AID Private Enterprise Policy Dialogue: Forms, Experience and Lessons

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Summary

This paper describes recent experience where AID helped expand the indigenous private sector by bringing about changes in policy. Usually the reasons behind policy change are numerous, there are many influences, and the process is not entirely discernible. We have tried to be scrupulous in identifying the AID role where clearly related to a policy change.

There are several vehicles for policy dialogue: Consultative Groups are donor clubs mainly chaired by the World Bank. These groups normally review a developing country's macro policies. Round Tables are similar to consultative groups but generally are for least developed countries. AID Programming processes are important occasions for policy discussion relating to proposed aid program content. Economic Assistance (such as balance of payment loans, cash grants,) are a basic vehicle for AID policy dialogue on economic policies affecting the private sector. AID experience with these vehicle goes back to the policy negotiations of the 1960s "program loans". Sector loans and food aid are important vehicles for dialogue relevant to the subject (agriculture, health, etc.) of these forms of aid. Projects also create occasion for dialogue on policies relevant to the activity in each case.

It is important to note that private sectors vary greatly among countries, from small-scale, informal, agricultural private sectors in lesser developed countries, to relatively advanced manufacturing and service sectors in the more advanced. The policy problems differ substantially along this spectrum; hence the dialogue takes quite different forms according to the situation.

Recent Dialogue Experience:

AID has had long continuous dialogue in Bangladesh on the role of the private sector. It has participated actively in the consultative group broader policy efforts, while focusing our attention on food, the policy framework for foodgrain prices and production inputs (mainly fertilizer), and the role of government agencies versus private enterprises in the marketing system. This dialogue has begun to yield results. Policy has shifted from government operations towards private dealers, with increased reliance on the operation of the market to achieve food price stabilization. AID focused on fertilizer distribution to bring private competition into play as a force that would result in faster expansion of fertilizer purchase by farmers. In the past year the government withdrew from retail fertilizer trade. The AID mission is now shifting the dialogue to the wholesale level, partially privatized, and the import

level. AID also got government agreement to deposit PL 480 loal currency generation in private banks, the first time government deposited funds in private rather than government-owned banks. At the project level AID has begun to help strengthen the private rural financial system.

In the Sudan, general import assistance in 1980 brought AID into close relationship with the country's macroeconomic problems. Besides supporting an IMF World Bank dialogue, AID emphasized problems particularly important for the AID program. For example, the government agreed to hire a private management firm to run a new public sector sugar mill which was to get foreign exchange for equipment imports under the AID program. The government hired a Louisiana firm and allows the refinery to be run as if it were private, i.e. free of civil service or other interventions. At the project level, AID identified problems of river transport as critical to Sudanese agriculture. The government agreed to turn all boats and boating over to private owners and limit state functions to facility maintenance (e.g. docks), at which point the mission initiated an assistance project. Finally, seizing a "target of opportunity" occasioned with a big increase in the commodity import financing program, AID suggested the trade in oil imports be turned over to private companies on a bidding basis. The suggested privatization was accepted and purchase under the new system began this year.

The policy shift in Somalia toward privatization was sudden and more sweeping. As a result of the shift in Soviet support to Ethiopia and away from Somalia, the Somali economy was in shambles. Somali political and government leaders who had survived the Soviet period but doubted the wisdom of the country's previous economic course, regained control over policy and introduced an about-face. The basic shift made the government receptive to increased reliance on the private sector. Covenants in the AID agreement stipulated that government would divest itself of losing state enterprises. AID is also helping the government carry out divestiture through a technical assistance project. Somalia also agreed to change policy respecting private sector access to foreign exchange and ended the Livestock Ministry's monopoly on distribution of livestock drugs, opening this activity to the private sector (important because livestock is a major economic activity in Somalia).

Kenya has always been basically market-oriented. But the effects of the rise in oil prices, budget deficits, and policies of protectionism and state interventions (especially in grain marketing) led to a need for basic policy overhaul. An FY 1983 $30 million AID Program Grant in support of a consultative group structural adjustment program describes the agenda being supported, including aspects of special interest to AID, viz. "reduced government participation in parastatals...rationalization of GOK regulations and procedures to promote investment and exports...increased reliance on the private sector". To sustain dialogue, AID has regular informal monthly meetings with the Kenyan Government, and has sketched out the areas AID will focus on under the anticipated support of the next couple of years.

Individual Project Level: Several missions have begun projects to fund independent expert studies of policy issues relating to the private sector, thus setting the stage for subsequent dialogue. In Thailand, the policy study activity is built into a mechanism for regular policy dialogue between the government and the Thai private sector. Similar projects have been started in Panama, Philippines, Indonesia and Somalia.

AID's Housing Guarantee Authority has financed one of the longest running programs that uses the project as the basis for dialogue. During its first decade, the HG program helped introduce savings and loan systems in many Latin American countries, with combined assets now of roughly $20 billion. Policies of an institutional, financial or regulatory character that have resulted in greater private sector participation in housing have resulted from HG dialogue in several countries, e.g. Honduras, Peru, Botswana, Tunisia.

AID has opportunities to encourage policy changes respecting the private sector through the way in which some projects are implemented. For example, in Zaire AID knew that the Ministry of Transport would not be able to maintain 200 kms of road within an AID area development program. AID proposed and the Zaire Government accepted the notion that a local private firm maintain these roads.

Conclusions:

The record shows a considerable level of policy dialogue in countries of varied political and economic character, involving varied styles and vehicles to suit the circumstances, and a fair degree (but not complete) success. The dramatic successes are where a government has undertaken a major reversal away from previous "socialist" strategy. A number of countries getting sizeable U.S. aid have been helped to strengthen the role of their private sector through policy dialogue and projects.

