THE BOTTOM BILLION

Why the Poorest Countries Are Failing and What Can Be Done About It

"Set to become a classic." —*The Economist*

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Part 4

The Instruments

CHAPTER 7

Aid to the Rescue?

THE STORY SO FAR: a group of countries with nearly a billion people living in them have been caught in one or another of four traps. As a result, while the rest of the developing world has been growing at an unprecedented rate, they have stagnated or even declined. From time to time they have broken free of the traps, but the global economy is now making it much harder for them to follow the path taken by the more successful majority. As a result, even when free of the traps they sit in limbo, growing so slowly that they risk falling back into the traps before they can reach a level of income that ensures safety.

A future world with a billion people living in impoverished and stagnant countries is just not a scenario we can countenance. A cesspool of misery next to a world of growing prosperity is both terrible for those in the cesspool and dangerous for those who live next to it. We had better do something about it. The question is what. This chapter and the ones that follow answer that question. I start with aid—the stuff of rock bands, G8 promises, and agencies—but I do not stop there. Aid alone is really unlikely, in my view, to be able to address the problems of the bottom billion, and it has become so highly politicized that its design is often pretty dysfunctional. Therefore I move on to three other instruments that would, I think, be effective but have been grossly underused to date.

What is it about aid that causes such intense political disagreements? It seems to bring out the worst in both left and right. The left seems to want

to regard aid as some sort of reparations for colonialism. In other words, it's a statement about the guilt of Western society, not about development. In this view, the only role for the bottom billion is as victims: they all suffer from our sins. The right seems to want to equate aid with welfare scrounging. In other words, it is rewarding the feckless and so accentuating the problem. Between these two there is a thin sliver of sanity called aid for development. It runs something like this: We used to be that poor once. It took us two hundred years to get to where we are. Let's try to speed things up for these countries.

Aid does tend to speed up the growth process. A reasonable estimate is that over the last thirty years it has added around one percentage point to the annual growth rate of the bottom billion. This does not sound like a whole lot, but then the growth rate of the bottom billion over this period has been much less than 1 percent per year—in fact, it has been zero. So adding 1 percent has made the difference between stagnation and severe cumulative decline. Without aid, cumulatively the countries of the bottom billion would have become much poorer than they are today. Aid has been a holding operation preventing things from falling apart.

In July 2005 at Gleneagles, the G8 summit committed to doubling aid to Africa. Is this going to double the contribution of aid to growth? Is it going to drag the bottom billion out of stagnation? If by doubling it you could add another percentage point to growth, the effect, while not dramatic, would at least gradually cumulate to substantially higher incomes. I think that with the right complementary changes this might happen, but as things currently stand, additional aid will not have such promising results. The statistical evidence generally suggests that aid is subject to what is called "diminishing returns." That is, as you keep on increasing aid, you get less and less bang for the buck: the first million dollars is more productive than the second, and so on. This is not very surprising, as diminishing returns are found all over the place and it would be odd if aid escaped. A recent study by the Center for Global Development, a Washington think tank, came up with an estimate of diminishing returns implying that when aid reaches about 16 percent of GDP it more or less ceases to be effective. Africa wasn't far off that level even before Gleneagles. So with the doubling of aid, if indeed it happens, we have broadly reached the limits to aid absorption, at least under existing modalities.

Can we change the way aid is provided, to make it more effective and increase the scope for aid absorption? There are plenty of horror stories about aid bureaucracies. Donors often trip over each other and fail to coordinate. I came across one case where three donor agencies each wanted to build a hospital in the same place. They agreed to coordinate, which doesn't always happen, but then faced the problem of having three incompatible sets of rules for how the work should be commissioned. It took them two years to reach a compromise, which was that each agency should build one floor of the hospital under its own rules. You can imagine how efficient that was likely to be. So there is plenty of room for improvement on the ground. Agencies also impose their own complex and differing accounting procedures upon recipient governments that have very limited capacity to manage even their own budgets, let alone those of donors. All this could indeed be made a whole lot simpler. The simplest is something called "budget support," which basically means that the donors give the government the money and it spends it on whatever it chooses, as if it were its own tax revenue. Aid just supports the budget. In some situations this is the best way to transfer aid, but it depends upon the budget being reasonable. In many countries of the bottom billion the budget is not reasonable, and in some it is grotesque.

The world has already conducted a natural experiment in giving the countries of the bottom billion a huge injection of budget support. It is called oil. Recall from Chapter 3 that a number of bottom-billion countries have received large inflows of oil revenue, much of which must have reached the budget. For example, over the last thirty years Nigeria has received something on the order of $280 billion. This is far larger than any realistic scale of aid to a bottom-billion country. Yet Nigeria has depressingly little to show for it. That was the past, however; how about now? The recent increase in oil prices provides a natural experiment about as current as we can get. Africa's oil-exporting economies have between them recently received a bonanza that dwarfs feasible increases in aid. So I looked to see what this had done for the non-oil part of their economies, and compared it to the growth of the rest of Africa, which, not having oil, of course got hit by these high oil prices. The latest data I could get from the IMF are for 2004. Adding them up, I found that the two growth rates were identical: those economies that were benefiting from the oil windfall were growing

no faster than the ones that were hit by it. Let us hope that this is just a matter of lags and that the oil economies will soon surge ahead. But so far, recent evidence is pretty consistent with past evidence: large inflows of money without any restrictions do not seem to be well spent in many of the countries of the bottom billion. In effect, budget support turns aid into oil: money for the governments of the bottom billion without restrictions on its use. So, to a first approximation, does debt relief. I am not against budget support and debt relief; they surely make sense for some countries. But as general instruments for developing the bottom billion they would be more reassuring had oil and other natural resource revenues been more successful.

Overall, despite the bureaucracy, aid has been much more successful than oil. Aid has raised growth, oil has lowered it. Yet both are financial transfers to bottom billion governments. The only difference is that aid has been handled by the aid agencies. So, unlikely as it seems, what the aid agencies have been doing has added a whole lot of value to the financial transfer. Given the bad public image of aid agencies and horror stories such as the hospital project I described above, this is hard to believe, but there it is. The projects, procedures, conditions, and suchlike have been beneficial overall, enhancing the value of the money transferred compared with just sending a check and hoping for the best. So getting rid of all this and just sending the money is more likely to make aid less effective than to make it more so. There are things we can do, and I will come to them, but the simple answer of just giving them the money is likely to be the right one only in the better-governed countries.

Aid has tended to be more effective where governance and policies are already reasonable. That does not sound very surprising: indeed, it sounds almost platitudinous. But it is actually pretty controversial. Partly, people quite reasonably do not like the harsh-sounding implication that the countries with the worst problems should get the least money. They obviously have the greatest need. However, there comes a point at which money is pretty ineffective in these environments. Recall that expenditure tracking survey in Chad: less than 1 percent of the money released by the Ministry of Finance for rural health clinics actually reached the clinics. In 2005 the European Commission gave 20 million euros to the government of Chad in budget support. How much of it do you imagine was well

spent? Do not forget that the tracking survey was only following money that was already intended for health care. This is not, unfortunately, a very high priority for the government of Chad. It prefers to spend its money on the military. The budget support given by the European Union can be spent on whatever the government chooses. I doubt whether much of it was allocated to health. And of the money allocated to health, we know how much actually reaches the front line of health care. So the European Commission's well-intentioned support for the desperately poor country of Chad is likely to have ended up largely financing the army.

Is this the fate of aid in general? Donors try pretty hard to avoid inadvertently financing military spending, but what do the data show about how much aid leaks into military budgets? It was not easy to determine this, not least because the data on military spending are not very reliable. Governments tend to be, shall we say, economical with the truth. Anke Hoeffler and I relied upon the Stockholm Peace Research Institute for the data. The institute would be the first to admit that the data have problems, but they are probably the best available (believe it or not, even the data on aid are inadequate—you would think that donors could keep better track of how much they give to whom and in what form). Anyway, after the data came the problem of interpreting causation: it runs in both directions, with aid affecting military spending and military spending affecting aid. That is, donor behavior is purposive: governments with high levels of military spending tend to get less aid. We allowed for this. Our conclusion was that some aid does indeed leak into military spending, but surprisingly little—our best estimate is about 11 percent. This is not negligible, but on the basis of this it would be grossly unfair to claim that aid is wasted. Nevertheless, in those bottom-billion societies that get a lot of aid, even 11 percent of it adds up to quite a lot of the military budget. We estimate that something around 40 percent of Africa's military spending is inadvertently financed by aid. So the donors have a legitimate interest in restraining military spending, or at least in worrying about it.

To be fair, the aid agencies are in something of a bind. If they allocate aid only according to need, it ends up financing the army in Chad. If they allocate it only according to effectiveness in the growth process, it ends up going to those with less need. Together with David Dollar, my colleague at the World Bank, I came up with the idea that aid should be allocated so as

to lift as many people out of poverty as possible. We tried to see how, in practice, need and effectiveness could be reconciled. In deference to the technocratic mind-set we termed our idea "poverty efficiency" (which must rank with "human capital" as a linguistic carbuncle). Anyway, the actual allocation of aid was very far from being poverty-efficient. The biggest deviation was that far too much aid was going to middle-income countries rather than to the bottom billion. The middle-income countries get aid because they are of much more commercial and political interest than the tiny markets and powerlessness of the bottom billion. Not all agencies are equally guilty. If we take the two biggest, the World Bank is far better protected from political influence than the European Commission, and so its aid has been much better targeted to the poorest countries. But herein lies a paradox: the World Bank until very recently has only been able to provide loans, whereas aid from the European Commission is entirely in the form of grants. So the loans have been going to the poorest countries and the grants to the middle-income countries. You might reasonably think that this is not particularly sensible and that aid allocation could be greatly improved. But if aid were better targeted to the bottom billion, would it help break the traps?

Aid and the Conflict Trap

Can aid actually make things worse? Some researchers think so: aid may be an inducement to rebellion and to coups because capturing the state becomes more valuable. In the societies of the bottom billion, aid is probably the key part of what is sometimes called the "rents to sovereignty"—the payoff to power. So is big aid an incentive to rebellion or to coups? How do you tell—conduct a survey of rebels and coup leaders?

Anke and I followed the same general method for both rebellions and coups: look at all of them and try to allow for the fact that aid is allocated purposively, so less tends to go to countries with the highest risks. Then, allowing for this purposive allocation, bring aid into the analysis of the causes of rebellion and the causes of coups. Of course, with this approach you cannot tell whether aid has had an effect in any particular instance, but you can tell whether it has a significant effect overall.

On average, as far as we can tell, aid has no direct effect on the risk of

civil war, though it has indirect effects (which I will come to shortly). This does not mean that it never has direct effects: people expert in particular situations can give you stories on each side, of aid inciting war or averting it. Any of these may well be right, but they do not add up to a systematic relationship. With coups it is a different matter: big aid indeed makes a coup more likely. So, going back to some of the results of Chapter 2, rebellions are encouraged by natural resource wealth but not by aid, and coups are encouraged by aid. Why this difference? Perhaps, because a rebellion usually takes many years, the prospect of aid if the state is eventually captured is not a potent lure. Resource rents, by contrast, are useful to rebels in the here and now of the conflict because they can be grabbed along the way; you don't need to control the entire state to control a diamond mine in the middle of nowhere. And why is aid a lure to coups if it isn't to rebellions? Perhaps because a coup does not take many years before it is resolved. It is over virtually as soon as it has begun, and if it is successful, the aid is there for the taking.

So to an extent aid does make the conflict trap worse. But it can also make things better. Recall that the key risk factors in rebellions and coups are slow growth and low income. The indirect effects of aid on conflict risk are benign. By raising growth and thereby cumulatively raising income, aid reduces these risks. Is the payoff worth the costs? Anke and I tried to answer that question. We already had an estimate of the costs of the typical civil war—around $64 billion—and we had just estimated how aid would reduce the risk of war through raising growth. So by putting the two together we got an estimate of the payoff to aid from enhanced security. To our surprise, it turned out that the payoff was not big enough to justify the cost. The reason was that aid was not very effective at raising growth in the conditions of poor governance and policies that typified the bottom billion. Challenged by Jeff Sachs, who thought we had asked the right question but come up with the wrong answer, we experimented. In countries with better governance and policies—that is, the countries that had already broken free of the poor governance trap—the security benefits started to mount up, reaching perhaps half of the cost of the aid. And of course our cost of conflict did not include any adverse spillovers for rich countries, such as drugs and terrorism. So although security considerations alone probably do not justify a big aid program, in some countries they are

a substantial addition to the normal benefits of aid—higher income and increased domestic consumption.

However, the cost-benefit analysis of aid for security looks very different in postconflict situations. In these situations the security benefits alone are more than enough to justify a large aid program. Recall that these are the times of highest risk—around half of all civil wars are post-conflict situations gone wrong. Aid happens to be particularly effective in raising the growth rate in these situations. This is hardly surprising—this is how aid got started. The World Bank was originally called the International Bank for Reconstruction and Development, and in fact the "and Development" bit was literally an add-on. Aid was invented to rebuild Europe after the Second World War. It worked. In more recent times the mistake with aid to postconflict situations has been that it has been too little and too soon. Yes, too *soon*. The peace settlements hit the media and the politicians hit their checkbooks. Aid floods in during the first couple of years, then rapidly dries up. Yet the typical postconflict country starts with truly terrible governance, institutions, and policies. It takes some time to improve them to a level at which aid can be of much use. So big aid needs to be sustained during the first decade postconflict, not just the first couple of years. To their credit, the donors are learning. Postconflict interventions really got going only after the end of the Cold War—until then, everything was too polarized. So the stock of experience has been pretty limited. For example, the World Bank introduced postconflict considerations into its criteria for aid allocation only around 2000—in the years of the Cold War its reconstruction role had been forgotten. And even when it introduced its special postconflict allocation, the extra money for a country was designed to be phased out after the first three years. In 2005 the rules were changed so that the extra money now lasts for seven years, a much more reasonable time frame. Agencies are learning, and aid so used has an important role to play in breaking the conflict trap. But aid alone is not enough. Growth is a slow process, and it takes time to bring risks down. After a decade of rapid growth, postconflict risks are usually brought down to manageable levels. But during that first decade, even big aid cannot do much to bring the risks down. We have to look at other ways of containing risks during that period while aid does its slow work of rebuilding the economy.

Other than in the postconflict period, to the extent that aid raises growth it is also useful in bringing down the risk of conflict. But the problem is designing aid in such a way that it works even in the environments of poor governance and poor policy that are most at risk of conflict. I will come to that. Let's first look at how aid affects the other traps.

Aid and the Natural Resource Trap

The second trap was the natural resource trap. Here, frankly, aid is fairly impotent. Evidently, the resource-rich countries have money coming into the government. They do not use it very well. There is nevertheless a moment for aid in these environments. That moment is when they try to reform—an incipient turnaround. I will return to it in the discussion of the trap of poor governance and policy.

Aid and the Trap of Being Landlocked

The third trap was being landlocked. These are the countries that basically need to be on international welfare for a long time. Eventually they might become viable, depending upon when their more fortunate neighbors start to grow and what market niches turn up. But we should not pretend that there are easy answers. In the meantime, there is no fast track available for these countries. In retrospect, it was perhaps a mistake for the international system to permit economically unviable areas to become independent countries. But the deed is done, and we have to live with the consequences. One of the consequences is the need for big aid as a means of raising domestic consumption in these desperately poor environments, even if the aid does not do much for growth. For these countries the psychology of aid needs to recognize that it is not there as a temporary stimulus to development, it is there to bring some minimal decency to standards of living.

Probably the key role for development aid—as opposed to direct support for consumption—in the landlocked countries is to improve their transport links to the coasts. Recall that the costs of transport to the coast vary enormously and tend to reflect the transport infrastructure of neighbors. Aid should have been financing the regional transport corridors that are the lifelines for the landlocked. It has largely failed to do so. Why?

