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STRUCTURAL ADJUSTMENT LENDING:
A PRELIMINARY ASSESSMENT

A Report Prepared for the
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by

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I. INTRODUCTION

During the 1970's and especially during the past five years, foreign assistance policy makers became increasingly interested in nonproject assistance. Over this period, nonproject loans and grants have come to absorb a growing portion of total foreign assistance. These resource transfers take many forms. In the U.S., Economic Support Funds (ESF) are the major form of non-project aid; they now comprise more than one-third of total U.S. economic assistance. In the near future, U.S. assistance to both the Caribbean region and to Sub-Saharan Africa are to be increased; and in both areas, nonproject aid is likely to be large. In French aid, there is now a category called "structural adjustment grants," and other bilateral donors are considering similar approaches.

Nonproject lending has also been growing at the World Bank, where so many kinds of loans are made that project lending shades gradually into program lending along a nearly unbroken continuum. But using a broad definition, program lending now accounts for upwards of 30 percent of all Bank lending. One set of nonproject loans, "Structural Adjustment Loans" (SALs), now involves more money than any other single category of World Bank nonproject lending.

This report touches on nonproject lending in general, but concentrates on SALs in particular. The purpose is two-fold: to summarize reports and descriptions of the SALs in order to give A.I.D. planners access to basic information not now readily available; and to assist A.I.D. in the future elaboration of policy in the area of nonproject lending, by providing some assessment of the SAL--the most important and innovative instrument of nonproject lending now in use.

The assessment must be tentative, for one obvious reason: SALS are new (they date from 1980) and their objectives are "medium-term," which most Bank documents describe as five to seven years. So it is too early for any firm evaluation of "success" or "failure" in meeting objectives. But there are other reasons for tentativeness: knowledge about the effects of the SALs is limited, almost exclusively official in origin and tone, and sometimes difficult to uncover. This paper, moreover, is based on a relatively brief research effort.

The paper is organized as follows. The reasons for the recent growth of interest in nonproject aid are outlined, and the nature and scale of nonproject flows are surveyed, with emphasis on the SALs. The SAL experience to date is then assessed on empirical grounds--how do these loans seem to have worked so far? Finally, a more analytic, or theoretical assessment is put forward, involving an examination of the pros and cons of conditional assistance in general, and of SALs in particular. The final part of the report consists of four case studies, found in an Annex.

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II. DESCRIPTION

A. Sources of New Interest in Nonproject Assistance

During the late 1970's, a number of factors operated simultaneously to make policy makers in donor agencies, bilateral and multilateral, more interested in nonproject lending: Many developing countries' capacity to absorb new projects became visibly strained while existing facilities were seen to be deteriorating or, because of import shortages, underutilized; aid donors increasingly recognized the importance of the policy environment for the success of particular projects and for general development; and nonproject lending was seen to be a better instrument to induce policy reform. Jolted by the 1979 oil price increase, more LDCs petitioned for quick-disbursing money; the IMF's Extended Fund Facility, with three year disbursements and 8 to 10 year repayment periods, suggested new possibilities for supply-side conditionality and in at least one donor country, the U.S., accumulating legislative and administrative rules and regulations reduced the flexibility of the "development assistance" category of aid, which almost always takes project form.

1. Constraints on Absorption of New Projects

In recent years, aid agencies have encounted limits on many developing nations' capacity to absorb new projects. In many LDCs, trained administrators and technicians are stretched to their limit. Financial resources, local "counterpart" and recurrent budgets, are also extremely scarce. New projects are often possible only by sacrificing existing uncompleted projects. Moreover, in many countries, productive and viable new projects are not so easily at hand; in Sub-Saharan Africa, for example, sound rural development projects are few because of scarce technical packages, uncongenial policy environments, and organizational weaknesses.

Simultaneously, A.I.D. policy makers have observed a growing stock of roads, manufacturing plants, buildings, irrigation canals, etc., in poor repair. Further, they have observed existing capacity--in manufacturing, transport, health, education, and agriculture--underutilized due to shortages of raw material inputs, spare parts, and funding for operating costs. The conclusion in donor circles has been that LDCs in this growing category need foreign exchange now but much less for new projects than for making old ones work better. In these cases, program lending appears to be more appropriate because it puts fewer local demands on staff and other resources and can be used to support rehabilitation and fuller and better utilization of the existing capital stock.

Project lending has become confined by regulations. In the United States, where Congressional oversight of foreign assistance is particularly detailed, legislative "barnacles" have accumulated rules that inhibit the flexibility of project lending. To force A.I.D. to do those things Congress believes it ought to do and to prevent it from doing those things that legislators believe it ought not to do, Congress has amended the Foreign Assistance Act to compel some actions and to prohibit others. Since successive Congresses have had different views of what ought to be and what ought not to be, the layers of barnacles have thickened as original advocates prevented repeal of old amendments while new "reformers" added new compulsions and new prohibitions. Furthermore, some observers believe that, even within A.I.D., administrative rules have accumulated in ways that have reduced the flexibility of project lending.

The "barnacles" have not been the only reason, but they have contributed to the growth of support in both A.I.D. and the State Department for the Economic Support Fund (hereafter, ESF). Part of the ESF goes to projects but most is divided between two nonproject assistance vehicles, commodity import programs (CIPs) and cash transfers. All of the ESF programs, even its projects, are less constrained by the administrative and historical "barnacles" than are the projects financed by A.I.D.'s "development assistance" budget.

2. Increased Recognition of the Importance of Policy

Increasingly, policy makers have come to recognize that changes in an initially unfavorable policy environment can do more to raise current output and to add to growth rates than can most projects. Yet, many LDC governments are seen to continue fiscal, monetary and employment policies, exchange control regimes, and agricultural price policies that prevent efficient resource use and that retard growth. They are similarly held back by inappropriate institutional structures--excessive reliance on state owned enterprises and direct controls over economic activity.

Project loans sometimes make disbursement at least partly contingent upon policy "reform," defined as policy changes aimed at more growth via more efficient resource use. But this kind of conditionality is almost always narrowly focused. Rarely can it be extended to more general policy problems. More important, projects are seldom halted because of violations of their conditionality provisions. Neither donors nor lenders are willing to stop construction of a dam, or road, or health clinic because government has not observed an agreement to provide for cost recovery. Again nonproject lending has appeared to be more appropriate than project lending, first because its conditionality can be extended over a wider range of policies and second, because it can be easily tranched, and the trances can be punitively delayed without stopping work on particular construction sites.

3. Increase in Requests for Quick Disbursing Money

As the international economic environment worsened after 1979, more and more LDC governments found themselves in need of quick disbursing monies. Their argument was that unless foreign exchange was made available quickly, imports would be cut, existing factories and farms would be denied essential inputs and parts, and production for both domestic uses and for exports would shrink. Since project money disburses slowly and is project specific, nonproject assistance was the obvious response to these requests.

Since the IMF exists to provide quick disbursing money, a further justification is needed to bring in the Bank or other lenders in these circumstances. The Fund's province is balance-of-payments support, generally short-term; so the further justification must exist that Bank assistance is to be used for purposes other than--or additional to--short-term balance-of-payments support. And that is the argument that has been made on behalf of both SALs and the Bank's "sector loans."

4. New Attention to Private Sector

Related to this, though of less importance, is the new emphasis on the private sector in the A.I.D. policies of many countries, and in the World Bank. Its critical importance as a motor of development is now generally recognized. But there are few ways to encourage the private sector via project lending;

the main instrument up to now has been loans or credits to financial institutions.

B. Growth of Nonproject Assistance

Both the amounts and the varieties of nonproject foreign assistance have been increasing. Only one-third of ESF is "projectized." Commodity Import Programs and cash transfers are two forms of ESF used extensively by the United States. The World Bank now uses many nonproject lending devices though it persists in officially describing many of them as "project" loans. This practice has permitted the Bank to increase nonproject lending without violating its "10% Rule": that nonproject lending is not to exceed 10% of the Bank's annual commitments. All IMF lending is nonproject; its standbys are distinctively different, but the Fund's Extended Fund Facility, established in September 1974, closely resembles in a number of respects, the Bank's sector loans and SALs.[1/] All of this nonproject assistance involves some degree of lender (or donor) conditionality, imposed to

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1/ "The EFF was designed to assist countries with economies suffering serious imbalances in their international payments because of structural maladjustments in production and trade, or countries with economies characterized by slow growth and inherently weak balance of payments positions that prevented pursuit of an active development policy." Joseph Gold, The Relationship Between the International Monetary Fund and the World Bank, p. 515. (Reprinted from Creighton Law Review, Vol. 15, 1981-82, No.2 Copyright 1982 by Creighton University School of Law.)

improve efficiency in resource use and to accelerate growth.

1. The ESF

Since the end of The Marshall Plan in the early 1950's, most United States foreign economic assistance has been for projects. But during the 1970's, as Table 1 shows, the (nonproject) Economic Support Fund grew in importance.

TABLE 1

Comparison of Total U.S. Economic Assistance
and the ESF, FY 1968-83
(Current Dollars)

Fiscal Years	Total United States Economic Assistance	Total ESF	
		Total ESF	ESF as a % of Total Economic Assistance
1968-72 1/	$3,732	$ 548	14.7%
1973-77 1/	4,866	1,076	22.1
1978-82 1/	7,357	2,254	30.6
1983	8,725	2,977	34.1

1/ Average

Source: Commission on Security and Economic Assistance. A Report to the Secretary of State, Washington: (Department of State), Nov. 1983, p. 18.

From about 15 percent of total economic assistance in 1968-72, the ESF grew to 31 percent of the total in 1978-82 and 34 percent in 1983.

Table 2 shows the division of ESF in recent years into its three components. Two of these, the "Commodity Import Program" and "Cash Transfers," are nonproject assistance. Table 2 also shows these two nonproject aid flows as a precent, first, of total ESF and, second, of total United States economic assistance in each of the fiscal years, 1979-82.

TABLE 2

Composition of the ESF, FY 1979-82

Fiscal Year	ESF Project Assistance ($millions)	CIP ($millions)	Cash Transfers ($millions)	ESF Nonproject Assistance As a Percent of: ESF	All Economic Assistance
1979	$715	$ 355	$ 873	63%	17.2%
1980	721	409	1,028	66	19,0
1981	789	370	1,040	64	19.3
1982	854	544	1,116	67	20.4

Source: The authors.

By this measure, nonproject aid is about two-thirds of ESF and 20 percent of total economic assistance. ESF nonproject assistance can be associated with policy dialogue and can serve as a vehicle for conditionality. However, in fiscal 1979 and 1980, fully 85% of ESF went to Egypt, Israel and the four "base-rights countries," the Philippines, Portugal, Spain, and Turkey (seven times as much to Egypt and Israel as to the other four). Since other considerations motivate this aid flow, the nonproject assistance to these six generally involves little or no economic-policy conditionality. But the portion of ESF going to countries other than the six is rising and was up to 35 percent in fiscal 1983, where it seemed likely to remain in fiscal 1984.

2. World Bank Program Loans

The Bank's first European reconstruction loans were nonproject in form. But all of the Bank's first loans to LDCs were project loans. Then in 1957, the Bank made its first LDC nonproject loan. The $75 million loan was to cover foreign exchange expenditures under Iran's Seven Year Development Plan. The next Bank program loan to an LDC was not made until 1971. This was a rehabilitation loan to Nigeria. The International Development Association (IDA) provided a series of industrial import credits to LDCs. The first of these went to India in 1964. They then were extended to Pakistan. The sixth in the series to India was made in 1970.

The Bank established program loans as a particular category of lending with a particular rationale. According to the Bank's operations manual, program loans can be made for four reasons:[1]

1. To assist in reconstruction following a natural or manmade calamity (e.g., war, earthquake, typhoons);

2. To provide balance-of-payments support in the face of sudden and severe fall in export earnings;

1/ The World Bank, Operation Manual Statement, No. 2.01, April 1979, para 2; and Operation Manual Statement No. 1.19, August 1977, para 33. The Manual does add that these four justifications "are not intended to be exclusive," No. 2.01, para 2.

3. To help deal with rapidly rising import prices; and

4. To help deal with problems resulting from capacity underutilization.

3. Other World Bank Nonproject Lending

The Bank's Annual Report lists most of its loans and IDA credits under various project categories, for example, "agriculture and rural development," "education," "energy," or "industry." In the separate category, "nonproject," recent Bank Reports list only SALs and program loans made for one of the four reasons just cited.

But the Bank (including IDA)-make other kinds of loans which are identified as project loans that have many of the same characteristics as do nonproject loans. Agricultural rehabilitation loans, manufacturing-export rehabilitation loans, fertilizer import loans, and sector loans generally are kinds of assistance in which loan proceeds are quickly disbursed in support of immediate balance-of-payment uses. Most also are conditional on specified policy changes. More recently, a new nonproject loan category was announced. In February of 1983, the Bank undertook a Special Action Program (SAP) to:

1. Support high priority operations that assist countries in adjusting their policies;

2. Expand lending to maintain crucial infrastructure and utilize existing capacity particularly for export oriented activities;

3. Maintain the momentum of high priority ongoing projects by increasing the Bank's share of the financing of existing projects and by accelerating disbursements where feasible.1/

1/ Finance and Development, June, 1983.

The SAP is to deliver an extra $2 billion a year to LDCs for at least two years. Like the reconstruction and other sector loans, it can provide more conditionality leverage than can project lending.

The Bank's management has made the case for sector loans on grounds of "greater opportunity to address broad sector policy issue" and for SALs on grounds of even larger opportunities for policy reform:

> Sector lending--defined as an operation where the Bank finances a slice of the sector investment program--provides greater opportunity to address broad sector policy issues. But in many countries the Bank is involved in only a limited number of sectors. Even in those countries where this is not the case, loans in each sector are typically spaced over three or more years. Given the low probability that the Bank would have a concurrent series of project or sector operations in all sectors in which policy issues are important for structural adjustment, SAL provides a unique opportunity to achieve a comprehensive and timely approach to policy reform.1/

Some sector loans are very close to being ordinary project loans. But those with very wide provinces (as recently in Sudan, Zimbabwe, and Bangladesh) are, at least in the scope of their policy influence, very much like the narrowest SALs. The point is that while SALs are distinct, there is, in practice, a gradual shading of SALs into sector and into project loans.

1/ Stanley Please, "Structural Adjustment Lending: IBRD Progress Report," April, 1982.

Although no formal rule exists, the Bank's management has told the Executive Directors that nonproject lending would not exceed 10 percent of annual commitments in any year. No one has calculated World Bank total nonproject lending in a way that commands general acceptance. But the total has certainly been growing, and some knowledgeable observers have placed the figure at around 30 percent of all Bank (and IDA) lending in fiscal 1982 and 1983.

The only official Bank figures on nonproject lending are for SALs and for program loans. As the share of SALs in Bank lending has grown, the share of traditional "program lending" has fallen. Fiscal 1979 was the last year without SALs. During fiscal 1979, six "program" loans involved $406 million, four percent of all Bank and IDA lending. During fiscal 1981, seven "program" loans involved $280 million, 2.3 percent of the total. During fiscal 1983, only two "program" loans were made; they totaled $150 million, just one percent of the total.

4. <u>The IMF's Extended Fund Facility</u>

When assisting a country with a foreign exchange shortage, the Fund once concentrated only on curbing demand. But for some years, the Fund has also encouraged changes in the pattern --the structure--of demand and production in directions that would increase availability of foreign exchange.

The Extended Fund Facility (EFF) has stressed the latter approach and, therefore, has touched on the same policy areas as do SALs. Manual Guitian described the purpose of the EFF in terms similar to those used to describe the purpose of the SAL:

> The Extended Facility was designed to alleviate two main categories of payments problems: (1) severe imbalances due to structural maladjustments in production and trade, where cost and price distortions were widespread and long standing; and (2) imbalances due to a combination of slow growth and an inherently weak BOP position that constrained the country's pursuit of effective development policies. In its formulation and administration, the Extended Facility has proved to be particularly beneficial to developing countries.1/

He asserts further that EFF conditionality is very close to the conditionality of the highest credit tranches of IMF standbys. The distinctive feature of EFF conditionality is that the borrower is committed to adhere to the agreed program for some three years; standby agreements generally expire in 12 months. EFF agreements cover policy reforms affecting "production, trade, and prices" with emphasis on more efficient use of resources and reduced reliance on imports. This is surely similar to SAL objectives and content, but the Fund stresses quantitative measures of compliance. Therefore, EFF conditionality prescribes little about the way borrowers do things. It concentrates instead on

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1/ Finance and Development, March 1981.

particular results that can be monitored by numerical measures. And while the Fund has, since the early 1970's, paid increased attention to programs affecting supply, EFF conditionality has continued to stress demand management to an extent clearly different from SAL conditionality.1/

According to the IBRD Annual Report 1980, the basic difference between SALs and IMF balance of payments support is that IMF assistance is "designed to meet the immediate consequences of crises,"2/ while SAL assistance is for programs finding solutions to a country's long-term structural problems. This language represents an earnest attempt to keep the two kinds of programs distinct. Bank reports, at least since 1981, have placed great emphasis on the need for SALs to be "complementary to support for adjustment programs provided by the IMF" and so to involve close "collaboration between the staff of the two institutions."3/ No formal rule exists, but in practice SALs are provided only to countries committed to some IMF programs.

1/ The SAL can neglect demand management since the IMF addresses it.
2/ World Bank, Annual Report 1980, p.68.
3/ World Bank, Annual Report 1981, p.70

C. The Nature and Scale of Structural Adjustment Lending

This section describes the loan terms of SALs, both the features that attract borrowers and the conditionality provisions that deter them. It presents details about the size and repayment provisions of each outstanding SAL, and it presents some information about SALs likely to be approved during the 1984 fiscal year. It presents statistics that suggest the degree of "need" felt by the borrowers and the degree of leverage obtained by the Bank. Finally, it compares the characteristics of SALs with those of other kinds of loans made by the Bank and the Fund.

1. Characteristics of SALs

Each SAL is conditional on a wide variety of borrower policy reforms affecting resource allocation. Each is designed to be dispensed in under 18 months, and after 3-5 years of grace, is to be repaid in 15-20 years at either standard Bank rates or IDA terms (mostly the former).

A typical SAL might contain all of the following provisions:

Loan Terms

Disbursements

(i) One-half available on the effectiveness date.
(ii) One-half conditionally available 4 months later.
(iii) Almost all imports are eligible except military, paramilitary, and luxury goods.
(iv) Each tranche to be disbursed in about three months.

Repayments and Interest

(i) 18 years for repayment.
(ii) 4 years of grace.
(iii) The standard variable interest rate (or IDA terms)

Counterpart Funds

Funds generated by sale of SAL foreign exchange to be used to finance the Government's development program.

