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POLICY REFORM IN DEVELOPING COUNTRIES

The Influence of Bilateral Donors

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CHAPTER ONE

THE RELEVANCE OF THE TOPIC

It is now widely recognized that distorted policy frameworks that were undesirable in the 1960's and 1970's are unsustainable in the 1980's and beyond... Domestic policy reform for most developing countries has now become essential and urgent if these countries are to be able to maintain a reasonable rate of growth of incomes and to achieve their other development objectives of human resource development and the provision for basic needs.¹

The belief that policy reform has become a necessary prerequisite for development is increasingly echoed in development literature. According to Grindle and Thomas, the development message of the 1980's for a large number of developing countries is that little can be done to enhance growth and welfare unless significant policy and institutional changes are undertaken and sustained.²

Based on this belief, specific action has taken place in the donor community. Official development finance has become much more closely bound up with adjustment and policy reform.³ The aid agencies have undertaken their own adjustment measures which will enable them to play increasingly important roles. The World Bank began Structural Adjustment Lending in 1980, and the International Monetary Fund (IMF) created its Structural Adjustment Facility in 1986. The bilateral donors have adjusted their portfolios in favor of quick-disbursing forms of assistance and have tended to concentrate their assistance in countries undertaking structural adjustment programs.⁴

Structural adjustment assistance at the bilateral level is a

relatively new concept. The World Bank and IMF are recognized as having particular authority and expertise in the area, and most structural adjustment assistance has tended to be on a multi-lateral basis. But the United States established itself early as a bilateral donor interested in structural adjustment and policy reform issues. As early as the mid-1970's, the Agency for International Development (AID) called attention to recipient country policies in the Sahel which were inhibiting long-term economic growth. Also, AID introduced an array of measures in the early 1980's including instituting economic policy discussions between AID Missions and host governments, placing a greater emphasis on making assistance conditional on policy reform, phasing disbursements, and designing programs that would directly assist the private sector in developing countries.⁵

Other bilateral donors are becoming increasingly involved in developing country structural adjustment and policy reform. The World Bank is currently investigating how bilateral donors might be associated with policy-based lending, and most Development Assistance Committee Members have stated that the promotion and support of policy reform and structural adjustment are among their major aid priorities.⁶ As compared with 1986, there has been a policy shift among the bilateral donors in favor of providing more quick-disbursing help and the resolve has been deepened to avoid financing lower-priority projects.⁷

Even though it is commonly agreed that the multilateral agencies are the primary actors in the structural adjustment and

policy reform arena, the bilateral donors have begun acquiring a role of their own. This role acquisition is based on encouragement from the multilaterals as well as the bilaterals' desire to make their development aid more effective.

The United States, the largest aid donor by volume, began the movement toward bilateral involvement in structural adjustment and policy reform in the 1970's and 1980's, and its experience is well documented. But there are other important bilateral donors in terms of volume, ODA/GNP ratios, influence, and expertise. The role that these other bilateral donors will play in encouraging structural adjustment and policy reform must be examined for a number of reasons.

First, structural adjustment and policy reform have been receiving increasing attention. Thus, for bilateral donors to be involved in one of the priority areas of development, they must be involved in structural adjustment and policy reform. Second, even in the event that adjustment and reform measures are achieved and sustained, it is likely that emphasis on them will continue. This suggests that bilateral donors must begin to acquire the knowledge and expertise in this area through involvement because the issues of structural adjustment and policy reform will continue to receive attention. Third, just as effective aid to the developing countries requires donor coordination, so does effective structural adjustment and policy reform assistance. In this regard, an examination of bilateral donor policies toward structural adjustment and policy reform can

serve the purpose of working toward greater donor coordination which would benefit developing countries. And finally, there appears to be a clear role for bilateral donors in developing country structural adjustment and policy reform.

SELECTION OF DONOR CASE STUDIES

The case study countries are the United Kingdom, the Federal Republic of Germany (Germany), the Netherlands, France, Sweden and Japan. All are members of the Organization of Economic Cooperation and Development (OECD) and of the Development Assistance Committee (DAC) which is the development branch of the OECD.

The countries were chosen based on volume of Official Development Assistance (ODA) and ODA as a percentage of GNP. Table 1 lists the OECD countries in descending order according to aid volume and ODA/GNP averaged over the period from 1965 to 1986.

France, Japan, Germany and the United Kingdom are second through fifth behind the United States in ODA volume. Although in volume, Canada is higher than the Netherlands, and Italy is higher than Sweden, both the Netherlands and Sweden rank much higher than Canada and Italy in ODA/GNP.

TABLE 1

#	COUNTRY	VOLUME (mil US \$)	#	COUNTRY	ODA/GNP
1	UNITED STATES	6843.8	1	THE NETHERLANDS	.87
2	FRANCE	3292.3	2	NORWAY	.82
3	JAPAN	2886.2	3	SWEDEN	.74
4	GERMANY	2542.3	4	FRANCE	.72
5	UNITED KINGDOM	1408.8	5	DENMARK	.66
6	CANADA	1115.9	6	BELGIUM	.55
7	THE NETHERLANDS	1082.3	7	AUSTRALIA	.51
8	ITALY	803.7	8	GERMANY (TIE)	.43
9	SWEDEN	705.2	8	CANADA (TIE)	.43
10	AUSTRALIA	614.8	9	UNITED KINGDOM	.38
11	NORWAY	424.0	10	UNITED STATES	.29
12	BELGIUM	417.0	11	JAPAN	.28
13	DENMARK	355.5	12	NEW ZEALAND	.27
14	SWITZERLAND	222.6	13	FINLAND	.26
15	AUSTRIA	151.8	14	AUSTRIA	.25
16	FINLAND	130.2	15	SWITZERLAND	.24
17	NEW ZEALAND	52.1	16	ITALY	.22
18	IRELAND	28.2	17	IRELAND	.16

(SOURCE: World Development Report, 1987)

PAPER FORMAT

Chapter Two presents the definitions and bilateral instruments used in structural adjustment and policy reform. In addition, a discussion of donor coordination, multilaterals and sustainability is included. The main purpose of this section is to make the reader aware of the terms and issues that are relevant to an examination of bilateral influence in adjustment and policy reform.

