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Recipient Governments' Willingness and Ability to Meet Aid Conditionality

The Effectiveness of Aid Finance and Conditions

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Abstract

This paper evaluates aid both by considering the evidence on aid effectiveness in promoting growth and by considering how effective has aid been in exerting leverage on policy choices. We argue that in both respects aid has had beneficial effects. It is rather easy to demonstrate that if a country is unwilling to implement policy reforms, attaching conditions to aid will not ensure sustained reform. In this sense conditionality does not work. This ignores the fact that donors, through aid and conditions, can influence recipient policies. The argument of this paper is that if the analysis focuses on channels of influence, one can better identify ways to enhance aid effectiveness. We argue that reform is a slow and difficult process and donors would be more effective 'development partners' if they see their role as being to support rather than force this process. In simple terms, donors should provide the information and technical assistance to help governments to make policy choices, rather than dictating choices by imposing conditions.

Keywords: aid effectiveness, conditionality

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1 Introduction

Following the UN Conference on Financing for Development in Monterrey in 2002, a number of donors, especially Britain and the US, expressed a commitment to increase aid allocations to the poorest developing countries (LLDCs). If donors are to increase the amount of aid allocated to LLDCs, they must believe—and ideally should be able to persuade their public—that aid is effective and/or can be made more effective. Such confidence in the beneficial effects of aid is not widespread. The aim of this paper is to present a concise review of the evidence on aid effectiveness in two respects. First, we consider if aid has been effective in contributing to economic growth. *Ceteris paribus*, do countries receiving more aid exhibit a better growth performance than similar countries receiving less aid? Second, we consider if aid, and specifically the economic policy reform conditions attached to aid, has had a constructive influence on policy reform. In both cases, we provide a qualified answer in the affirmative. On average, aid tends to contribute positively to growth and the broad direction of policy reform in recipients has been in line with that advocated by donors. The evidence supports the case for increased aid to LLDCs as a means of financing development.

For all but the richer developing countries, aid has been the major source of external finance since the 1970s. Comparing 1991-95 with 1970-75, for low-income countries on average, aid as a share of GDP increased from 6 to almost 15 per cent, while private capital inflows (including FDI) fell from 2 to 1 per cent of GDP. For lower middle-income countries, aid remained quite stable at over 3 per cent of GDP on average while private inflows remained around 2 per cent. Only for upper middle-income countries did private inflows exceed aid, but both fell: private inflows from 4 to 3 per cent of GDP on average and aid from 2.5 to 0.5 per cent of GDP (all data from Osei *et al*. 2002). For none of these groups of countries did FDI exceed 2 per cent of GDP on average in any sustained period since 1970. Consequently, it is not surprising that the evidence that FDI contributes to growth in developing countries is very weak (Lensink and Morrissey 2002). For the poorer developing countries, aid is the principal inflow that can affect growth.

In principle, aid can contribute to growth in two basic ways. The aid inflow, by relaxing financing constraints (low savings, foreign exchange and the government budget), can finance investment in physical and human capital that promotes growth. Donors also use aid as a lever to encourage policy reform, i.e. conditions are attached to the aid. The effectiveness of conditionality, the extent to which the reforms advocated by donors are in fact implemented, is mediated by the recipient government's willingness to accept the conditions *and* its ability to implement them (the latter in turn determined by domestic political and administrative capacity). Even if the conditions are accepted and implemented, there is no guarantee that the outcome (in terms of improvements in some indicator of economic performance) will be as anticipated—the conditions may have been inappropriate or other events may have undermined their impact. For example, privatizing coffee marketing would be expected to promote efficiency gains and increased export revenue. These benefits may not be realized if world prices of coffee are in decline. On the reasonable assumption that recipients want aid, their willingness to accept conditions will depend on their beliefs regarding the efficacy of the proposed policies in realizing government objectives. One such objective is economic growth, and this is also the criterion against which donors tend to evaluate aid effectiveness (recently, poverty reduction has become the criterion but existing empirical literature refers to the growth criterion).

To focus the discussion, we will assume that economic growth is the objective shared by donors and recipients. This allows us to consider conditionality within the broader context of aid effectiveness. The empirical literature on aid and growth has evaluated the effectiveness of aid according to whether or not aid inflows are positively associated with growth. However, aid *itself* does not affect growth, rather the way in which it is used will have effects on growth. Furthermore, aid is only one of the many factors influencing growth, and is unlikely to be one of the most important factors. Among the important factors influencing growth is policy, and aid is linked to policy via conditionality. Thus, aid effectiveness is mediated by the way in which aid is used and the leverage exerted by donors on policy. A central argument of the early part of the paper is that the empirical literature on aid effectiveness does not adequately address these mediating linkages, and is uninformative about the links between aid and policy and about the effectiveness of conditionality.

Conditional lending, specifically through structural adjustment loans, became the standard of donor aid policy in the 1980s. The motivation was to use aid as leverage to entice, cajole or encourage recipients to implement the types of economic policy reforms that the donors believed were necessary and essential to stabilize the economy and establish the foundations for sustained growth. By the early 1990s it was apparent that the strategy was somewhat less than perfect. It proved easy to demonstrate, in a formal or quasi-formal manner, that conditional lending was an ineffective mechanism to induce reform from unwilling governments and an inappropriate mechanism if governments were willing to reform (White and Morrissey 1997). Early evaluations of adjustment loans were critical, concluding that aid leverage was rarely sufficient to encourage governments to implement and sustain reforms they did not actually support themselves. Perhaps these evaluations were too strict—evaluating implementation on fairly narrowly defined measures within a short time horizon rather than taking a step back and considering the level of reforms attempted over a longer time frame. Evaluated strictly, as ensuring that specified policies were implemented effectively with the time period of the aid agreement, conditionality evidently failed. On the other hand, most recipients have been implementing reforms, donors have influenced the direction of the reform process (even if they cannot alter the speed), and conditions have been one instrument used by donors.

This paper re-evaluates experience with conditional lending, drawing the conclusion that effective reforms have been implemented, even if it has transpired that this took longer and the extent of reform was less than donors originally hoped. In many respects, echoing a very different line of argument presented in Griffin (2000), we argue for a gradual approach to policy reform. Furthermore, we argue that aid can, and has, played an important role in encouraging gradual reform; donors can and do influence the policy choices of recipients (for better or worse). The practice of the 1980s and 1990s we depict as *selective conditionality*. Donors did attach policy reform conditions to aid, but exercised judgement (were selective) in deciding what importance to attach to recipients' ability to implement and sustain the reforms. Most countries failed to implement, either fully or consistently, some conditions, but this was not always used by donors as a reason to suspend or delay the release of aid. This was not, on the donors' part, a judgement of Solomon. It was far more haphazard and *ad hoc*. This does not imply, however, that such a flexible approach was ineffective. For aid to exert policy leverage, it was only necessary that recipients appreciated some concept of 'minimum implementation requirements'. As donors and recipients did engage in

(regular and repeated) dialogue (negotiation or bargaining), the parameters for selective conditionality to have policy leverage were in place.