Generally speaking, AID needs to have a range of direct and indirect routes for dialogue; in some instances potential direct policy dialogue was curtailed because a political judgment was made that such discussion would have adverse effect on overall political/diplomatic relations. Further thought should be given to those situations which require AID and State to optimize developmental and political interests, e.g. where the U.S. must balance medium-term development benefits resulting from a particular policy change against potential short-term irritation or negative effect on the diplomatic climate.

The amount and form of the AID program appears closely related to AID's ability to get a hearing and be taken seriously by developing country government policymakers. Also, while a substantial program effort by a group of donors is not sufficient to guarantee policy dialogue success, it does appear to be a necessary condition. AID's greatest prospects for effective policy impact appears to be when the policy framework is defined by the IMF/World Bank and the LDC Government. Then AID can then select particular policy areas for dialogue, financing, and other forms of assistance.

Successful dialogue needs to persuade those levels of a developing country government in a position to veto or block effective implementation. When lower levels are convinced of the need for change, agreement at the top is easier to reach. The benefits in having large numbers of Western-trained professionals in government and commerce cannot be overstated. Ultimately, what is most important and lasting is that a developing country have its own capacity to undertake the necessary policy analysis, dialogue with its private sector, and create a positive, dynamic environment for economic growth.

I. Introduction

This paper describes recent experiences in which AID attempted to help expand the indigenous private sector of a developing country by bringing about changes in the policy environment. The "policy environment" is comprised of the general development strategy and rhetoric of a government; the specifics of government acts and interventions (and laws); and regulations surrounding the investment and operations of individual firms in specific sectors or lines of business.

The paper identifies a number of examples of impact on policies affecting the role of the indigenous private sectors. In some instances, significant policy change experiences are not documented because the host government asked that for domestic political reasons, sensitive "understandings" not be recorded or described in project papers as actions being taken at the request or suggestion of AID; or, are not recorded except in cable traffic because the policy area was not directly relevant to any project or other AID activity calling for its recording in the normal course of business. The AID documentation record alone thus gives less than full account of the Agency's total experience or impact.

Agriculture has always been a major sector for AID and predecessor agencies. In many countries, in connection with large PL 480 programs and agriculture development projects, AID conducted dialogue with government regarding policies affecting individual farmers, who typically comprise the largest group of private operators in these economies. The record of this dialogue -- on such matters as the work of extension systems with the farmers, systems for training farmers in irrigated agriculture, etc. - is well known. This paper, however, focuses on the commercial and other functions of the private sector as provider of services (marketing, inputs, finance) to the farmers, and, on the private sector in industry and other economic areas.

In many situations the reasons behind a major policy change are numerous. There are many influences at work, and the process is often complex and not entirely discernible. In this paper there has been a substantial effort to identify those 'cause and effect' situations where AID's role as policy interlocutor clearly related to a subsequent policy change. Account is also taken of situations where the U.S. engaged in policy dialogue defined mainly by IBRD and/or the IMF. The U.S. added all its weight to the general influence of these institutions and a group of donors rather than took the lead. It is difficult to say whether the policy outcome would have been different in those cases where the U.S. played only a "me-too" role, or, if the general policy direction developed within a consultative group context would have emerged without the U.S. participation.

II. Modalities for "Policy Dialogue"

Depending on the size of the AID program, political relations with the country, and other factors identified below, AID may have opportunities to discuss aspects of the developing country's private sector policy framework. Before examining some of AID's actual experience, however, it will be helpful to describe various types of situations and the kind and scope of "policy dialogue" that may be appropriate to each.

A. Consortia. The U.S. is a member of many country consultative groups, chaired by the World Bank. By agreement between the developing country government (LDC) and the donor members, annual consortium meetings normally cover a wide range of macro-economic policy questions, based on documentation prepared by IBRD and the LDC. Donor countries normally look to IBRD to set and prepare the agenda. The opportunity is always present, and frequently taken, for donors to propose issues. The U.S. has done so often, using both formal and informal channels with IBRD (The AID desk officer to IBRD desk officer; the regional AID Assistant Administrator to IBRD regional Vice President). Often private sector policies are examined and discussed.

While consortia usually meet formally only once a year, some consortia have more or less formal standing groups comprised of donor officials resident in the country concerned. These standing groups met frequently, offering scope for continuing policy dialogue. (Some consortia have special sessions, devoted to a single policy area the donors want emphasized.)

In recent years consortia have served as the forum for discussion of broad policy direction, with fewer cases of sharply focused, issue-specific sessions. Their general direction has been towards trade liberalization and market-orientation, providing a useful backdrop for AID in pursuing particular policies affecting the local private sector. For many specific matters, consortia are not the appropriate bodies for dialogue, either because they are more useful serving as the means to require an LDC government to lay out its broad strategy, or, because the issues involved may be too sensitive for formal airing.

AID recently (November, 1983) reviewed its consortia experience and concluded that the discussions were too vague and general. Nonetheless, the consortia mechanism can be particularly helpful in situations where; a) a government has strong reservations regarding liberalization, b) political considerations led the U.S. to conclude that bilateral dialogue on basic policy change would not be productive or helpful for U.S. relations with the government, or c) where the public record of consortia recommendations would be helpful to the LDC government in dealing with its own public opinion. (If AID decides to strengthen the policy dialogue aspect of the consortia process, shifting toward greater scope for the private sector could be a particularly appropriate subject.