Chapter Three is a presentation of the case study countries which includes their policies toward structural adjustment and policy reform and the instruments they use to implement those policies in the developing countries. A summary of bilateral trends based on the case studies is also included.

Chapter Four outlines out a potential future role for bilateral donors in developing country structural adjustment and policy reform.

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3. Development Assistance Committee, Development Cooperation 1987, (Paris: OECD, 1987), p. 75.

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CHAPTER TWO

DEFINITIONS Policy Reform

Policy reform is directed at certain harmful features of developing country policy which are seen to inhibit development.

Policy reforms are typically directed to:

- inefficient parastatals and government purchasing agencies offering disincentive prices and tax and exchange rate levels which distort production and investment decisions,

- trade regimes which go far beyond infant industry protection and preserve uncompetitive industries at home and even harm exports by excessive curbs on imports,

- the lack of encouragement to beneficial private, foreign investment,

- investment licensing which throttles the expansion of domestic enterprise and

- the domination of production by state intervention and controls.¹

Haggblade, Liedholm and Mead discuss distortions in the factor and product markets which result from developing country policies, and some examples of specific distortions follow.

In the domestic capital market, distortions may result from artificially low interest rates whether they are explicitly or implicitly imposed. Excess demand results from the low interest rates, and banks and other formal sector financial institutions have generally given priority to their large-scale clients for the scarce funds. According to the authors, relative to the

cost of capital in integrated and distortion-free capital markets, the actual cost of capital to large firms is unduly low.²

Distortions also result from the tariff structure and the operation of the foreign exchange market. The import duty structure can introduce distortions in two ways. First, many capital and intermediate inputs used by small non-farm enterprises are classified as consumer goods. The small firms end up paying a relatively higher duty on these inputs because most countries place higher duties on consumer goods than on intermediate and capital goods. Second, in many developing countries, large-scale enterprises are granted concessions that small firms are either unaware of or unable to undertake the lengthy bureaucratic procedures required to obtain them.³

Other distortions result from policies in the product market. Considerable evidence exists to support the view that developing country policies have tended to be biased against agriculture in favor of industrial activities. Industrial and other non-agricultural products in these countries are protected by relatively high tariffs while agricultural products generally are not. Thus, the protection acts like a tax on agriculture which raises the price of industrial products in relation to agricultural goods in the domestic market.⁴

These are a few examples of the distortions that may result from developing country policy, and they provide an indication of the type of distortion to which policy reform is typically

directed.

DEFINITIONS Structural Adjustment

Feinberg has defined adjustment* as the dual process of stabilization and liberalization. Stabilization refers to bringing expenditures in line with available resources, and liberalization refers to freeing prices to reflect international cost structures.⁵

The following is Killick's definition of adjustment:

Adjustment is the gradual, non-temporary response of the economy to the existence of an unviable balance of payments deficit, involving the reallocation of resources between sectors, between factors and between categories of expenditure (including savings). Such reallocation may occur automatically in response to changing monetary conditions and price relativities but governments will often judge it necessary to reinforce any automatic tendencies with the introduction of discretionary policy changes.⁶

According to Streeten, there are three main objectives for structural adjustment: 1) the reduction or elimination of a balance of payments deficit, 2) the resumption of higher rates of economic growth and 3) the achievement of structural changes that would prevent future payments and stabilization problems. The overall objective is to make the economy less vulnerable to future shocks by increasing its flexibility and adaptability.⁷

*According to the ODC, the terms adjustment and structural adjustment are interchangeable even though the latter may imply more profound change.

Typical structural adjustment programs include the restructuring of incentives (prices, tariffs, taxes, subsidies, interest rates), the revision of public investment priorities, improvement in budget and debt management and 4) the strengthening of institutions.⁸

The World Bank has recently noted that some twenty-five countries in Sub-Saharan Africa, accounting for a large portion of Africa's population and GDP, are implementing major programs of structural adjustment or are close to initiating programs.⁹

INSTRUMENTS Policy Dialogue

Policy dialogue describes the exchange between aid donors and recipients about the domestic policy framework, the outcome of aid transfers and the behavior of the economy as a whole.¹⁰

It seems clear that policy dialogue will continue to be a central feature of aid as donors attempt to make their aid effective and as recipients attempt to have a greater voice in the aid process. According to Cassen, there are at least three keys for successful policy dialogue: 1) the availability of adequate resources to sustain adjustment programs, 2) the analytical and negotiating capacities of recipients and 3) the ability of donors to comprehend local circumstances and respond flexibly to changes in the assumptions or forecasts upon which programs are based.¹¹

Cassen further suggests that dialogue is most effective where aid is in any case most effective and when the donor can

persuade the recipient to continue on a path on which the recipient already chooses to go. A more radical approach in policy dialogue which challenges prevailing vested interests or political conventions can only be implemented when the recipient's need for aid is overwhelming.

INSTRUMENTS Conditionality

Conditionality (also leveraging) refers to the conditions, generally relating to macro-economic policies, which developing countries have to meet to qualify for international loans. On a continuum of interventionist's instruments for adjustment and policy reform, conditionality and policy dialogue are at opposite ends. Initially, the term was used to describe the conditions associated with the IMF even though conditionality preceded the existence of the fund. Currently, conditionality applies to conditions associated with other international loans including those from the Bank and from certain bilateral donors.¹²

Conditionality is a controversial practice as evidenced by the extensive literature on the topic and the diversity of opinion regarding its efficacy and legitimacy. Some of these opinions follow.

