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POLICY REFORM AND SUSTAINABLE DEVELOPMENT WORKSHOP

February 1-5, 1988

DEVELOPMENT STUDIES PROGRAM

Institute for International Research • The American University
Agency for International Development

DEVELOPMENT STUDIES
PROGRAM
1331 H Street, N.W.
Washington, D.C. 20005
Suite 200
(202)783-2040

METRO:
Metro Center Station
use 13 Street Exit

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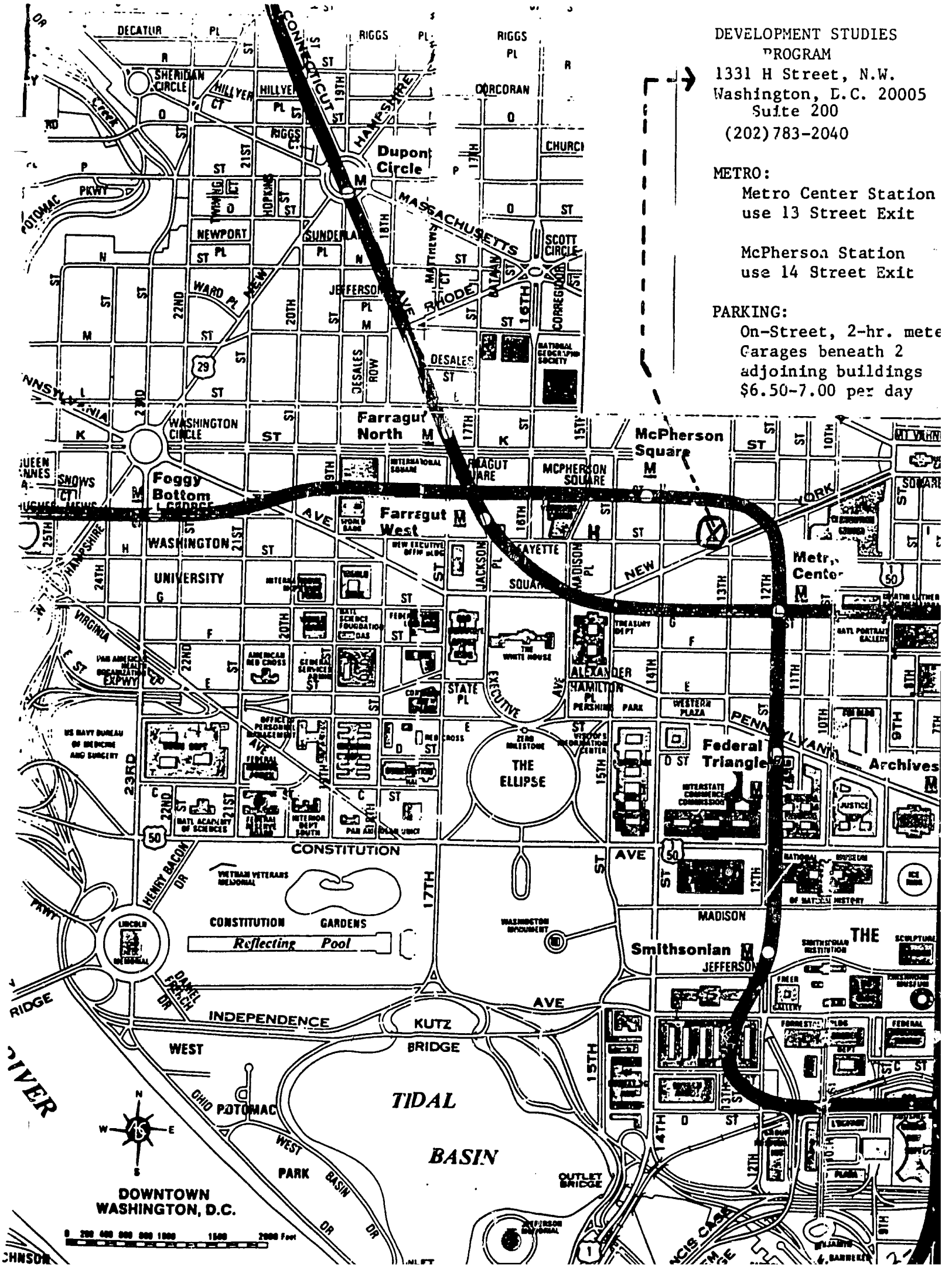

Policy Reform and Sustainable Development Workshop

Brief for Rapporteurs

One participant will act as rapporteur for each session. This role requires taking notes which outline:

main ideas discussed,
areas of group agreement and disagreement,
decisions taken,
follow-up required.

The issues/questions listed for each session in the syllabus should provide the framework for note-taking.

A second requirement is a brief oral summary at the end of the session to allow other participants to react to the rapporteur's notes.

Rapporteurs may use the electronic white board in the conference room for this report. Whatever is written on the board by the rapporteur can then be reproduced on a paper copy and duplicated for all participants.

Fifteen minutes are scheduled at the end of each session for this report. A five minute oral report, followed by discussion allows participants to respond to the summary.

On the last day of the workshop, the reporters will meet with the other workshop participants to prepare a summary statement of the workshop proceedings and findings. This statement will be the basis of the report to the Administrator and the subsequent discussion with him.

Policy Reform and Sustainable Development Workshop

CALENDAR

Monday, February 1

9:00-9:30	Overview
9:30-10:00	Introductions
10:00-10:45	The Relationship Between Market-Oriented Policy Reform and Development Performance
10:45-11:00	Coffee Break
11:00-11:45	Discussion
11:45-12:00	Rapporteur's Summation
12:00-1:30	Lunch Break
1:30-2:15	Policy Reform and the IMF
2:15-2:30	Break
2:30-3:15	Discussion
3:15-3:30	Rapporteur's Summation
3:30	Close

Tuesday, February 2

9:00-9:30	Structural Adjustment and the World Bank
9:30-10:00	Discussants
10:00-10:45	Questions
10:45-11:00	Rapporteur's Summation
11:00-11:15	Break
11:15-12:00	Policy Reform, Stabilization and Structural Adjustment in Costa Rica
12:00-1:00	Discussion (Working Lunch)
1:00-1:15	Rapporteur's Summation
1:15-1:30	Break
1:30-2:15	The Microeconomics of Policy Reform: The AEPRP in Malawi
2:15-2:30	Break
2:30-3:15	Discussion
3:15-3:30	Rapporteur's Summation
3:30	Close

Wednesday, February 3

9:00-9:30	Agricultural Policy Reform in Asia: Bangladesh
9:30-10:45	Comments
10:45-11:00	Rapporteur's Summation
11:00-11:15	Break
11:15-12:15	Policy Reform Programs and the Poor
12:15-1:00	Roundtable Discussion
1:00-1:15	Rapporteur's Summation
1:15	Close

Thursday, February 4

9:00-10:15	Recurrent Obstacles to Policy Reform in Developing Countries
	Group Discussions
10:15-10:30	Rapporteur's Summation
10:30-10:45	Coffee Break
10:45-11:15	An Alternative Approach to the Design and Implementation of Policy Reform Program
11:15-12:15	Discussion
12:15-12:30	Rapporteur's Summation
12:30-1:30	Lunch Break
1:30-3:15	Alternative Assistance Strategies for Sustainable Development
3:15-3:30	Rapporteur's Summation
3:30	Close

Friday, February 5

9:00-10:30	Policy Reform and Sustainable Development: Congress, PVOs, and A.I.D.
10:30-10:45	Rapporteur's Summation
10:45-11:00	Coffee Break
11:00-12:30	Preparation of Report to the Administrator
12:30-3:30	Lunch and Report
3:30	Close

POLICY REFORM AND SUSTAINABLE DEVELOPMENT WORKSHOP
February 1-5, 1988

This workshop addresses the central question--*How can foreign assistance be used most effectively to bring about the policy reforms needed for sustained development?*

PURPOSE

The purposes of this workshop are to--

1. Critically examine A.I.D.'s post 1980 experience with policy reform programs;

2. Assess the impact of policy reform programs on developing country efforts to sustain development;

3. Identify the distributive impact of stabilization and adjustment programs;

4. Consider the kinds of policy reform programs which can most effectively contribute to sustained development;

5. Share policy reform experiences with other development organizations; and

6. Consider foreign assistance legislation and A.I.D.-Congressional relations.

FORMAT

The workshop format requires the active participation of those attending in all sessions. Participants will make presentations, lead discussions, share insights, summarize discussions, and assist in the drawing of lessons learned.

Methodology will vary from session to session in order to actively engage all participants. Sessions may begin with a critique of the readings, a debate, forum, panel discussion or short presentation relevant to the issues to be discussed. Where appropriate, outside experts will be asked to make presentations. Limited background reading will be distributed in advance of the workshop.

Participant rapporteurs will record each day's discussions, noting areas of agreement and unresolved issues. These reports will serve as the basis for a summary report to be addressed to the Administrator in a final session.

LOCATION AND SCHEDULE

The workshop will take place at the offices of the Development Studies Program at 1331 H St., N.W. Suite 200, Washington, D.C. The workshop will meet daily from 9:00 to 3:30, except on Wednesday, when we will finish at 1:15. Tuesday and Friday lunches will be working lunches, provided by the workshop.

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WORKSHOP SYLLABUS

Monday, February 1

9:00-9:30 Overview, Michael Rock, Director, DSP

9:30-10:00 Introductions, Paula Cruz, DSP Faculty

10:00-12:00 **The Relationship between Market Oriented Policy Reform and Development Performance**

The purpose of this session is to examine the relationship between development policies and development performance. The focus is on policy reform, whether sponsored by A.I.D., or initiated by the host country.

Issues/Questions

1. Why policy reform?

2. What does the record show regarding policy reform and development performance?

3. When is the measuring and monitoring of development performance adequate and what should be measured?

4. What is the role of government in deregulating, providing needed protection to markets, establishing the right climate for private investment, and facilitating trade?

Moderator: James Weaver

Resource persons: Colin Bradford, Yale University
Eliott Berg, Berg Associates

Rapporteur: Jerry Wolgin

Reading: Colin Bradford, "East Asian "Models": Myths and Lessons" in J. Lewis and V. Kallab eds. Development Strategies Reconsidered, New Brunswick: Transaction Books, 1986, pp. 119-126.

"Pricing for Efficiency," World Development Report: 1983, Washington D.C.: World Bank, pp. 57-63, "Trade Policy and Industrialization," World Development Report: 1987, Washington, D.C.: World Bank, pp.78-94.

1:30-3:30 **Policy Reform and the IMF**

The purpose of this session is to learn how IMF stabilization programs work.

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Issues/Questions

1. Who determines the content of stabilization agreements and how is it determined? IMF / ECONOMIC / ACCOUNTING FRAMEWORK

2. How do Fund programs affect sector resource allocations and policies? NO CLEAR ANSWER

3. What kinds of data are necessary for determining the content and for proposing the adoption of policy reforms? MORE THAN WE HAVE

4. What are the most important problems that arise in the implementation of stabilization agreements? COMMITMENT, DURABILITY, LAGS IN RESPONSE

5. What is the record of stabilization agreements with respect to economic growth, inflation, balance of payments, and income distribution?

Moderator: Michael Rock

Resource persons: Alan Tait, Fiscal Affairs Division, IMF

Rapporteur: Michael Crosswell

Reading: W. Cline, "Economic Stabilization in Developing Countries: Theory and Stylized Facts," in J. Williamson (ed.), IMF Conditionality, Washington, D.C.: Institute for International Economics, 1984, pp. 186-200 and 206-208.

Fund Supported Programs: Fiscal Policy and Income Distribution, IMF Occasional Paper No. 46, September 1986, pp. 11-14 and 21-32.

TUESDAY, February 2

9:00-11:00 Structural Adjustment and the World Bank

The purpose of this session is to review the World Bank's recent experience with structural adjustment programs.

Issues/Questions

1. Why has the Bank moved to structural adjustment loans (SALs) and what are their main features?

2. Why has the Bank moved to sector adjustment loans (SECALs) and what are their characteristics?

3. What are the main problems associated with implementing SALs and SECALs?

4. What do we know about the impact of SALs and SECALs on development to date?

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Moderator: Jim Weaver

Resource persons: Vinod Dubey, Director, Economic Advisory Staff, Office of Senior Vice President for Operations, World Bank

Discussants: Martin Dagata
Charles Sykes

Rapporteur: Dennis Brennan

Reading: G.K. Helleiner, "Policy-Based Lending: A Look at the Bank's New Role," in R. Feinberg, (ed.), Between Two Worlds: The World Bank's Next Decade, New Brunswick: Transaction Books, 1986, pp. 52-65.

Operations Evaluation Department, World Bank "Structural Adjustment Lending: A First Review of Experience," 1987, pp. ii-viii.

V. Dubey, "World Bank Support for Structural Adjustment in Developing Countries: Structural and Sectoral Adjustment Lending," 1987, unpublished manuscript, 9 pp.

11:15-1:15 **WORKING LUNCH: Policy Reform, Stabilization and Structural Adjustment in Costa Rica**

The purpose of this session is to examine the macroeconomic analytics of stabilization programs funded by the IMF, the World Bank, and A.I.D. By focusing on the A.I.D. policy reform program in Costa Rica, this session will demonstrate how A.I.D. worked with these other agencies and the Costa Rican government to successfully implement a stabilization and macroeconomic reform program.