One reason was that in the 1990s infrastructure went out of fashion, at least for aid agencies. This was partly because there was an exaggerated belief that the private sector would finance infrastructure, so the aid agencies had better find something else to justify their continued existence. For example, in the World Bank, an agency whose core business had been infrastructure, infrastructure was now lumped in with private-sector development and finance, the whole package being merely one of five "networks." The shift away from infrastructure was also because there was growing pressure to spend aid on the photogenic social priorities—health and education—and on the increasingly sacred environmental goals (both of which got networks all to themselves at the World Bank). So agencies shifted their budgets away from infrastructure to make room for increased spending on the new priorities.

The other reason why regional transport corridors got neglected was that aid programs were overwhelmingly organized country by country. Uganda's link to the coast depended upon transport infrastructure in Kenya, not in Uganda. But the Kenyan government did not care about Uganda, and with the growing emphasis upon "country ownership" of aid programs, if the government of Kenya did not care then neither did those donors who gave money to Kenya. So the underfunding of infrastructure and country-driven aid programs together did in the regional transport corridors that the landlocked needed.

Aid and the Trap of Bad Governance

The fourth trap was being stuck with very poor governance and policies. Can aid help in getting countries out of these problems? This is where I think there is the most scope for additional aid. There are three ways in which aid can potentially help turnarounds: incentives, skills, and reinforcement. Let us see what works.

Aid as an Incentive

The use of aid as an incentive for policy improvement was initiated in the 1980s. It was known as policy conditionality. The donors provided aid if the government promised to reform. It was a pretty hopeless failure. There were two basic problems with it: the psychology and the economics. The psychological reaction to being told to do something is resistance. Any parent knows that, and it is just as true of governments as it is of children; how else can they establish their freedom? So conditionality pushed governments, and indeed whole societies, into opposing policy changes that would have been highly beneficial. Policy conditionality also messed up accountability. If governments were being ordered about by donor agencies, whom should an electorate blame if things went wrong? Governments were quick to exploit the full potential for evading responsibility. In the week when the government of Zimbabwe launched economic reforms in 1998, its minister of information told the local press, "They're not our reforms, they're the IMF's. We had to do them." That sort of statement not only shifted the responsibility but made the reforms very easy to reverse. And the government of Zimbabwe most surely reversed them.

Policy conditionality as then practiced depended upon the government promising to make changes. This, for those of you who prefer to think in Latin, is known as ex ante conditionality. The economics of getting money on the basis of a promise is known as the time consistency problem. Unless incentives are properly aligned, governments will promise, take the money, and then do what they like. To give you a real-life example, the government of Kenya promised the same reform to the World Bank in return for aid five times over a fifteen-year period. Yes, five times it took the money and either did nothing or made token reforms that it then reversed. The amazing thing is that the money kept coming. How did Kenyan government officials manage to keep straight, sincere faces as for the fifth time they made the same commitment? How did officials of the agency manage to delude themselves into thinking that adherence this time was likely? But aid agencies have very little incentive to enforce conditions: people get promoted by disbursing money, not by withholding it. Eventually, the World Bank and other donor agencies realized this limitation and largely switched to disbursing aid on the basis of the attained level of policies rather than on promises of improvement. For the Latin-speakers, this is ex post conditionality. It was more consistent with the research evidence that suggested that whether aid worked well depended upon the level of policies rather than on how they were changing, and it avoided the need for promises. The only problem was that it squeezed aid out of the very

countries that have the biggest problems. On the most favorable interpretation, it was a realistic recognition of the limits of aid to help in these environments. On a less favorable interpretation, it was giving up on the very environments where the agencies were most needed. Anyway, forget ex ante policy conditionality as a way of inducing policy improvement in failing states: it just doesn't work.

I take a very different view of *governance* conditionality. The key objective of governance conditionality is not to shift power from governments to donors but to shift power from governments to their own citizens. The struggle for this transfer of power took around two hundred years in Europe, and we should indeed want to speed it up in the bottom billion. External pressure was vital in the European struggle. The most common account of that struggle goes as follows. The threat of war forced governments to defend themselves with big armies. To pay for these armies the governments needed to tax. To get compliance for high taxation they had to concede representation and scrutiny. We cannot go through that process in the bottom billion. In Europe the threat of war turned into a reality sufficiently often for the whole process to have been murderous, and it would probably be so again. It was also slow. But the purely internal processes by which citizens force governments to accept scrutiny are probably pretty weak. External pressure is needed. And it is entirely legitimate. Why should we give aid to governments that are not willing to let their citizens see how they spend it?

Governance conditionality, in its ex post form, is gaining in popularity. Most dramatically, U.S. president George W. Bush launched his new Millennium Challenge Account based largely on allocation criteria of attained levels of governance. He wisely chose not to allocate the additional American aid money through the established American aid agency, for over the years USAID has been captured by congressional commercial lobbies. Voting line by line on USAID's budget, Congress has diverted spending so as to benefit particular American exporters, unrelated to African needs. However, somewhat surprisingly, no agency is doing ex ante governance conditionality. One advantage of such an approach is that it would be much clearer what a government had to do, and on what time scale, in order to be rewarded by extra aid. And the aid could be targeted to countries that initially had weak governance—so it would focus on the bottom billion

instead of excluding them. I will spell out more fully what I think could be the practical content of governance conditionality in Part 5. We have to accept that there are severe limits to what aid can do to improve governance. But we are not yet at those limits.

Aid as Skills

Conditionality looms large in discussions of aid because it is so sensitive, but reform of governance and policies is not just a matter of political will and political pressure. It also requires people with the relevant skills. Typically, in the societies of the bottom billion the civil service has lost whatever skills it once possessed. Once over dinner the former head of the civil service in one of the big bottom-billion societies described what had happened to the civil service that he had helped to build. He asked me to imagine being a schoolboy in his country on the eve of independence. The bright boys in the class aspired to join the civil service to help build the country. At the other end of the class, what were the aspirations for the dumb class bully? Forget the civil service with its tough exam. So the class bully set his sights on the army. Fast-forward two decades and a coup d'état. The army was now running the government. Between the class bullies, now the generals, and their objective of looting the public sector stood the class stars now running the civil service. The generals didn't like it. Gradually they replaced the clever boys with people more like themselves. And as they promoted the dumb and corrupt over the bright and the honest, the good chose to leave. Economists have a term for it: "selection by intrinsic motivation." So by the time the military ceded power back to civilian politicians, the civil service was broken: far from being the vehicle for developing the country, it was a vehicle for looting it.

Politics is full of idiosyncrasies, and from time to time reform-minded ministers and presidents come to power. But it is very difficult for them to implement change because they inherit a civil service that is an obstacle rather than an instrument. It is hostile to change because individual civil servants profit from the tangled mess of regulations and expenditures over which they preside. Aid has a potential role of providing the skills that the civil service lacks when they are most needed.

Recall from Chapter 5 that together with Lisa Chauvet I looked at the

preconditions for a turnaround from a failing state and for the conditions that helped success once a turnaround had started. In fact, the main purpose of our work was to see whether aid was helpful, either as a precondition or once a turnaround had started. We decided to distinguish between two types of aid: technical assistance and money to governments. Technical assistance means the supply of skilled people, paid for by the donor. Although the donor spends money, what the recipient government gets are skilled foreigners to work for it. Technical assistance accounts for about a quarter of all the money spent on aid. The other three-quarters is money either handed to governments to finance specific projects such as a school or simply provided to the government without a specified use, which is called budget support. Even to distinguish between technical assistance and money to governments was difficult because the donor agencies just have not been bothered to record their activities properly. We relied upon data provided by the Paris-based Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD), the main donor club. Even they thought the data were of poor quality.

I am going to focus on technical assistance. Usually the fact that a quarter of aid is provided as technical assistance is presented as some sort of scandal, on the grounds that the countries do not see any money—all they get is people. But really it depends upon whether the people are of any use. Reforms need skills, and in the bottom billion these skills are lacking—remember, the skilled people have already left. They're in London, New York, and Paris, not Bangui. The politically correct answer to the need for technical assistance is to support "capacity building" instead: that means train the locals rather than fly in experts. There is a lot of sense in capacity building, but there is also a chicken-and-egg problem. Until the country has turned itself around, capacity building is pretty difficult. You train people to an international standard, and if there are no prospects, then they use their credentials as a passport out of the country. I know—I have been training people for three decades. In the early stages of reform not only do the reformers need skills that are unavailable in the country, but some of these skills will no longer be needed once the transition has been accomplished. It actually makes sense for a country to import a bunch of skills temporarily while it gets over the hump of reform.

So Lisa and I introduced technical assistance into our analysis of

turnarounds. Did it help as a precondition for a turnaround? Did it help once a turnaround had already gotten started? Did it help when a new leader had just come to power? As usual with aid, we faced the problem that causality can run in both directions: the better the prospects of a turnaround, the more technical assistance the donors might choose to supply. To the extent that donors get this right, aid will tend to be targeted to situations that are ripe for improvement and hence subsequently do improve. With such behavior it is indeed likely that aid will appear to raise the chances of turnaround, but this would be because the wrong version of causality has been forced on the relationship. We might equally have found that a good prospect of reform causes aid to go up. The way to overcome the problem is to find a component of technical assistance that can be predicted country by country, year by year, and is devoid of any influence from the country's governance and policies. Fortunately, a substantial component of a country's aid receipts are determined not by its own current circumstances but by the characteristics of donors. For example, Ethiopia is likely to get a relatively large amount of aid from Italy, since Italians see their brief invasion of Ethiopia as giving them a historical connection. And Côte d'Ivoire is likely to get a relatively substantial amount of aid from France, its former colonial master (Abidjan used to be known as Africa's Paris). So if the Italian aid budget goes up and the French aid budget goes down, Ethiopia is likely to get an increase in its aid receipts relative to Côte d'Ivoire. Since this component of aid is unrelated to policy conditions in the recipient countries, we can study its effects on the chances of a turnaround and be fairly sure that causality is running only from aid to the turnaround. To continue the example, from time to time Ethiopia or Côte d'Ivoire gets lucky or unlucky with the configuration of aid donors, and we can see whether luck or the lack of it has any effect on the chances of turnaround.

Unfortunately, as far as we can tell, technical assistance in a failing state prior to turnaround has little effect on the prospect of a turnaround occurring. The experts come and preach and people listen politely, but not much happens. This is bad news for the agencies that do this and little else, and it is also bad news for failing states since pouring in big technical assistance would be pretty easy. However, things look dramatically different once a turnaround has started, or indeed if the state has a new leader.

Technical assistance during the first four years of an incipient reform, and especially during the first two years, has a big favorable effect on the chances that the momentum of the reforms will be maintained. It also substantially reduces the chance that the reforms will collapse altogether. To me this makes sense, because these early periods of turnaround are when the courage of a few brave politicians meets the brick wall of obduracy and incompetence in the civil service. Beyond the few reforms that just require the minister to sign something—stroke-of-the-pen reforms—most reform needs technocrats and managers able to implement change.

Lisa and I were quite surprised that the effect of technical assistance came out so strongly, and so we decided to push our luck. Could we tease out any sense of how much technical assistance was useful during this early phase of reform? Again to our surprise, we found that we got an answer in which we could have some statistical confidence. It told us that technical assistance packages during reform could usefully be really big—typically up to around $250 million a year could be spent on providing technical expertise before additional money became useless.

We first compared this with actual technical assistance during reform episodes. The actual scale of assistance was typically far lower, so donors appeared to be missing an opportunity. But at this stage we had not compared the costs with the benefits: if the benefits were sufficiently modest, then donors would be right in passing up these apparent opportunities. To discover whether pouring in technical assistance during incipient reforms is worth the money we needed to determine whether the benefits exceed the costs. It was simple enough because we already had our estimate of the costs of a failing state—around $100 billion—which I described in Chapter 5, and we now had the amount by which a technical assistance package would raise the chances of sustaining an incipient turnaround. We just had to bring the two together. The payoff came out at around $15 billion, and the cost of maximal technical assistance sustained for four years is only around $1 billion. So donors were in fact missing a really good opportunity for aid: spend $1 for an expected return of $15. And don't forget that the only benefits counted in that $100 billion are to the neighborhood; the additional security that spills over to the wider world is a bonus.

So why are aid agencies missing this opportunity? After all, it is not as if technical assistance overall were negligible—money spent on providing

countries with the skilled people who constitute technical assistance is a quarter of total aid flows, so it is huge. The problem is not the overall insufficiency of technical assistance but rather that it is organized so as to be unresponsive to country circumstances. In the parlance of the agencies, technical assistance is supply-driven rather than demand-driven. The same assistance is poured into the same places year after year without much regard to political opportunities. Indeed, given the prevalence of ex post policy conditionality—putting the money where things are already satisfactory—agencies simply cannot put their resources into failing states early in a possible turnaround; it is against the rules. Technical assistance needs to be reorganized to look more like emergency relief and less like a pipeline of projects. Just as when the Southeast Asian tsunami struck in December 2004 emergency relief teams were quickly flown in, so when political opportunities arise, skills should be available. Ideally, reforming ministers need to be able to draw on a large technical assistance account, which is theirs to decide how to use. And this would be useful even in the resource-rich failing states. Although the governments of resource-rich countries have revenues that in principle could be used to pay for big technical assistance, they are unlikely to do so. The political cost of using revenues in that way at the start of a reform effort would be massive. And so, at the right time and for the right things, aid can be very productive even in breaking the natural resource trap.

Aid as Reinforcement

So aid as technical assistance can help turn around failing states. What about aid as money provided to the government intended for projects or budget support? We followed the same approach and got completely different results. Money early in reform is actually counterproductive. It makes it less likely that the reform will maintain momentum. I was pretty suspicious of this result until we found a completely separate result that looks remarkably similar. I briefly mentioned it in Chapter 5, but now I want to make more of it. This is the effect of terms of trade windfalls such as oil booms and coffee booms. You might imagine that an improvement in the terms of trade would make reform easier—after all, there is more money coming into the country and people are better off. It turns out to

be the opposite, however: a terms-of-trade windfall early in a reform has the same adverse effect as an aid boom, in that early money chills the prospects of sustaining the reform. There is no technical economic reason for this, so it must be political. I wanted to get some insight as to whether the politics really was like this, so I asked Ngozi Okonjo-Iweala, who at the time was finance minister of Nigeria (and not just any finance minister, either—she was named Finance Minister of the Year for 2005 by *The Banker* in recognition of her efforts at reform). I first encountered her in the mid-1990s when she wrote to me at Oxford out of the blue. I was running a research center on African economies, and she was a director at the World Bank. She wrote asking whether she could come to the center for a month, using her vacation from the World Bank to study. Not many World Bank directors have done that. Anyway, by 2005 she was the ideal politician for this question: there she was, implementing reform, and doing it with remarkable success, in the midst of a huge oil boom. I asked her whether the high oil price that was generating big revenues for the Nigerian government was making reform easier or harder. She laughed. "Harder, much harder," was her assessment. Why? Because people's attention was focused on getting the extra oil money that they knew was there, rather than on the often painful, tedious, and fractious business of reform. Why lay off people when there is oil money? Why delay projects by insisting that the contracts be put out for competitive bid when there is money to pay in excess of the competitive price? And perhaps that is an example of a more general pattern: sudden extra money, whether from export booms or aid, detracts from the hard choices involved in reform.

After reform has continued for a few years, the statistical effects of technical assistance and money reverse themselves. Technical assistance becomes useless or even counterproductive—because, I suppose, governments at some stage need to build their own capacity, rather than continuing to rely upon outside experts—and money starts to become useful, reinforcing the reform process instead of undermining it. So what seems to show up is a sequence. Aid is not very effective in inducing a turnaround in a failing state; you have to wait for a political opportunity. When it arises, pour in the technical assistance as quickly as possible to help implement reform. Then, after a few years, start pouring in the money for the government to spend.