Various authors have written on whether conditions imposed from outside are effective. Cassen and associates believe that such impositions may help a country whose leaders are inhibited by domestic vested interest. Conditionality imposed from outside might also serve to provide the leaders with a scapegoat if the

reforms are not successful.¹³

Berg and Batchelder, however, believe that the key to policy change lies in changing the minds of developing country leaders. To support this belief, they make three statements: 1) People generally do not change their minds on the basis of an argument based on generalities or ideologically derived positions, 2) Minds are most likely to be changed if the relevant decision-makers understand - preferably participate in - the analysis which leads to a specific conclusion and 3) A process whereby policy changes are dictated from the outside and accepted only in order to receive an associated credit seems unlikely to lead to the rethinking necessary for sustainable policy change.¹⁴

Haggblade, et al, suggest that donor efforts to influence stabilization policies, such as exchange rates, trade controls, interest rates, government spending and overall credit allocations, are easier to condition than are policies or programs. This is the case because development issues often require institutional change rather than simple manipulation of policy levers. In addition, stabilization policies are often faster acting than efforts to promote broad-based development and stabilization policies lend themselves to more monitoring.¹⁵

In his work on structural adjustment, Streeten suggests that there is a paradox in conditionality. Namely, if the conditions are truly in the interest of the recipient country, why are they not pursued by recipient policymakers without conditionality?

In answer, Streeten suggests several possible explanations:

-Policymakers may be ignorant of causal relationships and in need of instruction,

-Their forecasts, objectives, weight given to objectives, ideology and/or causal analysis between levers and results may differ from donors,

-Policymakers may wish to put blame for unpleasant or unpopular measures on the foreign agency, even if they know they have to adopt the policy anyway and

-The risk aversion in adopting policies may be different for the two sides.¹⁶

Haggblade, et al, make four suggestions for effective leveraging: 1) Any conditions should be kept few in number, 2) Threats must be made credible by a willingness to withhold aid if conditions are not met, 3) The recipient must have potential administrative capacity and 4) There must be a significant aid program in the recipient country.¹⁷

INSTRUMENTS Financial Assistance

On a general level, the role of aid serves to cushion the often severe negative effects resulting from the contraction which takes place in the adjustment process. Specifically, aid contributes to debt-service payments and raises import levels to maintain consumption and investment levels higher than would have been possible without the aid.¹⁸

The OECD suggests that there is a dual aspect of adjustment assistance. The first is the total net financial resource requirements of developing countries carrying out policy reform or adjustment efforts. And the second aspect is the need of

assistance specifically designed to encourage and help developing countries carry out reform packages and adjustment programs negotiated with the World Bank and IMF. The first aspect of adjustment assistance consists of the type that softens the impact of adjustment while the second aspect of assistance would normally consist of quickly-disbursable non-project assistance.¹⁹ A third type which tends to resemble the second aspect of assistance is the bilateral structural adjustment loan. Currently, France is the only bilateral donor to use structural adjustment loans, so a more detailed discussion of them will be included in the case study on France.

The role of bilateral aid in softening the impact of adjustment and reform measures has received increasing attention. It has been acknowledged that reforms without financial support cannot go far in restoring growth because there are limits to how much consumption can be cut without endangering social and political stability.²⁰ Development aid is essential if there is to be progress on meeting human needs. One type of this aid is food aid which is considered to be a major asset in helping developing countries to sustain adjustment steps by easing the transition to non-regulated food pricing.²¹

According to Development Cooperation 1986, in Sub-Saharan Africa, higher volumes of ODA on concessional terms will be needed by those countries undertaking reform programs. This aid must be the type of aid adapted to policy reform needs (the second aspect of adjustment aid). This consists of quick-

disbursing funds for the financing of import requirements or program aid.²²

This shift to program aid to encourage adjustment resulted in part from past experience with project aid. With project aid there was no framework for policy dialogue, and the projects were sometimes low-yielding or complete failures because of policy failures or the institutional environment.²³ The present and prospective economic situation facing developing countries now makes it even more urgent to intensify the implementation of efficient but low-cost and replicable socio-economic programs.²⁴

DAC reports that there continue to be instances of donor preference for project aid to the detriment of non-project assistance even in situations where aid responses to the latter are positive.²⁵ The reluctance of donors to extend substantial amounts of non-project assistance to countries with relatively weak administrations is their concern with the effective use of resources for which they are accountable to financial authorities and parliaments.²⁶

There are serious risks in the large-scale and sustained use of non-project assistance in countries with weak policy design and implementation capacities. Real safeguards must be provided to ensure that effective policy reform efforts are undertaken, and that non-project assistance is used to effectively support these policy efforts. This should lead to more productive resource use and thus eventually reduce dependence on this type of aid. Of crucial importance in developing this framework for

program aid are the development of techniques to evaluate the results of program aid and the effective monitoring of policy progress in the joint interest of donors and recipients.²⁷

Even though financial assistance is used in support of adjustment and policy reform, there remain problems with the development of a theory based on the role of aid in the adjustment process. First, the link between aid and adjustment is tenuous. Second, the changes in aggregate figures resulting from successful adjustment are likely to be due more to the increasingly efficient use of existing resources rather than to the provision of additional resources including aid.²⁸ This supports the belief that the role of aid in the adjustment process is to offset negative effects of adjustment.

In spite of debate over the most effective role of aid in adjustment and policy reform, DAC calls for continued donor support in providing aid to developing countries both to offset negative effects from adjustment and to encourage continued adjustment and policy reform.

INSTRUMENTS

Technical Assistance and Sector Assistance

While the multilateral institutions are viewed as having expertise at the macroeconomic level, the bilateral donors are commonly viewed as having expertise at the sectoral level. As a result, the transfer of technical assistance to developing countries at the sectoral level can play a vital role in encouraging adjustment and policy reform.

Increasing the analytical ability of the developing country policymakers is a non-interventionist type of involvement and may serve to help the policymakers understand the need for policy reform.²⁹ In this sense, transfer of technical assistance to increase the analytical ability of developing country policymakers is simply a more sophisticated type of policy dialogue.

On the recipient side, governments often welcome help from bilateral donors in order to gain access to donor government departments, academic institutions or consulting firms they may particularly respect. And if technical assistance is being provided by the donor, policy dialogue is likely to be more effective.³⁰

Technical assistance can be used in a number of sectors, and the most effective use of technical assistance by bilateral donors depends on the expertise of the individual donors.³¹

INSTRUMENTS Debt Forgiveness

Debt forgiveness based on structural adjustment and policy reform* is relatively new, and most of the literature is country specific. No evaluations on the impact or effectiveness of debt forgiveness programs have been completed, so their potential for encouraging adjustment and policy reform is uncertain.