Issues/Questions

1. How was program content identified?

2. What problems emerged during negotiation?

3. What difficulties emerged during implementation?

4. What was the program's impact on sustainable development?

Moderator: Jim Weaver

Resource persons: Jim Fox, LAC/DP
Hernan Saenz-Jimenez, Executive Secretary, Administrative Tribunal InterAmerican Development Bank, Former Minister of Finance, Costa Rica

Rapporteur: Michael Crosswell

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Reading: H. Saenz-Jimenez, "Notes for a Lecture on Costa Rica's Experience with Policy Based Lending, 1978-1981," 18 August, 1987, unpublished manuscript, 11 pp.

1:30-3:30 **The Microeconomics of Policy Reform: The African Economic Policy Reform Program (AEPRP) in Malawi**

The purpose of this session is to examine the microeconomic foundations of policy reform programs. By focusing on the Africa Bureau's AEPRP program in Malawi, this session will consider the role of incentive structures on development performance.

Issues/Questions

1. How was program content identified?

2. What problems emerged during negotiation?

3. What difficulties emerged during implementation?

4. What was the program's impact on sustainable development?

Moderator: Michael Rock

Resource persons: Carol Peasley, AFR/PD
Jerry Wolgin, AFR/DP

Rapporteur: Duane Acker

Reading: "The African Economic Policy Reform Program," AFR/AID, pp. 1-7.

"Malawi Fertilizer Subsidy Removal Program: EPRP I Recap," Cable from USAID/Malawi to AID/W, December 1987, pp. 1-6.

"The Impact of the Fertilizer Subsidy Removal Program on Smallholder Agriculture in Malawi," a report by Robert Nathan Associates, June 30, 1987, Annex IV, pp. 10-31.

WEDNESDAY, February 3

9:00-11:00 **Food Aid and Agricultural Policy Reform in Bangladesh**

This session has two purposes. The first is to consider the possible uses of food aid in furthering agriculture policy reform. The second is to consider A.I.D.'s agricultural policy reform program in Bangladesh.

Issues/Questions

1. What is the evidence concerning the impact of food aid on incentive structures in LDC agriculture?

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2. How can food aid be used to support policy reform?

3. How was the Bangladesh program content identified?

4. What problems emerged during negotiation?

5. What difficulties emerged during implementation?

6. What was the program's impact on sustainable development?

Moderator: Brandon Robinson

Resource persons: John Westley, AFR/DP
Tom Reese, DAA/FVA/FFP

Rapporteur: Charles Costello

Reading: Edward J. Clay, "Food Assistance: Implications for Development and Trade" in U.S. Agriculture & Third World Development: The Critical Linkage, R. Purcell and E. Morrison (eds.), Boulder: L. Reinner Publishers, 1987. pp. ~~175-211~~. 176-191

H. Gunther and D. Ferguson, "Title III: Food for Development Program, FY 1986 Evaluation of the Bangladesh Program" Oct. 1986, pp. 7-16.

1:15-1:15 **Policy Reform Programs and the Poor**

The purpose of this session is to examine the distributional impact of tabilization and adjustment programs in developing countries. The session will lso consider ways of developing programs that more directly enhance the well eing of the poor.

Issues/Questions

1. What do we know about the impact of stabilization and adjustment programs on the poor?

2. What would have been the likely impact on the poor of continuing the status quo (without stabilization and adjustment)?

3. Can we develop policy reform programs that more directly enhance the well-being of the poor?

Moderator: Paula Cruz

Resource persons: Paul Altesman, UNICEF
Ronald Hood, Center for Development Technology
Owen Cylke, Acting AA/FVA
Alan Tait, IMF

Rapporteur: Terrance Brown

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Reading: R. Jolly, "A UNICEF Perspective on the Effects of Economic Crises and What Can Be Done" in D. Bell and Michael Reich (eds.), Health, Nutrition and Economic Crises, Dover: Auburn House, 1988, pp. 92-101 and J. Behrman, "The Impact of Economic Adjustment Programs," in Bell and Reich (eds.), pp. 105-6.

R. Hood, M. Starr, J. McGuire, Draft of "The Socioeconomic Impact of Macroeconomic Adjustment," Center for Development Technology and International Science and Technology Institute, December 1, 1987, pp. 52-64.

Fund Supported Programs: Fiscal Policy and Income Distribution, IMF Occasional Paper No. 46, September 1986, pp. 5-10 and 36-37.

THURSDAY, February 4

9:00-10:30 Recurrent Obstacles to Policy Reform in Developing Countries

The purpose of this session is to identify, based on participants' experience, obstacles to policy reform in developing countries and to consider possible donor strategies for dealing with these obstacles.

Issues/Questions

1. What are the major obstacles in LDCs to policy reform?

2. What donor strategies can contribute to removing these obstacles?

Moderator: Jim Weaver

Resource persons: Martin Dagata, DAA/PPC
Peter Askin, M/PM/EPM
Walter Bollinger, DAA/AFR
Charles Costello, LAC/CAP

Rapporteur: Bob Halligan

Reading: M. Grindle and J. Thomas, Draft of "The Political Economy of Policy Reform in Developing Countries" Harvard Institute for International Development, June 1987, pp. 1-24

10:45-12:30 An Alternative Approach to the Design and Implementation of Policy Reform Programs

1 The purpose of this session is to examine the design and implementation process used by the World Bank in its sector adjustment loan to Colombia as an example of one way to address the sustainability issue.

Issues/Questions:

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1. How can a collaborative process increase the effectiveness and efficiency of sector performance?

2. How can donors contribute to policy coordination within LDC's?

Moderator: Paula Cruz

Resource persons: Turid Sato, former Senior Loan Officer, Colombian Division, The World Bank
William Smith, Wharton School, University of Pennsylvania, consultant to The World Bank

Rapporteur: John Westley

Reading: W. E. Smith, Organizing for Development, draft manuscript, November 1987, pp. 62-68 and 155-172.

l:30-3:30 **Alternative Assistance Strategies for Sustainable Development**

The purpose of this session is to consider alternative ways that A.I.D. nissions might assist developing countries to achieve long run development goals.

Issues/Questions:

1. New A.I.D. relationships with advanced developing countries.

2. Collaborative sector analysis: a foreign assistance technique for improving LDC sector management.

3. Beyond stabilization in Central America: the role of sector loans.

Moderator: Michael Rock

Resource persons: Bob Halligan, M/PM
Brandon Robinson, PM/TD
Jim Fox, LAC/DR

Rapporteur: Carol Peasley

Reading: None

RIDAY, February 5

:00-10:45 **Policy Reform and Sustainable Development: Congress, PVO's, and A.I.D.**

The purpose of this session is to highlight the issues, problems, and trade-ffs involved in attempts to reform U.S. foreign assistance policy. The session will ddress PVO interests, political constraints in Congress, and A.I.D. perspectives.

Issues/Questions:

1. How can Congress, the PVO community, and A.I.D. develop a consensus about A.I.D.'s role in policy reform?

Moderator: Michael Rock

Resource persons: Ray Love, Counselor to the Agency
George Ingram, House Foreign Affairs Committee
Richard Collins, Senate Appropriations Committee
Charles Sykes, CARE

Rapporteur: Margaret Goodman

Reading: "Report Language from Conference Committee on the African Development Fund," undated, pp. 14-18 and 6-15 to 6-18.

11:00-12:30 **Preparation of Report to the Administrator**

The purpose of this session is for the participants to prepare a report for the meeting with the Administrator.

12:30-3:30 **Lunch and Report to the Administrator**

The purpose of this session is to report workshop results and discuss them with the Administrator.

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POLICY REFORM AND SUSTAINABLE DEVELOPMENT
WORKSHOP PARTICIPANTS

February 1-5, 1988

ADVISORY COMMITTEE

Martin Dagata, Deputy Assistant Administrator, Bureau for Program and Policy Coordination, A.I.D., Rm. 3942 NS, (202) 647-8899. A.B., Trinity College; M.A., University of Denver, Harvard Fellow, Center for International Affairs. Mr. Dagata first served in A.I.D. as Assistant Program Officer in Panama in 1968. He has worked in the Latin America Bureau, as Deputy Director in Honduras in 1976, in the Africa Bureau as Director of Southern African Affairs, and as Mission Director in Tunisia and El Salvador. He was also Acting Mission Director in Jamaica and Director of the Office of Caribbean Affairs, Washington.

James Fox, Chief, Economic Affairs Division, Bureau for Latin America and the Caribbean, Office of Development Programs, A.I.D., Rm. 2246 NS, (202) 647-5668. Ph.D. in Economics, University of North Carolina. He has worked in Colombia as a Program Economist, and in the Asia Bureau and the Latin America and Caribbean Bureau. He has also served as International Economist, U.S. Department of the Treasury, 1977-1982, and has conducted research in the area of Development Finance.

Robert Halligan, Director, Office of Personnel Management, Bureau for Management, A.I.D., Rm. 1418 SA-1, (202) 663-1309. B.A., Economics, C.W. Post College; post graduate, Princeton University. Mr. Halligan has been with A.I.D. since 1962 when he was International Relations Officer, Thailand, Asia Bureau. He served in Nigeria as Assistant Program Officer and worked in Vietnam, and then Thailand, where he was Regional Economic Development Officer. He was Program Officer in the Philippines and Program Analyst, Office of Development Programs, Bureau for Asia. From 1978-81 he was Director of the Office of Development Planning, Bureau for Asia; 1982-85, Mission Director in Thailand and 1985-86 Director of Office of Procurement, Bureau for Management.

Alexander R. Love, Counselor to the Agency, A.I.D., Rm. 5942 NS, (202) 647-8596. BS, University of California, Berkeley; M.B.A., Harvard University. Mr. Love served in the Asia Bureau as financial analyst from 1972 to 1978, in the REDSO East Africa Regional Development Office from 1978-1981. He was Assistant Administrator for Africa from 1982-1987.

Jerry Wolgin, Chief, Policy Analysis and Research Division, Office of Development Planning, Bureau for Africa, A.I.D., Rm. 3909 D NS, (202) 647-2994. He holds a Ph.D.in economics from Yale University, and has served in A.I.D., in PPC and the Africa Bureau. He was also assistant professor of Economics at Wayne State University, 1973-79 and a Project Specialist at the Ford Foundation, 1974-76, and has conducted research on the political economy of development.

GUEST PARTICIPANTS/RESOURCES

Richard Collins, Clerk, Subcommittee on Foreign Operations, Senate Appropriations Committee, Rm. S-128, U.S. Capitol, Washington, D.C. 20510, (202) 224-7205. Phi Beta Kappa graduate in Political Science from the University of

Connecticut; graduate studies, Johns Hopkins School of Advanced International Studies. He joined the Senate staff in 1971 and is presently staff director of the Appropriations Subcommittee on Foreign Operations, with oversight of security assistance programs.

Vinod Dubey, Director, Economic Advisory Staff, The World Bank, 1818 H Street, Rm. E3069, (202) 477-8051. Before joining the Bank, Mr. Dubey taught economics at the University of Allahabad in India. He joined the Bank in 1965 as economist in the Creditworthiness Studies Unit. He was chief economist for Europe and the Middle East, and from 84-85 was Director of the Country Policy Department. Mr. Dubey has addressed the Development Studies Program on the shift to policy based lending in donor organizations.

Margaret Goodman, Staff Consultant, House Foreign Affairs Committee, (202) 225-5021. M.A., Johns Hopkins School of Advanced International Studies. As Foreign Affairs committee consultant, she has had oversight of foreign assistance legislation since 1977. In addition, she was President of the Washington Chapter of the Society for International Development, 1982-84, and Member of the International Governing Committee of SID from 1985 to the present.

George Ingram, Senior Staff Consultant, House Foreign Affairs Committee, Room 2170 Rayburn Office Building, Washington D.C. 20515. (202) 225-5021. B.A., University of Northern California, M.A., Johns Hopkins School of Advanced International Studies, Ph.D, Economics and Political Science, University of Michigan. He has worked for the past fifteen years with the Committee on Foreign Affairs, responsible for economic policy and Latin America.

Charles Sykes, Director, Washington Liaison Office, CARE, 2025 I Street, N.W. Suite 1001, Washington, D.C.,20006, (202) 223-2277. Mr. Sykes worked twenty years with CARE overseas in Greece, Poland, Pakistan, India, Egypt, and the Dominican Republic. He opened the Washington Liaison Office in 1980. In addition to his work with CARE, Mr. Sykes is Co-Chair of the Policy Committee of InterAction, a coalition of 112 U.S. PVOs working in the international field. InterAction is intended to provide a focal point for group action on development issues. He has also co-chaired the Coalition on Food Aid Policy and Programs, a group of 10 PVOs and Cooperatives with hands-on experience with Food Aid programs in developing countries. He is also a member of the Board of the Washington Chapter of the Society for International Development.

Alan Tait, Deputy Director, Fiscal Affairs Division, International Monetary Fund, 700 19th Street, N.W., Washington, D.C., (202) 623-8725. Mr. Tait is responsible for Fund programming and fiscal policy. His research interests are in the area of tax policy. He has spoken frequently about the impact of fund programs on the distribution of income and wealth.

A.I.D. PARTICIPANTS/RESOURCES

Duane Acker, Agency Director for Food and Agriculture, Bureau for Science and Technology A.I.D., Rm. 311, SA 18, (202) 235-9012. Dr. Acker, a specialist in animal science, joined the Agency July 1, 1987. He was for eleven years President of Kansas State University and was Vice Chancellor at the University of Nebraska and Dean and Director of Agricultural Programs at South Dakota State University.

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He has worked on agricultural programs in the Philippines, Nigeria, Botswana, Argentina, and Swaziland. He just completed service on the Board for International Food and Agriculture Development and the Board of the Federal Reserve Bank of Kansas City.