Aid used in this way to support incipient turnarounds would be pretty high-risk. Even with aid many incipient turnarounds would fail. The payoff is high because the successes, when they happen, are enormously valuable. The process of aiding turnarounds is thus analogous, in terms of risk taking, to a venture capital fund—most of the firms in which a venture capital fund invests fail, but the fund overall can be successful because of a few winners. For aid agencies to become truly focused on the bottom billion they will need to adapt to this high-risk mode of operation. The venture capital fund approach is, I think, the right managerial model for dealing with such risks because it reconciles accountability with incentives. A "venture aid fund" preserves accountability for overall performance, but managers can achieve overall success despite a lot of failures. Without this sort of model bureaucracies just cannot cope with risk. Their staff will not take large risks because they imply periodic failure, and failure means a blighted career. Unsurprisingly, people are simply not prepared to take risks on these terms. The situation is getting worse as people are increasingly assessed in terms of the "results" they achieve. Within aid agencies there is a vogue for a results orientation, and up to a point this is sensible—senior managers are trying to get their workforce to focus on outcomes, not inputs. But a focus on results can very easily encourage people to avoid failures at all costs. And if this happens aid will increasingly be directed to the safe option of countries where performance is already satisfactory. To its credit the British government has understood this problem and provided the World Bank with the money to launch a fund that can be used to support turnarounds. Will other governments put money into this fund? To my mind that is one of the critical steps for aid in the next couple of years. If you want your children to grow up in a world with fewer failing states, one of the practical things you can do about it is to urge your government to back this sort of aid finance.

Aid Prior to Reform

The effectiveness of money pre-turnaround depends upon how it is given. The traditional way of trying to ensure that aid is spent properly is through projects. Instead of just giving unencumbered money to the government, the agency agrees on a project with the government and helps to

design and implement it. This is a cumbersome approach that is inappropriate for countries with reasonable governance, but for the countries with very weak governance it is probably sensible. There is, however, a catch: projects done in countries with weak governance and poor policies are known to be much more likely to fail.

Recently, Lisa and I were asked to investigate whether there was anything that could be done to make projects implemented in failing states more successful. The donors had liked our work on turnarounds enough to agree to finance a second phase. We used a huge data set that reported evaluations of thousands of donor projects around the world. It took us a long time to make sense of it, and I will issue a caveat: the results I am going to describe are not yet published and so have not yet been subject to peer scrutiny.

Sure enough, we found that in failing states projects were much less likely to succeed. But our question was whether anything could be done about it—anything, that is, that was within the donor's ability to control. It could, for example, be the type of project, or it could be how the project was implemented. It turned out that money spent by the agencies on project supervision has been differentially effective in failing states. It is this differential effectiveness that is the key result. If you put together the much lower success rate of projects in failing states with the differential effectiveness of supervision, then there is a clear implication for how an aid agency should function. Supervision costs money: it comes from the administrative budgets of aid agencies. So an implication is that when agencies operate in failing states, they should budget for a considerably higher ratio of administrative costs to money actually disbursed. Of course, agencies are under pressure to reduce their administrative costs relative to the money they disburse; this is sometimes used as a measure of agency efficiency. But it is misplaced. The environments in which agencies should increasingly be operating are those in which to be effective they will need to spend more on administration, not less. Mismeasurement of bureaucratic performance is a general problem. In aid agencies it encourages low-risk, low-administration operations that are the precise opposite of what they will need to be doing to meet the coming development challenges.

There is one other approach I would like to see tried in failing states, and that is what is known as "independent service authorities." The idea is that in countries where basic public services such as primary education and health clinics are utterly failing, the government, civil society, and donors combined could try to build an alternative system for spending public money. The key features would be a high degree of scrutiny by civil society as to how the money was being spent; competing channels of service delivery, encompassing public, private, and NGO; and continuous evaluation to see which was working best. The authority would be a wholesale organization for purchasing basic services, buying some from local governments, some from NGOs such as churches, and some from private firms. It would finance not just the building of schools and clinics but also their day-to-day operation. Once such an organization was put into place, managed jointly by government, donors, and civil society, both donors and the government would channel money through it. As it demonstrated that it was spending money well, donors would increase the flow of money. If performance deteriorated, the donor money would dry up. Not all governments of failing states would be willing to go along with such a model, but some would. It has not been tried yet, but let me give you an example that briefly got halfway there. The Chad-Cameroon oil pipeline has become a cause célèbre because the NGOs, quite rightly, worried that oil money going to the government of Chad would not be well spent. Indeed, it was more likely to deepen problems than resolve them. The attempted solution was the creation of a system of civil society scrutiny, known as the Collège de Contrôle et de Surveillance des Ressources Pétrolières. The oil money flowed into an account controlled by the Collège, which had to approve all expenditures. The expenditures were restricted by law to social priorities such as health and education. The evidence that this system was basically effective is that within months of it coming into operation in January 2005 the government of Chad changed it. Unsurprisingly, it wanted to make "security" a priority—read money for the military. The Collège was evidently effectively restraining the government from spending the oil money on the military; otherwise why go through the embarrassment and penalties involved in changing the law? Thus we can think of the Collège for the Chad-Cameroon pipeline as a proto–independent service authority. Paradoxically, although the idea has been tried only for oil revenue, it is much better suited for aid. The reason harks back to the time consistency problem that we have already encountered in other contexts. The

Chad deal was unfortunately not time consistent. The deal was that the government of Chad would pass a law establishing the Collège, and in return the oil companies would sink $4.2 billion of investment into oil extraction. Now ask yourself which of these is easier to reverse, the law or the investment. Once you have answered that, you have understood the time consistency problem and can see why it would not be such a problem if instead of oil it was aid. With aid you do not have to sink $4.2 billion in order to get started. It is just a flow of money that can be switched off, unlike the flow of oil. Knowing this, the government has no incentive to tear up the deal. What is the downside of an independent service authority? Well, it is that you start afresh rather than trying to reform the government ministries step by step from within the system, and so it is appropriate only when things are really bad and unlikely to get better by incremental means. So, to be clear, I do not want these authorities everywhere in the bottom billion. I want them to be an option in the worst settings, where the realistic prospect is that otherwise we are going to wait a long time for significant change. I call them independent service authorities for a reason—many governments have already established agencies called independent *revenue* authorities whose function is to raise tax revenue. The function was taken out of the traditional civil service for precisely the reason that I want basic public services to be taken out of the traditional civil service—there was no realistic prospect of the traditional system being made to work. Why did governments go for the radical option on revenue but not on service delivery? The answer is depressingly obvious: governments benefit from the revenue, whereas ordinary people benefit from basic services. Governments were not prepared to let the traditional civil service continue to sabotage tax revenues, because governments themselves were the victims. They *were* prepared to leave basic service delivery unreformed because the governing elite got its services elsewhere.

Aid and Marginalization

In Chapter 6 I argued that globalization was actually making things harder for the bottom billion. Export diversification has become more difficult because of China and India. Capital flight has become easier because of global financial integration. Emigration has become more attractive as the rich-poor gap has widened and more feasible as diasporas from the bottom billion have become established in the West. Hence, even countries that escaped from the traps might find themselves in limbo, unable to replicate the success of poor countries twenty years ago. How does aid affect this marginalization?

The major concern about aid is that it exacerbates the problem of breaking into global markets for new exports. This is due to Dutch disease, which I discussed back in Chapter 3. Aid, like natural resource revenues, tends to make other exports uncompetitive. The IMF feels so strongly about this that its current chief economist, Raghuram Rajan, a smart academic on leave from the University of Chicago's business school, launched a blistering public critique of aid in June 2005, just ahead of the G8 summit. It became a front-page headline in the *Financial Times*. His research showed that aid tended to retard the growth of labor-intensive export activities, precisely the activities needed for diversification in the bottom billion. So there is indeed a problem, and it has to be faced rather than denied. Fortunately, quite a lot can be done about it.

For a start, the aid can be spent on helping the export sector—for example, improving infrastructure at the ports. Even if such aid causes Dutch disease while it is being spent, once the port is improved and the aid is scaled back, there is no further Dutch disease, just a better port. What is required is a once-and-for-all big push, country by country. Such aid would be targeted at lowering the costs that potential exporters would face. It does not make sense to attempt such an approach everywhere. The landlocked and the resource-rich are likely to be out of the game, and there is little point in spending aid to try to get them into it. And even among the coastal, resource-scarce countries, those with really bad governance and policies may be out of it (although the experience of Bangladesh, previously described, suggests that poor governance is not necessarily a killer for exporting). The bottom billion would look a lot more hopeful if a few of their coastal economies really started to take off in global markets. Pioneering success is a sensible use of aid money partly because of the demonstration effect of role models. And remember, unless the coastal countries do well, the landlocked have few options. A big aid push for exporting is a

risky venture, because until it is tried there is simply no way of knowing whether it would work. In my view it is well worth the risk, but like other risky uses of aid, it simply will not happen under present incentives for aid agencies. Concentrating aid for a few years in a few countries and spending it on a strategy for export growth just breaks too many of the rules—not only the rules of caution that I have already discussed but also the rules of fair shares. Agencies operate with two types of fair-shares rules. One is for countries: it is difficult to privilege one country over another, even temporarily, although if the Krugman-Venables thesis of agglomeration economies is right, then one of its implications is that such temporary concentrations of aid are likely to be efficient. The other type of fair-shares rule may be even more difficult to surmount: fair shares among internal agency interests. Every aid agency is divided into fiefdoms—rural development, education, health, and so forth. Trying to get an aid agency to focus its resources on an export growth strategy runs afoul of all these interests, for if there is more money to be spent on the country, you can be absolutely sure that the rural development group will lobby for its share of the spending, whether that is important for export growth or not, and the same is true of the education group, the health group, and all the others. In bureaucracies, spending means jobs, promotions, success; it is how, in practice, staff measure themselves. So the present aid system is designed for incrementalism—a bit more budget here, a bit more budget there—and not for structural change. Yet we know that incrementalism is doomed because of diminishing returns to aid. Just doing more of the same is likely to yield a pretty modest payoff. For aid to promote structural change in countries requires structural change in aid agencies.

What else can be done to offset Dutch disease? Well, the aid can be spent on activities that have a large import content. Aid automatically increases the supply of imports, but depending on what you use it for, it can also increase the demand for imports. That is one advantage of technical assistance: it is all directly spent on the import of skills and so does not cause any Dutch disease. Aid spent on infrastructure will have a much higher import content than aid spent on education and so will cause less Dutch disease, dollar for dollar.

Finally, the adverse effects of aid can to an extent be offset by changes in trade policy, but I will come to that in Chapter 10.

Is Aid Part of the Problem or Part of the Solution?

One of the bugbears of the political right is that aid is going into Swiss bank accounts. Sometimes it does; there are well-documented cases. But what is the general relationship? Is aid financing capital flight, as it is financing military spending? Again, in the end it is an empirical question, not something that you can deduce from the first principles of an ideology. It's easy to think of ways in which aid might leak out into capital flight; for example, the president just steals it. But there are also ways in which aid could reduce capital flight. It is true that for this you have to think a little bit harder, as the image of the president stuffing dollars into his briefcase comes more easily, but here is an alternative mechanism. Aid improves the opportunities for private investment, and so money that otherwise would have fled the country gets invested inside it. That is evidently quite possible. The question is which predominates empirically.

For this project I teamed up again with Anke and Cathy. We had all worked on capital flight together twice before, and by now we knew how to control for two-way causation in interpreting the effects of aid. (I should note that at this stage, we have had our work reviewed by anonymous referees for a professional journal and the comments have been sufficiently encouraging for us to continue the process of revision, but it has not yet been published.) Our results indicate that aid significantly *reduced* capital flight. This surprised us, probably because that powerful image of the president stuffing his briefcase had penetrated our minds too. In fact, it seems that aid makes private investment more attractive and so helps to keep capital in the country. Aid, however, is not the only answer to the problems of the bottom billion. In recent years it has probably been overemphasized, partly because it is the easiest thing for the Western world to do and partly because it fits so comfortably into a moral universe organized around the principles of sin and expiation. That overemphasis, which comes from the left, has produced a predictable backlash from the right. Aid does have serious problems, and more especially serious limitations. Alone it will not be sufficient to turn the societies of the bottom billion around. But it is part of the solution rather than part of the problem. The challenge is to complement it with other actions.

CHAPTER 8

Military Intervention

AFTER IRAQ IT IS DIFFICULT to arouse much support for military intervention. For me this chapter is the toughest in the book because I want to persuade you that external military intervention has an important place in helping the societies of the bottom billion, and that these countries' own military forces are more often part of the problem than a substitute for external forces.

What External Forces Can Do

Until around 1990 international military intervention into failing states was just an extension of the Cold War. The Soviet Union armed the government of Angola, via Cuba, and the United States armed the Angolan rebel group UNITA, via South Africa. These interventions certainly did not help Angola. Only after the end of the Cold War did it become possible for military intervention to be motivated by different considerations. The 1990s began well for military intervention—the expulsion of the Iraqi invasion of Kuwait was a triumph of the new internationalism. Kuwait was a pretty clear-cut case for international intervention: expelling an aggressor. But there are three other important roles for external military intervention: restoration of order, maintaining postconflict peace, and preventing coups.

The Restoration of Order

After Kuwait came another situation that I regard as a clear-cut case for intervention: the restoration of order in a collapsed state. Total collapses are rare, but they happen. In this case it was Somalia. I say the case for this was clear-cut because it is surely irresponsible to leave a huge territory such as Somalia with no government. So did the United States, which sent in its forces under Operation Restore Hope.

Perhaps the U.S. military was overconfident after the huge success in Kuwait, or perhaps it got overruled by the politicians. In any case, the media-intensive military intervention—the invasion of Somalia by U.S. forces was actually delayed by twenty-four hours so that film crews could get ashore in Somalia ahead of the troops—surely invited hubris. Perhaps the scale of intervention was inadequate for the security problems it encountered, but given the media coverage, the eighteen U.S. fatalities that were repeatedly displayed on television doomed the intervention. Don't get me wrong: it is terrible when peacekeeping troops get killed, and it is magnificent of a nation to send its troops into a dangerous situation. But that is what modern armies are for: to supply the global public good of peace in territories that otherwise have the potential for nightmare. Sometimes soldiers will die in the line of duty, and those who do are heroes to be honored, but armies cannot function productively at zero risk. Anyway, what had perhaps been planned as a great media coup for the U.S. presidency had by October 1993 become a media nightmare, and U.S. forces were promptly pulled out. Of course, post-Iraq, the fact that the United States pulled out of Somalia as a result of a mere eighteen deaths looks even more bizarre, but that is what happened.

The consequences for Somalia were miserable: more than twelve years later it still has no functioning national government. By 1995 around 300,000 people had died, and beyond that there are no estimates of the deaths from continuing conflict and the failure of health systems. But the biggest killer consequent upon the withdrawal was not what happened in Somalia but the lesson that was learned: never intervene.