Current thinking on aid allocation or effectiveness does not seem to conform to this gradualist, selective conditionality, approach. If one reads World Bank (1998) and associated work, the lesson being drawn is one of *conditional selectivity*. If donors cannot, through aid leverage, ensure that recipients implement the policies they want them to adopt (conditionality), and donors are insecure in their ability to judge whether recipients are making reasonable efforts (selective conditionality), then pre-selection is the only option. Donors determine the type of policies recipients have to be seen to be willing and able to implement. If recipients can demonstrate their ability to meet/implement these conditions, then and only then will they be selected as being 'entitled' to significant aid (those not selected may receive aid, but not so much and on terms less generous). In the context of aid policy, there are roots for this in *Assessing Aid* (World Bank 1998), where the ineffectiveness of conditional lending is accepted, conditionality is rejected and the proposed alternative is pre-selecting eligible aid recipients on the basis of the policy reforms they are actually implementing. We argue that this drift towards conditional selectivity is neither conducive to policy leverage nor to aid effectiveness.

The paper begins with a brief overview of the aid effectiveness literature (section 2) to highlight a number of issues regarding the link between aid and policy. Specifically, while policy outputs can affect growth, aid revenues have no *direct* effect on growth. Evidence of aid effectiveness implies indirect effects, such as through investment or policy inputs, suggesting that it is the *aid relationship* that matters. Section 3 provides a critical overview of the literature evaluating the effectiveness of conditionality. Cross-country statistical studies are severely limited by reliance on deeply flawed measures of compliance; country case studies are more informative, but tend to be descriptive rather than analytic. Section 4 outlines a framework to analyse how donors can influence policy. Trade liberalization in Sub-Saharan Africa (SSA) is taken as an example to show how a sustained aid relationship can encourage significant reform if one takes a long-term perspective (5-10 years). Section 5 provides concluding thoughts on how donors can support reform efforts in recipient countries.

2 Policy and aid effectiveness

While much has recently been written about 'aid effectiveness', it is not always entirely clear what is meant. The most common meaning is that derived from the empirical aid-growth literature, where a positive significant coefficient on the aid variable is interpreted as evidence that aid was effective in increasing growth performance.[1] The most vociferous and widely cited claim for 'aid ineffectiveness'—that aid itself does not have a positive effect on growth—is that of *Assessing Aid* (World Bank 1998) and the Burnside and Dollar (2000) claim that aid is only effective conditional on 'good' policies being in place. This claim has been critically re-evaluated elsewhere (see Hansen and Tarp 2001; Tarp 2000; Morrissey 2001a) and we present no more than an

[1] There is another interpretation regarding the effectiveness of aid conditions in delivering policy reform—we refer to this as the effectiveness of conditionality. The two notions are closely related, but the thrust of this paper is to emphasize that they should be clearly distinguished.

overview. It is worth noting that if Burnside and Dollar are correct and good policies are necessary for aid to be effective, then effective conditionality (or some mechanism of ensuring that aid influences policy in the required way) is required for aid effectiveness. If, however, aid effectiveness is independent of good policy, then the need for conditionality is lessened. In other words, the Burnside-Dollar result on aid-policy interaction is at the core of the *Assessing Aid* argument that since selective conditionality has failed, conditional selectivity is required to make aid effective.

It is often under-appreciated that the empirical cross-country macro evidence is based on a very strict criterion of effectiveness as being impact on economic growth. Two general observations are in order. First, if the regressions fail to account fully and properly for all determinants of—and especially constraints on—economic growth the estimated coefficient on aid will be biased. At the least, incorrect inferences may be drawn regarding the conditional effectiveness of aid. More generally, as aid is more likely to flow to poor countries that suffer growth-retarding characteristics (that may not

Table 1
Selected aid-policy-growth regression results

	Burnside and Dollar	Hansen and Tarp	Gomanee *et al.*	Dalgaard *et al.*
Aid	-0.32	0.24*	0.43*	1.82*
Aid^2		-0.75*	-0.01*	-0.06
Policy index	0.74*			
Aid*policy	0.18*	-0.006		
Institutional quality	0.66*	0.81*	1.33* (a	0.76*
Initial GDPpc	-0.90	0.001	0.001*	-0.39
Investment			0.11* (b	
Policy indicators:				
Openness	2.25*	0.02*		1.75*
Inflation	-1.39*	-0.01*	-0.004*	-1.12*
Budget deficit	-6.49*	-0.10*	-0.15* (c	-0.07*
Sample period	1970-93	1974-93	1970-97	1974-93
Countries/periods	56/6	56/5	24/7	54/5
N	270	243	135	231
R^2	0.35		0.44	

Notes and sources:

Not all significant variables in the relevant regressions are reported, see below; t-ratios are not reported but * indicates significance (at least the 5% level). Due to measurement differences parameter values are not directly comparable. GDPpc is real GDP per capita. N indicates total number of observations.

Burnside and Dollar (2000): 2SLS estimation from Table 4, regression (5) also included ethnic fractionalization, assassinations and regional dummies. Coefficients on policy indicators from Table 3, 2SLS regression (2), which is similar to Table 4 in terms of results for other variables.

Hansen and Tarp (2001: Table 1, regression 1.1), instrumental variable method with lagged aid, also included policy squared, ethnic fractionalization, assassinations, and regional dummies.

Gomanee *et al.* (2002: Table 5, column 3) is a robust regression method for SSA countries only, aid measured as grants (lagged): (a = refers to a democracy variable where higher values are lower 'quality'; (b = investment measured as a generated regressor (excludes any effect of aid); (c = government consumption. Regression includes human capital.

Dalgaard *et al.* (2002: Table 2, column 3) is GMM regression also includes ethnic fractionalization, assassinations, geographical variables and regional dummies.

be specified), there is a greater likelihood of incorrectly drawing the conclusion that aid is ineffective. Second, not all aid (indeed, probably no more than a third of aid) is directed at uses that would be expected to have a medium-term observable impact on growth. Aid directed at financing health and education services, for example, would only affect growth in the long-term, if at all. In simple terms, the measure of aid used in most studies over-states the volume of aid available for growth-promoting uses.