Four General Categories of Adjustment Conditions

Prices

(i) Petroleum product prices are to increase during the next year.
(ii) Pricing policies on forestry products are to be reviewed.
(iii) A tariff study is to be commissioned with a view to replacing quantitative restrictions with a uniform tariff.
(iv) Urban water prices are to be increased within three months.
(v) Food subsidies are to be cut.
(vi) Cotton and grain prices are to be raised by 50% before the next crop year.

Public Investment Program

(i) Cut back investment program and focus on quick-yielding high-priority projects.
(ii) Subject a number of especially large projects to detailed technical review by independent consultants.
(iii) Study staffing needs of the investment planning agency.
(iv) Prepare a new three-year public investment program.

Budget Planning and Debt Management

(i) Prepare a complete inventory of public debt.
(ii) Establish a target range for debt service ratios.
(iii) Develop revenue and expenditure targets for the Plan period.
(iv) Revise the revenue code to simplify business taxes and consolidate excise tax law.
(v) Establish a tax arrears policy.
(vi) Introduce a three-year rolling budget for investment and foreign borrowing.
(vii) Prepare an initial review of recent and prospective recurrent expenditure trends.

Institutional Reforms

(i) Create an Investment Coordinating Committee to monitor all large investments.

(ii) Provide specialist planners in particular agencies.

(iii) Develop a concrete program for elimination of unwarranted losses for major public utilities over the medium term.

(iv) Begin a study of institutional mechanism to improve state enterprise efficiency.

Disbursements usually begin within a few days of the effective date of the loan. If loan conditions are satisfied on schedule, the whole loan is disbursed within a year--and in most cases--within a few months. The first tranche has been disbursed in as little as a few days.

Table 3 shows the size and some of the other characteristics of the 23 SALs made since SALs were introduced in 1980, through 1983; and of the 9 already made or under discussion for fiscal 1984. 1/ This table will be discussed more fully in the next section.

SALs carry customary Bank and IDA concessionality. Table 3 shows the repayment terms and the interest rate on each SAL in force.

Initial SALs are especially attractive to borrowers because they offer hope of more to come. When a country first agrees to an SAL, the Bank promises a series of such loans, three or four or more, on similar terms, if the conditionality provisions are

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1/ July 1983 through June 1984

satisfied. Turkey obtained its fourth (fifth if a 1980 "supplemental loan" is counted) SAL in 1983 and now stands as proof that the Bank will make good on this promise if the borrower does fulfill the prescribed conditions. In 1984, Turkey is expected to receive its fifth--and final--SAL.

The average interval between successive Turkish SALs has been 13 months. The second Thai loan also came 13 months after the first. But the loan interval has averaged 18 1/2 months for the 8 sequential SALs made to the six countries, Turkey, Kenya, Thailand, the Philippines, Jamaica, and the Ivory Coast. Clearly, the successor loans can follow quickly, but they can also be long delayed as in the cases of Kenya and the Philippines (28 and 32 months, respectively).

In connection with most SALs, the Bank negotiators arrange associated Bank project loans and loans from other concessional institutions. As a final attraction, the Bank usually provides the borrower with technical assistance--to be paid for out of the loan.

SAL disbursement generally is accomplished in two tranches. This is not always so; the two Thai loans and the Turkish Supplement loan involved no tranching; the Turkey I loan had three tranches. But the 19 other 1980-83 SALs were each divided into two tranches, the second to be released three to six months after the loan's effective date, conditional on Bank satisfaction that the conditional provisions were being adequately met.

In exchange for receiving a SAL, the borrower must conform to a lengthy list of conditions. Several are clearly pro forma. The loan proceeds, for example, may not finance military or "luxury" imports; but given the fungibility of money, that provision is not very restrictive. Similarly, the borrower is obliged to generate a counterpart fund of domestic currency that is to be used for development projects or programs. But this is easily done, and the Bank's staff does not appear to have devoted much attention to monitoring the use of those funds.

The general elements of SAL conditionality are the many provisions in the array of policy reforms the borrower must promise to undertake. The "traditional" areas of IMF responsibility--exchange rates, credit policy, budget deficits, and other monetary and fiscal macroeconomic policies--are left, mostly, to the IMF. But the SAL typically is very wide-ranging nonetheless.

The list of required reforms is generally comprehensive and touches virtually all areas of perceived--mostly microeconomic--policy deficiencies. The SAL reform agenda concentrates on four general areas: 1) prices (tariffs, subsidies, energy prices, and agricultural producer prices); 2) the size, rationality, and sustainability of public investment program; 3) budget preparation (development, foreign exchange, rolling budgets); and 4) keys areas requiring institutional reforms (state-owned enterprises, other parastatals, agricultural marketing, customs administration, etc.).

The Bank obliges each SAL borrower to provide a letter of commitment to the structural adjustment program called a "Letter of Development Policy," it is comparable to the Fund "Letter of Intent." That letter must satisfy the Bank management (and the Executive Directors) as representing an integrated and sustainable program of reform.

When SALs were first proposed, some Executive Directors feared that they would offer LDCs an alternative to IMF reforms. In Bolivia, the SAL's second tranche was released after a new Government had guaranteed compliance with the SAL terms but also after the Fund had decided to cancel Bolivia's standby arrangement. That SAL decision was mildly controversial, but the general rule has been that the Bank and Fund staff have engaged in extensive consultation before SAL agreements have been formulated.

Conditions adequate to permit borrower access to Fund resources have been a prerequisite for each SAL. Thus far, every borrower has been using a Fund facility at the time of its first SAL. (The cooperation operates in the opposite direction too. The Fund does not now authorize access to the EFF unless the Bank approves any relevant multi-year investment program.) The February 1982 Jamaican SAL introduced a model detailed comparison between EFF and SAL provisions.

TABLE 3

SALs, 1980-1984: By Country, Amount and Terms*

Fiscal Year and Approval Date	Country	Amount (in U.S. $ Millions)	Terms of Loan Repayment: Length Years	Grace Period Years	Interest Rate
1980					
18 Mar	Kenya	55 (IDA)	--	--	--
25 Mar	Turkey	200	17	4	8.25%
5 Jun	Bolivia	50	20	5	8.25
1981					
16 Sep 80	Phillipines	200	20	5	9.25
18 Nov	Turkey (Suppl)	75	17	4	9.25
18 Dec	Senegal	60 (30 IDA)	20	5	9.25
3 Feb 81	Guyana	22.0(8 IDA)	20	5	9.25
12 Jul	Turkey II	300	17	4	9.6
2 Jun	Mauritius	15	17	4	9.6
25 Jun	Malawi	45	20	5	9.6
1982					
24 Nov 81	Ivory Coast	150	17	4	11.6
17 Dec	Korea	250	15	3	11.6
23 Mar 82	Thailand	150	20	5	11.6
23 Mar	Jamaica	76.2	17	4	11.6
27 May	Turkey III	304.5	17	4	11.5
1 Jun	Pakistan	140(80 IDA)	20	5	11.6
1983					
1 Jul 82	Kenya II	130.9(70IDA)	20	5	11.6
31 Mar 83	Thailand II	175.5	20	5	SVIR
26 Apr	Phillipines II	302.25	20	5	SVIR
17 May	Togo	40.0 (IDA)	--	--	--
14 Jun	Jamaica II	60.2	17	4	SVIR
23 Jun	Turkey IV	300.8	17	4	SVIR
20 Jun	Yugoslavia	275	15	3	SVIR
1984					
5 Jul	Ivory Coast II	250.7	17	4	10.97
8 Nov	Korea II	300	15	3	SVIR
15 Nov	Panama	60.2	--	--	--
8 Dec	Mauritius II	40	17	5	10.47
20 Dec	Malawi II	55 (IDA)	--	--	--
(planned)	Jamaica III	60	--	--	--
(planned)	Peru	200	--	--	--
(planned)	Turkey V	300	--	--	--
(planned)	Costa Rica	80	--	--	--

* Twenty-three loans actually made between 1 Feb 1980 and June 1983; and nine SALs approved or under discussion for Fiscal 1984.

2. Size and Repayment Terms

Table 3 shows the size and the repayment terms of the twenty-four SALs made before August 1983, and it reports the size and character of the nine SALs under discussion in September 1983. Table 4 shows the geographic distribution of existing and prospective SALs and their division among repayment-terms categories.

Between February 1980 and June 1983, the Bank made twenty-three SALs. Twelve loans were for 20 years with 5-year grace periods; nine were for 17 years with 4-year grace periods; and the two loans to Korea and Yugoslavia were for 15 years with 3 grace years. These generalizations are shown in Table 4. (Togo was on standard IDA terms, 50-year maturity, 10-year grace.) The calendar 1980 interest rates were 8.25 and 9.25%; calendar 1981-82 rates were 9.25, 9.6, and 11.6% and calendar 1983 rates were all "standard variable." But exceptions to these interest rate rules are the IDA credits to Guyana, Pakistan, Kenya II, and Togo. (In these four cases, the IDA portion of the whole SAL was, respectively, 8/22nds, 8/14ths, 70/131sts, and 1.)

Table 4 shows for each fiscal year the division of the thirty-three loans, by number and by amount, among regions and among maturities. The total amount approved rose from $305m during the last five months of fiscal year 1980 to $1285m in fiscal year 1983. Eleven of the 23 loans and almost 80 percent of the amount approved before fiscal year 1984 have gone to Asia--though five of the eight Asian loans (and $1,180M of the

TABLE 4

Number, Amount, Distribution and Terms of World Bank Structural Adjustment Loans Made During Calendar Years 1980 - 1983, and Under Discussion for Fiscal 1984

Fiscal Year	Number of SAL's	Millions of Dollars Total	IDA	Number & Amounts to: AFR	ASIA	WEST.HEM.	TURK	TERMS Length/Grace 15-3	17-4	20-5a/
1980										
Number	3b/			1	1		1	1		
Amount:		305	55	55		50	200		200	120
1981										
Number	7			3c/	1	1	2		3	4d/
Amount:		717	38	120	200	22	375		390	327
1982										
Number	6			1	3	1	1	1	3	2e/
Amount		1070.7	80	150	540	76.2	304.5	250	530.7	290
1983										
Number	7f/			2	2	1	1	1	2	3g/
Amount		1284.7	110	170.9	477.8	60.2	300.8	275	361	608.7
1984 g/										
Number	10			3	3	4				
Amount		1345.9	55	290.7i/	650	352				
TOTAL										
Number	33			10	9	8	5	2	9	11
Amount		4723.3	338	686.6	1867.8	560.2	1180.3	525	1481.7	1130.7

a/ First number, length of loan. Second number, length of grace period.
b/ In the length-grace division the third loan was to Kenya on standard IDA terms.
c/ Includes Mauritius.
d/ $8 million of the $22 m Guyana SAL was a credit on standard IDA terms.
e/ $80 million of the $140 m Pakistani SAL was a credit as standard IDA terms.
f/ In the geographic division, the 6th loan was to Yugoslavia for $275 m. In the length-grace division, the 6th loan was to Togo for $40 m on IDA terms. Both Yugoslavia and the Togo loans are included in the $1,154 m total.
g/ $70 m of the 130.9 Kenya II SAL was a credit on standard IDA terms.
h/ Length-grace data unavailable for fiscal 1984 loans.
i/ Does not include the Malawi II loan figure which is to be determined.

$2,398 Million loaned to Asia) were to Turkey.

Other SALs are in the pipeline. A second Ivory Coast SAL was approved by the Board in July 1983. In September, 1983, eight other SALs were being considered. Of the nine, five would be successor SALs to countries already operating contractual SAL loan programs. Three countries, all in the Western Hemisphere, Costa Rica, Panama, and Peru, are slated to become first-time SAL recipients. If authorized, the five successor loans would exceed $700m (in addition to the $251m to the Ivory Coast). The three prospective first SALs would total $340.2m. If all eight are made, the FY 1984 total will equal $1,345.9 million, an increase of only 4.76% above the FY 1983 total representing, apparently, a termination of the previous trend. The terms of the eight new SALS have not yet been made public, but only Malawi appears likely to obtain a portion of all of the SAL as an IDA credit. Among the 9 prospective FY 1984 loans, some $650m, just under half of the prospective total, would go to the three Asian countries: Korea, Thailand, and Pakistan. The Western Hemisphere share would slightly exceed the African. The principal point suggested by this review of the possibilities for FY 1984, is that it shows the Bank remains committed to substantial use of the SAL vehicle.

3. Selection Criteria

A survey of the 15 countries with SALs and the four new countries being considered for SALs in the Fall 1983 leads to the conclusion that few definitive statements can be made about the criteria used by the Bank when deciding which countries are to receive SALs. For example, Table 5 suggests that the Bank has not viewed SALs primarily as a policy reform instrument for the lowest income countries. At the same time, the Bank has not restricted SALs to middle income countries.

Only three of the 15 countries with existing SALs, and none of the four being considered for SALs, had a per capita income level below the $375 line the Bank used to divide the low income from middle income countries in 1979. At the other extreme, six of the 15, and three of the four had per capita incomes above $1000. The Yugoslavian 1979 per capita income was even above the $2,500 mark.

Neither can borrowers be classified on the basis of uniformly fast--or slow--economic growth. For existing and potential SAL recipients, Table 5 shows growth figures for 1960-1980, compared with low income countries as a group (excluding China and India) and with middle income oil importers as a group.

In comparison with the average for other countries in their income group, six of the 15, and just one of the three were above the growth average while nine of the 15, and three of the four, were below the average. At the extremes, Senegal's growth was negative, that of Jamaica and Peru a low 1.7%; Korea's was a high 7 percent; Thailand's Turkey's and Yugoslavia's were all above 3.5%.

TABLE 5:

Level and Growth Rates of GNP in

Individual SAL Countries and in LDCs Generally[1/]

S A L Country, in order of first SAL group: Low-income Countries	Middle-income Oil Importers	Country's 1979 GNP per capita (U.S. $)	Average annual growth in GNP per capita (%) 1960-81	X for those above average annual growth for their
	Kenya	350	2.9%	
	Turkey	1330	3.5%	
	Bolivia	550	1.9%	
	Philippines	600	2.8%	
	Senegal	430	-0.3%	
	Guyana	580	1.8%[2/]	
	Mauritius	1030	2.1%[2/]	
Malawi		200	2.7%	X
	Ivory Coast	1040	2.3%	
	Korea	1480	6.9%	X
	Thailand	590	4.6%	X
Pakistan		260	2.8%	X
	Jamaica	1260	0.8%	
Togo		350	2.5%	X
	Yugoslavia	2430	5.0%	X
	Costa Rica	1820	3.0%	
	Panama	1400	3.1%	
	Peru	730	1.0%	
Averages for:				
Low-income Countries (except China and India):		$240	0.8%	
Middle-income Oil Importers:		$1550	3.7%	

1/ Includes 15 countries that have received SALs and three in which SALs are under discussion.

2/ These figures are growth rates for the 1960-80 period.

(Source: World Bank, World Development Reports, 1981, 1982, 1983.)

There is a third possible criterion which cannot be shown in tabular form: the general quality of policies which SAL recipients pursued during the 1970s. This is a criterion by which donors often distinguish good performers from bad ones. But the list of recipient countries indicates that in allocating SALs, the Bank has concentrated neither on the "good guys" nor on the "bad guys," defined in terms of "policy soundness." Korea, Thailand, the Ivory Coast, and recently Jamaica, have been frequently classified as "sound" policy countries. Bolivia, Senegal, and Guyana, have all been given lower marks--even before their failures with SALs; most other SAL recipients are run-of-the-mill in 1970's policy behavior.

The Bank has argued that SALs are provided to help produce sustainable balance-of-payments conditions. Therefore, balance-of-payment conditions antecedent to the award of SALs ought to provide some generalizations about the Bank's criteria for choice of SAL countries. Table 6 provides this kind of information. It should be noted that Table 6 is in one way distinctively different from Table 5. The important consideration in Table 5 was growth over the long-term (a 20 year period) and GNP per capita as a result of long-term growth. Therefore, to facilitate comparisons among the countries of Table 5, all growth figures are for the same 1960-80 period, and all per capita GNP figures are for the same year, 1979.

In contrast, in Table 6, the important consideration is the relationship between the Bank's selection of SAL recipients and each country's balance-of-payments conditions shortly before its selection. It should be stressed that given year-to-year, and even month-to-month, volatility of balance of payments events, this table is a very rough tool of analysis.

However, even the correct statistics for the period preceding the Bank's selection do not solve the problem of arranging fair comparisons between countries chosen for SALs in different years. When a country is chosen to receive an SAL, it is chosen over other countries in that same year. So the choices in 1980 are based on each borrower's 1979-80 circumstances relative to those of other potential SAL borrowers in 1979-80. If, for example, general conditions deteriorated between 1979 and 1982, then an absolute current need that might have justified selection for an SAL in 1979 may be insufficient for qualification in 1982. In order to deal with this problem, Table 6 reports each SAL country's debt-service ratio and months-of-reserves of other LDCs. The low-income SAL borrowers are compared with all low-income countries (except China and India). The middle-income SAL borrowers are compared with all middle-income oil importers. The results show that, relative to other countries within their income group, SAL countries have had high debt service ratios. Over half of those with available statistics have more than 100% the debt service ratio of the average country within their group, while only the Yugoslavian (23%) and Mauritius (28%) figures are low.

TABLE 6:

Debt-Service Ratios for Each SAL Country
Year Before First SAL with Country Group Averages.
(Source: World Bank, World Development Reports, 1981,1982,1983)

		Year before first SAL:		Relative to others in their country group	
Country	1979 GNP Per Capita	Debt Service Ratio a/	Months of Reserves	Debt Service Ratio a/	Months of Reserves
Kenya	380	7.5 1/	3.7 1/	65.22%	68.52%
Turkey	1330	12.9 1/	5.3 1/	112.17	98.15
Bolivia	550	29.6 1/	4.5 1/	257.39	83.33
Philippines	600	7.0 2/	4.6 2/	58.82	121.05
Senegal	430	13.7 1/	...	96.48	...
Guyana	580	29.5 1/	...	207.75	...
Maurituis	1030	4.0 1/	...	28.17	...
Malawi	200	18.4 2/	1.6 2/	193.68	76.19
Ivory Coast	1040	22.2 3/	0.1 2/	177.60	3.45
Korea	1480	13.1 3/	1.0 3/	85.06	30.30
Thailand	590	6.7 3	2.7 3/	53.60	93.10
Pakistan	260	9.6 3/	2.5 3/	109.09	131.58
Jamaica	1260	22.5 3/	0.5 3/	180.0	51.72
Togo	350	13.0 3/	...	147.73	...
Yugoslavia	2430	3.5 3/	1.5 2/	22.73	45.45
Costa Rica	1820	15.3 3/	1.0 3/	122.4	34.48
Panama	1400	11.5 3/	0.3 3/	74.68	9.09
Peru	730	44.9 3/	3.6 3/	359.2	124.14

Country Group Averages:		Debt Service Ratio a/	Months of Reserves
1979	Low Income Countries b/	10.8	2.8
	Middle Income Oil Importers	11.5	5.4
1980	Low Income Countries b/	9.5	2.1
	Middle Income Oil Importers	11.9	3.8
1981	Low Income Countries b/	8.8	1.9
	Middle Income Oil Importers	13.9	3.0

a/ Expressed as percentage of export goods and services
b/ Excluding China and India

1/ 1979 figures 2/ 1980 figures 3/ 1981 figures

But the Bank selection of SALs is said to be based as much on anticipations of need (and of reform) as on recent economic events. Thus, SALs can be made when the wolf is at the door. They can also be made when his approach is only expected. Thus, the Ivory Coast and Senegal received SALs because there was a balance-of-payments crisis while Thailand and the Philippines received SALs because they agreed to programs designed to avoid anticipated crises.