Peter Askin, Chief, Executive Personnel Management Staff, Bureau for Management, Office of Personnel Management, A.I.D., Rm. 1426 SA 1, (202) 663-1308. M.A., Montana State University. He joined the Latin America Bureau in 1969, served in Vietnam as Deputy Program Officer, as Deputy Assistant Director in El Salvador in 1977, as Regional Office Director of ROCAP, 1980, Mission Director, El Salvador, 1980, and Regional Development Officer of the Latin America and Caribbean Bureau, 1982.

Walter Bollinger, Deputy Assistant Administrator, Bureau for Africa, A.I.D., M.A., Columbia University, has served in the Asia Bureau; in Indonesia; as Mission Director in Jordan, 1981; as Assistant Administrator, Bureau for Food For Peace and Voluntary Assistance, 1984.

Dennis Brennan, Deputy Assistant Administrator for Technical Cooperation, Bureau for Science and Technology, A.I.D., Rm. 4942 NS, 647-4871. Law degree, Georgetown University. He joined A.I.D. in 1968 in Thailand, served in Indonesia as Project Development Officer, 1970; Near East Bureau; Asia Bureau; Nepal Foreign Affiars officer, 1981; Mission Director, Nepal, 1983; Senior Assistant Administrator, S&T, 1985.

Terrance Brown, Office Director, Development Resources, Bureau for Latin America and the Caribbean, A.I.D., Rm. 2248 NS, 647-9149. M.A., Tufts University. He joined A.I.D.in 1972 in Nicaragua, was Project Development Officer in El Salvador, 1973; LAC Bureau; and Bolivia.

Charles Costello, Director, Office of Central American Affairs, Bureau for Latin America and the Caribbean, A.I.D., Rm. 5258 A, NS, 647-6156. Law degree from University of California, joined A.I.D. in the Asia Bureau in 1975; served in the General Counsel's office, Near East Bureau, 1976; Legal Advisor in Bolivia, 1976; Assistant Director in Kenya, 1981; Mission Director in Guatemala, 1982; and Regional Development Office of Latin America and Caribbean Bureau, 1986.

Michael J. Crosswell, Economist, Bureau for Asia and the Near East, Development Program Office, A.I.D., Rm 5258, NS, 647-9246. M.A. and Ph.D. from Northwestern University, joined A.I.D. in 1977; has served as a financial economist and economist in PPC, IIA/EA, ASIA/DP, ANE/ASIA/DP, and ANE/DP.

Owen Cylke, Acting Assistant Administrator, Bureau for Food for Peace and Voluntary Assistance, A.I.D., Rm. 225 SA-8, 235-9418. Mr. Cylke has worked with A.I.D. since 1972 in the Africa Bureau as deputy regional development officer, as Deputy Mission Director in Afghanistan in 1977, as Deputy Mission Director in Egypt in 1979, as Mission Director in India, 1983.

Carol Peasley, Director, Office of Project Development, Bureau for Africa, A.I.D., Rm. 2637 NS, 647-8181. Masters degrees from the University of Sussex and Stanford University. She joined A.I.D.in 1970 in Nepal and has since served as Program economist in Costa Rica, and the Latin America and Caribbean Bureau, as Deputy Mission Director in Thailand in 1982, and in the Africa Bureau.

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Thomas H. Reese, III, Deputy Assistant Administrator and Coordinator, Office of Food for Peace, Bureau for Food for Peace and Voluntary Assistance, A.I.D., Rm. 402 SA-8, 235-9210. M.A., University of Pittsburgh. He served in Indonesia in the Population Division, in Egypt as the Population Advisor in 1979, in the Near East Bureau as Regional Development Officer. He joined the Food For Peace Office in 1984.

John Westley, Associate Assistant Administrator, Office of Development Planning, Bureau for Africa, A.I.D., Rm. 3913 NS. 647-3362. Ph.D., American University. He has served in A.I.D. in Ethiopia, in REDSO East Africa as Agricultural Economist, as Assistant Program Officer in India, in the Asia Bureau and Asia Near East Bureau, and as Mission Director in Dhaka in 1985. He also served as International Economist, U.S. Department of Treasury, 1966-69, and conducted research on rural development in Asia and Africa.

OTHER RESOURCES

Paul Altesman, Special Assistant to the Executive Director and Coordinator for U.N. Affairs, UNICEF, 3 U.N. Plaza, H-13F, New York, N.Y. 10017, (212) 326-7033. Mr. Altesman works on UNICEF's program policies and liaison with the development community. His prior experience includes several field postings in Southeast Asia and work on the special relief operation in Kampuchea. He has also conducted operations in Africa and Latin America. Prior to coming to UNICEF he taught economics at the Universite de Paris (Sorbonne) and Long Island University.

Elliot J. Berg, Berg Associates, 907 Duke Street, Alexandria, Virgina 22314, (703) 836-7466. Ph.D., Harvard University, Professor of Economics, University of Michigan; Director, Center for Research on Economic Development, University of Michigan, 1970-78. He was Coordinator of the Special Study on Africa, The World Bank, 1980-81. He was Senior Economic Advisor to the Secretary of State's Commission on Foreign Assistance (Carlucci Commission), 1983. Continued consultation for World Bank, IMF, AID, and other government agencies, 1981-present.

Colin I. Bradford, Jr., Associate Director of the Yale Center for International and Area Studies and Professor of Economics, School of Organization and Management, Yale University, Yale Center, Box 13A, Yale Station, 85 Trumbull Street, New Haven, Connecticut 06520, (203) 432-3410. Ph.D., Economics, Columbia University. He has also held positions as Director of the Office of International Development Banks, U.S. Department of Treasury. His principal area of research is economic policy making.

Ronald Hood, President, Center for Development Technology, 576 Denbury Avenue, Ottowa, Canada, K 2A 2N 9, (613)728-9439. CDT works in the area of structural adjustment, conducting studies for the World Bank and other development agencies. Mr. Hood is principal investigator for the report "The Socio-economic Impact of Macroeconomic Adjustment," Center for Development Technology and International Science and Technology Institute, December 1, 1987, dealing with the problems of definition of the poor and arriving at measures more finely tuned than the usual economic measures. The proposal requires specific country studies and micro-level data collection.

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Hernan Saenz-Jimenez, Executive Secretary, Administrative Tribunal, Inter-American Development Bank, SE 630, 1300 New York Avenue, N.W. Washington, D.C. 20005, (202) 623-2757. From 1978 to 1981, Mr. Saenz-Jimenez was the Minister of Finance of Costa Rica and Vice-President of the Central Bank. He recently prepared for the World Bank a model of the Ecuadorean economy which served as the basis for the strategy for Ecuador's participation in Treasury Secretary Baker's debt initiative. He was also Dean of the School of Economics, University of Costa Rica, from 1974-1978.

Turid Sato, economist and formerly senior loan officer, Colombia Division, the World Bank. 2134 Leroy Place, N.W., Washington, D.C. 20008, (202) 232-2212. With Bill Smith, designer of the Colombia Energy Sector Workshop, 1987.

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Chapter 5

East Asian "Models": Myths and Lessons

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Colin I. Bradford, Jr.

Not long ago, surveys by the "pioneers" of development theory were gloomy about the prospects of this subdiscipline of economics. W. Arthur Lewis, for example, noted in 1984 that "development economics is said to be now in the doldrums."[1] Some critics even have gone so far as to hail the demise of development economics.[2]

It is odd that development economics should be perceived by some to be in such difficulty in the wake of a period in which there has been remarkable development success. New concepts and terminology for categorizing the developing world are required today precisely because of the increased differentiation among countries over the last two decades. The term "Third World" no longer seems appropriate. Arthur Lewis has called the rapid growth rate of the "success stories" of the developing world an "outcome without precedent."[3] Yet, as Albert Hirschman has observed, development economics seems to have suffered more than profited from development success: "The concept of a unified body of analysis and policy recommendations for all underdeveloped countries, which contributed a great deal to the rise of the subdiscipline, became in a sense a victim of the very success of development and its unevenness."[4]

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The Debate: Theory, Politics, and Policy

There has traditionally been a healthy tension between economics as a discipline and development economics as a subdiscipline. With economics becoming increasingly formal, and with development economics confronting diversity in economic performance and understandably falling short of a single theory to account for differentiation, the tensions have grown. The debate has heated up in recent years as more theoretically inclined economists have celebrated the triumph of neoclassical assumptions in the development success stories in East Asia. This celebration is the latest manifestation of what Hirschman calls "monoeconomics"—the view that there is only one economics just as there is only one physics.[5] The rapture with which the East Asian cases are celebrated derives from the view that they constitute proofs of the results achieved when neoclassical theory, relying on markets and getting prices to reflect real scarcities, is put into practice. It is a way for economics to take over development economics by destroying the subdiscipline's basic underlying premise: that developing countries are different from advanced market economies and require different theories and policies to promote development. Not surprisingly, this attempted takeover has spurred a lively response.

The highlighting of the East Asian cases goes beyond the boundaries of economics. It is rooted in the larger realm of public opinion, where confidence in the market system was shaken in the last two decades by stagflation, oil shocks, productivity declines, and perceptions of loss of power in the United States and Western Europe. In the wake of the crisis of the welfare state in the West and the rise of fiscal deficits as a generalized problem, there has been a reaction that argues in favor of a reduced role for the state in the economy and an enhanced role for market forces. This reaction in the West has been given further encouragement by interpretations of the success stories of Hong Kong, Singapore, Taiwan, and Korea as having been market-driven. Commenting on such explanations, Staffan Linder has argued that: "This will yield what may be called an ideological effect. Political thought and economic thinking will be influenced in the old industrial countries, where faith in the system which once brought these countries their wealth is again rising after a long period of erosion."[6]

In addition, of course, this trend in public opinion has been reinforced and reflected in the political thrust of the Reagan, Thatcher, and Kohl governments, which have extolled the virtues of the marketplace and built their political support on opposing the

governmental structures that they themselves command. The result is that the political mood of our time is to trust most governments that govern least. This political outlook has carried over into North-South relations. Jagdish Bhagwati has commented in a recent lecture that:

> The Reagan administration's revisionist approach to North-South relations was twofold. It not merely sought to reverse what it perceived as an ideological surrender to statism and intervention in the different multilateral agencies via their very existence or through their methods of functioning. It also proceeded, in consequence, to become intolerant of the pluralistic political and economic approaches to development.
>
> The conviction with which the advantages of the invisible hand, and the disadvantages of the visible hand, were propagated and sought to be imposed on the faithless infidels whenever possible tempts one to describe this period as *The Age of Certainty*.[7]

A second extension of the debate beyond the confines of economic theory is the convergence of views between the short-run stabilization requirements of the International Monetary Fund (IMF) and the longer-run development policy perspective now predominant in the World Bank. During the 1970s success stories occurred not only in East Asia but in many regions: in Latin America (Mexico and Brazil), in Southern Europe (Portugal, Spain, Turkey), and in Eastern Europe (Yugoslavia, Poland, Hungary). However, the greater exposure of Latin America to financial shocks—due to its large variable-interest-rate debt—led to a stylized contrast between the development trajectories of East Asia and Latin America. The stylized version highlights Latin America's policies as inward-oriented, interventionist, import-substituting while the East Asian model is seen as outward-oriented, market-driven export promotion based on internal liberalization.

The stylized version of the East Asian success stories meshes with the conclusions of the price distortion research presented in recent annual volumes of the World Bank, *World Development Report*.[8] The research concluded that high price distortion was associated with low growth; and, conversely, low price distortion was associated with high economic growth.[9] Further World Bank research showed "that big distortions also lead to slower growth of exports and a greater likelihood of debt-servicing difficulties."[10]

If the commitment to an outward-oriented growth strategy is construed to mean internal liberalization, then adopting the styl-

ized version of the East Asian model will achieve high economic growth through both efficiency gains and increased exports.[11] In explaining why the economic growth of the Asian-Pacific countries has outpaced that of other countries, Helen Hughes has observed that: "The only hypothesis that explains why some developing countries have grown rapidly, while others have not, links the adoption of a positive development philosophy with a policy framework that leads through market mechanisms to efficient resource allocation and utilization."[12]

This stereotyped contrast fits well with the IMF's short-run demand management stabilization policy outlook. In the late 1970s, there had been greater flexibility in the policy approach of the Fund, most notably in the March 1979 Executive Director's conditionality guidelines, which embodied not only the possibility of medium-run stand-by arrangements, but also more sensitivity to social and political constraints and more openness toward supply-side dimensions of policy emphasizing additional investment and economic growth. The recent predominance of the more orthodox concerns for price stability and balance-of-payments equilibrium has overshadowed the structural elements in the 1980s.

The idealization of the East Asian model as having succeeded in development through getting prices right for resource allocation reasons and the shift toward demand-management stabilization policies that emphasize getting prices right to achieve balance-of-payments equilibrium constitute a consistent policy package. Both emphasize the need to give priority to removing import controls and adjusting the exchange rate to bring internal prices into alignment with world market prices. Both emphasize price stability and open markets prior to economic growth and export promotion. Both argue that the costs of the new orthodoxy of liberalization and conventional stabilization will be compensated for by balance-of-payments equilibrium and efficiency gains in the short run and by export-led growth in the longer run.

The short-run requirements of conventional stabilization are consistent with the policy reforms—based on the East Asian model—necessary for success in the long run. It could be argued that this signals a new conventional wisdom about stabilization and development—a new consensus that gives the Fund and the Bank a single, uniform policy approach—one that spells the triumph of neoclassical economics over development economics. If one believes the orthodoxy, "monoeconomics" prevails in both theory and practice.

Closer study of the East Asian economies reveals a different explanation of their success. The story is more complex, and not so easily told or summarized, as is necessary here; but it is precisely this complexity that creates some doubt about the advisability of construing the East Asian cases as a singular model for economic policy. First, there are differences among the four principal success stories—Hong Kong, Singapore, Taiwan, and Korea. Of the four, Hong Kong is the closest to the stylized version; Korea is probably the furthest removed.