Both observations taken together imply that cross-country regressions are biased against finding that aid is effective (as defined), i.e. there are good reasons to expect that the estimated coefficient on the aid term would be insignificant. Nevertheless, on balance, recent studies find consistent evidence that aid is effective, conditional on controlling for other influences on growth (of which policy is one, but only one and not necessarily the most important). These are findings for aid effectiveness on growth on average. One cannot in general draw inferences for specific countries from this evidence. In this sense, the appropriate interpretation of cross-country regressions is to identify factors that tend to be associated with growth, specifically if (the level of) aid is one of these factors.

Results from four empirical studies are summarized in Table 1; this is not intended to be comprehensive, but it is illustrative of a number of general issues in the aid-growth empirical literature. We first outline the major differences between the four studies. Burnside and Dollar (2000) and Hansen and Tarp (2001) are directly comparable and focus on the interaction between aid and policy: they use essentially the same data for the same sample, with mostly the same explanatory variables. The major differences are the treatment of outliers and the method of instrumental variables used (and these clearly affect the results). Dalgaard *et al.* (2002) use essentially the same sample, but focus on the interaction between aid and 'geography', arguing that aid appears to be less effective in tropical countries. Specifically, they find that a variable 'fraction of land in tropics' is negative and significant (itself and interacted with aid).

Gomanee *et al.* (2002) restrict analysis to a sample of Sub-Saharan African countries and focus on accounting for the relationship between aid and investment, the mechanisms via which aid is posited to affect growth. With the use of residual generated regressors they obtain a measure of the total effect of aid on growth, accounting for the effect via investment. Panel results for a sample of 25 SSA countries over the period 1970 to 1997 using robust regressions point to a significant positive effect of aid on growth, *ceteris paribus*. On average, each one percentage point increase in the aid/GNP ratio contributes one-quarter of one percentage point to the growth rate. They infer that Africa's poor growth record should not, therefore, be attributed to aid ineffectiveness.

Five issues are illustrated in Table 1:

i) All studies except Burnside and Dollar find a significant positive coefficient on aid, i.e. all studies except Burnside and Dollar find evidence of (conditional) aid effectiveness. The analysis of Hansen and Tarp suggests that the treatment of outliers and choice of instruments is the source of the different result in Burnside and Dollar.

ii) Coefficient estimates are sensitive to specification and sample, i.e. estimated values vary, but the same variables tend to be significant. In other words, there

is considerable agreement across the studies regarding the factors associated with growth.

iii) Policy variables tend to be significant, in particular openness, inflation and budget surplus (or government consumption spending). It is not, however, evident that these should be combined into one index and interacted with aid. Most importantly, none of the studies are relevant to how aid can influence policy.

iv) When included, the Aid^2 term tends to be negative and significant, typically interpreted as diminishing returns to aid. However, it is possible that this is picking up an effect of the volatility of aid flows. More unstable countries experience more volatility of aid inflows and this is associated with a poor growth performance (see Lensink and Morrissey 2000). The Dalgaard *et al.* result suggests this is correlated with location in the tropics.

v) Institutional and socio-political variables (including unreported variables) are clearly important in determining growth performance. Such variables could reasonably be expected to be related to policy and the way in which aid is used.

Our conclusion from the available evidence is that aid tends to be effective (i.e. contributes positively to growth performance). The question, given this, is why has growth performance been so poor in so many major aid recipients, especially those in SSA? The obvious response is that while aid is beneficial, the level of aid received is only one of the factors influencing growth. There appear to be growth-retarding features specific to SSA countries (only partly captured by policy and institutional variables), notably natural characteristics and vulnerability to shocks. These explain the poor growth performance, despite the beneficial contribution of aid, i.e. aid is not a guarantee of growth. In this context, it is relevant to note that most aid has not been of a form that would have a short-run discernible impact on growth. For example, (increasingly) large amounts of aid are allocated to social sectors, such as health and education. Such aid contributes to human capital and/or poverty reduction, but would not have an observable impact on growth within the time period considered in the econometric studies (typically five years).

Given that the positive contribution of aid has not resulted in significant growth it is understandable that attention has turned to policy and, specifically, conditionality. At one extreme is the Burnside-Dollar view that aid is only effective in a good policy environment (as shown by the positive coefficient on the interactive term, although this is not significant in all of their regressions). At the other extreme, is the Hansen-Tarp view that aid is effective irrespective of policy, and the Dalgaard *et al.* argument that characteristics associated with location in the tropics explain the poor growth performance (and reduce aid effectiveness). An intermediate position is that better policies will improve growth performance and therefore may be associated with more effective aid.

There is a conceptual problem regarding the manner in which aid and policy interactions are incorporated in these studies (acknowledging that none of the studies are trying to identify effects of aid on policy). Many of the policy indicators used, such as inflation or budget deficits, are outcome measures, whereas conditionality is

concerned with aid leverage on policy inputs.[2] To evaluate conditions, we would like to know how policy choices affect growth, but on this matter the evidence is weak. Furthermore, aid is measured as a share of GDP but there is no convincing *a priori* reason why, across countries, aid leverage should be highly correlated with the level of aid. Countries with the greatest dependence on aid may be least able to implement reforms (or be the most vulnerable to external shocks), at least in the short-term. The coefficient on the interactive term, while confirming that aid and policy may be related, does not permit one to draw inferences regarding the effect of aid on policy. It is to this issue that we now turn.

3 Evaluating conditionality

Whereas the empirical aid-growth literature is based on statistical analysis and yields a 'number' that represents aid effectiveness, the literature on evaluating conditionality is more *ad hoc* and often based on country case studies. The structural adjustment policies promoted by the World Bank in developing countries since 1980 constituted the maturation of conditional lending: aid was explicitly linked to policy reform conditions, to various degrees and with diverse outcomes. The reform conditions covered all areas of policy. Conditions relating to fiscal policy (taxes and deficits), trade liberalization, privatization of public enterprises and liberalization of agriculture featured in two-thirds or more of all World Bank programmes in the 1980s; monetary policy, financial sector liberalization, industrial, energy and wage policies were less frequently included (Dreher 2002: 52-3). The experience with adjustment has been extensively evaluated and written on, and will not be reviewed here (for a concise review see Greenaway and Morrissey 1993; a broader, comprehensive review of evaluating policy reform is provided in McGillivray and Morrissey 1999).[3] There is no ready means to summarize country case study material especially when the studies are not based on a comparable analytical framework, as is the case here. We present a broad review in this section, and consider the issues in terms of an analytical framework in the next section.