*Debt payment burdens of ODA loans have been eliminated or reduced through Retroactive Terms Adjustment (RTA) based on UNCTAD Resolution 165 (S-IX). RTA has not officially been made conditional on adjustment or policy reform agreements, even though some of the bilaterals require agreements for RTA.

In general, debt forgiveness programs work in the following way: The bilateral donor agrees to forgive some or all debt of the developing country if the recipient has an agreement with the World Bank or IMF. There are variations of this scheme. For example, some donors only forgive debt service for a specific amount of time so that they can monitor the progress made by the developing country on their adjustment and policy reform path.

Debt forgiveness can be considered conditionality in the sense that certain benefits are given to the developing country if they meet specific conditions. But the donor countries which typically use conditionality in their development aid, the U.S. and France, have not yet undertaken debt forgiveness schemes while those countries which have typically opposed conditionality, the U.K., the Netherlands and Germany, have debt forgiveness plans in operation.

At the Venice meeting of the Heads of State in June 1987, certain initiatives were suggested to further ease the debt burden of the developing countries. Among those initiatives was the following: "For those poorest countries that are undertaking adjustment effort, consideration should be given to the possibility of applying lower interest rates to their existing debt, and agreement should be reached, especially in the Paris Club, on longer repayment and grace periods to ease the debt service burden."³²

More specific details about the use and operation of debt forgiveness are outlined in the case study section.

ISSUES Donor Coordination

According to Development Cooperation 1987, the need to improve development cooperation efforts has come to be seen as perhaps the most urgent issue for multi- and bilateral agencies.³³ Donor coordination, one aspect of development cooperation, is necessary to avoid giving conflicting or overlapping policy advice to developing countries. The two major instruments for donor coordination are the World Bank Consultative Groups and the United Nation's Development Program Roundtables.

The Consultative Groups (CGs) provide a confidential forum for the exchange of information, ideas and comments among aid givers and receivers permitting a common assessment to be made of relative needs and performance. Increasingly, especially in Sub-Saharan Africa, they have become built around policy dialogue in connection with structural adjustment and other broad policy-oriented lending. The World Bank has become more selective in deciding on the establishment of CGs, and the current criteria is the willingness on the part of a recipient government to discuss its economic and financial policies and investment programs with donors, to consider policy adjustments towards enhancing efficiency in the use of scarce resources and the readiness on the part of the donor and recipient alike to attach the required priority to the strengthening of national economic management.³⁴

The Roundtables underwent major changes in 1985 which resulted in an approach similar to those of the CGs. Participa-

tion in the Roundtables is restricted to principle donors. The first meeting of the participants (including recipient) takes place outside of the recipient country, preferably in Geneva. This meeting is considered the first step in policy dialogue between participants on macro-economic and sectoral development policies. It should result in policy commitments on the part of the recipient government as well as commitments by the donor. Sectoral and special program consultations are also conducted with the development partners concerned.³⁵

Despite the general success of CGs and Roundtables, obstacles to effective coordination remain. The obstacles most frequently reported are: 1) preference of recipient governments to deal with donors on an individual basis in the hope of increasing the volume of aid, 2) the absence in recipient governments of the strong, central administrative capacity needed to manage internal coordination and arrangements with the donor community effectively, 3) disagreements among donors regarding the most appropriate sectoral approaches, 4) priorities and policies and 5) competition among donors due to varying commercial and political interest.³⁶

ISSUES Multilaterals

Given the extensive role of the multilateral institutions in adjustment and policy reform, a detailed examination of them is beyond the scope of this paper. The purpose of this section is to present an overview of the multilaterals in an effort to

better understand the current and potential roles of bilateral donors.

The World Bank and IMF have by vocation and circumstance played the lead role in assisting developing countries in financial crisis to implement comprehensive growth-oriented adjustment programs.³⁷

In 1987, 23% of the World Bank's lending was policy-based. The main instruments for such lending are the Sectoral Adjustment Loans which promote sector policies to sustain economic growth, and Structural Adjustment Loans which promote macroeconomic policies and associated institutional changes.³⁸

The IMF's main instrument for policy-based lending is the Structural Adjustment Facility which was tripled in December of 1987 to \$9 billion.³⁹ The main purpose of IMF lending is to redress external imbalances of low-income countries by supporting programs of macro-economic and structural adjustment and reform leading to the recovery of economic growth. The programs are based on medium-term Policy Framework Papers (PFPs) which are formulated by the recipient in collaboration with the IMF and World Bank. The PFPs set forth the policy priorities and objectives together with measures for structural adjustment and policy reform for a three-year period. A more detailed description of the reforms and policies to be implemented in the first year is also included.⁴⁰

Although the World Bank lends a smaller percentage of policy-based funds than the IMF, its conditionality is much more

pervasive and intrusive than the IMF and is sustained over a longer period of time. According to Loxley, the objective of the World Bank is nothing less than the wholesale revamping of the regime of accumulation in debtor countries, altering in a fundamental way the strategy and method of operations of economic institutions, the distribution of income and the balance of class power. As a result, only ten Sub-Saharan African countries qualified for World Bank Structural Adjustment loans by 1985. Realizing that it was trying to achieve "too much too soon", the Bank has begun to rely more on sector adjustment programs which are not necessarily tied to prior agreements with the IMF and do not involve comprehensive economic reform.⁴¹

Recent changes at the multilateral institutions have resulted in response to pressure by donors and recipients alike. One of the major criticisms of the multilateral institutions has been their insistence on more austerity measures in response to new problems. Recipient countries who have highly vulnerable economies are often severely affected by small changes in external conditions which are beyond their control.⁴² The IMF is currently considering a proposal for the creation of a Compensatory and Contingency Financing Facility lending up to 105% of member country quota for export shortfalls and other external contingency triggering events. This proposal has a near 100% certainty of adoption.⁴³