In the light of all that has been written here, generalizations must be modest. The Bank's decisions about SAL allocations are based on a wide range of considerations including, but not limited to those discussed above. One should not be surprised that the award of SALs does not correlate with any single variable.

There are two categories of countries that have been considered for, but have not received, SALs: 1) those whose representatives discussed SALs with the Bank but with no Bank loans following from the discussions; in fact, a rejection; and 2) countries that discussed SALs before reaching agreement with the Bank on another type of loan. Sometimes these alternative loans involved extensive conditionality and were, in effect, SALs called by some other name.

Sudan is an example of the second category. It was considered for a SAL but instead received agricultural rehabilitation loans with extensive conditionality and with tranches. Under the reform package, the real price of cotton was substantially raised, the exchange rate was cut, cost ineffective airport and seaport projects were cut from the public investment budget. Not only were conditionally-required studies carried out, they were--beyond the requirements--implemented.

4. The Importance of the SALs to Borrowers

Table 7 presents several measures of the relative importance of SALs to the borrowers. Column 1 shows each SAL as a percent of the nation's merchandise imports in the year of the loan. Column 2 shows each SAL as a percent of the nation's public external capital flow in the year of the loan. Column 3 shows each SAL as a percent of the nation's gross domestic investment in the year of the loan.

As a share of merchandise imports, the figures range from a high of 39% for Guyana and 12.5% for Malawi to a low of 1% for Korea. As a percent of public capital inflow, the figures range from a high of 105% for Togo and 35% for Malawi, to a low of 3.4% for Turkey and 4% for Korea. As a percent of gross domestic investment, the figures range from a high of 26% for Guyana and 16% for Jamaica, to a low of 0.52% for Turkey and 1.4% for Yugoslavia. From most observers' points of view, and excepting Korea, these numbers are large enough to give the lender "leverage" on the borrower, particularly with respect to public external capital flows.

Table 7

Measures of the Importance of the SALs to Borrowers:
The SAL as a Percent of the Nation's Merchandise Imports,
Gross Domestic Investment and Gross Public External Capital Flow[a]

Country	Date of the SAL	Merchandise Imports	Gross Public External Capital Flow	Gross Domestic Investment[b]
		Dollar value of the SAL as a percent of the borrower's:		
Kenya	18 Mar 80	2.39	13.29	4.17
Turkey	25 Mar 80	2.61	9.00	1.38
Bolivia	5 Jun 80	6.00	11.39	6.31
Philippines	16 Sep 80	2.59	14.39	1.88
Turkey(Sup)	18 Oct 80	0.98	3.38	0.52
Senegal	18 Dec 80	5.00	21.20	15.09
Guyana	3 Feb 81	39.22[b]	22.91[c]	26.16[b]
Turkey II	12 May 81	3.37	16.52	2.23
Mauritius	2 Jun 81	2.31[c]	n.a.	3.85[c]
Malawi	25 Jun 81	12.53	34.62	14.40
Ivory Coast	24 Oct 81	6.16	12.84	6.41
Korea	17 Dec 81	0.96	4.11	1.44
Thailand	2 Mar 82	1.50	10.27	1.46
Jamaica	23 Mar 82	5.17	18.68	16.09
Turkey III	27 Mar 82	3.42	16.77	2.26
Pakistan	1 Jun 82	2.62	20.80	3.27
Kenya II	1 Jul 82	6.73	27.50	7.52
Thailand II	31 Mar 83	1.75	12.01	1.70
Philipp.II	26 Apr 83	3.80	19.77	2.59
Togo	n.a.	6.70	105.26	14.66
Jamaica II	14 Jun 83	4.09	14.75	12.71
Turkey IV	23 Jun 83	3.38	16.56	2.23
Yugoslavia	28 Jun 83	2.52	23.29	1.36
Korea II	8 Nov 83	1.15	4.95	1.75
Panama	15 Nov 83	3.91	17.60	5.95
Mauritius II	8 Dec 83	6.17[c]	n.a.	10.27[c]
Jamaica III	Jun 84	4.07	14.71	12.67
Peru	Jun 84	5.25	13.61	4.53
Turkey V	Jun 84	3.37	16.52	2.23
Costa Rica	Jun 84	6.68	13.27	10.86

a/ All loans made or planned in 1981 through 1984 use 1981 figures when calculating the ratios unless indicated. Loans made in 1980 use figures for that year.

b/ 1978 figures c/ 1979 figures d/ Calculated from GDP and predent of GDP placed in domestic investment. (Source: World Bank, World Development Report, 1981, 82, 83.

5. The "Additionality" of the SALs.

When SALs were first introduced in February 1980, the Bank's management attempted to obtain additional funds so SALs would not rise at the expense of other Bank and IDA lending. That effort failed.

The Bank's management then undertook to provide SALs in amounts that would raise the portion of Bank-IDA lending going to the SAL borrowers. Table 8 examines the extent to which this happened. It compares the percentage of total Bank-IDA lending in FY 1979 to the twelve SAL recipients in good standing in fiscal 1983 with the percent of total Bank-IDA lending that went to those twelve in FY 1983. There was some additionality: the share of the twelve rose from 21.9 percent of Bank-IDA lending in FY 1979 to 24.3 percent in FY 1983.[1/]

The increase is small, however; the numbers are ambiguous in some respects; and no one can know what lending would have been in the absence of SALs. So no firm conclusion on additionality seems warranted at this stage, though it is likely the SAL countries do better in terms of total inflows of aid than do non-SAL countries.

1/ When comparing the percentage share each SAL country received in the years immediately before and after the SAL, additionality is noticed in a very small number of countries. More time is needed to prove additionality occurs. The present evidence is not conclusive.

TABLE 8

Total Lending to the 12 SAL Countries
in Good Bank Standing and as a Percentage of
Total Bank-IDA Lending, Fiscal 1979 and 1983

Country	1979	1983
Kenya	255.0	192.9
Turkey	312.5	669.4
Philippines	395.5	502.7
Mauritius	0.0	12.2
Malawi	39.5	56.4
Ivory Coast	52.4	32.2
Korea	225.0	672.0
Thailand	285.1	393.1
Jamaica	66.5	120.4
Pakistan	164.0	304.0
Togo	16.2	81.2
Yugoslavia	385.0	520.0
TOTAL	2,196.7	3,556.5
12 Country Totals as a percent of total Bank-IDA lending in the given year	21.94%	24.32%

III. EMPIRICAL ASSESSMENT

The SAL program has only been in operation for a little more than three and a half years; that is too short a period for a comprehensive assessment of a program whose objectives are expected to be realized over a medium-term time frame. This section looks at the record of experience to date in order to identify those efforts which might be called successful and those whch have been less successful.

An empirical review of the SAL program brings out two main points: (1) Some kinds of failure can be identified unambiguously, but success can only be tentatively identified. (2) There is no generally accepted way to evaluate the effectiveness of the SAL instrument: time horizons, intangible criteria, the large number of conditional elements, and uncertainties about the specific weights which should be attached to these items hamper evaluation.

A. <u>Some "Failures"</u>

The Bank has made two kinds of judgements of failure: SAL cancellation and refusal to provide a second SAL. Senegal is a case where the SAL was cancelled. Bolivia and Guyana were refused second SALs. SAL run-ons for several countries may be in jeopardy. These are examples of "revealed failure."

Cancellation Before Full Disbursal

When in June of 1983, the Bank cancelled a $16.2 million portion of the original $30.0 million SAL, Senegal represented the only instance where a SAL was cancelled before the full amount of the loan had been disbursed. The absence of positive action on two main elements of the reform program, (1) fertilizer subsidies and distribution and (2) seed distribution policies, led to the cancellation of the Senegal SAL. The Senegal SAL program is discussed in Annex I.

Bank Refusal to Agree to a Successor SAL

Guyana. Both tranches of Guyana's March 1981 $22.0 million loan were released, but a second SAL was not awarded. Guyana was unable to meet the EFF program targets and was unable, in 1982, to draw down the remaining $98.0 million SDR under that program. In its April 1982 Progress Report to consider release of the second tranche of the first SAL, the Bank observed that economic performance had fallen far short of the targets set in the SAL program. Further, the Bank said, a review of the compliance with SAL conditions suggested that the GOG had adhered only in part to the agreed conditions. In the same Report, the Bank discussed a lack of progress towards addressing the key constraints to economic development in Guyana, i.e., the inefficiency of the public sector, the overregulation of the economy, and the limited role assigned to the private sector.

Bolivia. In 1979, the Bank, the Fund, and the GOB put together a reform program. The Fund program provided for an exchange rate devaluation of 25%, price increases for hydrocarbons, and monetary and fiscal policy improvements. A Bank SAL followed. Its main features were: scaling down of the public investment program, and shifting investments to high priority items; a study of how to improve the process of public investment; a reduction of the high level of mining taxation; increases in agricultural producer prices and undertaking a study of agricultural marketing; increases on rates for power, railways, and airlines. The first tranche was released in June of 1980.

What went wrong? A coup occurred in July 1980, but the new government remained committed to the program. A Bank mission in August 1980 found adequate compliance in the areas of export competitiveness and in debt rescheduling. But the government failed to meet requests in two areas: the investment program and public enterprise price increases. The 1980 public investment budget was only 42% of planned expenditure, due in part to revenue shortfalls, but also to a special salary bonus awarded in May 1980. The GOB agreed to raise budget allocations to assure completion of high priority projects and to increase public enterprise rates and gasoline prices. On this basis, the Bank released the second tranche of the SAL on November 17, 1980.

The GOB did what it promised. But the economy started deteriorating again after mid-1980. Bilateral donors were slow in helping the new government. The IMF standby criteria were violated. Investment and growth fell, and inflation rose to 46% in 1980. But the GOB refused to devalue the peso, hurting exports. A severe balance of payments crisis ensued.

The basic reason for the SAL "failure" in Bolivia was the failure of the stabilization program -- the fiscal, monetary, exchange rate and price policies as specified in Fund agreements. There was nonetheless some real progress: the government pruned its investment program, dropping dubious projects; instituted better program evaluation procedures; improved the mining tax code; and completed some important studies and policy papers.

But the basic problem leading up to the SAL--excessive public sector expenditure and inadequate economic decision-making procedures--are deep rooted problems, inherent in underdevelopment. It is not evident that the SAL had much impact on them.

B. "Successes"

By October of 1983, 12 of the 15 SAL countries had received, were about to receive, or seemed likely to receive, a second SAL. Each successor SAL is a public judgment by the Bank that the performance under the previous SAL was sufficient to justify a follow on SAL. Though Thailand seems likely to obtain its third SAL, only Turkey has obtained more than three SALs to date.

These SALs do not represent uninterrupted successes. Release of the second tranche was delayed in the case of Kenya, Malawi, and the Philippines. By August of 1983, Kenya had received none of the $30 million second tranche and only $10.9 million of the $30.9 million first tranche of its August 1982 second SAL.

Within the Bank, many staff members regard the SALs to Turkey, Korea, Ivory Coast, Thailand, and the Philippines as examples of success. There is said to have been a great turn-about in the Turkish economy. The Philippines have adopted major tariff reforms. Thailand has rationalized pricing for irrigation water. Korea has addressed energy pricing policies. Early experience with the 1983 SAL to Yugoslavia is judged high satisfactory by Bank staff. The performances of Mauritius and the Ivory Coast under SAL programs are also viewed as satis-factory. Those of Malawi and Togo are viewed as acceptable. The assessment of Pakistan, once positive, has become much less favorable. To indicate the nature of the successes, there now follow several brief descriptions of the Thai, Korean, and Philippine SALs.

Thailand. The rationale for providing a SAL to Thailand in 1982 was explicitly given as encouragement to revise domestic policies with respect to energy pricing, other domestic price policies (including interest rates), import protection, public investment bias against agriculture, and the growing scale of the public sector relative to the government's ability to generate sufficient revenues to finance the public sector. These main problems led to the decline in the growth rate. Combined with external events, the net result was strain in the balance of payments.

The Bank regards overall experience with the Thai SAL as positive. In agriculture, measures were taken in land use policy, marketing and price policies, and water resource development. Domestic petroleum prices were increased. In the tax area, new sources of revenue were introduced, and tax administration was improved.

Korea. The Bank's first SAL to Korea was designed to support a strategy, the general lines of which had already been worked out by the GOK, to deal with major adjustment problems of the Korean economy. The main structural problems which Korea faced in 1980 were: supply bottlenecks, excess capacity in heavy industries, and a relatively energy-intensive output mix. The nature of these problems was apparently well-understood within the GOK.

As is well-known, the Korean economy achieved spectacular growth in the 1960's and 1970's. In the 70's, annual growth rates averaged 10%. By 1978, the rate had reached 12% and the public investment rate increased by 36%.

In 1979, the Korean economy went into recession, accompanied by high rates of domestic inflation. The recession was brought on by domestic policies--mainly miscalculations in the allocation of public investment--and by the same exogenous factors which affected most LDCs in the late 1970's. The situation there, as elsewhere, led to balance of payments problems; the latter provided the rationale for the first SAL to Korea. It focused on industrial efficiency (incentives and protection policies); energy efficiency (relative pricing of coal, petroleum and electricity and conservation policy); and public sector efficiency (increased levels of taxation). The second SAL added tariff reform and measures to promote foreign investment.

The Philippines. The conditionality provisions of the first SAL to the Philippines focused on industrial sector policies where high rates of protection, monopoly privileges, and favoritism had been common.

In 1979, a Bank mission was told that major changes could be made in trade policy and in the industrial sector if the Bank were to provide a balance-of-payments loan. At the time of these discussions, the Bank staff was also concerned about the country's financial system which was characterized by regulatory complexity and discretionary bureaucratic power. But the Bank and the government agreed to attack the problems of the industrial sector first, then to study the problems of the financial sector.

Presumably, if there had been no SAL program, the Philippines would have received a 1980 loan in an amount and with the same conditions as those of the SAL it obtained. The Philippines is now credited with having done well in fulfilling the terms of the agreement, although the second tranche was held up because, during a political campaign, the Parliament refused to pass "reform" provisions injurious to particular industrial vested interests.

Early discussions proposed that the second SAL would carry conditions to tie up loose ends of industrial policy reform and introduce some interest rate liberalization that would permit competition on both sides of financial markets. Although the 1981 report of a Bank mission had commended much of the energy program of the Philippines, the second SAL was also to carry conditions raising electricity and diesel prices and cutting back and diversifying the energy program. The limited range of conditions was judged by some in the Bank as insufficient for an SAL. Partly as a result of controversy on that point, and partly because of difficulty in getting commitments from the GOP, two-and-a-half years passed between the effective dates of the first and second SAL.

In the end, the terms of conditionality of the second SAL were narrower and deeper than those of most other SAL recipients. In contrast with other recipients, neither of the Philippines SALs required much in the way of either agricultural or in public resource management reform. Because of the Bank's tendency to extend the scope of an SAL's conditions over additional policy areas, and because public resource management and land tenure involve such serious problems, a third Philippine SAL, if agreed, will very likely carry conditions for reform in these sectors.

Summary

An objective assessment of the SAL program is difficult for a number of reasons. First, SALs have a 5-7 year time horizon. They cannot be judged on the basis of one or two loans, since the implicit objective, policy reform, is an ongoing process. The stated objective, in official Bank documents, is a "sustainable" balance of payments position in 5-7 years. However, if this objective were rigorously applied to each SAL country, only Turkey would qualify for final evaluation at this point. Secondly, a SAL may be classified as a success in terms of specific policy reforms which have been introduced, but the impact of the reform program may have been overwhelmed by unexpected changes in the external economic environment. Thirdly, there are so many elements in the conditionality package, so many intangible items, and so few quantitative criteria, that subjective factors are crucial to the evaluation. This important aspect of SALs will be taken up in the next section which discusses the monitoring problem and the degree of rigor of SAL conditions.

At this point in time we can report what the Bank itself asserts: that of the 15 countries that have received SALs, 12 are still in good standing, and are moving forward on a wide array of policy reforms. The question is whether this forward movement is genuine, and whether it will continue. If failure is defined as countries that failed to get a second loan, then the SAL rate of failure is running about 20% of loan recipients. But there are no performance criteria to apply to this statistic.

IV. ANALYTIC ASSESSMENT

A. Conditional Development Assistance in General

An analytic review of SALs must start with a review of conditional development assistance in general. We will summarize in this section the purported advantages and disadvantages of conditional assistance. It should be noted that we do not follow the convention, used by some writers, which makes the distinction between project and program aid synonymous with non-conditional and conditional assistance.1/

1. PROS

Five main advantages can be claimed for conditional aid.

1/ Albert O. Hirshman and Richard M. Bird, Foreign Aid--A Critique and a Proposal (Princeton University Press, 1968)

a) As is well-known, unsuitable policies can, and often do, render economic assistance ineffective. It makes little sense to undertake rural development projects that bring new inputs to farmers if price and marketing policies fail to provide adequate incentives to farmers. Industrial projects and programs will come to nothing if the exchange rate system denies an adequate supply of imported inputs to industrial firms. Roads built with aid money today can be in ruins in a few years, without attention to maintenance, financing and organization, and perhaps such related matters as fuel imports, regulations on axle loading, and private transport policy. This, above all else, is the most compellng reason for imposing concessional provisions on aid recipients.

b) Conditional assistance can, in fact, accelerate policy reform. It does so by making reform more acceptable to local authorities and by providing resources to compensate those who lose from an efficiency-increasing economic reform.

Resistance to reform arises often because the delivery of benefits to some people involves the imposition of highly visible costs on other people. A higher price for grain producers will normally mean higher costs for urban consumers. A move to a more rational tariff structure may hurt industries and firms benefitting from heavy protection. A move to free markets generally will reduce the direct political patronage available to the political class.