Second, there are different phases in the development experience of these four countries in which the mix of factors has shifted over time; what is true in one period gives way to a different configuration in the next. This problem is exacerbated today by the lags necessarily involved in publishing results of major research projects. Three major studies of development policy became available in the late 1970s, when attention was being focused on success of the East Asian success stories and other newly industrializing countries (NICs).[13] These research endeavors mainly focused on experience through the mid-1970s. This appeared largely to fit the stylized version: a shift from import-substitution industrialization to export-led growth seemingly coinciding with a shift from government intervention to internal liberalization. Studies published in the 1980s, focusing on the experience of the 1970s, generally reveal a more complex story, involving a mix of private market forces and public sector actions that overall yields a more *dirigiste* cast to the success story. This general conclusion, too, is out of phase, because in the mid-1980s—as the more balanced story of the 1970s is only now being highlighted—a shift toward more reliance on markets is in fact occurring in several countries.

Let me illustrate briefly. Wontack Hong estimates that "the annual provision of credit subsidies in the Republic of Korea amounted to at least 10 per cent of GNP each year on average in the 1970s."[14] He concludes that "the increasing exports of highly capital-intensive goods may only be explained by the extensive subsidies on capital use in Korea in the 1970s."[15] Credit rationing to preferred sectors accompanied this subsidization. Targeting sectors and establishing export targets for specific industries played a significant role.[16] Hong finds that the nine largest general trading groups increased their share of total commodity exports from 15 per cent to nearly 50 per cent from the beginning of the 1970s to the

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early 1980s and that this increased concentration was "at the expense of the share of small- and medium-size exporting firms."[17] This is not exactly an Adam Smith world of an invisible hand operating in an atomistic marketplace of small firms. Although these policies had a major effect on Korean economic performance in the 1970s, they also had some negative effects that are being corrected in the 1980s.[18]

The Brazilian development story, which is not dissimilar from that of Korea, also relied heavily on the involvement of the government in achieving an export boom that began in 1967 and entailed a major expansion in the export of manufactured goods in the 1970s. There is now movement in Brazil toward a more realistic exchange rate, a higher real rate of interest, cutting subsidies, reducing the public-sector deficit, mobilizing internal savings, and providing incentives for private-sector innovation and investment. Brazil is trying to continue export promotion and at the same time is seeking new opportunities for import substitution.[19] The Korean case was also characterized by import-substitution industrialization along with export promotion. A French study comparing Mexico and Korea shows that in both countries import substitution took place in sectors that were initially protected and then in later phases moved toward production for the export market; thus initial-stage industries spurred upstream industries such as steel that eventually produced for export.[20] The dichotomy between expo promotion and import substitution is overdrawn in descriptions the experiences of both Brazil and Korea in both the 1970s and in the 1980s.

Taiwan is also interesting from the perspective of the mythology of East Asian development success. Its trade regime has involved very selective management of both the volume and the composition of imports to boost the technological capability of the economy. Fiscal incentives were highly selective by product, reflecting the government's clear sectoral strategy to change the structure of the economy. Even though the country's banking system was government-owned, credit allocations were less prevalent in Taiwan than in Korea. On the other hand, public-sector enterprises constituted almost a third of fixed-capital formation in Taiwan in contrast to slightly more than a fifth in Korea. In comparison to Japan, government expenditures in Taiwan accounted for 30 per cent of GNP in contrast to Japan's 19 per cent in the mid-1970s. Taiwan also made a strong effort to keep macro policies in balance, keeping the exchange and interest rates realistic and inflation low. Along with other measures, this helped to keep the prices of lab

capital, and other factors of production close to their scarcity value.[21]

In the Taiwan case, import substitution was also found to accompany, rather than simply precede, export promotion. As Chi Schive puts it: "During the last two decades, the great success of export-led economies in East Asia, in particular Taiwan and South Korea, has led critics to label import substitution as inefficient, unnecessary, and even a sin." The results of Schive's analysis of Taiwan from 1966 to 1976 show that "secondary import substitution is clearly present at the industrial level during the period when Taiwan's exports increased rapidly." Schive goes on to say that "secondary import substitution industries in Taiwan seem to have been developed with little policy intervention"—he suggests a full investigation of this question—and that "the sequence of import substitution in Taiwan is directly in line with the backward linkage hypothesis," whereby downstream industries are spurred by dynamic final-goods sectors.[22]

The Taiwan development experience, then, is very difficult to stereotype *either* as a market-oriented success story *or* as an illustration of the triumph of dirigisme and policy intervention. Instead, its success is due to a mixture of both elements in effective and powerful interaction—and to a mixture, rather than sequencing, of import substitution and export promotion.

Singapore seems to be another case of development mix rather than dichotomous choice. Chung M. Wong points out that although Singapore has relied mainly on private enterprise, its government has tried to influence resource allocation in various ways, including incentives to industries regarded as desirable for the country. He cites the findings of Pang and Tan as having singled out the government as the most important factor behind Singapore's economic success. Wong goes on to argue that:

> At present the "pioneer status" (with relief of five to ten years from the 40 per cent tax on profits arising from an approved pioneer activity) and the investment allowance incentive (with tax deduction equal to up to 50 per cent of new fixed investment in plant, machinery, and factory buildings) are the main incentives used in investment promotion. Pioneer certificates are now mainly awarded to projects manufacturing new and high-technology products, while the investment allowance incentive is increasingly being used to promote the upgrading and mechanization of existing operations. Tax incentives are also given to encourage manufacturers to undertake research and devel-

opment activities. Projects believed to be of strategic importance to Singapore's industrial development can obtain long-term fixed-rate loans at favorable interest rates under the Capital Assistance Scheme (CAS) administered by the Economic Development Board.[23]

Ralph C. Bryant describes a similar set of circumstances—"the gradual extension of incentives and dismantling of constraints"—as part of Singapore's "aggressive," "conscious and active" policy to "create an environment for financial activity to flourish."[24] This priority to the development of the financial sector included favored regulatory and tax conditions. Here also, Singapore's emergence both as a major exporter of manufactures and as an international financial center relied heavily on supportive policies, some of which may have temporarily "distorted" prices in favor of priority sectors. Markets and private enterprises were also important. Pragmatism, rather than ideology or a single-formula model, seems to have been crucial to Singapore's success.

Against this background, it seems a bit overdrawn to conclude that "in South Korea and Taiwan, growth did not really start until around 1960 when, in both countries, there was a far-reaching redirection of economic policies away from regulation and interventionism over to a reliance on market mechanisms"[25]—or that "the East and Southeast Asian experience suggests that if the basic policy framework is appropriate, only limited sectoral policies are required to stimulate areas of actual and potential comparative advantage."[26]

Conclusions and Implications

Instead of providing a sound basis for the new conventional wisdom on development policy, the experience of the East Asian newly industrializing countries is at odds with this view. The real story of what constitutes successful development is more subtle and indeed quite different from what the stereotypes suggest. In the end, effective development relies on both market forces and public policies, and even on government intervention; it rests on *both* import substitution and export promotion. Credit and interest-rate subsidies, tax preferences, differential exchange rates, preferential treatment of capital goods imports, and other deviations from unfettered market signals have been integral parts of development policy. As Albert Fishlow has pointed out, "the more fundamental proposition is that the correctness of the prices must be decided by reference to a comprehensive development strategy, not independently of it."[27]

Sectoral priorities and industrial policies have been essential ingredients in the East Asian success stories. In Korea, Taiwan, and Singapore, the evolution of the production structure and the composition of exports was not left to the market but was the result of deliberate government design. On balance, the exchange rate, the interest rate, the tax system, and public-sector investment were not neutral factors subordinate to market forces in these cases; rather, they were leading indicators and important instruments of development strategy. What seems to distinguish the East Asian development experiences is not the dominance of market forces, free enterprise, and internal liberalization, but effective, highly interactive relationships between the public and private sectors characterized by shared goals and commitments embodied in the development strategy and economic policy of the government. The dichotomy between market forces and government intervention is not only overdrawn; it misconceives the fundamental dynamic at work. It is the *degree of consistency* between the two sectors—rather than the extent of implicit or explicit conflict—that has been important in the successful development cases. A coherent development strategy was not only formulated but followed by both the government and the private sector in providing an unusual degree of common direction to national energies in these cases.

The implications of this reality for development theory and policy thinking are far-reaching. As uncomfortable as it is for the social sciences in U.S. academic institutions to recognize the limitations of increased insights through specialization, understanding the fundamental courses of development success requires an interdisciplinary approach. The East Asian cases reviewed here clearly suggest this. Arthur Lewis asserts that "the wide range of performance of underdeveloped countries today, of whom one-third have been growing continually at more than 5 per cent a year . . . [is the] kind of question [that] belongs as much to history as it does to economic analysis."[28] It is interesting to realize that Albert Hirschman, whose intellectual role in political economy is seminal, views himself as a "dissenter" and that his intellectual framework was set inductively through his early experience (1952–56) in Colombia. Of that period, he writes that "my instinct was to try and understand better *their* patterns of action, rather than assume from the outset that they could be 'developed' by importing a set of techniques they knew nothing about."[29] Lloyd Reynolds, in his survey of the spread of economic growth to the Third World, comments that the explanation of differences in economic growth "does not seem to be mainly in the realm of factor endowments. . . . At this point, as a properly modest economist, I disclaim further re-

sponsibility and pass the problem to my political science colleagues."[30]

Far from a triumph of "monoeconomics," differential growth in the Third World highlights the limitation of explanations derived from economic theory alone. The success stories of East Asia point to a messier realm of interdisciplinary, political-economy research with strong historical and inductive methodologies.

The implications for policy practices in the World Bank and the IMF are also important. The eclectic reality of the East Asian cases contradicts the conventional wisdom. The consensus in which stabilization and development policy paradigms have become fused is brought into question. In the name of evenhandedness, it is not a helpful circumstance to have our premier international financial institutions wedded to a single model of a successful development policy or to a narrow definition of an effective stabilization program. The present convergence of paradigms seriously undermines the role of the Fund and the Bank in the world economy by restricting their scope and their effectiveness. It politicizes them by having them represent what Staffan Linder has rightly pointed out is an ideology, when their role is to be responsive to a variety of types of governments and economic systems.

The most serious result of the formation of the new conventional wisdom and the degree to which it has either been imposed on or embraced by the Fund and the Bank is the degree to which this set of ideas, and the molding of Fund-Bank instrumentalities in accordance with them, restricts the freedom of national governments around the world to determine their own policies and shape their societies in keeping with their distinct values and traditions. Lost in the trumpeting of the East Asian success stories are the views of others who recognize the excesses of intervention, who are concerned by overburdening the role of the state, who believe that getting prices right is an important part of development, but who nevertheless see national economic policy and the state as crucial instruments for shaping the destiny of their countries according to national norms.[31]

Given entrenched interests, structural problems, and a highly fluid international environment, the state and its economic policies can be vehicles for enhancing freedom, self-determination, and democratic values. Single-formula solutions are confining at best and undermining at worst to policy makers who are seeking to balance short-run and long-term requirements, stability and growth, real and financial dimensions in defining their nation futures and their roles in the world economy.

The World Bank and the IMF need to exercise more flexibility and diversity—both in their instrumentalities and in their policy outlooks—in dealing with the world economy of the mid-1980s and with the variety of policy mixes that can, in complex and varied circumstances, be effective in coping with the economic challenges currently facing national leaders.

The East Asian success stories do indeed provide a model for development strategies, but one that is different from the stylized version. More than this, they illustrate the joining of short- and long-run policy problems, macro-economic and structural forces, in what could be characterized as the new policy nexus.

Economic stabilization has been a global problem for nearly two decades.[32] Between the 1970s and 1980s, however, there was a shift in emphasis. Whereas in the stabilization policies and programs of the 1970s were driven more by inflation, the principal driving forces in the 1980s are balance-of-payments disequilibria and debt. The inflation-driven stabilization problems of the 1970s raised an issue of the degree of internal determination versus the extent of external transmission.[33] In contrast, economic stabilization issues in the mid-1980s, seem clearly linked with the degree of openness of national economies; the degree of interaction between trade, macro policy, and financial patterns; and the degree of interdependence among major nations in the world economy, now including new powers from the developing and socialist worlds.[34] This open-economy dimension is a major distinguishing characteristic of the stabilization problems in the mid-1980s.

A second major characteristic is the degree to which stabilization problems and policies are now embedded with structural issues related to growth, industrial policy, and the international division of labor and are not limited, as in the past, to short-run demand management policies. The short-run tensions and tradeoffs between growth and stabilization are well known in policy experience and in the literature. In the 1980s, the new element of restructuring has become a matter of equal policy priority. The pressure on industrial structures due to rapid technological change and diffusion and to the transnationalization of both production and financing is now global. France and the United States, Poland and Brazil, Korea and Japan are struggling in different ways and in distinct circumstances to find their niches in the international division of labor.

The embedding of the restructuring issue within the more conventional macro-economic framework gives economic policy a decidedly medium-run horizon. For many developing countries, this

is largerly attributable to the pressures of the debt burden that force a longer-term framework for scheduling debt payments and projecting export earnings. The need to export in order to finance debt adds to the structural pressures to find a niche in the world economy. The design of sectoral development strategies that are consistent not only with internal endowments and capabilities but also with the rapidly changing structure of trade relations has become a more pressing policy imperative.