- A number of these studies of adjustment (conditionality) include a cross-country statistical analysis that attempts to identify the importance of compliance with conditions in determining the performance outcome, typically growth. Mosley *et al.* (1991), for example, find that compliance is more important than the level of aid in determining a favourable outcome of adjustment. The most careful such analysis is provided by Noorbakhsh and Paloni (2001) who evaluate the effect of the extent of compliance, distinguishing conditions relating to macroeconomic stabilization, public sector management and private sector development, for SSA countries. While they find evidence that countries with higher compliance exhibit a better economic performance, the limitations of the data on compliance compel them to acknowledge 'that the evidence presented in this article is not conclusive regarding the relative advantages of good and weak compliance' (Noorbakhsh and

2 Indeed, 'poor' policy indicators may be one reason why countries need aid.

3 The early literature on structural adjustment includes World Bank (1988, 1990, 1992), Mosley *et al.* (1991), Thomas *et al.* (1991) and Corbo *et al.* (1992). Studies concentrating on Africa include Elbadawi *et al.* (1992), Husain and Faruqee (1994) and Sahn (1994). Patel (1997) provides case studies on the fiscal impact of adjustment whilst Edwards (1995) provides an illuminating discussion of reform experiences in Latin America.

Paloni 2001: 497). Other statistical analyses of compliance are even weaker in the conclusions drawn, as such studies are fraught with difficulties (see McGillivray 1999). These studies are all based on some supposedly comparative measure of compliance. As the justification for why we do not review such evidence in more detail, it is worthwhile detailing the major limitations of cross-country measures of compliance.

- In principal, one requires a measure of the change in the relevant policy input (the condition). Such measures are only available for a few specific types of conditions, such as devaluation, interest rates and reducing or eliminating a specific tax (e.g. on exports). Only very rarely is it possible to identify an input measure to capture if a condition was fully implemented, and even then one must infer that the aid condition was the true reason for implementation.

- In many cases, some form of aggregate policy input measure is available, such as change in average nominal tariff or change in tax/GDP ratio. At best, these measures are of questionable accuracy. For example, the average nominal tariff can be misleading even regarding the direction of trade policy reform (Milner and Morrissey 1999). In general, what happens to individual components and distribution effects is more important than the aggregate measure.

- In many cases, such as privatization or administrative and regulatory reforms, there is not even an aggregate measure available. Summary measures of policy inputs are not meaningful, yet the policy issues may be very important.

- Various compliance indices have been created but are all subject to the critique that judgements on compliance are arbitrary and subjective. Typically, the judgements are made by people, such as World Bank operations staff, who have a vested interest in reporting that compliance was at least satisfactory. While such indices may have information value, the lack of objective policy input criteria severely limits their quantitative validity.

- A compliance index does not distinguish between reforms that should be implemented and reforms that should not be implemented. The latter can include original conditions rendered inappropriate by events (e.g. removing food subsidies at a time of drought) or that were inappropriate (e.g. privatizing utilities in the absence of any regulatory framework), or measures that undermine a particular reform (e.g. replacing tariffs with a special sales tax).

- Overall compliance indices weight different reforms equally or arbitrarily, whereas some types of reform are clearly more important, especially in terms of an observable impact on growth (the appropriate lags for the effects of components of an index will vary). A related problem is that a summary index cannot allow for different degrees of implementation on specific policy issues. Some reforms can be implemented quickly and have immediate effects, others take time to implement and/or only have effects over time (often a long time). This problem can be reduced with a separate index for specific policy areas, such as for macroeconomic policy or trade reform, but the inherent problems of an index are not eliminated.

The core and insurmountable problem is that there is no available measure of compliance that is comprehensive, valid and comparable across countries. The compliance index measures used do not capture the effects of the reforms implemented, and cannot allow for the differential effects (over time and in intensity) of specific policy inputs on economic performance. At best, they are indicative measures of reform effort. While this may be informative, the use of an index measure in cross-country statistical analysis imbues a false sense of accuracy. Consequently, it is not surprising that cross-country statistical analyses of conditionality conclude no more than that there is a tendency for countries with higher compliance to exhibit better performance. Furthermore, none of these studies are actually evaluations of conditionality—they say nothing regarding which conditions are more likely to be implemented or what types of conditionality work better than others. More insight is gained from country case studies.

One could conceive of modelling the determinants of governments' willingness and ability to comply with conditions in a way that is amenable to econometric testing. This is an inherently fraught exercise, for reasons we now provide, and existing attempts are of severely limited relevance. The notional model should be of the general form

$$R = R(A, P, Z) \qquad [A1]$$

embedded in

$$E = E(R, A, Z, P) \qquad [A2]$$

where

R = measure of policy reform

A = aid variable (strictly, should be a donor influence variable)

P = vector of political and institutional variables

Z = vector of other control variables

E = measure of economic performance.

The studies including compliance discussed above have estimated variations of [A2] using either a dummy variable or a compliance index as a measure of R, and ignoring the underlying implicit relationship [A1]. Whatever the limited (informational) merits of these studies, they do not say anything about compliance with conditionality, which requires estimation of [A1]. However, for cross-country econometrics to be an appropriate way to assess the determinants of compliance, one needs measures of the variables that capture the most important cross-country variations. The simple limit to estimating a relationship like [A1] is that there are no satisfactory measures for the core variables. The problems with compliance indices are elaborated above. In principle, if one could identify an acceptable scale of compliance (none, weak, moderate and strong), one could use probit or logit estimates of determinants of this level of compliance. Some studies in this spirit are mentioned below, but do not yield strong or consistent results on the political explanatory variables. Even if one estimated [A1] in this way, it is not embedded in [A2] because the compliance measure of R does not

capture how the reforms should effect *E*. Certain types of reforms can be measured, such as devaluation or reducing tariffs, but cannot be added together. There is some scope to estimate [A1] and [A2] in respect of a specific policy area, but it is not feasible for reform on aggregate.

The determinants of whether reforms are attempted (i.e. willingness to accept conditions) are inherently political. However, there is no theoretical justification for the measurable political indicators that should be included in *P* and studies tend to use whatever measures are available (without due acknowledgement of the limitations). Even if we could measure *R* in an acceptable manner, there is little clear theoretical guidance on what should be included in *P*. This problem is compounded by the fact that available measures, such as the degree of democracy, are subjective and exhibit limited variation for the poorest countries (e.g. across SSA countries). For example, it is difficult, if not impossible, to think of measurable political variables that would capture the different reform efforts of Kenya, Tanzania and Uganda over the last decade. However, the compliance with conditions has differed greatly between these three countries, and political considerations have played an important role.

The final problem to mention is that even the aid variable cannot be measured adequately. Traditional studies of adjustment estimate variants of [A2] using the level of aid for *A* and a compliance index for *R* (e.g. Mosley *et al*. 1991). Such an approach does not meet our purposes. The level of aid is not adequate to capture the influence of donors, and one may even wish to know which donors are providing the aid. There is no evidence that countries receiving more aid implement more reforms (the arguments on the ineffectiveness of conditionality are based on the assertion that this is not the case), so the value of aid alone is an inadequate measure. The discussion of the 'aid-policy-growth' regressions in section 2 demonstrated that policy indicators and the level of aid have independent effects on growth, again implying that aid level is an inadequate measure.