The linking of aid flows to reform can have a significant impact on these sources of resistance. It is mainly here that the "compensation" rationale in conditional assistance is applicable. The additional resources can be used to "soften" the burden of change, to "lubricate" the reform process, by allowing reform governments to compensate groups that are hurt by the change--for example--by raising salaries for urban workers while reducing consumer subsidies for staples, and to provide resources while the reforms begin to work.

c) Conditional assistance can also accelerate policy reform by strengthening the bureaucratic and political clout of local reformers. The opponents of reform generally represent the concerns of those whom the reforms will hurt, of those who weigh objectives differently than do the reformers, and of those whose resistance is rooted in ideology.

The latter group is strong in the developing world. Most political leaders in LDCs do not believe that devaluation will be effective; many do not believe that raising producer prices will increase agricultural production. They are not persuaded that markets work the way most Bank or Fund or A.I.D. economists say they do. They believe that monopoly and monopsony are everywhere. They are profound pessimists. Many do not believe that the policy reforms advocated by the donor technicians and by some of their own technocrats, will really work.[1/]

1/ A more detailed discussion of the political dynamics of stabilization programs is contained in a recent paper by Joan M. Nelson, "The Political Economy of Stabilization in Small, Low-Income, Trade-Dependent Nations," Overseas Development Council, mimeo, January 1984.

Concessional assistance cannot change minds, but it can provide local reformers with a large marginal increment in the leverage they can apply during policy discussions.

d) Conditionality can increase the total volume of aid. Some part of the foreign assistance constituency in all industrial countries is concerned that aid money be used "effectively"--that it have significant effects on recipient countries' income and welfare. If aid is perceived to be wasted because of poor policies, political support for aid programs will diminish. This point can be put another way. An aid bureaucracy can rally greater political support for its program it is proposes to address policy inadequacies by conditioning its loans and grants, since it thereby wins over some of those who object to foreign assistance on the grounds that it is, because of bad domestic policies, "money down a rathole."

e) Foreign assistance without conditionality can delay reform. It sustains governments committed to wasteful, failed strategies, or--less broadly--to policies and programs that are simply unproductive. This point is made most frequently with respect to food aid, which critics argue has helped allow the survival of inappropriate policies and institutions in many countries. Unconditional assistance may, therefore, be worse than no assistance at all, from the point of view of long-term development.

Points a, d, and e raise no questions. Points b and c, however, are more debatable. They are, moreover, at the heart of the conditionality-policy reform issue. Because this constitutes the core of what can be called the "theory" of structural adjustment lending, we consider it later, in the section "Uncertain Theory of Institutional Reform."

One other consideration is fundamental in determining the effectiveness of donor-imposed conditionality provisions: this is the recipient country's perception of the donor's commitment to the reform. At one extreme is the perception of the IMF by a country with no major assistance alternative and convinced that the IMF will stop the operation if the country fails to comply. At the other extreme in recent years has been the Egyptian perception of the United States as having such a political stake in continued assistance that its conditionality provisions can be mostly ignored. The greater the willingness of the donor to impose sanctions, the more compelling the conditionality provisions.

2. <u>CONS</u>

a) It has been argued that conditional development aid is by its nature either superfluous or ineffective. If a government--more properly, the responsible authorities--want to reform, they do not need the inducement of conditional aid. It may be in a government's interest to make it appear that it is agreeable on policy changes in exchange for additional resources. But this will only be game-playing. If a reform is profitable, desirable and feasible, the government should be willing to do it in the absence of the conditional assistance.

On the other hand, if the changes are not considered profitable, desirable and feasible, the compliance will be slow and partial--or non-existent. The argument here is that donors may be unable to buy LDC policy reform. This is an unsettling proposition, since it flies in the face of what has very recently come to be the conventional wisdom in aid circles. There is, nonetheless, something in it. To see this, consider the question: why do governments so often persist in the pursuit of policies that technicians agree are "bad?"

i) They do so partly because of concern for those who would be injured by the reforms (as described in part "b" of the "Pros" section above).

ii) They do so also because political leaders weigh objectives differently than do technicians. The authorities in power will generally be more risk-averse than reformer-technocrats. In the policy areas, their position will reflect that of most of their countrymen; in a semi-arid, land-locked country, for example, most people may prefer huge national reserve stocks of foodgrains, even though there exist food security policies that can be shown to be cheaper and probably as safe. In many countries, political authorities prefer an inefficient parastatal to an efficient foreign-run enterprise; or they prefer the controllability of a state-owned enterprise to the independent though more dynamic indigenous entrepreneur--as in the distribution of agricultural inputs or foodgrain marketing. In many cases, the political authorities will be facing an immediate pressing problem of instability and so will weigh stability much higher than change (as in exchange rate policies, for example, or agricultural price policies) in comparison with reformers.

iii) Finally, as mentioned earlier, resistance may be rooted in beliefs or ideas--i.e., in "ideology."

As argued earlier, conditional aid can compensate losers and add to the leverage of reformers. Conditional aid might also influence the weighing of objectives and diminish risk-aversion so as to make responsible authorities more reform minded. But this effect is not likely to be significant. Moreover, there may be backlash effects that raise perceived risk (i.e., charges of buckling under to outside pressures).

Conditional aid, finally, will affect hardly at all that source of hesitation that is based on ideas about how the economy works. Moreover, belief that the "medicine" is inappropriate leads to half-hearted compliance and quick abandonment of reform programs by those who give in only while the reforms have foreign assistance in hand.

b) Conditionality can sow widespread resentment in the recipient country, on various grounds.

Local authorities will generally reject the notion that donor officials possess superior wisdom and sounder judgment than local people. The local officials are prepared to admit foreign technical superiority in such matters as building roads, generating power, calculating effective rates of protection, and modeling agricultural pricing scenarios. But they are not prepared to grant donor technical superiority in matters of political judgment or in understanding of the specific and usually highly particular circumstances of the local socio-economic environment.

c) Conditional assistance can be politically divisive, and weaken local support for recipient governments. This is obvious in IMF-type conditionality situations, such as assistance on reform of state-owned enterprises, removal of subsidies on farm inputs, reduction of consumer price subsidies, and opening an economy to international competition. But it can be true even in conditionality provisions covering more directly "developmental" matters -- e.g., the size of the public investment program and the fate of locally-desired large scale projects.

d) Less apparent is the danger that conditional assistance can reduce political support for foreign assistance in the donor community. This is relevant for bilateral donors and less clearly for multilaterals.

> In a simple model of international relations we may assume that, for the sake of independence, self-respect, and defense against accusations of

> being a satellite, the government of B, a poor country, is determined to maintain a certain average distance from country A, a greater power and a potential donor. Country B measures this distance along two dimensions, the extent to which it adopts economic policies suggested by A and the extent to which it takes A's position in the leading issues of international politics. Under these conditions, a success on the part of the great power in having B "do the right thing" in economic policy will result in a strong urge on the part of B to compensate for this move in the direction of A by a move in the opposite direction in international politics. Only in this fashion can the desired average distance be maintained.1/

The result is behavior that cuts away the constituency for foreign aid in donor countries. A recent example is the case of Zimbabwe, a recipient of considerable U.S. aid and of IMF resources. That country refused to vote with the U.S. at the U.N. on the Korean Airline incident and also led the forces condemning the U.S. for the invasion of Grenada.2/

B. Structural Adjustment Loans

Conditionality in development assistance can take many different forms. Project loans can--and do--have conditional elements - "covenants," which could be made harder or softer depending on circumstances. Program loans, which provide free-standing foreign

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1/ *Op. cit.*, p. 11.

2/ Hirschman and Bird cite the Quadros government's efforts in Brazil to become more neutralist after adopting an IMF agreement in the 1960s, *op. cit.*, pp. 11-12.

exchange, can also be nonconditional or conditional. The "traditional" program loan in the Bank portfolio was generally nonconditional: it was to meet a balance of payments shortfall, or a catastrophe. Sector loans, in traditional Bank terminology, were for financing a piece of a sectoral investment program, and were restricted to countries with good planning and implementing capacity. Conditionality was minimal.

In recent years, there has been a flowering of other forms of nonproject lending, as noted earlier--"export" or agricultural rehabilitation credits, which provide foreign exchange for critical industries, single import loans (e.g., the Nigerian fertilizer import loan), sectoral lending of various descriptions --the Sudan agricultural rehabilitation loan, for example. These carry varying elements of conditionality. And there is the SAL, the largest in size, broadest in scope, and most elaborate in conditionality of all the non-project lending instruments.

With respect to conditionality, the SAL has all the advantages and disadvantages listed above, most of them in magnified form. But the issue is not conditional versus non-conditional assistance. For nonproject assistance anyway, few observers would deny any longer the necessity for some kind of conditionality where the policy environment is particularly uncongenial to economic growth.

1. <u>The Evolving Rationale for SALs</u>

a) <u>When the Economic Rate of Return Becomes Irrelevant</u>.

As has been pointed out many times, the Bank has always been a project-oriented institution. The weight of its experience is heavily in project lending. Project identification, approval and supervision are what most of its staff does--and does very well.

The project focus also strongly influences the Bank's loan allocation process. Although allocation between countries is a mysterious process, the project bases of loans and credits serves as a kind of basic structure for decision-making. A loan/credit will have to pass through a screening process that--at least in principle--approves only "sound" projects. The Bank's main business has been to finance projects that have "acceptable" economic rates of return and other effects beneficial for development.

With SALs (and other forms of non-project finance) this traditional rationale is no longer relevant. How then is an individual SAL to be justified and what criteria are to govern the selection of SAL borrowers?

b) The Rationale in the Beginning: BOP Problems. The rationale for SALs was unclear from the start, as was the notion of "structural adjustment" itself. Three related but distinct rationales have been put forward by the Bank to explain the need for SALs: permanent changes in international price structures; balance of payments disequilibria requiring "structural" changes in domestic economies; reform of domestic policies.

The evolution of discussion of these matters began with the earliest published SAL review, done by Landell-Mills.[1/] He argued that adjusting to external shocks, not internal policy reform, was the main issue. He argued also that permanent changes had occurred in the international economy, and that these changes required adjustment; "external shocks," much more than domestic policy reform, were the rationale for the introduction of SALs.

Thus, when SALs were officially undertaken in February 1980 the rationale was that the economic situation had become distinctively different compared to earlier years. Four changes were typically underscored at the time:

1. the sharp and long-term rise in energy prices,
2. the inflationary rise in the prices of manufactured goods,
3. high interest rates, and
4. the drop in demand for primary products related to recession in the industrial countries.

Landell-Mills acknowledged that the four differences were affecting some developing countries more than others depending on the "vulnerability" of each country's economy and the "quality" of its economic management.

Then he went on to say,

1/ Finance and Development, Dec. 1981, p. 18.

> Conceptually, structural adjustment is designed to respond to permanent changes in the external environment and may be distinguished from structural reform to correct for inapropriate domestic policies. In practice, these two elements become inextricably interwoven and consequently, none of the programs supported by structural adjustment lending may be regarded as solely correcting for external shocks...Many of the reforms proposed under SAL are long overdue and are not necessarily specifically related to the changed international price structure. They are all designed, however, to have a direct impact on the BOP.[1/]

This formulation provided a more elaborate _raison d'etre_ for the SAL. But the analysis also raised some questions.

Of the four differences explicitly cited, only the first, energy prices, seemed at all likely to qualify as a "permanent" change. The price of oil had jumped in 1979--after over five years of decline, but no one in 1980 could guarantee it would not soon decline again. Nevertheless, within the Bank, the rationale used for the introduction of SALs was the "permanent or long-term character" of the "increase in the price of oil, high levels of inflation, and a prolonged period of slow growth in the OECD countries."

Given this premise of three (or four) permanent changes, the argument went on to assert that the consequent immediate problems were deteriorating terms of trade and growing current account deficits, that the appropriate solution would be "long-term structural adjustments in the economies of the developing countries," and, finally, that SALs would permit

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1/ Ibid.

borrowers to formulate and carry out appropriate structural adjustment programs. The analysis allowed that each country, and so each SAL, would be different. It also anticipated that "appropriate" programs might require some lengthy preliminary studies so that SALs would need to provide for a mixture of both do-it-now and study-it-first provisions. Nevertheless, the rationale included a premise that enough was already known to be able to anticipate that for most borrowers, "appropriate" adjustments would include:

1) reassessments of medium term investment programs,
2) diversification of exports, or other changes in the country's trade regime, and
3) revision of price incentives to promote efficiency in resource use.

The bottom line of that rationale was that the test of an appropriate structural adjustment program, successfully implemented, would be the achievement, within 5 to 7 years, of a viable current account situation--i.e., deficits reduced to a sustainable level.

Another indicator of the early uncertainty surrounding the Bank's arguments for SALs is the place of oil price rises in discussions at the time. For a period, within the first year of the SAL's use, the Bank's rationale for them may have shifted to concentrate on the "unanticipated shocks" caused by oil price increases. Given that assumption, policy reform was to concentrate on energy policy, including conservation and development of indigenous resources along with attention to agricultural and industrial policies and the public investment program. But a predominant energy policy focus--if it ever existed--never showed up in any SAL though most SALs do include some energy provisions among their many elements.

The balance of payments justification was strong in early discussions of SALs, and remains so now. The argument has been set out cogently by John Williamson, speaking about Fund conditionality. He has observed that there are three "traditional" sources of BOP problems: reversible, excess demand, and fundamental disequilibrium. Presumably, the IMF works on these. But there also exist "structural deficits," which have in his view re-emerged since 1974, and which have made balance of payments constraints once again "binding."[1/]

But the meaning of a "BOP constraint" in this context is not clear. At one level it simply means that governments would like to grow faster than their resources allow. If so, demand management is certainly required while government addresses the structural constraints, whatever they are. Policy changes are also required and relevant action on strategy (more export orientation, action on exchange rates, etc.). But all of this was true before 1974; so in this context, the SAL appears to have been a new solution to an old--not a new--problem.

c) The Rationale Now: Policy-Related Lending.

The Bank's rationale for SALs has evolved. No longer are

1/ Testimony given before the Senate Banking Committee, June 1982.

"permanent" exogenous changes cited as the primary reason for SALs. Instead, Bank writers now frankly acknowledge that many LDCs pursue many policies that retard development. The purpose of the SAL is therefore to demonstrate to prospective borrowers the Bank's convictions that change is urgently needed and that effective change requires a high-level agreement on comprehensive policy reform policies.[2/]

The explicit policy reform justification for SALs is analytically more satisfactory than the earlier ones--the financing of adjustment to permanently changed conditions, or (much the same thing) achievement of medium-term BOP equilibrium. But the lack of analytic underpinnings is less important than the fact that there is no clear guideline to Bank policy-makers as to which countries should receive SALs.

2. Which Countries Shall Receive SALs?

In no country is the policy environment without deep flaws, in terms of the economist's ideal. The problem here is the same as for the balance of payment criterion: almost all countries are worthy claimants for SALs on these grounds. So allocation criteria remain undefinable.

The Bank has added some other requirements: SAL claimants should have the expressed will to carry out an adjustment program

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[2/] Stanley Please, "Structural Adjustment Lending," IBRD Progress Report, April 1982.

and the capacity to draw one up and execute it. The "will" factor may eliminate some countries, but the "capacity" element is more fictional than real. The Bank is ready to help draw up SAL programs and provides technical assistance for implementation.

A glance at the list of SAL countries (actual and proposed) provokes a number of observations relative to allocation.

First, only three of the 15 recipients are low-income countries (Malawi, Pakistan, Togo) and one of these--Pakistan--will probably fail to qualify for a second loan. This means that this major new category of economic assistance is directed mainly to middle-income countries although as noted before it may represent little in the way of additionality.

Secondly, there are countries on the list that are certainly not characterized by either uncommonly poor economic policies or inflexible, unsuitable economic structures: Thailand, Korea, Yugoslavia, Barbados, Costa Rica, Panama, even the Ivory Coast. It is especially hard to understand how Thailand and Korea merit these loans. These are extremely fast-growing economies, highly adaptable and with sound policy environments. Certainly South Korea's energy policy needed fixing, as did its interest rate structure and credit policies. But the same is true for the rest of the planet; and in the Thai case, the SAL addresses long-term institutional issues, such as reform of the civil service, that have only a remote bearing on medium-term balance of payments issues, or policy reform properly defined.

This pattern of allocation could disadvantage the low-income countries. As a result of SALs, resources available for them may be less than they would be otherwise. There is some evidence to suggest that SALs bring "additional" resources to recipient countries; they receive somewhat higher shares of total Bank lending than they would get otherwise. Table 8 showed that the twelve SAL countries in good standing in 1983 increased their share of total Bank lending by almost 10% between 1979 and 1983.[1/]

For IDA countries, the implications are even stronger: the SAL is not really designed for the poorest countries, such as many of those in Sub-Saharan Africa. Since poverty reduction remains a prime Bank objective, and the poorest countries (especially Sub-Saharan Africa) remain a priority concern, the question arises whether the emphasis on SALs is fully consistent with basic Bank policy.

3. Underlying Theories of Reform

Implicit in the Bank's growing resort to non-project loans in general, and SALs in particular, are certain analytic propositions, or theories. These fall into two groups: propositions

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1/ The additionality tendency is not evident when the data are disaggregated by country. The conclusion is therefore very tentative.

about the relative cost-effectiveness of non-project and of project aid; and propositions about the strategy and tactics of institutional reform.

a) The Relative Cost Effectiveness of Non-Project Aid. On the first, we have already noted the key implicit premises:

- that policy reform may do more to promote economic projects;
- That non-project loans (credits) are more effective than project loans/credits in inducing policy reform in certain situations.

The first premise may be true because it has usually been true in the past, or because (1) the value of projects has decreased or (2) the usefulness of policy reform has increased. The attraction of project lending has indeed fallen. That point was made earlier, where reasons for the decline were outlined. The greater the decline in the expected value of project lending, the greater the attractiveness of program lending conditional on policy reform.

In addition, policy obstacles to development have accumulated over time; so the development usefulness of policy reform has increased. At the same time, obstacles to efficient project selection have accumulated, both in LDCs and in donor agencies. In the Bank, for example, new doubts have arisen in recent years about the effectiveness of "conventional" approaches to rural development projects, and about the utility of projects that impose significant claims on the future flow of public sector resources or of the public sector's organizational capacities.[1]

b) <u>Strategies and Tactics of Institutional Reform</u>. The broader and more important theoretical questions, relating to strategies and tactics of institutional reform, have received extraordinarily little attention in the writing about SALs. At issue are questions such as how economic reforms are most efficiently engineered, problems of opposition groups and coalition politics, bureaucratic responses, sources of resistance to change, etc.[2]

One central theme, more in informal discussion than in writing, portrays the SAL (and conditional assistance in general) as "compensation". The notion is that hesitant governments can be induced to adopt more reforms than they would otherwise, if they are rewarded by additional foreign aid. The mechanism by which this works is not often spelled out. It could be that opposition can be quieted, that losers can be compensated, that the process of change can be "lubricated." Thus, for example, wage increases can be financed for a short period, while food subsidies are removed. Or the prices of

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1/ The same is true for bilateral donors. In addition, the U.S., a major donor, is hamstrung in its project assistance by a dense set of legislature and administrative restrictions that make project aid less attractive.