Therefore, longer-term financial planning, sectoral development strategies, and export requirements play a more decisive role in shaping short-run macro-economic policies. In turn, macro policies have a crucial bearing on the realization of the longer-term goals. The sustainability of short-run macro policies is critical to the viability of the longer-run trajectory, just as the long-run trade and financial requirements shape short-run policies. Hence, achieving a sustainable balance between growth and stabilization in the short run becomes *inseparable* from the longer-term structural dimensions. The policy nexus of growth, stabilization, and restructuring now poses the central challenge for economic policy makers.

If there is a "new synthesis" of development strategies, it is that the confluence of these formerly separate forces and perspectives defining the policy nexus of the 1980s requires a new fusion of structurally oriented development and macro-economic policies. The East Asian success stories provide models of this new synthesis, integrating the multifaceted elements of policy into an effective strategy, eschewing one-dimensional solutions rather than enshrining them.

Notes

[1] W. Arthur Lewis, "The State of Development Theory," *The American Economic Review*, Vol. 74, No. 1 (March 1984), pp. 1 and 10.

[2] Thus Deepak Lal recently wrote: "In seeking to improve upon the outcomes of an imperfect market economy, the *dirigisme* to which numerous development economists have lent intellectual support has led to policy-induced distortions that are more serious than, and indeed compound, the supposed distortions of the market economy they were designed to cure. It is these lessons from accumulated experience over the last three decades that have undermined development economics, so that its demise may now be conducive to the health of both economics and the economies of developing countries." "The Misconceptions of 'Development Economics,'" *Finance and Development*, Vol. 22, No. 2 (June 1985), p. 13.

[3] Lewis," State of Development Theory," op. cit., p. 9.

[4] Albert O. Hirschman, "The Rise and Decline of Development Economics," in *Essays in Trespassing: Economics to Politics and Beyond* (Cambridge: Cambridge Univer Press, 1981), p. 20.

[5] Ibid., p. 4.

[6] Staffan Burenstam Linder, "Pacific Protagonist—Implications of the Rising Role of the Pacific," *American Economic Review, Papers and Proceedings of the Ninety-seventh Annual Meeting*, Vol. 75, No. 2 (May 1985), p. 280.

[7] Jagdish Bhagwati, "Ideology and North-South Relations," Bernard Fain Lecture, Brown University, Providence, R.I., April 18, 1985.

[8] "Pricing for Efficiency," in World Bank, *World Development Report, 1983* (New York: Oxford University Press, 1983), pp. 57–63, and World Bank, *World Development Report, 1985* (New York: Oxford University Press, 1985), pp. 54–55.

[9] Ramgopal Agarwala, *Price Distortions and Growth in Developing Countries*, World Bank Staff Working Paper No. 575 (Washington, D.C.: World Bank, 1983). See critiques by Colin I. Bradford, Jr., in "The NICs: Confronting U.S. 'Autonomy,'" in Richard E. Feinberg and Valeriana Kallab, eds., *Adjustment Crisis in the Third World* (New Brunswick, N.J.: Transaction Books, for the Overseas Development Council), especially pp. 121–26; and by Albert Fishlow, *The Economic and Social Progress in Latin America, External Debt: Crisis and Adjustment* (Washington, D.C.: Inter-American Development Bank 1985), pp. 123–148.

[10] World Bank, *World Development Report, 1985*, ibid.

[11] Anne O. Krueger, "Import Substitution versus Export Promotion," *Finance and Development* Vol. 22, No. 2 (June 1985), pp. 20–23.

[12] Helen Hughes, *Policy Lessons of the Development Experience*, Occasional Paper No. 16 (New York: Group of Thirty, 1985), p. 16.

[13] I.M.D. Little, T. Scitovsky, and M. Scott, *Industry and Trade in Some Developing Countries: A Comparative Study* (Oxford: Oxford University Press, 1970); Bela Balassa, "Export Incentives and Export Performance in Developing Countries: A Comparative Analysis," *Weltwirschaftliches Archiv*, Vol. 114, 1978; Anne O. Krueger, *Foreign Trade Regimes and Economic Development: Liberalization Attempts and Consequences* Vol. 10 (Cambridge, Mass.: Ballinger, 1978).

[14] Wontack Hong, "Export Oriented Growth and Trade Patterns of Korea," in Colin I. Bradford, Jr., and William H. Branson eds., *Trade and Structural Change in Pacific Asia* (Chicago: University of Chicago Press, NBER, forthcoming).

[15] Ibid.

[16] Yung Whee Rhee, Bruce Ross-Larson, and Larry Pursell, *Korea's Competitive Edge* (Baltimore: The Johns Hopkins University Press, 1984), Chapter 3.

[17] Hong, "Export Oriented Growth," op. cit., p. 40.

[18] "South Korea: A Special Economic Report," *International Herald Tribune* (Paris), October 6–7, 1984.

[19] Peter T. Knight, *Economic Stabilization and Medium Term Development Strategy in Brazil*, (Washington, D.C.: World Bank, 1985); Persio Arida, *Economic Stabilization in Brazil*, Working Paper No. 149, Latin American Program, (Washington, D.C.: The Wilson Center, 1984).

[20] Centre d'Etudes Prospectives et d'Informations Internationales, *Coree Mexique: Deux Experiences de Development Face a la Crise* (Paris: La Documentation Francaise, 1982).

[21] Robert Wade, "Dirigisme Taiwan-Style," in Robert Wade and Gordon White, eds., *Developmental State in East Asia: Capitalist and Socialist, IDS Bulletin*, Vol. 5, No. 2, (Sussex, U.K.: Institute of Development Studies, 1984).

[22] Chi Schive, *A Measure of Secondary Import Substitution in Taiwan*, (Cambridge, Mass.: Harvard-Yenching Institute, 1985).

[23] Chung M. Wong, "Trends and Patterns of Singapore's Trade in Manufactures," in Bradford and Branson, *Trade and Structural Change*, op. cit., citing Pang and Tan, "Employment and Export-led Industrialization: The Experience of Singapore," in Rashid Amjad, ed., *The Development of Labor Intensive Industry in ASEAN Countries* (Geneva: International Labour Office, 1981).

[24] Ralph C. Bryant, "Financial Structure and International Banking in Singapore," *Brookings Discussion Papers in International Economics*, Washington, D.C., May 1985.

[25] Linder, "Pacific Protagonist," op. cit., p. 280.

[26] Hughes, *Policy Lessons*, op. cit., p. 17.

[27] Fishlow, "State of Latin American Economics," op. cit., p. 141.

[28] Lewis, "State of Development Theory," op. cit., p. 9.

[29] Albert O. Hirschman, "A Dissenter's Confession: 'The Strategy of Economic Development' Revisited," in Gerald M. Meier and Dudley Sears, *Pioneers in Development* (New York: Oxford University Press, 1984), p. 91.

[30] Lloyd D. Reynolds, "The Spread of Economic Growth to the Third World," *The Economic Literature*, Vol. 21, No. 3 (September 1983), pp. 975–76.

[31] See Enrique V. Iglesias, "Latin America: Crisis and Development Options," and Aldo Ferrer, "Debt, Sovereignty and Democracy in Latin America: The Need for a New Orthodoxy," in Colin I. Bradford, Jr., ed., *Europe and Latin America in the World Economy* (New Haven, Conn.: Yale Center for International and Area Studies, 1985), pp. 44ff.

[32] William R. Cline and Sidney Weintraub, eds., *Economic Stabilization in Developing Countries* (Washington, D.C.: The Brookings Institution, 1981); and William R. Cline and Associates, *World Inflation and the Developing Countries* (Washington, D.C.: The Brookings Institution, 1981).

[33] Surjit S. Bhalla, "The Transmission of Inflation into Developing Economies," in Cline and Associates, *World Inflation*, op. cit., pp. 52–101.

[34] Colin I. Bradford, Jr., "New World Economy," in Bradford, Jr., *Europe and Latin America*, op. cit., pp. 7–14.

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6 Pricing for efficiency

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In the industrial market economies prices play a pivotal role in the allocation of resources. The centrally planned economies have also started to move in that direction, and in developing countries there is a growing body of evidence on the benefits of using prices to reflect scarcities and encourage growth. Remunerative prices helped foster South Asia's agricultural development in the 1960s, and competitive exchange rates contributed to the export successes of several East Asian countries in the 1970s.

Yet government development programs often still concentrate more on the quantity of saving, investment, and output than on prices. Where governments have intervened directly in prices, they have often produced unintended results. Price controls to improve income distribution, for example, have sometimes ended up hurting the poorest—as when low food prices, intended to benefit the urban poor, reduce the incomes of the (more numerous) rural poor. Similarly, import controls designed to save imports and improve the balance of trade have often harmed exports and home production and ended up worsening the trade balance. Controlled low interest rates intended to help investors and farmers often ended up reducing the pool of savings available and forcing small investors and farmers to rely on high interest rates in black or informal markets. Pricing policy became increasingly critical in the 1970s because of the international upheavals in energy prices, interest rates, and exchange rates.

This chapter reviews the extent of price distortions in developing countries in the 1970s and assesses their impact on growth. The main conclusion is that during the 1970s price distortions were serious in many developing countries. Those countries with the worst distortions experienced significantly lower domestic saving and lower output per unit of investment, thus leading to slower growth.

Price distortions

The issue of price distortions has been widely researched and debated in recent years and has been reviewed in several earlier *World Development Reports* . Distortions exist when the prices of goods and services, as well as of capital and labor, do not correctly reflect their scarcity. For goods that are internationally traded, scarcity is generally indicated by international prices (a fuller discussion is given in Box 4.1).

Price distortions may be caused by monopolistic tendencies in the private sector or by government intervention. It is possible for government interventions, if properly designed, to correct distortions. In most instances, however, price distortions are introduced by government directly or indirectly in pursuit of some social or economic objective, sometimes deliberately, sometimes incidentally.

In most cases, these price-distorting policies have their origin in a complex set of political and economic factors. In the 1950s the dominant theories of economic development played down the power of prices and the degree of flexibility in resource allocation. Instead, inward-looking trade policies were favored by governments in many newly independent countries, partly in reaction to the colonial power's keenness to export their agricultural products and to import industrial products from the metropolitan country. In other countries, particularly in Latin America, governments wanted to be less dependent economically on the dominant industrial powers. Many of the controls leading to distortions were imposed in response to scarcities of foreign exchange, or capital, or certain goods (particularly during and after World War II); but the controls were often continued even after their rationale had vanished. Often distortions have arisen as the unintended by-product of inflation under a regime of fixed exchange rates.

As background research for this Report, the available facts on price distortions have been collated for thirty-one developing countries, representing more than 75 percent of the population of the developing world excluding China. The analysis concentrates on distortions in the prices of foreign exchange, capital, labor, and infrastructure services (particularly power). Distortions are not measured against some theoretical ideal, but are practical approximations commonly used in policy analysis. For example, to measure distortions in the pricing of foreign exchange, one should ideally measure the effective exchange rates for imports and exports as they deviate from the "equilibrium" rate. In practice, it is difficult to calculate equilibrium exchange rates; policy discussions generally focus on changes in real effective exchange rates from a base period, together with the effective protection or taxation of traded goods. Similarly, distortions in interest rates are judged by how far interest rates were negative in real terms; in wages, by movements in real wages relative to productivity adjusted for changes in the terms of trade; in the value of money, by high and accelerating inflation; and in infrastructure prices, by the rates of return in utilities. The estimated price distortions are found to be inversely related to growth and efficiency, but there is no strong evidence of such distortions leading to any gain in equity.

Exchange rates

Changing the real exchange rate can be a powerful tool for balancing trade without burdening the administrative system and without distorting domestic incentives. Yet in the 1970s in many countries with a large balance of payments deficit, the exchange rate was allowed to become overvalued in relation to the purchasing power of the currency. This lack of competitiveness became particularly serious in sub-Saharan Africa, where the average real effective exchange rate appreciated by 44 percent between 1973 and 1981. (The real effective exchange rate is here defined as the import-weighted exchange rate adjusted by the ratio of the domestic consumer price index to the import-weighted combination of consumer price indices in the trading partners.) Several African countries now find that producers of traditional export crops cannot be paid enough to cover their costs of production, even though these are the crops for which they have a strong comparative advantage. (Cocoa in Ghana is an obvious example and is discussed in Chapter 8, Box 8.1.) While the problem was generally less severe for other regions, in several countries an overvalued exchange rate harmed not only the balance of payments but also their growth. Even in such countries as Argentina, Chile, Sri Lanka, and Uruguay, which initiated programs of economic reform during the 1970s, the real exchange rate was subsequently allowed to appreciate and thus weakened their reform programs.

Trade restrictions

Trade restrictions have often led to high and variable rates of protection between different manufacturing industries. By contributing to an overvalued exchange rate, such restrictions have inadvertently discriminated against both exports and agriculture. In several countries (such as Cameroon, Ghana, Senegal, Tanzania, and Turkey), this bias against exports has been supplemented by export taxes or even outright restrictions, sometimes leading to increased agricultural imports at the expense of domestic production.

When import controls are intended to protect infant industries, they are rarely geared to promote an industry's long-run growth potential; nor are they reduced even after the industry has reached adolescence. The loss of efficiency resulting from such policies can be considerable. In extreme cases—steel in Bangladesh, tin cans in Kenya, and cars in Thailand—the foreign exchange cost of importing raw materials and capital significantly exceeds the foreign exchange cost of importing the finished products. Apart from these losses, the system of protection in many developing countries has become a serious administrative burden and, by giving windfall gains to those who obtain import licenses, often makes the distribution of income more unequal as well.