B. Round Tables. These were developed by the United Nations Development Programe (UNDP) over the past couple of years to be the equivalent of donor coordination mechanisms for the Least Developed Countries. Round Tables have served thus far to assist the Least Developed Countries organize, and present to donors their project financing needs. (These meetings could be developed further in the direction of policy coverage and broad review of development progress and strategy.)

C. AID Programming. Often in connection with the preparation of a long term country development strategy (CDSS), AID missions have opportunities for broad policy reviews with the LDC government. These can be occasions for discussion of AID's views with respect to the role of the private sector in the country's development and the policy framework. The extent and success of such discussions depends on the size and relative importance of the AID program, the project content of the program at the time, and the volume of expected future year funding, and, the Mission's judgment as to the relative importance to the LDC government of private sector policy questions compared with other issues .

This latter factor is an important general point. In many countries governments maintain a market-oriented, private-sector oriented development strategy. In such cases, policy dialogue may achieve its "optimal" usefulness by concentrating on related problem areas, perhaps covering specific issues related to the private enterprise environment, e.g. institutional weaknesses in government-private sector relations, or export quality control, or credit for small and medium enterprises. In other countries the government may have strong reservations--if not hostility--towards private business; policy dialogue might then usefully focus on fundamental attitudes, or might have to be limited to incremental improvements, inducing greater investment activity or more efficient and productive private sector activity. In still other cases, barriers to entry of foreign private investment may be most important; in still other situations, complex relationships between government and private interests (having little to do with ideology) may pose serious obstacles to efficiency and competition.

Often these problems are complex and fraught with sensitive political ramifications. The ability of AID to conduct meaningful policy discussions will depend on the experience and credentials of the Mission Director and on the quality of staff work the Mission and AID/Washington performs to develop the U.S. position.

D. Balance of Payments Loans and Grants. Cash grants, Commodity Import Program (CIP) loans and other forms of general economic assistance ("program" aid) have long formed the basic vehicle for general policy dialogue. Going back to the highly conditioned 1960s style of program lending, with tranched releases keyed to meeting quantitative fiscal and monetary targets (often as defined by the IMF), this format for policy dialogue has been the most closely evaluated of all such vehicles, with mixed results.

Where such aid has been provided in conjunction with similar loan funds from the World Bank to help finance structural adjustment, the economic elements of the package usually include trade regime, exchange rate and other policies fundamental to improve the climate and incentive structure for private sector efficiency and export competitiveness. Usually these situations require deflation of domestic demand and reductions in public sector subsidies and other contributors to deficit financing. These policy approaches often impose severe strains on private enterprises facing contractions of their local markets. As noted above, the extent to which private sector policies, *per se*, are the subject of structural adjustment agenda varies from case to case.

E. The Sector Loan. This has been the most pointed aid instrument for policy dialogue. Initially, sector loans for imports needed by private manufacturing concerns (raw materials and intermediate manufactures) provided both direct resource assistance to the private sector and the occasion for discussion of relevant policy issues. (Program loans were used in a similar fashion.) In recent years it has been used largely for health and agriculture. Food aid under PL 480 has traditionally been treated as a sector loan in agriculture, involving attention to agriculture policy problems, which sometimes included questions concerning the role of the private sector in the marketing of inputs and produce, and other private sector issues.

F. Projects. In most countries the AID program is not large enough itself to create occasions for dialogue on broad, private sector development strategy. Occasions do arise where issues of specific institutional, regulatory, or other policy nature are pertinent to the planning or implementation of individual projects, and where the AID Mission can raise such questions with government. These are as follows:

1 Projects under which technical assistance is provided precisely to study and help the government develop strengthened policies regarding the private sector.

2 Where the usefulness of the project depends on the government taking decisions to alter some existing, unfavorable

policies. In the case of larger scale capital projects, these changes may be formally identified as conditions precedent to project financing.

3 When a problem arises during project implementation that was not anticipated during the planning phase, reflecting some unfavorable aspect of the policy environment for the private sector participants.

4 Where implementation of the project carries a change favorable to private enterprise, even if the purpose and content of the project is not inherently private sector oriented.

Before turning to AID's record and illustrations of policy dialogue approaches, a few observations are worth setting out as a reminder to the reader to avoid oversimplified conclusions:

First, this survey is limited to the private, indigenous, profit-making enterprise sector, excluding small farms. AID has been heavily involved in this latter area for a long time and thus the new private sector emphasis complements earlier attention in the sector. Also excluded is the private not-for-profit PVO sector, with which AID has also had extensive working relations.

Second, as an analytic category or a subject for policy and program attention, the private sector (even as above defined) is very heterogeneous and varied. This is immediately apparent if one compares the advanced state of commerce, international trade, and domestic manufacturing (and the role of private enterprise in these activities) in India, Thailand, Colombia, with countries like Nepal or the countries of the Sahel. In the former case the private sectors have long histories, well developed interest-group associations, numerous enteprises of relatively large scale and capitalization, a large cadre of people trained in modern management techniques, and ample supplies of entrepreneurs. These conditions do not exist in the latter cases. (The institutional and policy problems differ substantially across this wide spectrum.)

Third, some policy issues require more analytic sorting out than AID or the US Government is able to accomplish. Taking a position that initially seems sensible but turns out wrong is counter-productive - if the LDC government took the advice and the results were harmful, the U.S. relationship would be damaged, not to mention the setback to the country's development. Particularly troublesome is the common problem <u>within</u> the private sector that policies favorable to one group of enterprises are harmful to another (e.g. where infant-industry policies protect some enterprises by shutting out other entrepeneurs).