2/ In the general literature, Albert Hirschman's appendix in <u>Journeys in Progress</u> remains one of the rare discussions of some of these matters.

cash crops can be gradually raised while fertilizer subsidies are cut back. In both cases the reforms save the government money, but less than the costs of programs clearly big enough to compensate most losers. Donor assistance can permit the government--at least for a period of time--to compensate fully most of the people hurt by the reforms.

One other proposition constitutes the general case for conditionality as an instrument of policy reform: that conditional aid can strengthen the hands of local reformers.

Both of these propositions, it should be quickly observed, relate to conditional assistance in general. We will, therefore, treat them that way, and discuss later how the SAL is special.

Both propositions are clearly pertinent. But they are not robust enough to bear heavy theoretical weight in the analysis of SALs. This is partly because the same argument can support other forms of conditional assistance. But also, there are legitimate objections to them.

The "strengthen the good guys" proposition, for example, assumes that when the Bank helps pro-reform local people with conditional aid, it can tilt the internal balance of bureaucratic and political forces in a pro-reform direction, without undermining the position of the reformers by labelling them as "puppets". It also assumes a broader and deeper meeting of the minds than normally takes place. Hirschman and Bird write the following:

> At best, situations in which aid helps virtue to triumph in this fashion are the exception rather than the rule. The normal case is far more prosaic: the knowledge that aid is available if certain policies are adopted serves to make these policies more attractive and less costly than they would otherwise be. These policies will therefore often be adopted by aid-hungry governments in spite of continuing doubts of the policy-makers themselves, resistance from some quarters within the government, onslaught against the "deal" from the opposition, and general distaste for the whole procedure.
>
> Naturally, doubts and reservations are not voiced at the moment of the aid compact; hence the delusion on the part of the donor that there has been a full meeting of minds. But soon after virtue has been "bought" through aid under these conditions, the reservations and resistances will find some expression--for example, through halfhearted implementation or sabotage of the agreed-to policies--and relations between donor and recipient will promptly deteriorate as a result.1/

c) Buying a Place at the Policy Table.

The distinctive features of SAL conditionality suggest some other elements of implicit theory regarding institutional reform. These features are: larger aid packages and comprehensiveness of policy reform coverage.

To the extent that compensation and "lubrication" are relevant, a bigger aid package can have greater potential impact

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1/ *Op. cit*, p. 9.

and therefore a more substantial effect on the pace of policy reform. But the concept behind large-scale assistance is that of "buying a place at the policy table." There is undoubtedly something to this. But the concept also raises some questions.

i) It implies a discontinuous process of policy dialogue: at lower levels of aid, political attention and commitment are non-existent or small; at some unspecified but much higher level of conditional aid, the political community becomes involved. But, in fact, disaggregated reform policy dialogue can generate high-level political debate - e.g., over such mundane matters as bus prices, or fertilizer subsidies, or the price of gasoline.

ii) It assumes that there is such a thing as _a_ policy table, and that the real action takes place there and only there. As just noted, "action" on policy reform can take place all along the line--at ministerial levels, and down into the bureaucratic levels, the executing levels.

The Vice President of the World Bank and the Prime Minister of Ruritania can sit down at "the policy table" and agree that Ruritania's farmers should be paid more for their crops. That may be the _beginning_ of a policy change. But everything that really matters will happen lower down -- in a universe of uncertainty, limited data, and shifting variables; a world where those who must transform general policies into operational reality enjoy discretionary authority in abundance.

d) <u>Comprehensiveness and Synergism</u>. The other leading principle of the SALs is their comprehensiveness. It is by no means self-evident that expansion in the number of policy areas and issues increases the efficacy of the policy reform effort. In fact, a case can be made for strategies of incremental or piecemeal change--in this case via conditional project or sector loans. Project, and especially sector loans, can be designed for their policy reform potential. They can be monitored adequately, and the threat of Bank cancellation can be more convincing when it involves "only" one area of Bank-country contract. The project and sector loans also provide better opportunity for ongoing discussions of donor and local technicians on sector policy councils and, hence, for educational and training effects.

It would seem more promising, therefore, to narrow the area of battle, to concentrate resources on areas where policy deficiencies are critical and perhaps ripe for change, and to push for in-depth impact. This was the idea in the Philippine and Kenyan first SALs; their coverage was expanded later.

It may be that the theoretical explanation of the comprehensive approach found in the later SALs is not entirely convincing. Comprehensiveness may be partly the result of purely bureaucratic forces. Bank management, for example, insists on the large array of conditional items to show the Board it really means business on policy reform. And once that signal has been dispatched downward, Bank staff responsible for SALs respond by seeking to enlarge the range of conditionality. Nevertheless, the possibility of synergistic effects from simultaneous reforms in several areas remains an attractive feature of the SAL concept (though applicable also to other program loan categories, and the synergism of several smaller loans could exceed that of a large loan).

4. <u>Misperceptions in the SAL Approach</u>

The underlying theory of structural adjustment lending, then, is not especially robust, for reasons just outlined. But the analytic underpinnings are weak also because of certain misconceptions incorporated in the SAL approach.

The first is a neglect of the importance of real dialogue, of changing minds, as a basic engine of policy reform. The SAL stresses high-level discussion, political dramatization, cross-sectoral and comprehensive conditionality. As we showed above, this approach leaves too little room for sustained technical dialogue and for interaction between Bank staff and local technicians at the working level, the level at which people remain to be convinced that the reformers' ideas are right.

Secondly, the SAL approach in some cases confuses process and events. Bank reformers, like other reformers, intervene in a process and produce an event--a report, a committee, a plan. Self-deception can easily result when the reformers produce these noteworthy events and conclude that they have so changed the process that noteworthy events of reform will continue in the future.

But in most reform efforts, especially those that are externally-engineered, reformers' noteworthy events often occur in isolation from the process system around them. When the reformers leave, taking with them their good intentions, their skills, leverage, and reform lubrication, the original processes often remain in place largely undisturbed.

In the SAL context examples abound: the "contract plan" approach for improving performance-contracts between the state and public enterprises; the elaboration of medium-term public investment program or rolling budgets; the establishment of a committee to review agricultural prices. Few of these "events," recorded in SAL reviews as examples of successful reform, are likely to survive except insofar as changes occur in the administrative and intellectual environment in which they are implanted.

This is related to a third area of confusion in SAL "theory:" a mixing up of short or medium-term policy reform with long-run institutional change. There is, after all, a difference between pushing for an agricultural price increase and improving the budget process, strengthening the planning system or making the civil service work better. These latter efforts are addressed to fundamental deficiencies that derive from the condition of underdevelopment. Budget reform--to take one example--will require better accounting procedures in all ministries as well as at the Finance Ministry. It will require a clearing up of the financial debris and fiscal skeletons left over by years or decades of living with budgets that have been more fictional than real--budgets in which allocations are smaller than appropriations, programs are persistently under-costed, maintenance expenditures are cut every year, and line items are increasingly removed from real spending.

These are not matters subject to remedy in five to seven years. They will change, gradually, and can probably best be advanced only by slow and prudent steps. It is not clear that the SAL framework is appropriate for addressing these basic institutional weaknesses.

5. <u>The Importance of Changing Minds</u>

We noted earlier that persistence of inappropriate policies is a widespread phenomenon, attributable to a variety of factors. Vested interests, for example, obstruct change. Also at work is what we earlier called "ideology"--the economic world view dominant among public sector decision makers. While it has many facets, at its center is a set of ideas about how people behave as economic agents, about how markets work or do not work, and about the feasibility and beneficence of administrative controls over economic activity.

This "ideological" factor is fundamental: the name of the game, the key to effective, durable reform is the changing of minds. But the SAL, with its complex and heavy conditionality, is poorly designed to meet this goal.

The reason is that the SAL process permits little genuine dialogue between believers (Bank and local) and non-believers--local technicians and political leaders who doubt the applicability and/or efficacy of the Bank's medicine. The essence of the SAL process is the elaboration of the terms of the loan/credit by Bank staff, working more or less closely with committed (persuaded) local officials. On the technical level, the working out of "details" is done in most countries by Bank staff or consultants. On the bureaucratic-political level, the local reformers try to win acceptance in part by defending the reforms on their merits, but also--often mostly--by minimizing the extent of the proposd change, by pointing out the "flexibility" of the conditionality and by stressing the money pay-off. Very little in the way of mind-changing is involved in all this. The Bank staff in particular engages in little dialogue with those who are deeply opposed to the changes.

Moreover, because of the complexity of the conditionality provisions, SAL negotiations and monitoring involve extensive intra-Bank coordination, but relatively little training of local officials in the technical aspects of the policy reforms under consideration. So training effects, like the mind-changing effects, are relatively muted in the SAL exercises.[1/]

The point can be put another way. Policy dialogue, to be effective in changing minds, has to involve honest exchange of views, measured debate, not only of general principles, but of details. This implies sustained dialogue at the working level between foreign and local technicians. The SAL provides very limited opportunity for this kind of dialogue.

The SAL process can in fact lead more to game playing than to real dialogue. During elaboration of terms, both parties (Bank staff and local reformers) are more interested in putting the enormously complicated agreement together, and on avoiding "excessive" confrontration with opponents. Artful use of language often replaces confrontation. Bank negotiators have to assure their superiors that the conditionality is comprehensive and hard, while local reformers persuade local footdraggers that the agreement contains less than meets the eye.

1/ In one SAL country, negotiations on the agreement were well advanced, when a local official, attending a meeting called to discuss the draft agreement, expressed his ministry's opposition to one of the basic proposals--in this instance, the ultimate abolition of pan-territorial pricing for farm outputs and inputs. The official in question was two or three levels down in the hierarchy, but was in the key implementing ministry (agriculture). Yet, this opposition had not been openly expressed until late in the negotiation process. In the event, this led to change in the SAL terms.

Meanwhile, priority objectives of mind-changing and training take a back seat.

6. Personnel-Related Problems

By definition, negotiation and monitoring of a SAL absorbs an enormous amount of staff time. In some cases, it crowds out economic and sector work. The problem is complicated by the sparsity of outside consulting firms experienced in these questions, and the sparsity of suitable individual consultants who might be drawn from universities or elsewhere.

Moreover, the SAL requires skills that are particularly rare. Economists are good at analyzing macroeconomic problems in an aggregative way, and some can handle sectoral analyses pretty well. They are good at diagnosis, especially quantitative; they can measure effective rates of protection, and calculate domestic resource coefficients. But it is a long step from this general level of analysis to the definition of specific recommendations at a disaggregated level. It is one thing to say that the price of rice is low, quite another to say what it ought to be, and much more difficult to know whether a given price rise is "appropriate" or "acceptable." It is one thing to describe a tariff structure with inappropriate incentives, another--and very different thing--to invent a technically and politically acceptable alternative. Economists are good at the first set of problems, not so good at the second.

One commentary on the Kenya experience underscores this problem: (see Annex I, Kenya)

> Failure to fully anticipate implementation problems stems from insufficient knowledge of government procedures and insufficient understanding of bureaucratic procedures. Finally, experience with the Kenya operation reveals the need to work out action plans in greater detail. The Bank staff's strength lies in assessing development problems and outlining general lines of action to overcome them. It is on less firm ground when it comes to appraising and programming the specific actions that are required to implement them.

Moreover, effective monitoring of the many covenants in the standard SAL would seem to be virtually impossible, even for those tangible conditions that have some quantitative basis. The situation is always changing so fast--certainly faster than can be followed from far away. Prices are rising and falling; world prices are in constant movement. Political and security environments are subject to change. It is almost certain that the Bank technicians elaborating and monitoring an SAL will be out of touch with some of these changes, whether they sit in Washington or in Regional offices.

Then there is the problem of differential rank, which is especially severe in SALs. The Bank negotiators and monitors are normally quite junior compared to those with whom they are dealing in SAL matters--who are the highest administrative and political authorities in the aided country. Both sides make assessments of political feasibility and technical applicability. The disproportion in terms of level of responsibility and status is especially great in the SAL. It is, therefore, more likely than in other forms of dialogue to cause local irritations and resentment.

7. How Hard is SAL Conditionality?

Now, some observers argue that SALs contain the worst of two worlds in one respect: they give the impression or illusion of hard conditionality imposed by outsiders. But, in fact, they may not be very hard, for two reasons. First, they may be inherently unmonitorable or are so subjective that only extreme nonperformance can evoke a cessation of lending. Second, they may be soft because cessation of lending is, in most situations, too strong a response by the Bank. To break a SAL, by definition, a relatively large loan, is a kind of breaking of relations with the host country.

a) Limitations on Monitoring. Every SAL contains a very large number of actions the borrower must take to satisfy conditionality requirements. These are of many different types. Numerous studies are to be launched; intangible items, like improvement of procedures, are also common. A few conditions are quantified, but the bulk are not. Together, these circumstances make the SAL almost impossibly difficult to monitor.

First, the implied information gathering effort would itself be intolerable if vigorously pursued. This is true not only because of the number and complexity of the conditional items, but because effective monitoring would require close surveillance of a mass of shifting variables. For example, nominal prices can be increased--but can be effectively negated by a matching rate of inflation. The import licensing system can be abolished but with the effects nullified by changes in foreign exchange allocations. The monopsony powers of external marketing organizations can be terminated while changes in licensing regulations prevent entry of any private competitors.

Second, progress toward the intangible objectives are intrinsically very difficult to follow and weigh--such as, more collaboration between ministries of Planning and Finance, the education of local officials in policy analysis, or increasing the policy "awareness" of political authorities.

Third, is the general sparsity of hard criteria for measuring performance. Unlike the criteria in IMF standbys, which are quantitative and hence objective, the SALs provide long lists of criteria, almost all open to subjective judgment. This is true of almost all the institutional development objectives and the attitudinal change objectives. It is also not clear in the matter of determining an "acceptable rate of change." In all the usual conditionality targets, the SAL criteria involve "introducing" or "improving" or "reducing" or increasing" something; e.g., a new system of export incentives, salaries for managers of state-owned enterprises, the performance of SOEs or the role of the private sector. Not only do these variables defy quantitative measurement, those that are multi-dimensional, e.g., the role of a nation's 50 SOEs may not be measurable even in terms of "more" or "less," "better" or "worse."

Fourth, even if agreement were possible on acceptable rates of progress on individual reforms, an insoluble weighting problem would remain: if Kenya gets a B+ on tariff reform, an A- on rolling budgets, and a C- on grain marketing reform, how does the evaluation of the SAL as a whole add up? Because of the great number of elements in each agreement, every assessment of an SAL has to deal with this weighting problem. Since in every case, some variables will show little certain progress while some will show clear progress, those who want SAL success can weight the latter group heavily. Those who prefer SAL failure can weight the former group heavily. And the entirely objective outside evaluator would be hard-pressed to argue that any one weighting system was superior to all others given the Bank's general objectives. Finally, respecting this problem, given differences among countries' circumstances, a decision about weighting for one counry is unlikely to be of much help when choosing the weighting system for even the country next door.

Fifth, the monitors and evaluators may be tempted to feel a self-interest in the perpetuation of the SAL. There may be, consequently, a strong tendency on both sides to accentuate the positive. So where little has changed, the Bank people may point to recent signs of movement, or to imminent breakthroughs. Recipient country ministers may report how recalcitrant ministers are "now beginning to move in the right direction."

Finally, and along the same line, there are almost always ways to justify non-performance on non-invidious grounds. The enforcement of SAL conditionality is even more subject to the failings Laughlin Curie recently attributed to the Fund as overseer of standby conditionality.

> If the ceilings (on government spending or deficits or on credit growth) are not observed, the member undertakes not to make further drafts on standby credit without permission of the IMF. This sounds tough.
>
> The catch, however, is that permission appears always to be forthcoming. There are always explanations, and the explanations are accepted, and assurances that new measures being taken will prevent a recurrence are accepted.1/

b) Non-Credibility of the Deterrent. Added to the near impossibility of objective monitoring and the ease of positive performance evaluations, there is the non-credibility of the

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1/ The Role of Economic Advisers in Developing Countries, Westport, Conn., Greenwood Press, 1981, p. 102.

deterrent: the Bank must shrink from the ultimate sanction. Because the SAL places the Bank at the borrower's highest level policy table, Bank management and staff must hesitate before invoking the ultimate sanction, cancellation. No matter how bad the borrower's performance, the Bank will strongly resist cancelling because, at this level of operation, it would represent a rupture of relations between the Bank and the borrower. Not only would the borrower lose the SAL funding, it would also be publicly marked as a failed risk for commercial bankers, other private investors and other donors.

For this reason it takes very hard work by both parties for an SAL to be cancelled. Only in Senegal has it happened so far, there after only especially blatant non-performance, and even in that case the SAL is being replaced by a series of sizeable agricultural loans.

V. CONCLUSIONS AND IMPLICATIONS

Since the middle and late 1970's there has been growing interest in donor circles and among LDCs in non-project lending. There were many good reasons for this, among them, intensified balance of payments and fiscal problems; and the perception among donors that for many countries policy reforms were imperative if additional economic assistance was to be productively used. The World Bank's structural adjustment lending began in this setting in 1980.

The review of SALs in this paper is fairly critical--probably too critical. Observable, unambiguous failures have occurred in only three out of 15 countries that have received SALs. And the inherent difficulties of SAL evaluation demand caution in all judgements of their effectiveness.

The critical tone partly derives from the genre: all outside assessments tend to look more for what might be wrong than for what is going smoothly. Also, a critical perception seems needed; there is virtually no published literature on the SALs, and in-house critiques seem to be sparse. Moreover, there has been rather too little critical analysis of those ideas that have won the day in donor circles--conditionality, policy dialogue, policy reform. Conditionality and policy dialogue are too often regarded as synonymous. But they are not, and inquiry into the nature of their relationship has been neglected. The relationship between policy dialogue and conditional aid on the one hand, and reform on the other, has been similarly passed over by aid practitioners and by theorists of institutional reform.

The advantages of conditional assistance in general, shared by SALs, can be summarized as follows: It can change unsuitable economic policies that would make unconditional assistance ineffective. It can make reform more acceptable by providing resources to compensate losers and to increase the clout of local reformers. It can win over some in donor countries who otherwise would object to aid as wasteful; so it can increase total volume of aid. It forestalls unconditional foreign assistance that permit failed strategies to be maintained.