Interest rates

Overvalued exchange rates and low tariffs on imported capital goods encourage capital-intensive techniques at the expense of creating jobs. These tendencies are strengthened when interest rates charged to borrowers (and paid to savers) fall short of the inflation rate. At various times in the 1970s, negative real interest rates were almost a worldwide phenomenon. But they were particularly severe and persistent in countries such as Argentina, Brazil, Ghana, Jamaica, Nigeria, Peru, and Turkey, frequently reaching double figures. Such negative real interest rates not only penalize savers and

stimulate capital outflows but also encourage excess demand for credit—which is then suppressed by rationing loans, causing more administrative burdens.

Costs of labor

Capital-intensive investment has also been encouraged where the price of labor has been increased by unrealistic minimum wage laws and social security taxes. In many mineral-based economies, especially in Africa and Latin America, the drive for higher mining wages has spread to other sectors. This has pushed labor costs far above those of competitors, and encouraged rural people to leave the land in pursuit of the high wages paid to those lucky enough to find jobs in the urban sector. In some Latin American countries in the 1970s, social security contributions have added up to 20 percent to the cost of labor. In the 1970s wage negotiations in several countries (such as Ivory Coast and Sri Lanka) failed to allow for deterioration in the country's terms of trade. As a result, real wages grew significantly faster than productivity adjusted for changes in terms of trade.

Infrastructural services

The rapid increases in international costs of energy and capital in the 1970s required correspondingly higher prices for infrastructural services, which are generally both energy and capital intensive. With the exception of some oil-exporting countries and some energy products, most developing countries have adjusted domestic energy prices to international levels. However, infrastructure prices have been raised too slowly to judge by the low rate of return on capital achieved by power utilities. A review of sixty countries conducted by the World Bank in 1980 showed that about half had low (less than 4 percent) rates of return, while several incurred losses. In transport and water supply, rates of return are not available for any sizable sample of countries, but the indications are that most countries fail to recover the full costs of these services. Such underpricing not only increases demand for these capital- and energy-intensive services but also undermines the financial viability of the agencies supplying them.

Inflation

The 1970s was a decade of rising inflation the world over, with most developing countries experiencing double-digit rates. Nearly all the countries that had high—15 percent a year or more—inflation in the 1960s (such as Brazil, Chile, Republic of Korea, and Uruguay) continued in that category in the 1970s, and many others joined their ranks. In several countries (such as Argentina, Bolivia, Chile, Ghana, Mexico, Nigeria, and Turkey), the rate of inflation in the 1970s was high, and several times that in the 1960s. Rapid and accelerating inflation undermines allocative efficiency because it increases uncertainty and induces savers to invest in unproductive "inflation hedges" such as real estate, consumer durables, gems, and foreign currency deposits. Some countries have developed complex systems for indexing wages and prices to compensate for inflation, though this is administratively costly and tends to penalize those (mostly poor) people outside the indexation system. Where indexation does not exist, the "inflation tax" contributes to a growing sense of social and economic injustice.

Linkages among distortions

Most price distortions are connected: some counteract each other, others are reinforcing. For example, an overvalued exchange rate tends to offset the degree of protection given by tariffs, but it increases the bias against exports caused by export taxes. Consumer subsidies may moderate the pressures for raising wages but exacerbate inflationary pressures through increasing budgetary deficits. Low interest rates and transport prices for farmers, along with subsidized inputs, may counterbalance the losses they suffer from an overvalued exchange rate. Similarly, agricultural protection works not only through its effects on agriculture but also through its effects on wages and industrial efficiency.

It is therefore not enough to judge the efficiency of allocation on the basis of individual distortions—as is done, for example, when growth is related just to inflation or just to interest rates. Some composite measure of price distortions is needed. Nor is it enough to analyze only static efficiency. Price distortions that produce a loss of static efficiency might nevertheless increase dynamic efficiency, or they might produce cumulative dynamic losses. Finally, it is hard to know at what point investment encouraged by protection or subsidized interest rates becomes profligate. The answers to these questions must be sought from empirical evidence.

That evidence is set out in Figure 6.1. For each

TABLE 6.1
Indices of price distortions and various components of growth in the 1970s

Country	Distortion index	Simple group average	Annual GDP growth rate (percent)	Simple group average	Domestic savings income ratio (percent)	Simple group average
Malawi	1.14		6.3		14	
Thailand	1.43		7.2		21	
Cameroon	1.57		5.6		18	
Korea, Rep. of	1.57		9.5		22	
Malaysia	1.57	1.56	7.8	6.8	20	21.4
Philippines	1.57		6.3		24	
Tunisia	1.57		7.5		27	
Kenya	1.71		6.5		19	
Yugoslavia	1.71		5.8		27	
Colombia	1.71		5.9		22	
Ethiopia	1.86		2.0		8	
Indonesia	1.86		7.6		22	
India	1.86		3.6		20	
Sri Lanka	1.86		4.1		13	
Brazil	1.86	1.95	8.4	5.7	22	17.8
Mexico	1.86		5.2		22	
Ivory Coast	2.14		6.7		24	
Egypt	2.14		7.4		12	
Turkey	2.14		5.9		17	
Senegal	2.29		2.5		8	
Pakistan	2.29		4.7		7	
Jamaica	2.29		−1.1		16	
Uruguay	2.29		3.5		14	
Bolivia	2.29		4.8		20	
Peru	2.29	2.44	3.0	3.1	21	13.8
Argentina	2.43		2.2		22	
Chile	2.43		2.4		14	
Tanzania	2.57		4.9		12	
Bangladesh	2.57		3.9		2	
Nigeria	2.71		6.5		21	
Ghana	2.86		−0.1		9	
Overall average	2.01		5.0		17.4	

. . Not available.
a. Increase in real GDP valued at current prices divided by investment at current prices. This is the reciprocal of the incremental-capital-output ratio, adjusted for differential rates of inflation in investment goods and GDP. It is thus equivalent to income rate of return on revalued capital.
b. GDP growth rates were negative.
Source: World Development Report 1982.

of the major prices, distortions are classified as high, medium, or low on the basis of available figures and the qualitative judgments of Bank staff. For a particular country the degree of distortion may be widely different for different prices. A composite index was therefore obtained by calculating an average of price distortions (see Box 6.1). Figure 6.1 ranks countries in order of increasing distortion in the 1970s: Malawi, Thailand, Cameroon, the Republic of Korea, and Malaysia have the lowest distortion, while Argentina, Chile, Tanzania, Bangladesh, Nigeria, and Ghana are in the "high" category. It is interesting to note that these groups contain a mixture of countries, unconnected by geography, natural resources, or degree of government activism.

Price distortions and growth

A large body of theoretical literature has demonstrated how price distortions result in a loss of efficiency. At an empirical level, studies of Brazil, Chile, Pakistan, Philippines, and Turkey relating to the 1960s estimated that the costs of distorted

Additional output per unit of investment[a] (percent)	Simple group average	Annual growth rate of agriculture (percent)	Simple group average	Annual growth rate of industry (percent)	Simple group average	Annual growth rate of export volume (percent)	Simple group average
25.3		4.1		7.0		5.7	
27.6		4.7		10.0		11.8	
26.3		3.8		8.6		2.5	
31.1		3.2		15.4		23.0	
32.6	27.6	5.1	4.4	9.7	9.1	7.4	6.7
23.1		4.9		8.7		7.0	
31.4		4.9		9.0		4.8	
32.7		5.4		10.2		−1.0	
18.4		2.8		7.1		3.9	
27.4		4.9		4.9		1.9	
30.7		0.7		1.4		−1.7	
40.1		3.8		11.1		8.7	
15.6		1.9		4.5		3.7	
22.2		2.8		4.0		−2.4	
35.5	26.9	4.9	2.9	9.3	6.8	7.5	3.9
23.4		2.3		6.6		13.4	
25.5		3.4		10.5		4.6	
24.2		2.7		6.8		−0.7	
24.5		3.4		6.6		1.7	
12.8		3.7		3.7		1.2	
28.1		2.3		5.2		1.2	
. .[b]		0.7		−3.5		−6.8	
20.9		0.2		5.2		4.8	
22.7		3.1		4.3		−1.6	
21.5	16.8	0.0	1.8	3.7	3.2	3.9	0.7
10.7		2.6		1.8		9.3	
15.1		2.3		0.2		10.9	
23.9		4.9		1.9		−7.3	
22.3		2.2		9.5		−1.9	
23.8		0.8		8.1		2.6	
. .[b]		−1.2		−1.2		−8.4	
23.2		3.0		6.1		3.5	

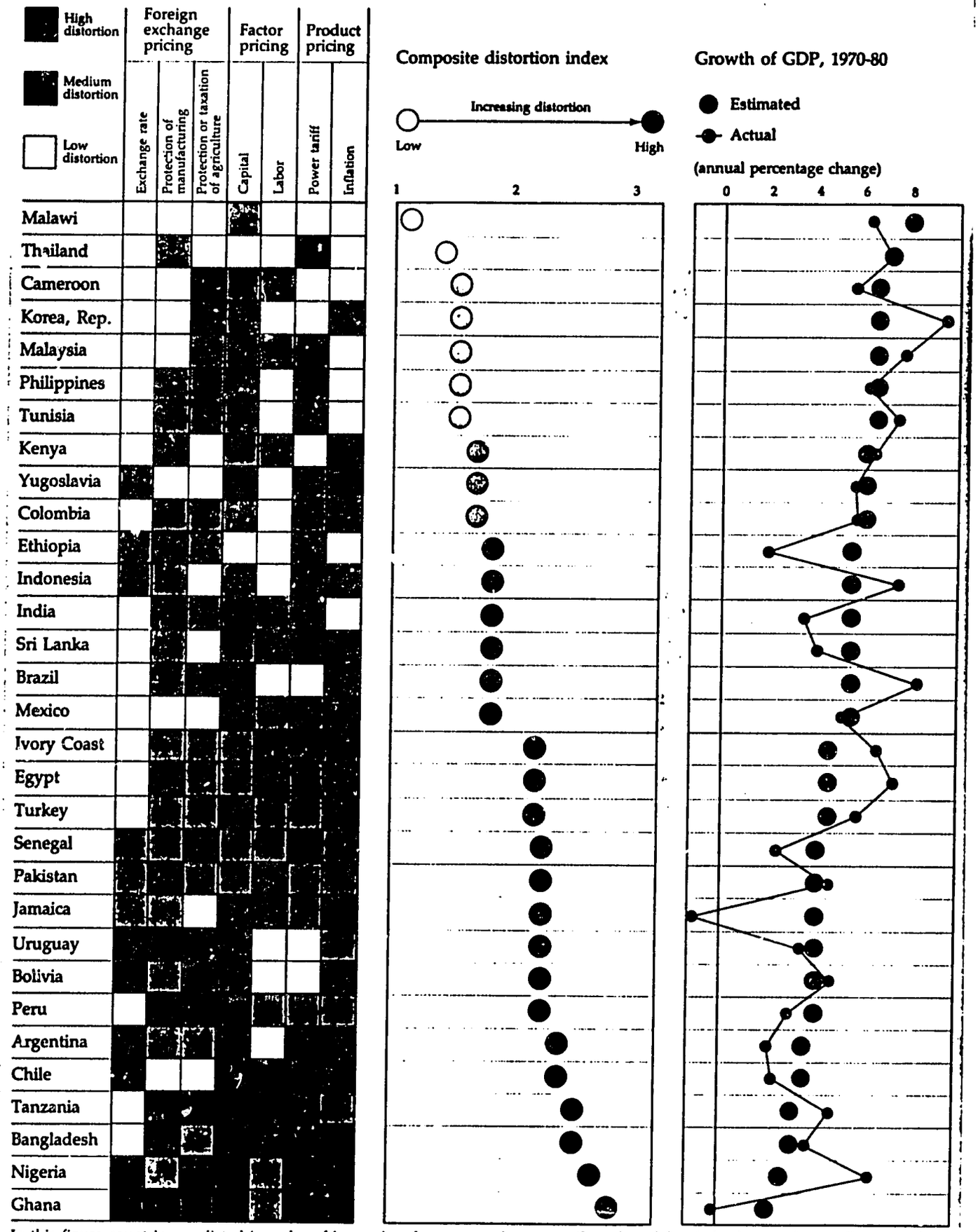
prices due to trade restrictions alone could have amounted to 4 to 10 percent of their GNP. Those countries that embarked on programs of correcting prices in the 1960s (for example, Brazil, Colombia, and the Republic of Korea) also showed significant gains in output (and employment) resulting from these liberalization efforts. More recently, as recounted in the 1981 *World Development Report*, it has been found that countries which avoided distorting trade policies were typically more successful in adjusting to external shocks in the 1970s than those with distorted prices.

Statistical analysis of the relationship between the price distortion index and growth in the 1970s confirms these earlier findings. The average growth rate of those developing countries with low distortions in the 1970s was about 7 percent a year—2 percentage points higher than the overall average. Countries with high distortions averaged growth of about 3 percent a year, 2 percentage points lower than the overall average.

The relation between price distortions and the various components of growth is presented in Table 6.1. High distortions are associated with low do-

FIGURE 6.1

Price distortions and growth in the 1970s



In this figure countries are listed in order of increasing degree of distortion in prices. In the first section, the color of the squares indicates the degree of distortion in the principal categories of prices. The middle section is a composite index of price distortion for each country: as a country's distortion index increases, the color of the circle changes from yellow to red. In the right hand section, the blue circles show the actual annual rate of growth of GDP; the green circles are estimates of GDP growth obtained by a regression relating growth to the distortion index.

Box 6.1 Price distortions and growth: a statistical analysis

In Figure 6.1 the distortion indices in major prices are classified as low, medium, and high. For statistical analysis, these categories were replaced by numbers 1, 2, and 3 respectively. For the panel of thirty-one countries, the degree of distortion in each price, thus defined, was found to be negatively correlated with the GDP growth rates during the 1970s, with the exchange rate distortion being the most significant.

