APPROACHES TO POLICY-BASED NONPROJECT ASSISTANCE

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by

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PREFACE

This study was prepared in 1987 and it examines the theory and practice of structural adjustment assistance as carried out by the Agency for International Development (A.I.D.), with a brief account of that practice in the World Bank and the International Monetary Fund. Extensive use is made of quotations and paraphrases from important documents from each of these institutions. In addition, the appendixes present considerable quantitative material on the size and focus of adjustment assistance. Both features enable the reader to make an independent judgment on the documentation underlying this study and to evaluate the writer's use of this documentation.

SUMMARY

The Need for Policy Reform

Large parts of the world, especially the countries of Sub-Saharan Africa, are in economic and political disarray, with incomes and per capita agricultural production falling and high degrees of political instability. In Latin America, large external debt is shaping policy decisions that have high short-run economic and political costs. In this world context, two great ideologies compete for center stage. One stresses the individual's freedom of action, market forces and competition, the role of price as an allocator of resources, and the constrained role of government. The other espouses government organization of the economy, limits to freedoms that might interfere with the state's decision-making authority, and a belief in the inefficiencies of markets. Each ideology comprises intellectual and political ingredients, and each claims to represent society's best hope of achieving material plenty while enhancing humane values.

Several major events in the 1970s precipitated the current emphasis on policy reform, the attempt to strike an optimal balance between the positive but constrained role of government and the necessarily more open-ended role of private initiative. The rapid increase in oil prices caused immediate problems throughout the world economy, but it most severely affected developing countries. The second oil shock in 1979 again worsened the economic position of these countries, but this time adjustment problems were compounded by rising interest rates on loans developing countries sought in order to maintain consumption in the face of falling real incomes. Third, population pressure in many areas worldwide began to threaten development and political stability, and raising productivity displaced short-run redistributive schemes as the single most important way of raising the poor out of poverty. Finally, political thinking in the developed countries began to reflect a broad suspicion that the boundaries of state authority had been extended too far into their market economies, resulting in inefficiency, reduced or negative growth rates, and worsening income distribution.

Many developing countries are now characterized by macroeconomic imbalances, inflation, and unsustainable rates of domestic resource absorption; reductions in net capital inflows and in some cases increases in net capital outflows; and heavy debt burdens that require raising domestic savings to very high levels. These countries need to expand and diversify exports, while addressing the high cost of required stabilization and structural changes.

This situation has resulted in a growing emphasis on policy reform (mainly in sub-Saharan countries and in middle-income countries with severe debt service problems). In donor programs, policy reform efforts take a variety of forms, ranging from education through persuasion to conditions that are attached to loans and credits. All attempts at reform contain common elements: smaller budget deficits, tighter monetary control, more realistic exchange rates, and similar macroeconomic measures. Also, conditions attached to loans often encourage institutional change such as the freeing of markets and a reduction in the role of parastatals. Finally, some conditions relate to strengthening a government's technical ability in such areas as budgeting and civil service management.

In brief, the argument in favor of policy reform rests on the need to reverse the collapse now being experienced in many developing countries and on the Western economic tradition of Adam Smith's market-led development. The other Western intellectual tradition of statist development is clearly on the defensive, both in the West and in various Soviet-type economies worldwide.

The Practice of Conditionality

Today, major donors suggest that market-oriented conditions, attached to nonproject assistance, will lead to badly needed policy reform and structural change in developing countries. The Agency for International Development's (A.I.D.) approach to conditionality is more eclectic than that of the World Bank or the International Monetary Fund (IMF). Essentially, it is based on a commitment to reforming all government policies that reduce efficiency, employment, equity, or growth, while recognizing the extent of the trade-offs among these variables. To achieve these goals, the conditions attached to loans are derived essentially from neoclassical economics and growth theory and embody a pragmatic approach to institutional changes that support market-led development.

The pattern of A.I.D. conditionality is revealed in several recent studies. A 1985 General Accounting Office (GAO) study examined conditionality in six countries (Bangladesh, Costa Rica, Egypt, Honduras, the Philippines, and Sudan). Only 6 of the 19 Development Assistance-funded projects reviewed required government action as conditions precedent or covenants. Of the eight Economic Support Fund programs studied, the four with policy conditions were in Egypt. In general, where A.I.D. did not use project conditionality, there were significant Economic Support Fund programs with conditionality.

The GAO report noted the difference in emphasis and scope among the three types of A.I.D. assistance (Development Assistance, Economic Support Fund, and Public Law [PL] 480 food aid) and concluded that each is unique in serving as a vehicle for the policy dialogue that is expected to effect policy change. There is, however, the additional consideration of the political and strategic position of the recipient country in A.I.D. programming. Given the gradations of political and strategic position among countries receiving A.I.D. assistance, it is difficult to generalize on the success of policy dialogue.

A different perspective is provided by a study of A.I.D. conditionality in its 1986 Commodity Import and Cash Transfer programs (A.I.D. 1986). In general, where conditionality was employed, it tended to become more comprehensive and detailed as the amount of resources devoted to the program increased. Also, while A.I.D.'s use of conditionality is increasing, the total amount of its resources conditioned on macroeconomic performance still constitutes a comparatively small proportion of total U.S. bilateral economic assistance. In fiscal year (FY) 1986, for example, only 20 percent of Economic Support Fund resources had some conditionality of this kind attached.

The study found that economic policy conditions attached to Economic Support Fund programs fall into four categories: (1) <u>nonfinancial public sector policy</u> (reducing expenditures; promoting tax reform; dismantling price and market controls, including low prices paid by parastatals for agricultural commodities; rationalizing the public investment budget; reducing subsidies; and divesting or restricting the activities of parastatal enterprises); (2) <u>monetary policy</u> (reducing the public sector's capacity to borrow domestically or abroad, decontrolling interest rates, and channeling more credit to the private sector); (3) <u>foreign trade and exchange rate policy</u> (reducing tariffs or administrative controls on imports, and, less commonly, eliminating export taxes, loosening administrative requirements for exports, and reducing the gap between official and market rates of foreign exchange); and (4) <u>private sector policy</u> (eliminating price controls and enhancing access to productive resources and markets).

This study also revealed that conditionality varied by region. The countries in Asia and the Near East, including the leading recipients of U.S. economic assistance, are subject to negligible conditionality. Conditionality in the Sub-Saharan region is relatively more concentrated in the external and private sectors. In the Latin American and Caribbean region, there is a wider variety of conditionality with greater frequency than in the other regions, and conditionality was more evenly distributed among the four functional areas noted above.

Conditionality rarely applies to only one functional area in either Africa or Latin America. Similarly, it was also rare for a recipient to be simultaneously subject to conditionality in all four areas. The only exceptions were Costa Rica and El Salvador, both of which had comparatively extensive programs.

Studies completed in 1987 summarize A.I.D.'s experience with policy conditionality in Mali (Wilcock, Roth, and Haykin 1987), Somalia (Goldensohn, Harrison, and Smith 1987), Zaire (Sines et al. 1987), Zambia (Weideman, Koropecky, and Thomas 1987), and Zimbabwe (Haykin 1987), which can be categorized as follows.

Agricultural sector impacts. (1) Farmers responded to changes in incentives. There is clear evidence that farmers responded to freer markets and price signals and made choices that maximized their welfare. (2) Policy reforms led to significant increases in food production. In the presence of adequate rainfall, donor-assisted policy reform programs were the dominant causes of increased food output in Somalia, Zambia, Zaire, and Zimbabwe. (3) The major beneficiaries were small farmers. (4) Agricultural policy reforms had a quick impact on output and income. This supports the view that the quickest way to lift African agriculture from its current stagnation is to support reforms in the producer's incentive structure. (5) Policy reforms had the greatest impact where other constraints were less binding. (6) Policy reforms promoted private sector development in rural areas.

Economywide impacts. (1) Distributional equity improved and the urban bias of the economic systems was reduced, results consistent with the United States' fundamental goals in supporting policy reforms. (2) Market structure and spending reforms helped African governments in their efforts to cut budget deficits. (3) Reform programs had favorable effects on balance of payments. (4) Macroeconomic progress was slow because of bad weather, falling export prices, and large debt service payments.

Implementation. (1) Policy reform implementation failures can defeat the best program (Zambia was most seriously affected by these problems). (2) Price interventions were extremely difficult to manage. (3) There was insufficient donor assistance to keep import levels from falling and inflation from increasing.

Role of donors. (1) In some cases, the combination of financial necessity and common sense led to structural adjustment even without reform programs. (2) At the same time, external assistance was critical to the adoption of policy reforms by African governments. (3) A.I.D.'s role was both catalytic and supportive.

Continued emphasis on policy reform. (1) Policy reforms are not the only answer to Africa's economic problems, but they are an important part of the answer. (2) Policy issues stretch beyond the purview of African governments (e.g., African debt and future world trade are international issues). (3) It is important that the United States and other donors maintain their commitments to reform programs if these programs are to succeed.

Operating Characteristics of Programs

Policy-based nonproject assistance among major donors can be viewed in terms of its various operating characteristics. There are, for example, various effectiveness issues attached to different kinds of aid such as its accountability, its effectiveness at the national versus the sector level, and the best kind of linkage between nonproject assistance and other aid. There are issues related to the consistency of application of assumptions and remedies in applying nonproject assistance among countries of different sizes and institutional capacities.

Measuring the effects of policy change resulting from carrying out conditionality provisions is extraordinarily difficult. There is no single quantitative measure, such as rate of return, for example, by which a program can be judged. The essential problem is the absence of the counterfactual--that is, knowledge of the conditions that would have prevailed in the absence of the program or of the effects that would have been experienced under alternative programs. Because of this limitation, emphasis in the evaluation of nonproject assistance is sometimes confined to nonquantitative indicators such as performance disbursement benchmarks that indicate the extent to which conditionality provisions were actually carried out. Although the benchmark approach is a practical method of checking on the administrative response to conditionality, it is unsatisfactory to those seeking a synthesized measure of economic effects of the program.

Advantages and Disadvantages of Conditionality

The major advantages and disadvantages of conditionality are presented in Boxes 1 and 2. They are drawn from criticism from the entire spectrum of literature on structural adjustment programs. (Accordingly, some of the language that follows quotes from or paraphrases this literature.) No judgment is made on the validity of these arguments; rather, they are intended to convey the range of controversy surrounding conditionality.

BOX 1. ARGUMENTS IN FAVOR OF POLICY-BASED ASSISTANCE

1. The policy setting in many developing countries inhibits growth and the achievement of equity. In many cases, the policy environment has become a hodgepodge of regulations, price fixings, prohibitions, and bloated and dysfunctional state sectors, resulting in the stagnation of economic growth while population continues to increase. The support that had once existed for statism began to erode in the grim light of reality--poverty, ignorance, and corruption. A solution was needed, and because the policies favoring state-led growth have come to be viewed as parts of the problem rather than as solutions, greater reliance on market forces is necessary. No matter what the imperfections of the market might be, both market and government failures must be addressed.

2. Political stability is the key to economic growth and economic growth is the key to political stability. While the evidence on the relationship between good policies and good growth can be debated in some cases, there is no case for the idea that a nation can have good growth without good policies. Similarly, while the evidence on the relationship between growth and political stability can be debated in some cases, there is no case for the idea that political stability can exist in the presence of economic chaos and decline. A semblance of stability might appear, but only at the cost of great repression of commonly accepted liberties. Finally, economic growth in which the bulk of the gain goes to a minority is not growth for the majority, so it does matter that the growth be shared somewhat equitably, which, in turn, further enhances political stability.

3. While random external events will affect development, economic growth and welfare depend primarily on domestic policies. External events can have an uplifting as well as a depressive effect on a nation's economy. Further, some economies are heavily export and/or import dependent and appear therefore to be "vulnerable" to world markets or to their chosen trading partners, as in the case of trade with Eastern Europe. How such a country adjusts to this apparent disadvantage in the long run depends on the policy set chosen in the short run. Even the poorest country in the world can choose a policy set appropriate to its economic condition. To the extent that local leadership is less interested in growth than in its own perquisites, then this generalization does not hold, and policy reform seems of rather academic interest. The result under this circumstance is economic stagnation and growing immiserization.

4. Conditionality may help developing country leadership accomplish its own goals. In some cases, policy changes that create economic losses for particular groups threaten the political strength of leaders and would not be made unless nonproject assistance were conditioned on the change. It is folklore in development circles that A.I.D. or other donors give advice to countries (either indirectly through dialogue or directly through conditionality) that their own leadership would like to give. While competent explanations of the dysfunctional policy and institutional settings often are available locally, there are indeed cases where outside advice has been helpful. Of course, in some cases, if the conditions are made public, the incumbent government may be threatened. This is obviously a delicate procedure. Nevertheless, outside advice can sometimes strengthen the political hand of local leaders who propose policy reform, provided the donor engages in true dialogue that is supportive rather than imperious.

BOX 2. ARGUMENTS AGAINST POLICY-BASED ASSISTANCE

1. Limited knowledge base. The gap between policy and its expected results is enormous even in developed economies. In developing countries undergoing rapid structural change, and for which the database is seriously limited, it is fantasy to suppose that any policy planner can "manage" economic development by changing interest or exchange rates, stipulating budgetary limitations, and the like. In effect, the operational mechanism through which policy changes affect reality is something of a "black box." Moreover, prices in such developing countries sometimes are unreliable indicators for rational investment decisions among projects, sectors, and regions. At best, policy recommendations should be limited to such critical issues as developing technical competence among developing country economists and others dealing with the economic problem, establishing local and international institutions for the ongoing review of problems and policies, providing for coordination among donors who express interest in providing assistance, and so forth. Thus, the limitations of our knowledge suggest a wider attempt at building local technical capacity and institutions capable of addressing policy issues on a continuing basis. Finally, the emphasis on market-oriented conditionality may represent wishful thinking, for in the very countries held up as examples of such growth, governments have exerted a strong influence on the shape of the economy (e.g., South Korea, where the Government has directly and indirectly influenced capital allocation for three decades).

2. Inherent ideological bias of policy-based lending. For various reasons, some economically emerging countries have chosen a development strategy emphasizing equity and growth as co-equal goals. This has sometimes led to dysfunctional expansion of the state sector, corruption and the elevation of "politics over economics," and economic collapse. In urging standard policy reform measures, however, donors are in effect substituting their own version of "the good life" (growth before equity) for that of the developing country (growth and equity). If the elimination of absolute poverty is a major objective, then the strategy of development must be designed to achieve this, based on conditions indigenous to the country. If a tendency toward egalitarianism is important, then policy conditionality must reflect this reality.

3. "Getting the prices right" is only the beginning. Although donors are concerned with short-run costs of adjustment programs, the compression of consumption following application of conditionality still receives insufficient attention. Equity may depend in part on current policies (direct aid to the poor, for example), but it also depends on who owns the economic assets and who controls the system. When there are wide disparities in asset ownership, the market widens rather than lessens income differentials. In effect, the ascendancy of policy reform lending is a return to a trickle-down strategy of development that ignores the lessons of history that led to the movement away from such theories and toward a "basic human needs" approach. Similarly, even with market-determined prices, there remain problems of structural rigidity, provision of public goods, widespread training problems, and institutional constraints. These problem are as important as prices; in fact, a case can be made that without attention to these problems, a market system will be difficult to create or maintain.

4. Asymmetrical policy conditionality. While stringent policy conditionality is applied to many developing countries, major lending countries engage in some of the very practices they condemn in developing countries. The difficulty of coordinating policy among Western Europe, Japan, and the United States dwarfs the policy problems of most developing countries. Further, the disarray in the agricultural policies of most developed countries surely matches the agricultural policy miscalculations in developing countries, although with different results. Growing trade restrictions in developed countries against exports of developing countries gives the game away as one of continuing attempts at exploitation of developing countries. (The limitations imposed by the United States in its Caribbean Basin Initiative are viewed among developing countries as symbolic of the real difficulty faced when a developed country proposes "helping" a developing country.) The basic difficulty with this asymmetry is that it reinforces within developing countries a climate of suspicion that assistance to them is a game among developed countries played out largely for internal political reasons, with the interests of the developing countries taking a distant second place to developed countries' concerns with their own economies. In the long run this approach has two effects: (1) it makes cooperation more difficult around mutual interests that surely exist between developed and developing countries, and (2) it fuels acceptance of radical thought from Eastern Europe, the Soviet Union, and China that suggests that the only safe course for developing countries is alignment with world socialism (Soviet- or Chinese-type).

There is no easy way to balance the advantages and disadvantages of policy-based program lending. A case can be and has been made in favor of each argument. In one sense, a balanced judgment will rest on two factors. First, much more analytical and empirical work is required on all aspects of the effects of conditionality. Second, the way one approaches the questions that need to be asked of conditionality, and indeed the questions themselves, will be affected by the researcher's world view, that is, whether the researcher "believes" that developing countries can prosper in the world economy in a positive sum game or that developing countries inevitably will lose in their struggle with more developed countries in a zero sum game.

Is there any consensus on conditionality? In general, there is widespread belief among major donors that policy-based assistance is not only appropriate but necessary given the crisis proportions of the development problem today. Among major recipients, there is a record of such assistance being associated with economic growth and alleviation of poverty. A few recipients have repudiated the agreement backing policy-based lending (e.g., Zambia). There has been no serious suggestion, however, that policy reform in those countries be repudiated as a principle. Instead, there are suggestions that in some cases policy reform should be carried out more slowly and that conditionality should be accompanied by greater economic assistance to ease the transitional costs, especially among the poor.

All of this suggests that while policy-based lending is controversial, more frequently than not it has been associated with economic success. It may be expected, therefore, that policy-based assistance will remain a permanent part of major donors' portfolios for the indefinite future.

Beneficiary Impact

While critics may concede that on balance better economic policies mean faster economic growth, they often insist that the poor do not benefit, or may actually suffer, from such growth. Who, then, are the gainers and losers in economic growth? The programs that have been subjected to the most intense criticism in this regard are those of the IMF. However, these programs have also been the most actively and visibly defended. The IMF's defense of its programs is recounted below because it is representative of the thinking among major donors, including A.I.D.

The IMF's basic argument is that while there may indeed be some reduction of consumption as a result of its structural adjustment programs, this may affect all groups rather than just the poor. In any case, the IMF stresses that this compression would have been greater in the absence of its adjustment programs and the financial support they provide. Specifically, the IMF view is that although the distributional impact of exchange rate devaluation is mixed in the short run, in the long run improved growth and employment will occur so that all groups will share in higher national income.

In the monetary area, appropriate policies on money creation and credit tend to curb inflationary pressures, which should help the poor who usually do not own assets that would rise in value with inflation. This beneficial effect is somewhat counterbalanced by the fact that established and urban firms are in a better position to compete for credit than are smaller firms in the rural sector, so the distributional benefit from appropriate credit policies is not as great as might first appear. At the same time, however, interest rate decontrol provides smaller firms in the rural sector greater access to credit.

The distributional impact of fiscal policy is also mixed. On the revenue side, through improved direct taxation the distribution of wealth and income can be made less unequal, and this is possible as well for selected indirect taxes. On the expenditure side, getting civil service size and salaries under control will have an immediate positive effect on distribution. Reduced subsidies, which result in increases in prices of food, transportation, and petroleum, ultimately will increase employment. Current food subsidies for the poor largely ignore the very poor who live in rural areas. Under any circumstance, food subsidies must be targeted much more closely to the lowest income households.

In general, development studies suggest that the only economically and politically adequate defense of policy-based nonproject assistance that will hold up in the long run is that the poor do in fact benefit. To ensure this, it is necessary to view policy reform and poverty reduction as complementary goals, not opposites. The important point is that economic crises will force adjustment in some form. Policy-based program lending provides the opportunity for an orderly transition away from the problems. However, without adequate attention to the poor, the transition itself is threatened, as is the likelihood of permanent improvement.

Recent work done at the Overseas Development Institute in London notes the following kinds of actions under recent World Bank programs (Addison and Demery 1986; see also ODI 1986). (A.I.D. was also active in some of the countries cited.) These actions were intended to (1) enhance the access of the poor to productive assets through land reform that is associated with structural adjustment, as was done in Thailand; (2) increase the rates of return on assets held by the poor, as done in Côte d'Ivoire, where positive income distributional effects resulted from higher agricultural prices; (3) improve access to gainful employment through assistance to retrenched public sector employees (as in Gambia and Guinea-Bissau), and in emergency employment schemes (as in Chile); (4) maintain or increase the rate of human capital accumulation of the poor through protection of social expenditures, particularly health and education, as done in Brazil and Indonesia; (5) target income and consumption transfers to the poor, whose incomes are not increased by structural adjustment, as in the case of food subsidies in Morocco and Jamaica.

The central point is that positive programs enhancing the contribution that the poor can make to structural adjustment can be built directly into policy-based programs and will be acceptable as parts of the economic growth process. The few remaining instances where transfers are required for the poor will be seen as a relatively small part of such programs.

Conclusions

Among most observers there is consensus that while structural adjustment programs cannot ensure economic growth, policies that inflate economies and distort resource allocation are inherently suspect as hostile to economic growth. Cornia and Stewart (1987, 105-127) have summarized "a few general lessons worth distilling" from the structural adjustment experiences of 10 countries. These are as follows:

1. The shocks to which the majority of the countries had to adjust were exogenous (i.e., the results of changes in the international environment or in climatic conditions, both factors beyond the control of national authorities).

2. Adjustment is necessary. Whatever the nature of the shock affecting the economy, countries have to adjust to a changing environment. Failure to do so normally entails huge losses of output and human welfare.

3. Growth-oriented approaches with structural adjustment have been successfully adopted. While several of the 10 countries analyzed followed predominantly contractionary policies, others adopted more growth-oriented approaches incorporating elements of structural adjustment, and in some cases of human protection.

4. Growth-oriented adjustment is necessary but not sufficient to protect vulnerable groups.

5. In the short-to-medium term, the well-being of children and other vulnerable groups can be protected and even improved with the adoption of appropriate targeted programs, even during periods of economic decline.

6. Most programs aimed at protecting the poor are relatively inexpensive in terms of total government expenditure and GDP.

7. Foreign financing is important in facilitating a smooth program of adjustment. While the availability of medium-to-long-term financing in sufficient amount allows the investment necessary for structural adjustment, external assistance (often to meet foreign exchange costs of imported inputs) for specific programs designed to protect the poor also proved an important element for the successful protection of human conditions.

These conclusions point to serious problems but also provide a basis for optimism. Some strategies for economic growth and alleviation of poverty do exist. However, what kind of growth occurs--whether it improves the lot of the poor or not--largely depends on the kind of strategy chosen.

The general lessons of structural adjustment and policy reform outlined above can be given broad programmatic definition. First, some asset redistribution is necessary, either with economic growth or prior to growth, including tenurial changes, massive education, and broad investment in assets that are complementary to those assets owned by the poor, such as nutrition and education, irrigation, and credit programs or input subsidies. A second complementary strategy is to increase the relative and absolute demand for unskilled labor, which should be accompanied by the strengthening of institutions that improve labor mobility and access to jobs. Both strategies imply yet a third strategy to move prices (including exchange rates) closer to clearing levels.

A study of World Bank experience by Demery and Addison (1987) gives added weight to the suggestion that structural adjustment can be carried out while providing protection to the poor. They examined attempts of more than a dozen developing countries to assist the poor while undertaking structural adjustment. Basically, Demery and Addison found that the effort must be made to increase the participation of the poor in activities that are expanding under structural adjustment and to maximize the ability of the poor to generate income, so that transfer payments may be targeted to the most vulnerable groups. They "distinguish five broad approaches to assisting the poor under adjustment: (i) increasing their access to productive assets; (ii) raising their return on assets; (iii) improving their employment opportunities; (iv) ensuring their access to education and health services; and (v) supplementing their resources with transfers." Illustrations from each approach are drawn from a variety of programs undertaken with Bank assistance. In short, these approaches provide many examples of the possibility of protecting the poor while undertaking structural adjustment.

Because there is nothing magical about these strategies, considerable controversy surrounds each suggestion. Perhaps the best that any government can do in the matter of economic policy reform is to try to achieve and retain an optimal balance between regulation and other forms of government intervention and the free play of market forces. Both theory and experience (as seen, for example, in the Japanese and Korean models) suggest that a vital and growing economy requires both a strong private sector and a strong and proactive government.

There is yet another perspective on specific interventions that support policy-based adjustment. In a sense, the essential development problem facing developing countries is not that the potential of the market is not understood. Rather, it is that changes that took centuries to achieve in developed countries are being collapsed into decades in developing countries. In many cases, there has not been enough time for the institutional, cultural, and political development that underlies market-led growth to occur. Some common features of societies integrated through markets are a system of laws protecting property and contracts, acceptance of the rule of law surrounding civil liberties, broad-based capital markets and a reliable system of public accountancy, the concept of relatively equal opportunity, and a spirit of rationality. From this perspective, a strategy of development must combine broad-based policy adjustment with those projects that help developing countries overcome the institutional and cultural deficiencies that impede market development but that require more time to correct.

On the whole, A.I.D.'s experience with policy conditionality has been positive, as reflected in several country evaluations, although many difficulties remain. Current evaluation efforts in A.I.D. will be devoted to estimating the impact of policy reform on lower income groups in developing countries. Preliminary results for Africa will be available by mid-1989.

There is little doubt that the effort at policy reform is overdue and appropriate. However, evaluating the effects of such reform remains difficult. Wildly out of balance budgets, overvalued exchange rates, inefficient government restrictions on the sale of agricultural products, and a host of similar economic aberrations usually produced the opposite of growth--economic chaos, stagnation, and poverty. Under these conditions, real development is unlikely to occur and the poor unlikely to benefit except from the random largess of a leader trying to buy political support.

As with other approaches that have gained ascendancy at different times in development thinking, policy reform raises expectations. In this case, however, the expectations go beyond the limited hope that good results will be forthcoming from structural adjustment programs. Policy reform requires extensive restructuring of economies, sometimes to the short-run disadvantage of large numbers of the poor. In turn, this requires that donors accept responsibility not only for sufficient assistance for the "reform," but for the costs that must be borne by those "losing" as a result of the changes, and hence for political stability over the medium term. In other words, donors, as well as developing country leadership, must be willing to stay the course. The repudiation by Zambia in May 1987 of the major conditions of the adjustment package of the World Bank and the IMF, and other donors, is a case in point. Perhaps another dozen African countries as well will be unable to repay their external debts. It is widely agreed that the reforms initiated but now abolished by Zambia were basically sound and that donors should have been aware of the extra funding requirements they implied over the medium term.

The role of the developed countries in the policy reform efforts of developing countries merits special emphasis. Policy conditions bear heavily on borrowing countries under our current international economic system, while industrial countries typically do not face such conditionalities. This asymmetry in policies can and often does have severe, adverse effects on developing countries undertaking policy reforms. Similarly, some developed countries urge policy reform to stimulate increased exports from developing countries while, for domestic political reasons, adopting restrictive trade practices that inhibit those potential exports. This practice is well known among all observers and brings into question the seriousness of the proposals by representatives of developed countries for policy reform in developing countries.

GLOSSARY

A.I.D.	-	Agency for International Development
DA	-	Development Assistance
ESAF	-	Enhanced Structural Adjustment Facility (of the International Monetary Fund)
ESF	-	Economic Support Fund (of A.I.D.)
GAO	-	General Accounting Office
GDP	-	gross domestic product
NIC	-	newly industrialized country
OECD	-	Organization for Economic Cooperation and Development
PAAD	-	Program Assistance Approval Document
PL 480	-	Public Law 480 food assistance program (of A.I.D.)
PRMC	-	Cereals Market Restructuring Program (Mali)
SAF	-	Structural Adjustment Facility (of the International Monetary Fund)
SAL	-	Structural Adjustment Loan of the World Bank
SDR	-	Special Drawing Right (of the International Monetary Fund)
SEL	-	Sector Adjustment Loan (of the World Bank)
U.N.	-	United Nations
UNHCR	-	U.N. High Commissioner for Refugees
USAID	-	A.I.D. country Mission

1. THE RATIONALE FOR AND EMERGENCE OF POLICY-BASED LENDING

In its 1986 World Development Report, the World Bank (1986d) presented three plausible scenarios for global development. On the assumptions of the central case scenario (neither optimistic or pessimistic), the Bank projected zero growth in average per capita income in Sub-Saharan Africa during the period 1985-1995. The conditions this implies for that region are appalling and are among the reasons that policy reform is now receiving special attention:

> Zero growth in average per-capita income implies declining income for many people who are already on the verge of subsistence. Some three-fifths of Africa's population is already too poor to afford a diet that supplies the minimum number of calories as recommended by the U.N.'s Food and Agriculture Organization and World Health Organization. Most of these people are less productive and energetic than they would be if they had more adequate diets. Between a quarter and two-fifths of Africa's population is too poor to afford even 80 percent of this minimum standard. Among these people, infant and child mortality is high, and the children are often stunted in their physical and intellectual development. For those enduring these conditions, the prospect of economic stagnation is surely unacceptable.[1]

The "coming of age" of the idea of policy reform was marked by the publication of a World Bank study (1981; dubbed the Berg Report, after its principal author and coordinator) that detailed the chaos resulting from government intervention in Sub-Saharan economies and advocated policy reform and stimulation of the private sector. More recently a major section of World Development Report 1985 (World Bank 1985) was devoted to the role of economic policies.

Although current development thought stresses appropriate policies and market-based development, it is useful to note that this approach is not new within the Agency for International Development (A.I.D.). "Policy dialogue" as a route to policy reform became one of the four "pillars" of A.I.D. programming in the early 1980s (A.I.D. 1982). A recent study (A.I.D. 1986) summarizes the history of conditionality in A.I.D.:

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[1]Policy Reform: What Must Be Done," Challenge January/February 1987: 9-15. This is a statement by the International Relations Department of the World Bank, adapted from a paper commissioned by the Aga Khan Foundation for the Enabling Environment Conference.

> Since the early 1980s the Agency has been devoting a substantial volume of resources in the form of nonproject assistance to support the objectives of economic stabilization and structural adjustment. During the 1960s program loans were provided for similar purposes in a number of countries. Their use declined significantly during the 1970s, however. The reasons included questions about the overall effectiveness of the attached conditionality, concern that the poor majority reaped few benefits, and even might be adversely affected, and doubts about the desirability of continuing such programs in the face of a declining level of real resources.

As this quote demonstrates, A.I.D. has implemented the concept and practice of conditionality and structural adjustment for three decades. Over the years, however, there have been subtle changes in the connotation of the word "structural" (Feinberg and Kallab 1986, 11). In the 1950s and 1960s, "dependence" of Latin America on imported technology was viewed by "structuralists" from that region as retarding growth, along with creating such structural problems as unequal land distribution and reliance on a limited number of export commodities. In the 1970s, "structural adjustment" implied the upward adjustment required in domestic oil and food prices as world prices of those products increased. Today the term usually relates to "liberalizing" economies, reducing government's role, and equalizing incentives for domestic and export production or actually directing policies toward an export-led development strategy.

Today, both critics and proponents of structural adjustment agree that donor emphasis, and increasingly emphasis in the developing world, is on market-based development to a degree that has not existed before. Two great streams of political and economic thought have collided in the 1980s: the first is based on Adam Smith's theory of free markets, and the second is based on various streams of socialist thought that propose the state not only as an instigator of growth but also as a stabilizing and reinforcing influence in a wide variety of social and economic concerns, frequently under a single-party leadership. Why is world opinion tilting toward free market economies today instead of state intervention, as was the case 20 to 30 years ago?

Opinions vary, but the following explanations would probably be on most lists:

- -- A growing belief in some developed countries that the boundaries of state authority had been extended too far into their market economies. The result was believed to be inefficiency, reduced or negative growth rates, and worsening income distribution.