ISSUES Sustainability

The 1987 issue of Development Cooperation, states that the challenge for the developing countries and the donor community is to support the deepening of the adjustment process on a sustained basis after the most obvious reforms have been implemented. To that end, "internationalization" of the adjustment and policy reform process is required so that recipients view the programs as their own, bilateral input into program design will increase, bilateral resources to recipient will be enhanced and recipient's analytical capacity will be improved.⁴⁴

Joan Nelson writes that the odds that a stabilization effort will be abandoned or seriously diluted before completion are directly affected by the strength of commitment to the program on the part of the country's leadership, the government's ability to implement the program and manage policy responses and the political response that the program evokes from influential groups. The conclusion that political as well as economic factors must be considered in the adjustment process carries implications for the level and content of external support. According to Nelson a range of instruments, such as non-project bridging assistance, project finance and technical assistance are needed to encourage sustainability.⁴⁵

Grindle and Thomas have suggested three hypotheses about the relationship between the adjustment and policy reform implementa-

tion process and the determinants of sustainability:

-When self-implementing policy reforms are undertaken, their sustainability tends to be determined by the degree of consensus among policymakers about the wisdom of the reform and the reactions of opposition after the initiative is carried out. Sustainability is significantly affected by the stability of the regime in power and the power of its opponents.

-When non-self-implementing policy reforms are undertaken, their sustainability tends to be determined by the reactions of opponents to the change and the compliance and responsiveness of bureaucratic actors charged with carrying out the reform. Sustainability is significantly affected by the nature of bureaucratic politics and the way in which political interests penetrate the administrative apparatus.

-When organizational reforms are undertaken, their sustainability tends to be significantly determined by the reaction of bureaucratic actors and units. The implementation of organizational reforms is largely determined by the nature of bureaucratic politics within the affected organization and the extent of political support for change.⁴⁶

The political dimension of adjustment and policy reform must be considered for effective programs of adjustment. It is often argued that international organizations and bilateral donors should not become involved in the political dimensions of the programs they assist. Nelson believes that there are sound moral and practical reasons to support this argument, but that in the case of stabilization, it is both illogical and impractical. Attempts by international organizations and bilateral donors to anticipate political and administrative obstacles and to design programs to cope with them are more likely to be constructive and practical than interventionist.⁴⁷

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CHAPTER THREE

CASE STUDIES

The case studies will be presented individually in the following form: 1) A general explanation of the policy of the donor with regard to adjustment and policy reform and 2) A discussion of the instruments used by the donor to encourage adjustment and policy reform. Table 2 provides a summary of the instruments used by each donor in encouraging adjustment and policy reform.

TABLE 2

	<u>UK</u>	<u>GERMANY</u>	<u>NETHERLANDS</u>	<u>FRANCE</u>	<u>SWEDEN</u>	<u>JAPAN</u>
DIALOGUE	X	X	X	X	X	
CONDITIONALITY	X	X	X	X	X	
FINANCIAL ASSISTANCE	X	X	X	X	X	X*
TECHNICAL SECTORAL ASSISTANCE	X	X	X	X	X	
DEBT FORGIVENESS	X	X	X			
STRUCTURAL ADJUSTMENT LOANS				X		

*Japan has recently announced plans to provide non-project grants for adjustment in Sub-Saharan Africa, but this is the first assistance of this kind from Japan.

UNITED KINGDOM Policy

The general policy of the United Kingdom has been one of support for adjustment and policy reform. Aspects of adjustment are evident in almost every form of British aid and assistance to the developing countries, and a clear preference has been accorded to those countries who either have agreements with the IMF or are in the process of developing an agreement with the IMF.

Instruments

The conditionality use by the U.K. is based upon the recipient country's agreement with the IMF or World Bank on a program of structural adjustment. The conditionality is evident in the U.K.'s priority for aid, technical and sectoral assistance and debt forgiveness to those countries with an IMF/Bank agreement. The U.K. does not require that the recipient meet other conditions imposed by the U.K.

The British use policy dialogue, especially at the sectoral level, to improve the effectiveness of transfers of aid and technical and sectoral assistance. Policy dialogue is used with all of the other instruments as well. For example during the initial stages of a planned transfer of assistance, consultants discuss the proposed program with the recipient government in great detail.¹

The British have long used program aid to assist countries with balance of payments difficulties which are in need of

quick-disbursing funds to finance imports. This program aid is extended to those countries which have adopted appropriate stabilization and adjustment measures (IMF/Bank agreement). It is unusual for program aid to be committed for multi-year periods because of the importance Britain attaches to continued adherence to IMF programs. But where there is a continuing balance of payments need, and where stabilization policies are being followed, Britain is prepared to provide repeated tranches of program aid.²

It is now a principle of British aid policy that with limited aid resources, priority for commodity aid should be accorded to countries committed to adjustment programs. Commodity assistance in support of structural adjustment programs was provided to Gambia, Malawi, Ghana, Somalia, Tanzania and Zambia, and a further extension of this type of assistance is seen for Mozambique and Uganda which have reached an agreement with the IMF.³

In the longer term, Britain's policy is to focus increasing attention on specific sectors and institutions, such as parastatals and/or research and educational establishments, by combining financial assistance and technical cooperation to encourage institutional and policy reforms. In the past, British sectoral aid has been centered on agriculture, rural development and food production. Technical cooperation in these areas is used to promote and assist structural adjustment and reform in the sectors.⁴

In addition, Great Britain is willing to forgive developing country debt conditional upon IMF/Bank structural adjustment agreements. This forgiveness is based upon the UNCTAD Retroactive Terms Adjustment policy of 1978.⁵

GERMANY Policy

Like Great Britain, Germany is a strong advocate of adjustment and policy reform. Also like Britain, this support of adjustment and policy reform is evidenced in the German preference for giving aid and assistance to those developing countries which have structural adjustment agreements with the IMF/Bank.

Instruments

Policy dialogue is used by Germany to strengthen the effectiveness of its aid transfers, and Germany participates in the CGs and Roundtables with the recipient developing countries. Germany also uses policy dialogue in its sector aid to determine, with the recipient, which sectors should receive assistance.