In technical terms, one can express the problem as being that reform efforts are a fixed effect—there will be an unquantified feature of each country in the sample that accounts for its respective reform effort. It is a feature of cross-country econometrics that where fixed effects dominate, other explanatory variables (especially if they exhibit low variance across the sample) will be insignificant. The fundamental limit of econometric studies is that most of the factors of interest are not quantifiable.[4] The issue of compliance can more appropriately be addressed through rigorous and structured case studies rather than through cross-country econometric studies.

A few studies of compliance with IMF conditionality have been able to circumvent the problem of measuring compliance by considering the determinants of interruptions (Dreher 2002) to, or the duration of programmes (Joyce 2001). In effect, these studies use as the dependent variable an indicator of revealed non-compliance. Such an approach is not feasible for the World Bank as clear suspensions of programmes are few and hard to identify. The best predictors of interruptions to IMF programmes are having had interruptions in the past and indicators of weak economic performance. There is weak evidence that interruptions are more likely in more democratic countries and are more likely prior to elections (although the coefficient on the interaction term for these

4 One could 'tolerate' difficulties in measuring some explanatory variables. The point is that *all* of the important variables in [A2], dependent and explanatory, are subject to severe measurement error.

variables is negative). Measures of democracy are not very reliable, and the significance is weak (Dreher 2002). Although many variables and specifications are examined, Joyce (2001) finds no evidence that political variables influence the duration of IMF programmes.

If the limitations of aggregate measures render it problematic to analyse economy-wide compliance, it is possible to measure and study reform in specific areas. Perhaps the best example, or the case where the largest literature has emerged, is trade policy reform. There are many major difficulties in measuring trade reform (Milner and Morrissey 1999), but broadly acceptable measures exist and have been used to test the significance of openness on performance. The evidence is fairly robust that trade liberalization, or increased openness, is associated with improved economic performance (Mbabazi *et al*. 2001). While there is a large literature on the association between trade policy and growth, few have tried to identify econometrically the determinants of trade policy reform (beyond the established literature on lobbying behaviour). An exception is Hausken *et al.* (2002) who find that more fractionalized democracies, i.e. the greater the checks on executive power and number of parties in parliament, are more likely to liberalize trade. This suggests the plausible conclusion that reform efforts are more likely, and hence compliance greater, in countries with functioning democracy, i.e. where there are pressures on policy to reflect the public interest. The relevance of this, and difficulty of 'capturing' it in a measure, applies to our East African example above. Uganda has 'no party' elections, hence appears less democratic than Kenya or Tanzania. However, on important issues, the Museveni regime has tried to represent the public interest more than have its two neighbours. The willingness of Uganda to comply is a fixed effect not captured by indices of democracy.

These arguments are not intended to imply that econometric studies of or including compliance should not be attempted. Rather, the implication is that, given the 'current state of the art' (especially on measurement), one should not be surprised that the available evidence is so weak and inconclusive. The econometric evidence, limited as it may be, confirms that political factors are important, and provides indicators of the features of politics that are associated with reform. What such studies cannot do, a limitation inherent in their cross-country nature, is explain how politics matters. Such insights are more likely to be found in case studies of the policy process.

Given these limitations of cross-country studies, can we rely on accumulated evidence from country case studies (see references in footnote 3)? A collection of country studies on the impact of aid on policy and performance, using a common framework of analysis, has yet to be conducted (to the author's knowledge), and is long overdue. Unfortunately, available country case studies tend to be *ad hoc*, often severely so, so that it is difficult to draw any general conclusions. Partly this is due to the practical problem of a lack of sufficient data for careful time series analysis, but very few case studies are econometrically based. More usually it reflects the absence of any conceptual framework for the analysis; case studies tend to be descriptions of 'what happened when' without any model (implicit or explicit) of the underlying process. Furthermore, most country studies are not actually concerned with aid effectiveness, in terms of affecting growth or some other measurable indicator, but address the question 'has aid been an effective instrument to leverage policy reform?' Even in addressing this question, few studies concerned with aid exhibit any political science understanding of policy processes, and hence provide very little information underlying a relationship such as [A1].

The case study evidence does find that aid has been associated with policy reform, but this need not justify a conclusion that aid leverage has been effective. There are questions of whether it was the aid resources (finance) or the policy conditions that had beneficial effects, and in what ways the two combine. There is also, at least implicitly, an issue of whether aid was associated with sufficient reform. A serious difficulty with country case studies is the difficulty of distinguishing between a) the leverage of conditionality in encouraging attempted reform, b) other constraints on implementing reform and c) outcome (performance) indicators that may only partly reflect reform efforts. Studies often confuse the latter two with the former and infer from observing a poor outcome that conditionality failed. One can observe a number of implicit biases (against concluding that aid is effective in the sense of ensuring policy reform) in much of the country case-study evidence available. Two types of bias are most common:

- *Use of 'tight' implementation criteria*: The studies are concerned with evaluating how aid (and donors) influenced government policy and actions; i.e. they assess the implementation of policy reform conditions linked to aid. But implementation has to be evaluated against some criteria and these are not always specified. How much implementation, given other factors influencing policy, constitutes 'effective' aid leverage? In many studies it appears as if the implicit criterion is that full implementation is required within the time period of the aid agreement (typically 3-5 years for adjustment programmes). Almost all studies reveal that conditionality has encouraged reform efforts that may not otherwise have been attempted. This means that aid has had effects, but how does one judge how effective? Some studies go to the other extreme, identifying examples of partial implementation to conclude that aid was ineffective (implicitly, this means that aid was not associated with as much evidence of policy reform as the authors wanted to find). However, there are many factors unrelated to aid or donor efforts that limit implementation of policy reform (Morrissey 1999). Consider the example of exchange rate liberalization, a common condition of IMF programmes in Africa in the 1980s. Most SSA countries had fixed exchange rates in the early 1980s, and few had fully liberalized by the end of the decade. In this sense, they did not fully implement the IMF conditions. By the mid-1990s, however, most SSA countries had quasi-floating exchange rate regimes. Compliance may not have occurred within the period of the agreement, but the direction of policy reform was established.

- *Confusing outcome indicators with policy inputs*: Some studies use criteria relating to outcomes (e.g. the effect of trade reform on export growth) rather than implementation. Even if the reforms were implemented (implying the aid was effective on this criterion), if the outcome was less than expected it is often claimed that the aid (conditionality) was ineffective (in fact, it is the reforms that failed and/or external events or shocks undermined the impact).