-- The external debt crisis of Latin America, coupled with a growing suspicion that the "market" economies of that region have not, in fact, been true market economies. Only recently, with the proliferation of informal markets, are the economic freedoms guaranteed in most Latin American constitutions being experienced.[2] A second major criticism of the "capitalism" found in Latin America is that the continuing poverty of the region has its sources in the nature of the Latin American political system (an alliance between Church and state that is stifling to "unauthorized" businesses or other initiatives), the economic system (top-down initiatives of the state, and a latifundia system wasteful of both land and labor), and the moral-cultural system (with its "emphasis on personal rather than civil and economic values"). (See Novak 1982 for an example of this type of reasoning.)

-- The famine crisis and the growing evidence of "underdevelopment" in Sub-Saharan Africa. The 1985 declaration of the Organization of African Unity (OAU) may have been a turning point in African development: "The primacy accorded the state has hindered rather than furthered economic development." This message was then reiterated at the U.N. Meeting in May 1986 and further defined in the OAU's preparatory document for the U.N. special session on Africa's economy ("the African coun-

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[2]See Llosa (1986, 28-30, 42, and 46-47). Llosa's article is based on his introduction to the book by Hernando de Sota, El Otro Sendero (1986), which will be available as The Other Path (New York: Harper and Row, 1989). Llosa suggests that "one of the most widely accepted myths about Latin America is that our backwardness results from the principle of economic laissez-faire adopted in almost all our constitutions when we achieved independence from Spain and Portugal.... According to this myth, the opening of our economies to market forces made us easy prey to imperialists, whose voracious business practices brought about the inequities between rich and poor." In contrast to this view, Llosa suggests "that Peru--as well as other Latin American countries and probably the majority of third-world nations--never had a market economy.... It is only now, with the proliferation of black markets, that Peru is beginning to get a market economy: a savage market economy, but a market economy nonetheless."

tries should adopt fundamental changes in their development priorities and policies").[3]

-- Population pressure in many areas worldwide. Rapid population growth began to threaten development and political stability, and rising productivity displaced short-run redistributive schemes as the single most important way of raising the poor out of poverty.

-- The post-Mao achievements in the People's Republic of China. These achievements have allowed limited market forces (prices, incentives, profits) to exert their influence on resource allocation. The current retrenchment or slowing-down of the "liberalization" process attests visibly to the continuing struggle in China between the more orthodox brand of Marxism (providing an intellectual haven for the go-slow conservatives) and the urgent necessity of improving resource allocation, productivity, and incomes.

-- The striking achievements of the "Gang of Four" in Asia (Korea, Taiwan, Hong Kong, and Singapore). The achievements of these nations have focused attention on the merits of an export-led development strategy. Import substitution has failed, especially in Latin America (where this strategy bred dual economies with low rates of GNP growth, balance of payments deficits, capital intensity and widening unemployment, and severe inequity and poverty), while these Asian economies prospered with high GNP growth rates and sharply reduced poverty.

Although Asian countries are cited frequently (and somewhat erroneously) as examples of successful growth under "pure" market conditions, the most massive policy shift to stimulate more efficient resource allocation today is occurring in Sub-Saharan Africa. Almost two dozen countries in that region have adopted policy changes including devaluation, reduction of civil service jobs, privatization, increases in real interest rates and food prices, and reduction of regulations hampering private industry. These changes have reversed previous emphases on urban over rural development. Perhaps the best measure of this restructuring effort is the fact that 22 African countries have qualified for loans from the World Bank's Special Facility for Africa, a $1.7 billion fund established in 1985 to lend money to countries re-

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[3]Cited in an address by Secretary Shultz before the Senegalese Business Council, Dakar, Senegal, January 8, 1987, quoted in Current Policy, No. 907, published by the Bureau of Public Affairs, Department of State, Washington, D.C.

shaping their economies. The Deputy Assistant Secretary of State for African Affairs, Roy Stacy, has said, "We're at a very historic moment in Africa, with the most significant economic reform process we have seen in a long time. It is a fragile trend, one that urgently needs underpinning and new kinds of support" (The New York Times, April 13, 1987).

Donors' attention now focuses on two groups of countries: middle-income countries with very severe debt servicing problems, and those countries lying below the Sahara (excluding South Africa). The latter group had a negative average growth rate in the period 1980-1986, while the former had an average growth rate of less than 1 percent (if Brazil were included, the rate for that group would also have been negative). Output per capita declined in both groups of countries.

While specific conditions differ in each country, a World Bank study (Michalopoulos 1987b) notes that there are common problems encountered in both groups, indicating the extent and severity of the present situation. Problems noted in the study are as follows:

-- Severe macroeconomic imbalances and resulting high rates of open or suppressed inflation and unsustainable rates of domestic resource absorption have been observed in these nations.

-- Significant reductions in net capital inflows, which, coupled with a deterioration in their terms of trade, have necessitated major structural adjustment in the countries studied.

-- Heavy debt burdens and severe debt servicing problems, which absorb considerable domestic savings and require raising domestic savings to very high levels, are prevalent in both groups of countries. (In some middle-income countries, to make up for lower levels of external financing and to provide for additional investment, marginal savings rates must exceed 50 percent or more for long periods to service debt.) When per capita income has been stagnant or declining, however, as is the case in countries of Sub-Saharan Africa, it is difficult to raise marginal savings rates.

-- Severely limited new private capital inflows are evident in these countries, although it is clear that additional financing from abroad can help restore growth and ease the domestic savings constraint.

-- These countries need to substantially expand exports so as to transform domestic savings into payments in foreign exchange for debt service and imports. This action would imply a structural shift in Sub-Saharan countries toward tradables in the face of economic structures that are inflexible and undiversified.

-- Significant transitional costs in the form of unemployment have resulted from macroeconomic stabilization and structural change.

There are, of course, many other severe problems facing these economies (especially those in Africa), such as weak physical and human infrastructure, weak or dysfunctional institutions, rapid population growth, and drought. It is this daunting list of problems that has given rise to structural adjustment lending and conditionality.

Policy-based lending is intended to enhance market-oriented development. But what is this thing called the "market"? The heart of the matter is decentralized units operating autonomously on the basis of knowledge generated within the market system.

Any economic system can be thought of in terms of the following four sets of social relationships:[4] (1) a decision-making structure, through which decision-making authority is allocated among members of the system; (2) an information structure for collection, transmission, processing, storage, retrieval, and analysis of economic data; (3) a motivation structure, which relates to the way decision-makers carry out their authority to make decisions; and (4) a coordination structure, such as the market or plan by which decisions are harmonized with each other. Thus, the market model, in this light, is just one possible coordinating arrangement for decision-making, information generation and processing, and institutional and individual motivation.

The case for the market model rests on its efficiency. The profit-maximizing producer combines inputs (capital, labor, land) so as to equate marginal factor outlays and marginal revenue

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[4]These suggestions are derived from organizational theory, and these or related categories are widely used in the study of comparative economic systems. For example, see Neuberger and Duffy (1976) and Pryor (1973). These and similar works move the study of economic systems away from the "isms" stage (capitalism, socialism) toward a more systematic approach whereby important aspects of a system, such as property ownership, behavior rules, and the structures cited above, are defined carefully, thus permitting measurement in some form (see Montias 1976).

products. The utility-maximizing consumer, similarly, will buy goods and services so as to equate marginal utilities per dollar. As long as producers and consumers are aware of prices, and prices reflect real relative scarcities, maximum output will be produced at minimum cost. This model ensures that allocative efficiency (exactly the "correct" amount of each item is produced) and production efficiency (each item is produced at minimum average total cost of production) will be achieved. The crucial role of price is clear: it communicates relative scarcities to all participants in the economy. Government in this model is a referee, policing "honest weights and measures" and providing legitimate public goods (e.g., education and defense).

In brief, the market model is based on the broad concept that decentralized market-based resource allocation is more effective than administrative planning and controls. This concept comprises the following points: (1) development is seen to have the best chance of succeeding when private initiative is encouraged ("privatization"); (2) the economic systems of developing countries work best when they are allowed to work freely and efficiently; (3) the greatest harm to development in developing countries is government policy that distorts economic incentives and causes the economy to misallocate resources and therefore to produce at less than maximum possible levels; (4) if developing countries eliminate subsidies, price controls, and the protection of inefficient industries, development will accelerate; (5) developing countries should "get their prices right" (if the prices of labor, capital, foreign exchange, and commodities are appropriate, growth will occur); (6) developing countries are small parts of the international economy, and they must take their price signals for tradable goods from international markets and must produce commodities that reflect their comparative advantage. At the same time, institutions conducive to market-oriented development must be strengthened or created, government must not be a source of inflation, and impediments to resource mobility must be eliminated, so that the full force of price incentives will be felt throughout the economy.

Although these points make the case for the market, they do not adequately justify or explain policy-based lending. While few today would disagree that getting the prices right promotes the efficient allocation of resources, this is clearly not the only aspect of policy-based lending. Providing adequate infrastructure and increasing institutional capability are also important ingredients of policy-based lending. Thus, to hinge the rationale for policy-based lending largely on getting prices right is to seriously misstate the case.

Instead, a more useful understanding of policy-based lending rests on a multidimensional view of the theory of policymaking, which encompasses not only decentralized decision-making at the individual producer and consumer levels and decision-making based on scarcity prices, but also the creation of both physical and human infrastructure. This broader view acknowledges the need for government to intervene in markets to avert misallocations that arise from externalities, public goods, and other well-recognized departures from efficiency where prices deviate from social marginal costs.

In brief, in a larger treatment of policy-based lending than provided here, it would be useful to make the case for such lending by beginning with a rather narrow focus on optimal intervention for reaching microeconomic efficiency and then relating that intervention to the need for a consistent macroeconomic policy framework within which to undertake reforms.

In this broad context of market-oriented development with an outward orientation, more attention is being directed to the agricultural sector of developing countries. Adelman (1984) has suggested that external conditions are causing a reassessment of the export-led model. The central concern expressed in Adelman's article is that an agriculture- rather than export-driven strategy may be appropriate for countries that have not yet broken into industrial export markets. Such a strategy would be based on a public investment program intended to increase agricultural output. The heart of the strategy, Adelman states, "consists of building a domestic mass-consumption market by improving the productivity of agriculture and letting farmers share in the fruits of the improved productivity."

There are three important arguments for this strategy. First, it will stimulate domestic demand for industrial products, through linkages and through its distributional effects. Second, because agriculture is far more labor intensive than manufacturing, this strategy is a growth and employment program and also has the contours of basic needs and food security programs. And finally, this is a risk-reducing strategy, ameliorating the effects of weather and environment through irrigation programs and the use of pesticides. Industrialization would be accomplished, in effect, by expanding internal demand for consumer and other industrial goods. Internal demand will be especially important in the years ahead, because Adelman estimates that the rate of growth in world demand for imports may be about one-half its level during the 1960-1973 period.

The suggestion of an emphasis on agriculture does not negate the importance of an outward-oriented strategy, because the agricultural sector itself will benefit from such a strategy (it has been harmed in the past by an import-substitution strategy). This point is exemplified in the work of John Mellor of the International Food Policy Research Institute (see Mellor, Delgado, and Blackie 1985), and most recently in an article that summarized his position as follows (Mellor 1986).

Because economic development is a process that transforms a rural and agricultural economy into an urban and industry- and service-oriented one, Mellor asks the question: What is the role of agriculture, the originally dominant sector? He suggests that this question has essentially been neglected in theory as various development fads have come and gone (growth of capital stock, import substitution, basic needs, export promotion), although some countries in practice have given agriculture a central role (e.g., Taiwan, post-Meiji restoration in Japan). Mellor's thesis is that there is an "essential connection between agricultural growth and employment growth--and hence the need always to speak of an agriculture- and employment-based strategy, not of one or the other independently" (p. 69).

Mellor bases his reasoning for such a strategy on three elements. First, the limitations of relatively fixed land areas must be overcome through land-augmenting technological change. Second, domestic demand for food (not exports) must be increased through increased employment, which at low income levels translates quickly into increased demand for food. In this context, a decline in food prices would not be a favorable sign, because it would indicate an unbalanced strategy in which food output is exceeding increases in employment by an inappropriate margin. Third, a prosperous agricultural sector will provide increasing domestic demand for labor-intensive goods and services. This will follow if two conditions are met. Increased demand must result from what Mellor calls volume-increasing and unit-cost-decreasing technological change. Simply raising prices is not likely to help very much. Also, "highly developed infrastructure is essential to agricultural production growth, favorable consumption incentives, and to the complex, interactive system of region-based urban centers that are so essential to a high-employment content in an agriculture-based growth strategy" (p. 81). In all of this, additional capital will be generated in the agricultural sector, and at any rate, "agricultural linkages can contribute to reducing [capital] intensity and to spreading capital more thinly."

The policy implications of this development strategy are very clear. First, an open trading regime is required since the growth of needed capital-intensive imports supporting overall labor-intensive production will in turn require labor-intensive exports. As Mellor puts it, "a somewhat undervalued exchange rate facilitates full pricing of agricultural commodities; encourages restraint in using inputs that are capital-intensively produced because they will be imported and thus more highly priced; and provides some additional incentive to export the more labor-intensive commodities, helping to overcome the various institutional hurdles to exports that inevitably exist in developing countries" (p. 82).

Second, wherever poverty is massive this strategy should receive priority, because it increases the supply of less expensive food and increases the demand for labor, "the two essentials for removing poverty through growth" (p. 83). Regional disparities that may result can be overcome through migration. Also, income transfers may be necessary during the transition, and large-scale rural public works will help.

Third, there must be substantial public support for the small-scale agricultural sector in, for example, transport, power, communication, research, eduction, and input supply systems. Where and as soon as feasible, many of these functions should be transferred to the private sector. Because of the massive size of required infrastructure investment, governments must have the political stamina to commit a large share of the budget to this strategy and to continue this strategy in the face of other pressing needs.

Fourth, price signals in an economy undergoing rapid structural change are sometimes inefficient indicators of relative resource scarcities because of the lag between investment and results. For example, market prices are a weak guide on whether to initiate a vast irrigation project. At a minimum, shadow prices will be required for cost-benefit calculations, and several assumptions about the future desirable structure of development will need to be clarified. Therefore, it will be better for government to anticipate needs in the economy without always waiting for signals to indicate the needs. Also, in some subregions, technology may increase agricultural output faster than effective demand is increasing. This may necessitate government acting as a buyer of last resort, stockpiling, and shipping to other regions.

Fifth, developed countries need to keep their markets open for labor-intensive goods and services so that critical capital-intensive items can be imported for the high-employment strategy. Initially, foreign aid must play a very important role in improving education, particularly for conducting the advanced technical studies essential to this growth strategy. Finally, assistance "can contribute to financing imports of capital-intensive goods and services during the early stages of the strategy, when exports may still lag; and food aid can help provide infrastructure, facilitating a stable political environment through food for work and food subsidies. Such assistance will be useful during the transition period in overcoming the inequities built into the old strategy" (p. 86).

In brief, there is widespread agreement that agriculture must be improved greatly (see World Bank 1986d). Agricultural development is tied to overall economic growth, and growth is related to an outward orientation. Thus, agriculture prospers under an outward orientation.

A World Bank study (1987) of 41 developing countries for the 1963-1973 and 1973-1985 periods unambiguously established the beneficial effects on growth of an outward orientation. For this study, countries were classified as strongly outward oriented, moderately outward oriented, moderately inward oriented, and strongly inward oriented. Classification was made on the basis of the following quantitative and qualitative criteria: "(i) effective rate of protection (the higher the effective protection for domestic markets, the greater the bias toward import substitution); (ii) use of direct controls such as quotas and import-licensing schemes (the greater the reliance on direct controls on imports, the more inward oriented the economy); (iii) use of export incentives; and (iv) degree of exchange rate overvaluation (inward orientation generally leads to an overvaluation of the exchange rate)" (p. 82).

Although considerable mystery remains (e.g., does an outward orientation set the stage for rapid economic growth, or does such growth make possible an outward orientation?), the macroeconomic performance of the 41 countries studied clearly indicates that an outward orientation is strongly associated with growth (World Bank 1987, 83-87), as based on the following facts.

-- During 1963-1973, the annual average growth rate of GDP was 9.5 percent for the strongly outward-oriented group, more than double that attained by the strongly inward-oriented group. For 1973-1985, the respective rates were 7.5 and 2.5 percent.

-- The strongly outward-oriented group more than doubled its savings rate by 1985, while savings rates of the other three groups grew only slightly or stagnated.

-- Efficiency in the use of additional capital was higher in the strongly outward-oriented group, as measured by the economies' incremental capital-output ratios. For both periods, increased outward orientation was associated with decreased ratios.

-- During the inflationary 1970s and early 1980s, the strongly outward-oriented economies maintained relatively low and stable rates of inflation.

-- The growth rate for manufactured exports was clearly superior in the strongly outward-oriented economies.

-- In addition to a strong theoretical case that suggests that outward orientation leads to a more equitable income distribution, Gini coefficients (rough measures of income inequality) declined in several outward-oriented countries.

If history is a guide, then this study will undoubtedly be challenged on a variety of grounds by critics who will insist that the general inferences that can be drawn from the study are more limited than its authors suggest. For development specialists, however, this is yet another piece of evidence that suggests that appropriate market-oriented policies (in this case, those particularly important to international trade) do tend to be associated with rapid growth and its beneficial effects. An outward-oriented development strategy is key to industrialization in the future and, as Mellor notes, to current development of the agricultural sector.

This study shows that the actual performance of countries that provide equal incentives to exports and import substitutes do better in terms of growth, employment, and efficiency than countries that have inward-oriented strategies. As commonly defined, an outward-oriented strategy is one in which equal or neutral incentives are provided to both import substitution and export promotion activities. Seen this way, there is no conflict between an export-oriented strategy and agricultural development. Indeed, at low levels of income with relatively abundant land and labor, a country would have better agricultural development under an outward-oriented strategy than under an inward-oriented strategy.

In summary, the currently ascendant development strategy assumes that donors can help support development by encouraging developing countries to adopt appropriate macroeconomic policies, prices and incentives, and institutional changes. The possibility for such encouragement is associated with the increasing importance of nonproject assistance among donors.

2. A.I.D. CONDITIONALITY

This section examines the types of policy conditions applied by A.I.D. and briefly notes their conceptual basis. It then looks at some operating characteristics of nonproject assistance conditionality and concludes with an examination of the relationships between country size, institutional capacity, and policy reform. Finally, because A.I.D. practice does not occur in a vacuum, but reflects and influences the practices of other major donors, this section discusses World Bank and International Monetary Fund (IMF) theory and practices. (The rationale for and criticism of Bank and IMF practices are presented in Appendixes B and C on the basis of documentation available from those institutions.)

It is important to emphasize at the outset that there is no way of "grading" the experience of A.I.D., the Bank, and the IMF in their use of conditionality. For one thing, very little work has been done on the relationship between the stipulation of conditions in a nonproject aid package and the carrying out of those conditions. The operating assumption is that donors have some "leverage" to make host countries carry out policy and institutional changes deemed desirable by the donor. While this makes intuitive sense and there is some empirical justification for it, the absence of systematic studies of the functional relationship between conditionality and policy change is a cause for caution. Second, where policy change has been carried out, there is a wide range of criticism on various aspects of the results, and there is no way to systematically "weight" these in any final grade. What follows, therefore, is simply an attempt to summarize practices and goals of these institutions and to note the main criticisms directed thereto. No judgment is made on the comparative quality of the programs.

Current thinking among major donors is that market-oriented conditions attached to nonproject assistance will lead to badly needed policy reform and structural change in developing countries. Nonproject assistance is thought to be more useful for this purpose than is project assistance, mainly because the threat of withholding disbursements until reforms are implemented is credible with program aid but is not credible with project assistance. Also, the World Bank, and to a lesser extent the United States, has been able to concentrate assistance in such large amounts in single, quick-disbursing programs that it has been able to "buy a place" at the recipient government's "policy-making table." Critics suggest, however, that if the nonproject aid is very large, this probably represents a political commitment on the part of the donor that cannot be rescinded.

It is useful to note initially the current trends in conditionality among donors. A.I.D. perhaps has the most difficult assignment because its conditionality (described below) encompasses the whole range of possible policy changes that may be recommended. The World Bank bases its conditionality essentially on the two-gap model and its variants[5] and stresses market relationships within a strategy of export-led development. The IMF takes a narrower view of conditionality, concentrating largely on financial programming based on a clearly defined conceptual model of nominal financial flows.

Current trends in thinking in the three agencies diverge somewhat. Within A.I.D., policy conditionality is still on its ascendancy path, with the number of conditions attached to individual nonproject assistance very large, and possibly growing.[6] It seems reasonable to suggest that current emphasis on policy conditionality within A.I.D. will continue, but perhaps with increasing attention devoted within a policy framework to beneficiary impact (see Section 5).

The World Bank seems to be emerging as the main multilateral institution stressing conditionality, with its expansion of structural adjustment lending, although not all within the Bank think this is a positive development.

In the IMF, the new managing director, Michel Camdessus, faces several increasingly intense problems that are now part of public discussion on the IMF's future.[7] For one thing, continu-

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[5]The original works on the "gaps," which were prominent in the acceptance of this concept, were by McKinnon (1964) and Chenery and Strout (1966). This line of thought was associated with the growth theory popular in the 1960s that emphasized capital inputs and their relationship to domestic savings and investment, on the one hand, and to exports, imports, and foreign economic assistance, on the other. In effect, planners would identify two "gaps," the domestic investment gap and the foreign exchange gap, which would be determined on the basis of projected rates of economic growth.

[6]There is no hard evidence on whether the number is growing, but conversations within A.I.D. suggest that there remains widespread belief in the possibility of adding additional conditions to meet multiple objectives.

[7]For example, see "IMF Role May Change Under Camdessus As Nations and Banks Exert New Pressure," The Wall Street Journal, April 6, 1987. The remarks here summarize this article.

ing tensions between banks in the more developed countries and those in debtor countries have brought into question the effectiveness of the current global debt strategy. At the same time, there is increasing concern about the rather drab growth rate of the global economy, and growing questions about the current drifts in major exchange rates. All of these problems are worsened because the IMF's three largest members--the United States, West Germany, and Japan--face very large trade and payments imbalances. Some economists suggest that these problems could bring on a global recession, if uncorrected.

2.1 Types of Conditionality in A.I.D. Programs

Policy reform has several central goals: moving toward market-clearing prices (including exchange rates), correcting urban bias, rationalizing the public sector, promoting private sector investment and competition, and implementing institutional changes to support these goals. Policy instruments designed to achieve these goals vary widely, depending on donor interests and developing country institutional and political capacity.

A.I.D.'s approach to conditionality is more eclectic than that of either the World Bank or the IMF. Essentially, it emphasizes all government policies that reduce efficiency, employment, equity, or growth, while recognizing the extent of trade-offs among these variables. Several recent studies reveal the pattern and effectiveness of A.I.D. conditionality. Highlights of these studies are provided in Appendix A. The wide range of A.I.D. conditionality is presented in Table 1.

In 1985, at the request of the Chairman of the House Foreign Affairs Committee, the General Accounting Office (GAO) completed a study of conditionality in Bangladesh, Costa Rica, Egypt, Honduras, the Philippines, and Sudan (GAO 1985). (A brief description of each project or program and its conditionality provisions is provided in Table A-1 in Appendix A.) The internal A.I.D. transmittal memorandum on this report concluded that it is positive in tone and is a good compilation of A.I.D.'s policy dialogue efforts since FY 1982, and the efforts and results of negotiating policy reform in these six countries.

Briefly, the GAO report found that only 6 of the 19 Development Assistance (DA) projects studied required government action

Table 1. A.I.D. FY 1986 Conditionality Provisions by Policy Area and Country

FISCAL

Tax Reform
- Jamaica
- Senegal

Improve Tax Administration
- Haiti
- Honduras
- Jamaica
- Senegal

Reduce Expenditures
- Chad
- Costa Rica
- Dominican Republic
- El Salvador

MONETARY

Limit Domestic Borrowing
- Costa Rica
- El Salvador
- Honduras

Limit External Borrowing
- El Salvador

Permit Interest Rates To Rise to Market-Clearing Levels
- Ecuador

Enhance Private Sector Access to Commercial Credit
- Costa Rica
- Togo

EXTERNAL TRADE

Limit/Reduce Export Taxes
- Dominican Republic
- Zaire

Reduce Import Tariffs
- Ecuador
- Kenya
- Senegal
- Zaire

Promote Exports
- Belize

Require Purchase or Attribution of Equivalent amount in U.S. Commodities (code 000)
- Bolivia
- Costa Rica
- Dominican Republic
- Ecuador
- Guatemala
- Israel
- Jamaica
- Mozambique
- Panama
- Somalia
- Tunisia

Require Purchase or Attribution in Code 000, 899, or 941 Countries Only
- El Salvador
- Egypt
- Grenada
- Honduras
- Sudan

Enhance Private Sector Access to Foreign Exchange
- Costa Rica
- Honduras
- Mozambique
- Somalia

Reduce Restrictions on Exports
- Belize

Reduce Administration of Restrictions on Exports
- Belize
- Kenya
- Haiti
- Senegal

Foreign Exchange (general)
- Zaire
- Zambia

Reduce/Eliminate Difference Between Official and Market Exchange Rates
- Costa Rica

PRIVATE SECTOR

Deregulate Price and/or Controls
- Belize
- Ecuador
- Grenada
- Kenya
- Mozambique
- Togo

Decrease Administrative Controls/Regulations
- Kenya

Enhance Access to Markets and Productive Resources
- Dominican Republic
- El Salvador
- Mozambique
- Somalia

Enhance Entrance Into Selected Activities
- Somalia
- Togo

Reduce Price or Market Controls
- Belize
- Kenya
- Togo

Increase Access to Domestic Credit
- Somalia

Increase Private Sector Access to State Agricultural Holdings
- Dominican Republic

PARASTATALS

Divest Parastatals
- Costa Rica
- Grenada
- Panama

Restrict Parastatal Activities
- Belize
- Grenada

Source: A.I.D. (1986).

as conditions precedent or as covenants.[8] Three of these were in Bangladesh "where A.I.D. is a relatively large donor, and where policy dialogue is not affected by overriding U.S. security concerns." (Bangladesh did not receive Economic Support Fund [ESF] assistance.) Of the three other projects containing conditionality provisions--one in Honduras and two in Sudan--two focus on sectoral policy and the third focuses on trade policy. In general, where "A.I.D. did not use conditionality extensively in project assistance--Costa Rica, Honduras, Sudan--A.I.D. has significant ESF programs in which conditionality is an integral part."

Of the eight ESF projects studied, the four with policy conditionality were in Egypt. "In most cases, ESF projects finance activities within A.I.D.'s six development accounts and usually have the sectoral policy orientation of DA-funded projects. In Egypt, A.I.D. has attached some conditionality to its ESF project assistance focusing on Egypt's need for major economic adjustments. However, the political nature of the Egypt program limits the extent of the conditionality which A.I.D. can apply."

ESF conditionality in the projects studied related mainly to macroeconomic reform. However, the extent and success of A.I.D.'s conditionality varied in each program reviewed, as the following quote suggests.

For example, U.S. political and security interests in Honduras and the Government of Honduras' reluctance to

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[8]The GAO report states: "A condition precedent is an action A.I.D. requires the recipient government to take before assistance funds can be disbursed. A covenant is an action A.I.D. requires the recipient government to take before, during, or after assistance is provided, but is not required for disbursement. Covenants could involve actions that continue over a period of time, such as maintaining free market prices. Conditions precedent and covenants are found in both ESF [Economic Support Fund] and DA agreements. Self-help measures, which are unique to the PL 480 program, are similar to covenants; they are actions the recipient government agrees to undertake, but are not required prior to the delivery of food commodities. A.I.D. policy guidance suggests that conditions precedent, covenants, and self-help measures be as explicit as possible, though not necessarily quantifiable, to facilitate monitoring and evaluating progress." It is noted that "the summary of Costa Rica includes discussion of several conditions known as Prior Actions which were not part of formal agreements, but which were identified by A.I.D. as significant policy conditions" (p. 3).

> undertake reforms has affected A.I.D.'s ability to enforce and require difficult policy changes. In Egypt, where U.S. political interests are also an important factor, A.I.D. has not required the Government of Egypt to undertake extensive policy reform, although policy dialogue is a part of A.I.D.'s program. In Costa Rica, on the other hand, A.I.D. has been more successful because of effective donor coordination and the Government of Costa Rica's commitment to economic adjustment (GAO 1985, 4).

Legislation requires that the PL 480 Title I programs "contain self-help measures aimed at improving the efficiency of the agriculture sector," but "the policy focus of the self-help measures differed in each country" (GAO 1985, 2).

In summary, the GAO report contains information of a generally positive nature on A.I.D.'s attempts at policy dialogue and policy reform. At the same time, the report cites many variations that relate both to the funding source (ESF, DA, or PL 480) and to the political and strategic place of the country in A.I.D. programming. As a result, it is difficult to define all of the conditions for future programming under which success might reasonably be anticipated. One is tempted to say that conditionality seems to work under some conditions and not to work under other conditions.

A different perspective is provided by a November 1986 report on A.I.D. conditionality that examines the types of conditionality applied to ESF Cash Transfer and Commodity Import programs as seen in the original project proposals (the Program Assistance Approval Documents [PAADS], for nonproject assistance) for 1986.[9] The study is limited in three ways: (1) it examines data for only 1 year and thus does not indicate trends, (2) it excludes Titles I and III PL 480 programs and includes only one DA-funded project to which conditionality was attached, and (3) it does not reflect what actually resulted from A.I.D. conditionality, since that would become evident only in the loan agreements that were eventually concluded. Although these are significant limitations on the general applicability of the report, A.I.D. has until recently devoted very few resources to evalua-

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[9]Interoffice memorandum from Kenneth Kauffman (Associate Assistant Administrator, Office of Economic Affairs, Bureau for Program and Policy Coordination) dated November 25, 1986, with an attachment entitled "A.I.D. Conditionality: A Review of Recent Conditions Contained in FY 1986 Program Assistance Approval Documents (PAADS)." This discussion is based on that report, which is quoted and paraphrased.

tion or understanding of its policy-conditioned programs; this report is an important step in that direction.

The November 1986 report offers three general observations on A.I.D. conditionality. (See Tables A-1 through A-6 of Appendix A for details on conditionality.) First, conditionality was employed with greatest frequency in the Latin America and Caribbean region, but is scarcely used at all in Asia and the Near East. Sub-Saharan Africa fell in between these extremes. Second, where conditionality is employed, it tends to become more comprehensive and detailed as the amount of resources devoted to the program increases. Third, while A.I.D.'s use of conditionality is increasing, the total amount of resources conditioned on macroeconomic performance still constitutes a comparatively small proportion of total U.S. bilateral economic assistance. In FY 1986, for example, only 20 percent of ESF resources had some conditionality of this kind attached.

The economic policy conditions contained in the 1986 PAADs examined fall into four categories of policy reform: nonfinancial public sector policy, monetary policy, foreign trade and exchange rate policy, and private sector policy.

Nonfinancial public sector policy. Policy conditions in this area included efforts to reduce public sector expenditures, promote tax reform, dismantle price and market controls, and divest or restrict the activities of parastatal enterprises.

In recent years, severe budget deficits have characterized the economies of Chad, Costa Rica, the Dominican Republic, and El Salvador. Conditions were stipulated for those countries that called for reducing the budget deficit as a percentage of GDP by lowering expenditures. A.I.D. allowed the countries to choose which programs to cut and by what amounts. The Costa Rica conditionality was somewhat different in its approach. USAID/Costa Rica divided the disbursements into tranches, releasing some funds for a Government commitment to accept the targeted reduction as official public policy and releasing the remainder upon statistically verified achievement of the objective.