Germany uses conditionality in much the same way that Britain uses it: to determine priority for aid and assistance. Beyond that, Germany applies no individual conditions to transfers.

In addition to policy dialogue, Germany provides support to developing countries who have IMF/Bank agreements in the form of maintenance and rehabilitation assistance, technical assistance for institution building, sector aid and general commodity

assistance.⁶

In 1987, the German government introduced a new instrument to strengthen its capacity for providing quickly-disbursable commodity aid to low-income countries which have IMF/Bank agreements. The structural aid from this facility will be used to support reform measure in a specific sector (sectoral adjustment program) or in the economy as a whole (structural adjustment program). Generally, this aid is provided in connection with corresponding Bank programs in the form of co-financing. In 1988, Germany plans to extend one-third more general commodity and structural aid than in 1987.⁷

Germany believes that the traditional single-project approach often does not contribute significantly to solving pressing development problems, many of which result from structural weaknesses. Germany's response to this has been to give priority to the use of funds for maintaining and upgrading existing capacities over financing new projects.⁸

The German government extends technical assistance by providing an increasing number of government advisors for development and economic planning in the recipient country. There is a strong emphasis in all technical cooperation on the establishment and expansion of institutions, and Germany believes this promotes adjustment.⁹ In addition, Germany has concentrated its technical assistance on the agriculture and rural development sectors.¹⁰

In June of 1988, Germany announced an initiative to forgive

2.2 mil. DM of developing country debt providing that the recipient has an adjustment agreement with the IMF or World Bank. According to Germany, this adjustment agreement indicates that the country is going in the right direction.¹¹

THE NETHERLANDS Policy

The Netherlands government is continuing its longstanding development cooperation policy which is aimed at combatting poverty structurally. The main difference between the Dutch policy and that of the other donors is that while the other donors tend to concentrate their aid on the most needy of the developing countries, the entire Dutch aid program revolves around extending aid to certain program countries.¹²

Instruments

The Dutch government uses conditionality like the U.K. and Germany in deciding which countries will receive priority in assistance and uses policy dialogue to increase the effectiveness of aid transfers.

The Netherlands has extended increasing amounts of flexible forms of assistance such as balance of payments support. Since 1984, balance of payments support has come from a special budget category for "macroeconomic emergency assistance". This support is mainly extended in the form of commodity grant assistance, but in 1985, included balance of payments stabilization loans as well.¹³ Funds provided through this program have increased significantly. In 1986, such funds were concentrated on Sub-

Saharan Africa and countries willing or prepared to adopt restructuring policies. A total of \$100 mil. was made available in 1986; this represents 10% of Dutch bilateral aid.¹⁴

Sector aid from the Netherlands is extended according to a special sector program designed in 1985. There is considerable flexibility in the way this money can be used, and it is extended to the program countries as well as twenty other countries specifically designated to receive such aid. This aid constitutes an addition to the regular country program aid and can be used as an incentive to the recipient to undertake needed actions or reforms.¹⁵ In addition, sector experts have been appointed to embassy staffs to advise on the implementation of sector policies and to facilitate the research in support of policymaking.¹⁶

The Netherlands has agreed to debt service relief for countries which have agreements with the IMF or World Bank. Thus far, Egypt, Kenya, Zambia and Mozambique have qualified. The relief will last until 1990 and can be renewed providing the countries are following appropriate adjustment policies.¹⁷

FRANCE Policy

Since the beginning of the 1980's France has undertaken, over and above their sectoral aid, to implement programs of assistance to help the economies of the developing world involved in structural adjustment. The most obvious difference between the policy of France and that of the other donors is France's

concentration of assistance in franc-zone countries. In fact, in 1987, France was urged to better adapt their aid to non-franc-zone countries and to the needs of those countries.¹⁸

Instruments

Policy dialogue has been institutionalized in the French "mixed committees" which meet every two years or more frequently if the need arises. The committees allow the donors and recipients to discuss the main features of development cooperation. According to Claus, France's African partners take "policy dialogue" to mean "policy dictate", and so formal use of the term is avoided.¹⁹

France tends to be reticent where conditionality is concerned. Specific conditions are indirectly imposed by the strong local presence of French cooperators, but when it comes to the enforcement of conditions, France is often inconsistent.²⁰

The two main instruments of financial aid in the adjustment process are budgetary subsidies for policies oriented in the direction of adjustment or reform and structural adjustment loans from the Central Bank for Economic Cooperation. The structural adjustment loans assist countries in implementing reform programs adopted in consultation with multilateral institutions or in the case of countries which have no program, assists them in the development of one.²¹

There is a heavy concentration of French funds in the technical assistance sector, particularly education. But there is no real evidence that this type of assistance is extended to

promote policy reform or adjustment.²²

SWEDEN Policy

Sweden has been a reluctant donor in encouraging adjustment and policy reform. This reluctance resulted not from a belief that adjustment and reform were not proper or effective, but from their general reluctance to advise or dictate policy issues.

Instruments

Sweden initially approached policy dialogue rather hesitantly, but reversed its approach as a result of Swedish aid ineffectiveness. Sweden now sees donor coordination and policy dialogue as prerequisites for making aid more effective, and also as a means of increasing flows to countries which endeavor to undertake structural adjustment.²³

Even though the Swedes have come to accept policy dialogue as a necessity, they offer some caveats in its practice: 1) A readiness to engage in dialogue should not be expected from the recipients as a matter of course; such a readiness must be actively encouraged, 2) The dialogue should always take place in the recipient country and 3) Non-development intentions which are linked with aid should be made clear in the dialogue because obfuscation of export intentions and specific foreign policy considerations would undermine the dialogue.²⁴

The Swedes tend to conduct policy dialogue at the project and sector levels, but macro-level issues have been discussed in some special cases. Sweden believes that the most concrete

results can be achieved at the project and sector levels.²⁵

Sweden believes that conditionality should basically be confined to the functional conditions of Swedish-funded projects and programs. Only in countries where Swedish engagement is particularly strong and where the development process is especially vulnerable to crisis should Sweden accept a policy-level conditionality.²⁶