These distortions are interrelated among themselves and each distortion affects growth through a complicated set of interactions on various elements of the economy. There are therefore major conceptual and statistical problems in any attempt to identify simultaneously the effects of individual distortions on overall growths or the relative importance of different distortions in the total mix. In these circumstances the composite distortion index in Figure 6.1 is obtained as a simple unweighted average of the individual distortions.

The figures on growth rates and distortion indices show that the relatively high (top one-third) distortion countries had growth rates about 2 percentage points lower than the average (which is about 5 percent a year) and the low (bottom one-third) distortion countries, were about 2 percentage points higher than average.

The regression equation relating growth to the composite distortion index shows that price distortions can explain about one-third of the variation in growth performance. Many other elements, not least natural resource endowment as well as other economic, social, political, and institutional factors, would need to be considered in a more complete explanation to account fully for the variation in growth rates. Thus as shown in Figure 6.1, Brazil, Egypt, Indonesia, Nigeria, Republic of Korea, and Ivory Coast did much better than would have been predicted by the regression equation, and Ethiopia, Ghana, and Jamaica considerably worse.

While the degree of distortions in prices has a significant association with growth, the analysis indicated virtually no correlation with the distribution of income. For twenty-seven countries for which figures are available on income distribution, the analysis shows that the distortion index explains hardly 3 percent of the variation in equity, when the latter is measured by the proportion of income going to the bottom 40 percent of the population.

mestic savings in relation to GDP and with low value added per unit of investment (this latter association being statistically stronger). Distortions also affect growth rates in agriculture and industry, with a marked influence on exports. In short, the statistical analysis clearly suggests that prices do matter for growth.

However, price distortions alone can explain less than half the variation in growth among countries; the rest is the result of other economic, social, political, and institutional factors. So a country well endowed with natural resources (such as Nigeria) or with an active and mobilized labor force (such as China) could still grow relatively fast even if its price structure is distorted. With fewer price distortions, however, its growth would be significantly faster.

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CHAPTER 5

Economic Stabilization In Developing Countries: Theory and Stylized Facts

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William R. Cline

In October of 1979 the Brookings Institution held a conference on economic stabilization in developing countries.[1] That conference focused on the theory and practice of economic stabilization (defined broadly as correcting inflation and balance of payments deficits) rather than on the issue of International Monetary Fund (IMF) conditionality, although analysis of IMF practices arose in the context of country studies. The purpose of this paper is to recapitulate the principal findings of the Brookings conference in both theory and stylized facts. Rather than repeat a paper-by-paper overview of the Brookings conference, this essay sets forth the issues thematically, drawing upon common strands in several of the conference papers to examine each issue and add the findings of more recent research where appropriate. As will become apparent, the state of the art as reflected in the Brookings conference contains considerable debate about the theory and policy strategy for stabilization.

The Orthodox Model

Orthodox stabilization theory focuses on excessive money creation and overvaluation of the exchange rate as the sources of inflation

[1] William R. Cline and Sidney Weintraub, eds., *Economic Stabilization in Developing Countries* (Washington: Brookings Institution, 1981).

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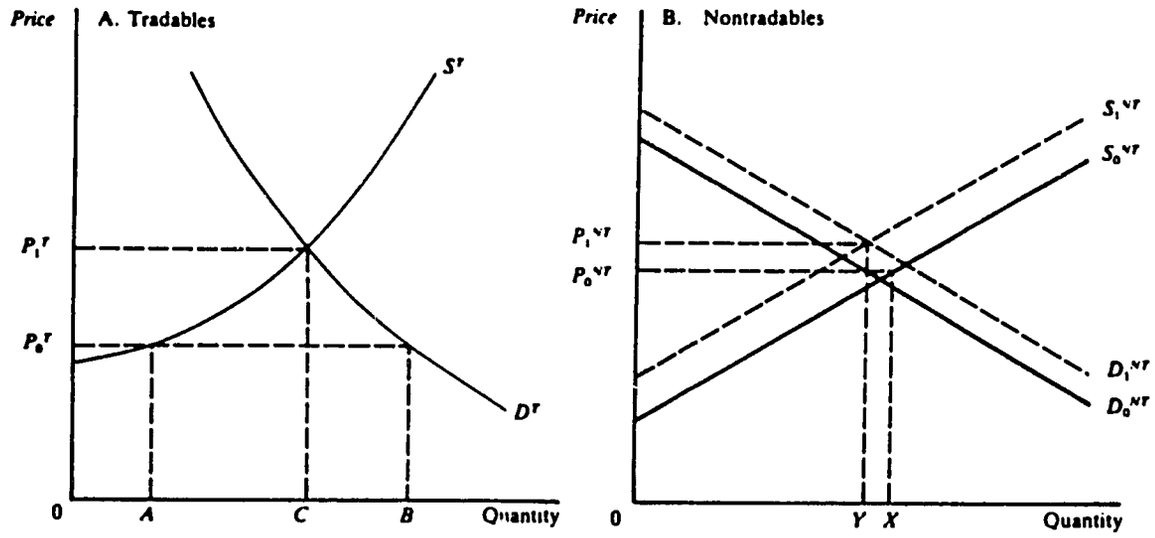
and balance of payments deficits. The principal orthodox policy measures for achieving economic stabilization are reduction in the rate of growth of domestic credit and devaluation of the exchange rate. An influential formulation of the orthodox theory is that by Jacques Polak.[2] In the Polak model, income *equals* money supply *times* velocity (by the quantity theory); money supply *equals* domestic credit *plus* international reserves. In equilibrium, this year's income *equals* last year's. Therefore, this year's money supply must equal last year's. Any growth in domestic credit must therefore be offset by a reduction in reserves to hold money supply constant. Reduction in reserves means a balance of payments deficit. There is thus a monetary theory of the balance of payments: deficits exist because the rise in domestic credit must be offset by decreased reserves to maintain monetary and income equilibrium. Essentially, any expansion of domestic credit leaks abroad through balance of payments deficit and reserve loss. Accordingly, a balance of payments deficit may be corrected by reducing domestic credit. The model transposes to a growth basis as follows: if domestic credit is growing too fast for consistency with real output growth (and velocity trend), reserve losses will result, and stabilization can be attained by a reduction in the growth rate (rather than the absolute level) of domestic credit. This basic monetary model of the balance of payments has influenced IMF stabilization programs for years; typically these programs contain clauses specifying limits for expansion of domestic credit.

A more general version of the orthodox model of stabilization involves a package of three instruments: exchange rate, money supply growth, and government spending deficits. The package is designed to reduce inflation and the balance of payments (current account) deficit. For stabilization, the fiscal deficit is reduced following the absorption approach. From national accounts, $M - X = (I - S) + (G - T)$. The trade deficit (imports M *less* exports X) *equals* the investment-savings gap $(I - S)$ *plus* the fiscal deficit (government spending G *minus* taxes T). To the extent that the trade deficit corresponds to an investment-savings gap, there is no particular problem if foreign capital can be mobilized. But if the origin of the trade deficit is in excess government spending $(G - T)$, domestic absorption exceeds domestic output for reasons of excess current consumption, not capital formation, and the situation is remedied by reducing government spending (G) or by raising taxes (T).

[2] J. J. Polak, "Monetary Analysis of Income Formation and Payments Problems," *IMF Staff Papers*, vol. 6 (November 1957), pp. 1–50.

Figure 9.1 *Markets for tradables and nontradables in the orthodox stabilization model*



The monetary part of the general stabilization package stems from the quantity equation, $HV = PT$ (where H = money supply, V = velocity, P = price level, and T = transactions or real activity). To reduce inflation, money supply growth is decelerated. ($\dot{H}\downarrow \rightarrow \dot{P}\downarrow$, where the overdot indicates percentage change.)

The exchange rate component of the package is designed to address the trade deficit. Devaluation of the exchange rate should increase exports (as domestic producers receive more domestic currency per unit exported) and reduce imports (as consumers must pay higher prices for imports in domestic currency).

The three traditional elements of the policy package are complementary. Any recessionary impact of reduced fiscal deficits, and of a reduction in activity rather than price in response to monetary deceleration, tends to be offset by the stimulative effect of devaluation's impact on the trade balance. That is, in the national accounts the drag of imports is reduced, and the contribution of exports is increased, under the orthodox response of trade to devaluation.

Two of the more subtle aspects of the orthodox package concern reallocation of resources and induced inflation. To reduce the external deficit, resources must be shifted out of production of nontradables and into production of tradables, while consumption must be shifted out of tradables and into nontradables, so that the net exports of tradables may rise. This process requires a change in the price signals between the two groups: the price of tradables must rise relative to that of nontradables, to induce producers to shift resources into tradables and to induce consumers to shift consumption to nontradables. In Figure 9.1, panel A shows that, at the initial price of tradables P_0^T, the quantity of domestic demand exceeds that of supply (with

the supply curve including foreign supply), and a trade deficit of AE exists. To eliminate the deficit, the price is raised to P_1^T, where excess demand for tradables disappears. The price of tradables rises from P_0^T to P_1^T as the direct consequence of devaluation.

Panel B of figure 9.1 shows the indirect consequences for the nontradable sector. Its initial equilibrium is at output X and price P_0^{NT}. As resources shift out of the sector because of reallocation to tradables, the supply curve shifts upward (to S_1^{NT}). Meanwhile, consumers discouraged by higher prices of tradables shift their consumption to nontradables, raising the demand curve (to D_1^{NT}). The new equilibrium is at a higher price (but lower quantity, because some resources have exited from the sector).

Taken together, the two panels of Figure 9.1 show the well-behaved case where devaluation raises the relative price of tradables ($P_1^T/P_0^T > P_1^{NT}/P_0^{NT}$). The figure illustrates the problem of induced inflation even in the nontradable sector as a consequence of devaluation; that is, the equilibrium price in the nontradable sector rises.[3] Harberger provided a classic early statement of the potential importance of induced inflation of this sort from devaluation in developing countries.[4] The problem of inflation induced from devaluation shows once again why the policy package has complementary components: if monetary restraint is missing, the effects of devaluation are likely to be inflationary, especially if supply and demand elasticities are low in the sector of nontraded goods and services.

Before turning to critiques of the orthodox model, it is important to consider the relationship of orthodox "stabilization" to the problem of "structural adjustment." In its simplest form, the orthodox policy package for stabilization is designed to correct short-term departures from equilibrium, usually departures precipitated by internal imbalances such as temporary loss of budgetary control. In the 1970s the problem was often the need for longer term structural adjustment to changes in the economic environment and, in particular, to terms of trade losses imposed by higher oil prices. While some elements of the orthodox stabilization package remain appropriate for such adjustment (especially devaluation), it has been increasingly recognized

[3] Technically, the rise in P_{NT} will in turn shift the demand and supply curves in the tradable sector once again, leading to a successive approximation of equilibrium but no change in the basic conclusion.

[4] Arnold C. Harberger, "Some Notes on Inflation," in Werner Baer and Isaac Kerstenetsky, eds., *Inflation and Growth in Latin America* (Homewood, Ill.: Richard D. Irwin, 1964).

that longer term development measures (such as development of alternative energy sources) are an important additional element in longer term adjustment as opposed to short-term stabilization.[5] The new orthodoxy (for example, the standard IMF approach in recent years) embraces the need for special developmental measures in achieving structural adjustment, as the lengthening of IMF lending maturities (and entrance of the World Bank into program lending for this purpose) testify.

A final element in the orthodox theory concerns the behavior of real wages under successful devaluation.[6] There is a tendency to assume that the orthodox model requires a decline in real wages for devaluation to be effective. However, a more careful reading of the standard analysis suggests that this rule need not apply generally. Indeed, in the case of the developing economy it might more often be the case that external stabilization through devaluation is possible without a decline in real wages (although a decline in wages relative to the price of traded goods would be required).

Following the absorption approach, lower real wages would facilitate external stabilization by reducing consumption, if consumption is wholly or primarily out of wages (the Cambridge assumption). The corresponding rise in saving would reduce the absorption-output gap represented by $(I - S)$ in the national accounts equation. Alternatively, if the economy were at below full employment because of excessive real wages and were operating inside its production possibility curve between traded and nontraded goods, devaluation together with a decrease in the real wage could raise activity to the production frontier, with the bulk of the rise in output coming in

[5] See Andrew Crockett, "Stabilization Policies in Developing Countries: Some Policy Considerations," IMF *Staff Papers* 28(1) (March 1981). Balassa has proposed an accounting decomposition of external adjustment in the 1970s into components: import substitution, export expansion, deceleration of domestic growth, and increase in external borrowing. Conceptually, to the extent that import substitution and export expansion result from devaluation, they lie within the more traditional stabilization approach; to the extent that they result from special developmental investments, they lie within the orthodoxy expanded to include structural adjustment; and to the extent that they result from new import barriers or export subsidies, they go beyond the expanded orthodoxy and enter into the area of trade distortions. Bela Balassa, "The Newly Industrializing Developing Countries after the Oil Crisis," *Weltwirtschaftliches Archiv*, Band 117, Heft 1 (1981), pp. 141–94.

[6] I am indebted to Rudiger Dornbusch and Jeffrey Sachs for comments prompting the discussion of real wages.

tradable goods so that external balance (as well as internal) could be achieved.