Fourth, policy impact evaluation after the fact is much more difficult than project evaluation. For one thing, AID is often not the only (or most important) party to policy discussion with the government. In some situations an external donor only helps achieve a policy improvement that elements within the LDC government have already formulated. The "dialogue" serves as part of the policy process rather than as initiator. Another obvious complication is the time at which an evaluation is undertaken. A changing world and domestic economic environment may turn a previously good policy into an irrelevant or inappropriate one. Finally there is the general problem of evaluating the effects of specific policy changes: Were we right? Did the change achieve the expected result? In other words, the operation may have been a success, but the economic patient died anyway, from other causes.

III - Recent Dialogue Experiences: Different Modalities

A Full-Scale Agenda Experience

In reviewing policy dialogue experience we begin with cases where dialogue has been the most extensive.

1. Bangladesh. Bangladesh is one of the countries with which AID has had a long continuous dialogue, and there is still the same general area of concern regarding the role of the private sector. The dialogue has been carried on in the context of consortia meetings, food aid, development assistance import financing, and individual projects. It has focused on the food sector, in particular foodgrain prices and production inputs (mainly fertilizer), and the role of government agencies versus private enterprises in marketing systems.

Since independence in 1971, successive Bangladesh governments have had to work with an inherited system of government control and operation of the food distribution system. They were strongly inclined to continue an extensive command system in the food sector, especially since the availability and pricing of foodgrains were seen as central to the country's politics. The system was both inefficient and a drain on government resources. Food system reforms were part of the general policy agenda on which the World Bank worked. They defined recommendations which were then supported by the many donors regularly attending the consortium meetings and frequent in-country dialogue sessions.

Apart from US participation in the general dialogue of the consortium, the AID Mission for several years had worked with the Government of Bangladesh on food policy problems of particular importance and interest to the US. These were in much greater detail and with much greater frequency of discussion than those pursued in the consortium context. After several years of AID analysis and the exercise of considerable diplomacy, the effort has begun to yield results. Some policy changes entail major reductions of direct government operations in favor of private dealers and merchants, and increased reliance on the operation of the market to achieve foodgrain price stabilization. AID focused the dialogue on the fertilizer distribution system to bring private competition into play to stimulate rapid expansion of fertilizer purchases by farmers. In the past year the Bangladesh Government has withdrawn itself entirely from fertilizer sales at the retail level, leaving the field to private dealers. AID is now shifting the policy dialogue to the wholesale level, already partially privatized, and the import level.

The Bangladesh Government has also begun a divestiture program, starting with large segments of the jute and cotton milling industry. A number of plants nationalized by an earlier government have been turned back to private ownership. (While the World Bank took the lead on this subject, the US supported this policy discussion in the consortium context.)

Another interesting policy change agreed to by the Bangladesh Government is that a portion of PL 480 local currency generation can now be deposited in private commercial banks. This represents the first occasion in which government funds are placed in private banks rather than government-owned banks, thereby increasing the resources available to these private institutions. (The decision is consistent with the broader policy the government introduced in 1983 to begin denationalization of commercial banks and allow establishment of new private banks.)

At the project level, AID recently begun to supplement its work on food production through an effort to help expand and strengthen the rural financing system. Based on an earlier experimental effort, AID negotiated a project in May 1983 requiring several reforms that will, among other things, strengthen the role of the private rural financing system. (The project contains provisions for future policy dialogue, as necessary.)

Finally, it is worth underscoring how remarkable the entire Bangladesh policy movement of the past two years has been. The shift toward a greater economic role for the private sector in such fundamental activities as food production, distribution and finance, incorporating many of the policy changes donors had been urging for years, represents a sharp departure from past economic philosophy. The decision was taken at a time of considerable economic stress and recession, by a government that was apparently reluctant and uncertain of the outcome. The role and impact of the policy negotiation process, both in terms of broad policy thrust and many detailed particulars, appears direct and unambiguous.

During this same period, AID in three African countries was engaged in similar across-the-board policy dialogues. They involved different aid modalities, and also helping to bring about significant policy change. These reflect differences in nuance and style to the Bangladesh situation, or for that matter, the "classic" policy conditioning approach of AID's balance-of-payments "program loans" in Latin America in the 1960s.

2. Sudan

In the case of Sudan, the initiation of a general commodity import program (CIP) in 1980 brought AID into close relationship with the country's macroeconomic problems. To understand the situation and identify the major policy problems AID might respond to, two noted U.S. economists reviewed Sudanese economic conditions. Both concluded that greater reliance on the private sector was essential to address a) the country's resource mobilization needs, and b) severe inefficiencies plaguing the transport, manufacturing and other sectors, heavily dominated by parastatal organizations.

Like the Bangladesh case, in addition to supporting IMF/IBRD dialogue AID emphasized certain policy areas that appeared particularly important and appropriate. The CIP allocation process gave AID entry into related subjects where dialogue with the Government might be productive. For example, despite the poor record of small goverment-run sugar mills, the Sudanese Government had decided to establish a large new refinery. Because the new company needed access to import financing for its equipment under the CIP program. the Government accepted AID's recommendation that a private management firm be hired to run the plant. A Louisiana firm was hired and ran the refinery as if the refinery were a private company, e.g. free of civil service, pricing or other government interventions.

At the project level, AID identified river transport problems as critical to Sudanese agriculture. Following three years of discussion, the Government agreed to turn all boats and boating over to private owners, and limit State functions to facility maintenance (dredging, docks, etc.) With that commitment AID initiated an assistance project.

The Sudanese experience is particularly interesting in light of recent AID actions in that country. AID took advantage of a "target of opportunity", provided by the sizeable increase in the FY 1984 CIP program to $120 million, compared with $80 million in FY 1983. This increase made AID a significant source of financing for Sudanese petroleum imports. Oil importing and distribution had been reserved to an inefficient State enterprise. AID suggested to the Sudanese Government (and other donors providing import financing), that petroleum import and distribution should be done by private oil companies, on a competitive bidding basis. The suggested "privatization" was accepted and purchase under the new system began this year.