Many case studies of 'aid and reform' lack analytical rigour, and 'collected studies' lack consistency across countries (that this applies to a recent large World Bank study is clearly demonstrated in Tarp 2001). This is compounded by the criteria bias. In simple terms, irrespective of how much positive achievements there may have been, a few instances of non-compliance can be picked out to conclude that aid was not effective. For example, trade liberalization is typically one of the policy reform conditions attached to aid, with very little specificity regarding what level of tariff reductions (by sector or proportional reduction) constitutes 'effective' compliance. If a government

reluctantly reduces the average tariff by 10 percentage points because of aid conditions, there has been an effect. Is that effective? If this reduction was achieved while maintaining or even increasing tariff levels on sensitive products, one could point to this as evidence of ineffective aid even though policy has been moving in the 'right' direction. To achieve a broad policy thrust (liberalization), concessions or exemptions are often offered to particular groups.

The inherent deficiency of country studies is their anecdotal nature. Instances where aid did not have the intended effect or specific deficiencies in programme or project implementation are typically cited as evidence that aid did not work. In principle, one could try to balance these against instances where aid did have positive effects (e.g. schools were built, medicines were provided). However, it is unlikely that any project or reform could be implemented 'perfectly' so it is always possible to point to aspects that could have been better. Inevitably, subjective judgement is required. There seems to be a tendency in such judgements to emphasis failings and limitations rather than highlighting achievements. Given the inherently subjective nature of the exercise, it is perhaps inevitable that some consider the glass half empty while others consider it half full. To form a more balanced judgement, one should look at how the relationship between donors and recipients (the aid relationship) influences policy over a prolonged period of time.

4 Conditionality: the case of trade policy reform

Much of the literature reviewed in the previous section suggested, if it did not clearly conclude, that conditionality was ineffective. If, within the time period of the adjustment loan, the policy reforms actually implemented and sustained were compared with the policy reform conditions, then rarely were the conditions met to a convincing degree (World Bank 1988, 1990, 1998). Specifically, if countries displayed no initial tendency to implement reforms of the desired type, then conditional lending appeared to have little effect in encouraging reform. The only countries that appeared to meet conditions were those whose governments favoured the economic policies embodied in the adjustment programme (Mosley *et al*. 1991); it was government preferences, not aid conditions, that determined reform efforts (Morrissey 1999). If interpreted strictly, specified reforms to be 'substantially' implemented within a short time period, conditionality fails.

This does not, and should not, imply that conditional lending has no effects. Rather, what researchers have shown is that conditional lending *per se* is not an effective instrument for ensuring relatively rapid policy reform. Perhaps this should be no surprise as reform, except in cases of severe (political and economic) shock, is an inherently slow process. There are few cases where reform was implemented quickly and dramatically (the 'big bang' approach), and these cases were almost all failures. A gradual implementation is the most common case, largely because reform is politically difficult, even if governments are convinced of the economic arguments (see Griffin 2000; Morrissey 1999). In this section we argue that conditional lending has had effects, often quite pronounced, but these tended to become apparent slowly. We consider the case of trade policy reform in Sub-Saharan Africa (SSA), although the basic arguments apply to other regions and other policy reforms.

Almost all SSA countries have implemented trade policy reform in the last decade and the World Bank, through structural adjustment lending (i.e. conditionality), played an important role in promoting this process (Greenaway and Morrissey 1996). We will take the merits of reducing anti-export bias and the distortions associated with import restrictions as given; the arguments for trade liberalization are strong, and need not be confused with moving to completely free trade (see Greenaway and Morrissey 1994). The effectiveness of conditionality has been addressed in studies of trade policy reform such as Papageorgiou *et al.* (1991) and Dean *et al.* (1994). In the early 1980s, trade regimes in SSA were almost all highly restrictive and distortionary. Trade reforms were a significant and almost ever present element in the adjustment programmes adopted by many SSA countries as the decade progressed, although even by the late 1980s very little actual reform had been implemented, Ghana being perhaps the major exception (Morrissey 1995). Trade reform is difficult to implement. It is economically costly, both because the government stands to lose a major component of tax revenue (tariffs) and cheaper imports may put pressure on the balance of payments (especially if export response is sluggish relative to import response). Perhaps most important, it is politically costly. The vested interests that have gained from protection tend to be powerful whereas the potential gains to exporters, and consumers, and more disparate and distant. The losers tend to mobilize their opposition more effectively than potential gainers mobilize support (Morrissey 1999). In this sense it is an inherently slow process, and aid can compensate for the costs.

If one looks at SSA countries in the late 1990s, however, significant trade policy reform has been achieved. Morrissey (2001b) reviews the achievements with trade policy reform in some 12 SSA countries since the early 1980s. A number of countries have achieved a significant and sustained degree of trade liberalization in the past two decades, notably Ghana, Mauritius and Uganda, with Madagascar and Tanzania to a lesser extent. These countries have also liberalized the exchange rate regime and implemented export promotion measures. On an implementation criterion, all would score highly (conditions have had effects). However, in terms of export growth, Mauritius is the only clear success story. Thus, using an output performance criterion, conditionality has been effective in only one case. Other SSA countries have had a more erratic experience, implementing and then reversing reforms or often counteracting reforms with new measures. Kenya and Nigeria exhibit such a pattern. Other countries have achieved much less: Côte d'Ivoire and Senegal are good examples, both constrained by membership of the Franc zone.

An inherent problem in attempts to evaluate trade reform, and conditionality more generally, is the difficulty in actually measuring implementation of reform (as discussed above). Many commonly used measures of reform fail to identify which relative prices are affected and how; in economic terms, relative price effects are among the most important features of reform. For example, changes in the average tariff are often calculated from the published tariff schedule but, if some scheduled tariffs are redundant and there are many exemptions, this can give a misleading impression of trade policy reforms. Average tariffs may even be misleading on the direction of reform, let alone the magnitude (Milner and Morrissey 1999).

Furthermore, many conditions relate to regulations and institutions rather than prices, e.g. removal of quantitative restrictions (QRs) or establishing an export promotion agency. While difficult to quantify, hence implementation of conditions is difficult to evaluate, these types of reforms are very important, especially if one takes a long-term

view. To evaluate implementation of a policy reform, the measure should capture the impact of the reform (such as on relative prices). As simple measures are often misleading (and the more simple the more likely they are to be misleading), one should be very careful in interpreting the evidence on the extent of policy reform. Such measurement problems are one reason why the evidence on the economic effects of trade liberalization is so mixed, although on balance it appears to be favourable (Morrissey 2001b). Many cross-country studies use (variants of) the Sachs-Warner index which essentially classifies countries as open or not (a judgement based on considering a range of trade policy indicators). This is quite good at capturing the orientation of trade policy, and the evidence is that openness is associated with growth (e.g. Hoeffler 2001; Mbabazi *et al*. 2001). Nevertheless, it is not clear which components of trade policy are the most important for growth, nor how aid and conditions may have affected trade policy reforms. Again, country case studies are useful.