It took only months to prove how disastrously wrong this lesson was. Remember that 1994 was the year of Rwanda. We didn't want a second

Somalia, with another eighteen American soldiers killed, so we got Rwanda, in which half a million people were butchered, entirely avoidably, because international intervention was inadequate. This chapter is written for people who cannot imagine that it is better for half a million Rwandans to have died than for eighteen Americans to be sacrificed. But there is another factor to consider, too: the consequences of civil war spill over to the rich world in the form of epidemics, terrorism, and drugs. Some citizens of the rich world are going to die as a result of chaos in the bottom billion. The choice is whether these deaths will be among civilians as victims of the spillovers or among soldiers who have volunteered to put things right. And there have been spillovers from Somalia. As a result of the continuing chaos, there has been an exodus of young Somali men to developed countries. In July 2005 one of them, an asylum seeker in Britain, filled his rucksack with explosives and tried to blow up commuters on the London Underground. In November 2005 a Somali gang murdered a policewoman in a bank robbery in Bradford, United Kingdom. I have a young son, and when he is older I don't want him to be exposed to the risks of being a peacekeeping soldier. But I don't want him exposed to the risk of being blown apart in London or shot in Bradford by some exile from a failing state, either. Nor do I want him exposed to the risk of disease. Somalia was the last place on earth to be home to smallpox. It was eliminated there by international health interventions a few years before the Somali state collapsed. Now such elimination would not be possible. Had the Somali state not lasted as long as it did, we would still have smallpox. On balance, I think that my child, and everyone else's, will be safer if we respond to the problem of failing states by restoring order, rather than by relying only on the myriad of defensive measures that we need if we don't.

Maintaining Postconflict Peace

After Rwanda, military intervention was back in business, and the new role was the maintenance of peace after conflict ended. It was pretty hit-and-miss: some places got lots of troops, others not many. About the highest ratio in the world of foreign peacekeepers to population was in East Timor. One peacekeeper I met there was from Gambia, one of the smallest

and poorest countries in Africa. When I asked him about the situation in East Timor, he told me that it was terrible. "These people are *really* poor," he said. If he thought so, they were. Later, when I met up with the diplomatic set, I asked why there were so many peacekeepers in that country. The answer I got about summed up the problems of foreign military intervention: because it was safe there. Governments that send soldiers to serve as UN peacekeepers are paid $1,000 per individual per month. For some countries this is not a bad way of getting some income from their armies. The imperative is then that soldiers should not get themselves killed, so safe environments such as East Timor are ideal, and risky environments such as the Democratic Republic of the Congo are unattractive. Even if troops are sent to dangerous places, they often play it safe. The best-known example occurred near Srebrenica in Bosnia in 1995, where Dutch troops were supposed to be providing a safe haven but failed to protect the scared refugees, who were massacred. The Dutch seem not to have learned a lesson from this—when Liberia looked worrying in 2004, as it has periodically in recent years, the Dutch sent a naval vessel, but their instructions were, broadly, to sail away if trouble developed. Another revealing case is the ragtag United Nations force in Sierra Leone. In 2000 the RUF rebel movement took five hundred of these soldiers hostage and stripped them of their military equipment. Was the RUF such a formidable fighting force? Hardly—once a few hundred British troops arrived a few months later, willing to take casualties, the whole rebel army rapidly collapsed. The UN troops were an easy target because the RUF understood that they would not resist. They were carrying their guns like tourists flaunting their jewelry.

So much for how not to provide international military intervention. By contrast, the British intervention in Sierra Leone just mentioned, Operation Palliser, has been a huge success. It has imposed security and maintained it once the RUF was disposed of. The whole operation has been amazingly cheap. I can think of no other way in which peace could have been restored and maintained in Sierra Leone. Anke Hoeffler and I even tried to do a cost-benefit analysis of the operation. Finding out about the costs was surprisingly easy—I simply phoned the Foreign Office, and not only did they more or less know, they more or less told me. The harder part was to estimate the benefits. After all, nothing much had happened in

Sierra Leone since the British troops established peace. This, of course, was the point. Without them there would have been some probability that plenty of very bad things would have happened. That avoided probability is the key to the payoff to British troops. We used our model of conflict to estimate the likely risk of reversion to conflict in Sierra Leone—admittedly a pretty crude approximation because we used the model of a typical postconflict country, which ignores the particularities of Sierra Leone. But as a way of estimating a representative payoff to postconflict interventions, sidestepping the particularities is not such a bad thing. We then took this avoided probability of conflict and multiplied it by the typical cost of a civil war, already estimated at around $64 billion. I have to say that I do not like making calculations such as this; our model is better used to establish which policy interventions might typically work than to estimate risks in any particular case, because there is so much important information about each situation that a model must omit. But for what it's worth, we estimated that the benefits of intervention were around thirty times its cost. With a cost-benefit ratio like that, there is quite a bit of room for error in the calculations before they become misleading.

Operation Palliser was brilliant, and the British army can be proud of its contribution to the development of Sierra Leone. It also serves as a model for military intervention in the bottom billion: cheap, confident, and sustained. It was welcome, too—the people of the country were truly thankful. Yet it is completely uncelebrated. Instead, reverberating in the newspaper headlines each day is Iraq. As with Somalia, the apparent lesson from Iraq is to never intervene. That is not just the popular reaction but also the reaction of the insiders. In November 2005 I was invited to Brussels to address a bunch of specialists, and the room was awash with military braid. When I made my pitch on Sierra Leone, the first response was, "But surely that's been blown out of the water by Iraq." The important thing to remember, though, is that we've already discovered what happens when we stick our heads as deep in the sand as they will go: we get Rwanda.

So we should intervene, but not necessarily everywhere. Sierra Leone rather than Iraq is the likely future of intervention opportunities in the bottom-billion countries. Look at the contrasts between the two situations. In Sierra Leone our forces were invited in by the government and hugely welcomed by the local population. In Sierra Leone we could not be accused of going in for the oil, as there wasn't any. In Sierra Leone we did not have to worry about "fixing what we broke," for there was not much to break, and we ousted the RUF with minimal damage. In Sierra Leone we needed less than a thousand proper soldiers to achieve decisive military change. The differences seem obvious.

Protection Against Coups

It is politically correct to argue that the military forces of the rich countries no longer have a role in the bottom-billion countries. Indeed, for fear of arousing anticolonialist sentiments the French have got themselves into the odd position of maintaining large military forces in Africa that they dare not use. For example, in 1999 they let the head of the tiny army in Côte d'Ivoire, Robert Gueï, mount a successful coup against the legitimate government despite having two thousand troops stationed in the country. To keep the French forces in their barracks, the coup leader promised to hold an election within six months. And so the French decided to let the coup succeed—after all, it was only for a little while. Evidently, the French government was not aware of the problem of time inconsistency: that sometimes the incentive to break a promise is overwhelming. To be fair, the coup leader did stick to the letter of his promise and held an election. But he put himself forward as a candidate and banned both of the country's most prominent political leaders from running. As you might imagine, this did not produce a happy outcome, and so the French army did eventually have to intervene to prevent a rebel group from seizing the capital. But instead of either putting down the rebellion or forcing a compromise settlement, the French simply held a line separating the government and rebel forces, yielding a de facto partition of the country that has now persisted for several years. Each side has used the respite to rearm; after doing so, the government attacked the French forces, since they saw them as protecting the rebels.

The French hesitation to intervene is mirrored in the deployment of the European Union's new rapid reaction force. Ostensibly this force is for deployment in African emergencies. I suspect that it will never be deployed. For example, it has not been used in Darfur, Sudan, where

government-backed militias are currently slaughtering and terrorizing the region's people, nor to put down the August 2005 coup in Mauritania. Its creation allows Europe to present the impression that it is doing something, just as the continuing French military presence in Africa creates the illusion of French power. But in reality these forces are impotent because Europe does not have an authorizing environment for their use. The United Nations does, but actually for many bottom-billion environments we can do better: we could turn to the regional political groupings. Most of the costs of state failure accrue to neighbors—that is, state failure is a regional public bad. So it is the region that has the strongest interest to do something about it. But in Africa no country really has the resources or the political ascendancy to impose order on failing neighbors. So the European Union has the forces and the aspirations, and the affected regions have the interests and can confer legitimacy. This situation has the potential for a marriage: the African Union could provide the political authority for military intervention, and the European rapid reaction force could be the backbone of whatever force was used to intervene. I will give an example of what I have in mind, something that almost worked out well, but didn't: Togo.

Togo was ruled as the personal fiefdom of a dictator, Gnassingbé Eyadéma, for thirty-eight years, a longer continuous period of rule than anywhere else other than Cuba. His rule was economically ruinous as well as politically stifling. He died in February 2005, and his son, Faure Gnassingbé, declared himself president. At this point the African Union, to its considerable credit, classified the event as a coup and insisted on a constitutional process. The African Union had sufficient power relative to Togo that Gnassingbé agreed to elections. Triumph? Nearly. Gnassingbé decided not only that he would be a candidate in the elections but that he would run them. To nobody's great surprise he announced himself the winner, though had he actually taken the trouble to count the votes he would have discovered that he had lost. So what should have happened? Well, surely what should have happened is that once the African Union had declared the coup unconstitutional, an international military force should have arrived promptly in the country to take temporary power. It really would not have needed to be a very big force. Speed would have been more important than size. In fact, what was needed was a rapid reaction force, which the European Union already had. A temporary military intervention would

have supervised free and fair elections. Nobody could have accused such an intervention of being neocolonialist, as the international force would not have been trying to colonize Togo. It would have sat there for perhaps four months. As it is, the world may have to wait a good long time until Gnassingbé makes his own decisive contribution to its development by dying, for he was thirty-eight when he became president.

Coups such as the one that destabilized Côte d'Ivoire are still a problem for the bottom billion. Remember, they are driven by much the same factors as rebellions are: poverty and stagnation. And yet it would be relatively easy to make coups history. We just need a credible military guarantee of external intervention. Obviously the European Union is not going to offer a blank check to every regime in the bottom billion. But we could offer a guarantee to democratic governments conditional upon internationally certified free and fair elections. I will spell out the conditions we might specify in Chapter 10, on international norms.

Are Domestic Militaries a Substitute?

You might well be prepared to accept that in extreme situations such as Somalia, where there is a total breakdown of authority, there is a need for external intervention. But as for postconflict situations and the risk of coups, why don't the governments of the bottom billion rely upon their own security forces? Well, because in precisely the situations where governments face the greatest risks their own military establishments are not the solution but rather part of the problem.

Peace Through Strength?

Back in Chapter 2 I discussed the risk that postconflict situations might revert to conflict. It's a substantial risk, and postconflict governments know it. Typically what they do is to keep their military spending high—almost as high as during the war itself. They forgo the chance of a peace dividend, thinking it too risky. This is a natural reaction, and you can see it on the ground—high levels of domestic military spending are typical in postconflict situations. But this could just be inertia. I wondered whether it would be possible to test whether governments set their levels of military spending

specifically in response to the risk of civil war. Anke and I were already working in the specialized world of military spending in order to determine whether it was financed by aid, as I discussed in Chapter 7. And we had already modeled the risk of civil war, as you saw in Chapter 2. We now brought the two together. Sure enough, the level of military spending that a government chose reflected the risk of civil war that it faced. Postconflict governments were spending more on the military largely because they faced abnormally high risks. Then we decided to confront the issue of whether this high level of postconflict military spending was effective in deterring conflict. This was not an easy question to answer because obviously the governments that spend the most are likely to be those that face the biggest risks. As a result, unless military spending is totally effective, high spending will be correlated with reversion to conflict. In other words, because causality runs from risk to spending, it is hard to distinguish any causality from spending to risk. We think we managed to overcome this problem, and our published results indicate that high military spending in postconflict situations is part of the problem, not part of the solution. It makes further conflict substantially more likely. It is natural for a postconflict government to try to defend itself, but it doesn't work. We have an idea of what goes wrong, and it involves time inconsistency. In postconflict situations neither side trusts the other. The rebels face the greater problem because governments can maintain their armies during peace much more easily than can the rebels. So although the government has an incentive to promise an inclusive peace deal, as time goes on it has less and less of an incentive to keep its word. As a result, there are sure to be factions among the rebel forces wanting to go back to war preemptively, while the option is still open. High military spending by the government may inadvertently signal to the rebel forces that the government is indeed going to renege on any deal and rule by repression.

I was once brought in to talk to a depressingly large group of finance ministers from postconflict countries, and I put to them this argument that high military spending is likely to be dysfunctional. Despite the fact that military spending is often a taboo subject, there was an enthusiastic chorus of approval led by the finance minister of Mozambique, Luisa Diogo. Now prime minister, Diogo gave us the example of her own country. Completely bucking the usual trend, her government had radically cut

military spending to virtually nothing, and the peace had endured. It turned out that, far from favoring big military budgets, finance ministers wanted evidence to defend their spending priorities against the demands of the powerful military lobby.

The key implication is that in postconflict situations risks are high. Governments recognize these risks. Eventually, if they run the economy well, this will bring the risk down, but it is going to take around a decade. There is no magic political fix, and so there has to be some military force to keep the peace during this dangerous period. But if the force is domestic, it exacerbates the problem. In the typical postconflict situation external military force is needed for a long time.

Grand Extortion

One obvious feature of coups is that they are perpetrated by the military. Our work on coups and on military spending shows pretty straightforwardly that after a successful coup the new leaders slam up military spending. But Anke and I wondered whether in response to a high risk of a coup governments tried to buy the military off. If this was the case, the military would, in effect, be running a protection racket on a grand scale. We termed this grand extortion. So we had a clear question: did a high risk of a coup drive up military budgets? Again, it was not an easy question to answer. Our research (which is still new and as yet unpublished) revealed that behavior was distinctive in the governments of the bottom billion. In countries that are richer than the bottom billion the risk of a coup is small, and if it increases a little, the military budget is not increased—indeed, if anything the military gets cut if it starts to be a nuisance. By contrast, in the countries of the bottom billion coup risk is generally much higher. The threat from the military is indeed probably the biggest risk of losing power that most of these governments face. And they pay up: more risk induces more money for the military.

If, however, we are right, then governments in the bottom billion are in a bind. They are genuinely threatened by their own armies, and so, threatened by grand extortion, they pay up. I say "they" pay up, but remember from Chapter 7 than in many of the bottom-billion countries around 40 percent of military spending is inadvertently financed by aid. So actually,

we in the West pay up. The militaries of the bottom billion are running an extortion racket and our aid programs are the victim. Coups are usually a dysfunctional way of changing government, and that is the core reason why we need to provide external military guarantees against them. But we might also bear in mind that if we provided military guarantees, the protection rackets would collapse. Governments could spend our aid on development instead of extortion.

CHAPTER 9

Laws and Charters

SO FAR I HAVE LOOKED at aid and at military interventions. Both are useful, but both are pretty costly, one in money and the other in guts: political guts, and sometimes soldiers' guts. Now I am going to look at a range of interventions that are strikingly cheap. They fall into two groups: changes in our own laws that would benefit the bottom billion, and the generation of international norms that would help to guide behavior.

Our Laws, Their Problems

In Chapter 1 I discussed the danger that the societies of the bottom billion might become safe havens for criminals, terrorists, and disease. Paradoxically, some of this is reciprocal: the rich countries have been a safe haven for the criminals of the bottom billion.

One grotesque form of this safe haven role has been that Western banks have taken deposits looted from the bottom-billion societies, held the money in great secrecy, and refused to give it back. Many Western countries are incriminated in this shameful practice. In the United States it came to light in 2004 that Riggs Bank, in Washington, D.C., was holding huge deposits from the president of Equatorial Guinea and writing him cringingly effusive letters of encouragement. As soon as the matter came to light it was stopped and the bank radically reorganized. In Britain, it was revealed in 2000 that the family of Sani Abacha, a former military dictator of

Nigeria, had made massive cash deposits into London banks with no troubling questions whatsoever. But probably the all-time prize goes to Switzerland. Also around 2000, it came out that Abacha had placed money there as well before his death in 1998. When the post-Abacha Nigerian government pursued the money, the Swiss did not exactly cooperate. Even after a Swiss court eventually ruled that the deposits belonged to the government of Nigeria, the Swiss minister of justice refused to return the money. He had to be shamed into doing so. Does Switzerland really need to make a living this way?