3. Somalia

Compared with the evolving change in the Sudan, the policy shift in Somalia was sudden and more sweeping. Somalian leaders faced an economy in shambles when the Soviets switched to support Ethiopia, withdrawing their assistance as well. Somalis who had survived the Soviet period but doubted the previous economic course, regained control over economic policy and introduced an about-face. The U.S. base agreement and the increase in the AID program (including ESF general import financing), set the stage for an active AID role and policy dialogue. The basic policy shift made the government receptive to the specifics of increased reliance on the private sector. AID dialogue requirements, for example, were expressed in covenants in the CIP Agreement. They included commitments the government would divest itself of losing state enterprises. AID helped the Somalian Government carry out divestiture through a technical assistance project that is now providing IESC expertise to analyze individual parastatals and prepare divestiture plans (when the Government first offered to sell off industrial parastatals a couple of years ago, there were no interested takers). The U.S.-Somalian CIP program also opened the door to policy change with respect to private sector access to foreign exchange.

At the sub-sectoral project level, AID persuaded the Government (contrary to its Ministry of Livestock) to end the Ministry's monopoly on the import and distribution of livestock drugs, opening this activity to the private sector. With livestock raising and export the most important single economic activity in Somalia, livestock drug distribution is not a minor detail. This decision led to a request from the Livestock Ministry for assistance to help it and the private sector function under the changed policy. The policy change recommended by AID, in favor of "privatization" on efficiency grounds, was accepted on its merits by the Government, with a facilitating project coming only after the policy change.

The prospect for a more private-sector, market-oriented development strategy survived the previous policy because numerous Somalian officials had been educated in the West. This is recognized by the Government; participant training abroad has now switched back to the West; officials educated in the Soviet Union are now being retrained in Westeren countries.

4. Kenya

A third example of policy dialogue associated with a broad policy change agenda worked out between the LDC government and the World Bank is the case of Kenya. Kenyan development strategy has always been basically market-oriented with major reliance on the private sector. By the late 1970s however, the effects of the rise in oil prices, mounting public sector deficits, and previous policies of protectionism and selected state intervention (especially in grain marketing), led to a need for basic overhaul of the policy framework. In 1978/79 AID proposed that its program be associated with the structural adjustment program defined by the Kenyan Government with IBRD assistance. This was done, and is reflected in a FY 1983 $30 million AID Program Grant supporting the structural adjustment program. AID documentation spells out formally the policy agenda supported by the assistance, referring in so mamy words to U.S. policy dialogue with the government of Kenya (GOK). This includes private sector aspects of the adjustment program of special interest to AID, such as "reduced Government participation in parastatals.... rationalization of GOK regulations and procedures to promote investment and exports..... increased reliance on the private sector to achieve development objectives."

Beyond the statement of broad policy objectives, the Agreement contains "conditions", some of which are taken from specifics of the IMF stand-by and IBRD Structural Adjustment Loan understandings, and some are AID-specific. These have to do with export promotion (simplification of export control procedures), and liberalization of imports of agricultural inputs (easing access to foreign exchange licenses for private importers), all of which are beneficial to the private sector. To sustain the dialogue AID has instituted a system, informal but regular monthly progress reviews, and has also sketched out for the Kenyan Government areas of the adjustment process AID will focus on under antipicated import financing support over the next few years. Finally, the package includes $2.0 million to finance consultants to assist the Kenyans define the details of several policy aspects of the adjustment program, including parastatal policy. A portion of these funds are also to be used to evaluate the results under the FY 1983 Agreement, and, to help define the policy content of the expected FY 1984 Agreement.

B. Informal Policy Dialogue Experience

Sri Lanka is an unusual case of a country that recently made an about face in economic philosophy through elections. The new government is convinced Sri Lanka should move sharply away from heavy state intervention, and, rely on the private sector and the operations of the market. The impetus for fundamental change in economic strategy appears to have arisen from within Sri Lankan Government and political circles, not from international institutions or donor pressure.

Nonetheless, AID policy dialogue in the 1980s led to a significant changes that affected the private sector. This is generally unrecorded, however, because the dialogue was completely informal and unconnected with conventional AID activity. The Sri Lankan Government was seeking to develop alternative approaches to food subsidy policies inherited from the previous government. The AID staff in Sri Lanka brought to their attention the U.S. food stamp system, which relies on private retail food stores, rather than government distribution agencies. Discussion about the merits of the U.S. approach led Sri Lankan officials to visit the U.S. on their own and observe the workings of the food stamp system. The government subsequently shifted physical rationing traditionally handled through government distribution, to a stamp allocation system run through the private retail food distribution system.

C. Individual Project Level Experience

1 Projects Which Address Policy Issues

In the last couple of years, several AID Missions have developed projects which finance independent, expert studies of policy issues relating to the private sector. While development of the projects themselves does not involve substantive policy dialogue, agreement for such a project sets the stage for future dialogue. It also indicates an LDC's recognition that its private sector policies could benefit from change. The existence of such a project clearly implies general agreement between the LDC Government and AID about the basic economic philosophy guiding the country's development; the studies are then designed to facilitate progress in the agreed direction.

In Thailand an AID policy study activity is built into a mechanism the government established shortly before the project design exercise, to facilitate systematic policy dialogue between the Government and the Thai private sector. Studies are designed to strengthen the technical quality of this dialogue. (With variations appropriate to the local circumstances, similar private sector policy study projects have been started in Panama, Philippines, Indonesia, and Somalia.)