4.1 Aid, donors and policy learning

Morrissey and Nelson (2001) use theories of policy learning and of policymaking to examine how global institutions such as the World Bank can influence policy choices by developing countries in the area of trade liberalization. If policymakers engage in pure learning by doing, policy choices are based solely on information relating to the history of the policy they have experienced and policymakers have no information on alternative policies (as these have not been implemented). Social learning provides information on alternatives as policymakers can observe the policies chosen by others, although they have limited ability to observe the effects of these policies. External agents, such as donors, can influence policy choice by contributing to the learning process. For example, donors could provide information on policies that have 'worked' in other countries, or could support analysis of the effects of policies being implemented.

Table 2 identifies various stages in the policy process and indicates the ways in which donors can exert influence at each stage. The willingness of governments to implement reforms (to alter their policy choice) will depend on beliefs regarding the effect of any given policy (described as priors regarding the policy) and the range of policy options. In other words, stages A and B of the process refer to willingness to reform. Donors can influence willingness to reform in a number of ways. They can give information on the probable effects of alternative policies, affecting both priors and options, especially if they provide information on the effects of policy choices in other countries (knowledge transfer). By expressing their own views, preferably supported by analysis of evidence, donors can influence the policy agenda, and thereby influence choice. Note that such actions by donors do not require conditions.

Much of the discussion of policy reform in developing countries has been concerned with the concepts of 'ownership' and/or 'commitment' (e.g. Leandro *et al*. 1999). Ownership is often seen as necessary if policies are to be implemented successfully and sustained. What this means is not always clear. Morrissey (1999) adopts a strict definition: a government truly owns a policy reform if it has the capacity to analyse options and to choose and implement the preferred policy. True ownership requires that the policy choice originates with the government. Under this strict definition, donor

Table 2
Donor influence through aid leverage on policy processes

Policy stages	Aid leverage
A. Priors	Beliefs regarding the effects and efficacy of policies Placing specific concerns high on the agenda
B. Options	Provide and interpret information on policy options Policy advice and knowledge transfer
C. Design	Technical assistance on elements of policy design
D. Capacity	Support for policy choice and implementation strategies Taking responsibility for unpopular policies Providing evidence to build support or counter opposition
E. Commitment	Financial support for adopting policies Building policymaking capability
F. Administration	Technical support and assistance

Notes: Discussion in text. Adapted from Morrissey and Nelson (2001).

leverage and influence undermines ownership, but true ownership is not necessary to ensure sustained policy reform. All that is necessary for a genuine attempt at reform is that the government chooses the policy because it believes it is the right policy. It does not really matter if this belief was arrived at because of analysis conducted by the government itself or because it was persuaded by information provided by donors (or other agencies, including independent researchers). The central issue is choice, not ownership. Donors should provide information and options, they may even indicate their preferences, but governments should then be allowed to choose. If donors agree with the free choice (which need not mean exactly the donors preferred policy), policy conditionality is not required (but donors could have fundamentally influenced the choice). Aid commitments should be released in full, although there may be use or monitoring conditions attached to the aid (McGillivray and Morrissey 2000).

Perhaps the more interesting case is if donors do not agree with the choice. Here, theory and evidence suggest that conditions will be ineffective (White and Morrissey 1997). An appropriate donor response would be to reduce the amount of aid released. In this context, donors should indicate which policies they consider very important or immediate, and which they consider less important. While a major part of the aid commitment may relate to an overall programme of budget support, much aid will be linked to particular reform areas. Only in extreme cases would donors wish to terminate aid support completely. In principle, for any specific policy area aid disbursement can be linked to implementation of reforms in an agreed direction. If governments are not moving in that direction, disbursement is not triggered. In practice, all parties have an interest in disbursing aid once the money has been committed (this is the main reason why the threat required to enforce conditionality is not credible). If donors took a long-term view aid commitments could be triggered by policy choices (in the right direction) with disbursements phased to support implementation.

The other stages of the policy process (C-F in Table 2) relate to ability to implement reforms, and donor influence and support is even more important here. Governments

may have made the 'approved' policy choice, but may lack the political and administrative ability to design and implement the policy effectively. Even if governments 'made' the policy choice because it was required by conditions, failure to implement is often due to administrative and capacity weakness rather than to an unwillingness to reform (Morrissey 1999). Donors can assist with technical and financial support. It is worth noting that if a government has chosen the policy (is willing to reform), it will be receptive to donor assistance in implementation. Indeed, many governments argue persuasively that they need technical assistance (e.g. in implementing standards and regulatory commitments under the WTO). As illustrated in Table 2, donors can support the ability to implement at a number of stages in the policy process. Technical assistance with design and administrative are the most important and effective forms of support. Supporting political capacity (e.g. persuading the opposition or civil society) needs to be undertaken cautiously as it can appear to be political interference.

Ultimately, if the aid relationship is to be one of development partnership, donors should aim to support policymaking and analysis capacity in the country.[5] Current schemes to build trade policy capacity in Africa (supported by DFID, USAID, the EU and World Bank amongst others) provide a good example. The aim is not to tell governments what policies to implement, but rather to help them to identify the effects of implementing alternative policies so that they can exercise policy choice. The schemes also help countries to negotiate in regional and multilateral fora that influence policy. This is a clear and desirable move away from attaching conditions to aid—the support is for policymaking rather than for implementing specific policies. Financial aid can also be important. For example, import liberalization can be associated with a loss of tariff revenue, reducing tax revenue in the short run, and aid can help maintain government spending without increases in the fiscal deficit and borrowing.

Governments will choose the policies they believe in so if donors want to influence the direction of reform they should influence beliefs. If the government then chooses the policy, donors should 'put their money where their mouth is' and offer aid support, for implementation of the policy and perhaps programme support more generally. Arguably, donors should go further: if donors believe in the policy, they should be willing to compensate governments that implement the policy if the outcome is unfavourable (Morrissey and Nelson 2001). Viewing donor influences on the policy process in this way serves to show why conditionality has been ineffective.

