function. If donors aren’t able to better discipline themselves, it is difficult to suggest real changes in government behaviour.

Fourth, this strategy would need to be fully funded upfront by appropriate combinations of long-term government and donor funding.

Fifth, one clear source of funding is the scholarship funds available from various donors. My view is that these too should be consolidated into one program for the entity involved. Having one donor coordinate this would also make sense. I also feel that the traditional focus on technical scholarships could be made more flexible to ensure that potential institutional leaders, as well as technical staff, can receive scholarship support.
Sixth, I would argue for selectivity at the country level. It makes no sense to try a new approach across too many ministries and parastatals. Reforms should be focused on two or three entities that play an important role in the government’s development efforts. This would also make it easier to mobilise adequate support for reform.

Seventh, in the institutions engaged in reform, all self-standing project units should be eliminated. If one is committed to the program’s goal of better performance, using this long-standing substitute for effective local capacity needs to be precluded.

Eighth, poaching of key staff by donors during implementation of the institutional reform program should be strictly forbidden. While I appreciate, and have supported, the greater use of local professionals by the World Bank and other donors, the continuity of key professional staff is central to progress and must be protected.

Ninth, I think one can make a case for the greater use of creative twinning with effective institutions from outside the recipient. The combination of a longer program and more robust resourcing makes long-term twinning a much more sensible alternative. Twinning with successful developing country capacity seems particularly attractive, as they will have more recent experience with the challenges of institutional reform. Implicitly I am suggesting that this twinning should not involve simply a ‘commercial’ relationship. For example, building long-term relations between weak universities/ministries and parastatals, and better functioning universities/ministries and parastatals from other countries, would appear particularly attractive.

Finally, there would need to be an agreed system for regular reviews of progress in reform in the entities involved.

This is my initial suggestion list. As this is the first time
I have presented such an agenda, I look forward to comments, criticisms and corrections. Given what I see as a vacuum of new approaches, I really do want to encourage innovation and creativity.

I would add that in developing this list there is one institution building program I have drawn heavily on – the IMF’s work with central banks in developing countries. While I recognise that central banks have some unique advantages over other government institutions, in my view they (with IMF support) have used many of the ideas suggested above to ensure a more robust and successful program of institutional reform in the central banks they provide support to. The IMF engagement is long-term, they have a clear strategy on institutional reform, they often play a central role in coordination of support, and they typically provide experts from other central banks to address capacity gaps. Finally, they have a regular review process of capacity as a key part of their supervision function.

In closing, I have one additional suggestion for analytic work to support institution building more broadly. While the program above would focus on developing specific institutions, there is also a case for regular and serious reviews of the appropriate size of government, including a review of possibilities for privatisation, as well as a regular examination of the overall structure of government and the government salary structure. We know appropriate pay is key to stronger institutional performance, and a serious and regular review of salary options can provide important insights into how to best approach this issue in the general environment of resource constraints.

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Capacity building: important but unsuccessful

Capacity building is a long-standing aspect of development efforts that I think we can agree has not been an area of broad success. After 50 years of development support, while there are examples of dramatic improvements in institutional performance, the broad problems of weak institutions – ministries and parastatals that are not effective users of development support – is a constant refrain of project documents. Specifically, across the work I have participated in within the education and health sectors in three World Bank regions (Africa, Latin America and East Asia), I found the pattern of weaknesses in those key ministries has been remarkably consistent. I would underline that these ministries are both substantial users of budget resources as well as donor support; indeed in many countries the education budget is the largest single line item in the overall budget.

In addition, donor efforts at broader civil service reform have not fared well. When one reviews World Bank performance in supporting self-standing public sector reform projects, the results are not encouraging. Indeed, the low success rate of Bank projects in this area has discouraged future work. More broadly, I find it interesting, and a bit sad, that the challenge of capacity building seems to have disappeared in the reorganised World Bank – it appears nowhere in the 14 new global practices.

Further, the long-standing but more narrow investment of the World Bank (and other donors) in technical assistance (TA) is
often an area of frustration and criticism for recipients and
donors alike. Governments often feel that TA is imposed on
them by donors and that local capacity is not fully respected.
They worry about the costs of foreign advisors and resent the
fact that the administration of TA is typically overseen by
the donor rather than by the recipient. At the same time,
donors often find finalising TA contracts difficult and time-
consuming, and worry that the lack of technical capacity will
undermine the substantial investment of resources they are
committing.

This situation is particularly challenging given the key role
institutions generally, and technical capacity particularly,
play in ensuring sustained development impact. Indeed, when I
was questioned in the Bank during my tenure as Regional Vice
President of East Asia and the Pacific on what the key
differences are between the successful economies in East Asia
and the more challenging record in Africa, I increasingly
focused on institutional capacity and the key role it plays in
development performance. In particular, I would often note
that while the senior technocrats and parastatal managers in
East Asia and Africa typically are similarly well-qualified,
in East Asia these officials were much better supported by
qualified staff in lower level positions in the bureaucracy;
positions that were often vacant or filled by unqualified
staff in Africa.