Reform of the existing tax structure was established as a condition for balance of payments assistance in Honduras, Jamaica, and Senegal. In these countries it was argued that marked reductions in the tax rates, together with an expansion in the tax base, would encourage the efficient allocation of resources, improve equity, and lead to a more flexible and responsive tax system. The programs in Honduras were restricted to municipal and local taxes, while those in Haiti and Senegal also required additional improvements in the administration of revenue collection.

Deregulation of price and/or market controls was a condition of the assistance provided to the sub-Saharan African countries of Kenya, Mozambique, and Togo, and the Latin American countries of Belize, Ecuador, and Grenada. The requested deregulation was usually related to a narrow range of relatively important commodities--petroleum in Ecuador, fertilizer in Kenya, a limited number of cereal grains in Mozambique, and corn in Togo. Only in Belize and Grenada were more general reforms required. Belize was to reduce by half the number of items subject to price controls, and Grenada was to submit a plan for decontrolling prices that would be acceptable to USAID/Grenada.

Divestiture of parastatal enterprises was a condition employed almost exclusively in Latin America (Malawi was the only exception). Costa Rica, Grenada, and Panama were all required to continue an ongoing process of identifying state enterprises for divestiture. No parastatal enterprises were specifically identified for such action at this time, however. The Government of Belize was required to restrict the parastatal marketing board's operations to a much narrower range of activities.

Monetary policy. Reducing the public sector's capacity to borrow domestically or abroad, decontrolling interest rates, or channeling more credit to the private sector were the goals in this area of policy conditionality.

Relatively few conditions were established in this area. Most of them related to limiting the borrowing authority of the public sector, permitting interest rates to rise to market-determined levels, or enhancing private sector access to commercial bank credit.

Because limiting the public sector's capacity to borrow was clearly a matter for concern for some Missions in Central America, Missions in Costa Rica and Honduras proposed conditions that would restrict the host government's ability to finance budget deficits through continued domestic borrowing. PAADs for both countries expressed concern for the extent to which the practice unduly restricted the private sector's access to credit and for the potential of deficits to fuel inflation and increase the domestic debt burden. Moreover, Costa Rica and Togo were requested to increase private access to credit. Concerns in El Salvador were similar, but conditionality there was targeted at the Government's foreign borrowing operations.

Foreign trade and exchange rate policy. Conditionality in this area involved reducing tariffs or administrative controls on imports and, less commonly, eliminating export taxes, loosening administrative requirements for exports, and reducing the gap between official and market rates of foreign exchange.

Conditions for reducing tariffs on imports appeared in sub-Saharan Africa (Kenya, Senegal, and Zaire) and Latin America (Ecuador). In addition, Kenya and Senegal had to reduce administrative red tape associated with applications for permission to import. Belize was to substantially reduce the number of items for which importation was prohibited. The Dominican Republic and Zaire were subject to conditionality provisions requiring the reduction or elimination of taxes on exports. In Belize, a reduction was required in the amount of paperwork required to export.

Conditions for three countries--Costa Rica, Zaire, and Zambia--related to reducing or eliminating the difference between their official and market-determined exchange rates. Mozambique and Somalia in Africa and Costa Rica and Honduras in Central America were specifically required to make a larger amount of foreign exchange available to the private sector.

Private sector policy. Elimination of price controls and enhanced access to productive resources and markets were the conditions for this policy category.

Many of the measures included under this heading are either identical or similar to those discussed above under foreign trade and exchange rate policy. Their distinguishing characteristic under this category is that they are linked explicitly to measures to be taken on behalf of the private sector. Measures designed to reduce regulatory controls in one form or another were employed fairly frequently, especially in sub-Saharan Africa. Conditions for both Kenya and Togo required fewer price controls and greater leeway for price determination at or closer to levels that would clear the market. Conditions for Kenya also required fewer or simpler administrative controls over market transactions.

Enhancing private sector access to productive resources and markets appeared as a condition in the programs of the Dominican Republic, El Salvador, Grenada, Mozambique, Somalia, and Togo. In some cases, the conditions specified a fairly restricted area of activity. In Mozambique, for example, the conditionality was limited to private sector involvement in the import and distribution of commodities financed under the program. Likewise, in Kenya the conditionality applied only to the importation of fertilizer. In other cases, however, the requirements were more sweeping. In Guinea, they applied to the sale and distribution of all agricultural inputs. In Somalia, the conditions were phased to permit the establishment of private sector financial institutions, the exportation without license of the principal export commodities, and a general opening of all economic activity to private enterprises, in that order. Likewise, the Dominican Republic and Grenada had to permit private sector access to state agricultural holdings for a variety of agricultural pursuits.

Beyond these four types of conditionality, there were other procedural conditions attached to nonproject assistance. For example, there was an administrative requirement tying the stabilization/structural adjustment program to the purchase of an amount of goods equivalent in value from the United States or a restricted group of developing countries. This requirement was widely imposed to reflect U.S. interests rather than the reform of policies in the host countries. Indeed, it was so frequently employed in the Latin America and Caribbean region that it is simpler to note that Haiti was the only country in which the requirement was not used. Furthermore, the rationale for the omission of the requirement in Haiti's case was that the country already acquired such a large proportion of its imports from the United States that a formal condition would not be necessary.

Note, however, that two of the Central American countries, El Salvador and Honduras, were permitted to make some purchases in other countries. This was done because the programs in both countries had become so large relative to the size of their economies that requiring them to purchase an equivalent amount of imports exclusively from the United States would severely disrupt the structure of their international trade. As members of the Central American Common Market, both are treaty-bound to purchase from other members. They were also permitted to meet some of their requirements for imported petroleum with purchases from a non-U.S. source.

The situation in Sub-Saharan Africa was markedly different, however. Fewer than half of the countries in that region were subject to tied aid. Moreover, two of those countries (Kenya and Sudan) received their ESF funds exclusively in the form of Commodity Import programs. Finally, in the Asia and Near East region, only Egypt and Israel were subject to the requirement and then only for certain components of their nonproject assistance programs.

It is clear, then, that conditionality varied in many ways in those programs studied. Variations by region were as follows. The countries in Asia and the Near East, including the leading recipients of U.S. economic assistance, were subject to negligible conditionality. Conditionality provisions in the Africa region were relatively more concentrated in the external and private sectors. In the Latin America and Caribbean region, A.I.D. employed a wider variety of conditionality provisions with greater frequency than in the other regions (the conditionality provisions also appeared to be relatively more evenly distributed among the four functional areas). Conditionality was rarely applied to only one area in either Africa or Latin America. Similarly, it was also rare for a recipient to be subject to conditionality in all four areas simultaneously (the sole exceptions were Costa Rica and El Salvador, both of which had comparatively large programs).

Finally, the November 1986 report summarized the relative size of programs containing conditionality provisions. In recent years, the overwhelming majority of nonproject assistance programs have been funded through the ESF account. Occasionally, however, DA resources also have been employed for the same purpose. In FY 1986, for example, $10 million in DA funds were obligated for Malawi to support the divestiture of several parastatal enterprises. In that fiscal year, $724.9 million was devoted to nonproject assistance programs containing conditionality provisions other than requirements relating to the source of imports. This was 27.6 percent of the total obligated for Commodity Import and Cash Transfer Programs, 20.2 percent of the $3,581.6 million contained in the entire ESF account, and 15 percent of the $4,822.4 million contained in the total DA and ESF accounts for bilateral U.S. foreign economic assistance.

Studies completed in early 1987 of programs designed to improve the agricultural sector in Mali (Wilcock, Roth, and Haykin 1987), Somalia (Goldensohn, Harrison, and Smith 1987), and Zambia (Weideman, Koropecky, and Thomas 1987) provide further evidence of the nature of A.I.D. conditionality. The programs studied represent sector approaches to conditionality. These studies were concerned with the effects or consequences of policy reforms, including those independent of conditionality. They do not address the question of the effect of conditionality on policy reform.

In Mali (see Wilcock, Roth, and Haykin 1987, 8-23), conditions were directed toward the restructuring of state participation in marketing of staple cereals (Table 2). Major reforms were undertaken, mainly under three IMF Standby Agreements in effect since 1981. These agreements resulted in the restriction of domestic credit expansion and Government borrowing abroad; abolishment of the Central Bank of Mali and establishment of its participation in the West African Monetary Union beginning in June 1984; reduction of Government debt, especially from reduction of Government employment; the restructuring of public enterprises; and curtailment of state intervention in the private sector.

In this context, A.I.D. developed the Cereals Market Restructuring Program (PRMC) "to assist Mali to achieve food security on a self-sustaining basis. Its purpose is to achieve marketing policy reform in the cereals subsector with the coordinated support of Mali's largest donors. PRMC Phase I involved three distinct but interrelated stated <u>objectives</u>: market liberalization; the improvement of cereals production incentives; and a reduction in subsidies to the state grain marketing system" (Wilcock, Roth, and Haykin 1987).

The following major policy actions (see Table 2) were carried out under the Mali program.

Table 2. Major Policy Reforms Made Under Cereals Market Restructuring Program in Mali, by Impact Area

Private Trade	Producers	OPAM/ODRs[a]	Consumers
Ended confiscation; reduced harassment	Raises official floor prices	Reduced OPAM mandate	Allowed private cereals trade
Made existing trade in grain and rice legal	Legalized private trade	Increased marketing margin	Regulated consumer price; increased consumer price
Legalized private cereals imports		Improved efficiency; reduced subsidies	Provided food security "safety net"

[a]OPAM/ODR is the State Cereals Marketing Agency/Rural Development Organization

Source: Wilcock, Roth, and Haykin (1987).

<u>Liberalizing the grain market</u>. The Government agreed in March 1981 to give private merchants, producers, and government agencies (including parastatals) the legal right to purchase and sell foodgrain. Specific action taken included continuing the practice (begun in mid-1980 before the liberalization program) of not restricting grain shipments on the main roads, opening all grain trade to licensed merchants, and legalizing grain imports by private merchants without taxing the imports, applying quotas, or restricting access to foreign exchange.

<u>Improving cereal production incentives</u>. This included two actions: (1) periodically increasing Government-set floor prices for sorghum/millet, maize, and paddy to stimulate more planting or intensification of production, and (2) legalizing grain sales from farmers to private merchants for resale.

<u>Reducing subsidies and improving public sector performance</u>. A major intent of this change was to reduce subsidies needed for the operations of state buying and marketing agencies. This was to be accomplished by increasing the allowed margin for state grain marketing in the official price schedule and by decreasing the role of state agencies in grain marketing and improving their efficiency.

Evaluation of this program concluded that

> Policy reforms had not have the desired effect in three critical areas. First, no link has been established between increases in cereals production and policy reforms. Second, although farmers' incomes probably increased, it is not possible to disentangle the incentive effects of policy reforms from improvements caused by the weather. Third, variability in domestic cereal production overwhelmed the public sector. It was barely able to stabilize consumer prices as expected during the drought years. When cereals output rebounded, the public sector was unable to sustain its buying operations (Wilcock, Roth, and Haykin 1987, 29).

In Somalia (see Goldensohn, Harrison, and Smith 1987), A.I.D. and other donors tried to convince the Government to undertake a series of liberalizing reforms of economic and agricultural policy. Since 1981, several important changes have been made:

> The exchange rate has been freed to float to a more realistic level; domestic cereal and livestock marketing has been privatized; a stabilization program has been adopted to curtail demand expansion; certain government and parastatal monopolies have been abolished including those ... to import consumer goods, the Banana Board to purchase and export bananas, the Livestock Development Agency to purchase and market animals for export, and the Agricultural Development Corporation to purchase and sell domestic cereals; imports of most goods, including most agricultural inputs, have been liberalized; civil service reform has begun and the [government] has ceased acting as an employer of last resort; the [government] has reoriented its basic

> strategy from an urban/industrial to an agricultural one (p. 1).

(These changes are presented in detail in Table A-6, Appendix A.)

It is interesting to compare A.I.D.'s efforts in Somalia with those of other major donors, as shown in the policy inventory matrix presented in Table 3. A.I.D. conditionality provisions often touched all major areas of policy change. Other donors, in contrast, were more selective in their efforts.

The evaluation team thought that the Somalian economy had "responded well to the increased opportunities for private sector activities." They noted, among other changes, the following results: (1) grain production has dramatically increased, accompanied by rising farmer income; (2) herder income has kept pace with rises in consumer prices, and may have risen faster; (3) the private sector has reacted to decontrol and increased disposable income in many sectors of the population by expanding dramatically; (4) small- and medium-scale enterprises seem to have proliferated spectacularly; (5) production inputs are becoming more readily available through the private sector, including some veterinary drugs, medicines, fertilizers, agricultural chemicals, and seeds; (6) exports from the privatized banana sector have risen, and exports from the privatized livestock export sector have begun to capture new markets and to approach the level of exports enjoyed by the country before Saudi Arabia banned imports of Somali cattle; (7) a reverse rural exodus has begun, with urban dwellers returning to the countryside to farm, either as permanent residents or as transhumant farmers; and (8) consumer welfare in the cities has improved, because legal prices for domestic foodstuffs are relatively lower than they were under socialism, when almost no food was available officially and the black market supplied small quantities at excessive, speculative prices (pp. 1-2).

Despite the successes, problems remain in Somalia's economy. The evaluation notes a large external debt burden and poor balance of payments situation, staggering annual budget deficits, an agricultural sector still vulnerable to catastrophic drought, and an expensive and inefficient public administration. The evaluation lists the following as "among the most urgent remaining reforms": (1) remaining state or parastatal monopolies and monopsonies must be rationalized; (2) civil service reform must be pursued; (3) Government expenditures must be reduced to the level of potential revenues and budgeting improved; (4) the Government must begin assuming responsibility for recurrent costs of projectized activities; (5) the privatization of key economic sectors, such as banking, insurance, and petroleum imports, should be encouraged; (6) the official exchange rate should reach a realis-

Table 3. Areas of Policy Reform in Somalia, by Donor

Donor	Exchange Rate Unification	Exchange Rate Freedom	Civil Service Reform	Privatization of Parastatal	Recurrent Costs	Interest Rates	Liberalized Marketing	Liberalized Input Supply	Bank Privatization	Surrender Requirement	End Price Control	Food Aid
A.I.D.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Low as possible	Yes	Yes
World Bank	Yes	Yes	Yes	Only when appropriate	Yes	Yes, but might accept subsidies for some sectors	Yes	Yes	Yes	Ok as tax at these rates	Floors, ceilings	No
IMF	Yes	Not necessary	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Necessary	Floors, ceilings	No
Germany	Yes, support IMF	Not necessary, but encouraged	Yes	Yes	No	Yes, weakly	Yes	Yes	Yes	--	Floors, ceilings	No, UNHCR only
Italy	Yes, weakly	Yes, weakly	Yes, weakly	Ambiguous	Italy will pay them	Yes, weakly	Yes	Yes, weakly	No hope	--	Slow, gradual	No
France	Favor, but don't expect it	Yes	Yes strongly, but no action	Yes, lead to investment	Not much	Yes	Yes	Yes	Yes, but not French bankers	Eliminate if possible; useful as tax	Yes	No
U.N. Agencies	Not interviewed	Not interviewed	Yes, but only pushing	Where appropriate	Yes, but not pushing	Not interviewed	Yes	Yes	Not interviewed	Not interviewed	Floors, ceilings	Yes (WFP)

Note: The donor opinions reproduced in this table are drawn largely from interviews with representatives in Somalia. Exceptions are the World Bank, whose Somalia Agriculture Projects Officer in Washington, D.C., received the team and provided them with his policy options documents, and the IMF and A.I.D., which also provided the team with policy option papers. While the IMF, the World Bank, and A.I.D. have active stances on all of the policies mentioned in the table, the other donors usually do not. The French, German, and United Nations agencies do not attach any conditionality provisions to their aid and thus engage only indirectly in policy dialogue. They say they are the country to help the Government of Somalia or for humanitarian and or political reasons. The Italians are the most important bilateral donor in Somalia, but their progr coordinated very little if at all with those of the other donors. Most of the Italian assistance is outside of the Public Sector Investment Program and was conceived in reac to the pressures of the Government of Somalia requests and Italian commercial interests.

Source: Goldensohn, Harrison, and Smith (1987).

tic level; (7) rules, codes, and regulations governing land use and tenure, foreign and domestic investment, taxation and incentives, and customs must be simplified and codified; and (8) effective decentralization of governance and revenue generation and use must be studied and implemented (p. 4).

However, in general, the evaluation of the Somalia program is very positive.

In Zambia (see Weideman, Koropecky, and Thomas 1987), the main thrust of the program in agriculture has been deregulation of producer prices, the freeing of marketing from some state intervention, elimination of fertilizer subsidies, and establishment of free market exchange rates. At the same time there have been efforts to reduce or eliminate subsidies on consumption, marketing, transport, and handling of maize. Finally, there have been moves to rationalize tariff structures and remove import barriers and to allow interest rates to seek free market levels.

The more important policy changes in Zambia since 1979 are summarized in Table A-7 (Appendix A).

The largely successful results of the program were assessed by the evaluation team in summary form as "lessons and implications" and are worth citing verbatim because they touch on the most important aspects of agricultural reform in most countries. (This record should be read in the context of Zambia's 1987 repudiation of many aspects of the structural reform package to which the country was committed, which is discussed below.) The lessons and implications are as follows (pp. 42-44):

1. The turnaround in Zambian agriculture and agricultural exports suggests that it was the policy environment, and not the physical environment, that until recently acted as a constraint on agricultural production.

2. A basic and monumental change has been taking place in the roles of the Government and the private sector in the Zambian economy. Zambia is changing from a very interventionist and controlled economy to a more liberal, mixed economy, while at the same time preserving the philosophy of humanism.

3. The display of political will in carrying out the restructuring of the economy has been impressive in the face of some very high costs in terms of disruption and loss of income for critical groups. Among Zambians there is nowhere near unanimity of opinion on "staying the course" in carrying out

reforms, however, and there has been some equivocation.

4. Changes are beginning to show positive results after an initial period of floundering. Preliminary results are beginning to be felt in increases in agricultural and manufacturing income, replenishing of manufacturing capital stock, rising agricultural exports, and a general shifting of the terms of domestic trade in favor of agriculture. However, there have been costs in terms of real income losses in urban areas, increased inflation, and political disruptions.

5. The economic restructuring that is underway generally seems to be regarded by most Zambian officials as heading in a laudable direction. However, they will frankly admit that mistakes have been made in the implementation and management of some programs. Many of the complaints about the restructuring are directed at implementation and management, rather than toward the contemplated change.

6. Small farmers with marketable surplus in particular have responded to changes in the incentive structure by adjusting the level and mix of inputs, altering cropping patterns, and increasing levels of output. The increased output has placed strains on the storage and marketing infrastructure.

7. The groups that most clearly have benefited from the economic restructuring are the small farmers and traditional farmers and, to a lesser extent, the large commercial farmers, manufacturers, exporters, and the private sector in general. The groups most favored under the old system (formal sector wage workers, Government employees, and public enterprises) have been hit hardest by the economic restructuring.

8. Smallholder farmers constitute a high proportion of the population and are among the poorer segments of society. Since the economic restructuring favors this group, income distribution in Zambia is becoming more equitable. Because the economy was in a long-term decline, it is not clear whether groups that have not yet directly benefited (such as urban consumers) are presently better off or worse off than they would otherwise have been under the old policies.

9. The economic restructuring in progress is a long-term undertaking. The first significant steps in this restructuring process were taken 4 years ago and the process is still not complete. There is evidence that the economic decline that started in the mid-seventies is slowing and perhaps has bottomed out. The recovery process is anticipated to require as much as 10 years to allow the changes to work fully through the economy.

10. The IMF and World Bank have taken a lead among the donors in requiring and supporting economic restructuring. Donors are generally aware that the economic restructuring places tremendous pressures on the social and economic fabric of the country and that there are likely to be mistakes, delays, and slippage. An important question is whether the donor community is sufficiently aware and committed to "stay the course" with the additional resource transfers necessary to ensure the success of the restructuring program.

In brief, according to the evaluation report, the Zambian economy is changing from a very interventionist and controlled system to a more liberal, mixed, and decentralized one. The sequencing or phasing of policy reforms is central to success. In Zambia, change began with a strong statement by the Government in 1979 emphasizing agricultural development. In 1980, producer incentives were improved, followed in 1981 by another round of timely price increases and a reduction of the maize subsidy of more than 50 percent. In that year, the importance of the marketing parastatal was also reduced. In 1982, retail prices were decontrolled for all major products except wheat, maize, and candles. In 1983, the kwacha was devalued 20 percent and allowed to float. And so it went, with further decontrols and greater reliance on market prices, reduced subsidies, and a freer exchange rate. The full list of important policy changes over the 1979-1986 period is provided in Table A-7 (Appendix A).

In general, A.I.D.'s experience with policy conditionality in Africa (primarily in Mali, Somalia, Zaire, Zambia, and Zimbabwe) falls into the following categories of impacts (Haykin 1987, 32-38).

Agricultural sector impacts

-- Farmers responded to changes in incentives. There is clear evidence that farmers responded to freer markets and price signals and made choices that maximized their welfare.

-- Reforms led to significant increases in food production. In the presence of adequate rainfall, donor-assisted policy reform programs were the dominant causes of increased food output in Somalia, Zaire, Zambia, and Zimbabwe.

-- The major beneficiaries were small farmers.

-- Agricultural policy reforms had a quick impact on output and income. This supports the view that the quickest way to lift African agriculture from its current stagnation is to support reforms in the producer's incentive structure.

-- Policy reforms had the greatest impact where other constraints were less binding.

-- Policy reforms promoted private sector development in rural areas.

Economywide impacts

-- Distributional equity has improved: these countries reduced the urban bias of their economic systems. This improvement in distributional equity is consistent with fundamental U.S. goals in supporting policy reforms.

-- Market structure and spending reforms helped African governments in their efforts to cut budget deficits.

-- Reform programs had favorable effects on balance of payments.

-- Macroeconomic progress has been slow due to bad weather, falling export prices, and large debt service payments.

Implementation

-- Policy reform implementation failures can defeat the best program (of the three countries studied, Zambia was most seriously affected by these problems).

-- Price interventions are extremely difficult to manage. In general, supporting high prices in the face of supply gluts is too much of a drain on government resources.

-- There has been insufficient donor assistance to keep import levels from falling and inflation from increasing.

Role of donors

-- In some cases, the combination of financial necessity and common sense will lead to structural adjustment even without reform programs.

-- At the same time, external assistance has been critical to adoption of policy reforms by African governments.

-- A.I.D.'s role has been both catalytic and supportive.

Continuing emphasis on policy reform

-- Policy reforms are not the only answer to Africa's economic problems, but they are an important part of the answer.

-- Policy issues stretch beyond the purview of African governments (e.g., African debt and future world trade are international issues).

-- It is important that the United States and other donors maintain their commitments to reform programs if these programs are to succeed.

2.2 Operating Characteristics of Nonproject Assistance

Nonproject assistance can be viewed in terms of its various operating characteristics.

2.2.1 Effectiveness Issues

There are effectiveness issues specific to various forms of aid. These issues, which are common to nonproject assistance from all donors, include the following[10]:

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[10]This section is based on reported discussions concerning concessional flows within the Development Assistance Committee of the Organization for Economic Cooperation and Development in 1983.

-- The relationship between the effectiveness of nonproject assistance and its accountability (Is nonproject aid as accountable as project aid? If not, how can it be made more accountable? Will this make it more effective?)

-- The fungibility of nonproject assistance (How can the effectiveness of such assistance be ascertained if this form of aid is particularly vulnerable to being preempted for other than agreed-upon uses?)

-- The effectiveness of structural adjustment assistance as a vehicle for encouraging policy reforms at the sectoral or country level

-- The effectiveness of the linkages between nonproject assistance and other flows, including the IMF and private financial flows to developing countries

-- The effectiveness of sector support

In contrast, issues common to project aid include the following:

-- The advantages and disadvantages of rate-of-return analysis in assessing project contributions

-- The effect of government policies on project achievements

-- The effectiveness of project lending as a vehicle for promoting policy reform, institutional reform, and improvements in efficiency and management in recipient countries

-- Issues in project design

-- The effectiveness of "poverty oriented" projects in alleviating both rural and urban poverty in developing countries

-- The impact of contextual factors on project effectiveness, including the domestic context (such as local sociocultural and political features) and the international context (such as movements in international prices)

The effectiveness issues related to the conditionality provisions often attached to nonproject assistance may be divided into two parts: issues internal to program conditions and issues external to program conditions. For example, a reduction in overvalued exchange rates will not have the salutary effects intended if the state budget deficit is expanded, resulting in further inflation.

It is also the case that while appropriate policies may be a necessary condition for growth and improved equity, there are other external conditions that must be fulfilled if the policy reforms are to be effective. External conditions could include the following (from Richardson and Ahmed 1987):

-- A favorable international environment for developing country exports

-- Appropriate levels and types of external economic assistance, including debt relief

-- Development of effective regional markets that reduce scale limitations for the smaller economies

-- A stable and predictable political environment

-- Increased legitimacy of leadership in developing countries

-- Existence of an institutional and legal environment conducive to private sector development

-- A population that does not pose an insurmountable "dependency" burden

-- At least the rudiments of an environmental policy inhibiting debasement of the natural resource base through deforestation, desertification, and overgrazing

-- Adequate manpower and skill availabilities, with appropriate attention directed toward the "brain drain," especially in the smaller developing countries

-- A resilient institutional structure

In brief, there are both internal and external "enabling conditions" important for effective policy reform. In the absence of such conditions, the efficacy of policy reform is much in doubt.

2.2.2 Country Size and Institutional Capacity for Policy Reform

Do poorer developing countries have the institutional basis to apply the free market model? In many such nations, much of the economy is a nonmarket subsistence economy. How much can be expected from price and market policies when so much of the economy is outside the modern price/market economy? Policies and prices work through markets for capital, labor, raw materials, imports/exports, and final products. If such trading markets are thin and represent only a small share of GNP, how much impact can macroeconomic policy changes have? Does more work need to be done to improve skills, markets, and institutions before emphasizing policy reform? These are some of the questions that must be addressed in the design of conditionality.

Significant political differences between small and large countries add an additional note of uncertainty in the application of policy conditionality. As Nelson (1986) has stated:

> There are no neat and realistic "models" available to predict and analyze the interactions of politics and alternative stabilization packages for a specific country. Even if such theoretical models existed, most of the country-specific data needed for such a model would not be available. Indeed, some of the crucial information is closely held, especially information on goals and perceptions of key factions and individuals in the highly personalistic politics of many small, poor countries (pp. 984-985).

In sum, the necessary political analysis of likely outcomes from stabilization policies may be more difficult in small countries than in larger countries.

A case can be made that any difference in IMF treatment of small and large countries is most likely to be related to the nature of the current exchange rate system. Erb (1986) argues that the current system permits countries that can borrow to do so freely, while those with limited borrowing capacity are subject to external pressures. "This means simply that small countries must meet more external rules than large countries. Similarly, it might be alleged a country can run a large surplus without being subjected to pressure to adjust. Here again, this is more a function confusing asymmetry under the current system with the process of surveillance per se, and it is really a function more of the structure of the exchange rate system than of surveillance" (p. 4).

2.3 Measuring Progress in Carrying Out Policy Reform

Twenty years ago Hirschman (1967, 160-188) argued for what he called "the centrality of side-effects" in project appraisal. His essential point was that "some of the so-called side-effects ... turn out, a bit surprisingly, to be inputs essential to the realization of the project's principal effect and purpose" (p. 161). A single example will illustrate his point:

> A recent publication argued strongly that in evaluating investment in highways (as an alternative to railways) considerable attention should be given to the indirect benefit consisting in the enhancement of entrepreneurship and upward social mobility that the trucking industry brings with it. Now if the matter is put in this way, one can just see the hard-boiled, no-nonsense transportation economist shrug off this unquantifiable advice and stick to his usual, difficult-enough-as-it-is estimate of transport cost savings, supplemented at most by a forecast of new transportation generated by road, or alternatively, railroad (Hirschman 1967, 162).

The secondary effects (growth of entrepreneurship, in this case) become essential inputs (or traits) that would further stimulate truck transport. "In other words, while their presence brings benefits that are perhaps difficult to evaluate, their absence inflicts penalties that are anything but nebulous" (p. 163).

Hirschman, in brief, makes the case for including side effects along with rate of return in project evaluation. Further, the indirect effects are so varied that they do not lend themselves to evaluation by standard criteria uniformly applied to all projects. Thus, Hirschman suggests that "the search for a ranking device that would presume to aggregate the direct and indirect effects of projects" be abandoned. Moreover, the analyst "cannot even pretend to classify uniformly, for purposes of decision-making, the various properties and probable lines of behavior of projects, as either advantages or drawbacks, benefits or costs, assets or liabilities" (p. 188). He concludes:

> But this modesty with respect to generalized evaluation and quantification is in reality the necessary counterpart of the large and free-swinging ambitions [that] projects must entertain and cultivate in countries where they are called upon to make a contribution to progress that goes far beyond their immediate production tasks (p. 188).

All of this calls attention to the difficulty of establishing with certainty the economic impact of program lending. In effect, policy conditionality is designed on the basis of an essentially market-oriented behavioral model of the economy. The changes implied in the conditionality are intended to move the economy of the developing country closer to the kind of economy found in the model (i.e., toward greater reliance on market-clearing prices and the free play of market forces). Even enterprises within the state sector will be expected to act on the basis of such forces.

Several difficulties are common to evaluating the effects of policy reform:

-- While standard economic theory guides conditionality among Western donors, the precise links between policy change and expected change in the performance of the economy need far greater understanding, which in turn will rest on new research.

-- Program lending is associated with policy dialogue. The latter, however, goes much beyond policy conditionality and includes a wide array of institutional reforms. Systematically separating the effects of each is not possible.

-- It is sometimes difficult to separate the effects of a specific policy change from effects resulting from policy changes stipulated in other programs (the IMF or the World Bank, for example).

-- It is difficult to distinguish the effects of a given policy condition from external factors, such as the decline in export markets resulting from the recession in developed countries in the early 1980s.

-- Major internal events such as drought or especially good weather affect the results of policy changes.

-- Often a policy change is intended as merely the first in a series of changes, so that understanding the effects of the change will depend on when the evaluation is carried out.

In reviewing World Bank lending in adjustment programs, Constantine Michalopoulos (1987b) of the Bank summarizes the difficulty of measuring the "impact" of such lending:

> [This review of policy issues] ... should not be viewed as an evaluation of the "impact" of past World Bank SALs [Structural Adjustment Loans] and SELs [Sector Adjustment Loans]. Such an analysis lacks a credible counterfactual, e.g., it is impossible to determine what would have been the recipients' policies and performance in the absence of the programs. This is a familiar problem, which reduces most analyses to contrasting country performance after the assistance to performance before .... Such "before compared with after" analysis is dangerous because: (i) it assumes that countries would have made no policy changes to improve their situation in the absence of the World Bank program, while in fact their policies may have been unsustainable and (ii) it does not take into account changes in the international environment or other exogenous events that influence country performance. In addition, it is difficult to isolate the effect of World Bank programs from those of the IMF, which has been actively working in almost all the countries which the Bank is assisting through SALs or SELs .... Finally, the analysis also does not address a number of implementation issues, such as the size of SALs, tranching, the scope of conditionality and the like, all of which have a bearing on the question of program effectiveness (pp. 32-33).

In brief, although standard economic theory suggests the chain of events to be expected from a given policy change, there is no way to establish a causal relationship between the policy change and the subsequent changes hypothesized. In most cases, evaluators can cite with certainty only specific policy changes. The direct effect of these changes will be indeterminate. At most, the evaluators will be able to argue only that the policy changes possibly were a factor contributing to observable improvements in the sector. Their quantitative effects are uncertain, will work themselves out over the long run, and are probably part of other changes being made in the economy or occurring in the international economy. The most that can be done systematically is to determine through benchmarks the policy and institutional changes that were in fact carried out.