2 Policy dialogue as a result of projects

a Housing Guarantee

AID's Housing Guarantee Authority (HG) is one of the longest running programs using the project as the basis for policy dialogue affecting the relative roles of government and the private sector. HG deals with important policy aspects of urban development, the introduction of new institutions, and adoption of appropriate regulations required to support a shift toward a greater private sector role. For various reasons, including its legislative mandate and because it is funded with private U.S. financing, the HG program has been highly conditioned. Since most LDCs initially lack any history of private institutional housing finance, interest rate and other policies that could support a viable private housing finance system, this greater conditionality has been more readily accepted.

During the first decade of the HG program it was confined to Latin America. HG introduced and helped establish savings and loan systems in many Latin countries, now having combined assets of roughly $20 billion. More recently Western Hemisphere projects have focused on policy dialogue leading to legal changes regarding low-income shelter, especially slum legalization (Honduras and Peru) and upgrading. The requirement that beneficiaries of HG financed projects be below the country's median income has frequently occasioned dialogue i.e. such as that in Honduras, which resulted in a lowering of municipal construction standards. (Higher standards kept publicly financed housing too expensive for the lower income levels.) In Honduras lower income families now have access to 70 percent of public housing finance compared to virtually zero a decade ago. (Greater private sector financial and construction participation in housing has resulted from HG program dialogue in recent years in a number of other countries, including Ecuador, Panama, Botswana, Tunisia.)

The HG experience is interesting and unusual in the context of foreign assistance. Although it has occasionally been "programmed" along with other aid accounts as part of an overall U.S. package, the HG program has normally pursued a relatively independent path. This has been explained by its need to negotiate particular conditions under which its projects must be implemented, and by its particular financial character. Its policy negotiation experience has also been distinct because it often negotiates directly with municipal rather than central governments. This tends to limit the impact of disagreement. For example, a failure of negotiations with the city Government of Seoul is less likely to have a major impact on overall U.S.-Korean relations than failure at the national level.

HG program ability to negotiate policy change has been enhanced by its regular practice of undertaking a housing sector study before defining the ground rules for an initial project (and occasionally thereafter). In most cases these studies have been innovations that have defined the problems of the sector, especially that segment the HG would consider financing. The result has been to put on the table the policy issues identified by expert analysis.

b Project Specific Cases

Even if a project purpose has little to do with encouragement of the private sector, AID can encourage private policy by its implementation approach. In Thailand AID helped finance construction of over 5,000 small bridges and culverts. The bridges and culverts were the weakest links in the Thai "highway" system at that time. (Up to that point all public works were constructed by Government.) AID convinced the Thai Government that this project should be implemented by private contractors although the indigenous private construction sector had no experience, in this type of construction. Further, the private construction sector consisted of a small number of small firms.

Initially construction activities by these small contractors was overseen by an engineering consultant firm under close supervision by the AID Mission project engineer. After several years, the local construction industry was comprised of over 75 firms with public works construction capability developed substantially under this project. When AID began a major highway reconstruction project in the early 1960s, the bridge contractors were helped to increase their capabilities further, and awarded contracts for short stretches of highway. Again, they operated under supervision of an engineering consultant firm responsible for overall design and implementation of the complete highway.

Thus, while the purpose of these projects were to improve transportation, an important accomplishment was the creation of a substantial private sector civil works industry. The key was a change in Thai Government policy respecting the relative roles of government and private entities, a change brought about by AID. This case reflects the natural inclination of Americans to look to the private sector for the bulk of economic activity, has long been part of the "culture" of the U.S. development program, even during periods when encouragement of the private sector was not a deliberate priority.

There are many other cases in recent years of AID use of private contractors for civil construction projects. For example, in Zaire AID was aware the Ministry of Transport would not be able to maintain the 200 kilometers of road within an AID area development program. AID proposed an arrangement with a local joint venture firm under which the private firm would maintain these roads. (AID provided technical assistance to enable the firm to take on this additional, normally public road maintenace responsibility.)

The Thai and Zaire cases are similar in that an AID initiative led to LDC government agreement to relax previous policies under which road maintenance was strictly a public sector responsibility. In both cases, the AID policy contribution came at a time when expanding civil works requirements faced severe public sector capacity constraints, in effect creating the need and opportunity for a private sector option. Such implementation cases are far more numerous than this exercise describes. Many did not involve changes in formal policy and may not have a negotiating character to be identified as such in AID documentation.

Finally, to provide the reader with some sense of the range of private sector policy issues AID is involved in, below are a few illustrations:

-- transfer of public tubewells to private ownership-(Pakistan)

-- private sector distribution of contraceptives-(Pakistan, Nepal)

-- divestiture of public companies-(Pakistan, Nepal)

-- private sector marketing of agriculture produce and/or inputs-(Senegal, Pakistan, Mali, Zambia, Guyana)

IV. Conclusions

The record reflects considerable policy dialogue, in varied political and economic environments, involving different styles and modalities to suit local circumstances, and a fair degree of success, including cases of substantial policy change. The dramatic cases are those where a government undertook a major reversal away from a previous "socialist" strategy. The less dramatic, e.g. the absence of highly visible strategy dialogue in major LDCs such as Thailand or Indonesia, does not reflect less AID intent or interest in the role of the private sector. Often the country's development strategy already contains market-oriented, private sector components and the issues are more subtle, perhaps more technical and administrative, and best shaped for dialogue through the policy-project approach.