Beyond the general advantages attributed to conditional assistance are particular advantages credited to SALs. Judging from the scattered writings on SALs and from conversations with Bank staff and other knowledgeable people, five main advantages seem to reside in the SAL:

a) It allows the Bank to "buy a seat at the policy table." The SAL usually involves big money. Its symbolic value is sizeable; it signals to the rest of the donor community that the recipient country is willing to change ineffective policies and restructure unsuitable institutions. Governments not inclined to engage in policy dialogue when the stakes are smaller can be induced to do so by an appropriately-sized SAL.

b) The SAL raises the level and political relevance of policy dialogue. The size and breadth of these agreements require wider government participation--very nearly cabinet wide, and the dialogue is certain to attract attention--hopefully also commitment--at the highest levels of government.

c) The inclusion of so many issues, cutting across so many sectors, has synergistic effects. The fact that reforms are being considered in one sector makes it easier for reformers in other sectors to push their proposals. Moreover, the coordination of policy changes is presumably easier when the reform program as a whole is included under one umbrella.

d) Detailed covenants implying heavy conditionality demonstrate that the Bank is not giving money away for plain budget or balance of payments support. This reassures skeptical but influential political figures in donor countries. Hence, it facilitates a larger volume of lending than would otherwise be forthcoming.

e) The SAL process has given a new focus and cohesion to the economic and sector work of the Bank's economists and may be improving the ability of the Bank to make effective applications of this kind of economic analysis.

The criticisms of conditional assistance, applicable to SALs as well, can be summarized as follows: It is either superfluous or ineffective since the recipient countries will be led without aid to take steps that are profitable, desirable, and feasible while they will find ways to avoid taking steps they view as not profitable, desirable, and feasible. It sows resentment in the recipient country by asserting superior wisdom not only in technical matters but in matters of political judgment appropriate to the local socio-economic environment. It sows resentment also when middle level donor staff attempt to impose conditions upon very senior recipient nation policy makers. Its conditions can be politically devisive and threaten to weaken support for recipient governments. It can even weaken support in donor countries if recipients give in on economic conditions and then compensate with broad political gestures distancing themselves from the donors.

Beyond these general criticisms of conditional assistance, our observations and analysis identify four main criticisms of the SAL:

a) It rests on weak theories that reforms can be bought; and second, that global, comprehensive "reform-mongering" is more effective than incremental, piecemeal approaches to policy change.

b) Its apparently hard and all-encompassing conditionality is largely illusory: its conditions are mostly non-monitorable, and overall assessment is subjective; sympathetic evaluators can normally find enough forward movement to justify another round; finally, cancelling a SAL for non-performance suffers from the same disabilities as the nuclear deterrent; it is too awesome for use in banal circumstances.

c) Because of its complexity and its heavy overlay of apparent conditionality, it is not a good vehicle for real dialogue on policy between Bank staff and local authorities.

d) Finally, it demands too much Bank staff time, and anyway, more is always needed since the situation is always changing and the list of conditional items is so large; and it demands competence of a kind rare in the Bank and in recipient countries.

This diagnosis suggests that the SAL is perhaps not quite what it seems to be--a powerful engine of policy reform via conditional assistance. From this, it follows that it should certainly not be the only or even the principal instrument of non-project lending and/or conditional lending. Other forms are in fact in use. Sectoral loans, such as the Sudan Agricultural Rehabilitation Credit, have the potential for varying degrees of conditionality and they can also be effective in encouraging real dialogue. In the Sudan case the conditionality included some macroeconomic items, even though it was an agricultural loan.

The project itself can be a vehicle for policy reform. An example of application of SAL experience to project lending might involve tranching project loans (or grants). A longstanding argument, already cited here, has been that project loans cannot provide effective conditionality because no one is willing to stop work on a dam or power station "merely" because the borrower has failed to adhere to a particular reform as promised, e.g., raising electricity rates. But many project loans could be tranched. A donor or lender could agree to finance construction of the first 7 miles of a given road if X is first done by the borrower; while the next 6 miles would be financed only if Y were done, and the last 12 miles would be financed only if Z and Z' were done. The problems and details of these reforms could be the subject of ongoing technical discussion while construction was underway. The second and third tranches of support for a rural development project could also be made to depend on particular policy reforms.

One other application of this discussion is that the relationships between conditionality, policy dialogue and policy reform need closer analysis. Even with the constraints on the use of conditional assistance, less emphasis should be placed on the formal structure of conditionality. What is critical is policy dialogue--sustained discussion, primarily at the technical level, to bring about a closer meeting of the minds on policy issues. There is no point in making a fetish of hard conditionality, in any event, since it is rarely applied in a punitive manner, and especially when the super-structure of negotiations and monitoring may get in the way of real dialogue.

In some circumstances, SALs may be the most effective instrument of conditionality and policy dialogue. But the Bank possesses a range of conditional lending vehicles that can produce policy reforms. In different cases, different vehicles will be suitable. The Bank is already moving in this direction, as indicated by the new Special Action Program, which will utilize a broad range of lending vehicles, including sector and sub-sector loans. One reason the SAL acquired its heavy layer of conditional items may have been management's desire to allay the Executive Director's concerns about avoiding "pure budget support". It would be unfortunate if, in trying to avoid wasteful program aid, U.S. Government representatives prevented the Bank management from further adaptations in SAL tranches--for example introducing deeper kinds of conditionality and dialogue. We should not send the wrong signals to Bank staff and management in this regard. What matters is not formal conditionality but genuine dialogue, which is the only way to durable policy reform.

Priority to dialogue and a more moderate role for formal conditionality open up other possibilities for bilateral donors in the policy reform area. Sectoral or sub-sectoral loans are especially suitable. The conditionality can be light and mainly implicit: effective dialogue and forward movement in policy would be understood to bring additional assistace. This is decidedly an area where A.I.D. should experiment.

ANNEX I

Structural Adjustment Loan Programs: Case Studies

This Annex gives a synopsis of structural adjustment lending to Kenya, Turkey, Jamaica and Senegal. It describes:

i) The situation in each country which led to the Bank's decision to award a structural adjustment loan;

ii) The conditions which the Bank attached to individual loans;

iii) How the Bank assessed the recipient country's response to the SAL reform package and elements in the Bank's decision to continue or curtail loan payments.

The countries chosen for analysis are representative of the World Bank's SAL program, and include examples of SALs considered to be both "successes" and "failures". They are geographically dispersed (Asia, Africa and Latin America). They represent different stages of development; some are predominantly agricultural economies, others more diversified and industralized.

COUNTRY: KENYA

Structural Adjustment Loan History

SAL I. Loan Amount: $70.0 million

SAL II. Loan Amount: $60.0 million
Date: June 1982

The Economic Background

In the first decade following independence, Kenya ranked high among the LDCs of Africa for its record of economic growth and structural transformation. From 1964-73, GDP grew at an annual rate of close to 7 percent. Agriculture and manufacturing grew at an annual rate of 4.7 and 8.4 percent, respectively. The redistribution of large estates to smallholders, and the extensive distribution of hybrid maize contributed to the expansion of smallholder output. The rise in agricultural incomes brought about an expansion in domestic demand, which in turn, stimulated manufacturing growth. The latter also benefited from liberal attitudes toward foreign investment and active government promotion and participation in manufacturing ventures.

Despite its post-independence record, Kenya continued to have the fundamental problems of overall poverty and high unemployment levels. Population pressures, limits on arable land, and inward looking patterns of industrialization were the contributing factors. In the mid-1970s Kenya experienced wide swings in its international terms of trade and in the growth of the economy. Between 1974 and 1979, there were three distinct periods of boom and deceleration as world coffee prices gyrated. Internally, Kenya's domestic development strategies tended to move in tandem with international events: The upswings were characterized by expansionary fiscal and monetary policies; in the downswing these policies were reversed. A low growth rate for the period 1972 to 1978 indicated the inadequacy of development strategies and policies and showed that a less viable economic structure was in the making.

Nonproject Lending to Kenya

In the mid-1970s, the World Bank began a series of Program loans to Kenya. The 1975 Program Loan of $30.0 million was specifically designed to support GOK efforts to restructure the economy in response to the sharp deterioration in the country's international terms of trade. Another Program loan was in process of being considered in 1979 following the deterioration of prices in the international coffee market, and the balance of payments problems which this posed for Kenya. This loan became, in fact, the first SAL awarded by the Bank. It was awarded to Kenya in early 1980.

SAL I.

The first structural adjustment credit to Kenya, as outlined in the Government's Letter of Intent, was designed primarily to reform the country's system of industrial protection and incentives to produce a more efficient and outward-oriented pattern of economic growth. The program also contained measures to protect the country's creditworthiness and improve resource mobilization. It was also supported by an IMF stand-by arrangement.

The genesis of the structural adjustment operation in Kenya was an Economic Mission in October-November, 1978, before the Bank had developed the concept of structural adjustment lending. The mission found a receptive environment for positive policy changes. The Fourth Development Plan 1979-83, which was about to be issued at that time, was deemed to be well-conceived. The Plan emphasized the need to shift industrialization strategy to a more outward-oriented approach which would encourage industrial efficiency and permit more rapid and diversified growth of exports. It also proposed policies to raise agricultural growth, including greater attention to land tenure, pricing and marketing policies. In addition, it acknowledged a population problem and called for expanded government involvement.

At the same time, it was evident that despite a respite from balance of payments constraints and rapid growth because of a temporary boom in coffee prices, the country was headed for a period of balance of payments difficulty. The worsening economic environment would have an adverse impact on the implementation of the policies in the new plan. It was, therefore, proposed that Kenya's development effort be supported by a series of quick-disbursing nonproject loans conditioned on carrying out key elements of the strategy set forth in the Plan.

The program worked out with the Government involved carrying out the industrial strategy set forth in the Plan, while preserving the country's financial stability and international creditworthiness. Priority was attached to industrial strategy since it was felt that rationalization of industrial protection and improvement in export incentives could quickly contribute to better balance-of-payments performance. In addition, it involved commitments to: (a) revise the public investment program to make it consistent with resource availabilities and responsive to economic circumstances (b) improve management of external debt and protect creditworthiness and (c) promote exports; and (d) improve resource mobilization.

The program was converted into a structural adjustment loan after the program had been negotiated since it had many of the characteristics of the emerging SAL concept.

The Assessment of SAL I.

Actions on Specific Policy Issues. The Bank viewed implementation of the first SAL to Kenya as satisfactory, insofar as "the general direction of policy agreed to was maintained." Actions on specific issues were reviewed by the Bank and summarized as follows:

a) Rationalization of Protection and Industrial Incentives. The key policy initiatives in the structural adjustment program were aimed at (i) establishing a set of input-output price relationships which would encourage a more efficient pattern of industrial development, (ii) more rapid growth of agriculture and (iii) expansion and development of exports. This required redressing an imbalance between incentives for import substitution industry and those for export and reducing the bias against agriculture. This was to be accomplished by replacing the quantitative restrictions on imports (QRs) with a moderate and relatively uniform tariff. It also required compensating changes in the exchange rate to reduce dislocations for individual firms and redress the bias against agriculture. Appropriate changes would also be made in export compensation (subsidies). The SAL program provided for a gradual phasing out of QRs. As a first step, so-called "Letter of No Objection" privileges, which gave firms the right to prevent imports they viewed as a threat to their markets, were to be abolished. Since the state of knowledge about cost structures of firms and actual levels of effective protection was inadequate, studies were planned to determine the level of protection, develop recommendations for the ultimate levels of protection and prepare proposals to help the economy and individual firms adjust to the new regime.

In June, 1980, all Letters of No Objection and bans on imports for protective reasons were abolished. Tariffs were raised on these goods to compensate for removal of QRs with a maximum rate of 100%. In addition, tariffs on capital and intermediate goods were increased and the sales tax on machinery was abolished. A temporary tariff surcharge of 10% was imposed on all dutiable items. This measure satisfied and even went beyond the commitments in the Letter of Intent.

Revision of the Government's Investment Program. Because of less favorable prospects for GDP growth and the likelihood of lower revenues than had been expected when the Fourth Plan was drafted, it was necessary to scale down expenditure plans for the last three fiscal years of the Plan (1980/81--1982/83). It was agreed that this would be done by preparing a forward budget for this period. A new macroeconomic framework was prepared and ministries were asked to (a) give priority to programs and projects which promoted exports and increase agricultural output; (b) concentrate on programs and projects which promised more immediate returns in terms of output and expenditure; (c) review costs and benefits of projects in the Plan, in the light of recent developments; and (d) ensure that sufficient funds would be available for project completion and recurrent costs before starti new projects.

However, the Bank concluded that despite the emphasis given to it in the SAL, the forward budget concept was not yet a satisfactory basis for evaluating, planning and programming government outlays. A need to adopt standard project evaluation criteria, integrate the expenditure plans of the public sector, strengthen technical capacity for project evaluation, and improve project monitoring and implementation, was revealed. In addition, a full-scale review of projects and programs under implementation was necessary.

External Borrowing and Debt Management. Because of an upsurge of external commercial borrowing, problems of coordination of external aid requests and indications that debt outstanding might be understated, the program called for improvements in debt management. This included a cap on external commercial borrowing for FY1980/81, the introduction of a system of yearly external borrowing plans, and improvements in the machinery for the processing of external borrowing operations.

Despite the straightforward nature of the administrative actions required, the program proved difficult to carry out. Preparation of the external borrowing plan proceeded slowly. In order to devise the plan, it was necessary, first, to build a statistical base by surveying debt outstanding. This, in turn, required creation of a new office in the Ministry of Finance. There was no existing unit with the responsibility for such activity. Also qualified staff had to be recruited. Two missions from the Bank's External Debt section went to Kenya, and foreign consultants were hired to devise a reporting system, verify data, and arrange for computerized processing and tabulation. This was not completed until early 1982 and preparation of a satisfactory external borrowing plan for 1982 was not completed until April, 1982. However, the Bank felt that treasury monitoring of external borrowing by government agencies was improved and the office responsible for aid coordination strengthened.

Interest Rates. The structural adjustment program provided for a review of interest rate policy to identify measures necessary to promote development. Studies of the level and structure of interest rates were undertaken and the Government articulated a policy recognizing their importance in influencing saving/ investment decisions, resource allocation and factor use. Regular reviews were instituted to ensure that interest rates reflected changing economic conditions. As a result of these reviews, the key commercial bank lending and deposit rates were adjusted upward three times since mid-1980. Maximum commercial bank lending rates rose from 10% to 14% and saving deposit rates from 5% to 10%. Other rates were adjusted in line with these.

Promotion of Exports. The SAL program involved a commitment by the GOK to ensure sufficient incentive for production of export goods and that prices are competitive on world markets. It was agreed that this would include review of the exchange rate (which was also an implicit requirement of rationalization of the trade regime). As part of the stand-by arrangement with the IMF, there were two exchange rate changes in 1981, representing a cumulative depreciation of the shilling of 20% relative to the SDR. The Government also increased export compensation from 10% to 20% in June, 1980.

The program also anticipated adoption of an export insurance and financing system. A study by the Kenya External Trade Authority on the need for and possible structure of such a system was undertaken and it was expected that the system would be introduced by September, 1980. However, the review process took longer than anticipated and the proposal was ultimately rejected. The reasons for the rejection were budgeting costs associated with its establishment. Also there were fears that the insurance program could not be administered in a manner which could avoid serious problems of fraudulent claims.

Evaluation of Implementation Process

Despite certain delays in implementing the program, the overall operation of the first SAL was judged a success on the basis of the following criteria: incentives for export were increased; there was major improvement in the import regime; management of external debt was strengthened; and interest rates were raised. In addition, some of the actions taken in connection with the program were held to form the basis for future policy reform. For example, changes in the import regime, while beneficial in themselves, served as a prerequisite to future changes in the system of protection and incentives. The forward budgeting exercise, which was plagued with difficulty, was useful as an entry point for a more detailed and comprehensive look at planning and budgeting procedures. Most of the measures included in the program were deemed sufficiently specific to permit monitoring.

In broader terms, the Bank found that the experience of the first Kenya SAL indicated there are difficulties in assessing the ability of the government to carry out SAL-type policy reforms. These difficulties included: gauging the support within government for the program and the administrative problems encountered in carrying it out. Optimism on both counts led to establishing an unrealistic time horizon for implementation. Improper assessment of the support for the program was, in part, the result of the tendency to discuss policy reforms with a relatively small circle of civil servants who are predisposed to agree with the program. These individuals tended to be optimistic about their ability to ensure the required political support. This suggested that more time needed to be spent and a broader spectrum of officials contacted--in designing and gaining support for the SAL operation.

The Kenyan experience also demonstrated that the government was able to carry out certain economic policies such as exchange rate changes, raise interest rates, increase export subsidies and eliminate protective trade restrictions, with relative ease. However, measures which were largely administrative and would have seemed to be easier to take such as, preparation of a forward budget, or improvements in debt management--proved to be difficult to achieve.

The failure to fully anticipate these kinds of implementation problems stemmed from insufficient knowledge on the part of donors about government procedures and insufficient understanding of the local bureaucratic process. There was not enough known, e.g., about the workings of the Kenyan system of import administration or the legal procedures or mechanisms for changing it. There was a lack of understanding of the GOK weaknesses in planning, budgeting and monitoring of government expenditures. Finally, organizational and personnel deficiencies in the Ministries and their potential effect on the pace of improvement were not fully appreciated.

Experience with the Kenya operation revealed to the Bank staff the need to work out action plans in greater detail. The Bank's strength lies in assessing development problems and outlining general lines of action for dealing with them. The Bank felt that it was on shaky ground when it came to specific actions required to implement the reform package. This is an especially important problem in the African context where governments have limited ability to design actions. It raises the issue whether even the World Bank has, with its enormous professional resources, the staff to design specific actions appropriate to the political and institutional context of countries receiving SALs.

The Economic Impact of SAL I and The Second Structural Adjustment Operation

The potential macroeconomic impact of the first structural adjustment credit was not fully realized when, in 1982, the Bank awarded a second loan to Kenya. Thus, the Bank observed, "although the measures taken under SAL I represented considerable policy improvements which would eventually have positive effects on Kenya's growth and external equilibrium, the effects were not evident in recent economic performance." This was attributed, in part, to the fact that major measures such as devaluation and the new import regime occurred very late in 1981, and, in part, to exogenous factors, which were not anticipated. Among the exogenous factors were: the impact of rising petroleum prices (1979-1980) on Kenya's import bill; persistent drought conditions which hampered agricultural exports and necessitated increased food imports; a slide in coffee prices and a deterioration in economic conditions in nearby export markets. The value of exports actually declined in 1981, despite increases in the volume of coffee and tea exports.