Appendix D contains methods for future policy reform assessments that were suggested by the evaluation team studying agricultural reform in Mali. This team believes the lessons of their evaluation to be generally applicable to French-speaking countries of the Sahel that have an ecological setting and institutional and policy heritage similar to that found in Mali. Whatever else they may indicate, the team's remarks are a reminder of the many difficulties impeding sound evaluation practices.

2.3.1 Evaluating the Relationship Between Conditionality and Policy Change Through Performance Disbursement Benchmarks

This section focuses on the extent to which conditionality leads to policy change. Within A.I.D., some programs provide for detailed, ongoing performance evaluation. In its most developed form, ongoing monitoring of nonproject assistance occurs through the establishment of performance disbursement benchmarks that accompany the tranches. Funding in this instance is divided into a series of tranches, which are disbursed on the basis of satisfactory progress in implementing policy and institutional reforms. Policy and institutional changes are similarly divided into a sequence of revisions. Benchmarks are established to track progress toward achieving ultimate policy and institutional objectives. In effect, because the program is evaluated throughout its life, a final evaluation would include a summary and analysis of previous tranche benchmarks and an update relating program results to the original program purposes.

Chris Hermann (1986a; see also Hermann 1985 and 1986b) of A.I.D.'s Center for Development Information and Evaluation has examined the principal information requirements of policy reform programs within A.I.D. and summarizes them as follows (p. v-vi):

> Compliance data. Central to program implementation are data which demonstrate host country compliance with the conditions for disbursement. A range of data can be used for this purpose. Qualitative data describing changes in organizations and processes are often sufficient. Quantitative measures, such as budgetary data or operational statistics, also can be used to track compliance. A checklist consisting of the reforms to be made, the date when action is taken, and supporting evidence of actual implementation is a simple means for monitoring compliance. For the most part, the information requirements for compliance are contained in the program agreement.
>
> Performance of public sector institutions. Policy reforms are often intended to improve the performance of public sector institutions. As reform measures are enacted, data are needed to monitor improvements in performance. Data collection should concentrate on readily observable changes in government institutions

which result directly from the reforms, rather than on more global measures of public sector performance. Operational records and statistics will be very useful in this regard.

Program implementation and context. Joint review committees involving host country and USAID representatives are established to assess implementation progress and the short-term effects of reform measures. The committees meet prior to the release of program funds to determine whether conditions for disbursement have been satisfied. Compliance data and institutional performance data are necessary for these reviews. An important consideration in assessing progress is the economic and political context in which the program is being implemented. Changes in these conditions during the course of the program can significantly affect the implementation of reforms and their effects. Data that monitor contextual factors, therefore, are needed to determine whether mid-course adjustments to the program are required to expedite program implementation.

Policy reform impact and private sector response. The objectives of many policy reform programs include reducing government control over market operations, decreasing the operating costs of public sector institutions, lowering government expenditures while increasing public sector efficiency, and stimulating private sector development. Therefore, in addition to the categories of data cited above, information is also needed on the private sector's response to reform measures. This often requires conducting special evaluation studies during the latter stage of the reform program. A broad range of studies varying in complexity according to program resources and other constraints may be necessary. In general, the studies should examine whether the business community has reacted to the reform program as expected, and the likely effects of the reform measures on private sector growth. These studies can also generate information for planning subsequent programs to stimulate private sector development.

While policy reform programs often relate to the entire economy of a developing country, they possess several characteristics that help to delimit the information requirements necessary for their evaluation, according to Hermann (1986a, 22):

> First, the conditions for disbursement establish the basic data needs for monitoring program implementation. Second, the degree to which program funds are directed to specific uses influences the scope of program information requirements. Third, the degree to which policy reforms can be linked empirically to macroeconomic and sectoral conditions sets parameters on program evaluations.

On this last point, Michalopoulos (1987b) addresses the question of appropriate indicators of progress for programs with medium- to long-term objectives in his review of the limitations of the conceptual framework of World Bank program lending. He notes that all Bank programs contain commitments to specific actions by the recipient that can be monitored. However, "these have usually involved government commitments to specific policy steps at different points over time. Until recently ..., there was little effort to use quantitative performance indicators of progress that could form a framework for monitoring the effects of policy reform" (p. 41). For example, in a recent Bank program, target figures were cited for changes in GNP and the export growth rate.

Work is currently underway in A.I.D.'s Center for Development Information and Evaluation to develop guidelines for establishing the necessary database on which to design policy reform programs. Among other things, this database will address such questions as the number of reforms that can feasibly be handled, the theoretical base of such reforms, and the timing of fund obligations relative to agreement on the reform package. Current practice on these points varies widely within A.I.D.

2.3.2 Monitoring and Its Data Requirements

There are obvious advantages in monitoring progress in quantitative rather than qualitative terms (although both are necessary in practice). Yet, as Toh (1984) suggests based on his experience with the Niger sector program, "the formulation of quantitative targets as conditionality in a policy-oriented sector assistance program is more difficult than for macro-economically oriented quantitative targets for economic and financial stability (such as credit ceilings and overall government spending)". This follows for two reasons.

> First, the stabilization theory at the macro level is more developed and there is more evidence in support of the relationship between stabilization and the vari-

> ables chosen as conditionalities. Accordingly, more confidence can be placed on conditionality. On the other hand, the association between the policy factor and the eventual goal of agricultural growth and development is fragile. It can easily be upset by external shocks or factors which are difficult to predict, such as the closure of the Nigerian borders or the drought as in the case of Niger. Both of these are likely to impede or delay achievement of the policy objectives. Second, the contribution of appropriate policies to economic growth is indirect. Getting the policy right is only the necessary condition; external resources for technological transfer and institutional development are also required. The two reasons mentioned here suggest that flexibility would be required to deal with policy reform at the sectoral level. Conditionality must be viewed in relative terms; interpretation of whether certain conditions are met has to be reviewed in the context of specific circumstances and decisions made based on informed judgment (p. 10).

In sum, evaluation of the effects of nonproject assistance remains an undeveloped art. In part, this is because behavioral models linking policy changes with expected outcomes are still underdeveloped. Similarly, our increasing knowledge of "rational expectations" suggests that major economic actors will, in their actions, anticipate such policy changes so that in effect such policy changes are aimed at a "moving target." Another evaluation problem results from the long time required for the effects of policy to work out, and the degree of dependence for the success of such changes on institutional reforms and on such random events as weather. All of this suggests that evaluation of nonproject assistance will continue to rest heavily on various performance indicators measuring the extent of a government's compliance with the conditions stipulated.

2.3.3 Outcome Indicators for Adjustment of Program Loans

As noted above, there are accepted ways to establish benchmarks for the fulfillment of various conditions. A different and far more difficult problem arises in judging whether adjustment should be made in the conditionality depending on the short-run changes occurring in an economy. For example, while conditions may stipulate a series of changes expected to result in a 5-percent annual increase in exports over a 4-year period, should the conditionality be adjusted when it turns out that the value of exports in fact begins to fall by 2-percent for the first 2 years of the loan period? In effect, should outcome indicators (export value in this case) be used to adjust other conditions, and should such indicators be stipulated in the original conditions?

The problem is extraordinarily difficult. First, it is recognized that weak data usually form the base for conditionality. Second, the behavioral link between policy and expected outcomes is often obscure, in part because of random events outside the control of policymakers (e.g., weather). Third, those stipulating the conditions cannot fully anticipate the reactions of major actors in the economy to the new conditions, so that every new condition that is imposed, or that might be imposed in light of various outcome measures, may be outdated when promulgated.

It is probably for these reasons that almost no attempt is made to specify in original program documentation the outcome indicators for mid-course corrections in conditionality. Although such changes often will be desirable and will appear necessary, it is unlikely that they can be anticipated with the degree of knowledge necessary to ensure that they are in fact not only new conditions but are at the same time appropriate conditions to justify adjustments to program conditionality.

2.3.4 Appropriate Time Frame for Measuring Benefits

It is often suggested that policy reform sets in motion forces that will have a "payoff" only in the long run. Certainly this is the case for programs in which institutional change is an essential ingredient of the reform. For example, establishing an economically competent cadre of managers, for example, requires years, and the effects of the managers' increased competence will in turn be felt yet years later. Similarly, in industry the long gestation period for new investment will delay for years any final outcome of policy reform. The picture is made more complex by the fact that much capital will need to be imported and its availability will rest in turn on an adequate supply of foreign exchange. Foreign capital availability may be influenced by suitable policy reform, but it is a separate consideration.

In contrast to the relatively longer payoff times for policy reform in institutional change and industry, the results in agriculture appear rather quickly. The results of policy reform depend first on farmer awareness--for example, of increases in farm-gate prices. On the basis of this awareness, farmers' adjustment in planting and marketing often occurs in the following season, depending of course on the availability of necessary inputs and weather conditions.[11]

3. ADVANTAGES AND DISADVANTAGES OF CONDITIONALITY IN A.I.D. PROGRAM ASSISTANCE

There are widespread suggestions among proponents and critics alike that policy-based loans and grants have on the whole been appropriate and beneficial even in those areas in which suggested policy changes have been resisted. This view is held generally in donor agencies and in developing countries.

At the same time, profound and growing questions exist on the efficacy of "policy reform" based on policy dialogue. Cassen (1986) has coordinated a major intergovernmental study of aid effectiveness, and his conclusions reflect the importance of policy-based aid flows as well as their limitations. His major findings are as follows.

-- Experience with policy dialogue ranges from the reasonably successful to the conspicuously unsuccessful. In effect, it is easier to identify common faulty policies (overvalued currencies, unsatisfactory price structures, and the like) than to design a strategy that is appropriate to each country's capacities and likely to succeed in contemporary conditions.

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[11]"In Zambia, cotton and maize production rose by 20 percent during 1983-1985, and the amount marketed rose by 55 percent during 1984-1985, following price increases. Similarly, cotton production in Togo doubled during 1984-1985. While it is difficult to separate the effects of weather conditions from the price effect, the clear correlation between the level of commodity prices and the amount of agricultural output is too dramatic to ignore. Cross-country comparison reveals the same pattern. For both Tanzania and Kenya, coffee is the major export earner. In Tanzania, the farmers' share of the export price of coffee was only 40-50 percent in 1984, while it was 90 percent in Kenya. Coffee production in Tanzania has remained stagnant over the past decade, with significant deterioration in quality. Meanwhile in Kenya, it thrived even during the international recession of the early 1980s and severe drought in 1984; coffee deliveries grew 7 percent per year over the 1979-1984 period and actually increased sharply during the drought of 1984" (Richardson and Ahmed 1987, 16-25).

-- Sometimes inadequate consideration is given to the relationship between short-run programs and the requirements for future development. For example, exchange rate reductions will need longer term support in poorer countries than in middle-income countries. Similarly, higher prices to farmers must be supported by provision of essential inputs such as credit, fertilizer, appropriate plant varieties, and transport. Particular attention must be paid to effects on the poor as food prices increase. Improved World Bank and IMF cooperation will be important in coordinating the short- and long-range policy effects.

-- The success of policy reform rests heavily on the institutional capacity of the developing countries. This includes the political commitment of the leadership and adequate negotiating strength and analytical capacity, which may require technical assistance. In the absence of these criteria, the policy reforms will be viewed locally as having been imposed. In short, the recipient should play a full role in negotiating policy reforms. As Cassen puts it, "'dialogue' should not become 'monologue' with money.'"

-- In their policy recommendations, donors should avoid what Cassen calls "asymmetrical liberalism," that is, donor's encouragement of liberal trade policies and domestic market forces in developing countries, while donors increase their own trade protection and employ aid conditions (especially tied aid and mixed credits) that distort the competitive process.[12]

Cassen's list of cautions is useful. Nevertheless, the theory of markets remains a powerful tool of analysis and the market remains a strong driving force in policy formulation throughout the world, for it answers questions at what might be called the "strategic level," the level at which government must

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[12]Erb (1986) rejects the contention that IMF surveillance is essentially asymmetrical and that it is applied mainly to developing countries. In part, he suggests that this contention can be traced to a confusion between conditionality and surveillance, two separate activities of the IMF. Conditionality, which the IMF associates with the use of its resources, is applied in lending. A surveillance discussion, in contrast, carried out under Article IV of the IMF charter, is more frequently focused on the major economies of the world.

consider its actions. Government can, after all, help establish functioning markets, free the exchange rate, and privatize parastatals. At the same time, the market model by implication limits the possibility for some kinds of positive government action by stressing that government lacks both the knowledge of local market situations and the ability to act in those situations. In a word, both theory and experience suggest an important but limited role for government.

There is, however, an important qualification. The conditions that underlie market efficiency are very stringent and unlikely to be found in practice. These "efficiency conditions" are said to be met when the economy is in such perfect "balance" that no one can be made better off without making someone else worse off.[13] They include, for example, the necessity that prices reflect full social costs and that producers and consumers alike adjust their consumption and input decisions precisely in accord with such prices.

Because these conditions tax credulity, economists have explored the significance of policy recommendations in their absence (i.e., in the real world of market imperfections of various kinds) (see Lipsey and Lancaster 1957). In this "second best" real world it is recognized that if even one of the efficiency conditions is not met, then all consumption and production decisions become economically ambiguous. This means that if there are, for example, important elements of monopoly in the economy, then the welfare effects of this or that policy recommendation can never be fully understood.

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[13]When economists mention "efficient," they usually have in mind the line of thought developed by Vilfredo Pareto, a 19th century Italian economist and sociologist. One condition is that the marginal rate of substitution (in consumption) between any two goods, or between any good and leisure, should be the same for all consumers in the absence of externalities. This provides for efficient allocation of goods. A second condition is that the marginal rate of substitution (in production) between any two inputs should be the same for all producers, whether producing the same or different goods. This provides for efficient allocation of resources. Income distribution is taken as given, and there is the further assumption that the welfare of each individual depends solely on his own consumption and is not affected by the consumption of others. In this model, prices must reflect full social costs (no externalities).

K. Toh of A.I.D. explored this possibility in a paper presented to A.I.D. economists in 1984. His central point summarizes well the significance of second-best solutions. Because in practice it is very difficult to trace the complicated effects of one change on the rest of the economy, he suggests that three implications follow:

> First, it is unwise to advocate any particular policy without understanding the particular circumstances under which the policy operates. Second, the argument for government controls in order to correct the failings of unregulated markets is generally not valid. Government is not omnipotent. It is not only markets which fail; there are government failures too .... Third, given the facts that market failures are relative and not absolute, and the continuing presence of the second-best problem, one practical solution is to compare the relative efficiency between public and private sectors and allow each to do those things which it can do better than the other (p. 4).

In sum, the central lessons taught by the second-best problem are that global policy suggestions are inappropriate and that within a national economy small steps may be better than large ones until the full implications of a policy change become apparent.

3.1 Need for a Strengthened Analytical Framework

In his review of World Bank adjustment programs, Michalopoulos (1987b) cites the limitations of the present analytical model guiding adjustment program conditionality. His comments are representative of questions being raised in the field about the intellectual underpinnings of program conditionality that seeks to achieve significant structural change and stimulate growth.

> The [World Bank's] analytical framework .... provides a good basis for the design of adjustment policies in most countries. But it falls short of providing a quantitative structure for linking inputs (policy actions) and outputs (macroeconomic performance). The Bank uses a quantitative framework to ensure consistency in its projects of financial "requirements," but this framework has very few behavioral relationships linking proposed policy steps to future outcomes.... Indeed, the framework has little to say about the quantitative impact of key components of policy reform

> (e.g., trade reform, improvements in pricing, public investment reviews and the like) on medium-term economic performance (on which the Bank usually focuses). Thus ..., one can be more confident about the long-term outcome of policy packages than about the precise dynamic profile of results following the introduction of specific reforms (p. 40).

The problem is compounded, of course, by the growing knowledge economists have of "rational expectations." As this view suggests, "there are endogenous changes in the behavior of economic agents in response to changes in policy actions, and these changes cannot be readily captured by models built on previous experience" (p. 41). Michalopoulos concludes that these and other

> uncertainties about the quantitative impact of specific policies and developments in the international environment mean that flexibility and willingness to adjust objectives should be a key element in all programs. Second, in parallel, additional analytical work is needed if we are to continue to strengthen our understanding of the sequencing and timing of particular policies and to improve the quantitative framework for projecting economic performance in the medium term (p. 42).

3.2 The Role of Policy Dialogue in Program Assistance

In general, policy dialogue is a process that "involves negotiation, compromise, and usually a gradual movement toward a desired policy change." Such a process gains force through "conditionality," which "refers to policies which a donor or lender expects or requires the recipient government to follow or avoid in order to receive the donor's resources" (GAO 1985).

One level of question relevant to nonproject assistance conditionality is whether it is an appropriate vehicle for stimulating change in a developing country. The answer varies with the type of program assistance provided, as follows (GAO 1985, 1-2).

> Economic Support Fund (ESF) assistance is provided for the economic stability and development of the economy as a whole and depends for its effectiveness on the soundness of a recipient country's overall macroeconomic policies, thus providing a natural link between the program and its conditionality relating to taxation,

exchange rate policies, and the like. ESF can also be used to fund specific development projects and thus can be used to influence policies in a specific sector such as agriculture or health. However, where there are overriding political and security interests in the country, A.I.D.'s leverage is not as strong.[14]

Development Assistance (DA) sectoral emphasis (e.g., agriculture, human resource development) has a policy component. A.I.D. has recently increased the focus of DA on improving host government economic analysis to support policy change. Negotiations with the host government about a project can be a forum to exchange views on how the economic policy environment may affect a project and can also serve as a vehicle for discussion on broader policy issues. One limit to the use of DA for this purpose can be the relatively small size of the program.

Public Law 480 (PL 480) since 1967 has been explicitly linked to development objectives, and recently A.I.D. has placed greater emphasis on the use of this assistance to promote more effective agricultural and rural development policies. PL 480 can serve as a vehicle for discussion of either or both macroeconomic and sectoral policies because it carries general balance of payments implications. Title I loans are made on the condition that the recipient countries undertake self-help measures to improve agricultural production and marketing. Title III provides multiyear food aid commitments and loan forgiveness as incentives to low-income countries to undertake development-oriented economic policy reforms.

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[14]Note that "a principal element of U.S. macroeconomic conditionality often has required the recipient country to enter into an IMF agreement or, if an arrangement is in place, to comply with the performance criteria of the arrangement. The Congress amended the FY 1985 Foreign Assistance Continuing Resolution and FY 1984 supplemental appropriation (Kemp-Kasten Amendment) to prohibit the withholding of U.S. bilateral assistance from obligation or disbursement '... solely as a result of the policies of any multilateral institution.' AID has reviewed its policy and has issued worldwide guidance on the amendment. This guidance emphasizes that the U.S. Government must make independent judgments on appropriate conditions to govern particular obligations and disbursements" (GAO 1985).

In summary, large nonproject assistance programs appear to provide considerable leverage for conditionality, but this is reduced somewhat where security considerations dominate the United States-developing country relationship. PL 480 programs are evolving as an increasingly important tool for encouraging policy reform in agriculture and rural development. DA-funded projects may or may not be appropriate vehicles for conditionality, depending mainly on their size relative to the economy as a whole or to a particular sector.

3.3 Speed Versus Accountability of Program Assistance

A.I.D. has used nonproject assistance, chiefly in the form Commodity Import and Cash Transfer programs, for rapid response to balance of payments crises. All foreign economic assistance is fungible, meaning that it is difficult to trace final effects of the funds in an economic sense (whereas it is easy to trace funds in an accounting or audit sense). Sometimes the criticism is made that it is even more difficult to trace these quick-disbursing funds and that there is a trade-off between the need for quick action and the need for economic accountability. However, this criticism is largely based on an illusion, given the fungibility of all assistance, and therefore cannot be considered a problem only with program assistance. (See Development Associates, Inc. 1985.)

3.4 Sustainability of Structural Adjustment Programs

There are serious questions about the economic and political sustainability of structural adjustment programs associated with nonproject assistance (Nelson 1986). Political sustainability rests on three factors: (1) the strength of political leaders' commitment to the program; (2) the capacity of the government to implement the program and manage political responses; and (3) the political responses to the program by various groups within the political system. This listing is a reminder of the great complexity encountered in political assessment. Because these factors are interrelated, that complexity rises exponentially with the number of factors at play.

Economic sustainability is related to the more severe structural and institutional rigidities encountered, especially in smaller countries. Nelson suggests that these "delay supply responses longer than in more advanced and flexible economies."

At the same time, "the welfare implications of demand constraint measures are particularly disturbing for populations living very close to the margin of survival."

However, there is an aspect of sustainability that cuts across both its political and its economic aspects. As Nelson notes:

> A number of analysts have argued that stabilization measures, because they impose hardships on many groups within society and challenge the position of vested interests, are most readily carried out by authoritarian regimes. More disturbing, they suggest that advocating stabilization measures, and more generally urging market-oriented policies of decontrol and liberalization in nations characterized by extensive "populist" state intervention, implicitly encourages and endorses authoritarian political tendencies (p. 986).

The present study does not explore the efficacy of authoritarianism in policy reform. Further, the author has not encountered any statements on this matter in official documentation of either bilateral or multilateral lending agencies.

3.5 Arguments in Favor of Policy-Based Program Assistance

1. The policy setting in many developing countries inhibits growth and the achievement of equity. In many cases, the policy environment has become a hodge-podge of regulations, prohibitions, bloated and dysfunctional state sectors, and worsening international positions, with the result that growth has stopped while population continues to increase. The support that had once existed for statism began to erode in the grim light of reality--poverty, ignorance, and corruption. A solution was needed, and because the policies favoring state-led growth have come to be viewed as parts of the problem rather than as solutions, greater reliance on market forces is necessary. No matter what the imperfections of the market might be, both market and government failures must be addressed.

2. Political stability is the key to economic growth and economic growth is the key to political stability. While the evidence on the relationship between good policies and good growth can be debated in some cases, there is no case for the idea that a nation can have good growth without good policies. Similarly, while the evidence on the relationship between growth and political stability can be debated in some cases, there is no

case for the idea that political stability can exist in the presence of economic chaos and decline. A semblance of stability might appear, but only at the cost of great repression of commonly accepted liberties. Finally, economic growth in which the bulk of the gain goes to a minority is not growth for the majority, so it does matter that the growth be shared somewhat equitably, which, in turn, further enhances political stability.

3. While random external events will affect development, economic growth and welfare depend primarily on domestic policies. External events can have an uplifting as well as a depressive effect on a nation's economy. Further, some economies are heavily export and/or import dependent and appear therefore to be "vulnerable" to world markets or to their chosen trading partners, as in the case of trade with Eastern Europe. How such a country adjusts to this apparent disadvantage in the long run depends on the policy set chosen in the short run. Even the poorest country in the world can choose a set of policies appropriate to its condition. To the extent that local leadership is less interested in growth than in its own perquisites, then this generalization does not hold, and policy reform seems of rather academic interest. The result under this circumstance is economic stagnation and growing immiserization.

4. Conditionality may help developing country leadership accomplish its own goals. In some cases, policy changes that create economic losses for particular groups threaten the political strength of leaders and would not be made unless nonproject assistance were conditioned on the change. It is folklore in development circles that A.I.D. and other donors give advice to countries (either indirectly through dialogue or directly through conditionality) that their own leadership would like to give. While competent explanations of the dysfunctional policy and institutional settings often are available locally, there are indeed cases where outside advice has been helpful. Of course, in some cases, if the conditions are made public, the incumbent government may be threatened. This is obviously a delicate procedure. Nevertheless, outside advice can sometimes strengthen the political hand of those local leaders who propose policy reform, provided the donor engages in true dialogue that is supportive rather than imperious.

3.6 Arguments Against Policy-Based Program Assistance

1. Limited knowledge base. The gap between policy and its expected results is enormous even in developed economies. In developing countries undergoing rapid structural change, and for

which the database is seriously limited, it is fantasy to suppose that any policy planner can "manage" economic development by changing interest or exchange rates, stipulating budgetary limitations, and the like. In effect, the operational mechanism through which policy changes affect reality is something of a "black box." Moreover, prices in such developing countries sometimes are unreliable indicators for rational investment decisions among projects, sectors, and regions. At best, policy recommendations should be limited to such critical issues as developing technical competence among the developing nation economists and others dealing with the economic problem, establishing local and international institutions for the ongoing review of problems and policies, providing for coordination among donors who express interest in providing assistance, and so forth. Thus, the limitations of our knowledge suggest a wider attempt at building local technical capacity and institutions capable of addressing policy issues on a continuing basis. Finally, the emphasis on market-oriented conditionality may represent wishful thinking, for in the very countries held up as examples of such growth, governments have exerted a strong influence on the shape of the economy (e.g., South Korea, where the Government has directly and indirectly influenced capital allocation for three decades).

2. Inherent ideological bias of policy-based lending. For various reasons, some economically emerging countries have chosen a development strategy emphasizing equity and growth as co-equal goals. This has often led to dysfunctional expansion of the state sector, corruption and the elevation of "politics over economics," and economic collapse. In urging standard policy reform measures, however, donors are in effect substituting their own version of "the good life" (growth before equity) for that of the developing country (growth and equity). If the elimination of absolute poverty is a major objective, then the strategy of development must be designed to achieve this, based on conditions indigenous to the country. If a tendency toward egalitarianism is important, then policy conditionality must reflect this reality.

3. "Getting the prices right" is only the beginning. Although donors are concerned with the short-run costs of adjustment programs, the compression of consumption following application of conditionality still does not receive sufficient attention. Equity may depend in part on current policies (direct aid to the poor, for example), but it also depends on who owns the economic assets and who controls the system. When there are wide disparities in asset ownership, the market widens rather than lessens income differentials. In effect, the ascendancy of policy reform lending is a return to a trickle-down strategy of

development that ignores the lessons of history that led to the movement away from such theories and toward a "basic human needs" approach. Similarly, even with market-determined prices, there remain problems of structural rigidity, provision of "public goods," widespread training problems, and institutional constraints. These problem areas are as important as prices; in fact, a case can be made that without attention to these problems, a market system will be difficult to create or maintain.

4. Asymmetrical policy conditionality. While stringent policy conditionality is applied to many developing countries, major lending countries engage in some of the very practices they condemn in developing countries. The difficulty of coordinating policy among Western Europe, Japan, and the United States dwarfs the policy problems of most developing countries. Further, the disarray in the agricultural policies of most developed countries surely matches the agricultural policy miscalculations in developing countries, although with different results. Growing trade restrictions in developed countries against exports of developing countries gives the game away as one of continuing attempts at exploitation of developing countries. (The limitations imposed by the United States in its Caribbean Basin Initiative are viewed among developing countries as symbolic of the real difficulty faced when a developed country proposes "helping" a developing country.) The basic difficulty with this asymmetry is that it reinforces within developing countries a climate of suspicion that assistance to them is a game among developed countries played out largely for internal political reasons, with the interests of the developing countries taking a distant second place to developed countries' concerns with their own economies. In the long run this approach has two effects: (1) it makes cooperation more difficult around mutual interests that surely exist between developed and developing countries, and (2) it fuels acceptance of radical thought from Eastern Europe, the Soviet Union, and China that suggests that the only safe course for developing countries is alignment with world socialism (Soviet- or Chinese-type).

3.7 Balancing the Advantages and Disadvantages of Policy-Based Assistance

There is no easy way to balance the advantages and disadvantages of policy-based program lending. A case can be and has been made in favor of each argument. In one sense, a balanced judgment will rest on two factors. First, much more analytical and empirical work is required on all aspects of the effects of conditionality. Second, the way one approaches the questions that need to be asked of conditionality, and indeed the questions themselves, will be affected by the researcher's world view, that is, whether the researcher "believes" that developing countries can prosper in the world economy in a positive sum game or that developing countries inevitably will lose in their struggle with more developed countries in a zero sum game.

Is there any consensus on conditionality? In general, there is widespread belief among major donors that policy-based assistance is not only appropriate but necessary given the crisis proportions of the development problem today. Among major recipients there is a record of such assistance being associated with economic growth and the alleviation of poverty. A few recipients have repudiated the agreement backing policy-based lending (e.g., Zambia). There has been no serious suggestion, however, that policy reform in those countries be repudiated as a principle. Instead, there are suggestions that in some cases policy reform should be carried out more slowly and that conditionality should be accompanied by greater economic assistance to ease the transitional costs, especially among the poor.

All of this suggests that while policy-based lending is controversial, more frequently than not it has been associated with economic success. It may be expected, therefore, that policy-based assistance will remain a permanent part of major donors' portfolios for the indefinite future.

4. BENEFICIARY IMPACT OF POLICY-BASED NONPROJECT ASSISTANCE

What has been the effect of policy-based nonproject assistance on developing country beneficiaries? Are the poor doing better with nonproject assistance than with project assistance? These questions are at the heart of both the current emphasis on and growing criticism of nonproject assistance.

The basic intent of policy reform is to "unleash" non-governmental forces to do the kinds of development jobs that cannot be done well by government. The evidence of a correlation between high growth rates and large private sectors is clear, although there is question about the reasons for the correlation.

> In Sub-Saharan Africa, the countries that have shown the most impressive performance are those in which the private sector predominates (Kenya, Malawi, Mauritius, and Cameroon). In countries where the public sector dominates, economic activities have shown a negative performance (Ghana, Senegal, Madagascar, and Somalia).

> The same holds in other regions (Asia, South Korea and Thailand have done better than Indonesia and the Philippines) (Richardson and Ahmed 1987, 19).

These and similar comments affirm the importance of policy-based growth. Nevertheless, crucial questions remain about the precise behavioral links between policy change and its expected outcomes. Equally important is the question of who gains and who loses in the process of policy reform.

Among major donors using policy-based nonproject assistance, the IMF perhaps has received the most criticism. In turn, it is the IMF that has defended its programs most intensively and most frequently. For this reason, the IMF defense is presented below in response to the criticism that the poor suffer unduly under structural adjustment.

Perhaps the best way to understand IMF conditionality is to examine the major conditions attached to IMF-supported adjustment programs and to describe the logic underlying such conditions. An IMF study (1986)[15] examined the policy measures adopted as part of 94 IMF-supported programs from 1980 to 1984 and highlights the effects of such programs on different socioeconomic groups. The study's general conclusion is that while there may indeed be some reduction of consumption as a result of such programs, this may affect all groups rather than just the poor. In any case, the study stresses that this compression would have been greater in the absence of the adjustment programs and the financial support they provide. The reasoning presented in the study is as follows, by policy area.

Exchange rate policy. The distributional impact of exchange rate devaluation and of tighter controls on money and credit creation is mixed. Devaluation, for example, benefits labor and capital employed in sectors favored by the devaluation; in most developing countries this improves the lot of the agricultural sector at the expense of the urban population. Because those living in the urban sector often have benefited from an income distribution skewed in their favor, and have been heavy importers of luxury goods, devaluation would lead to a more equitable income distribution. Although it is true that devaluation often results in an initial windfall for the small and wealthy urban class with assets abroad (with farmers and other small businessmen who invested domestically suffering), improved efficiency in

[15]The discussion presented here is from a summary of IMF 1986 published in IMF Survey, November 17, 1986.

the long run will stimulate growth and employment so that all groups will share in higher levels of national income.

Monetary policy. Appropriate policies on money creation and credit tend to curb inflationary pressures, which should help the poor who usually do not own assets that would increase in value with inflation. Also, increased allocative efficiency resulting from improved access to credit markets, the limitation of insider loans, and promotion of the ability of each sector to compete for available credit will probably tend to improve income distribution. It is true, however, that large and well-established firms in the urban sector may be in a better position to compete for credit than smaller firms in the rural sector. The result therefore may be that the distributional benefit from appropriate credit policies is not as great as might first appear. At the same time, however, interest rate decontrol provides smaller firms in the rural sector greater access to credit.