A major rethink of how to approach capacity building would be
timely and appropriate; but this hasn’t happened. When I
consider why, I don’t have a definitive answer, but I do have
some tentative ideas.

The real issue is that institutional development is risky and
difficult. First, institutional change takes time. The typical
cfive year length of donor investment projects may make sense
for infrastructure investments, but it seems very short for
institutional development.
Second, sustained efforts at institutional building will have real costs for the government. Ensuring more competitive salaries and funding for training will require long-term government support.

Third, continuity of leadership and a clear strategy for institutional improvement are necessary conditions that seldom exist. Numerous donor behaviours (which I will elaborate on in the next post in this series) do not help the cause.

Finally, bad institutions seldom reform on their own, and a broad absence of outside pressure from recipient governments and the donors to reform allows the momentum of failure to prevail.

What I propose to do is make a number of specific suggestions on how to increase the probability of success in this area. These will follow in the next instalment in this series.

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Africa’s economic reform experience: lessons for the
Pacific

If one looks at the economic scene of Africa today one can’t help but be impressed by the tremendous changes in economic performance in countries that have been serious about reform. Overall growth rates are robust, budgets are far more disciplined, agricultural prices have been liberalised, market driven exchange systems are universal, governments have been downsized, regulations have been reduced, there is broad emergence of a more effective private sector and increased resources have been deployed to expand programs in education and health.

Average GDP growth in Burkina Faso in the first half of the 80s was 1%. Over the past five years (2007-12) it has risen to 6.2%. Ghana was broadly seen as a “basket case” in the early 80s with an average growth rate of -1.9%, yet over the last five years it recorded growth of 8.6%. In Mozambique, early 80s growth averaged -3.9%, but recent growth reached 7%. And these are countries that have not relied on the resource boom driven by China.

While GDP growth is by no means the only measure of success, in Africa we see growth being translated into poverty reduction. In the two countries where I lived and worked, Tanzania and Uganda, the poverty level has fallen from over half to one-quarter.

In summary, the results of the difficult reforms that marked the 80s and 90s in Africa have been overwhelmingly positive.

Contrast these numbers with the performance that has marked parts of the Pacific over the same period. In Fiji economic growth remained at .7% over both periods; in Kiribati average growth fell from 1.5% to 1.4%; in Samoa the respective averages improved from -3.6% to a modest .7%. Interestingly, PNG was the one country that looked more like Africa. Its
average growth of 0% in the 80s rose to 7.8% over the past five years, of course helped by the resource boom.

Africa’s long experience with reforms has a number of lessons to teach the Pacific and its donors. The first is that serious economic reform programs can dramatically and positively impact growth. While the Pacific does not face the level of crisis Africa faced in the early 80s—and while I recognise that Pacific constraints (particularly size and distance) will not allow the region to quickly replicate some of the African examples—these regions confront many common challenges.

It remains clear to me that the very low rates of GDP growth in the Pacific can and should be more aggressively addressed. A greater emphasis on economic reform in the Pacific will pay substantial dividends. But how to go about it? There are many important ingredients to a successful approach to reform, with requirements not only for the Pacific island countries but also for donors, especially in a region as aid-dependent as the Pacific. In my lecture, I make a number of suggestions for the Pacific island region and its donors based on the African experience. Here I focus on the critical issue of the capacity to undertake reform.

In the mid-1980s when the call for structural adjustment was at its peak in Africa, a clear sense emerged that too much of the debate on reform and adjustment was dominated by donors. The local capacity involved was both too small and of limited depth. The near total absence of solid economic analysis emerging from within the continent was an obvious gap requiring action. There was a parallel concern about the quality of the economic training within the region. In direct response, an effort was led by a number of donors to put in place support for developing a network of qualified policy-focused economists.

Called the African Economic Research Consortium (AERC), it began operations in 1988. From its initiation, the AERC
included a program of funding and training young economists in the area of economic policy, with a strong focus on quality and regular workshops to exchange ideas. Today, governments across Africa see AERC-funded work as central to their policy-making processes. They are no longer totally dependent on outside researchers and donors. AERC graduates are increasingly taking on senior policy positions across Africa. The AERC itself has expanded from the original three countries in which it began to cover the entire continent.

In the Pacific, as in Africa, there is no substitute for home-grown analysis. There continues to be a shortage of capable policy makers, advisers and commentators in the Pacific region. Increased domestic and regional capacity in economic policy analysis will be critical to address the Pacific’s economic reform challenges.

The AERC model can’t be directly copied, but its accumulation of 25 years of successful experience does provide some useful guidance for the Pacific and its donors on how to go about the critical task of building the economic capacity required to promote and sustain economic reform.

Jim Adams retired in 2012 after 37 years at the World Bank. His last assignment was as the Vice President for East Asia and the Pacific. He spent almost half of his career working on Africa. This post is extracted from his 2013 Harold Mitchell Development Policy Lecture, delivered at the Australian National University on Thursday 14 November.

A podcast of the lecture is available here and a full transcript available as the latest Devpolicy Discussion Paper here.