Exogenous factors were, however, not the only explanation for the lack of sizeable results. Kenya's fiscal management was unexpectedly expansionary due to escalating defense costs, large public sector wage increases, and ineffective expenditure controls. The expansion of the budget deficit prevented the GOK from meeting ceilings on net bank credit to the Government and net domestic credit of the IMF stand-by program at the end of FY1980/81. The net result of the exogenous and policy-related factors was that economic growth remained relatively high, averaging 4% per year in 1980-81, but inflation remained at about the 12% level. The net result was that Kenya's balance of payments current account deficit climbed sharply.

SAL II.

The Bank argued that the first Kenya SAL was not designed as a comprehensive reform package, but, rather, was aimed at specific actions. The lesson that the Bank drew from its first Kenya experience was that a more complete, cross-sectoral program was needed in order to realize desired macroeconomic effects. This explains why the reform package under the second SAL to Kenya was greatly expanded. The second SAL program built upon the first operation and extended the structural adjustment program.

(a) The scope of industrialization policies covered was widened to make the incentives given to new industries consistent with the objectives of trade reform;

(b) In the agricultural sector the program was expanded in three key areas: pricing and marketing, land use and tenure and management of agricultural projects and programs;

(c) Because of Kenya's dependence on foreign oil and its importance in the balance of payments, actions designed to increase the supply of domestic energy and to encourage conservation were included in the program. The issue of population growth was also addressed.

The program continued initiatives in the first program to increase resource mobilization to improve planning and budgeting of government outlays and to optimize foreign borrowing. In addition, it contained new measures to improve project implementation, and to ensure internal and external financial equilibrium. These are discussed below.

Additional Components

Rationalization of the System of Industrial Protection. The new system of import administration would serve as the base for a progressive reduction of quantitative restrictions, their replacement initially by tariffs, and the gradual rationalization of the entire tariff system. Over the four years (1982-85), 20% of the items presently on Schedule 2 (A and B combined) are shifted to Schedule 1.

Incentives to New Industries. Kenya's system of tailor-made concessions for new projects led to investments in projects with low or negative economic rates of return, disguised by concessions which made them financially profitable. In recognition of this, the following new guidelines have been developed:

(a) Government equity contributions, loans or loan guarantees to privately owned companies, will be restricted to economic activities fundamental to development and will be subject to rigorous economic evaluation using standard cost-benefit analysis.

(b) Import duty concessions will not, as a rule, be granted;

(c) Exclusive technology licensing agreements will be time-limited;

(d) Extraordinary tariff protection will be granted on a diminishing basis and limited to no more than eight years;

Government Investments in Parastatals and Public Companies. In order to ensure that new GOK investments in parastatals and private enterprises are economically, financially and technically sound, measures to strengthen and improve procedures for evaluation and approval for public investments include: (a) adoption of a standard handbook for project evaluation along with specific guidelines on how key parameters are to be estimated, (b) new regulations governing the review process which ensure that economic evaluation has been carried out will be issued, and (c) the Treasury will not sign project or financing agreements unless project and budgetary approvals have been obtained according to the guidelines.

Agricultural Pricing and Marketing. Because of the importance of maize as a crop for both smallholders and larger farmers, and its role in the Kenyan diet, the program will give special attention to ensuring the adequate growth of domestic production of this crop. This will be accomplished by providing adequate incentives to producers, efficient marketing, transportation, storage and distribution of the crop, and prices to consumers which reflect economic costs of production and distribution. In addition, the GOK has determined that adequate provision must be made for domestic food security.

Steps toward a general rationalization of pricing policy have recently been taken. The emphasis of pricing policy for all crops will be on maintaining adequate incentives for producers and consumer prices will not be subsidized (except in the case of emergency food imports and for costs of maintaining security stocks). Subsidization of consumer maize prices, when high price imports are required to supplement domestic supply, would be through direct budgetary appropriations. NCPB would also be compensated for its market development activities through budgetary provisions. In line with this decision, past loans by the Treasury to the National Cereals and Produce Board are being written off, in recognition of the subsidy elements in its past operations. The Government has also carried out a study of the financing of cereal marketing, through the Cereals and Sugar Finance Corporation, in order to improve the process.

For non-border areas the extraordinary restrictions placed on maize marketing over the last few years have been relaxed. A study is to be undertaken to determine the appropriate market structure. The study would consider the full range of options from the present de jure Government monopoly to systems which involve minimal intervention. It would cover: (a) investigation of the optimal division of functions between Government, the cooperatives and the private sector; (b) recommendations on an appropriate food security plan; and (c) recommendations on a program of market development, including information, services and infrastructure.

Land Policy. The de facto subdivision of large farms is legal, in the sense that it is not an offense under the Land Planning Act. However, granting of titles has been stymied by lack of financial and technical resources for survey, adjudication and provision of basic services. The structural adjustment program therefore aims at accelerating the process of regularization of de facto subdivision of large farms so as to realize the output potential of the high quality land involved.

Under the SAL reform package the following issues will be addressed: (a) review the effectiveness and impact of the existing land tenure system and the laws governing land adjudication and land transfers, and formulate proposals for improvement; (b) make recommendations for subdivision policy for other lands; (c) harmonize existing laws and regulations relating to land use and tenure; (d) develop regional land use and planning proposals; and (e) develop programs to assure conservation of soil, water and forest resources.

Risks with Respect to Implementation. The Bank recognizes that it has established a wide-ranging list of objectives under the Kenyan SAL reform package. The principal risk of the loan and credit is seen to be the capacity of the GOK to implement the program in its entirety. The program is admitted to be complex, involving a number of sectors and requiring studies and the development of programs, and carrying out measures in a timely and coordinated manner. This places a burden on the GOK's technical and administrative capacity and also tests the flexibilit and responsiveness of the civil service. An additional risk involves the adverse reaction on the part of groups within the country with vested interests in sustaining the status quo. This could delay or even cause abandonment of key elements of the program.

COUNTRY: SENEGAL

Structural Adjustment Loan History

SAL I. Loan Amount: $60.0
Date: November, 1980

The Economic Background

Despite the existence of an industrial sector which is much more developed than in the other Sahelien countries (25% of GDP, 1982), Senegal's largely rural economy and limited resource base have imposed severe limitations on economic growth. Growth has been inherently more difficult to achieve in Senegal than in some other African countries. Senegal did not possess the rich agricultural potential or mineral resources of the Ivory Coast. It could not even match the modest growth rates of its Sahelien neighbors like Mali, Mauritania and Upper Volta, for the simple reason that it started off in 1960 with an average level of income double those countries' -- a level artificially high relative to Senegal's resources and to the productivity of most of its labor force. Slow growth in incomes limited domestic savings, prolonged dependence on foreign budgetary support and made structural adjustment measures, especially those involving short-run cuts in consumption, more difficult to achieve.

In an effort to overcome resource constraints, and to diversify the economy and develop its human resources, Senegal has engaged in costly programs to improve farm productivity, to raise output in rainfed areas, and develop irrigation. It expanded the parapublic sector in an effort to stimulate the development of natural resources and new industries. In the social services sector, it launched ambitious and expensive programs of higher education. These helped to make Dakar a leading center of African intellectual and artistic achievement, but were not related to the real needs of the economy.

In the late 1970's, in the face of the cumulative effects of successive droughts and adverse terms of trade, the GOS came to recognize the shortcomings of its approach. The capacity of the groundnut and phosphate sectors to finance the rest of the economy had been dramatically reduced. In 1979, Senegal announced a program designed to stabilize the economy, increase investments in the productive sectors, increase public savings, liberalize trade, reverse the policy of state-ownership and streamline the parapublic sector. This "new thinking" formed the basis of the

Bank's structural adjustment program with the GOS. It also facilitated the mobilization of important balance of payments and budgetary aid to Senegal in 1980 and 1981, including those under various IMF arrangements.

The SAL Program Objectives

In 1979, the GOS announced an Economic and Financial Recovery Program to come to grips with the causes of long-term stagnation and financial problems. It included adoption of several strategies related to the improvement of public investment and of the country's institutional framework, particularly in the agricultural sector. In a clear departure from the previous reliance on ad hoc corrective measures, the GOS appeared committed to a comprehensive program of economic recovery. Following is a summary analysis of the objectives of this program, the Bank's evaluation of that program, and a forecast of Senegal's medium-term economic prospects.

The broad objectives were first, to stabilize the economy by reducing the gap in the balance of payments; second, to stimulate growth; and third, to reduce urban-rural income inequalities. The first two to three years of the program focused on the stabilization objective. The main quantifiable objectives were:

- reduction of the current account deficit from 15.6 percent of GDP in 1980 to 6-7 percent in the medium-term.

- generation of (net) public savings through the budget equivalent to 15 percent of public investment in 1981 and to 25 percent in 1985.

- an overall rate of investment of 16 percent in 1981 rising to 18 percent in 1985 (including an average of 10 percent of GDP for the public sector).

- credit expansion slightly below the 8 percent of 1980.

- containment of inflation at a rate below 10 percent on average.

- an average growth rate of 4 percent of GDP in the last two years of the program and thereafter (i.e., about 1.3 percent above population growth).

In order to obtain these objectives, the program prescribed measures in four interrelated areas: (a) fiscal and monetary; (b) prices and incentives; (c) public investment; and (d) the parapublic sector, primarily in agriculture. The first set of measures aimed principally at economic stabilization through containing aggregate demand, and reducing the share in GDP of private and public consumption. The other measures focused on stimulating supply, while new pricing policies and the reform of agricultural institutions were also expected to eventually lead to a shift of income towards the rural population. On this basis, a structural adjustment loan was awarded to Senegal in 1980.

In July 1983, after extensive discussions with the GOS lasting over several months, the Bank issued a notice that it had decided not to extend, for a second time, the Structural Adjustment Loan beyond its current closing date. About US$16.7 million on the loan was cancelled by this decision.

Implementation Problems

Background. Agricultural reform was at the core of the Bank's structural adjustment program. Senegal, like other African countries, has tended to feel that the marketing of cash crops is too important to be left to private traders. A comprehensive state-controlled system was organized after independence to replace the merchants who were buying groundnuts from farmers and selling them to foreign-owned crushing mills. However, instead of involving rural communities and strengthening village-based farmers' associations, the marketing system relied on large, regionalized operations which attempted to function as cooperatives. The operations were poorly managed, neglected the requests of production-oriented regional development agencies, and were indifferent to the expressed wishes (and complaints) of farmers. The system was based on a highly centralized national agency, the Office National de Cooperation au Developpement (ONCAD), whose services were entirely responsible for the management of regional cooperatives.

The Government's main purpose in creating ONCAD was to market groundnuts at a fixed, guaranteed price, set at uniform levels throughout the country. However, ONCAD's functions were subsequently broadened to include the monopoly for transport of groundnuts, procurement and delivery of agricultural inputs, and later the management of seed stocks. A cumbersome procedure was developed for grouped orders of fertilizers and tools. In 1971, ONCAD was also given the monopoly for marketing of rice, and in 1975 for sorghum and millet, following the same system of uniform, guaranteed prices, fixed every year before the planting season.

It took some time before the GOS became aware of the shortcomings of its policy in the area of crop marketing and input supply. One reason was the tendency to attribute most of the problems in the agricultural sector to droughts rather than ONCAD's inefficiencies.

The major flaw in the agricultural marketing system was its failure to encourage farmers' participation in the management of cooperatives. In addition, the rapid expansion of ONCAD's functions and personnel caused its performance to deteriorate. Not only did farmers frequently not receive the quantities of fertilizers and other inputs requested, but deliveries were increasingly delayed and inputs often arrived too late to be used during the agricultural season. Cooperative accounts were not kept correctly, and farmers complained that ONCAD asked them to repay credits they had neither requested not received. Unexplained losses of part of the groundnut crop between the time of purchase from farmers and delivery to crushing mills became more frequent. ONCAD's discredit became total when a very bad crop in 1979/80 was universally blamed by farmers more on ONCAD than on the irregular rainfall which occurred in that year. Farmers felt that the impact of the irregular rainfall was compounded by ONCAD's having delivered seeds of very poor quality, a result of inadequate storage and handling practices.

The old system also included guaranteed prices and input subsidies. Guaranteed and uniform producer prices were supplemented with a comprehensive system of input subsidies designed to encourage farmers to use modern cultivation techniques specifically, increased quantities of fertilizers and a variety of agricultural tools and equipment. Subsidizing inputs has the advantage of minimizing farmer risks associated with purchasing expensive fertilizers which have little impact on total output in years when rainfall is inadequate. However, financing subsidies out of earnings from groundnuts sales tends to reduce producer prices, thus discouraging efforts to increase output and improve yields through labor-intensive cultivation techniques, which, in the case of groundnuts, influences output more significantly than fertilizers.

Bank-Senegal Relations. The main reason for the Bank's decision not to extend the Senegal SAL stemmed from the slow implementation of the agricultural reform program, and the lack of new policy direction in areas where this program failed. The GOS reform program reflected that the institutional framework of the agricultural sector had become inefficient and prohibitively expensive. Also, the agricultural credit system had collapsed under the weight of unpaid debts, and farmers had insufficient price incentives to permit increases in groundnut yields at reasonable costs. The key objective of the first round of reforms was to raise the level of involvement among farmers, and to reduce the cost of state intervention.

Thus, it was decided to dismantle the centralized state monopoly (ONCAD) which was responsible for crop marketing, distribution and agricultural credit, and to replace it by a decentralized structure. Under the new system, it was intended that groundnuts would be collected for processing by the private sector, agricultural equipment sold by the manufacturer (private companies), and credit provided by the banking system. The responsibility for supply of fertilizer and seeds was to be gradually transferred to the manufacturers and to farmer organizations. But until these arrangements could become fully operational, a new parastatal agency (SONAR) was to assure the necessary supply over a transitional period. The economic agents would deal principally with largely autonomous village groups that collectively sell their crops, store seeds, buy the other inputs, and provide mutual guarantee on credit. The farmer groups were to receive technical assistance from the regional rural development agencies. In view of the unfavorable trends in the world markets, emphasis was to be given to increased efficiency and cost savings in the intermediary institutions to make room for better farmer remunerations in the future.

Policy changes with respect to fertilizer and seed distribution were the essential elements of the SAL agricultural reform package. On two occasions, the Bank reached understandings with the GOS on a set of concrete measures in the area of fertilizer and seed distribution that would have represented real progress towards a less costly and more effective input delivery system.

The GOS had agreed to reduce the fertilizer subsidy as part of the original reform package. This was, in fact, accomplished. Under the SAL, counter-part funds were to be provided in order to provide for fertilizer purchases. Fertilizer was to be offered to farmers on the basis of cash sales. The GOS had negotiated with a private company which was to undertake responsibility for fertilizer sales. In the interim, an election campaign intervened; politicians promised farmers there would be a return to the old system of fertilizer distribution. This led farmers to expect a reinstatement of the old subsidy system along with credit sales of fertilizer. Believing this, farmers were not disposed to purchase fertilizers under the new system. In fact, only 3,000 metric tons of fertilizer were sold to farmers in 1982, and the government was left holding 35,000 metric tons of unsaleable fertilizer stocks.

The Bank felt that in the agriculture sector, the government's strategy was unclear and its commitment to implementing agreed reforms shaken by election campaign. There was progress in some areas, notably the dissolution in 1980 of the bankrupt marketing and credit agency, ONCAD, and a reform of groundnut marketing. To encourage agricultural production, the government increased producer prices for groundnuts, rice and cotton in 1981.

These steps opened the way for testing further reforms proposed under the SAL, of seedstock and fertilizer distribution systems. However, the announcement in late 1982 of new policies for fertilizer distribution (cash sales and a reduced subsidy) and seeds (payment of a premium to farmers who stored their own seeds) was followed by sluggish performance in implementing the changes, and in March 1983 the GOS suddenly announced its decision to return to the old systems of subsidized central seed distribution and fertilizer provision for the next agricultural season. In light of this policy reversal, the Bank recommended that the June 30, 1983 deadline for release of the SAL second tranche not be extended again.

SAL Achievements. A producer incentive system was put in place in 1982. A general duty of 15 percent on most imports, intended to protect domestic producers, had already been implemented in 1981. However, the GOS had decided not to increase the price of imported rice because the economy was suffering under a second successive year of severe drought conditions that had made domestically produced cereals scarce and expensive. In 1982, after a good domestic crop, consumer prices for rice were increased by 31 percent which represented a significant step in providing more protection for domestic cereal producers. In 1981, an export promotion scheme for five manufacturing sub-sectors was implemented. In a period of collapsing domestic markets, the export promotion scheme resulted in substantial production and employment opportunities in these sub-sectors, and the GOS is in the process of further improving the system and applying it more widely in the manufacturing industry.

New policies in the parastatal sector were introduced on a case-by-case basis. Some enterprises were closed down, and others were sold to private interests. In addition, the government started to rehabilitate viable public enterprises by designing financial and organizational reconstruction programs spelled out in program-contracts between the state and the management of individual companies. Because of this new approach, it was possible to avoid substantial mis-investments, and to help assure improved management structures and increased tariff levels for particular enterprises.

Despite the progress in these areas, the Bank found it was unable to release the second tranche of the general imports program because of two main problems: 1) problems in implementation of the agricultural reform program discussed above, and 2) economic stabilization.

Budgetary Problems. Senegal has experienced major problems in controlling the public sector deficit (notably on the expenditures side). After difficult negotiations, in 1980 the IMF replaced its Extended Financing Facility with a Standby Arrangement. This was renewed for 1982/83 at a level of US$50 million and the first tranche (US$6.2 Million) was released in December 1982. However, the GOS was unable to contain current commitments sufficiently to remain within the agreed performance criteria. In April 1983 the program was discontinued in favor of efforts to define a new, workable program. There were misperceptions on the part of the GOS about prospects for continuation of the Bank SAL program after the IMF's action. It was apparently felt, that if the IMF funds were unavailable, the Bank would feel an obligation to extend the SAL to Senegal. Events proved this to be a false perception.

Adjustment Prospects and Constraints

In the Bank's view, Senegal remains cautious about undertaking serious economic and social reforms because growth prospects remain unclear and the political risks of belt-tightening are great. It believes Senegal tends to see international assistance as a viable alternative to domestic adjustment, particularly since the foreign money is highly concessionary and fungible. And, for the moment, aid flows remain substantial. Bilateral donors have not yet insisted on much conditionality, and Senegal's inefficiency in project implementation and slow disbursements have not yet proved troublesome.