Fiscal policy. The distributional impact of fiscal policy is also mixed and certainly the results are often not discernable within the time frame of an IMF program. On the government revenue side, while the effects of changes in direct taxation (e.g., personal and corporate income taxes) may have little effect on the distribution of wealth and income in the short run, they will almost certainly in the longer run improve equity. The effects of indirect taxes are less clear. Some indirect taxes (e.g., excise taxes on alcohol and tobacco) may worsen distribution while others may improve it. Taxes that improve distribution include (1) the more general and broad-based taxes on goods and services; (2) higher differential tax rates on those goods and services typically consumed by higher income households; (3) import duties that replace such quantitative import restrictions as quotas and licencing systems; and (4) reduction of export duties that are borne chiefly by small farmers.

In addition to concern with raising revenues, IMF-supported programs also typically recommend reducing government expenditures such as wages and salaries of public sector employees, food and petroleum subsidies, and transfers to cover the losses of public enterprises. While noting that such policies are among the most important aspects of IMF-supported adjustment programs, the report also notes that they are among the most controversial. The report also suggests that policies have had the most obvious success in improving income distribution. For example, freezing civil service positions and remuneration, especially where public service is paid well in relation to the private sector, will obviously and immediately improve income distribution.

Subsidies to keep prices of basic goods and services below their market levels typically strain the budget, and most IMF-supported programs require reduction in subsidies through increases in the prices of food, transportation, and petroleum. This leads to an increase in employment, and thus a reduction in income inequality, because improved price flexibility strengthens the overall adjustment program by transmitting exchange rate movements throughout the economy, restructuring incentives, and improving resource allocation.

It is frequently asserted that food price increases have their most devastating effects on the very poor and that food subsidies are needed to protect this sector of the population. The IMF report argues, in contrast, that most food subsidies are directed toward the urban population, while the "really poor" usually live in rural areas. At any rate, to benefit from a subsidy one must have the purchasing power to buy subsidized goods; thus, the very poor are excluded from the benefits of the subsidy program. To ensure that the lowest income households are the sole beneficiaries of such subsidies would require that the funds be targeted more accurately than they have been in the past.

In sum, the IMF report provides a strong conceptual defense for the kind of nonproject conditionality now common among major donors in the areas of exchange rate, fiscal, and monetary policies.

A related but different perspective on gainers and losers is provided by the analysis of Michalopoulos (1987b, 42-46) on the distributive effects of World Bank program lending for structural adjustment and growth, an analysis applicable as well to A.I.D. programming. He notes initially that several issues get confused in this discussion:

> The first is the question of whether the programs undertaken produce a short-run decline in output and incomes which is somehow excessive, e.g., whether, given the amount of financing available, alternative programs would have permitted more gradual adjustment over time and required less demand restraint, which is inimical to growth. Second is the issue of whether the poor have suffered disproportionately in the adjustment process, in the sense that their incomes have fallen by more than those of other groups. A variation on this issue is the suggestion that the adjustment process has resulted in significant absolute declines in the levels of income of the poor, and has meant that many more families' incomes fall below a "poverty" standard.

> Third is the issue that government policies and, in particular, patterns of reduction of government expenditures, have disproportionately affected the poor (pp. 42-43).

Good data on income distribution over time are generally lacking. It is nevertheless true that in some countries, including those with Bank support, the absolute levels of income of the poor have declined (Michalopoulos 1987b), and it is now widely recognized that the transitional costs resulting in higher unemployment or reduced subsidies to the poorest members of a society require special attention.

From a different perspective, development studies suggest that the only economically and politically adequate defense of policy-based nonproject assistance that will hold up in the long run is that the poor do in fact benefit from such assistance. To ensure this, it is necessary to view policy reform and poverty reduction as complementary, not contradictory, goals. This means, in turn, that poverty must become a policy focus in any policy reform program seeking to enhance overall economic growth. In effect, a "growth with equity" model is the appropriate analytical framework by which to design policy reform. The important point is that economic crises will force adjustment in <u>some</u> form. Policy-based program lending provides the opportunity for an orderly transition away from the problems. However, without adequate attention to the poor, the transition itself is threatened, as is the likelihood of permanent improvement.

In brief, if the claims of poverty alleviation are seen as opposed to the needs for structural adjustment, the claims of poverty might be ignored in a crisis situation. Therefore, actions taken to alleviate poverty must become an integral part of the policy reform package; such actions must be seen as contributing to increased productivity and growth and not merely as income transfers that will reduce growth.

The Overseas Development Institute (ODI) in London (Addison and Demery 1986; see also ODI 1986) notes the following kinds of actions taken in recent World Bank lending (cited with permission of the Bank) to (1) enhance the access of the poor to productive assets through land reform that is associated with structural adjustment, as was done in Thailand; (2) increase the rates of return on assets held by the poor, as done in Côte d'Ivoire, where positive income distributional effects resulted from higher agricultural prices; (3) improve access to gainful employment through assistance to retrenched public sector employees (as in The Gambia and Guinea-Bissau) and through emergency employment schemes (as in Chile); (4) maintain or increase the rate of human capital accumulation of the poor through protection of social expenditures, particularly health and education, as done in Brazil and Indonesia; (5) target income and consumption transfers to the poor whose incomes are not increased by structural adjustment, as in the case of food subsidies in Morocco and Jamaica.

The central point of citing these examples is that positive programs enhancing the contribution that the poor can make to structural adjustment can be built directly into policy-based programs and will be acceptable as parts of the growth process. The few remaining instances where transfers are required for the poor will be seen as a relatively small part of such programs.

Attesting to the growing interest in growth-oriented adjustment programs, the first joint IMF/World Bank symposium on this topic was held in February 1987. Among other important issues raised, was the view that there are narrow limits on the extent to which structural adjustment can be traded off for growth. At the same time it was recognized that in the short run a growth slowdown may be unavoidable for successful stabilization (Corbo, Goldstein, and Khan 1987; summarized in IMF 1987). In a word, this symposium calls attention again to the central problem in adjustment--maintaining consumption in the face of necessary policy changes.

A study of the impact of Zaire's economic "liberalization program" casts some light on how women fare under policy reform (Sines et al. 1987). Its conclusions are as follows (pp. E-6 and E-7):

-- <u>In Zaire, women provide a major source of labor in food crop production</u>. The accrual of the gains made under policy reform by women depends to a large extent on intrahousehold decision making. To the extent that this process is inequitable to women in individual households, women will not share equitably in any production or income increases.

-- <u>Women account for only a small proportion of those involved in plantation agriculture</u>. Policy reforms which favor this sector will not have as large a positive impact on women as those favoring the traditional sector.

-- <u>Women are important in all aspects of the food marketing chain</u>. Women farmers appear to be selling more as a result of price liberalization. The impact on their nutritional status is unclear at this time.

-- Price liberalization has had a positive impact on the number of women traders. Abolition of prohibitions on interregional trade has had a positive impact on women as they are free to benefit from price differentials between regions.

-- Policies which require a husband's permission before women can obtain bank accounts and sometimes credit have a negative impact on married women's access to banking services. These policies have had a negative impact on the operations of women traders.

While the Zaire experience may not be a guide to expectations elsewhere, the differential impact on women of various kinds of policies does suggest strongly that this impact must be an important consideration in program design.

More generally, an A.I.D.-commissioned study (Hood, McGuire, and Starr 1988, 50-51) suggests that

> significant variation [exists] between countries in the degree, duration and distribution of hardship associated with the transition. With respect to the degree and duration of hardship, three important factors are:
>
> -- The magnitude of the adjustment problem. In general, the larger the magnitude of the adjustment problem, the larger the initial contraction required to stabilize the economy. Countries with heavy debt burdens and significant terms of trade deterioration have been particularly likely to undergo pronounced--and sometimes prolonged--recessions (e.g., Chile). This includes many of the heavily indebted middle-income countries, as well as low-income countries in Sub-Saharan Africa.
>
> -- The "deep-rootedness" of the adjustment problem. In general, the longer the period of postponing adjustment via ad hoc measures, the more deep-rooted the problem becomes in the sense of producing a distortion-driven economic structure. Large divergences between the pattern of investment, production and employment and underlying international competitiveness

tend to produce large initial contractions in inefficient sectors and long periods before growth resumes. In contrast, some countries developed large cyclically induced macro imbalances in the early 1980s that had to be addressed through stabilization; but because their underlying economic structures were basically competitive, growth resumed, unemployment fell, real incomes returned to normal levels, etc., with world economic recovery (e.g., Costa Rica).

-- The level of development and degree of economic dynamism. The speed at which benefits of adjustment materialize depends on countries' level of development and degree of economic dynamism. For example, the medium-term impact of devaluation on encouraging efficient import substitution and non-traditional export promotion is likely to be much greater in a context where a dynamic group of industrial entrepreneurs already exists. Higher food prices raise small farmers incomes and induce a supply response only if they are integrated in to the market via a system of decent roads. Reorienting government services to target the poor may take an unacceptably long time if the bureaucracy does not work well to begin with. In other words, while adjustment may be a necessary condition for sustained growth and development, it is not necessarily sufficient.

5. CONCLUSIONS

In many developing countries, poverty has outpaced growth over the past 30 years, and inequities in income distribution have widened. In all countries, the worst and most widespread poverty is found in rural areas. While poverty is worldwide, countries in Sub-Saharan Africa are perhaps the most seriously affected in the world. In most places worldwide, poverty has worsened sharply since the second oil shock of 1979. Poverty has resulted in part from natural disasters, but more generally it can be traced to two factors: internal policies that discriminate against the poor, and external factors over which developing countries have little influence. In the 1980s in Latin America and in Africa, outflows of interest and amortization have exceeded inflows of new capital, thus forcing enormous adjustment problems on developing countries and, symmetrically, on more developed countries. In sum, developing countries now face a challenge of unprecedented proportions, and policymakers must try to meet this challenge with a kit of analytical tools that seem dwarfed by the problems.

The major new approach to development in the 1980s has been structural adjustment and policy reform based on donor conditionality. As with so many other approaches to development, the concept is not really new, but its widespread application among major donors is new. Early in the decade, conditionality related largely to a mixture of market and institutional reforms affecting both supply and demand conditions and demand restraint was common to all donor programs. In the last half of the decade, greater concern is being expressed for the distributional effects of the adjustment/reform package.

A voluminous body of literature has emerged on this topic, in which rationales can be found for defending almost any position on the efficacy of adjustment/reform programs. However, most observers agree that while such programs cannot ensure economic growth, policies that inflate economies and distort resource allocation are inherently suspect as inappropriate to economic growth.

Cornia and Stewart (1987) have ventured to sum up the following "general lessons worth distilling" from the adjustment experiences of 10 countries[16]:

1. The shocks to which the majority of the countries had to adjust were exogenous (i.e., the results of changes in the international environment or in climatic conditions, both factors beyond the control of national authorities).

2. Adjustment is necessary. Whatever the nature of the shock affecting the economy, countries have to adjust to a changing environment. Failure to do so normally entails huge losses of output and human welfare.

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[16]The countries are Botswana, Ghana, and Zimbabwe in Africa; the Philippines, South Korea, and Sri Lanka in Asia; and Brazil (Sao Paulo), Peru, Chile, and Jamaica in Latin America. These case studies are examined in detail in Vol. 2 of the Cornia and Stewart study.

3. Growth-oriented approaches with structural adjustment have been successfully adopted. While several of the 10 countries analyzed followed predominantly contractionary policies, others adopted more growth-oriented approaches incorporating elements of structural adjustment, and in some cases of human protection.

4. Growth-oriented adjustment is necessary but not sufficient to protect vulnerable groups.

5. In the short-to-medium term, the well-being of children and other vulnerable groups can be protected and even improved with the adoption of appropriate targeted programs, even during periods of economic decline.

6. Most programs aimed at protecting the poor are relatively inexpensive in terms of total government expenditure and GDP.

7. Foreign finance is important in facilitating a smooth program of adjustment. While the availability of medium-to-long-term finance in sufficient amount allows the investment necessary for structural adjustment..., external assistance (often to meet foreign exchange costs of imported inputs) for specific programs designed to protect the poor also proved an important element for the successful protection of human conditions.

These conclusions point to serious problems but also provide a basis for optimism. Some strategies for growth and poverty alleviation do exist. The point is that there are known strategies that can generate growth. What kind of growth occurs--whether it improves the lot of the poor or not--depends on the kind of strategy chosen.

The general lessons of structural adjustment and policy reform outlined above can be given programmatic definition, as suggested by Adelman (1986) and others.[17] First, some asset redistribution is necessary. One approach is that of Hollis Chenery (1974) and others who advocate "redistribution with growth," by which a larger share of any economic growth is directed toward asset accumulation by the poor or to investments that are complementary to assets owned by the poor such as nutrition and educa-

[17]The comments here are based on the Adelman article.

tion, irrigation, and credit programs or input subsidies, all directed exclusively toward the subsistence farmer. Adelman calls her suggestion in this regard "redistribution before growth." This suggestion follows from her studies of newly industrializing countries--notably South Korea and Taiwan--that combined accelerated growth with relative stability in the incomes of the poor. On this basis she advocates "(i) tenurial reform in agriculture before implementation of policies designed to improve the productivity of agriculture, and (ii) massive investments in education before rapid industrialization" (p. 57).

A second complementary strategy is to increase the relative and absolute demand for unskilled labor, which should be accompanied by the strengthening of institutions that improve labor mobility and access to jobs. Adelman suggests "reliance upon export-oriented growth in labor-intensive manufactures and reliance upon agricultural-development-led industrialization" (p. 58). Such measures would include education, reduced barriers to migration, and reduction of discrimination in hiring. Growth must be based on labor-intensive, high-productivity activities. If the emphasis is on manufacturing, then demand creation will be important, and this will mean external demand for the smaller economies. On the other hand, if agriculture or services are the focus, then existing demand can be taken initially as a given with emphasis placed on increasing labor productivity in these sectors.

Both strategies imply yet a third strategy to move prices closer to clearing levels. An open-market strategy requires elimination of overvalued exchange rates and tariffs, while an agricultural strategy requires improvement in the internal terms of trade for farmers. As Adelman notes, "price-increasing policies can operate through factor or commodity markets, and/or they can increase the productivity of the assets owned by the poor" (p. 61). In a relatively free labor market, labor-intensive development can increase wages if unemployment and underemployment are relatively small. In commodity markets, an increase in the price of agricultural products will help the farmers. The productivity of labor--the major asset of the poor--can be raised through investment in human capital, increasing the availability of assets complementary to labor power (land, capital), or technical change (land-intensive innovations).

A study of World Bank experience by Demery and Addison (1987) gives added weight to the suggestion that adjustment can be carried out while still protecting the poor. They examine attempts of more than a dozen developing countries to assist the poor while undertaking structural adjustment. Basically, Demery and Addison found that the effort must be made to increase the participation of the poor in activities that are expanding under adjustment and to maximize their ability to generate income, so that transfer payments may be targeted to the most vulnerable groups. They "distinguish five broad approaches to assisting the poor under adjustment: (i) increasing their access to productive assets; (ii) raising their return on assets; (iii) improving their employment opportunities; (iv) ensuring their access to education and health services; and (v) supplementing their resources with transfers" (p. 3). The authors provide examples of each approach by drawing from a variety of programs undertaken with Bank assistance. In short, there are many specific examples of the possibility of protecting the poor during adjustment.

There is nothing magical in this list of strategies. On the contrary, considerable controversy surrounds each suggestion. Moreover, these suggestions must be matched against the requirements and potentials of individual countries and their external environments. In all cases, however, as both economists and political scientists recognize, the adjustment/reform package is basically political because some groups gain and some groups lose as the conditions are carried out, particularly in the short run. From this perspective, perhaps the main problem encountered in encouraging policy reform is to convince the leadership that they will be able to survive, and even prosper, while power and authority are redistributed under the adjustment/reform package. This is why policy reform cannot be imposed from the outside if it is expected to be of lasting value. Policy dialogue requires patient, long-term (a decade or more) collaborative efforts among donors and recipients alike if it is not to become just another promising, but failed, development fad.

Today, after two "successful" development decades in which growth of GNP in developing countries rose briskly at 5 percent in the 1960s and 6 percent in the 1970s (while poverty simultaneously became more widespread), the strategy being sought is that found in the theory of markets, and market-based development. At the same time, the best that any government can do in formulating economic policy is to try to achieve and retain an optimal balance between regulation and other forms of government intervention and the free play of market forces. Sometimes, advocates of policy reform appear to be suggesting that the market will solve all problems. Both theory and experience (as, for example, the Japanese model) suggest that a vital and growing economy requires both a strong private sector and a strong, active government.

There is yet another perspective on specific interventions that support policy-based structural adjustment. In a sense, the essential problem of development in developing countries is not that the potential of the market is not understood. Rather, it is that changes that took centuries to achieve in developed countries are being collapsed into decades in developing countries. In many cases, there has not been enough time for the institutional and cultural development that underlies market-led development to occur. Some common features of societies integrated through markets are a system of laws protecting property and contracts, acceptance of the rule of law in the area of civil liberties, broad-based capital markets and a reliable system of public accountancy, the concept of relatively equal opportunity, a spirit of rationality, and the like. From this perspective, a development strategy must combine broad-based policy adjustment with projects that help developing countries overcome the institutional and cultural deficiencies that impede market development and require more time to change.

A.I.D. supports policies that stimulate rapid economic growth. In doing so, it emphasizes both individual projects and nonproject assistance as embodied in structural adjustment and policy conditionality. Policy dialogue underlying policy adjustment emphasizes open trading regimes, market forces, and strengthening of the private sector. At the same time, it is recognized that some adjustment measures may restrict incomes of the poor, which in turn will require positive counterbalancing action by government. On the whole, A.I.D.'s experience with policy conditionality has been positive, as shown in several country evaluations, although many difficulties remain. Current A.I.D. evaluation efforts will be devoted to estimating the impact of policy reform on lower income groups. Preliminary results for Africa will be available by mid-1989.

There is little doubt that the effort at policy reform is overdue and appropriate. Evaluating the effects of such reform remains difficult because there is no simple quantitative expression by which to judge success or failure. However, wildly out of balance budgets, overvalued exchange rates, inefficient government restrictions on the sale of agricultural products, and a host of similar economic aberrations usually produced the opposite of growth--economic chaos, stagnation, and poverty. Under these conditions, real development is unlikely to occur and the poor are unlikely to benefit except from the random largess of a leader trying to buy political support.

Nevertheless, there are already signs that policy reform based on this strategy may be promising too much. There are standard technical arguments for a go-slow approach on reform. Just as our knowledge base is limited (particularly in those areas with the most serious problems) so too are the data on which policy will be based. Also, ambitious donors often pile condition on condition so that the complexity of meeting any condition is tied in with meeting the others. Moreover, a behavioral model that more clearly relates policy change to expected outcomes is lacking. The connection between these two elements often is impenetrable to rational, empirically based analysis.

Finally, as with other "strategies" that have gained ascendancy at different times in development thinking, policy reform raises expectations. In this case, however, the expectations go beyond the limited hope that good results will be forthcoming from the program. Policy reform requires extensive restructuring of economies, sometimes to the short-run disadvantage of large numbers of the poor. In turn, this requires that donors accept the responsibility not only for sufficient assistance for the "reform," but for the costs that must be borne by those "losing" from the changes, and hence for political stability over the medium term. In other words, donors, as well as developing country leadership, must be willing to stay the course. The repudiation by Zambia in May 1987 of the major conditions of the adjustment package of the World Bank and the IMF, and other donors, is a case in point. Perhaps another dozen African countries as well will be unable to repay their external debts. It is widely agreed that the reforms initiated but now abolished by Zambia were basically sound, and that donors should have been aware of the extra funding requirements they implied over the medium term.

The role of developed countries in policy reform efforts in developing countries bears special emphasis. As currently practiced, policy reform generates cynicism among some observers, who note that developing countries are expected to run a "tight ship," while the more developed countries are permitted profligate domestic practices as well as restrictive international practices. Policy conditions bear heavily on borrowing countries under our current international economic system, while industrial countries appear to have fewer conditions imposed on them. This asymmetry in policies can and often does have severe adverse effects on developing countries undertaking reforms. This is yet another dimension of the earlier statement that policy reform is fundamentally a political act. Some developed countries urge policy reform that may depend on increased exports from developing countries while, for domestic political reasons, adopting restrictive trade practices that inhibit those potential exports. This problem is well known among all observers and brings into question the seriousness of the proposals by representatives of developed countries for policy reform in developing countries.

APPENDIX A

CONDITIONALITY AND PROGRAM ASSISTANCE IN THE AGENCY FOR INTERNATIONAL DEVELOPMENT

Source:

Table A-1	GAO, "A Study: Conditionality in the Agency for International Development's Economic Assistance Programs in Six Countries," February 27, 1985, Xerox, pp. 6-15.
Table A-6 through A-9	A.I.D., "A.I.D. Conditionality: A review of Recent Conditions Contained in FY 1986 Program Assistance Approval Documents (PAADs), xeroxed interoffice memorandum from Kenneth Kauffman (AAA/PPC/EA) dated November 25, 1986.
Table A-11	Wesley Weideman, Orest Koropecky, and E. Scott Thomas, "Zambian Agricultural Sector Policy Impact Assessment," Office of Development Planning, Bureau for Africa, A.I.D., March, 1987, Appendix C.

TABLE A-1

Conditionality in AID Economic Assistance in Five Countries (Costa Rica, Honduras, Egypt, Bangladesh, (Sudan)

Basic information each project and program is given as well as, if applicable, the nature of the policy conditionality (macro stands for macroeconomic and micro stands for microeconomic), a summary of the conditionality and a general statement about whether the conditionality was met from AID's point of view. "Type of Assistance" refers to the funding source. The funding account for each DA project is given as follows: A/RD/N, Agriculture, Rural Development and Nutrition; PP, Population Planning; HE, Health; EHR, Education and Human Resources; and SDA, Special Development Activities.

Costa Rica

Project/Program	Type of assistance	Fiscal year initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality[a]	Were conditions met?[b]	See the following pages for details
Campesino Union Strengthening (515-0180)	A/RD/N	1982	0.5 grant	No	-	-	-	17
Private Sector Export Credit (515-0187)	A/RD/N	1982	10 loan	No	-	-	-	17
Northern Infrastructure Development (515-0191)	A/RD/N	1982	14.7 loan and grant	No	-	-	-	17
Training for Private Sector Development (515-0212)	EHR	1984	5 grant	No	-	-	-	18
Health Service Support (515-0203)	HE	1983	10.3 loan and grant	No	-	-	-	18
Family Planning Self-Reliance (515-0168)	PP	1983	2.5 grant	No	-	-	-	18
Economic Stabilization Recovery I (515-0185)	ESF	1982	20 loan and grant	Yes	Macro	Negotiate with IMF; banking/currency legislation; export development	Yes	20
Economic Stabilization Recovery II (515-0186)	ESF	1983	64.5 loan and grant	Yes	Macro	Exchange rate adjustment; private sector development; IMF stand-by; credit policy; banking/currency legislation	Yes	22
First Amendment	ESF	1983	9.2 loan and grant					24
Second Amendment	ESF	1983	5 grant					25
Third Amendment	ESF	1983	45 loan and grant	Yes	Macro	Credit policy; export policy	Partially[c]	25

[a]This is not an exhaustive listing of conditions. For a full listing, refer to the specific country section.
[b]Determinations about compliance are based on examination of AID documents and discussions with AID officials.
[c]"Partially" indicates that the recipient government has complied with some of the conditions in the agreement.

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Costa Rica (continued)

Project/Program	Type of assistance	Fiscal year initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality[a]	Were conditions met?[b]	See the following pages for details
Fourth Amendment	ESF	1983	32 loan and grant	Yes	Macro	Negotiate IMF stand-by; commercial bank credit	Partially	25
Economic Stabilization Recovery (Loan) III (515-0192)	ESF	1984	12 loan	Yes	Macro	Banking/currency legislation; import/export management; IMF compliance	Partially	26
First Amendment	ESF	1984	23 loan	Yes	Macro	Compliance with previous conditions	Partially	30
Economic Stabilization Recovery (Grant) III (515-0192)	ESF	1984	35 grant	Yes	Macro	Banking/currency legislation; economic policy strategy	Partially	30
First Amendment	ESF	1984	60	Yes	Macro	Maintain compliance with previous conditions	Partially	33
P.L. 480	Title I	1982-85	94	Yes	Micro/Macro	Grain storage and handling; research extension; agricultural policy; export promotion	Partially	33

Honduras

Project/Program	Type of assistance	Fiscal year initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality	Were conditions met?	See the following pages for details
Export Development and Services (522-0207)	SDA, A/RD/N	1984	22 loan and grant	Yes	Macro	Import/export legislation; establish export fund	Partially	40
Development Administration (522-0174)	EHR	1982	2.5 grant	No	-	-	-	40
Small Farmer Titling Services (522-0173)	A/RD/N	1982	12 loan and grant	No	-	-	-	41
Tegucigalpa Power Restoration (522-0026)	ESF	1982	1.8 grant	No	-	-	-	41
Small Farmer Livestock (522-0209)	A/RD/N	1983	12 loan and grant	No	-	-	-	41
Small Business Development (522-0205)	SDA	1984	0.6 grant	No	-	-	-	42
Economic Recovery Program (522-0192)	ESF	1982	35 loan	Yes	Macro	IMF stand-by	Yes	43
First Amendment	ESF	1983	3 loan	Yes	Macro	IMF stand-by	Yes	44
Second Amendment	ESF	1983	15 loan and grant	Yes	Macro	IMF stand-by; tax policy; debt renegotiation	Yes	45
Third Amendment	ESF	1983	8 loan and grant (not disbursed due to noncompliance)	Yes	Macro	IMF stand-by; tax policy; policy studies; export policy	Waived	45
Fourth Amendment	ESF	1983	30 loan and grant (not disbursed due to noncompliance)	Yes	Macro	IMF stand-by; policy studies; export policy	Partially	46

Honduras (continued)

Project/Program	Type of assistance	Fiscal year initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality[a]	Were conditions met?[b]	See the following pages for details
Fifth Amendment	ESF	1984	0 (alter conditions to Third Amendment)	Yes	Macro	Tax policy; economic policy discussions	Yes	47
Sixth Amendment	ESF	1984	0 (alter conditions to Fourth Amendment)	Yes	Micro/ Macro	Tax policy; economic policy discussions	Partially	49
Seventh Amendment	ESF	1984	30 loan and grant	Yes	Macro	External debt payments	Partially	50
Eighth Amendment	ESF	1984	10 loan and grant (not disbursed)	Yes	Macro	Export/Import legislation and regulations; external debt payments	-	51
P.L. 480	Title I	1984	22	Yes	Micro	Agriculture policy changes; investment promotion; forestry reforms	Partially	52
P.L. 480	Title III	1982-83	10	Yes	Micro	Agriculture policy changes; water resource reform; farmer training	Partially	53

Egypt

Project/Program	Type of assistance	Fiscal year initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality	Were conditions met?	See the following pages for details
Aswan High Dam Rehabilitation (263-0160)	ESF	1982	100 grant	Yes	Micro	Electricity pricing	No	55
Energy Policy and Renewable Energy Field Testing (263-0123)	ESF	1982	32.6 grant	No	-	-	-	56
Safaga Grain Silos (263-0165)	ESF	1982	80 grant	No	-	-	-	56
Family Planning II (263-0144)	ESF	1983	102.6 grant	Yes	Micro	Acceptance of family planning	No	57
Ismailia Thermal Power Plant (263-0009)	ESF	1983	109 grant	Yes	Micro	Electricity pricing	No	57
Cairo Sewerage II (263-0173)	ESF	1984	See p. 58	Yes	Micro	Water/Wastewater pricing	Yes	58
1982 Commodity Import Program (263-K-604)	ESF	1982	350 grant	Yes	Macro	Economic policy dialogue	Yes	59
1983 Commodity Import Program (263-K-606)	ESF	1983	301.1 grant	Yes	Macro	Economic policy dialogue	Yes	59
1984 Commodity Import Program (263-K-607)	ESF	1984	300 grant	Yes	Macro	Economic policy dialogue	Yes	60
1984 Program Cash Transfer (263-K-608)	ESF	1984	101.9 grant	No	-	-	-	60
P.L. 480	Title I	1982-84	760	Yes	Micro	Agricultural policies	Partially	61
P.L. 480	Title III	1982-83	30	Yes	Micro	Agricultural policies	Partially	61

Bangladesh

Project/Program	Type of assistance	Fiscal year initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality	Were conditions met?	See the following pages for details
Rural Finance (388-0037)	A/RD/N	1983	75 grant	Yes	Micro	Rural savings; interest rate policy	Yes	65
Fertilizer Distribution Improvement II (388-0060)	A/RD/N	1984	65 grant	Yes	Micro	Marketing policy, private sector participation	No	68
Family Planning Services (388-0050)	PP	1984	26 grant	Yes	Micro	Voluntary sterilization program monitoring	Yes	69
P.L. 480	Title III	1982-85	284	Yes	Micro	Agricultural policies	Yes	70

Sudan

Project/Program	Type of assistance	Fiscal year Initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality	Were conditions met?	See the following pages for details
Southern Agricultural Development I (650-0046)	A/RD/N	1982	10.1 grant	No	-	-	-	74
Energy Planning and Management (650-0059)	SDA	1982	8.5 grant	Yes	Micro	Donor coordination, pricing and private sector participation in the energy sector	Partially	75
Model Family Planning (650-0063)	PP	1982	1.8 grant	No	-	-	-	76
Southern Region Road Maintenance and Rehabilitation (650-0043)	A/RD/N	1983	19.7 grant	No	-	-	-	76
Policy Analysis and Implementation (650-0071)	ESF	1983	5 grant	No	-	-	-	77
Western Sudan Agricultural Marketing Road (650-0069)	A/RD/N	1984	60 grant	Yes	Micro	Transportation sector regulations and donor coordination	See p. 77	77
1982 Commodity Import Program (650-K-603)	ESF	1982	100 grant	Yes	Macro	Economic policy changes including private sector participation, exchange rates, imports, price controls, etc.	Partially	78
1983 Commodity Import Program (650-K-604)	ESF	1983	60.25 grant					80
1983 Program Grant (650-K-605)	ESF	1983	20 grant					82
1984 Commodity Import Program (650-K-606)	ESF	1984	102 grant (82.5 not disbursed)					83
1984 Program Grant (650-K-607)	ESF	1984	18 grant	Yes	Macro	Economic reform involving budgetary reductions, taxation, and decentralization.	Yes	84

Sudan (continued)

Project/Program	Type of assistance	Fiscal year initiated	Amount ($ millions)	Policy conditionality	Nature of conditionality	Type of conditionality	Were conditions met?	See the following pages for details
P.L. 480	Title I	1982-85	115	Yes	Micro	Agricultural policies	Partially	85, 90
P.L. 480	Title III	1982-84	60	Yes	Micro	Agricultural policies	Partially	88

Table A-2

AID FY 1986 Conditionality by Country

Tax Reform

Senegal

Jamaica

Improved Tax Administration

Senegal

Haiti

Honduras

Jamaica

Reduced Expenditures

Chad

Costa Rica

Dominican Republic

El Salvador

Deregulation of Price and/or Market Controls

Kenya

Mozambique

Togo

Belize

Ecuador

Grenada

Divestiture of Parastatal Enterprises

Costa Rica

Grenada

Panama

Restricted Activities for Parastatals

Belize

Grenada

AID FY 1986 Conditionality

Monetary Policy

Limit Domestic Borrowing	Limit External Borrowing
Costa Rica	El Salvador
El Salvador	
Honduras	