Sweden supports the IMF and World Bank, but only in cases where the results of aid projects and programs are seen to be dependent on particular policy changes and aid transfers made conditional on multilateral adjustment agreements.²⁷

Since 1985, Sweden has used a new aid facility which provides special support to the developing countries which are most indebted. The funds are extended to ease the recipient's balance of payments situation and to strengthen their capacity to pursue structural adjustment and long-term development policies.²⁸

In addition, Sweden encourages adjustment and reform by reallocating funds from project to general commodity assistance, concentrating on smaller rather than larger projects, rehabilitating existing facilities as opposed to building new ones and emphasizing institution-building through the provision of specific technical assistance.²⁹

JAPAN Policy

At the 1987 DAC review of Japan's aid policy, it was suggested that one of the most useful contributions Japan could make in the current African context would be the provision of substantially increased assistance for meeting urgent adjustment needs.³⁰

A major difference in Japan's development policy when compared to the cases previously considered is the geographic location of aid provision. While the European countries give mainly to Sub-Saharan Africa, Japan concentrates its aid in Asia. This concentration of aid in Asia, while the bulk of the adjustment programs are taking place in Africa, could be part of the reason why Japan's policy on adjustment and policy reform is not as developed as the other bilateral donors.

According to Hofmann, Japan sees development policy as distinct from and in competition with the policies of other countries. Japan assumes that recipient countries can protect their self-determined interests and that the outcome of negotiations will reflect a balance of interests.³¹ Currently, Japan has only one program to encourage adjustment and policy reform and only two countries will be affected, one in Asia and one in Sub-Saharan Africa.³²

Instruments

Japan does not encourage adjustment or reform on a bilateral basis, but holds certain opinions about the instruments other bilaterals use. An examination of these opinions may help to

suggest Japan's future role, if any, in bilateral adjustment and policy reform.

In Japan's opinion, only the multilaterals have the authority of their charters to participate in a dialogue on policy. Japan is willing to join a consortia of donors and recipients formed by the World Bank or UNDP, but wants to avoid the appearance of "ganging up" on the developing country.³³

Support for adjustment and policy reform has essentially taken the form of contributions to the special facility for Sub-Saharan Africa administered by IDA. Bilateral efforts on Japan's part remain limited to providing policy advice in the course of annual consultations with Asian developing countries, and the dispatch of high-level economic missions at the request of such countries.³⁴

Hofmann suggests that Japan's leaders are well aware of the grave problems facing Africa, but they have little desire to make any major contributions to its development. They see this primarily as the task of the former colonial powers and multi-lateral organizations.³⁵

It is not clear to what extent, if any, commodity assistance and other types of assistance are tied to support of policy reform efforts. But Japan recently announced plans to provide \$500 mil. in non-project grants over the next three years for adjustment in Sub-Saharan Africa.³⁶

According to Mr. Fujimoto at the Overseas Economic Cooperation Fund, structural adjustment and policy reform are very

difficult to encourage at the bilateral level, but Japan continues to encourage it at the multilateral level.³⁷

SUMMARY Policy

Bilateral influence in developing country adjustment and policy reform has developed from primarily U.S. involvement in the process to inclusion of other bilateral donors. Almost all of the other major bilateral donors have indicated strong support for adjustment and policy reform, and most have developed and implemented measures in their donor policies.

This move toward encouraging adjustment and policy reform resulted from a number of factors including the desire on the part of the donors to make their aid more effective and donors' realization that adjustment and policy reform were necessary for continued and sustained development. In some cases, the call for donor encouragement in adjustment and policy reform came directly from the developing country involved as in the case of Tanzania and Sweden.³⁸

The move has been almost universal among the major bilateral donors. Sweden was initially reluctant to even engage in policy dialogue, but now supports adjustment and policy reform efforts with a certain degree of politeness in the process.

Japan is still reluctant to develop policies in support of developing country adjustment and policy reform, and various reasons are suggested: 1) That Japan views such involvement as solely within the domain of the multilaterals, 2) That most of

the adjustment is occurring in Sub-Saharan Africa and Japan feels that is the responsibility of the former colonists and 3) That Japan's experience with development has been confined to Asia and thus, Japan is not even aware of the African situation. It is difficult to know exactly which of these reasons forms the basis of Japanese hesitancy to become involved in developing country adjustment, but given the increasing volume of aid extended by Japan, it is likely that more pressure will be placed on Japan to become involved in adjustment and policy reform.

Thus, the general policy of the bilaterals studied has been support of developing country adjustment even though Sweden's acceptance of the policy has been reluctant and Japan's acceptance of the policy has not yet materialized fully. This support will probably continue, and Japan will likely become more involved in adjustment and policy reform in the developing countries.

Instruments

All of the bilaterals studied, except Japan, use policy dialogue, financial assistance, technical and sectoral assistance to support adjustment and policy reform measures in the recipient developing countries. Of these instruments, Japan only uses financial assistance and its use has developed quite recently.

Conditionality is used by all, except for Japan, for the transfer of certain types of assistance. Conditionality is practiced by the United Kingdom, Germany, the Netherlands, Sweden, and France by requiring the recipient to have an

agreement with the IMF or World Bank. In addition, France imposes certain individual requirements on recipients who receive Structural Adjustment Loans bilaterally from France.

Debt forgiveness based on structural adjustment agreements is practiced by the United Kingdom, Germany and the Netherlands. There has been increasing interest in debt forgiveness as evidenced by its discussion at the recent economic summit of seven world leaders. Given the increasing interest in adjustment and policy reform, it is likely that other bilaterals who choose to forgive debt will condition it on IMF/Bank agreements.

Of the countries studied, France is the only one to extend bilateral structural adjustment loans. The majority of loans are extended to franc-zone countries with whom France has a particularly close relationship with in any case.