The costs and complexities of getting corrupt money repatriated make the process prohibitive in all but the most dramatic and publicized cases. Is changing this at all feasible? If we made the reporting of any potentially corrupt deposits a requirement of banking, and if we made the freezing and repatriation of those deposits radically easier, would it seriously damage our financial system? I doubt it, because if the money is suspected of having a connection to terrorism we already do it. The West's current concern is terrorism, so we do something about it. The problem of governance in the bottom billion is not seen as ours, and so we do the minimum. Consequently, corrupt politicians in the bottom billion continue to stack their money away in Western banks. Of course, most bankers are people of integrity. But the banking profession has a responsibility to clean up its act, just as De Beers did in respect to diamonds. At present, a small minority of bankers are living on the profits from holding deposits of corrupt money. We have a word for people who live on the immoral earnings of others: pimps. Pimping bankers are no better than any other sort of pimp. They have to be driven out of banking, and it is primarily the responsibility of the banking profession itself to do it, for it's the bankers who have the inside knowledge, just as the main defense against quacks is the medical profession. The agency with official responsibility for oversight of the financial sector is usually the central bank. Central banks are about as far removed from aid agencies as it is possible to get while still being agencies within the same government. For example, politically, the staffs of aid agencies are on the far left of government, while central bankers are on the far right. Aid agencies have little choice but to focus on the bottom billion; they are not going to be able to duck the problem. But central bankers will most surely be able to duck it, claiming it has nothing

to do with them and that their priorities lie elsewhere. Somehow, the central banks have to get this onto their agenda.

It is not just the banks. Until very recently, if a French company bribed a public official in a bottom-billion society, the payment was tax deductible. Think it through: French taxpayers were subsidizing bribery. Of course, it did not apply to the same behavior within France: if a French company had reported that it had bribed a French politician, the consequence would have been a criminal investigation, not a reduced tax bill. France was not alone in this practice. No Western government wanted to force its companies to behave properly because there was the reasonable fear that this would disadvantage its companies in winning contracts. The great commercial game in bottom-billion societies has been to bribe your way into a lucrative contract. This is an instance of a coordination problem that game theorists call the prisoner's dilemma. We would all be better off in a world in which our companies did not bribe the governments of the bottom billion, but the worst outcome is for the companies in one nation to refrain from bribing while those of other nations continue. And so for a long time we were all locked into bribery.

Eventually, after a lot of pressure, in 1999 the OECD managed to organize the necessary coordination to escape this dilemma: an agreement among its member governments that they would all legislate to make bribery of a public official in a foreign country an offense. The question is now how vigorously this legislation will be enforced. Again, all the incentives at the corporate and country level are not to cause trouble. At least bribes are no longer tax deductible. But of course it is very easy to dress up a bribe as a "facilitation payment" for some service. It is only when whistleblowers within a company have an incentive to report the truth that the law can be properly enforced. Within government, this sort of work comes under the responsibility of the department that deals with trade and industry. These departments see their external role as helping to win exports. It is hard to get them to worry about the impact of their actions on the governance of the bottom billion. Like central banks, they do not see it as their problem.

Corruption has its epicenters. I started by focusing on our banks, where much of the loot is deposited. Among the companies that pay the bribes two sectors seem to stand out: resource extraction and construction. I will

discuss how to deal with the problems of resource extraction shortly; it has been publicly recognized as a problem at least since the launch of the Extractive Industries Transparency Initiative by Britain's Tony Blair in 2002. By contrast, corruption in the construction sector has been a dirty secret. Transparency International decided to bring it to greater prominence by devoting its *Global Corruption Report 2005* to the sector. Construction has all the ingredients conducive to corruption: each project is a one-time-only thing, and so cannot readily be priced. There are so many uncertainties in execution that it is not possible to draw up what economists refer to as a "complete contract." As a result, it is easy to evade the discipline that would otherwise be imposed by competitive tendering. A crooked construction company colludes with a public official to win the contract with an artificially low bid, but then they recontract on points of detail that crop up during construction. A friend of mine was finance minister in Eritrea, at the time one of the least corrupt of the bottom-billion countries. Even so, he realized that he would not be able to prevent corruption in construction projects, and that this would undermine governance more widely. His drastic solution was to minimize spending on construction, vetoing projects wherever possible. He was not foolish. There are now credible studies for some countries that estimate how much corruption in the construction sector is raising the cost of infrastructure and thereby reducing growth, and these effects are large.

Why is corruption in the construction sector particularly important now for the bottom billion? Well, the Gleneagles G8 summit in July 2005 announced a doubling of aid, focused on infrastructure. As this gets implemented there is going to be a massive construction boom in many of these countries. Under present circumstances, this will amplify what is already a serious problem of misgovernance. Corrupt money is not just a waste. Think back to the natural resource trap. Big corrupt money is likely to undermine the political process, enabling the strategy of patronage to triumph over honest politics. Aid for infrastructure makes sense, but only if it is matched by a radical tightening of the enforcement of anticorruption norms and regulations in the construction sector. The construction companies are largely our companies. Their behavior depends upon our laws and how they are enforced.

Norms for the Bottom Billion: Making International Standards and Codes Pertinent

Most conduct is guided by norms rather than by laws. Norms are voluntary and are effective because they are enforced by peer pressure. Over the past fifty years the world has generated a huge range of them, enshrined in international standards and codes. Most of these are voluntary; others ultimately have the force of law and so curtail national sovereignty but are largely enforced by peer pressure rather than by legal penalties. Norms can be massively effective in inducing changes in governance. To see how effective, look at Eastern Europe over the past decade. The typical situation was that the countries of Eastern Europe, having escaped from the Soviet bloc, wanted to lock themselves into being market democracies. They had one hugely attractive option to hand: membership in the European Union (called the European Community until 1992). But the EU had an established set of rules, the *acquis communautaires,* to which all new members had to adhere. Over the course of a decade, the countries of Eastern Europe made a massive effort to change their societies into market democracies in order to meet these standards and so have a chance of becoming members. This was the power of a set of international norms at its most stunning. If you want to understand why some countries of the former Soviet Union have done well while others are becoming failing states, a pretty good guide is geography. The further away from the EU and so the less credible the prospect of EU membership, the worse they have done. The societies of the bottom billion need some set of norms that are analogous to the EU effect.

They do not, however, literally need the *acquis communautaires*. These rules were written for western Europe. The countries of the bottom billion need rules that are appropriate for societies at their level of development, that address the problems they face. There are lots of standards and codes, but mostly they codify desirable behavior for either the already developed countries or the emerging market economies. The societies of the bottom billion have different problems and need different norms. In this chapter I am going to focus on what norms really matter for them. How to get these norms adopted is going to be deferred until Part 5. I am going to propose five international charters—norms that I think would help reformers within the societies of the bottom billion to achieve and sustain change.

A Charter for Natural Resource Revenues

In Chapter 3, I set out what goes wrong in resource-rich countries. International standards are our best hope of helping reformers within these societies to put things right, and the payoff would be huge. Resource revenues to the bottom billion are bigger than aid, and far more poorly used. If we could raise the effectiveness of resource revenues even to the present level of aid effectiveness, the impact would be enormous. The British government has already made a start on proposing international standards, launching the Extractive Industries Transparency Initiative in 2002. This is a good start, but only a start. What should a more comprehensive charter say?

Let's explore the chain from undiscovered resources in the ground to the basic public services that they could finance. Step one is awarding the contracts to get the resources out of the ground. This step has usually been a disaster: companies have bribed their way into contracts that are lucrative for them and for the bribed politicians but lousy for the country. Tufts University economist Maggie McMillan has managed, thanks to the much greater freedom of information in the United States than elsewhere, to get data on the international investment returns of U.S. oil companies. She is finding that their returns have been higher the worse the governance of the countries in which they operate. Of course, the companies will explain this as compensation for risk, and in part it is. But it also probably reflects the returns to the lack of transparent competition. An oil field in a developed country is auctioned off in a transparent process. This should be a basic requirement of an international charter on resource extraction. Since the design of auctions is complicated and apparently transparent processes can still be corrupt, a charter could usefully spell out some of the key features of an effective process.

Step two is what the contracts say—in particular, who bears what risk. At present, price risk is borne by governments, not by companies. Tiny countries, with governments that lack the competence to manage even a village post office, are trying to cope with boom-bust cycles, rather than the task being done by the financially sophisticated and huge oil companies at the other end of the contract. It does not have to be like that. Oil companies could bear at least part of the price risk—for example, undertaking to provide a set quantity of oil at the world price averaged over several years, thereby stabilizing a component of total oil revenue.

Step three is to make all payments of revenue transparent. This has been the focus of the Extractive Industries Transparency Initiative and of its precursor, the Publish What You Pay campaign. It was the right place to start. Unless citizens know what money is coming in, they have little hope of scrutinizing how it is used. All companies must be included, most especially the national oil companies that are sometimes governments within governments. There is also a need for some honest broker to collate the individual company information into a coherent picture of flows into government. For example, in Angola there are thirty-four foreign oil companies and a state-owned national oil company. It is a skilled job to make sense of the information supplied by each individual company. The obvious agency to do this would be the World Bank or the IMF, as either of these has the expertise and does not stand to gain from falsification. The broker would act merely as an accountant, not as a police officer, converting a confusing morass of information into knowledge that citizens could use.

Step four is transparency in public expenditures. In the resource-rich countries effective public spending is the vital route to development, and this is not going to happen without transparency. Whereas transparency in public spending is always desirable, in the resource-rich countries it is vital. And so there is a need to set out minimum standards of transparency. I spell this out below when I discuss the charter on budgets.

Step five is a set of rules for smoothing public spending in the face of revenue shocks. The history of resource revenue shocks is a pretty sad one: booms have often been the prelude to crises. Astonishingly, given its core role in crisis management and prevention, the IMF has not yet come up with simple guidelines on how to manage volatility in resource revenues. It is true that perfection is elusive and the details can become complex. But a guideline does not have to be so sophisticated in order to be an improvement on what has gone on in the past. At present, resource-rich countries have to come up with their own, ad hoc systems, each different. Often these are the pet project of some reforming minister and do not survive beyond the minister's departure. An international standard would make smoothing arrangements easier to introduce and harder to remove. It is important to distinguish between smoothing out shocks, which is a

medium-term strategy, and accumulating financial assets for future generations. Norway, about the richest country in the world, parks some of its oil revenue in a "future-generations fund," and several countries of the bottom billion have sought to imitate it. This may be a good idea for Norway, which has capital coming out of its ears, but it is a pretty doubtful one for the bottom-billion societies, since they are extremely short of capital. They need to learn how to invest their money well domestically, not how to park it in the U.S. stock market. Future-generations funds are even politically risky in low-income countries: as they accumulate they are a mounting temptation for populism. Consequently, future-generations funds are unlikely to make it through to some future generation and more likely to be a transfer from the prudent governments that establish them to the imprudent governments that dismantle them. Sadly, that is what the record to date bears out.

If such a charter were launched, would it have any effect? I first became convinced of the need for a charter when I visited East Timor. The Indonesians had recently pulled out and the new government had yet to be elected. However, the little group of exiles who had returned from Portugal and who formed the provisional government had decided to hold a planning retreat, since East Timor was about to get seriously large oil and gas revenues. The exiles knew that managing the revenues would be difficult, and to their considerable credit they knew that they knew nothing—and had done something about it, looking for a model of how to handle the revenues. If there had been a model spelled out in an international charter, most probably they would have adopted it and turned their attention to some of the other thousand things that a postconflict government has to worry about. But there was no charter. Instead, they used two criteria to find a model, both of which were understandable. The first criterion was that it had to come from a country with oil. It was hard to argue with that one. Criterion number two was that it had to come from a Portuguese-speaking country, so that they could understand it. This also appears to have some logic to it—except that when you put the two criteria together, you come up with Angola. They sent a team to Angola to learn how to manage oil revenues, but they might as well have sent a team to a brothel to learn about sanctity. As it turned out, they had more sense than to use Angola as a model. But unfortunately they used Norway instead. This episode convinced me that a charter would be useful.

And so it has proved. The Extractive Industries Transparency Initiative, which was launched by the British government in 2002 as a proto-charter, has already had an effect. It has been picked up by East Timor and by several West African governments, not least the reform team in Nigeria. I remember attending a meeting of West African ministers at which the governance of oil revenues was discussed. The delegations that were decidedly unenthusiastic about transparency sat there quietly, perhaps hoping to be shielded by an Africa-versus-the-outsiders mentality. It didn't happen. Several of the other African delegations wanted change and committed to transparency. What followed was an intense internal debate within some of the recalcitrant governments on whether or not to commit to the charter. There were evidently some voices within even the worst governments wanting change, just as, unsurprisingly, there were voices wanting the gravy train to continue. Can you imagine that happening without the spur of an international charter? This peer pressure is one way in which international standards might get adopted: as reformers from time to time gain power in bottom-billion countries, they seize their moment to adopt the standards, and then it becomes politically troublesome to abandon them. As more countries adopt them, pressure on the nonadopters grows because they begin to stand out as conniving at corruption.

The main point of pressure for the adoption of international standards would come from within the bottom-billion societies themselves, especially from civil society. An international charter gives people something very concrete to demand: either the government adopts it or it must explain why it won't. All societies of the bottom billion have plenty of latent opposition to bad governance. But transforming this latent opposition into effective pressure is difficult. Even at the best of times such pressure is a public good and so subject to all the problems of free riding—the "why bother, let's leave it to someone else to stick their neck out" attitude. And, of course, in many societies it requires courage as well as effort. What is more, because reform is complicated, people can reasonably disagree on what needs to be done, but such disagreements divide and dissipate the reformist opposition. Often such disagreements elide into disputes over leadership: backing someone else's idea for reform is perceived as acknowledging the other as leader and thus giving up one's own claim. Where villains are in power they should not be underestimated. Not only do they

have money, but they are skilled in the tactics of divide and rule. They will be actively trying to create and amplify disagreements. An international standard provides something that all the opposition can coordinate around without conceding leadership to anyone in particular.

A third key pressure point in cleaning up resource revenues is the international companies in the extractive industries. The model here is De Beers and its Kimberley Process for the certification of diamonds. For many years De Beers had been in denial that conflict diamonds were a problem. Then pressure from NGOs persuaded the company that denial was not going to work: if the image of conflict diamonds became entrenched in the mind of consumers, diamonds could go the way of fur. To their considerable credit, De Beers radically changed tack. They came up with a plan for certification, and they are still pressing ahead to make this process more effective. For example, they are promoting a new smart-card technology that can be used to make it far harder for alluvial diamonds, dug up from riverbeds by individual prospectors, to be smuggled. As certification becomes more effective the rents from diamonds can accrue to governments rather than to traders. One expert told me that he thought alluvial miners were currently getting only around 10 percent of the true market price.

De Beers demonstrates that big companies can become a key part of the solution rather than being part of the problem. What worked for diamonds may not work for oil, but in one respect the task of transparency is quite a bit easier: it is far harder to smuggle oil than diamonds. There has been some "conflict oil": at one stage oil worth about a billion dollars a year was being "bunkered"—stolen—from the delta region of Nigeria. But because of the trace elements found in oil, its origin is detectable, and so certification could be effective. Indeed, once the Nigerian government managed to track down where its oil was being sold it was able to curtail the problem.