Permit Interest Rates to Rise to Market Clearing Levels

Ecuador

Enhance Private Sector Access to Commercial Bank Credit

Togo

Costa Rica

AID FY 1986 Conditionality

External Trade

Limit/Reduce Export Taxes

Zaire

Dominican Republic

Reduce Restrictions on Exports

Belize

Reduce Import Tariffs

Kenya

Senegal

Zaire

Ecuador

Export Promotion

Belize

Reduce Administrative Restrictions on Imports

Kenya

Senegal

Belize

Haiti

Require Purchase or Attribution of Equivalent Amount in U.S. Commodities (Code 000)

Mozambique

Somalia

Bolivia

Costa Rica

Dominican Republic

Ecuador

Guatemala

Jamaica

Panama

Israel

Tunisia

AID FY 1986 Conditionality

External Trade (continued)

Require Purchase or Attribution in Either 000, 899 or 941 Countries Only

Sudan

El Salvador

Grenada

Honduras

Egypt

Foreign Exchange (General)

Zaire

Zambia

Reduce or Eliminate Difference Between Official and Market Exchange Rates

Costa Rica

Enhance Private Sector Access to Foreign Exchange

Mozambique

Somalia

Costa Rica

Honduras

AID FY 1986 Conditionality

Private Sector

Increase Access to Domestic Credit

Somalia

Fewer/Lower Price Controls

Kenya

Togo

Belize

Fewer Administrative Controls/ Regulations

Kenya

Enhanced Access to Markets and Productive Resources

Mozambique

Somalia

Dominican Republic

El Salvador

Enhanced Entrance into Selected Activities

Somalia

Togo

Allow Enhanced Access to State Agricultural Holdings

Dominican Republic

Grenada

Table A-6

CATEGORIZATION OF ECONOMIC SUPPORT FUND OBLIGATIONS - FY 1981-1987
(DOLLARS IN MILLIONS)

Category	FY 1981 Actual	FY 1982 Actual	FY 1983 Actual	FY 1984 Actual	FY 1985 Actual	FY 1986 Estimated	FY 1987 Proposed
Project-Type Assistance	650.600	684.950	881.127	944.718	1,043.333	1,055.613	1,309.748
Percentage of Total	29.58%	24.73%	29.65%	30.03%	22.18%	22.44%	31.31%
Com. Imp. Prg./Spec. Procurement Activities	370.500	597.500	497.250	563.055	436.062	475.953	341.500
Percentage of Total	16.85%	21.57%	16.73%	17.90%	9.27%	10.12%	8.16%
Cash/Balance of Payments	1,178.200	1,487.814	1,593.085	1,638.394	3,224.290	3,172.120	2,532.052
Percentage of Total	53.57%	53.71%	53.61%	52.08%	68.55%	67.44%	60.53%
Total	2,199.300	2,770.264	2,971.462	3,146.167	4,703.685	4,703.686	4,183.300
Total Percentage	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

TABLE A-7

Trends in Economic Support Funds by Categorization, FY 1981-1987

(obligations, millions of dollars)

Bureau	FY 1982 Proj-Type Asst.	FY 1982 CIP/ Sp.Prc.	FY 1982 Cash/ BOP	FY 1982 Total	FY 1983 Proj-Type Asst.	FY 1983 CIP/ Sp.Prc.	FY 1983 Cash/ BOP	FY 1983 Total
Africa	61.610	187.500	45.714	294.824	66.862	137.250	82.000	286.112
Asia/Near East	583.080	410.000	1,153.000	2,146.080	717.840	360.000	1,107.000	2,184.840
Latin America/Caribbean	39.760	0.000	289.100	328.860	96.275	0.000	404.085	500.360
Other	0.500	0.000	0.000	0.500	0.150	0.000	0.000	0.150
Total	684.950	597.500	1,487.814	2,770.264	881.127	497.250	1,593.085	2,971.462
Percentage of Total	24.73%	21.57%	53.71%	100.00%	29.65%	16.73%	53.61%	100.00%

Bureau	FY 1984 Proj-Type Asst.	FY 1984 CIP/ Sp.Prc.	FY 1984 Cash/ BOP	FY 1984 Total	FY 1985 Proj-Type Asst.	FY 1985 CIP/ Sp.Prc.	FY 1985 Cash/ BOP	FY 1985 Total
Africa	92.110	170.000	71.000	333.110	85.172	156.000	176.680	417.852
Asia/Near East	759.384	393.055	1,195.394	2,347.833	867.320	357.200	2,613.000	3,837.520
Latin America/Caribbean	92.116	0.000	372.000	464.116	143.525	0.000	841.500	985.025
Other	1.100	0.000	0.000	1.100	7.000	0.000	0.000	7.000
Total	944.718	563.055	1,638.394	3,146.167	1,103.017	513.200	3,631.180	5,247.397
Percentage of Total	30.03%	17.90%	52.08%	100.00%	21.02%	9.78%	69.20%	100.00%

Bureau	FY 1986 Proj-Type Asst.	FY 1986 CIP/ Sp.Prc.	FY 1986 Cash/ BOP	FY 1986 Total	FY 1987 Proj-Type Asst.	FY 1987 CIP/ Sp.Prc.	FY 1987 Cash/ BOP	FY 1987 Total
Africa	59.304	115.488	113.910	288.702	88.448	181.500	140.552	410.500
Asia/Near East	841.320	291.730	2,579.192	3,712.242	1,069.300	160.000	1,597.500	2,826.800
Latin America/Caribbean	127.324	0.000	531.188	658.512	151.000	0.000	794.000	945.000
Other	15.385	28.844	0.000	44.229	1.000	0.000	0.000	1.000
Total	1,043.333	436.062	3,224.290	4,703.68[illegible]	1,309.748	341.500	2,532.052	4,183.300
Percentage of Total	22.18%	9.27%	68.55%	100.00%	31.31%	8.16%	60.53%	100.00%

Table A-8

CATEGORIZATION OF FY 1986 ECONOMIC SUPPORT FUNDS OBLIGATIONS
AS OF SEP 3 1986
(DOLLARS IN MILLIONS)

REGION/COUNTRY	PROJECT-TYPE ASSISTANCE	COM. IMP. PRGS. & SPEC. PROC. ACTIVITIES	CASH/ BALANCE OF PAYMENTS	TOTAL FY 1986 OYB
FY 1986 New Obligational Authority:				
AFRICA				
Botswana	7.623	0.000	0.000	7.623
Chad	2.519	0.000	7.000	9.519
Djibouti	2.950	0.000	0.000	2.950
Guinea	0.000	0.000	10.000 b/	10.000
Kenya	0.000	14.355	0.000	14.355
Liberia	0.000	0.000	28.203	28.203
Madagascar	0.844	2.000	0.000	2.844
Mauritius	0.000	1.914	0.000	1.914
Mozambique	0.000	0.000	9.570	9.570
Niger	0.000	0.000	4.373	4.373
Senegal	1.000	0.000	25.484 b/	26.484
Seychelles	0.000	1.914	0.000	1.914
Somalia	1.000	0.000	21.011	22.011
Sudan	0.000	25.162 **	0.000	25.162
Togo	0.000	0.000	7.850 b/	7.850
Zaire	9.527	0.000	15.000 b/	24.527
Zambia	0.000	0.000	15.000	15.000
Zimbabwe	5.000	0.000	0.000	5.000
Sahel Regional	0.678 a/	0.000	0.000	0.678
So. Afr. Republic	4.735	0.000	0.000	4.735
So. Afr. Reg'l	28.814 a/	0.000	0.000	28.814
Africa Regional	0.977 a/	0.000	0.000	0.977
Subtotal	65.667	45.345	143.491	254.503
ASIA & NEAR EAST				
Afghanistan	14.335	0.000	0.000	14.335
Cambodia	3.350	0.000	0.000	3.350
Cyprus	14.355	0.000	0.000	14.355
Egypt	469.384	199.730	110.055	779.169
Fiji	0.957	0.000	0.000	0.957
Ireland	0.000	0.000	50.000 c/	50.000
Israel	0.000	0.000	1,148.400	1,148.400
Jordan	9.323	4.549	0.000	13.872
Lebanon	1.380	0.000	0.000	1.380
Morocco	11.484	0.000	0.000	11.484
Oman	19.556	0.000	0.000	19.556
Pakistan	186.750	52.500	0.000	239.250
Philippines	0.000	0.000	119.625	119.625
Portugal	0.000	0.000	76.487	76.487
South Pacific	0.957	0.000	0.000	0.957
Spain	11.484	0.000	0.000	11.484
Thailand	0.000	0.000	5.000	5.000
Tunisia	18.974	0.000	0.000	18.974
Turkey	0.000	0.000	119.625	119.625
Asia Near East Reg'l	14.308 a/	0.000	7.000 d/	21.308

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Disk 5

CATEGORIZATION OF FY 1986 ECONOMIC SUPPORT FUNDS OBLIGATIONS
AS OF .. SEP: 1986
(DOLLARS IN MILLIONS)

REGION/COUNTRY	PROJECT-TYPE ASSISTANCE	COM. IMP. PRGS. & SPEC. PROC. ACTIVITIES	CASH/ BALANCE OF PAYMENTS	TOTAL FY 1986 OYB
LATIN AMERICA				
Belize	0.000	0.000	1.914	1.914
Bolivia	0.000	0.000	7.177	7.177
Costa Rica	0.000	0.000	120.582	120.582
Dominican Repuolic	0.000	0.000	40.000	40.000
Ecuador	0.000	0.000	20.110 e/	20.110
El Salvador	30.045	0.000	147.000	177.045
Guatemala	0.500	0.000	47.350	47.850
Haiti	3.321	0.000	18.000	21.321
Honduras	0.000	0.000	61.248	61.248
Jamaica	0.000	0.000	58.000	58.000
Panama	0.000	0.000	5.742	5.742
Peru	7.000	0.000	0.000	7.000
Uruguay	0.355	0.000	14.000	14.355
Caribbean Regional	21.172	0.000	4.000	25.172
LAC Regional	7.583	0.000	0.000	7.583
ROCAP	43.713	0.000	0.000	43.713
Subtotal	113.689	0.000	545.123	658.812
OTHER				
S&T Bur. (Ocean. Res.)	1.435	0.000	0.000	1.435
Subtotal	1.435	0.000	0.000	1.435
GRAND TOTAL	957.388	302.124	2,324.806	3,584.318
Percentage of Total	26.71%	8.43%	64.86%	100.00%

ESFCAT86
Disk 5

CATEGORIZATION OF FY 1986 ECONOMIC SUPPORT FUNDS OBLIGATIONS
AS OF SEP 5 1986
(DOLLARS IN MILLIONS)

REGION/COUNTRY	PROJECT-TYPE ASSISTANCE	COM. IMP. PRGS. & SPEC. PROC. ACTIVITIES	CASH/ BALANCE OF PAYMENTS	TOTAL FY 1986 OYB

a/ Includes local support costs as follows: Sahel Regional-$.678 million (includes Chad $.266m and Niger $.412m); Africa Regional-$.601 million (includes Djibouti-$.025m; Madagascar-$.027m: Liberia-$.507m; and Zaire-$.043m); So. Afr. Regional-$.678 million (for Botswana-$.[illegible]m: Zimbabwe-$.021m; So. Afr. Reg'l-$.052m); ANE Regional-$1.362 million (for Afghanistan-$.[illegible]m; Egypt-$.786m; Jordan-$.247m; Lebanon-$.247m; Oman-$.014m; Portugal-$.073m; and Tunisia-$.166m); and for Latin America-- Peru-$.035 million; Haiti-$.111 million; and Caribbean Regional $.172 million. Africa and Asia/Near East have included local support costs in their Regional programs; LAC has kept local support costs in PD&S projects within those affected countries.

b/ Includes funds for the Africa Economic Policy Reform as follows: Guinea $10 million; Senegal $15 million; Togo $7.85 million; and Zaire $15 million. Total: $47.85 million.

c/ These funds are the FY 1986 U.S. contribution for the International Fund for Ireland and Northern Ireland in accordance with Public Law 99-190

d/ These funds are for the India Defensive Mixed Credit program.

e/ Ecuador includes $6 million reprogrammed from Somalia deobligations.

** In process of reallocating $15.162 million from Sudan to other programs.

TABLE A-9
Country Application of Conditionality in AID

REAS AFFECTED BY CONDIT[illegible]ITY	Chad	Djibouti	Kenya	Mozambique	Senegal	Somalia	Sudan	Togo	Zaire	Zambia
	SUBSAHARAN AFRICA									
. Nonfinancial Public Sector										
.1 Reduce expenditures										
.1.1 Reduce current expenditures										
.1.2 Reduce capital/maintenance expenditures	X									
.2 Increase revenues										
.2.1 Tax reform					X					
.2.2 Improved tax administration					X					
.3 Deregulation of price and/or market controls			X	X				X		
.4 Parastatal Enterprises										
.4.1 Divestiture of parastatal enterprises										
.4.2 Restrict activities of parastatal enterprises										
. Monetary Policy										
1 Restrict growth of money supply										
1.1 Limit public sector domestic borrowing										
1.2 Limit external borrowing										
2 Permitting interest rates to rise to market clearing levels										
3 Enhance private sector access to commercial bank credit								X		
External Trade										
1 Exports										
1.1 Reducing restrictions on exports										
1.2 Limiting/reducing taxes on exports or changing export taxes from quota to ad valorum basis									X	
1.3 Other forms of export promotion, e.g., special credit lines to exporters.										
2 Imports										
2.1 Reduce tariffs on imports			X		X				X	
2.2 Reduce administrative restrictions on imports			X		X					
2.3 Require purchase or attribution of equivalent amount in U.S. commodities (Code 000)				X		X				
2.4 Require purchase or attribution in either 000, 899 or 941 countries only							X			
3 Foreign Exchange										
3.1 Reduce or eliminate the difference between the official and market exchange rates									X	X
3.2 Enhance private sector access to foreign exchange				X		X				
Private Sector										
1 Increase private sector access to:										
1.1 Domestic credit						X				
.2 External credit										
.3 Foreign exchange						X				
.4 Require equivalent amount of foreign exchange be made available for the import of U.S. goods and services										
Reduce Public Regulation										
.1 Fewer/lower price controls, including interest and exchange rates			X					X		
.2 Fewer administrative controls and/or regulations			X							
.3 Lower, more equitable tax rates										
Enhance Access to Productive Resources/Markets				X		X				
.1 Remove prohibitions to private sector entrance						X		X		
.2 Allow expanded private sector access to public sector agricultural holdings										
Other	X									

REAS AFFECTED BY CONDITIONALITY	Egypt	Israel	Philippines	Portugal	Tunisia
	ASIA AND THE NEAR EAST				
. Nonfinancial Public Sector					
.1 Reduce expenditures					
.1.1 Reduce current expenditures					
.1.2 Reduce capital/maintenance expenditures					
.2 Increase revenues					
.2.1 Tax reform					
.2.2 Improved tax administration					
.3 Deregulation of price and/or market controls					
.4 Parastatal Enterprises					
.4.1 Divestiture of parastatal enterprises					
.4.2 Restrict activities of parastatal enterprises					
Monetary Policy					
1 Restrict growth of money supply					
1.1 Limit public sector domestic borrowing					
1.2 Limit external borrowing					
2 Permitting interest rates to rise to market clearing levels					
3 Enhance private sector access to commercial bank credit					
External Trade					
1 Exports					
1.1 Reducing restrictions on exports					
1.2 Limiting/reducing taxes on exports or changing export taxes from quota to ad valorum basis					
1.3 Other forms of export promotion, e.g., special credit lines to exporters					
2 Imports					
2.1 Reduce tariffs on imports					
2.2 Reduce administrative restrictions on imports					
2.3 Require purchase or attribution of equivalent amount in U.S. commodities (Code 000)		X			X
2.4 Require purchase or attribution in either 000 or 941 countries only	X				
3 Foreign Exchange					
3.1 Reduce or eliminate the difference between the official and market exchange rates					
3.2 Enhance private sector access to foreign exchange					
Private Sector					
Increase private sector access to:					
.1 Domestic credit					
.2 External credit					
.3 Foreign exchange					
.4 Require equivalent amount of foreign exchange be made available for the import of U.S. goods and services					
Reduce Public Regulation					
.1 Fewer/lower price controls, including interest and exchange rates					
.2 Fewer administrative controls and/or regulations					
.3 Lower, more equitable tax rates					
Enhance Access to Productive Resources/Markets					
.1 Remove prohibitions to private sector entrance					
.2 Allow expanded private sector access to public sector agricultural holdings					

EAS AFFECTED BY CONDITIONALITY	LATIN AMERICA AND THE CARIBBEAN							
	Belize	Bolivia	Costa Rica	Dom Rep.	Ecuador	El Salvador	Grenada	Guatemala
Nonfinancial Public Sector								
1 Reduce expenditures			X	X		X		
1.1 Reduce current expenditures								
1.2 Reduce capital/maintenance expenditures								
.2 Increase revenues							X	
.2.1 Tax reform								
.2.2 Improved tax administration								
.3 Deregulation of price and/or market controls	X				X		X	
.4 Parastatal Enterprises								
.4.1 Divestiture of parastatal enterprises			X				X	
.4.2 Restrict activities of parastatal enterprises	X							
Monetary Policy								
1 Restrict growth of money supply								
1.1 Limit public sector domestic borrowing			X					
1.2 Limit external borrowing						X		
2 Permitting interest rates to rise to market clearing levels					X			
3 Enhance private sector access to commercial bank credit			X					
. External Trade								
.1 Exports						X		
.1.1 Reducing restrictions on exports	X							
.1.2 Limiting/reducing taxes on exports or changing export taxes from quota to ad valorum basis				X				
.1.3 Other forms of export promotion, e.g., special credit lines to exporters	X							
.2 Imports								
.2.1 Reduce tariffs on imports					X			
.2.2 Reduce administrative restrictions on imports	X							
.2.3 Require purchase or attribution of equivalent amount in U.S. commodities (Code 000)		X	X	X	X			X
.2.4 Require purchase or attribution in either 000 or 941 countries only						X	X	
.3 Foreign Exchange								
.3.1 Reduce or eliminate the difference between the official and market exchange rates			X					
.3.2 Enhance private sector access to foreign exchange			X					
. Private Sector								
.1 Increase private sector access to:								
.1.1 Domestic credit								
.1.2 External credit								
.1.3 Foreign exchange			i					
.1.4 Require equivalent amount of foreign exchange be made available for the import of U.S. goods and services								
.2 Reduce Public Regulation								
.2.1 Fewer/lower price controls, including interest and exchange rates								
.2.2 Fewer administrative controls and/or regulations								
.2.3 Lower, more equitable tax rates								
.3 Enhance Access to Productive Resources/Markets				X		X		
.3.1 Remove prohibitions to private sector entrance								
.3.2 Allow expanded private sector access to public sector agricultural holdings							X	
6. Other		X						

Table A-10

Policy Inventory Matrix for Somalia

Policy Category: Fiscal

Policy Intervention	Implementing Institution	Impact Assessment						Reforms Undertaken
		Production	Imports	Domestic Consumption	Exports	Inflation	Government Revenues	
Recurrent Spending	Ministry of Finance, although constrained by promises made to the Politburo.		-	-		--		The GOS is seeking to cut recurrent spending and hike taxes t reduce budget deficits. In recent years, deficits hade been excessive, ranging as high as 11 percent of GDP. To reduce recurrent spending, the GOS: - abolished the practice of automatic employment for all hi school graduates in 1983. - has representatives in all spending ministries and agencies to review all expenditures requests before authorization in order to limit expenditures within budget allotments and disallow low priority purchases. - reduced civil servant employment two (2) percent in 1985. Over 2,500 civil servants were retired between January a: October 1985 and an additional 1,600 were awaiting President's approval for retirement. Also, 1,300 were dismissed and given the opportunity to work in agriculture or fisheries. Since October 1985, retired employees are being replaced. - was adjusting expenditure ceilings for the remainder of 1986. Those ministries who exceeded budgetary allocatio in the first half of 1986 were reduced by the same amoun the second half. In addition, there was an across-the-boar reduction of five (5) percent in all ministries and no n allocations. Total savings equivalent to 12 percent of non-interest ordinary outlays were projected.

Policy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken
Taxation	Ministry of Revenue	Production - Imports - Domestic Consumption Exports + Government Revenues - Inflation	While tax revenues as a share of GDP had fallen from 8.6 to . percent over 1982-85, they were expected to approach 4.6 perc in 1986. Tax collections were up 175 percent in the second quarter of 1986 over the second quarter in 1985 and 72 percen over the first quarter of 1986. The GOS: - is altering specific tax rates to ad valorem basis; - is broadening the coverage of excise duties already in - is basing the calculation of import duties on a more realistic exchange rate; - is enhancing revenue collection through extensive staffi and administrative improvements; -- Mogadishu has been divided into 13 revenue collectior districts. -- A concerted effort is underway to deny exemptions and require full payment of all levies. -- A survey of all commercial establishments and propert is being undertaken. -- Additional collection posts are to be opened up. -- Training programs have been instituted in various t sectors. - is implementing new taxes, consisting of (a) an excise effective 7/85 at ad valorem rates between 5 and 100 perc on 30 commodities, (b) a 5 percent cascade sales tax, and (c) introduction of a 20 percent surcharge applicable to non-government imports to replace a 50 percent surcharge imports transacted through external accounts.

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Policy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken

Parastatal Enterprise	Ministry of Commerce and Industry and other sectoral ministries.	Production
		Imports
		Domestic Consumption
		Exports
		Government Revenues
		Inflation
		
		Little immediate impact on any of the above variables.
			Forty nine parastatal enterprises have been established. The performance of the enterprises has been poor in recent years. Most enterprises operate well below capacity and many are faci financial difficulties. As a consequence, devolution of parastatal enterprise is taking place.
			
			- In 1982, an Inter-Ministerial Commission was set up. I
			  - conducting financial audits of all enterprises;
			  - recommending measures to improve enterprises' operation
			  - seeking to reduce the number of enterprises; and
			  - standardizing accounting procedures.
			
			- In 1984, employees of industrial public enterprises were brought under the labor code that applies to the private sector.
			  - Compensation is now determined by bargaining.
			  - The GOS can offer production incentives to individua enterprises.
			  - Parastatal are free to hire and fire.
			
			- In 1984, a number of enterprises were transferred to workers' cooperatives.
			- Board of Directors are being established for each enter to enable them to operate more autonomously.
			- Foreign rehabilitation of some enterprises, e.g. a ceme factory, has taken place.
			- Some entities that were operating uneconomically, consi of e.g. a gypsum plant, have been shut down where rehabilitation was not feasible.
			- IBRD has agreed to finance feasibility studies for rehabilitation and divestiture of public enterprises.
			- Parastatals no longer receive preferential treatment when acquiring credit.

Policy Category: Foreign Exchange

Policy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken
Exchange Controls	Central Bank	+ Production + Imports Domestic Consumption + Exports Government Revenues Inflation	Exchange controls are being liberalized. Exchange controls, which limited access to requisite foreign exchange, had constituted a major impediment to economic growth in Somalia. - External account facilities were opened on July 15, 1981. All Somali Nationals owning foreign exchange abroad were allowed to open external accounts in the form of either time or demand deposits. - On January 1, 1985, the opening of export promoting and import accounts denominated in foreign currencies by Somali nationals or foreigners was allowed. - While surrender requirements for the proceeds from exports of goods were hiked from 35 to 50 percent during 1986, they are still considerably lower than the 100 percent level existing prior to 1985. Although the franco valuta system under which Somali nationals could finance imports with foreign exchange abroad was abolished in 1985, the introduction of the system of import and external accounts, nonetheless, means that imports financed with foreign exchange held abroad continue, in effect, to be permitted freely.
Exchange Rate	Central Bank	+ Production - Imports - Domestic Consumption + Exports - Government Revenues + Inflation	Since 1982, the GOS has adopted a flexible exchange rate policy; in the previous eight (8) years the currency had been pegged to the U.S. dollar at a fixed rate, thereby becoming significantly overvalued. The official exchange rate was depreciated 140 percent in 1982, 15 percent in 1983, 48 percent in 1984, and 63 percent in 1985. Under the 1985 IMF financial program a freely floating system was established for most private transactions. Also, although it was recently suspended by the GOS, an auction to be held monthly was started in September 1986; proceeds from commodity import arrangements are placed in the auction.

Policy Category: External Trade

Policy Intervention	Implementing Institution	Impact Assessment: Production	Imports	Domestic Consumption	Exports	Government Revenues	Inflation	Reforms Undertaken
Import Controls	Ministry of Commerce and Industry.		+	+		+		The GOS is easing import controls. With the exception of a relatively few items prohibited for reasons of public safet social policy, all items can be imported without restrictio licensing requirements virtually have been abolished.

Policy Category: Prices

Policy Intervention	Implementing Institution	Impact Assessment: Production	Imports	Domestic Consumption	Exports	Government Revenues	Inflation	Reforms Undertaken
Price Controls	Ministry of Commerce and Industry	+					+	Price controls have been relaxed in recent years. A de fac elimination of all price controls took place at the beginni 1985. Prices of all products except petroleum products, cigarettes, and sugar are now set freely. As for petroleum products, in March 1986 the price of gasoline exceeded impo parity and the price of diesel reached import parity in Jun 1986.

Policy Category: Monetary

Policy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken
Interest Rates	Central Bank	+ Production Imports Domestic - Consumption Exports Government Revenues Inflation	The GOS is moving toward an interest rate structure designe provide for a positive real rate of return to savers and fu cost recovery on lending operations. Although interest rates remain negative in real terms, they are being hiked. The most recent instance was four percent in September, 1986.
Money Stock	Central Bank Ministry of Finance	Production - Imports Domestic - Consumption + Exports Government Revenues - Inflation	Inflation, although down considerably from the nearly tripl digit levels of several years ago, remains high. Monetizat of government budget deficits has been a primary causal fac In order to control inflation, the GOS, thus, is striving to reduce the growth of the monetary stock; the expansion in net domestic credit is being reduced to eight percent. Also, the use of commodity import program (CIP) funds will be limited to SS 6,600 million with any receipts in excess of the amount to deposited to a blocked account at the central bank rather than at the commercial bank; in limiting the loanable funds of the commercial bank, this will dampen demand pressures and inflati

Policy Category: Private Sector

olicy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken
rivate Sector Activity	Various institutions including the Ministries of Planning and Agriculture	+ Production Imports Domestic Consumption Exports Government Revenues Inflation	The GOS is seeking to stimulate private sector activity, especially in manufacturing which contributes but 5 percent of GDP. - In order to guarantee a minimum level of credit to the private sector, limits have been placed on Agriculture Development Corporation (ADC) credit extensions. - A quasi-private Chamber of Commerce has been established; the private sector also may form trade associations. - The operation of private schools and private practice by physicians are now allowed. - A revised private and foreign investment law has been approved at the technician level and was expected to be put to the Council of Ministers before the end of 1987. The la will reduce regulations and give incentives to private firm - A law allowing the formation of private commercial banks an insurance institutions has been prepared and was awaiting the President's signature. - Private importation of all goods is allowed and all livestock and bananas are exported privately.

Policy Category: Agriculture Sector

Policy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken
Marketing	Ministry of Commerce and Industry Ministry of Agriculture	+ Production - Imports Domestic Consumption + Exports Government Revenues Inflation	Significant market liberalization is taking place. In the pas most agriculture marketing was undertaken by the GOS and this constituted a drag on agriculture performance. - The Livestock Development Agency (LDA) was abolished in April 1981; livestock trade is now conducted primarily by private traders. - After 1981, the GOS discontinued the requirement that fishermen sell their catch directly to the government agency SOMALFISH at set prices, resulting in closure of the agency. Fishermen can now sell their catch at prevailing market prices. - The National Trading Agency (ENC) had held monopoly import rights for rice, wheat, flour, edible oil, pasta, sugar, tea, and most other consumer goods. They operated an extensive distribution system, supplying both public institutions and private shopkeepers with imported foodstuffs. While continuing to receive donor-funded wheat wheat flour, oil and rice and selling them at below market prices, the Agency since 1981 no longer imports other goods purchases no goods outside Somalia and only sells to the private sector when public sector institutional demand is satisfied. - The requirement that farmers sell their main staple product for domestic consumption to the ADC has been waived since 1982. The ADC, which had held a monopoly over the domestic grain trade, is confined to purchasing local production at prevailing market rates and selling to institutions such as hospitals, schools, and the military. Therefore, the organization is now a marginal factor in the marketing of locally produced maize and sorghum with purchases declining from 30 percent to a very small fraction of domestic production in 1985.

Policy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken
Pricing	Ministry of Agriculture	Production + Imports - Domestic Consumption Exports + Government Revenues + Inflation +	Prices of major agriculture products are increasingly set by market forces; support prices are revised periodically. Artificially low prices had affected production negatively. For example: - In 1981, producer prices for most agriculture products were increased 30 to 50 percent; for bananas the hike was 100 percent. - At the beginning of 1985, producer prices of bananas were doubled, amounting to a real increase of 38 percent. They were increased again by almost 45 percent at the beginning of 1986. - Minimum export prices for livestock now move in line with current market conditions.
Input Supply	Ministry of Agriculture, Ministry of Commerce and Industry, Ministry of Health	Production Imports Domestic Consumption Exports Government Revenues Inflation Little impact in near term on the above variables.	The GOS is encouraging private sector distribution of agriculture inputs which consist primarily of tractors, oil, fertilizers, veterinary drugs and pumps. - The GOS is to permit any private individual, group of individuals, or company to obtain licenses to import diese fuel and lubricants and distribute them through private channels without additional charges. - ONAT, the state tractor service company, has been subsidizing tractor rentals, discouraging private sector distribution. Under the IBRD Agricultural Sector Structur Adjustment Program (ASSAP), ONAT will be required to achie full cost recovery for tractor rentals. - The GOS is increasing the number of non-prescriptive veterinary drugs classified as safe for private imports.

Policy Intervention	Implementing Institution	Impact Assessment	Reforms Undertaken
Parastatal Enterprises	Ministry of Agriculture	Production Imports Domestic Consumption Exports Government Revenues Inflation Little impact in the near term on the above variables.	Some devolution of parastatal enterprise is taking place. With few exceptions, none of the public sector enterprises processing agricultural products or providing agricultural services had been able to cover costs and most were making substantial losses. In addition to closing the LDA and SOMALFISH and restricting the operations of the ADC and ENC, the GOS transformed the National Banana Board on August 1, 1983 into a joint venture company, SOMALFRUIT. The Board is now owned 60 percent by DeNadai -- a multinational headquartered in Italy - and 40 percent by the GOS. With the help of external assistance, the GOS has rehabilitated the Mogadishu Dairy and the Juba Sugar Plant and milk and edible oil factories have be shut down. The GOS also may rationalize the operations of the Hide and Skins Agency (HASA). A study is underway and agreeme must be reached between the GOS and the World Bank on the disposition of HASA prior to release of the second tranche of the ASSAP.

Table A-11 Significant Policy Changes in Zambia Since 1979

The narrative which follows documents the more significant changes which have affected agriculture since 1979:

1979:

-- The GRZ began placing increasing emphasis on agriculture with increasingly strong statements concerning the importance of agriculture at the 1979 Consultative Group meeting. However, actions failed to match the intensity of the rhetoric.

-- Producer prices for maize were increased by 32 percent.

1980:

-- The GRZ continued to improve producer incentives through timely price increases.

-- The Ministry of Agriculture and Water Development Planning Unit was expanded.

-- An agreement was signed with AID to improve capacity in agricultural policy analysis, research and extension.