1. Development Assistance Committee, "Aid Review 1986-87, Memorandum of The United Kingdom", (Paris: OECD, 1986), p. 11.
2. DAC Aid Review 1986-87, p. 11.
3. DAC 1987, p. 83.
4. DAC Aid Review 1986-87, p. 6.
5. Mr. Leader, World Bank, Telephone Conversation of July 13, 1988.
6. DAC 1987, p. 80.
7. Development Assistance Committee, "Aid Review 1987-88, Memorandum of Germany", (Paris: OECD, 1987), pp. 1-3.
8. DAC Aid Review 1987-88, p. 12.
9. DAC Aid Review 1987-88, p. 14.

10. Selim, Hassan M., Development Assistance Policies and the Performance of Aid Agencies: Studies in the Performance of DAC, OPEC, the Regional Development Banks and the World Bank Group, (New York: St. Martin's Press, 1983), p. 101.
11. Mr. Klaussen, The World Bank, Telephone Conversation of July 13, 1988.
12. Development Assistance Committee, "Aid Review 1987-88, Memorandum of the Netherlands", (Paris: OECD, 1987), pp. 1-6.
13. DAC 1987, p. 81.
14. DAC Aid Review 1987-88, p. 20.
15. DAC 1987, p. 82.
16. Development Assistance Committee, "Aid Review 1986-87, Memorandum of the Netherlands", (Paris: OECD, 1987), pp. 18-22.
17. Van Vliet, JoAnna, The Netherlands Embassy, July 22, 1988.
18. DAC 1987, p. 67.
19. Claus, Burghard, France's Development Cooperation Policy, (Berlin: German Development Institute, 1986), p. 45.
20. Claus, p. 45.
21. DAC 1987, p. 80.
22. Selim, p. 85.
23. Development Assistance Committee, "Aid Review 1987-88, Report by the Secretariat and Questions", (Paris: OECD, 1987), pp. 15-16.
24. Lembke, Hans H., Sweden's Development Cooperation Policy, (Berlin: German Development Institute, 1986), p. 40.
25. Development Assistance Committee, "Aid Review 1987-88, Memorandum of Sweden", (Paris: OECD, 1987), p. 21.
26. Lembke, p. 40.
27. DAC Aid Review 1987-88, Memorandum, p. 20.
28. DAC Aid Review 1987-88, Memorandum, p. 7.
29. DAC 1987, p. 83.

30. DAC 1987, p. 67.
31. Hofmann, Michael, Japan's Development Assistance, (Berlin: Institute of Developing Economies, 1985), p. 49.
32. DAC 1987, p. 81.
33. Hofmann, p. 49.
34. DAC 1987, p. 81.
35. Hofmann, p. 49.
36. DAC 1987, p. 81.
37. Mr. Fujimoto, Overseas Economic Cooperation Fund, Telephone Conversation of July 25, 1988.
38. Lembke, p. 39.

CHAPTER FOUR

CONCLUSION

It is clear that the emphasis on structural adjustment and policy reform will be a feature of development policy for some time to come. The multilateral agencies, because of their expertise and mandate, have taken the lead in adjustment and policy reform. But the bilateral donors are heavily involved in development assistance, and as such play a role in adjustment and policy reform as well.

The bilateral role in adjustment that has evolved over the past few years has been a secondary role in support of the multilateral agencies. While the multilateral agencies work with the developing countries on the macroeconomic level to encourage policies that will result in sustained growth, the bilateral donors support the process by extending larger volumes of non-project aid to lessen the negative impact of adjustment programs. This role in providing aid to support developing countries during adjustment will continue.

The role of the bilateral donor in adjustment and policy reform is still evolving, but suggestions have been made for the future of that role in addition to aid support for policy reform and adjustment. Joan M. Nelson suggests that there must be a sensible division of labor between the multilateral agencies and bilateral donors in the adjustment process.¹ This division of labor would serve to benefit the developing countries as well as assist the donors in making their aid programs more effective.

This sensible division of labor concept must be considered when examining future possibilities for bilateral donors in the process.

The suggestion which is most often made is that the bilateral donors have an important role to play at the sectoral level in terms of technical cooperation. This is a role that has already been assumed by most of the bilateral donors, but it has received increasing emphasis in the literature.

One of the guiding principles of development, according to Development Cooperation, 1986, is the call for donor cooperation to help the developing countries establish and implement improved policies. DAC members recognize the need for greater participation by bilateral aid agencies in assisting developing countries in their efforts to improve their policies and programs. DAC suggests that the bilateral donors can play a role in providing or assisting with the often costly preparatory analytical work, especially at the sectoral level.² According to one analyst, bilateral donor capacity and expertise give them roles in dialogue at sectoral or project levels on a par with the multilateral agencies' macroeconomic expertise.³

Another suggestion regards the role of bilateral donors at the public relations level. DAC believes that the bilateral aid agencies should join the World Bank and IMF in explaining to a larger audience the essential importance of adjustment assistance for successful development. In support of this, DAC suggests the development of a methodology for measuring the

economic impact of adjustment aid for the purposes of accountability before donor country legislatures and parliaments.⁴

In her work on sustainability, Nelson suggests that outside donors can help recipient governments do a better job of persuading their own officials and citizens of the need for stabilization measures and can be more imaginative and energetic in promoting stronger commitment among leaders. A major obstacle to commitment is lack of confidence in the economic rationale for stabilization and adjustment measures, and this should be addressed in the longer term setting. Nelson suggests that the U.S. should encourage more efforts in joint studies and analysis in which countries' own staff would be involved.⁵ Other bilateral donors could be encouraged along the same line.

A final suggestion involves the broader international environment of development. DAC believes that it must be recognized that the responsibilities of donors are much broader than the field of development finance. A more autonomous pattern of financial flows will only come with a healthy world economy and trade regime. According to DAC, the OECD countries have the responsibility of resolving their own large payments imbalances in a way which secures stability and growth in the world economy.⁶ Not only would this benefit the developing countries in an economic sense, but it might also serve to make them more receptive to adjustment measures if they feel the donor countries are undertaking steps to make their own economies stronger.

1. Nelson, July 11, 1988.
2. DAC 1986, p. 106.
3. Cassen, p. 86.
4. DAC 1987, p. 77.
5. Nelson, p. 117.
6. DAC 1987, p. 51.

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