In another respect, however—the organization of the industry—oil is harder than diamonds. De Beers is far more important to the diamond market than any single oil company is to the oil market. When BP tried to work in a transparent manner in Angola, the Angolan government threatened the other thirty-three oil companies operating there that the first one to follow would be thrown out. None did. Oil companies are too competitive for the

industry to organize itself of its own accord. This is where Western civil society comes in. Brent Spar was an oil well in the North Sea that had reached the end of its productive life. Shell, the owner, proposed to discard it in a way that might have damaged the environment. The reaction by European environmentalists was so devastating to Shell's image and sales that it changed its policy on closing oil wells. At first the Shell management tried to stand firm, but then sales of Shell products in Germany crashed by 30 percent, prompting the manager of Shell Germany to break ranks. Where did all this power come from? Well, perhaps it was the accumulated effects of German teenagers in the backseat of the family car, saying, "No, Mom and Dad, not that gas station—did you hear what Shell wants to do?" and the parents presumably thought it was better to avoid the argument. Brent Spar demonstrated that what ordinary people in the West think about oil companies really matters. Those with brand names have spent billions building up their reputation and do not want to see it destroyed. The problem is that at present the pressure is for things that just do not matter very much for the bottom billion. Companies are being pressured on their environmental policies and on their employment policies, both of which are frankly peripheral, when what is needed is pressure on their policies toward governance. If there was an international charter on standards along the lines of the five points laid out above, NGOs could start to demand that companies adhere to it. For example, a company that entered into an extraction contract won without competitive bidding would be censured. Potentially it is even possible for oil companies to be required to display at their gas stations where the oil used in the gasoline is from. Obviously, oil from different sources gets mixed together, but for the purposes of consumer pressure the source of oil is a financial concept, not a physical one. If a thousand barrels of oil from Angola go into a storage tank, one thousand barrels of the oil that comes out could be designated as being from Angola. If consumers refused to buy gasoline "from" Angola, the companies would be reluctant to put it into the storage tanks in the first place. Angolan oil would become harder to sell, except at a discount, and this would create a financial incentive for the Angolan government to be transparent. The same process that so effectively pressured Shell to clean up Brent Spar would be directed to the far more valuable task of making oil revenues effective for development.

Consumer pressure works only on those companies that have brand names to protect. Some don't. I have already raised the specter of the Chinese scrambling for natural resources without much concern for governance. Western consumer pressure is not going to cut much ice with the Chinese, and don't hold your breath waiting for Chinese consumer pressure, either. This is the argument put forth by at least some of the Western oil companies: impose standards on them and all that happens is that the Chinese are let in. Can anything be done about this? I think so. In part what the Chinese government wants is a place at the top table—recognition by the international community that China is a key country, powerful and important. The deal has to be that with power come a few responsibilities, one of which is adherence to international standards for resource extraction. If Western consumers force the big-brand oil companies to adopt international standards, then in turn the oil companies will pressure their governments—the United States, Britain, and France—to come to an arrangement with China. The West has to offer China greater inclusion in power in return for adherence to international standards. It has to be made in China's interests for the bottom billion to develop rather than to fall apart.

A Charter for Democracy

Since the fall of the Soviet Union democracy has spread rapidly across the developing world. Political scientists actually measure it. There is an index called Polity that rates the degree of democracy on a scale from 0 to 10. In the 1980s the average developing county scored only around 2; now the average is around 4.5. However, to date, this transition to democracy has been defined overwhelmingly in terms of elections. This has been inevitable. Electoral competition can be introduced with great speed even in the most unpromising bottom-billion conditions, such as Afghanistan. As the prospect of elections moves toward becoming a reality, many individuals and groups have incentives to behave in ways that facilitate their introduction: they form political parties as a means to acquiring power. But remember, elections are not enough. Electoral competition can make things worse, because patronage will often win out over honest politics in the struggle for votes—recall the survival of the fattest.

By contrast, checks and balances take time to introduce, and they are political orphans: those parties that expect to rule have a direct interest in frustrating their introduction, and the entire political class stands to lose if patronage politics is made infeasible. Elections determine who is in power, but they do not determine how power is used. Because of the different time scales for elections and for checks and balances, the instant democracies must almost inevitably go through a phase in which electoral competition faces few restraints. The real issue is whether this is merely a phase or becomes a permanent feature of the polity—whether these countries get stuck with a parody of democracy.

Why have elections spread around the world? Their spread surely demonstrates the power of international influence, especially that of the international media. Being events, elections get intensively reported. Citizens in the developing world have inevitably come to see an election as the defining feature of democratic legitimacy. Not only does international reporting spread a model that local populations follow, but also it enables them to harness the power of international pressure. Many of the banners at political demonstrations are in English, demonstrating that we are part of the intended audience for these protests. Hence, our message matters, but to date the message has been concerned nearly exclusively with elections. Checks and balances are continuous and complex—they are not events—and so they have been much less newsworthy. The mature democracies now need to use our evident influence to encourage the less visible aspects of democracy.

Since growth itself gradually increases income to the level at which checks and balances are secured, an improvement in them eventually becomes self-sustaining. An international effort to promote checks and balances would therefore only need to be temporary. The wave of electoral competition that swept the developing world in the 1990s, and may now sweep the Middle East, thus needs to be complemented by a wave of enthusiasm for political restraints.

As with resource rents, it would help if there was some international minimum standard, analogous to the minimum standards set out by the European Union. I would start with rules about the media, which are the most effective form of scrutiny. In the societies of the bottom billion the key media are probably the radio channels and increasingly television. One

rare and dramatic story from Peru illustrates this. The government of Alberto Fujimori was notably corrupt, so much so that the chief of the secret police, Vladimiro Montesinos, who was charged with the task of implementing all the corruption, decided to keep careful records. These records now provide a very rare quantitative window on political corruption, and John McMillan of Stanford Business School has analyzed them. His work shows that the Fujimori government set out to systematically undermine each check and balance that restrained it. It bribed members of parliament, judges, newspaper editors, and the staff of radio stations and television stations. If there was a restraint, the government undermined it. The amount it was prepared to pay reflected its view of the importance of each restraint. From our perspective it is not just creepily fascinating to see a system of bad governance on display; it also tells us what is really important in the fight against it. Where the Fujimori regime put most of its money is probably where we should be most vigilant. While the official constitutional restraints, such as parliament and the courts, were bought, the regime did not spend serious money undermining them. The newspapers were also bought, but it was the same story: thousands of dollars a month, not millions. Where the zeros rolled out on the checks was to buy the television stations. There were ten stations, and the government bought them at nearly a million dollars each per month. This money bought a proper contract—each day the station had to screen its evening news program in advance for Montesinos and make the required changes. So for the government it was the television news that was the vital restraint to control. Was this paranoia? No, it turned out that the government was quite right. We know because the government had only bothered to buy the nine biggest television channels—it decided not to bother with the tenth, a tiny financial satellite service with only ten thousand subscribers. That is how the government fell. Someone leaked a video of Montesinos bribing a judge, and it was broadcast on this one television channel. Protest escalated uncontrollably. So in Peru the key restraint upon the government was the media, and among the media, it was television. I think that in most bottom-billion countries television is still too limited to be the key medium; it is more likely to be radio. Thus among the checks and balances I would place keeping radio out of government monopoly control as vital. Radio stations are sufficiently cheap to

establish that, freed from government restraints on entry, there are likely to be too many of them for the government to be able to control them all.

Beyond the media, what else? Democracy is designed very differently in different places, so it is pointless trying to set out some grand blueprint that all democracies should follow. There is, however, one other aspect of democracy where international standards would help to curtail massive abuse, and that it how money is raised and spent on election campaigning. I grew up in Britain, which has very strict limits both on how money can be raised and on how it can be spent. I used to be amazed by U.S.-style campaign finance, but that was before I looked around. Even before we get to the bottom billion, campaign spending in the new democracies is amazing. Look at Russia. An election campaign costs around four times as much there as it does in the United States, despite Russia's income being only about a tenth of that in America. In relative terms this is forty times the U.S. level of spending. And look at Nigeria. Never mind the presidential campaign there—just to get elected as a senator costs around half a million dollars. With spending like that, no wonder the politics is corrupt. To raise that sort of money candidates have to sell their houses, borrow, and beg, and then if they win they have just four years to recoup their investment.

How is money spent during campaigns? Voters are often literally bribed to support a particular party. Transparency International has studied the various types of bribe: money, food, and clothing. All this obviously detracts from choosing candidates on the basis of their performance. There is no ideal way of financing election campaigns, but surely we can all agree that outright bribery of voters is not acceptable. Probably parliaments should also set some ceilings on contributions, and require some transparency in party finances. This is not a very ambitious agenda, but it would at least get the issue of campaign finance started.

A Charter for Budget Transparency

How governments spend money is at the core of how they function. At present spending by the governments of the bottom billion is often atrocious. Remember the survey tracking spending on health clinics in Chad—99 percent of the money did not reach its intended destination. It is possible to do something about that sort of failure. Practical measures of scrutiny

and accountability can make a big difference. Here is a more encouraging story. The heroes are Emmanuel Tumusiime-Mutebile, now governor of the central bank of Uganda, but in the mid-1990s permanent secretary of the Ministry of Finance and Planning, and Ritva Reinikka, a former student of mine. The story begins with Reinikka devising a survey to track public expenditure (the same survey that was done in Chad). She initially devised it for Uganda, where it came up with rather depressing results: only around 20 percent of the money that the Ministry of Finance released for primary schools, other than for teachers' salaries, actually reached the schools. In some societies the government would have tried to suppress information like this, but in Uganda, far from suppressing it, Tumusiime-Mutebile used it as a springboard for action. Obviously, one way would have been to tighten the top-down system of audit and scrutiny, but they had already been trying that and it evidently wasn't working too well. So Tumusiime-Mutebile decided to try a completely different approach: scrutiny from the bottom up. Each time the Ministry of Finance released money it informed the local media, and it also sent a poster to each school setting out what it should be getting. Tumusiime-Mutebile is a practical man who wanted to know if things were working, so three years later he repeated the tracking survey. Now, instead of only 20 percent getting through to the schools, 90 percent was getting through. In state-of-the-art statistical research that analyzed this experiment in detail, Reinikka and her colleague Jakob Svensson were able to demonstrate that the media had been decisive—in this case reports in newspapers. So scrutiny turned 20 percent into 90 percent—more effective than doubling aid and doubling it again. Not that scrutiny and aid are substitutes: if scrutiny can make spending effective, it then becomes more worthwhile to scale up aid.

Tumusiime-Mutebile's strategy of publishing budget releases was taken up by Ngozi Okonjo-Iweala when she became minister of finance in Nigeria in 2003. One of her first acts was to publish the budget releases to the states, month by month. On the first day of publication newspaper circulation spiked: citizens wanted to know what was happening to their money. That and the death threats made her realize she was on the right track.

So a charter on budget processes could usefully specify scrutiny from the bottom up as well as from the top down. There is a third type of scrutiny that comes sideways, so to speak: comparison with peers. I first

came across this as a serious strategy for the bottom billion when it was promoted by a young Nigerian academic, Charles Soludo, who at the time was a lowly consultant to the Economic Commission for Africa but is now the reformist governor of the Central Bank of Nigeria and has just been voted Governor of the Year. The idea next surfaced in a process known as the African Peer Review Mechanism, whereby African countries volunteer for self-evaluation, modeled on the OECD. It is also useful within countries, as local governments can be compared against each other and ranked. Public agencies hate such rankings because they generate very effective pressure, both from the humiliation within a peer group and from the anger of users. Of course performance measures can be misleading, but the answer is to make them better.

Each of these three directions of scrutiny can operate ex ante and ex post. Ex ante is about authorization for spending and ex post is about evaluation, such as the tracking surveys. Finally, two very distinct aspects of expenditures need to be scrutinized: their honesty and their efficiency. Reformers usually focus on honesty, but efficiency may be even more important, and its scrutiny requires radically different skills. I think of them as a double hurdle.

A charter for budget scrutiny does not need to be sophisticated. It could just spell out these three directions of scrutiny, the two time frames, and the two criteria. Introducing scrutiny into the societies of the bottom billion will always take courage, but perhaps the existence of an international charter would lower the threshold a little.

A Charter for Postconflict Situations

Probably the situation that presents the greatest scope for an international charter pertinent for the bottom billion is the end of a conflict. Think of Afghanistan, Sudan, and Burundi. Recall that although these situations typically start out with very poor governance and policies, they are highly fluid: change is easy. However, the range of postconflict outcomes is extremely wide. Some countries grow rapidly and maintain peace, while others fall apart again. This range of outcomes is far wider than the normal diversity of country experience. The very diversity suggests that some standards might be useful—if we could bring the worst up closer to the present

best, it would make an enormous difference. Standards do not need to be abstract, but can draw upon the experience of what has worked well.

A postconflict charter should include guidance on behavior by donors and the international security regime. Donors should be committed for the decade, not just the first couple of high-glamour years. International security forces should likewise be committed for the long haul. In return, postconflict governments should reduce their own military spending—as we have seen, it is dysfunctional. They should have a transparent budgetary process, so that public power does not translate into private profit. They should include opposition groups in power, for example through decentralization. And they should sort out conflicting and confused property claims quickly. These essential steps could be set out in an international charter. The international community has a very strong interest that postconflict situations should go right, and it puts huge resources into them. Postconflict governments are typically highly reliant upon others, and it is entirely reasonable that they should be, in effect, on probation for that first decade, placed under a set of rules that define the minimum acceptable progress before untrammeled sovereignty can be achieved.

A charter for postconflict situations could also usefully draw on the successful experiences of truth and reconciliation commissions; perhaps the most highly visible one is South Africa's, but there have been others. Neither a vindictive pursuit of victor's justice nor a blanket of forgetfulness is desirable. An international norm would provide a much-needed sense of impartiality, typically lacking when procedures are drawn up ad hoc by whoever holds power in each particular situation. Some postconflict processes have managed a swift drawing of lines that prosecutes some of the major offenders on both sides and gets as much as possible of the rest into the public record.

One aspect of postconflict policy is noticeable by its absence from the above suggestions: that relating to elections. At present, postconflict political evolution is often dominated by elections, which are often imagined to be the key to reestablishing peace. If that is indeed the case, then elections should be a part of the postconflict charter. But are they in fact so important? The team working on this included Anke Hoeffler, Måns Söderbom, and myself. Somewhat laboriously we built a data set on all postconflict experiences—more than sixty of them. We then looked to see

what effect elections had on the risk of the reversion to conflict. (This work is new, so it has yet to be properly peer-reviewed.) The issue is contentious. In the world of postconflict studies there are two camps: those who think elections make things better, and those who think they make them worse. Each camp can point to particular elections for which their thesis looks plausible, but they cannot both be right. They can, however, both be wrong. As far as we can see, they are. Elections during the postconflict decade seem to *shift* the risk. In the year before an election the risk of renewed conflict goes sharply down, perhaps because the various groups direct their energies to the electoral contest. In the year after an election the risk goes equally sharply up: presumably whoever has lost the election does not like the result and is inclined to explore other options. So elections may be desirable for all sorts of reasons, but they do not seem to make the society safer. Perhaps as solutions they have been a little overplayed.

A Charter for Investment

The bottom billion need private capital. Even though the world is awash with capital, the poorest countries are failing to attract it and are instead hemorrhaging their own. Remember that a key problem is the lack of reform credibility. Credibility looms large because investment runs up against the time consistency problem that we have repeatedly encountered. Once made, investment is far more difficult and costly to reverse than are policies, and so investors are wary of falling for a policy that looks attractive but is not maintained. The only option that is currently open to individual governments that are committed to reform is the costly and dangerous strategy of revealing their true type by going too far too fast. Can an international charter do better?

What would an investment charter do? It would set out some simple rules to which a government would commit itself in its treatment of investors. Many governments already do this through national charters, but these charters lack credibility for precisely the reasons that there is a problem in the first place. The rules should apply to domestic investors as well as foreign investors, otherwise capital flight would be accentuated. Essentially, a charter would preclude governments from strategies of confiscation.