1981:

-- Price increases were announced in a timely manner for maize and other crops. Increases ranged from twelve to sixty percent.

-- The subsidy on maize consumption was reduced over 50 percent.

-- The role of the marketing parastatal, Namboard, was reduced by decentralizing management control of the cooperatives and allowing them more freedom in marketing. Certain of the Namboard storage areas along the line of rail were turned over to cooperatives.

-- Changes in tax laws and the tariff structure provided increased incentives for agricultural production. Income tax was reduced from over 50 percent to 15 percent for farmers. Equipment was given accelerated write-off and tariffs and duties on most equipment were eliminated. Commercial farmers benefitted more than traditional or emerging farmers since most of the smaller farmers paid little or no taxes and had little equipment to depreciate.

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-- Some animal traction equipment was available at a lower price because of the lowering of tariffs.

-- The role of the tobacco parastatal was reduced by selling off land and assets to the private sector.

1982:

-- Producer prices were increased in real terms between 3 percent and 15 percent. Purchase prices were announced for cassava and sorghum.

-- Retail prices were decontrolled for all major products except wheat, maize and candles. This increased the flow of goods into rural areas because transportation costs could be recovered in the selling price. This also helped to increase producer prices with the official producer price becoming a floor price instead of a fixed price.

-- An early warning crop forecasting system was established.

1983:

-- The kwacha was devalued by 20 percent and allowed to float against a basket of currencies of major trading partners. This was partially in recognition of the need to reduce import demand and encourage new exports.

-- Fertilizer subsidies were reduced and the price of fertilizer was allowed to rise by 60 percent

-- The consumption subsidy on mealie meal was reduced and prices allowed to increase by 30 to 40 percent.

-- Producer prices were increased in real terms by 7 to 20 percent.

-- The subsidy to Namboard was reduced.

-- Interest rates on savings and loans were increased.

1984:

-- The kwacha continued its pegged float and depreciated 40 percent against the dollar.

-- Producer prices were increased and for the first time border prices instead of costs of production were introduced in the pricing decision for all crops except maize.

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-- Retailers were allowed to charge for transport costs on mealie meal hauled over 25 kilometers.

-- Interest rates were increased to 15.5 percent on savings and 17.5 percent on loans.

-- Wheat price controls were eliminated.

-- Floor prices were established for a controlled commodities except maize. Farmers are free to negotiate for a higher price.

-- Consumer subsidies on maize were reduced and prices allowed to increase 22 percent.

-- In October exporters of non-traditional exports were allowed to retain 50 percent of the foreign exchange earnings generated from export sales.

<u>1985:</u>

-- Restitution payments to cooperatives were eliminated forcing cooperatives to become more cost conscious.

-- Subsidies on tractor hire units were decreased and rates allowed to increase by 40 percent.

-- Transportation rates for truck haulage were increased by 33 percent.

-- Subsidies to Namboard were increased and Namboard was reinstated as the primary buyer and seller of maize with cooperatives acting as agents of Namboard.

-- Consumption subsidies on maize meal were reduced approximately 40 percent and prices were allowed to increase 40 to 50 percent.

-- Interest rates were decontrolled in the economy.

-- A foreign exchange auction system was started.

-- Liberalized procedures for import licenses were established.

-- Producer prices for maize were increased 95 percent over the previous season.

-- Steps were taken to reduce the civil service through early retirement and limited replacement.

-- Producer prices on processed agricultural items such as dairy products and sugar were decontrolled.

1986:

-- The foreign exchange auction continued and devaluation in one year reached almost 70 percent.

-- Fertilizer subsidies were decreased further and prices allowed to increase almost 200 percent in one year.

-- Namboard's monopoly on maize and fertilizer marketing was eliminated as cooperatives and private traders were allowed to market maize.

-- Full cost recovery was allowed on grain bags.

-- The domestic fertilizer producer was allowed to charge import parity on compound fertilizers.

-- Consumer subsidies were eliminated on breakfast meal and prices on lower quality mealie meal were set at K28.31 per 50 kilogram bag. However, the price increases were partially rescinded in the face of food riots and a number of large millers were nationalized.

-- Increased transportation rates in rural areas.

1987:

-- Because of lack of foreign exchange and agreement with the London Club to negotiate and consolidate short-term commercial arrears, payments on the short-term commercial arrears have been delayed.

APPENDIX B

WORLD BANK CONDITIONALITY

1. STRUCTURAL ADJUSTMENT LENDING AND ITS RATIONALE

The World Bank began its structural adjustment lending program in 1980. Although there was program lending prior to this within the Bank, this was the first large-scale attempt at attaching significant policy conditionality to loans. The discussion in this appendix of Bank practice with conditionality is based on several Bank publications on the theoretical appropriateness of policy reform and the actual results of such reform. The discussion is also based on interviews in Washington and abroad with development economists within and outside of the Bank.

The Bank's Operational Manual defines Structural Adjustment Loans (SALs) as nonproject loans to support programs of policy and institutional change necessary to modify the structure of an economy so that it can maintain its growth rate and the viability of its balance of payments in the medium term. Sector Adjustment Loans (SELs) have policy objectives similar to those of SALs but are directed toward limited sectors of the economy.

The new SAL program was a response to the sharply worsened international economic conditions of the time and to the growing difficulties experienced by many developing countries. These included, for example, weakening exports, large current account deficits, high and growing debt service ratios, and declining and in some cases negative growth rates. In effect, the creation of SALs reflected three new realities. First, many of the economic problems facing developing countries could not be touched through individual projects because the macroeconomic environment was hostile to project success. Second, by the late 1970s there was greater appreciation that prices are often more effective as incentives than are government initiatives. Third, it became glaringly apparent after the second oil shock of 1979 that developing countries needed to adjust their economies to international prices.

Consistent with the nature and urgency of these problems, SALs have essentially three characteristics. First, they are an instrument for policy dialogue between the Bank and recipient developing countries. Second, they are intended to provide support over several years, often 3 to 5 years. Finally, they carry provisions for quick disbursement of foreign exchange for imports not linked in advance to specific investment programs. In this light, it can be seen that SALs are intended to be complementary to International Monetary Fund (IMF) balance of payments assistance, because they differ in type of assistance, scope, and time frame in which the effects of policy change occur.

Initial internal guidelines suggested that program lending could constitute up to 10 percent of total Bank lending commitments, but this is no longer applicable. In general, the volume of adjustment lending (both SAL and SEL) is expected to be in the range of 15 or 20 percent of total lending over the next few years (see Table B-1 for the structure of Bank lending by lending instrument from FY 1975 to FY 1986). Current practice does not limit potential SAL borrowers to those developing countries suffering from any particular kind of problem. While most countries receiving early SALs were middle-income countries, today the pattern of SAL lending is more widely dispersed.[1]

The question has been raised of why several countries, despite serious adjustment problems, have not chosen to seek SALs. Common reasons suggested by Bank staff include the great multiplicity of conditions, the "high visibility of a SAL" within a country, the developing country leadership's fear of having "surrendered" to the Bank, and the general concern for both social and political costs associated with structural adjustment.

Table B-2 indicates the kinds of policy and institutional changes that have been sought through SALs, and the country application of institutional reform conditions is shown in Table B-3. These tables are reminders of the wide variety of possible approaches to policy and institutional change. Perhaps the point most graphically illustrated is the necessary association in Bank practice between policy conditionality and institutional change. This means that technical assistance is considered to be an integral part of policy conditionality.

In 1986, SELs were about 14 percent of World Bank loans and credits, while program and Structural Adjustment Loans were only about 5 percent.[2] Although the focus in this appendix is mainly on SALs, the importance of SELs, and their similarity to SALs, must be noted. SELs are generally medium-term, quick-disbursing

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[1]World Bank staff report that up to the end of FY 1986, 20 countries had received 38 SALs, and another 25 SALs were being considered for 1987-1988. Countries with SAL programs at the end of FY 1986 are Bolivia, Chile, Costa Rica, Côte d'Ivoire, Guinea, Guyana, Jamaica, Kenya, Korea, Malawi, Mauritius, Niger, Pakistan, Panama, Philippines, Senegal, Thailand, Togo, Turkey, and Yugoslavia.

[2]Discussion of SELs is based on "Sector Adjustment Lending: Progress Report" (World Bank 1986c).

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loans (with an average disbursement of 2 years). About 25 percent of all sector lending was in countries in Sub-Saharan Africa, with minor allocations of SELs to South and East Asian and Pacific countries. SELs have much in common with SALs: (1) they support policy and institutional reform, (2) they stress rationalization of public sector investment, and (3) their success requires an appropriate macroeconomic policy framework.

Table B-1. Distribution of World Bank Loans and Credits by Lending Instrument, FY 1975-FY 1986 (percentages)

Lending Instrument	FY 75	Average FY 79-80	Average FY 81-82	FY 83	FY 84	FY 85	FY 86
Specific Investment Loans	58.5	58.5	44.7	39.4	41.1	49.6	45.2
Sector Investment Loans	15.9	22.5	26.3	24.6	26.4	27.0	19.0
Financial Intermediary Loans	16.7	13.1	18.6	20.6	13.3	9.6	12.4
Sector Adjustment Loans	0.0	0.5	0.5	4.4	8.5	10.3	14.0
Program and Structural Adjustment Loans[a]	8.8	3.3	8.0	9.6	8.4	1.1	5.0
Technical Assistance Loans	0.2	0.4	1.7	1.2	2.1	1.4	1.4
Emergency Reconstruction Loans	0.0	1.2	0.2	0.2	0.3	1.0	3.1
Total[b]	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[a]Includes both program and Structural Adjustment Loans and credits. Prior to the introduction of structural adjustment lending in the early 1980s and in some instances thereafter, the Bank has provided a small number of program loans and credits with a similar overall policy focus.
[b]May not add exactly due to rounding.

Source: Michalopoulos (1987b).

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Table B-2. Key Components of World Bank Structural Adjustment Operations Through 1984, by Country and SAL

	Bolivia	Guyana	Côte d'Ivoire 1 2	Jamaica 1 2	Kenya 1 2	Korea 1 2	Malawi 1 2	Mauritius 1 2	Pakistan	Panama	Philippines 1 2	Senegal	Thailand 1 2	Togo	Turkey 1 2 3 4	Yugoslavia
Trade Policy																
Tariff Reform and Import Liberalization				xx	xx	xx		x		x	xx	x	xx		xxxx	x
Import Incentives and Improved Institutional Support		x	xx	xx	xx		x	xx	x	x	xx	x	xx		xxxx	x
Resource Mobilization																
Budget Policy		x		xx	xx	xx	xx	x	x			x	xx	x	xxxx	x
Interest Rate Policy		x			xx		xx								xxxx	x
Strengthening of Institutional Capacity to Manage External Borrowing	x	x	x		xx		xx	xx				x	x	x	x xx	x
Public Enterprise Financial Performance	x	x	x	xx		xx	xx		x	x		x	xx	x	xxxx	x
Efficient Use of Resources																
Public Investment Program Revision and Review of Structural Priorities	x	x	xx	xx	x	xx	xx	xx	x	x	x	x	xx	x	xxx	x
Pricing Policy																
Agriculture	x	x	xx	xx	x	xx	xx	xx	x	x	x	x	xx	x	xxx	x
Energy	x	x		x	x	xx	x	x	x				xx	x	xxxx	x
Incentive System																
Industry			x	xx	xx	xx	x	xx	x	x	xx	x	xx	x	xx	x
Energy Conservation Measures . .		x			x	xx					x		xx	x	xxx	x
Development of Indigenous Energy Sources		x			x	xx		x	x				x	x	xxx	
Institutional Reform																
Strengthening of Institutional Capacity To Formulate and Implement Public Investment Program		x	xx	x	xx	xx	xx	xx				x	xx	x	xxxx	
Institutional Efficiency of Public Enterprises	x		xx	xx			xx	xx	x	x		x	x	x	xxx	
Improved Institutional Support to Agriculture (marketing, etc.)		x	xx	xx	x		xx	x	x	x		x	x	x	xxx	
Institutional Improvement in Industry and Subsector Programs			x	xx			xx	x	x	x	xx		x			

Source: World Bank (1984).

Table B-3. Institutional Reform Components of World Bank Structural Adjustment Lending Through 1984, by Country and SAL

	Bolivia	Guyana	Côte d'Ivoire 1	Côte d'Ivoire 2	Jamaica 1	Jamaica 2	Kenya 1	Kenya 2	Korea 1	Korea 2	Malawi 1	Malawi 2	Mauritius 1	Mauritius 2	Pakistan	Panama	Philippines 1	Philippines 2	Senegal	Thailand 1	Thailand 2	Togo	Turkey 1	Turkey 2	Turkey 3	Turkey 4	Yugoslavia
Economic and Financial Management																											
Economic Policymaking Bodies (includes SAL monitoring) . . .			●	●								●	●	●				●		●	●	●	●				
Planning Process Mechanisms, Institutions								●			●	●			●					●	●	o			●		
Public Sector Investment Program Management		●	●	●	o	●	●	●	●	●	●	●	o	●		●			●		●	●	●	●	●	●	
Budget Process Institutions . .			●			●		●										o		●	●	o					
Tax Administration														●		●				●			o	o	●	●	
Accounting and Auditing Systems																		o		●	●	o					
Debt Management Systems, Institutions	o	o	●				●	o			●	●	●	●		●			●		●	●	o	o	●	●	●
Public Administration																											
Government Employment, Pay, and Incentives					●	●					o		o						●		o						
Civil Service Management and/or Reorganization						●														o	●						
Parastatal Economic Performance																											
Government Enterprise Framework	o		●	●		●	o			●	●	●			●				o		o	●	●	●	●	●	
Enterprise-Level Reforms				●	o	●					●	●	●	●	●	●			●		●	●		●	●	●	
Nonfinancial Sector Institutions or Ministries																											
Agriculture	o		●	●	o	o		●			●	●	●	●	●	●			●			●		●	●	●	o
Energy										●	o	●			o			o						●	●	●	
Industry		o	o	●	o	o					●	●	o		●		●	●									
Trade Administration Reforms																											
Tariffs, Import Licensing Procedures, Administration of Export Incentives, etc. . .						●							o			●	●	●		o	o		o	●	●		●

Note: ● indicates important aspect of program, specific reform, action plan, or assistance program, and o indicates minor aspect of program, statement of intent without specific action, preparatory studies, and so on (in some cases leading to stronger measures in subsequent SALs).

Source: World Bank (1984).

The major difference between SALs and SELs is that SELs, by concentrating on a limited group of policies and activities in a sector, can be more detailed and pursue reform in greater depth than is possible with SALs, which address broader economy-wide policy reforms and therefore are more taxing of the host country's policy and administrative apparatus. Two preconditions suggest when a SEL is the more appropriate loan vehicle: (1) in countries that do not have or would find it difficult to draw up a comprehensive adjustment program, in which case the SEL can be the first step in that direction; (2) in countries that have adjustment plans or that have the capability of drawing up such plans, whereupon lending should begin with a series of SALs and then proceed to the sector level with SELs.

The policy objectives of SELs are similar to those of SALs: promoting increased resource mobilization and efficient resource allocation, which will lead to increased growth. As with SALs, they address four interrelated areas: (1) reform of trade regimes; (2) mobilization of resources through fiscal and financial policies, particularly measures for rationalizing interest rates and tariffs; (3) improvements in the efficiency of domestic resource use, including rationalization of the public sector investment program and reductions in the level of government involvement in economic decisions, particularly regarding prices; and (4) institutional reform.

Essentially, the analytical model followed by the Bank in its adjustment programs is based in part on standard neoclassical economics and variants of the two-gap growth model that stress the saving-investment balance and foreign exchange constraints. Such models emphasize the availability of external resources (which can close either gap) and the capital requirements necessary to sustain planned growth targets. The focus is on national accounts and real variables in a Harrod-Domar model of an open economy.[3]

Although frequently cited as stressing an export-led economy, the Bank strategy in applying the model, according to Bank staff, is strictly neutral, emphasizing an approach that favors neither export promotion nor import substitution. While the emphasis on changing relative prices is in the neoclassical tradition, the Bank also stresses institutional change such as financial and tax reform, revenue collection, limitations on parastatals, and so forth. This institutional component in SALs is pragmatic and intended to support the stipulated policy changes. The Bank generally follows the IMF in monetary and exchange rate policy (although the Bank has been involved in institutional changes relating to exchange rate adjustment). (The Bank approach can be contrasted with the model used by the IMF, which rests essentially on the monetary approach to the balance of payments, as discussed in Appendix C.)

In his recent World Bank paper, Michalopoulos (1987b)[4] states that it is useful to note what experience suggests concerning appropriate policies for stabilization and adjustment in developing countries. First, it is clear that prolonged and significant aggregate imbalances (with aggregate demand exceeding domestic and foreign resource availability) is inimical to longer term growth. Such imbalances are manifest in high and unpredictable inflation and periodic balance of payments crises. In this process, savings are inhibited and resources are misallocated, and price controls prove ultimately dysfunctional. The remedy implied by this syndrome is to bring spending in line with domes-

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[3]The Harrod-Domar model, in the words of a standard development textbook (Herrick and Kindleberger 1983), "shows the dynamic relationship between a single scarce factor of production (capital stock) and a single homogeneous output. Its main contribution lies in the recognition that one period's capital formation is the next period's source of output, i.e., that investment creates the capacity for increased production in the future, which in turn affects the size of equilibrium output and income. Like many other intellectual advances, this conclusion may seem less than earth-shaking, but it represented a considerable step forward when compared with the unquantified Keynesian theory that preceded it. Furthermore, it is clear that the framework is more generally applicable than was first imagined."

[4]The discussion here is based on Michalopoulos, but another World Bank document also describes SALs and is available for public use (World Bank 1984).

tic and foreign resource availability by using monetary, fiscal, and exchange rate policies as the three main instruments of the stabilization program. The key issue for adjustment and growth is to find the combination of the three macroeconomic policy instruments that will, for any given level of external finance, attain stabilization objectives while also being the most supportive of future structural adjustment and the least disruptive to growth. Of course, how these policies are applied is important. For example, if the adjustment burden falls mainly on physical and social infrastructure or essential maintenance activities (as a means to reduce a government deficit), then future growth will be jeopardized.

According to Michalopoulos, several policy areas require attention in attempts to induce structural change and growth. For example, public savings can be increased and resources can be mobilized by a reduction in government expenditures and/or an increase in revenues. Deficits can in many cases be reduced without adversely affecting growth or distribution objectives. Public sector performance can usually be improved by increasing efficiency in enterprises, closing weak parastatals, and privatizing others. Also, the tax base can be broadened and revenue collection can be improved.

Second, private savings can be increased by stable and predictable macroeconomic policies, particularly as they relate to interest rates and inflation.

Third, the more prevalent types of microeconomic distortions can be reduced. These include, for example, price controls, highly differentiated incentives in the trade sector, subsidized interest rates, credit rationing, and impediments to labor mobility and adjustment in real wage controls.

Fourth, allocation of public investment can be improved. It should be reduced in commercial sectors such as industry and agriculture (where private investment is as, or more, efficient) and shifted to activities for which there are significant externalities, such as human resource development and physical infrastructure.

Fifth, to stimulate a shift in resources and an increase in the supply of tradables, two sets of policy measures are important: (1) a macroeconomic policy mix resulting in an appropriate real exchange rate and (2) a proper incentive structure that is neutral toward production for the domestic market and production for the foreign market.

Against this background, three important issues in the Bank strategy of economic policy reform can be briefly outlined (as developed in Michalopoulos 1987b).

The first issue concerns the <u>sequencing of reforms</u>. There is agreement that economic stabilization needs to precede structural adjustment. (It has been shown that failures of trade liberalization reforms have stemmed mainly from the failure of the accompanying anti-inflationary programs.) Unfortunately, economic theory offers little guidance on an optimal sequence for removing market distortion (e.g., agricultural pricing or tax regimes first?). Internationally, the usual argument is that the current account should be liberalized first, leaving the capital account until much later.

A second issue concerns the <u>speed of reforms</u>. Structural adjustment is not an end in itself but a means of raising the efficiency of resource allocation, among other things. Because allocation depends on price expectations, the credibility of any reform is very important. This means that timetables have to be realistic. However, the faster the speed of adjustment, the higher the transitional costs.

A third issue is the <u>selection of macroeconomic policies</u> to be used in adjustment. For example, the importance of an early devaluation is clear. Also, monetary expansion has to be compatible with the devaluation rules adopted. The deficit must be compatible with domestic credit expansion and available external resources. Measures toward greater labor market flexibility will be needed to permit a drop in real wages in previously protected sectors and to allow the shift of labor toward sectors previously discriminated against. Otherwise, unemployment will result.

Program loans and SALs in FY 1986 constituted 5 percent of total World Bank loans and credits, and SELs were 14 percent. Thus, almost one-fifth of Bank loans and credits are concentrated in adjustment programs. Sector lending grew relatively faster in Sub-Saharan Africa, while SALs grew more rapidly among the more highly indebted countries (Table B-4). In West Africa, Europe/Middle East/North Africa, and Latin America, these two kinds of lending were about one-third of total commitments in each region in FY 1986. In East Asia and the Pacific and South Asian regions, in contrast, this assistance accounted for zero and less than 8 percent, respectively, of the regional totals for that year.

As shown in Table B-5, SALs and SELs jointly comprise a rising proportion of total World Bank lending to low- and middle-income countries, but the increase has been much faster in the latter group, with an even greater increase for highly indebted

Table B-4. Regional Distribution of World Bank Loans and Credits by Lending Instrument, FY 1975-FY 1986
(US$ millions and percentages)

Region/Lending Instrument	FY 75	FY 79-80	Average FY 81-82	Average FY 83	FY 84	FY 85	FY 86
East and South Africa Total	656.5	730.4	794.4	1,129.8	1,186.6	786.0	915.9
1. Sector Adjustment	0.0	3.8	3.2	17.3	6.3	8.3	17.5
2. Program and Structural Adjustment[a]	9.1	3.8	8.9	11.6	12.2	0.0	4.9
1+2 (% of total)[b]	9.1	7.5	11.3	28.9	18.5	8.3	22.4
West Africa Total	419.2	644.0	1,012.6	664.2	1,181.7	811.3	1,130.6
1. Sector Adjustment	0.0	0.0	0.0	6.0	29.4	12.3	4.3
2. Program and Structural Adjustment[a]	0.0	27.2	33.6	6.0	21.2	3.4	28.4
1+2 (% of total)[b]	0.0	27.2	33.6	12.0	50.6	15.8	32.7
Europe, Middle East, and North Africa Total	1,223.7	2,378.7	2,407.5	2,535.6	3,125.8	2,429.2	2,304.8
1. Sector Adjustment	0.0	0.0	0.0	0.0	7.7	16.5	32.5
2. Program and Structural Adjustment[a]	5.7	7.4	14.1	22.7	12.0	0.0	0.0
1+2 (% of total)[b]	5.7	7.4	14.1	22.7	19.7	16.5	32.5
Latin America and the Caribbean Total	1,215.0	2,474.4	3,070.6	3,459.6	3,025.6	3,698.2	4,771.2
1. Sector Adjustment	0.0	0.6	0.6	11.7	21.7	9.7	26.3
2. Program and Structural Adjustment[a]	0.0	3.6	1.6	1.7	2.0	3.6	5.2
1+2 (% of total)[b]	0.0	4.3	2.3	13.5	23.6	13.4	31.5
East Asia and Pacific Total	951.4	2,249.3	2,540.9	3,708.6	3,302.0	3,100.6	3,565.2
1. Sector Adjustment	0.0	0.0	0.0	0.0	0.0	12.0	0.0
2. Program and Structural Adjustment[a]	10.5	0.0	11.8	12.9	9.1	0.0	0.0
1+2 (% of total)[b]	10.5	0.0	11.8	12.9	9.1	12.0	0.0
South Asia Total	1,189.6	2,256.7	2,827.6	2,979.2	3,700.6	3,559.1	3,631.0
1. Sector Adjustment	0.0	0.0	0.9	0.0	0.0	5.0	1.9
2. Program and Structural Adjustment[a]	24.4	2.8	5.4	3.7	4.6	0.0	5.5
1+2 (% of total)[b]	24.4	2.8	6.3	3.7	4.6	5.0	7.4

[a]Includes program and Structural Adjustment Loans and credits. Prior to the introduction of structural adjustment lending in the early 1980s and in some instances thereafter, the Bank has provided a small number of program loans and credits with a similar overall policy focus.
[b]May not add due to rounding.

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Table B-5. Distribution of World Bank Loans and Credits by Country Group, FY 1975-FY 1986
(US$ millions and percentages)

Country Group/Lending Instrument	FY 75	FY 79-80	Average FY 81-82	Average FY 83	FY 84	FY 85	FY 86
Total Lending to All Countries	5,895.9	10,746.1	12,653.5	14,477.0	15,522.3	14,384.4	16,318.7
Sector Adjustment, Program, and Structural Adjustment Loans[a]	520.0	403.3	1,082.4	2,035.6	2,619.8	1,637.9	3,099.5
Percent of Total	8.8	3.8	8.6	14.1	16.9	11.4	19.0
Low-Income Countries[b]	2,051.2	3,270.2	3,965.4	4,906.4	6,164.7	5,771.5	6,046.1
Sector Adjustment, Program, and Structural Adjustment Loans[a]	350.0	122.5	290.0	445.9	447.5	354.5	574.5
Percent of Total	17.1	3.8	7.3	9.1	7.3	6.1	9.5
Middle-Income Countries[b]	3,844.7	7,476.0	8,688.1	9,570.6	9,357.6	8,612.9	10,272.6
Sector Adjustment, Program, and Structural Adjustment Loans[a]	170.0	280.8	792.4	1,589.7	2,172.3	1,283.4	2,525.0
Percent of Total	4.4	3.8	9.1	16.6	23.2	14.9	24.6
Highly Indebted Middle-Income Countries[c]	1,803.4	3,403.7	4,428.4	4,668.3	4,398.6	4,558.4	6,070.5
Sector Adjustment, Program, and Structural Adjustment Loans[a]	0.0	98.3	231.6	1,042.8	1,396.1	745.0	2,105.0
Percent of Total	0.0	2.9	5.2	22.3	31.7	16.3	34.7
Sub-Saharan Africa[d]	1,075.7	1,374.4	1,807.0	1,794.0	2,368.3	1,597.3	2,046.5
Sector Adjustment, Program, and Structural Adjustment Loans[a]	60.0	230.0	429.8	406.5	818.2	192.9	574.5
Percent of Total	5.6	16.7	23.8	22.7	34.6	12.1	28.1

[a]Includes both program and Structural Adjustment Loans and credits. Prior to the introduction of structural adjustment lending in the early 1980s and in some instances thereafter, the Bank has provided a small number of program loans and credits with a similar overall policy focus.

[b]Countries with annual per capita income less than US$400 in FY 1987 dollars are considered low-income countries; those above that level are classified as middle-income countries.

[c]The 17 countries in this category are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Côte d'Ivoire, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, the Philippines, Uruguay, Venezuela, and Yugoslavia. Lending to this group is also included in that of middle-income countries.

[d]This group covers all countries south of the Sahara, except South Africa.

middle-income countries. At the same time, the share of total SEL and SAL lending to low-income countries has increased as well, although much more slowly.

The following are the main lessons of policy reform derived from Bank experience as noted in the Bank report (Michalopoulos 1987b).

Domestic resource mobilization. Policy has focused on systems of new taxation and reduction and reform of parastatals. Mobilization has been stimulated also by improving the financial sector and reducing interest rate distortions. The report notes that "broadly speaking, the key issues that have arisen from the Bank's experience ... are the need to ensure an orderly transition for banking systems saddled with a lot of non-performing loans, sometimes of public enterprises, and the liberalization of previously controlled lending and deposit rates" (p. 34).

Improved efficiency and resource use by the public sector. Here the main effort went to rationalization of public investment programs, improved public sector enterprise performance, and rationalization of the size of the public sector, including divestiture of public holdings. Most Bank reviews of public investment have recommended changes in investment priorities. "The key problem usually was that ongoing projects were not accompanied by the actions in other fields that were required for project viability" (p. 35). (In Africa, for example, there was inadequate financing of maintenance and recurrent costs.) It is important that developing countries develop their own capacity for review of the public sector. In many SALs, improved financial performance of public sector enterprises was a goal, with the focus on better internal management and raising prices. More generally, divestiture has been a SAL goal.

Reform of trade regimes. Emphasis has been on provision of financial incentives (through tax rebates, subsidies on imported inputs to offset import controls, and preferential access to imports and credit), reform of administrative procedures and the establishment of better institutional support for exporters, and real devaluation. The report suggests that "implementation of trade reforms is not very successful when it is not accompanied by other measures to assure a shift in the real exchange rate--which is needed to produce the desired shifts in incentives" (pp. 38-39). Experience also suggests that future reforms ensure that export expansion programs be accompanied by significant import liberalization and action on the exchange rate. The report notes that Bank experience does not suggest the desirability of holding import liberalization until export reforms have increased the supply of foreign exchange. "This kind of sequencing is likely to be self-defeating, since it is extremely difficult to reorient producers towards export markets as long as heavily sheltered domestic markets offer them sizable assured profits" (p. 39).

Other pricing policies. Agricultural and energy pricing reforms were common features of many SALs and SELs. In agriculture, reforms usually focused on bringing producer prices closer to international prices and on cutting input and consumer subsidies. Generally these loans, especially in energy, resulted in "significant benefits to the recipient," with increased agricultural production and improved rural incomes. The key issue here, the report suggests, is "how to deal with the transition costs entailed by raising the foodstuff prices paid by politically powerful urban consumers" (pp. 39-40).

2. EFFECTIVENESS OF STRUCTURAL ADJUSTMENT LENDING

Indirect evidence on the efficacy of Bank structural lending is provided in the study by Agarwala (1983) on price distortions and growth in 31 developing countries in the 1970s.

Agarwala found that countries with low levels of economic distortion generally grew faster (and in many cases more equitably) than did countries with significant market intervention. With real GDP growth as the dependent variable, Agarwala classified seven economic variables (based on empirical and subjective investigation) by whether distortion was above or below a prespecified medium range. The independent variables included: (1) exchange rate distortions; (2) protection of manufacturing; (3) distortions in agricultural pricing, including both protection and taxation; (4) distortions in the pricing of capital; (5) distortions in the price of labor; (6) infrastructure pricing distortions; and (7) inflation. In general, Agarwala's work gives credence to the underlying assumptions of policy-based lending. Countries experiencing low policy distortion have grown faster and shared the benefits of that growth more equitably than have countries experiencing high policy distortion.

Policy-based World Bank lending is not without its critics, of course. The extreme position on the left suggests that the problems of developing countries are problems inherent in the development of world capitalism, which by its nature remains exploitative and subject to increasing crises. In this view, the World Bank, the IMF, and individual capitalist donors are really powerless to improve the lot of the poor because they are merely parts of this exploitative system. One writer suggests that the Bank as a matter of formal policy simply seeks to promote the interests of private capital (Payer 1982; 1986). Because this view would endorse fundamental changes in the system in order to

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stimulate "real" development among developing countries, it is of interest largely as an analysis of the problems, not as a set of policy suggestions that a political leader could take to a legislative body.

More toward the center is the kind of critique raised by Berg and Batchelder (1985) in their paper prepared for Bank self-assessment of structural adjustment lending. Writing about the 1980-1983 experience, they cite first the "lack of clear selection criteria." Rates of return on projects in the past have provided clear guidance for project selection. Program lending precludes rate of return calculations, yet criteria for program selection--"to determine who is and who isn't eligible"--remain unclear. Few poor countries were selected initially, and the tendency to direct such assistance to middle-income countries increased in recent years (see Table B-5). Further, SALs have gone to countries with fairly good growth rates. In their words, "The SAL selection process, then, has tended to give low priority to poorer countries, slow-growing countries, and countries suffering from especially poor policies and/or institutional weaknesses" (p. 22).