At the same time, there are numerous countries, especially in Africa, where development is being hampered seriously by state intervention, inefficient parastatal monopolies, and the absence of encouragement or outright negative attitude of government toward the private sector. In many instances AID does not appear to have achieved much in the way of policy change. This review has not attempted to make the connection between the need for policy reform and where AID has expended most of its policy reform efforts. It is clear, however, that a number of countries receiving substantial AID funding have also been assisted to shift toward and/or strengthen the role of their private sectors. While the pursuit of an economic philosophy with fundamental similarities to that of the U.S. does not guarantee a country will consistently pursue a foreign policy of positive relations with the U.S., it is much more likely to create the basis for such a predisposition than adherence to an economic strategy suspicious or hostile to the private sector.

One does find an important example (Egypt) where a large assistance program involving several modalities has not been sufficient to significantly affect policy. While the basic orientation of Egypt is favorable to private enterprise, the Government reflecting the legacy of socialism tends to overregulate and overcontrol the economy. Nor does there appear to be cases where AID has had major policy dialogue with only a minor-sized U.S. aid program, apart from the role AID may have played as part of a consortium. The spectrum of countries and policy-dialogue situations tends to result in the following, not surprising mix: In countries where the U.S. has relatively minor interests and involvement, the U.S. relies on the multilateral development banks to take the lead in policy dialogue; in countries of somewhat greater interest the U.S. takes a leading role in the consortium; and where there is great U.S. Government interest AID often independently conducts policy dialogue. Depending on the politics of each case, the skills the U.S. is able to bring to bear, and the roles of other multilateral and bilateral donors, the potential nature and style of the policy dialogue varies. The substantial resources and analytic capabilities of the international financial institutions, the varying interest and influence (where coordinated) of other donors in different countries, all greatly augment the AID bilateral policy dialogue capabilties and influence.

Generally speaking, it is clearly important to have a range of direct and indirect policy dialogue routes. One reason is that in some instances potential or incipient independent private sector dialogue may be curtailed because of a U.S. political/diplomatic judgment that dialogue would have short term adverse effects. AID has apparently encountered many different forms of this situation. In one case the whole subject was deemed too sensitive for a "forward" position beyond low-key concurrence with IBRD. In another, the specifics were judged too political for AID involvement beyond informal conversation. In another, AID was able to press on very sensitive policy issues, pertinent to general import/financing despite some Washington held views that political relationships might be upset. This was because the Ambassador saw the situation differently, and felt the economic issues at stake were worth the short-run risks. In other cases, the combination of strong LDC government suspicion of the private sector and high U.S. political interest (particularly in conjunction with a small AID program), led to the conclusion that private sector policy dialogue was neither in the U.S. interest nor likely to succeed.

Further thought needs to be given in terms of how AID and State could optimize the decision-process. One area is where the medium term development impact potential is positive but balanced against possible short-run irritation or negative effects in the diplomatic climate or general political/security relationships.

Under what circumstances has AID been able to bring about major policy change affecting the private sector?

In general, the amount and form of the AID program appears closely related to AID's ability to get a hearing and be taken seriously by government policy-makers. Also, while a substantial program among the group of donors is not a sufficient condition to guarantee such dialogue efforts bearing fruit, it does appear to be a necessary condition. The ability to affect policy (or "leverage", where the initial disagreements are strong), however, does not automatically flow from having a large program.

It is striking that in the cases described above (where we were looking only at private sector policy dialogue) a key characteristic of AID's earlier experiences is repeated, namely that both donor and recipient accept the suitability of dialogue (or tough negotiation) on a range of subjects that appear connected with the form in which the aid was being provided. The modalities and the project content play an imporant role in determining what can be raised for dialogue without surprise on either side, with size being a separate dimension. (We are not dealing here with resentment some countries express over the substance of the conditions being negotiated, or over the power relations reflected in the position in which they find themselves, or the rigidity or heavy-handedness they perceive on the donor side and the distinctions normally accepted without protest as to what kinds of subjects are on the table depending on what kinds of money is on the table.)

The amount of the resources AID provides, relevant to the problems being addressed, is a kind of "necessary" condition to establish U.S. seriousness about the issues we want to discuss. What level of assistance adds up to "seriousness" in any case is a matter of perception by both parties, and cannot be quantified as a generality. With regard to form, it is important to note the lesson of the Kenyan experience in 1983 whereby the economic value of the program assistance (and hence usefulness of the funds to the Kenyan economic authorities) was significantly enhanced by the early timing and quick-disbursing character of the grant. Where AID is in a position to provide funds in a manner that gives the monetary authorities the foreign exchange liquidity needed to meet immediate needs, especially related to adherence to IMF conditions under a time-table, such funds have a "value" greater than their mere size. In short, form and timing are important attributes of aid in addition to amount, and properly brought into play, can enhance AID's dialogue credentials and chances of reaching mutually acceptable understandings.

The personal contacts and confidence that a resident AID Mission can build up offer AID important opportunities for policy dialogue. It is necessary to have something useful to say; the presence of policy-analysis staff and the use of expert and well-known consultants are key factors.

In many instances the general drift of government policy is a key factor. The most significant achievements cited above were in countries where the government was in transition, and where AID was able to quickly help define new main lines of private sector policy, or speed adoption of specific approaches the new government was willing to accept assistance to bring about. In some instances, AID found itself able to help effect more rapid policy change by strengthening the hand of the finance or planning authorities in internal debate within the government, with other reluctant ministries, as to the pace and nature of the change involved.