A government set on confiscation in fact has many options open to

it—it does not literally have to confiscate the assets. It can manipulate taxes, the exchange rate, and the prices that public utilities charge. That is, it can use policy instruments that all governments use, but push them into a range that is meant to be ruinous for a given company or industry. This is inevitably a matter of judgment, and so the essence of an effective charter is that there has to be some system of adjudication. Governments of course have their own judicial system, but it is hardly reassuring for investors if their only defense is through the courts of the government that has confiscated their investment. There are two complementary solutions, international arbitration and investor insurance. International arbitration is not an affront to sovereignty. It is simply a recognition that a government may find it very useful to put itself in a position where it has to argue its case before a neutral body rather than be free to ignore its own commitments. The governments that would find such a facility most useful are those that have severe problems of reputation and are trying to live them down. Arbitration has its limits because even if the arbitrator finds in favor of an expropriated company the government may choose to ignore the decision. That is where insurance comes in. Those rich-country governments with companies that have substantial investments abroad long ago established insurance protection for them. In the United States the organization is called the Overseas Private Investment Corporation (OPIC), and in the United Kingdom it is the Export Credits Guarantee Department (ECGD). Obviously, they only provide insurance coverage for their countries' own companies. Eventually, the board of the World Bank established an insurance company that could cater more globally. It is called the Multilateral Investment Guarantee Agency (MIGA). If a firm that has taken out insurance with MIGA is expropriated, then MIGA pays up. It tries to recover the money from the offending government, which often takes years, but the company does not have to worry. Since the bottom-billion countries need private investment and this requires addressing the problem of investor risk, it was entirely appropriate for a global public development agency such as the World Bank to provide this service.

MIGA, however, has one grave shortcoming. MIGA covers only foreign investment, and this creates two major problems. Domestic investors are important—behind them lies all the capital that has left the country, in part because of risk, and needs to be attracted back into the country. And

by covering only foreign investors MIGA breaches the level playing field that governments are routinely urged to create for investors. Indeed, if you think about it, it is self-evidently preposterous that a global public institution should be favoring foreign investors over the citizens of low-income countries. The recent Commission for Africa proposed that MIGA should be opened up.

The world nearly got a charter on investment. In the late 1990s the OECD proposed a Multilateral Agreement on Investment. The OECD probably was not the ideal institution to promulgate such a charter because it does not have developing-country representation and so can easily be portrayed as merely serving the interests of rich countries. However, given the extreme shortage of agencies in a position to overcome the free rider problem associated with such a charter, the OECD was decidedly better than nothing—but that is what we have ended up with. The OECD was opposed by two groups. One was the governments of the bottom billion that are run by crooks and populists. Leaders as notorious as Idi Amin, Mobutu Sese Seko, and Robert Mugabe have depended upon not being differentiated from those who are genuinely trying to develop their countries. The whole point of an investment charter is for newly reforming governments to be able to signal their separation from this nefarious crew more cheaply than through the signaling strategies that are presently available. While this source of opposition was inevitable yet could have been faced down, the other source was not inevitable but proved decisive. The development NGOs lobbied against the Multilateral Agreement on Investment in much the same way that, as you are about to see, the British charity Christian Aid has more recently lobbied against African trade liberalization. This was because the NGOs misread what the charter was about. They saw it as rich countries ganging up on poor countries to protect their capital investments, and did not acknowledge the reality that in the bottom billion there was no capital to protect because the risks had frightened investors off. An investment charter, and indeed the World Trade Organization (WTO), can provide the governments of the bottom billion with a means of locking themselves into the commitments that they choose to make. In the language of economics the general concept is termed "commitment technologies." For the bottom billion these technologies are chronically lacking, and the resulting credibility problem is debilitating for

private investment. Without radically higher private investment the reforming countries will not be able to reach middle-income status but will linger in limbo and risk falling back into one of the traps. By posing the problem as that of a grasping rich world imposing its rules on a weak poor world, the NGOs conjured up a satisfyingly simple moral struggle in which they could campaign. But it was a fantasy world that, sad to say, did a disservice to the very people the NGOs are passionately trying to help. It was the headless heart in action.

Changing Our Laws, Promulgating International Charters: Global Public Goods

Changing our laws and promulgating international charters are global public goods. This is a grandiose way of saying that providing them is going to be problematic. Global public goods are grossly undersupplied because nobody has much interest in providing them. Being good for everybody, they face the ultimate free-rider problem. The real problem, therefore, is not that of not knowing what to do but getting around to doing it. I will return to that problem in Part 5.

CHAPTER 10

Trade Policy for Reversing Marginalization

GENERALLY, I DO NOT MUCH CARE for rich-country wallowing in guilt over development. I find it contrived, and it diverts attention from a practical agenda. Citizens of the rich world are not to blame for most of the problems of the bottom billion; poverty is simply the default option when economies malfunction. However, I am now going to pin some blame on citizens of the rich world, who must take responsibility for their own ignorance about trade policy and for its consequences. You personally may be well informed about trade, but if so, you are in a minority; in general rich-country electorates are deeply misinformed. Here is an example of the consequences.

In fall 2004, Christian Aid—about the most trusted of the British charities—started a huge and expensive advocacy campaign about trade policy for the countries at the bottom. Under the slogan "Free Trade: Some People Love It," a capitalist, literally depicted as a pig, sat on top of an African peasant woman. That a Christian charity should be peddling the crudest images of Marxism may strike you as a little strange and is an interesting line of inquiry, but this ideological cross-dressing is not my point. The key thing is that this message was grotesquely wrong. Trade policy is the area of economics least well understood by the NGO world.

In the fall of 2005 Christian Aid stepped up its advertising campaign—trade advocacy, it said, was its biggest issue. It claimed that Africa's rather modest reductions in its trade barriers had already cost the region

an astonishing $272 billion. This estimate, proclaimed the Christian Aid Web site, came from work it had itself commissioned from "an expert in econometrics" whose work had then been reviewed by "a panel of academic experts." I was somewhat surprised by this, so I e-mailed Christian Aid, and they duly sent me the study and the composition of the expert panel. Christian Aid, I concluded, was being a little economical with the truth—surely somewhat unfortunate in one of our most respected charities. The "expert" they had commissioned turned out to be a young man at the School of Oriental and African Studies, the only economics department in Britain that is solidly Marxist. He had, as far as I could tell from Google Scholar, never published an article on trade, but had previously written an unpublished paper denouncing international trade policies. However, I was reassured to see that his paper was issued by a group called CEPR, which I took as the acronym for the Centre for Economic Policy Research, probably the most respected economics think tank in Britain. You have to be a fellow of the CEPR to issue one of their working papers, and they set high standards. But then I discovered that the CEPR that had issued his paper was not the internationally renowned London group but the Center for Economic and Policy Research, a little outfit in the United States. I do not imagine for a moment that there was any deliberate misrepresentation involved; it just misled me. And, after all, there was the "academic panel." Unfortunately, this turned out to be two gentlemen whom the author himself had chosen and who were not noted for their expertise on international trade. So here was the largest charity campaign in the United Kingdom spending many thousands of pounds donated by Christians around the country who had given their money to what they imagined was an organization that they could trust beyond question, and the campaign was based on this unpublished paper. I decided that it was time to subject this paper to proper scrutiny. As it happens, I did my doctorate on international trade; though I would not claim to be one of the real experts, at least I know who they are. So I sent it to three of the world's leading experts on international trade: Jagdish Bhagwati, professor at Columbia University, Kofi Annan's trade advisor, and probably the greatest living expert on international trade; Tony Venables, whose work you have already come across in Chapter 6 and who is professor of international economics at the London School of Economics and

currently also chief economist at the Department for International Development, Britain's aid agency; and finally David Greenaway, a professor at the University of Nottingham, head of its Globalization Centre, and editor of the journal *The World Economy*. They all decided that the study was deeply misleading. In the end, we sent a joint letter to the *Financial Times*, issuing a warning.

I do not know whether this is simply an example of the headless heart. Trade policy is unusually difficult for people to understand, and Christian Aid may well not have done sufficient homework. It may instead be that its advocacy department has been infiltrated by Marxists, as briefly happened to the British Labour Party in the 1980s. The most depressing explanation I have heard came from an expert at the Department of Trade and Industry, who had better stay nameless. His account was: "They know it's crap but it sells the T-shirts." As I write, it is too early to tell which situation it is—confused Christians, infiltrating Marxists, or corporate marketing executives—so you will need to consult the group's Web site and judge for yourself.

Another government insider who had also better remain anonymous told me that the politicians were too scared of Christian Aid to dare to contradict it. Clare Short, a soon-to-retire member of Parliament and a former secretary of state for international development, was the only one with the guts to take them on, he said, and she's gone. So, unlikely as it seems, it is the NGOs that now have power without responsibility. And that is because the general public is ignorant of trade policy but trusts Christian Aid to get it right. The question, then, is what a responsible NGO should be campaigning for.

Rich-Country Trade Policy Is Part of the Problem

As everyone knows, there are some indefensible aspects of OECD trade policy. The least defensible, from the perspective of both OECD citizens and people in developing countries, is probably the protection of agriculture. We waste our own money subsidizing the production of crops that then close off opportunities for people who have few alternatives. When U.S. and European Union trade negotiators jointly proposed that instead of the OECD lowering these production subsidies poor countries might

shift to other activities, I personally felt they had crossed the line beyond which the normal diplomatic act of lying for your country becomes too shaming to accept. The U.S. South really does have alternatives to cotton: its cotton growers live in the most bountiful economy on earth. But cotton growers in Chad? Another dysfunctional aspect of rich-country trade policy is tariff escalation: the tariffs on processed materials are higher than on the unprocessed materials. This makes it harder for the countries of the bottom billion to diversify their exports by processing their raw materials before exporting them. It hurts us and impedes the development of countries that are already facing enough impediments.

These are examples of "policy incoherence," where one policy works against another. It is stupid to provide aid with the objective of promoting development and then adopt trade policies that impede that objective. The reason this happens is that trade policy is *negotiated*. The essence of the World Trade Organization (and of its predecessor organization, the General Agreement on Tariffs and Trade, or GATT) is that the reduction in our trade restrictions is something that we concede only in return for others doing likewise. The countries at the bottom played no part in GATT—mostly they were not even members. But when the WTO was formed in 1995 they all joined, for being in this club meant belonging to the modern world. However, they have virtually no role in an organization that is designed for bargaining. The countries at the bottom have no markets of any interest to the rest of the world, and so their high trade restrictions are also of no interest.

Bottom-Billion Trade Barriers Are Also Part of the Problem

What about trade protection on the part of the bottom billion themselves? Their own individual markets are tiny and stagnant, so focusing on the domestic market, which is all that protection can achieve, is going to get nowhere. Despite this, trade protection has been the ostensible strategy of bottom-billion governments for forty years, although its main motivation for protection was probably not strategic at all. The high tariffs induced a high-cost, parasitic industry that realized its profits depended upon lobbying rather than on productive efficiency. Globally, we now know what produces productivity growth in manufacturing: it is competition. Firms hate

competition because it forces them into painful changes, and painful change is what generates productivity growth. Bottom-billion firms have faced very little competition. They have been protected from external competition by trade barriers, and from internal competition because the domestic market is often too small to support more than one or two firms in an activity. The quiet life that bottom-billion firms have enjoyed has been paid for by ordinary people, who have faced prices inflated above world levels by protection. That is what protection means. The quiet life has shown up in the rate of productivity growth. In bottom-billion manufacturing the rate has been around zero, in contrast to the global trend of rapid progress. Gradually, over the past two decades governments have been coaxed and cajoled into reducing trade barriers. Inevitably, when exposed to external competition these unviable activities curl up and die. I am not, however, an enthusiast for "big bang" trade liberalization: where there is some hope that firms can become globally competitive it may be better to draw their feet gradually closer to the fire than to push them into sudden death. Trade liberalization has got parasitic firms off the backs of ordinary people, but it has not enabled other activities to flourish. For that governments need to change a whole range of policies that between them determine firms' costs.

Why do the governments of the bottom billion typically adopt high trade barriers? Partly because they are one of the key sources of corruption. That's why political reformers such as Marc Ravalomanana in Madagascar, Emmanuel Tumusiime-Mutebile in Uganda, and Ngozi Okonjo-Iweala in Nigeria all made trade liberalization a priority. The corruption generated by trade restrictions works on both grand and petty scales. On the grand scale, governments confer protection on the businesses owned by their friends and relations, or ones that pay for the privilege. At the petty level, actually running the system of protection day to day can be lucrative. Becoming a customs officer is about the best job you can possibly get in these countries. For example, in Madagascar, to become a customs officer you have to go to the school that trains them. So getting into the school is a passport to prosperity. The bribe to get a place is fifty times the country's per capita annual income. That tells you all you need to know about the customs service in Madagascar. The vice president of Nigeria used to be a customs officer. He had talents and so was offered promotion, but he turned it down; one can imagine why.

The enthusiasm of the villains for the opportunities for corruption that trade restrictions constitute, and the consequent struggle of reformers to reduce barriers, is misread by NGOs such as Christian Aid. Seeing everything through the spectrum of rich countries oppressing poor countries, these agencies spend charitable donations opposing the reduction in African trade barriers. Lenin had a phrase for those in the West who supported him without understanding his true intent: "useful idiots." Today's useful idiots campaign for trade barriers.

Aid Worsens the Problem of Trade Barriers

Although Christian Aid wants Africa to maintain high trade barriers, of course it also wants a big increase in aid. These two positions are disastrously incompatible. Extra aid needs to be accompanied by African trade liberalization or it could even increase poverty. Aid can only be used for imports. I know this sounds a bit odd: aid is supposed to be paying for schools and suchlike. But aid is foreign exchange—dollars, pounds, euros. If governments choose to spend this aid on schools, they have to sell the foreign exchange to generate local currency. People buy the foreign exchange in order to pay for imports. So aid is valuable only to the extent that people want to buy imports. If imports are banned or have very high tariffs imposed on them, then the demand for foreign exchange will be low and the aid will not buy much schooling. It gets worse. Other than through aid, societies pay for imports through exports. Exporters earn foreign exchange and sell it to people who want to buy imports. So importers have the choice between getting their foreign exchange from exporters and getting it from aid. Put another way, aid is in competition with exporters. More aid means less need for exports and so exporters earn less. The mechanism that generates this effect is the exchange rate: aid appreciates the exchange rate, making a dollar earned by an exporter worth less in terms of local currency. Exporters get squeezed as a result, and some go out of business. This is the problem of Dutch disease once again. Dutch disease is rather worrying for aid enthusiasts. If a big increase in aid ruins export competitiveness, then inadvertently it accentuates the very problem that the bottom-billion countries need to put right—making new export activities competitive.

Fortunately, trade liberalization is one of the remedies for Dutch disease. Extra aid increases the *supply* of imports, and so a matching increase in the *demand* for imports is needed. Only with a matching increase in demand are exporters not disadvantaged by the extra aid. Trade liberalization increases the demand for imports by making them cheaper without the need to appreciate the exchange rate: the taxes imposed on imports are reduced. How much trade liberalization is needed? That depends upon what the aid is used for. If the aid is used to buy foreign expertise, it directly increases the need for foreign exchange, as foreign experts are paid in dollars. But if the aid is used to pay for local schoolteachers, then it has little direct effect on the need for foreign exchange, as schoolteachers are paid in local currency and probably don't spend much of their salary on imports. So the sort of social uses that NGOs tend to favor generally require more trade liberalization than the growth-oriented uses such as expertise and infrastructure. Christian Aid should be campaigning for African trade liberalization alongside extra aid. I do not know whether the advocacy people in Christian Aid simply have not understood this connection between aid and trade policy. It is not Christian Aid's fault if trade liberalization doesn't sell T-shirts as well as depictions of capitalist pigs do, but profiting from popular misconceptions *is* their fault.

What Are the Answers?

Is Fair Trade the Answer?

The fair trade campaign attempts to get higher prices for some of the bottom billion's current exports, such as coffee. The price premium in fair trade products is a form of charitable transfer, and there is evidently no harm in that. But the problem with it, as compared with just giving people the aid in other ways, is that it encourages recipients to stay doing what they are doing—producing coffee. A key economic problem for the bottom billion is that producers have not diversified out of a narrow range of primary commodities. Raising their prices (albeit infinitesimally, since fair trade is such a small component of demand) makes it harder for people to move into other activities. They get charity as long as they stay producing the crops that have locked them into poverty.