Second, Berg and Batchelder suggest that the "theory of reform" underlying SALs is weak. To make their point, they pose two questions: "Why don't governments change the policies that are holding back their development? Why don't they adopt the reforms that experts tell them will raise both their current national output and their growth rate, thereby increasing the economic welfare of their people and brightening their future economic prospects?" (p. 23). Answers to both questions, they suggest, lie deep in the institutional and political structures of developing countries. The problem with SALs, therefore, is that perfectly sensible policy suggestions are put forth without attention to the many and complex reasons explaining why they were not instituted in the first instance.[5]

Third, Berg and Batchelder note that although early SALs carried few conditions, with time more and more conditions have been loaded onto programs, creating such problems as the follow-

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[5]Berg and Batchelder suggest, for example, such reasons as vested interests, "policymakers' preferences" for things other than economic growth (fear or loathing of the private sector, or of a major ethnic part of the private sector, ideology, etc.), absence of "intellectual consensus on either the nature of the problem at hand or the likely impact of given policy changes," short time horizons including, for example, "short expected ministerial tenure," and absence of a sufficient "number of local technicians to prepare detailed and well-argued reform programs."

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ing. With limited staff assigned to oversee increasing numbers of conditions, it has become impossible for staff to devote sufficient time to any one condition to ensure its progress. Institutional reform is certainly appropriate, but is fundamentally different from policy reform (among other things, it has a different time frame, and is more process-related). "Yet institutional 'reforms' are included in SALs as though they are amenable to the same kinds of dialogue and monitoring as policy reforms...." (pp. 34-35). In effect, the inclusion of institutional reform probably weakens rather than strengthens SALs. Another criticism is that SALs are so comprehensive and large that conditionality loses credibility as "cancellation becomes too strong a sanction to use" (p. 36). And of course, evaluation becomes extraordinarily difficult because there is no definitive way to weight the various conditions.

Critical empirical studies are emerging that challenge some of the earlier scholarly findings that helped establish the intellectual case for SALs. For example, Balassa's work (1981, 1982, and 1984) suggesting that countries with an export-oriented development strategy (of the kind stipulated in SALs) have fared better than those with import-substitution strategies is now being questioned. Among other things, it is suggested that Balassa's choice of base periods and form of decomposition impart a bias favoring the export-led model. Also, critics note that individual country time-series comparisons yield results different from those of Balassa, which were based on international cross-section regressions. In effect, it is suggested that country-specific factors largely account for differing comparative growth rates. As might be expected, Ph.D. dissertations are being written that attempt independent empirical verification or negation of the Balassa and similar conclusions. For example, in one proposed study (Stevenson 1986) of selected countries, a review of existing critical literature highlights the following:

> [Among neoclassical critics] Fishlow [1984] argues that Balassa's methodology (choice of base periods, form of decomposition, etc.) can be interpreted as biasing the results against inward-looking countries in the survey. Furthermore, his reading of Balassa's 1984 update tends to confirm the "advantage of more inward-oriented development in limiting susceptibility to adverse external shocks, at a potential cost in average performance. The results might have been better still had the inward-oriented NICs [newly industrialized countries] not succumbed to the temptations of cheap and abundant foreign loans. <u>Their problem was not inwardness alone, but rather an asymmetric openness built partially upon the exaggeration of their export potential</u> ..." (emphasis added) (p. 15).

A second level of criticism of Balassa's and others' contention that there is an empirical association between exports and economic growth in the outward-oriented economies is that even where this correlation exists, "the theoretical causal mechanism linking exports and economic growth is less clear" [Fransman 1984]. Jung and Marshall [1985] performed causality tests between exports and economic growth for 37 developing countries and found results which were "remarkable for the lack of support that they provide for the export promotion hypotheses." They suggest that one reason that their conclusions differ from those of Balassa, for example, is that they compare each individual country's time series rather than doing international cross-section regressions, i.e., they do not presume the similarity of different countries. The thrust of many studies is that the cumulative effect of country-specific factors over time accounts for much of the difference in relative rates of economic growth (e.g., Singer [1984]). Other studies suggest the correlation between export growth and GNP growth has never been applicable to the least developed countries anyway (e.g., Helleiner [1986]).

The findings of Agarwala (1983) are being challenged as well. His work suggests that high growth is associated with low policy distortions. Bradford (1987) examined Agarwala's work and concludes that his data can be interpreted to show that in countries in which the price of capital was distorted (i.e., kept below its market-clearing level), investment and growth were accelerated. In brief:

> The tilt of the evidence given here is of the same order but in the opposite direction from the World Bank research on price distortions. That research concluded that "prices matter for growth, though not only prices." This research leads in the direction of concluding that policies matter for growth, though not only policies. It is difficult to see how the NICs could have achieved the unusual economic and export performance which distinguishes and defines them as NICs without the crucial input of government policies.
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> [This work] suggests that the conventional view of export-led growth deriving from an open economy with competitive market prices responding to world demand may not be the dominant pattern in explaining the surge of manufactured exports from the NICs. Rather the evidence here suggests that a supply-push development model with government playing a key role in stimulating

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capital formation through macropolicies and in accelerating structural change through sectoral strategies affecting the output and export mix may provide a more accurate framework for capturing the causal elements explaining rapid transitional growth (pp. 313-314).

These criticisms of World Bank conditionality have also been subject to criticism. For example, World Bank staff suggest the following:

-- The criticism of Balassa's studies (1981, 1983, and 1984) that are alleged to have helped to establish the intellectual case for SALs in the Bank is not well founded. Balassa's studies of the relationship between exports and economic growth belong to a different class of studies from that which has established the case for export-oriented strategies. There is no conceptual equivalence between studies that examine the relationship between export and income growth and those that examine the relationship between neutral incentives and economic performance.

-- Even in the case of Balassa's studies of the former type, there are several problems with the criticisms cited. The uncritical acceptance of the Jung and Marshall study (1985) overlooks several deficiencies in their work: (1) the use of the Granger causality test without an underlying theoretical model study could produce spurious results; (2) their statistical test reveals that for some countries growth causes exports, but that is not inconsistent with a positive relationship between export and income growth (one could argue that for a small country pursuing its comparative advantage that result is inevitable); and (3) as noted above, even if the conventional statistical test relating exports to income growth fails, the case for outward orientation is not based on the correlation of export growth with income growth.

-- Many of these critical studies cited as invalidating the allegedly export-led model have been evaluated and found to be wanting in several respects. For example, the Fishlow study (1984) also makes the mistake of equating the relationship between exports and incomes to one of providing neutral incentives for exports and import substitutes.

In summary, World Bank SAL lending is based on a model providing incentives that are neutral toward production for domestic use and that for export use (which is technically different from

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an export-oriented market model), and is buttressed by considerable Bank experience with the structure and sequence of appropriate policy change in this context. Limited evidence suggests that the Bank's conditionality is generally appropriate. Difficulties sometimes have been encountered in countries adopting such policies, and a body of critical literature is growing. However, in practice, World Bank conditionality is widely acknowledged to be useful. At the same time, there is as yet no intellectually definitive criticism of Bank policy-based lending that suggests that this approach is fundamentally flawed. The most useful literature is that which suggests improvements in this approach, rather than its abolition. Such suggestions concern the theoretical assumptions underlying policy reform, the manner in which it is administered, and the methodologies on which favorable past evaluations of conditionality lending have been based.

APPENDIX C

INTERNATIONAL MONETARY FUND CONDITIONALITY

Essentially, the International Monetary Fund (IMF) approach to conditionality is derived from the monetary approach to the balance of payments. The approach uses a flow-of-funds methodology and is concerned solely with nominal magnitudes, as explained by Khan et al. (1986).[1] The IMF's emphasis is on measures to reduce balance of payments deficits in the short run, whereas the World Bank's conditionality is directed more toward raising growth rates to raise living standards and avoid balance of payments deficits in the medium and long run.

The basic model may be labeled "international monetarism"[2] and is based on an accounting identity: the balance of payments deficit equals the change in international reserves, which in turn equals the growth in the money supply minus domestic credit creation. In viewing the balance of payments deficit in this way, the rate of domestic credit creation is seen as central to controlling the balance of payments at a given exchange rate. In short, both the balance of payments and inflation are viewed as monetary phenomena, and the model deals with both. This is hardly the full content of the model, but it suggests the power thought to reside in the model.

Khan et al. note that while cooperation between the IMF and the World Bank has increased, "there is ... a significant lack of understanding about how the two institutions formulate programs that support their lending, and in particular on the analytical underpinnings of the Bank and Fund approaches" (p. 1). According to Khan, IMF programs

> are designed to achieve a sustainable balance of payments position within the context of improved long-term growth performance and internal price stability. Clearly, short-run demand restraint through control of domestic credit expansion, supplemented perhaps by exchange rate action, would not be sufficient to achieve the multiple objectives of a program. A typical Fund program, would, therefore, also call for fiscal measures, such as reduction in government expenditures and increases in taxation, increases in domestic interest rates and producer prices to realistic levels, policies to raise investment and improve its

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[1]The discussion in this appendix is based on the Khan et al. paper.

[2]This term and these comments are adapted from Fischer (1987).

> efficiency, trade liberalization, and wage restraint (p. 2).

In brief, World Bank and IMF programs are complementary, with the difference being one of emphasis. As stated, the IMF stresses the balance of payments, whereas the World Bank focuses more on raising growth rates.

The policy content of 30 IMF-supported programs in 1980 is shown in Table C-1. Monetary and public sector policies were stipulated in all 30 countries; various reforms in tax structure, rates, and administration were stipulated in 27 countries; and external debt policies were stipulated in 25 countries. In 24 countries, exchange and trade policies and wage and prices policies were stipulated. Policies related to nonfinancial public enterprises were stipulated in 23 countries, and overall public sector policies were stipulated in 22.

The policy content of IMF programs[3] is summarized by Morris Goldstein (1986) as follows:

> A typical Fund-supported program encompasses a comprehensive set of measures, with emphasis usually laid on credit ceilings, restraint of public expenditure (especially of public wages and salaries), increases in tax rates and improvements in tax administration, adjustment of tariffs and administered prices, reduction in the ratio of the public sector deficit to GDP, formulation of an investment plan, control of public or publicly guaranteed debt commitments and disbursements, exchange rate reform, export promotion, and overall wage and price policies (p. 8).

The central fact in understanding IMF programs is that the IMF, in the words of Richard Erb, Deputy Managing Director of the IMF,[4] is not an aid agency, in that it does not provide long-term balance of payments financing. The IMF's advantage over a development agency or development bank is that it can provide a country with fairly large-scale, quick-disbursing, and untied resources in a short period. This gives development institutions time

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[3]Section 5 (of the main report) on beneficiary impact examined in more detail typical IMF programs, with emphasis on the question of whether IMF conditionality unduly compresses consumption. This appendix notes some general concerns with the IMF.

[4]See Erb (1986). This is excerpted from an interview with Erb.

Table C-1. Policy Content of 1980 Fund-Supported Programs (in number of programs)

Policy	Stand-By Arrangements	Extended Fund Facility Arrangements	Total
Monetary policies	17	13	30
Credit ceilings	17	12	29
Reserve requirements	3	2	5
Interest rate policies	11	7	18
Other	2	—	2
Public sector policies	17	13	30
Restraint of: Expenditure	14	12	26
Investment	8	4	12
Subsidies	5	8	13
Transfers	5	7	12
Wages and salaries	10	6	16
Other current expenditure	5	3	8
Other	3	4	9
Reform/improvements	14	13	27
Reform of tax structure	5	6	11
Increase in tax rates	9	8	17
Improvement in tax administration	10	9	19
Other	3	1	4
Nonfinancial public enterprises (NPE)	12	11	23
Curtailment/rationalization of expenditure	6	2	8
Adjustment of tariffs and administration prices	8	10	18
Employment	1	1	2
Wages	2	—	2
Other	1	3	4
Overall public sector			
Reduction in deficit-GDP	12	10	22
Improvement in NPEs			
Reduced bank borrowing (real)	3	3	6
Reduced transfer from government (real)	6	6	12
Formulation of investment plan	6	9	15
External debt policies	15	12	27
Control of commitments/disbursements			
Public/publicly guaranteed	14	11	25
Private sector	3	2	5
Improvement of maturities			
Public/publicly guaranteed	6	4	10
Private sector	2	—	2
Other	2	1	3
Exchange and trade policies	12	12	24
Exchange rate reform	6	6	12
Fixed rate	2	2	4
Frequently adjusted rate	3	4	7
Floating rate	1	—	1
Liberalization/reform of exchange system	3	6	9
Liberalization/reform of trade system	4	5	9
Import substitution measures	—	2	2
Rationalization of import protection	2	1	3
Export promotion or liberalization	5	6	11
Reduction of arrears			
Other	4	3	7
Wage and price policies	15	9	24
General wage restraint policies	10	6	16
Wage guidelines in public sector	9	5	14
Producer price adjustments	7	3	10
Retail price adjustments	7	5	12

Note: The total number of programs is 30, of which 17 are stand-by arrangements and 13 extended arrangements.

Source: Morris Goldstein (1986, 9).

to mobilize more resources so as to provide medium- and longer term financing on a sustainable basis. In this context, "the policy analysis, the policy advice, and the short-term financing that the Fund provides can be extremely important in helping countries achieve their development objectives. The Fund's analysis ... is very much growth-oriented."

In recognition of short-term adjustment costs, the IMF created a Structural Adjustment Facility (SAF) in March 1986. In December 1987, the IMF established the Enhanced Structural Adjustment Facility (ESAF), which "is expected to provide resources totaling Special Drawing Rights (SDR) 6 billion ($8.4 billion) to low-income developing countries engaged in economic and structural adjustment. These resources will supplement the SDR 2.2 billion that remained to be disbursed under the SAF" at that time (IMF 1988, 5-6). Also, to protect countries against sustained higher interest rates or destructive droughts, negotiations have been completed on a new contingency lending facility, thus widening further the IMF's role in helping debtor countries. The contingency facility builds on the Compensatory Financing Facility, which has provided $20 billion to 80 countries since 1962. Under this program, loans are provided to countries that experience unexpected shortfalls in exports as a result of conditions beyond their control.

The IMF has sometimes been criticized for seeming to have a "cookie cutter" approach to policy reform, making the same recommendations around the world without regard to country differences. Richard Erb of the IMF denies this and suggests that if IMF policies appear to be rather uniform "it may be because the problems that countries face are very similar." Also, the IMF focuses on macroeconomic policy, with little involvement in microeconomic problems (partly at the insistence of developing countries, Erb notes). This means in effect that the IMF can focus only on a rather narrow range of policy questions. Thus, it might appear that in making recommendations on exchange rates, for example, every country hears the same message. Aspects of the microeconomic message would often be more varied (Erb 1986).

The IMF's own interpretation of the measurement of program effects can perhaps best be summarized as follows (Goldstein 1986, 45-47):

- -- Actual results in program countries should be compared with what would have happened in these countries in the absence of Fund programs.
- -- In forming a judgment about what would have happened in the absence of programs, the Fund's direct and indirect catalytic role in providing additional

finance to program countries must be considered; this means that any compression of expenditure and imports during the program period needs to be weighed against the (larger) expenditure and import changes that are likely to have occurred in the absence of this program-induced financing.

-- Fund-supported programs should be characterized by the full range of policy measures included in typical past programs and not just be government budget targets, domestic credit ceilings, and exchange rate changes alone; similarly, given the adverse initial position of most program countries and the failures of policy in the pre-program period, it should be recognized that credibility and confidence may produce a different result from a given policy package within the context of a Fund program than without it.

-- The effects of Fund programs, particularly on growth, should be assessed in the medium- to long-term (certainly over more than a year) rather than in the short run; an excessively short-run framework will almost inevitably exclude any positive growth effects of supply-side and structural measures in programs, and will make it very difficult to distinguish between the adjustment to a sustainable internal and external position and that sustainable position itself.

In addition, Goldstein explains the IMF approach in three critical areas. First, it is recognized

> that Fund-supported programs do lead to changes in expenditure, output, and import volumes in program countries, [and] one should expect these change to induce changes in these same macroeconomic variables in the rest of the world and in the same direction. But perhaps the more telling point is that even with roughly 35 developing countries undertaking programs supported by the Fund, the size of these global trade and

> economic activity effects is likely to be relatively small (Goldstein 1986, 45-47).[5]

Second, while "the concern that the simultaneous exchange rate depreciations by program countries could have serious and deleterious effects on prices of the exports of program countries is certainly a reasonable one in theory, ... in practice, however, the risks of adverse aggregate effects on exports prices are much reduced...."[6]

Finally, the IMF puts considerable and systematic care into its policy advice, which is based on an attempt to assess "the aggregate effects of that advice, as well as to ... [ensure] its consistency and feasibility across countries." Goldstein notes:

> At the broadest level, these effects are analyzed by the staff and discussed by the Fund's Executive Board at least twice each year during the World Economic Outlook exercises. Program countries are of course included in that analysis and discussion, albeit as part of more structural country-classification groups (major exporters of manufactures, low-income countries, or 25 major borrowing countries) rather than as a separate entity. At the level of individual consultation missions and program negotiations, cross-country effects are analyzed as part of normal mission preparation and of normal program design. The waivers and

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[5]This is because "(1) program countries still account for rather small shares (7-8 percent) of world imports and of world exports; (2) relatively little (8-9 percent) of program countries' trade is with other program countries; and (3) the average size of the initiating changes in import volumes in program countries has been rather small (3-6 percent) over the past decade" (Goldstein 1986).

[6]This is the case for five reasons: "(1) primary commodities now represent a much smaller share of the exports of non-oil developing countries than they did two decades ago; (2) non-oil developing countries now account for only about 30 percent of world exports of non-energy primary commodities; (3) supply-price elasticities for most primary commodities are rather low in the short run; (4) the share of program countries of world production of various primary commodities is much below the share for all developing countries; and (5) not all program countries change their exchange rates during the same period, and those that do will usually not export identical bundles of primary commodities" (Goldstein 1986).

> modifications provisions in Fund programs also represent a well-established mechanism for assessing, and if necessary, redressing the consequences of, inter alia, unforeseen interdependence effects.

Goldstein concludes his study of IMF programming by noting that

> none of this means that the evaluation of the global effects of Fund-supported programs within the Fund staff itself is unerring. But it does suggest that serious efforts are being made to consider the repercussions of these Fund programs on other countries and on the operation of the world economy as a whole.

What can be said about country effects of IMF activities? These have been summarized in an IMF report by Khan and Knight (1985, 24-25). They suggest initially that while IMF-supported adjustment programs have been strongly criticized as reducing growth and employment, very little empirical substantiation of this position is evident. On the basis of limited available empirical studies, the report notes the following pattern of effects.

-- Effects are analyzed as part of normal mission preparation and of normal program design. The waivers and modifications provisions in IMF programs also represent a well-established mechanism for assessing, and if necessary, redressing the consequences of, among other things, unforeseen interdependence effects.

-- The studies reviewed generally indicated that, while the size of the effect varied, tighter monetary and credit policies would result in a fall in the growth rate in the first year after they were implemented. Furthermore, if these restraints took the form of a reduction in the flow of credit to the private sector, then private capital formation and possibly the long-run rate of growth would be adversely affected.

-- No studies showed any clear empirical relation between growth and fiscal policy. There are close links between monetary and fiscal policies in developing countries, and it is difficult to measure the independent role of fiscal policy.

-- There is some evidence that supply-side policies, particularly policies to increase producer prices and domestic interest rates, have favorable effects on production and savings, although the effects of variations in real interest rates on savings is quite small.

-- There is a close relationship between the growth rate and capital formation. Therefore policies directed at increasing investment and improving its efficiency will tend to have a beneficial effect on long-term development.

-- Available empirical evidence is consistent with the view that devaluation would, on balance, exert an expansionary rather than a contractionary effect on domestic output, even in the short term.

This study suggests that a possible reason for continued criticism of IMF programs as contractionary is that critics focus on reductions in aggregate demand through contractionary monetary and fiscal policies. However, this is far too narrow an interpretation of IMF programs, according to the report, because it ignores the other growth-inducing measures of IMF programs.

Generally, the report suggests that there are "serious limitations" in existing empirical analysis of IMF-supported adjustment programs and their relationship to economic growth. The report concludes that to evaluate the deflationary impact of IMF programs will require a case-by-case approach. Such studies

> would also have to be supplemented by some type of modeling and simulation analysis so as to handle the issues that arise in comparing the set of policies included in a Fund program with a hypothetical alternative package of measures or in comparing the effects of a Fund program with the outcome that would occur in the absence of a program (Khan and Knight 1985, 25).

The authors further note that it

> has to be recognized that a IMF program may lead to a lower growth in the first year, but can pave the way to a recovery in succeeding years. The central question is, would an alternative feasible set of policies that differed from Fund programs in either the emphasis placed on certain instruments or in the choice of instruments, or both, have achieved the same objectives at lesser cost? (p. 25).

Further effort must be made to address questions of this type before conclusions can be drawn on the efficacy of IMF-supported programs versus alternatives that might have been available to the recipient country.

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Zambia's repudiation in May 1987 of the reform package that it had adopted at the insistence of the World Bank, the IMF, and other donors illustrates a growing concern with IMF and other conditionality.[7] Zambia's President Kaunda said that debt repayment would ruin his country, although if the debts are not repaid on schedule or rescheduled, then further IMF or World Bank assistance apparently is barred. Western economists are quoted as characterizing recent large IMF loans, most of which are to be repaid in 3 years, as "criminal," "illogical," and "a mission impossible from the start." The IMF is said to have recently conceded that it made serious miscalculations in determining Zambia's ability to repay the loans. As recently as 1986 the reform package was cited by the World Bank as a model in Africa.

The irony is that the reforms seemed to be working. Higher agricultural prices apparently stimulated production. Availability of foreign exchange to buy spare parts boosted factory use sharply. The crux of the problem was that IMF and other donor requirements essentially required a reduced standard of living for Zambians whose economy has suffered from a long-run decline in the world price of copper, that country's major export. Newly instituted price controls (which are contrary to adjustment package conditionality) already have resulted in the disappearance of such items as soap and cooking oil from stores, although they are now again widely available on the black market. Several factories closed in May and June of 1988 for lack of foreign exchange to buy raw materials. A Swedish economist, summing up the problem, said, "the IMF medicine was correct, but the dosage was too strong. The time frame was too short."

In summary, the IMF provides short-term balance of payments assistance under emergency conditions and tries (not always successfully) to give the recipient countries time to adjust and mobilize resources for long-term development. While IMF conditionality attached to such assistance is sometimes criticized as harshly compressing consumption, the basic evaluation problem is in establishing the counterfactual conditions: what would have been the situation without IMF assistance or with an alternative set of policy changes?

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[7]These comments are based on The Washington Post, June 29, 1987, which is quoted and paraphrased for this discussion.

APPENDIX D[1]

METHODS FOR FUTURE REFORM ASSESSMENTS BASED ON AN ECONOMIC POLICY REFORM ASSESSMENT IN MALI

1. INTRODUCTION

The current effort to assess the impact of policy reform efforts in Africa, and in this case in Mali, has demonstrated the difficulty of conducting this exercise given the frequent lack of necessary data and studies. Here we reflect on some of the methodological lessons which may be gleaned from the Malian experience and help in future assessment.

The lessons from Mali will be generally applicable to the French-speaking countries of the Sahel, which share an ecological similarity and a common institutional and policy heritage (see Wilcock 1978). There also may be application elsewhere in Africa but more caution would have to be exercised.

Attempts to conduct this type of assessment will always face unusual measurement difficulties in the Sahelian environment due to two basic factors. One, data collection will always be a scarce luxury in this environment. Two, extreme variability will continue to characterize supply and demand conditions in the cereals subsector because of (a) highly variable, weather-induced supply conditions for the primary dryland sorghum and millet crops, and (b) continued instability in world grain prices and food aid availability. This variability simply means that it will always be difficult to trace causality.

Assessment is always easier when there is a clear definition of reform program objectives, program actions, and predefined impact indicators. These should be carefully defined at the beginning of the program. In Mali, we have seen that the objectives of the Cereals Market Restructuring Program (PRMC) were not defined particularly clearly in its first phase. However, the donors do seem to be making a clear effort to remedy this situation for Phase II of the joint PRMC program.

Finally, in introduction, the Mali case presents a unique opportunity to examine agricultural policy reform assessment; this is the objective of an ongoing Michigan State University [MSU] Food Security Project micro-level research effort. In fact, the two principal investigators in this effort, Professor John Staatz and field research supervisor Josue Dione, are plan-

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[1]This appendix is from the A.I.D. report by Wilcock, Roth, and Haykin (1987).

ning to produce a book describing this particular experience in the development of field assessment methods.

2. METHODOLOGICAL SUGGESTIONS BY IMPACT AREAS

2.1 Impacts on Producer Response

In the Phase I period, the effort to assess impacts on producers is complicated by the virtual total lack of relevant data. Second, and more fundamentally, short-term planting and other production decisions in the highly precarious environment for dryland sorghum and millet in the Sahel are characterized predominantly by risk reduction survival strategies rather than by responding to market price signals.

In Phase II a number of improvements could be made in this situation. First, the overall effort to assess impact would be substantially easier if the collection of basic, recurrent statistics were improved. New approaches being tried using very focused, mobile team techniques in collecting basic production data on a sample basis would have high payoffs in the Sahelian environment. These methods place great reliance on simply asking farmers how much grain (or other crops) they produced. Various data collection tests have shown these methods to produce results that are at least as good or better than the traditional yield plot approach (and much better than the "office meeting" estimation techniques often used in the Sahel).

Even if no improvement is made in basic agricultural data collection, there are low cost ways to get a better picture of marketing reform impacts on producer incentives. First the problem needs to be simplified and subdivided by time period and by crop. By time period we need to distinguish between short-term reactions to recent prices on the next season's production decisions and longer term changes (over a 3- to 5-year period) to adopt higher yielding technologies. Next, the investigations need to distinguish among crops: dryland sorghum and millet, maize (either traditional compound maize or maize grown with chemical fertilizer for the cash market), and finally different types of rice production (total water control as in the "Office du Niger," rainfed rice, and flooded floating rice such as is planted along the Niger and which may only produce a crop in 1 year out of 4). Response to market price changes would be only one of a number of factors affecting technology adoption to be examined. The following are four types of production response studies which could be done in Mali (most could be done in other Sahelian countries as well) in the future.

Short-Term Planting Intentions for Sorghum and Millet. A one-shot survey could be done which would directly ask farmers questions on how they determine acreage of grain to plant, and how mid-season weeding and post-harvest marketing decisions are made. The current USAID/Mali farming systems project or the MSU data collection team could do such a small study.

(CMDT) Malian Textile Development Company High-Input Maize Study. A short study should be done of available secondary data on CMDT farmers growing and marketing high-input maize. The analysis of secondary [data] could be followed with a rapid reconnaissance type survey of a sample of CMDT maize growers stratified by use of animal traction, whether cotton is grown, etc. It would be easy to do this in the high extension coverage area of CMDT in the dry season.

Rice Production and Marketing Study (If this has not already been done). Basic information [should be collected] on the major rice production systems in Mali: total water control irrigation, rainfed rice (particularly in the Sikasso area), and riparian, floating rice along the Niger. Existing information and studies need to be consulted first (such as work of the WARDA [West Africa Rice Development Association] group in Mopti), then rapid reconnaissance survey could be done in the major production areas. Key questions: rough cost of production and yields, marketing patterns, response to market prices. WARDA might help with this on a low-cost contract basis.

Longer Term Producer Adoption of Improved Dryland Sorghum Millet Technologies. It would be useful to sort out, perhaps with the help of the A.I.D.-funded ICRISAT [International Crops Research Institute for the Semi-Arid Tropics]/Mali research team, to what extent Malian producers seem to have adopted any improved techniques for producing sorghum and millet under dryland conditions. This could involve mechanical technologies (animal traction-update Shulman/USAID study; different agronomic techniques, green manuring, etc.); biological technologies (any improved varieties, with or without fertilizer?); and chemical technologies (including fertilizer and herbicides). If there has been some adoption, how and why did producers start using the technologies? (Direct questions to adopter farmers.)

2.2 Impacts on Efficiency in Market Channels

There are indications of major cost reduction in the market channels between the farm gate and the consumer due to the liberalization portion of the PRMC reform package. These need to be examined more systematically, first by the MSU team currently in the field and perhaps by some well-focused follow-up studies. These approaches would have wide applicability across the Sahel. There are two reasons why the impacts occurring in market channel efficiency have not received much attention. First, there is almost no reliable information on real costs of grain marketing through the channels (in Mali, private trade was illegal and [therefore] could not be studied) and secondly, views of transactions are often just partial: farm gate to wholesale or the cost of distribution from wholesale bulk stocks to consumers. What is needed is to look across the whole grain marketing channel over time (are there changes between deficit and surplus years?) and over space (do channels serving Bamako, Gao, and Mopti work substantially differently?).

2.3 Residual Functions for State Trading Agencies

The subsidy reduction impacts within OPAM [Mali Grain Marketing Board] are perhaps the most visible and easiest to quantify of all impact areas examined in this assessment. As we have seen, care must be taken in attributing causality, even with these clearer indicators. For example, it was easier for OPAM to cut expenses in the first 3 or 4 deficit years when a major function was to distribute food aid. Once conditions changed to surplus, the gains made rapidly disappeared. In other words, measures of efficiency and cost reduction need to be defined with respect to alternative market conditions.

Currently, OPAM needs assistance in defining alternative decision rules and procedures to respond to different possible supply and demand situations both within and outside Mali. Much of this can be done on a relatively informal, accounting model basis, which would simply take account of production, public and private stocks, commercial pipeline imports, food aid, and consumption figures. Obviously close "early warning" monitoring of the domestic coarse grain production situation and the world rice situation would be most important.

At the regional, Sahelian level, there is a great opportunity to examine the change which has occurred in grain marketing institutions and activities in the 10 years since the Elliot Berg group looked at the subject in 1976/1977. We know already that major institutional changes have occurred across the region and there may be opportunities to examine certain data series within a 10-year perspective.

2.4 Consumer Impacts

In contrast to a developed economy where 3 or 4 percent of the population feed the rest and where the distinction between consumer and producer is somewhat clearer, these distinctions are often blurred in the Sahel. The first question that must be addressed, therefore, is which consumer groups we are talking about. The consumers who are also producers? Urban populations: urban unemployed or relatively well-off civil servant groups? Next, the relevant performance measures which apply to these different groups must be more clearly defined. As in everything else, there are no data. The lack of consumption studies is perhaps even more chronic than the lack of reasonable agricultural production statistics. Currently in Mali a group from Tufts University is analyzing data from an urban consumption survey, which may provide some interesting clues as to individual patterns of expenditure and incidence of benefits. Further studies of this kind should be encouraged along with focused studies of food distribution by consumer cooperatives and other urban groups.

2.5 Data Collection and Policy Analysis Capability Must Be Institutionalized

Perhaps one of the greatest shortcomings of the PRMC program, and related donor efforts, is the lack of institutionalization of necessary basic data collection and policy analysis capabilities. While some progress has been made in improving data collection within OPAM (some market price information and improvements in management data collection), most of the key data which could be used to evaluate the program and to plan annual grain marketing strategies was being collected by ad hoc donor-sponsored efforts, such as the much praised MSU effort. There has been a near total lack of attention paid to institutionalizing this capacity within the Malian government. This is particularly true of the development of the Malian capacity to analyze relevant policy options. This is in contrast to policy reform efforts in other countries where part of the assistance has gone into efforts to gradually beef up the analytical capability, which in turn creates a demand for better data since it can be shown that data collection has a practical and important consequence.

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