The 1980s appear to be a period in which many LDCs are swinging back from the socialist or state capitalism policy preferences of the 1960s and 1970s, to more market-oriented philosophies. AID's negotiating style, as reflected in the documentation reviewed, is very suitable for the 1980s, more than the 1960s and 1970s. For example, present approaches do not heighten intergovernmental tension by explicitly and frequently (sometimes quarterly) requiring the LDC government to appear at bilateral, formal reviews to be interrogated about performance "targets" and aid doled out in "tranches" (or withheld). The question of opportunity and right circumstances is more likely now to hinge on program content, whether it leads "naturally" to acceptable policy exchange, and whether the staff on the ground have the credentials and skill to conduct "development diplomacy".

Dialogue at What Levels?

In many if not most AID countries, decision-making is very centralized; cabinet-level decisions are often required for matters that strike Americans as not important enough to warrant the personal attention of the head of state. As some of the examples indicate, however, it does not follow that the most effective approach for policy dialogue is "top-down", assuming agreement on a policy change with the most senior ministerial levels assures implementation. Aspects of experiences in Bangladesh, Pakistan and Kenya illustrate that agreement at the top, even if embodied in formal understandings, can readily be followed by delay in implementation, or even continuing uncertainty as to whether the understandings will in fact be adhered to. In some cases delay, or difficulty in reaching policy agreement, stems from resistance in other layers or branches of the public sector. (Much of what would be labeled "political" difficulties is found within government bureaucracy, particularly in statist systems or one-party parliamentary systems.) Successful policy dialogue needs to pursuade varied levels of government in position to interpose a veto or block effective implementation.

The converse is also true, as the Somalia case demonstrates: When lower government levels are convinced of the need for a policy change, agreement at the top can be reached quickly following major political changes. The long-run development impact in having large numbers of well-trained, Western-trained professionals in government (and commerce) is enormous.

Over What Policies?

The key policy areas respecting the role of the private sector that figure in the experiences reviewed, are: a) the basic governmental public/private sector orientation; b) extent of government intervention in agricultural marketing; c) parastatal competition or monopoly; d) import and foreign exchange licensing and allocation; e) protectionist import substitution vs. export orientation; f) credit and interest rates; g) government-private sector dialoque processes.

AID's ability to move an LDC government away from a fundamental statist or collectivist strategic preference is very limited. The domestic political roots (with or without a foreign policy overlay) are often too deep for any reorientation simply because external resources may be made available. Nonetheless, demonstration of private sector approaches may be possible even where the economic philosophy is extreme, as in Burma with AID's involvement in oil seeds marketing. In this case a parastatal monopoly is being reduced to make room for marketing by cooperatives. (This is a modest step, but if successful, in Burmese policy terms it could lead to further relaxation of the extreme centralism of economic activity.)

In most cases AID cannot apply resources sufficient to be the leading interlocutor on major macroeconomic framework issues that affect the private sector in powerful ways (e.g. foreign exchange rates, trade regimes). These issues are better left to the World Bank and IMF for leadership, as has been the case in the situations examined. (U.S. support of IBRD/IMF is important.) AID's greatest prospective for semi-independent effective policy dialogue appears to be when AID aligns itself with financing in support of a significant policy shift, and, where the framework defining the dialogue between the LDC government and IBRD/IMF leaves significant policy areas still to be worked out, or to be defined operationally. The policy agenda is set through the combination of AID's having a significant seat at the consortium table and AID choosing the specific items to carry further.

A basic observation can be made with respect to the kinds of private enterprises, and therefore the kinds of issues AID deals with. In most African countries agriculture is the largest sector of economic activity, and the private sector is comprised mainly of firms or self-employed entrepreneurs which deal in agricultural marketing, small-scale transport, and small- or medium-scale manufacturing for the small urban market. The so-called non-formal, private sector is also a major element of the private economy. Thus, marketing, pricing and credit policies are most important and most frequent among the subjects AID discusses in these economies. In Latin American and Asian countries where the manufacturing sector is more developed, and where transition from import substitution to export orientation is the main dialogue framework, the most important issues for AID are those concerning import and exchange policies, parastatals, as well as the institutional basis and processes for LDC government-private sector dialogue.

At the statist end of the spectrum, there is a basic distinction between countries embarked on "socialist" development because of its relationship to political processes and objectives, and those countries relying on State initiative because of the weakness of the domestic private sector and the absence of an indigenous tradition of commercial entrepreneurship. Among the latter set of countries, and in a small number of cases among the former, there has been a significant shift in recent years towards greater pragmatism and encouragement of private expansion. This has been due to the recognition that state enterprise performance has been disappointing, which has been focused on by external aid agencies and the IMF.

Once a government is prepared to shift away from extensive government operations and intervention, the policy changes required are often easy to identify. Greater reliance on the private sector parallels movement toward greater economic efficiency in resource allocation and enterprise management, and in the substitution of market forces for government economic management.

At the other end of the spectrum, in the numerous cases where there is reliance on the private sector but the alliance of political and economic interests has resulted in systems highly distorted and non-competitive (if not corrupt), policy reform has a different character. Reliance on private ownership and operation of commercial and industrial enterprises, and the development of systems of political freedom and democratic power-decentralization with enduring natural association with the "Western" democracies, are undermined in such situations, posing both political and developmental problems.

In conclusion, while AID has most of the elements of comprehensive policy dialogue guidance, it has not drawn them together in a concise "how-to" hardbook. It would be hard to do because, as the AID policy paper on "Policy Dialogue" (ref. 8) points out, it would be artificial to try to write a cookbook applicable to every set of ingredients, because no dialogue takes place unless two parties disagree on something at the start. In the long run what is most important is that the country reaches a position where it has the institutional capacity to undertake its own policy analysis, and sustain processes through which the private sector and government maintain regular domestic dialogue for an airing of their different perspectives and interests, hopefully in a climate conducive to outcomes that promote development rather than mere confrontation.

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