Is Regional Integration the Answer?

For forty years the politically correct solution to bottom-billion trade problems has been regional integration. The success of the European Community as an economic free trade area (technically a customs union) added political impetus to a strategy that was already attractive. Countries could keep high barriers against rich countries but remove them against each other. There are so many fallacies in this approach that it is a question of where to start. But the politics were indeed magical. So attractive were regional integration schemes that they proliferated. In fact, the world now has more regional trade schemes than countries, so some countries must be in many of them; the typical African country is in four arrangements, often incompatible ones. Why have they been so popular? Well, presidents could get in their jets, meet up with some of the neighbors and sign a trade protocol, set up a regional secretariat to which they appointed their friends, and fly out again, having garnered lots of publicity.

Such schemes have not accomplished much, however. One reason is that even in the best-case scenario, the resulting markets remain tiny. A famous statistic is that the whole of sub-Saharan Africa has an economy about the size of Belgium's. A second reason is that if you combine a number of poor, slow-growing individual economies, you have a poor, slow-growing regional economy. Trade is really generated by differences, and the big opportunity for low-income countries is to trade with rich countries, harnessing the advantage of their cheap labor. Within a group of poor countries there simply are not sufficient differences to generate much trade. Worse, the differences that do exist between poor countries will get reinforced rather than reduced. The model of the European Community is unfortunately deeply misleading.

Recall that Europe's great success has been convergence: the poorer countries, such as Portugal and Ireland, have caught up with the richer countries. Free trade within Europe has been equalizing and will continue to be with the recent enlargement of the EU. Tony Venables discovered, on the other hand, that regional integration between poor countries generates *divergence* instead of convergence. The reason for this is that regional schemes, whether between rich countries or poor countries, benefit those member countries that have characteristics closest to the global

average. In a rich-country club, the member closest to the global average is the poorest member; in a poor-country club, the member closest to the global average is the richest. So in the rich-country clubs the poorest member gains (convergence) while in the poor-country clubs the richest member gains (divergence). Why does a regional scheme benefit those countries closest to the global average? Think of the European Union. Its common external tariff keeps out labor-intensive goods from poor countries. This creates opportunities for the countries within the EU that have the cheapest labor, which are the poorest member countries. The middle, with relatively cheap labor, is protected from the very cheap-labor extreme. Now think it through for a scheme among the bottom billion. The common external tariff keeps out skill-intensive goods from rich countries. This creates opportunities for those countries within the club that have the most skills, which are the richest members. The relatively skill-abundant middle is protected from the very skill-abundant extreme.

Where regional trade schemes have been effective in the bottom billion we see these forces for divergence at work. In West Africa, Burkina Faso lost market share to the local leaders, Senegal and Côte d'Ivoire. In East Africa, Uganda and Tanzania lost market share to local leader Kenya. Of course, the countries that lose out don't like it. In East Africa the experiment of regional free trade ended with a complete closure of borders and an intraregional war. More commonly, the arrangements never get implemented. For regional schemes among the bottom billion to make sense, the external tariff has to be low. A high external tariff implies that ordinary people in Tanzania and Burkina Faso are subsidizing inefficiently high-cost industry in Kenya and Senegal. These transfers are regressive and pointless. Only low external tariffs can keep them at manageable levels.

Good access to neighboring markets is vital for landlocked countries without resources—countries such as Burkina Faso and Uganda most surely need regional integration. But they should not have to pay for this market access by large transfers to richer neighbors. Uganda has good and plentiful agricultural land. It should be feeding Kenya. When the Kenyan government permits the imports, it does just that. But Uganda has no power over Kenya. Daniel arap Moi, president of Kenya from 1978 to 2002, was famously in hock to local business interests. At one stage some Kenyan businessmen took a speculative position on food grains, stocking

warehouses in anticipation of higher prices. But because of imports from Uganda, prices didn't go up. The businessmen lobbied President Moi, and sure enough, he imposed a total ban on food imports from Uganda. So ordinary Kenyans had to pay more for their food, and ordinary Ugandans lost the chance to earn a living through exports. Only President Moi's business friends were happy. I expect they showed their gratitude. I met Moi just after he had taken this decision, and challenged him on it. He told me that he had done it for the Kenyan poor, but one of his aides was sufficiently irritated by this answer to take me aside after the meeting and tell me the truth. So regional integration is a good idea, but not behind high external barriers.

Part of the Answer: Export Diversification

Manufacturing in the bottom billion is in decline. Thirty years of protection created a parasite with stagnant productivity, and a decade of modest liberalization has merely reduced its size. How could manufacturing get on a productivity escalator?

For over a decade I have been part of a large network of scholars, Industrial Surveys of Africa, that has been studying African manufacturing. The group has been trying to discover what would make firms grow. We have looked, for example, at how firms cope with a high-risk environment, at why they invest so little, and at the effect of credit constraints. One of our most striking findings concerned exporting. African firms can and do export, but not many of them are involved. Those firms that are involved experience rapid growth of productivity. As usual with such a correlation, the problem is to sort out the direction of causality. Is it that the rare firms with rapid productivity growth are the ones able to export? (In which case, so what?) Or is it that exporting induces productivity growth? There have been similar studies for firms in the United States and for emerging market economies such as China, but ours is, I think, the only one for bottom-billion economies. For firms in the United States, exporting has no effect on productivity growth. This is not surprising, since firms can learn as much from competing to sell products in Kansas as they can from selling them in France. The same turns out to be true of China. Evidently, the Chinese market is sufficiently large and competitive that

companies have to keep getting more productive in order to survive. But Africa is a different story. There, exporting really does appear to raise productivity. Domestic markets are too small to support much competition, and so learning from exporting is differentially powerful. We found it was a big effect: whereas the norm for African manufacturing was stagnant productivity, exporting got a firm on a productivity escalator.

So if Africa, and by extension the other bottom-billion economies, are to get a dynamic manufacturing sector, it is more likely to come from breaking into export markets than from going back to the years of cozy domestic monopolies. The problem is how to get firms over that initial hump of competitiveness and enable them to get on the escalator.

How to Get Export Diversification Started: Protection from Asia

The bottom billion do need some helpful OECD trade policies, but they are not fair trade, nor could they be described as trade justice. And they certainly don't fit with Christian Aid's Marxist slogan. The bottom billion need to diversify their exports into labor-using manufactures and services, the sort of things that Asia is already doing. Remember that this is the problem—having broken into these markets, low-income Asia now has the huge advantage of established agglomerations where costs are lower than for those just starting up elsewhere. When Asia broke into these markets it did not have to compete with established low-cost producers, because it was the first on the block. For the bottom billion to break into these markets they need temporary protection *from Asia.*

What this means is that goods and services exported from the bottom billion to the rich world markets would pay lower tariffs than the same goods coming from Asia. However you package this, it is hard to get the word "justice" or "fair" into the frame. Privileging the bottom billion against low-income Asia is not just or fair; a more accurate word might be "expedient." Without such a pump-priming strategy, the bottom billion are probably doomed to wait until Asia becomes rich and is at a substantial wage disadvantage against the bottom billion. Even with high Asian growth, it will take several decades to open up a wage gap that is wide enough to spur firms to relocate. Only around 16 percent of the cost of labor-intensive goods is, in fact, wages. So if bottom-billion wages were one-sixteenth of

Asia's, this would provide only a 15 percent cost advantage. You then set the meter ticking on other cost disadvantages, such as transport costs, law enforcement, corruption, electricity, and availability of skilled labor and business services. You soon get to 15 percent. Remember, the Asia-OECD wage gap grew very wide before Asia became competitive with the OECD.

It is, of course, inconceivable that the OECD would impose new tariffs on Asia that protected the bottom billion in OECD markets, nor should they. Rather, they should remove tariffs against the bottom billion where they already have tariffs against Asia. One vital implication of this is that the strategy is urgent. World tariff levels are falling. The WTO is in the process of negotiating mutual tariff reductions between the successful developing countries, which clearly have a lot to bargain with, and the OECD. This is its core business, and over the next decade it will probably succeed. So by around 2015, OECD tariffs against Asia will not be high enough for there to be much scope for protecting the bottom billion. We must use this policy opportunity now because it will not be available later. However, the same feature that makes the strategy urgent also makes it both acceptable and potent. The policy is urgent because tariffs against Asia are temporary. This makes protection for the bottom billion much more acceptable for Asia—the policy will phase out. Indeed, it might be to Asia's advantage. Once OECD protectionist interests realize that their lobbying is helping the bottom billion rather than themselves, they will be less inclined to oppose the liberalization that Asia is so keen to see happen. Temporariness also increases potency. If governments in the bottom billion know that they have a window of opportunity of only a few years to break into OECD markets, they are more likely to make the complementary policy changes than if they thought the opportunity would always be there.

Is temporary protection for the bottom billion against Asia in OECD markets politically infeasible? Definitely not—in fact, we are already doing it. The United States has a scheme called the African Growth and Opportunity Act (AGOA), which does just that. Products from Africa enter the U.S. market duty free. The EU has a scheme called Everything but Arms (EBA) that is supposed to do the same for access to the European market. And in Singapore in December 2005 rich-country governments from all the OECD countries committed to freer access for the least developed countries. If we are already doing it, why the fuss? Because these schemes

don't work. This is not because they are a bad idea but because the devil is in the details and the details are wrong, probably deliberately—such schemes were designed not to be effective but to appease lobbies. AGOA got adopted because sixty thousand African Americans sent letters to their congressional representatives supporting it.

So what details matter? The first and foremost are the rules of origin (ROOs). In modern production inputs are brought in from around the world and assembled, and the result is exported. ROOs are about those imported inputs, where they can be from, and how much value they can constitute relative to what is produced. ROOs are not arcane. If the economies of the bottom billion really could export anything to the rich countries free of import restrictions, with no ROOs, then all China's exports to us would pass through bottom-billion countries to have little labels added saying "Made in X." They would then come in duty free. It would help China, and incidentally it would help us, but it wouldn't do much for the bottom billion. But at present we are at the other extreme: the ROOs are too restrictive. If a Ugandan fishing boat on Lake Victoria employs a Kenyan, the fish are not eligible for the EU scheme. The same problem was initially true of AGOA, but a special waiver was added. So even if a Kenyan garment manufacturer uses cheap Asian cloth, the garments can now be imported into the United States. As a result, AGOA has increased African apparel exports by over 50 percent, whereas EBA has been totally ineffective. ROOs can be fine-tuned to make preferential access either effective or useless.

Another detail that matters is the time scale. AGOA grants the special waiver for only one year at a time, and AGOA itself is only guaranteed for three years. This is simply too short a period for firms to make investment decisions based on the market access that AGOA provides. For example, textile firms in Madagascar are now highly profitable exporting to the United States, but they don't expand because they do not know what is going to happen. A longer horizon would be a different matter. If aid is targeting the Millennium Development Goals for 2015, then so should trade policy. The EU scheme certainly doesn't suffer from a short horizon; in fact, it appears to be intended for eternity. But that is about how long it would take firms to understand the documentation—the scheme is massively complicated, and many firms are simply not bothering to use it.

A final important detail is the countries that are included. EBA is

confined to the least-developed countries, so Somalia and Liberia are in, but Senegal, Ghana, and Kenya are excluded. AGOA is more inclusive. Confining the arrangements to the least developed superficially sounds well focused but is actually idiotic. Which African countries stand the better chance of breaking into the global markets for manufactures, those like Somalia or those like Ghana? It's the headless heart again, well-meaning gestures rather than well-analyzed actions.

What is needed is one simple scheme—the same scheme across the OECD—with more generous rules of origin, pan-African coverage, and a 2015 phase-out. The details of the scheme need to be sufficiently flexible that they can be adjusted until it works. The intention should be to get the bottom billion into new export markets.

The Other Part of the Answer: Rethinking the Bottom Billion in the WTO

What are the countries of the bottom billion doing in the WTO? It is the successor organization to the GATT, and its basis is reciprocal bargains: I open my market to you if you open your market to me. It is not an international organization in the same sense as, say, the World Bank, the IMF, or the United Nations Development Programme. It does not have resources to disburse to countries, nor an objective that its staff must achieve with such resources. It is not a purposive organization but rather a marketplace. The WTO secretariat is there merely to set up the stalls each day, sweep the floor each evening, and regulate the opening hours. What happens is determined by the bargaining. This made some sense when the bargaining was between the United States and the European Union. Over the years, U.S.-EU trade in manufactures became virtually free of restrictions. The WTO brought in the emerging developing countries: India, Brazil, China, and Indonesia, which have a lot to offer both to each other and to rich countries in terms of reduced trade barriers. In return they can negotiate better access to rich-country markets. But the markets of the bottom billion are so tiny that even if their governments were prepared to reduce trade barriers, this would not confer any bargaining power on them. If the U.S. government decides that the political gains from protecting cotton growers outweigh the political cost of making American taxpayers finance a hugely expensive farm bill, the offer of better access to the market in

Chad is not going to make much difference. So far, the WTO has functioned badly. The present round of trade negotiations was termed a "development round," but such labels really have no possibility of content in an organization designed for bargaining. You might as well label tomorrow's trading on eBay a "development round." Trade negotiators are there to get the best deal for their own country, defined in terms of the least opening of the home market for the maximum opening of others. The countries of the bottom billion joined the WTO hoping to receive transfers in some shape or form, just as they do in the other international organizations such as the World Bank, the IMF, and the United Nations. But the WTO is simply not set up to do this. As long as it is merely a marketplace for bargaining, the bottom billion have no place in it. Their only possibility of power is to threaten the legitimacy of the whole organization. This they have already done, to the point of bringing the round to the brink of failure. The way out of this is for the WTO to add a transfer role to its bargaining role. By this I do not mean a transfer of money. It would be absurd to turn the WTO into yet another aid agency, as there are too many already. By a transfer I mean an *unreciprocated* reduction in trade barriers against the bottom billion: a gift, not a deal. I think that the secretariat of the WTO should be charged with negotiating such a gift as the first phase of each round. The World Bank evolved in an analogous way. Originally, the World Bank was a mutual assistance organization: the International Bank for Reconstruction and Development (IBRD). It issued bonds on the New York market, and lent them on at a small premium to countries that were sufficiently creditworthy. This was of no assistance to low-income countries since they were too risky to be borrowers, so the Bank added a new role: the International Development Association (IDA). Unlike IBRD, which has never cost rich countries a single cent, IDA is a transfer. Every three years the secretariat of the World Bank goes around to the governments of rich countries persuading them to put money into IDA. How much each gives depends upon how good each wants to look relative to the other contributors. The Bank then distributes the funds. So the Bank evolved by adding a transfer role targeted on low-income countries to what was originally a mutual assistance role for richer countries. That is what should happen to the WTO. The secretariat could work on an unreciprocated trade offer, just as World Bank staff have learned how to run an IDA round. The essential step is to

quantify the trade concessions offered by each rich country into a common unit—say, expected additional bottom-billion exports. Once concessions are quantified, they can be compared. Then the pressure starts. Why is Japan offering so little relative to Europe? Why is the United States offering no more this round than it did last round? That is the reality of how IDA has worked, and the WTO could do the same. Only once the transfer round was concluded would the bargaining round be permitted to start, and this would put pressure on the rich countries to make acceptable offers. But only once the bargaining round was concluded would the transfer round come into effect, and this would put pressure on the bottom billion to facilitate the bargaining process rather than wreck it. Further, if the bottom billion wanted more than they had received at the end of the transfer round, they would have to get it through bargaining. The two contrasting cultures of transfers and deals would not be confused, as is currently the problem.