The Bank also views Senegal's long-run development prospects as modest. Growth sectors could be mining (Faleme iron ore), export-oriented processing industry, tourism and transport services and irrigation agriculture, both large and small-scale. But these possibilities will not be realized unless Senegal can recover from the present financial and economic crisis, which has now lasted since 1979. Such a recovery plan implies government actions on the financial front, above all to reduce the size of the overall budget deficit. In terms of economic policies, the first strategic priority should be to arrest the stagnation of the rainfed agriculture sector and to reduce food imports. Both of these areas, which directly affect the size of the current account deficit, need to be addressed in order to recover creditworthiness with foreign investors, because their capital and technology will be necessary to exploit the major mining, industrial and agriculture projects of the next decade. Concessional aid sources alone will never be sufficient to finance such programs.

COUNTRY: JAMAICA

Structural Adjustment Loan History

SAL I.	Amount of loan:	$76.2 million
	Date:	Feb. 1982
SAL II.	Amount of loan:	$60.2 million
	Date:	May, 1983

I. The Economic Background

During the 1970s, Jamaica was affected by severe economic disturbances. This is attributed to both external shocks and the impact of domestic policies. Per capita GDP declined every year from 1973 to 1980, and reached a cumulative decline of 26%. Increases in energy costs, a mid-decade recession in the industrial countries, fall-offs in export volumes and in the price of sugar and aluminum, affected Jamaica negatively. On the domestic side, programs to tackle unemployment and redistribute land coincided with the deterioration in the external environment and led to an overextended public sector and the disruption of production. At the same time, an increasingly populist image on the part of the government affected the confidence of the private sector. This contributed to a reduction in investment and increases in the outflow of capital and skilled labor.

By 1980, total GDP stood 18% below the 1973 peak. The expenditure components of GDP show the impact of policies: consumption expenditures increased their relative importance at the expense of investment expenditures. The share of public consumption expenditures increased gradually, from 18% in 1974 to 25% in 1980. Agriculture was one of the few sectors where output did not decline during the decade. Overall agricultural production increased at a trend growth rate of .7% per annum from 1970 to 1980. The major components, however, showed contrasting trends: Export agriculture including sugar, bananas, citrus, coconuts, coffee, cocoa, and spices declined at a rate of 4.0% per annum. Domestic agriculture increased at 3.8% per annum. These trends, to a large extent, reflected a shift in the use of agricultural land. Between 1970 and 1979 the area devoted to export crops decreased 27%; the area planted with domestic crops increased 54%. The remainder of the agricultural sector, livestock, fishery, and forestry, declined at a rate of .4% per year.

<u>Export Sector</u>. The poor performance of the export sector was heavily influenced by developments in sugar and banana production. Sugarcane output declined throughout the decade, from 4.2 million MT in 1970 to 2.7 million MT in 1980. The failure

of the 23 sugar workers' cooperative, created in 1974, to cultivate land that had belonged to the sugar estates (45,000 acres, or about one-third of the sugarcane area) was an important factor. These cooperatives were never endowed with the managerial resources needed to operate effectively. In time, cultivation practices deteriorated and inadequate prices led to the diversion of lands to other uses. The deterioration in cultivation practices led to the spread of plant disease and reduction in yields. More recently, inputs have been insufficient due to a foreign exchange shortage. The sugar factories that were bought by the government (80% of factory capacity was eventually government-owned) were inefficiently managed. Output of bananas fell from 384,000 MT in 1971 to 69,000 MT in 1980. A major reason for the decline was a diversion of banana lands to production for the domestic market. Also the price structure was inadequate. Yields fell as a consequence of the deterioration in the quality of services provided by the state-owned Banana Company. The problems affecting the production of sugar and bananas were, to a large extent, similar to those affecting other export crops. Farmgate prices were regulated by an external marketing organization and, in an inflationary environment, they lagged behind farmgate prices for domestic crops. Productive activities related to export crops took place in an increasingly regulated environment characterized by the expansion of the non-marketing functions of the external marketing organizations. These functions included direct involvement in production, supply of inputs, credit, insurance, extension, and research.

Mineral Sector. The role of the bauxite-aluminum sector as a major element in the economic development of Jamaica came to an abrupt end in 1974. Between 1970 and 1974 the sector grew at an average real rate of 9.7%, continuing a pattern established in the 1960s. Bauxite-aluminum real value added fell by 37% in the mid-1970s. Output had recovered by 1980 but value added was still 15% below its 1974 level. Three major factors account for the decline in Jamaica's bauxite-aluminum industry: 1) the tendency of aluminum producers to diversify their sources of aluminum supply; 2) the 1975 recession in the industrial countries, and 3) the bauxite levy imposed by the government in 1974.

The imposition of the bauxite production levy in the 1970s was a significant factor. While some of the other major producing countries followed Jamaica, its competitive position deteriorated vis-a-vis Australia, Brazil and Guinea. Jamaica's share in the world bauxite and aluminum trade declined from 18% in 1974, to 7% in 1979. On the credit side, the bauxite production levy increased more than fivefold the public revenues originating in the sector. In late 1979, the government reduced the levy.

By 1980, the manufacturing sector's output was 31% below the 1973 peak. The problem lay in the shocks undergone by the economy, frequent labor unrest, unavailability of skilled manpower, and the deterioration of the country's infrastructure. An unfavorable investment climate led producers to shelve expansion plans. Although manufactured exports showed some growth, they did not compensate for the decline in the domestic economy. The import-substituting-oriented industries set up in the 1950s and 1960s were largely failures. The structure of incentives, resulting from a protective system based on quantitative restrictions to imports, made sales to extraregional markets less profitable than sales to the sheltered but limited CARICOM market, and these, in turn, less profitable than sales to the domestic market.

External Sector. In 1973-1980 Jamaica's balance of payments was under continuous pressure. The Bank cites the following causes: a) poor export performance reflecting unfavorable conditions in the international economy as well as the impact of domestic policies; b) sharply rising oil bills; c) increasing debt-service caused by increased recourse to public capital inflows; d) and private capital outflows caused by the deterioration in private sector confidence. By 1976, there was an acute scarcity of foreign exchange. In 1977-1978, stabilization policies and the refinancing of commercial debt eased the shortage. In 1980, stabilization efforts weakened and the balance of payments position deteriorated again.

The decline in volume of the major export commodites was a major contributing factor. The volume of exports of goods had showed a declining trend since 1974. As a result of the producers' reactions to the bauxite levy, the volume of bauxite and aluminum exports had dropped 25% between 1974 and 1976. In 1980, the volumes of sugar and banana exports were off by more than one-half and more than three-fourths the peak levels of 1970. Import controls were progressively tightened in an attempt to allocate the increasingly scarce foreign exchange to priority uses. The volume of non-oil imports in 1980 had fallen 61% below the 1970 level, and shortages of imported goods, particularly inputs and spare parts were acute.

II. The Structural Adjustment Program

The first SAL strategy in Jamaica was export-oriented and was expected to rely on the private sector which is described in Bank documents as "the main engine of development." The strategy was designed and adopted in two stages. The first contained priority actions supported by an Extended Agreement reached in March 1981 with the IMF. This program focused on the need gradually to restore financial viability. Total IMF support amounted to SDR 536 million. The second and longer-term program emphasized measures to overcome deficiencies in Jamaica's economy. This refers to the Bank's SAL Program.

Both the SAL and the IMF's program were designed to address four main areas of economic difficulty: the balance of payments situation, fiscal imbalance caused by inadequate public savings and excessive public investment; sluggish performance of both the industrial and agricultural sectors, and an overregulated economy. The program supported by the first SAL was viewed by the Bank as the beginning of the process of adjusting the economy by taking certain actions and by initiating studies to identify critical constraints and design appropriate programs.

When a decision was being made whether to provide a second SAL, the Bank argued that the first SAL to Jamaica was primarily a "preparatory exercise." There have been no substantial changes in the structural adjustment program between the first and second Jamaica SALs. Jamaica was expected to continue with the same program and direction under a second loan. More explicitly, the Bank pointed out: "Industry cannot become competitive overnight; export markets have to be found and cultivated; utility tariffs can be raised only gradually and in line with improved services; buyers must be found for public enterprises scheduled for divestment; and institutions have to be nurtured. A start has been made, and it is proposed to provide continued support to the structural adjustment effort." This carries a strong implication that little of real value had been accomplished when the second SAL was released to Jamaica.

The schema below shows the major policy objectives together with a notation of the actions taken.

Policy Objectives	Steps toward Reform
Savings and Investment	
1. To increase the current savings of the major public enterprises through reductions in costs and increases in rates and prices charged. To eliminate all current account deficits.	1. This program was included in the conditionality of the Power Loan. Base tariffs have been raised by 1% per month during 1982, and all fuel cost increases have been passed on. A further 8% increase in base tariffs in January 1983, achieved a 5% rate of return on net assets in 1983.
a) Increases in the domestic price of sugar.	a) No further increase in the domestic price of sugar was implemented because it is felt it would be counter-productive in present circumstances. Nevertheless, the budget subsidy will be eliminated in FY 83/84.
b) Formulation and adoption of specific programs for:	
- Banana Company (JBC)	- Adoption of an action program for the Banana Company awaits the completion of a management audit.

Policy Objectives	Steps toward Reform
- Jamaica Omnibus Service (JOS)	- An initial action program for JOS was adopted and included making 600 workers redundant. No budget subsidy will be required in 1983/84. A program for the privatization of a large part of JOS is being prepared.
- Jamaica Railway Corporation (JRC)	- An initial action program for JRC was adopted but was considered unrealistic.
2. Establishment of functional medium-term lending institutions in order to make medium-term financing available to the domestic private sector.	2. An operating manual, and a statement of policies and procedures wer adopted in August 1982.
3. Preparation of a public sector investment program and financing plan in order to rationalize the investment activities of the public sector in line with the development strategy of the GOJ.	3. A program was prepared and submitted in September 1982. The monitoring system is in place, and the first two quarterly monitoring reports have been issued.
4. Promotion of domestic savings through increases in the after-tax returns on financial assets and through a more efficient functioning of capital markets.	4. No action on the progressivity of the tax system has been taken. The study of the availability of risk capital has been completed.
Balance of Payments Management	
1. To achieve greater efficiency in the allocation of foreign exchange, moving from a specific licensing system to a general-open license. Target to be attained over five years, subject to availability of foreign exchange.	1. The Trade Administrator's Department has been abolished and replaced by a Trade Board with private sector representation. A decision was taken to institutionalize the parallel foreign exchange market, and have it operated within commercial banks.
2. To attract private external capital through the creation of appropriate incentives for direct foreign investment, repatriation of Jamaican capital, and attracting migrants' savings.	2. A study has been completed, but no scheme has yet been implemented.

Policy Objectives	Steps toward Reform
Agricultural Sector Policies	
1. Land Use:	
a) Development of a program for the sale or lease of state-owned lands, in order to reduce the uncertainty faced by farmers.	a) A policy has been developed and adopted, and sales/leases are under way.
b) Reduction in the idleness or underutilization of privately owned agricultural lands, through the implementation of a program of land classification to induce the adoption of appropriate crops.	b) The land-use inventory has been completed. A study is under wa to determine optimum land use.
c) Rationalization of soil conservation activities, emphasizing maintenance, in order to control erosion on hillside farms.	c) A soil conservation program has been developed and is being implemented.
d) Increases in agricultural production under irrigation, through increased efficiency in water management and the development of new irrigation systems.	d) Work has been done on the irrigation program, but during the preparation, the problems were wider than originally thought, so that further work is required
2. Improvement in the efficiency of external marketing organizations in order to increase price incentives for farmers. Allow participation of private organizations in external marketing of export crops.	2. The management audits for the sugar were completed. Studies of the marketing functions are under way, for the external marketing organizations.
3. Elimination of praedial larceny in order to assure farmers are rewarded for their work.	3. The system of agricultural wardens is in place.

COUNTRY: TURKEY

Structural Adjustment Loan History

SAL I.	Loan Amount:	$200.0 million
	Date:	February 1980
SAL II.	Loan Amount:	$300.0 million
	Date:	May 1981
SAL III.	Loan Amount:	$304.5 million
	Date:	May 1982
SAL IV.	Loan Amount:	$300.8 million
	Date:	May 1983

The Economic Background

Turkey, a large country about the size of France and Germany combined, has an estimated GNP per capita of $1,330 and a population of around 43 million. Population density is a low, 78 per square km. of agricultural land, and the rate of urbanization is high, about 45 percent. School enrollments are expanding, but the rate of adult illiteracy remains at a high, 40 percent. Despite substantial emigration in the early 1970s, unemployment is about 20 percent of the labor force. Income distribution is relatively unequal by international standards, and the level of urban social services tends to be low.

The Agricultural Sector

Agriculture is the most important sector in the economy, accounting for about 25 percent of GDP, and employing about 60 percent of the labor force. It is also the primary source of merchandise exports. Turkey is one of the few LDCs which is self-sufficient in food. Agriculture, however, has tended to play a lesser role in Turkish development strategy. The main objectives in agriculture have been to increase total output and to provide exports to finance the development of the industrial sector. Turkish agriculture is dualistic. A modern irrigated commercial sector uses modern inputs in coastal areas and produces cash crops and most exports. A traditional rainfed agricultural sector on the Anatolian plateau emphasizes grains and livestock. Despite massive investments, only a small part of the irrigation potential has been developed. Agricultural investments have been concentrated in large, slow-gestation projects.

Turkey is considered to have the potential to expand agricultural production and exports. There are, however, major constraints on agricultural growth and productivity. These include: (a) limited development of irrigation and drainage facilities and poor utilization of existing facilities; (b) small and fragmented farm holdings; over 70 percent of holdings are less than 5 hectares, and over 95 percent less than 20 hectares; (c) inadequately funded research and extension services; (d) insufficient availability of credit; and (e) inadequate marketing arrangements, especially for export crops. These issues are the major elements in the SAL agricultural reform package.

The Manufacturing Sector: SEEs

Turkish development strategy has focused on rapid industrialization, so that manufacturing industry has absorbed about 25 to 30 percent of total investment. Manufacturing accounts for 21 percent of GDP and 38 percent of exports. The private sector is dominant in exports, and accounts for some 60 percent of value-added. The principal instruments of industrial policy have been large investments in the State Economic Enterprises (SEEs) and generous incentives combined with high levels of protection for private investments. These policies have had a positive effect on growth rates, but they have also resulted in the establishment of a number of uncompetitive industries, which tend to waste scarce capital and are too dependent on imported inputs. They are also characterized by low employment and limited export possibilities.

The Bank sees the major constraints to Turkish industrial development as: (a) low levels of capacity utilization; (b) limited export capability in some subsectors; (c) inefficiency of the manufacturing SEEs; (d) uneven quality of investments; and (e) lack of sufficient long-term financing for industry.

The Structural Adjustment Program

SAL I.

Turkey has received four structural adjustment loans. Under SAL I, an array of export promotion policies were adopted. It also provided for a study of the system of export incentives and import protection. Basic reforms realized under the first SAL included some improvement in internal debt management and domestic resource mobilization. The major elements of the reform package under the second SAL were tax reform and reform of the State Economic Enterprises (SEE). At the end of the second SAL, initial steps had been taken to rationalize public investments, and to liberalize import measures. The specific monitorable actions were in the areas of tax reform (courts, coverage, and collections), SEEs (defining objectives, monitoring, delegation, contracts, and employment), and petroleum pricing.

Continuing Issues under SALs II, III & IV

The theme of the third SAL called for providing (a) a sustainable level of public investment; (b) determining priorities and concentrating resources on a limited number of key projects to complete them within a shorter time frame to improve the efficiency of investment; (c) the intersectoral pattern of investment; and (d) the system of project selection, design and evaluation The fourth Turkish SAL is described as a continuation of policy objectives initiated under the earlier loans. It includes: continued rationalization of the public investment program, reform of the SEEs; import liberalization and export incentives; and implementation of measures to address structural issues and the shortcomings in agriculture as discussed above.

The State Economic Enterprises

Reform of the SEE sector has been an ongoing issue in the Turkish SAL program. Much of the Bank documentation on the SAL experience in Turkey is addressed to this issue.

Background. The State Economic Enterprises were started in order to spur development in the absence of, and as a powerful means of creating, an indigenous class of Turkish entrepreneurs. SEEs play a particularly important role in manufacturing as well as in traditional infrastructure sectors. Their investment has constituted about 25 percent of total fixed investment in the last several years. Yet their operational losses have amounted to as much as 1.5 percent of GDP. The SEEs constitute major factor behind the deterioration in Turkish fiscal accounts.

Poor performance of SEEs can be attributed to three sets of causes: (a) the conflicting objectives and constraints imposed by Turkey's development strategy, (b) the macro-institutional inefficiencies of the system, and (c) the micro-economic inefficiency of individual SEEs. SEEs have been expected to perform many functions. For example, they are expected to: contribute to the growth of output; to supply goods at stable prices; to provide employment opportunities; and to be efficient and enhance productivity. There are certain inherent conflicts among these objectives. As public enterprises, they have also been susceptible to political pressures and constraints. Besides, they have been frequently involved in large, capital-intensive investments with long gestation periods, as well as a long process of learning by doing. The high levels of protection that are granted, and near monopoly in the domestic market, provide little incentive for improving efficiency.

Macro-institutional deficiencies exist which relate to both the organization of the SEEs and their relations with the public sector. The SEEs are subject to interference and control from different sources. These interferences relate to policy questions as well as matters on day-to-day operations. The Council of Ministers, Finance Ministry, local governments, various Ministries dealing with economic issues, the political parties, and even Parliament, have all affected SEE decisions. Overstaffing problems in the SEEs are traditionally traced to political pressures. Many important decisions have usually been made outside the enterprise. The frequent changes of government in the 1970s were often accompanied by changes in SEE management. The lack of continuity in top management, and a lack of experienced middle level administrative and technical personnel, have had a negative effect on performance.

Scope for Reform. The Bank has recognized that whatever their form and sphere of responsibility, SEEs are likely to remain a central feature of Turkish economic life. Its approach, therefore, has been to seek gradual reform, not the abandonment of the SEE concept.

Turkey perceives benefits of SEEs and these perceptions are difficult to dislodge. These perceived benefits include the role of SEEs in the development of basic industries, the provision of key services, promoting social objectives such as the regional dispersion of industry or employment, and introducing large and complex technologies where the private sector lacks the resources to invest.

The Bank and government have not reached clearcut agreement on specific actions needed to reform the SEEs, but there is a general consensus that the SEEs investment program has to be reduced, and its quality improved. The importance of this reform is neglected in the fact that at the beginning of the SAL program, SEEs accounted for almost 47 percent of the total public investment program.

Complementary with a reduced SEE investment program, there is the need to improve management and operational autonomy. Since the beginning of the SAL program, the Bank reports some increased autonomy has been achieved in pricing and there has tended to be a greater reliance on SEE self-financing.