Conditions are not an instrument for altering beliefs, and may even be counter-productive. If donors really believed the policies were right, why should they have to make them conditional? Surely donors would be able to present the evidence to the government and alter beliefs? The practical problem is that often the evidence is less than persuasive. While most economists will agree that removing trade distortions is a good policy, the evidence that trade liberalization *causes* (as distinct from being associated with) growth is weak. As discussed in section 2, growth is usually the major or ultimate objective of aid and conditions. Thus, implicitly if not explicitly, donors are saying meet these conditions and you will achieve growth. If the country does not achieve growth, the World Bank (1998) argument seems to be that they must not have

[5] Dijkstra and White, in their evaluation of Swedish programme aid (www.sida.se), make the related argument that policy dialogue between donors and recipients should aim at facilitating debate on policy issues within recipient countries.

implemented the policies correctly, and hence aid was ineffective. An alternative view is that they may have been inappropriate policies, i.e. the conditions were wrong, and while aid is effective it was insufficient to ensure growth. The aid should not be tied to conditions.

There is a danger if donors such as the World Bank are influential and give 'standard' policy recommendations to all governments, so that all countries are following almost identical policy prescriptions. This will encourage policy herding, reduce the information gain from policy experimentation and reduce the chance that countries will be given the 'optimal' policy advice (Morrissey and Nelson 2001). Unless donors could be certain that they are providing each country with the correct policy recommendation, countries should be allowed to experiment. Policy experimentation benefits all as it provides more information on what appears to work or fail under different circumstances. Thus, rather than impose conditions, donors should provide information and advice but encourage governments to make policy choices. If these choices are in the right direction, then support for implementation should be provided. Ultimately, donors should support policymaking capacity in countries.

5 Conclusions

Conditionality has been a core component of aid agreements for almost two decades. The conventional view is that conditionality does not work. This is true in the sense that attaching conditions to aid will not ensure that governments will undertake reforms they would not have chosen willingly. Furthermore, if governments are willing to undertake the reforms then conditionality is unnecessary and may even be damaging (White and Morrissey 1997). If conditionality does not work, what is the alternative? It depends on one's objective. The approach taken by the World Bank and other donors is that certain policies are required to make aid effective. If aid cannot induce implementation of these policies (conditionality does not work), then aid should be directed to countries that have adopted the 'right' policies (conditional selectivity). The aim of this paper has been to refute this line of argument (and propose an approach based on supporting policy processes rather than imposing conditions), and we here summarize the various steps and our counter-arguments.

The case against conditionality is stated in *Assessing Aid* (World Bank 1998), which is principally concerned with the effectiveness of aid in promoting growth and reducing poverty. The message it presents is clear, usually expressed in short highlighted phrases such as 'aid works in a good policy environment' (p. 2) or 'assistance must be targeted more effectively to low-income countries with sound economic management' (p. 4). The basic argument is simple. Aid has tended to be ineffective, in the sense that there is little evidence of a positive association between aid and growth. The exception to this is in countries that exhibit good policies. Thus the claim that aid only works (in promoting growth) in a good policy environment, and the implication drawn that aid should be reallocated largely towards such countries. It is also claimed that attaching conditions to aid has not been effective in driving policy reform. The two important arguments are, first, that good policy is a prerequisite for aid to be effective and, second, that conditionality is ineffective. The main purpose of this paper has been to challenge both of these arguments.

In section 2 we challenge the evidence on the link between good policy and aid effectiveness. The World Bank argument is based on a result that is not empirically robust. Indeed, a balanced review of the cross-country evidence suggests that aid contributes positively to growth performance, and such aid effectiveness is independent of policy. Furthermore, many of the policy variables used were measures of outcomes, e.g. countries with lower inflation or smaller budget deficits tended to have higher growth. The empirical studies on aid effectiveness do not identify the policy inputs conducive to growth, and do not address how aid may influence policy inputs. In sum, it is not evident that aid is only effective when countries have adopted certain specified types of policies. The evidence is that aid can contribute to growth in many policy environments. It follows that it is not necessary (for aid effectiveness) to attach strict policy conditions to aid; all that is required is a reasonable policy environment. Almost everybody would agree that there are certain regimes and/or policies that are disastrous, but this only captures a number of countries at one extreme. The majority of aid recipients have policies that are more or less reasonable; there may be general agreement on the direction that policy should take, but not on the details.

Is there a role for conditionality if the majority of recipients have more or less reasonable policies? Our answer is no, but this does not mean that aid, and more specifically the donor-recipient relationship, does not play a role in influencing policy choice and implementation. Section 3 considered the literature evaluating the effectiveness of conditionality. A specific weakness of this literature is that there are few rigorous comparable studies that analyse the chain from aid conditions to policies implemented to outcomes observed, allowing for non-aid related factors. Many studies argue, in effect, that not all conditions were fully implemented; therefore, conditionality did not work. This shows scant understanding of the nature of the policy process (Morrissey 1999). Alternatively, studies observe that the outcomes (e.g. investment, exports or growth) were not as good as anticipated and infer that conditions were not met. Even if the policies were implemented as required, there are many reasons why the anticipated benefits may not be observed. The one point on which there is agreement is that rarely, if ever, are all conditions fully implemented within the time period of the aid agreement. In this sense conditionality does not work.

Conditionality is, in effect, dictating the policy choices that governments should make and then tying aid to the implementation of those policies. This is not a solid foundation for a development partnership between donors and recipients, yet all donors advocate partnerships. They also advocate policy ownership by recipients, but this at least requires that countries be allowed to choose their own policies. We argue in Section 4 that aid support can be used in various ways to help governments identify policy options, make informed choices and implement policies effectively. We illustrate this with the case of trade policy. While trade reforms featured prominently among aid conditions, and strictly evaluated conditionality failed, many developing countries have implemented trade policy reforms over the past two decades and aid has played an important role. Aid plays an important role in policy not by dictating choice but by informing and supporting the policy process.

This brings us to a final point. As mentioned, the poorest countries are also those with the least capacity, administratively, institutionally and in terms of policymaking. This is recognized as a major constraint on their ability to implement policy reforms, and often the underlying reason why many are deemed not to have reached satisfactory levels of implementation (Morrissey 1999). The few trained officials in these countries tend to

spend their working lives in negotiations with donors, leaving little time to make or implement policy. Put simply, countries with the least ability to do so are being expected to design and implement highly sophisticated (and effectively experimental) policy programmes. The poorest countries do not possess the policy capacity needed. If donors are offering a partnership, or at least a sustained relationship, with recipients, they should help governments to choose policy, but not dictate the choice. It is reasonable to expect that donors may propose parameters of policy, political legitimacy and human rights within which governments must stay to receive aid. Within these parameters, recipients should be empowered to make their own policy choices. Such empowerment will be associated with promoting political process that encourage governments to recognize the public interest, and political process of this orientation are more likely to result in policy reform. Donors may also feel entitled to attach some restrictions on the ways in which aid can be used. Such support for the policy process does not require conditionality.

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