In Meade's early formulation, if money wages were flexible downward, the gold standard could achieve external (and internal) balance. If money wages were fixed, devaluation would accomplish the same goal, but only with "sufficient divorce between movements in the cost of living and movements in money wage rate." In Meade's terms, "this decline in real wages . . . must be accepted. Any offsetting rise in money wages . . . would prevent the terms of international trade from moving against [country] B and would therefore remove the whole inducement to shift demand back again from [country] A's more expensive products to B's relatively cheaper products."[7]

But Meade's specification of adjustment in the form of a decline in the terms of trade is a clue to the possible irrelevance of this approach to the developing country. For most developing countries, especially small exporters of raw materials, external terms of trade are set exogenously by the world market. External adjustment occurs not through orchestrating a decline in the terms of trade by devaluation, but through shifting the focus of activity from nontraded to traded goods. Similarly, the typical developing country is not operating inside its production possibility frontier because of excessive real wages, but is operating on that frontier, and needs to move away from nontraded and toward traded goods to achieve external balance.

The more recent orthodox literature focusing on the distinction between traded and nontraded sectors establishes the framework in which devaluation can correct external imbalances with or without a decline in real wages, depending on the circumstances. Essentially, prices and profitability of traded goods must rise relative to prices and profitability of nontraded goods. For profitability of traded goods to rise (inducing resources to shift to traded goods), nominal wages should lag behind devaluation (where tradable goods prices rise by the amount of the devaluation). That is, the ratio of wages to prices of traded goods must fall. However, prices of nontraded goods should not rise as much as nominal wages (assuming the country is on the production possibility frontier). Indeed, if resources are to be moved out of nontradables, profitability will have to decline in the sector, and the ratio of wage to price must rise.[8]

[7] James E. Meade, *The Theory of International Economic Policy, vol. 1: The Balance of Payments* (London: Oxford University Press, 1951), pp. 202–3.

[8] As Dornbusch puts it, "Corresponding to that equilibrium we have a reduction in the real wage in terms of traded goods and an increase in the

In this two-sector approach, the final outcome for real wages depends on the relative weights of tradables and nontradables in the consumption basket of workers and on the extent of induced price increases in nontradables. In particular, if d is the percentage devaluation, $\dot{w}$ is the percentage rise in nominal wages that accompanies devaluation (as the result of union pressures or indexing), ϕ_T the share of tradables and ϕ_{NT} the share of nontradables in worker consumption, and $\dot{P}_{NT}$ the induced price rise in nontradables (depending on elasticities as shown in Figure 9.1), then the percentage change in real wage w^* is:

$$\dot{w}^* = \dot{w} - \phi_T d - \phi_{NT} \dot{P}_{NT}.$$

Thus, if nontradables and tradables each account for half of the consumption basket (for example), and a 15 percent devaluation induces a 5 percent increase in prices of nontradables, a nominal wage increase of 10 percent will fulfill the condition that wages fall relative to prices of traded goods while holding real wages constant [$\dot{w} = 10 - (0.5)15 - (0.5)5 = 0$]. The smaller the induced price rise for nontradables, and the larger the share of nontradables in consumption, the easier it will be to hold real wages constant (or even to raise them) while achieving the necessary reduction of wages relative to prices of tradables.

In the developing country context it is unclear how large the role of tradables in consumption will be. While food is often traded, some forms of subsistence foods (such as manioc) may not be. Housing expenditures are in the nontradable sector. The broad point is that it may be possible to achieve external stabilization through devaluation without reducing real wages. And it should certainly be possible to achieve stabilization without a reduction of real wages by the full extent of the devaluation. This conclusion has major policy implications. Draconian reductions in real wages are not necessarily required for external stabilization, and the standard theory does not provide an automatic justification for the extent of real wage reductions that have often been observed in some of the more politically conservative stabilization efforts.

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real wage in terms of nontraded goods, so that money wages rise relative to the price of home goods." Rudiger Dornbusch, "Real and Monetary Aspects of the Effects of Exchange Rate Changes," in Robert Z. Aliber, ed., *National Monetary Policies and the International Financial System* (Chicago: University of Chicago Press, 1974), pp. 77–78.

Neo-Structuralist Critiques

The old structuralist critique of orthodox stabilization is well known and need not detain the discussion here. Inflation was viewed as structural, not monetary; it was considered to be caused by structural phenomena such as rigid agricultural supply (attributable to archaic agrarian structures) and weakness of the tax system; monetary expansion was considered accommodative rather than causal in the inflationary process; and corrective measures were envisioned as active (increased investment to break structural bottlenecks) rather than passive (reduced investment to cut back the fiscal deficit). Neither side convinced the other in the structuralist-monetarist debate of the early 1960s. But the monetarists claimed that theory was on their side, and that the structuralists' arguments were ad hoc, lacking in any underlying theory comparable to the quantity equation of the monetarists.

Now neo-structuralism has struck back. Some of its practitioners employ sophisticated mathematical methods and forthrightly announce their intention to show that the theories of the earlier structuralists were right after all, even though they had not yet been rigorously formulated. Two neo-structuralist critiques were emphasized at the Brookings conference: (1) devaluation can be recessionary instead of expansionary; (2) monetary and credit restraint can cause more inflation rather than less. Thus, two fundamental components of the orthodox stabilization policy are called into question.

Devaluation may be recessionary for at least three reasons: (a) higher import (and export) prices may mean decreased consumption through the real balance effect (Pigou); (b) failure of export and import quantities to respond sufficiently to devaluation will mean that higher local currency prices of both will widen the trade deficit expressed in domestic currency, causing a recessionary increase in the net imports component of GNP; and (c) under plausible conditions devaluation may redistribute income from workers to owners, causing consumption to fall relative to savings (under the assumption that savings are mainly out of profits, not wages).[9] The greatest emphasis

[9] Recessionary devaluation is discussed in detail in Montek S. Ahluwalia and Frank J. Lysy, "Employment, Income Distribution, and Programs to Remedy Balance-of-Payments Difficulties," in Cline and Weintraub, *Economic Stabilization*, pp. 149–88. Ahluwalia and Lysy cite the earlier work of Richard Cooper and Carlos Diaz-Alejandro (with respect to the domestic currency value of the trade deficit) and Taylor and Krugman (with respect to possible income distributional effects).

in the neo-structuralist critique is on the perverse trade-balance effect. To see this effect more clearly, consider an initial trade deficit of $P_0^x X_0 - P_0^m M_0 = -100$, where P_0^x and P_0^m are the initial peso prices of exports and imports, and X_0 and M_0 are export and import quantities. In the extreme case, trade quantities do not respond at all to devaluation. Doubling the peso price of the dollar causes P^x and P^m to double, so that $P_1^x X_0 - P_1^m M_0 = -200$. Devaluation has unambiguously caused a greater drain of net exports in the national accounts equation, $Y = C + I + G + X - M$ (in domestic currency).

Ahluwalia and Lysy develop a one-sector model that yields an equation showing the critical elasticity of demand for exports at which devaluation changes from being contractionary to expansionary:

$$e^* = mC/E\,(1 - m),$$

where e = export demand elasticity, m = the (fixed coefficient) ratio of imported inputs to production, and E = a term involving a scaling factor and the ratio of the (peso-dollar) exchange rate to the (peso) price of domestic output. The authors maintain that, under Malaysian conditions, the equation means that the elasticity of demand for exports must be at least 0.5 to avoid contractionary effects of devaluation.[10]

The Ahluwalia-Lysy model makes no allowance for substitution of imports by domestic supply (although in a subsequent five-sector model, substitution is permitted). Moreover, the authors' view that an export demand elasticity of 0.5 might not be unusual stands in question. In the traditional small country model, the elasticity is infinite.

In a less simple model the elasticities of export supply, import demand, and import supply all matter. The more dominant view at the Brookings conference (including that of Carlos Diaz-Alejandro, a charter member of the neo-structuralist school) was that experience had shown that trade-elasticity pessimism had been exaggerated; trade response to devaluation had typically been sufficient for the normal expansionary case to apply. Although there is a need for more empirical work on this point, numerous recent studies have tended to confirm that trade is relatively responsive to the exchange rate in

[10] $E = A(r/Px)$, where A is a scale factor, r is the exchange rate, and Px is output price; $Px = vPv + mPm$, where v is the ratio of value added to gross output and Pv is the price of value added, which depends on capital and labor prices. Ibid., pp. 158–63.

developing countries.[11] In short, the first plank of the neo-structuralist platform is a theoretically useful insight but one of dubious empirical relevance. Low elasticities combined with a prestabilization trade deficit may make devaluation contractionary, but (notwithstanding Ahluwalia and Lysy) in practice the trade elasticities are likely to be sufficient that this perverse effect of the orthodox stabilization package will not occur.

The second neo-structuralist plank is considerably more heterodox. Lance Taylor has developed a model concluding that monetary restraint causes more inflation, not less.[12] The heart of Taylor's analysis is the postulate that, because interest payments on borrowed working capital are typically a high component of production costs in developing countries, tighter money tends to raise prices by raising the interest rate and thereby raising production costs, which are passed on to product price on a mark-up basis. In particular,

$$P = f[(1 + i)w, (1 + i)eP_0, rP],$$

where P = product price, i = the interest rate, w = the wage rate, e = the exchange rate, P_0 = the external price of imported inputs, and r = the profit rate. The term $(1 + i)$ enters product cost (and price) because working capital is borrowed to cover operating costs of labor and imported inputs.

Taylor develops a series of IS-LM diagrams to analyze this system, although instead of the conventional interest rate-output labels the axes show price and output (because of the assumption that price varies positively with the interest rate). But the central idea is not complicated; in the United States, it has been called the "Wright-Patman effect" in honor of the congressmen who tirelessly complained that the Federal Reserve's tight money caused inflation by raising interest rates and, therefore, interest-sensitive prices such as mortgage costs.

[11] See Donal J. Donovan, "Real Responses Associated with Exchange Rate Action in Selected Upper Credit Tranche Stabilization Programs," *IMF Staff Papers* 28(4) (December 1981), pp. 698–727, and the reference therein to studies by Khan, Brillembourg, Teigeiro and Elson, Singh, and Okonkwo. In the Brookings Conference, Alejandro Foxley also maintained that export pessimism is unwarranted, based on recent experience in Uruguay, Brazil, and Chile. Alejandro Foxley, "Stabilization Policies and Their Effects on Employment and Income Distribution: A Latin American Perspective," in Cline and Weintraub, *Economic Stabilization*, p. 218.

[12] Lance Taylor, "IS/LM in the Tropics: Diagrammatics of the New Structuralist Critique," in Cline and Weintraub, *Economic Stabilization*, pp. 465–503.

Several participants in the Brookings conference criticized the Taylor model for capturing only the short-run effect of monetary restraint. Discussant Kemal Dervis noted that over a longer period the more conventional anti-inflationary effects of monetary restraint could take hold, but that before that time was reached political disruption in response to the short-run inflation could well scuttle the program.

It would appear that a major problem with Taylor's analysis is that it contradicts a large body of empirical evidence. Many studies have shown that money growth is positively, not negatively, associated with inflation in developing countries.[13] And it is insufficient to respond, as neo-structuralists tend to do, that the standard empirical studies misconstrue causation, that rising prices cause accommodative money expansion and not vice versa. That response is methodologically inadmissable because in the neo-structuralist formulation money supply is causal, so a fair test must allow a causal role in both cases. The only question is: is the sign relating (induced) prices to (causal) money positive or negative.[14] Although there are some isolated instances where empirical results purport to find a negative relation between money and prices,[15] the vast bulk of evidence supports the conventional (quantity theory) positive relationship. Moreover, where causality tests (of the Granger-Sims variety) have been conducted, they have tended to confirm causation from money to prices rather than vice versa.[16]

An important implication of the Taylor analysis, nonetheless, may be that the timing and severity of monetary restraint are crucial.

[13] See Robert Vogel, "The Dynamics of Inflation in Latin America," *American Economic Review* (March 1974).

[14] If the causation from prices to money is accepted, the neostructuralist model becomes garbled indeed. With P = prices and M = money, the following dynamics would result: (1) $M\ P$ (Taylor-Patman); (2) $P\ M$ (the "prices induce money" response to empirical correlations; (3) $M\ P$ (by the logic of Taylor-Patman); and (4) $P\ M$ (price induces money); at this point return to (1) and recycle. Any shock to money would cause an oscillating sequence of cycles, with money and prices rising and falling.

[15] S. van Wijnbergen, "Stagflationary Effects of Monetary Stabilization Policies: A Quantitative Analysis of South Korea," Washington: World Bank, 1981; restricted circulation). However, Wijnbergen's simulations show that the perverse inflationary effects of tighter credit dominate only in the first two quarters, lending support to the critique (by others) that Taylor's analysis focuses excessively on the short run.

[16] See Surjit S. Bhalla, "India's Closed Economy and World Inflation," in William R. Cline and associates, *World Inflation and the Developing Countries* (Washington: Brookings Institution, 1981), pp. 161–65.

Taylor himself does not conclude that the best solution to inflation is to increase the money supply (despite the logic of the model); instead, his main policy thrust is that the conventional IMF stabilization package can cause severe stagflationary results. Devaluation can cause recession, while monetary restraint can cause both recession and inflation. Broadly, Taylor prefers gradualism to shock treatment because of the danger of overkill from the orthodox policy package. But to reach this policy conclusion more rigorously, it would be necessary to develop a time sequence analysis, presumably one that would show the negative causal relationship (Taylor-Patman) causing higher inflation as the result of tighter money in the first quarter or two, followed by the conventional anti-inflationary consequences later. Analysis with specific time dimensions would be extremely helpful for policy formulation, especially in the choice between shock treatment (e.g., a massive initial reduction in money growth) and gradualism (e.g., a more moderate phasing-in of slower money growth).

Stabilization and Growth

A central issue in stabilization policy is the extent to which real growth must be sacrificed to reduce inflation to acceptable levels and to correct external disequilibrium. A related issue is whether any growth effects are likely to be transitory or extend to the medium- and long-run period. Anne Krueger has emphasized the long-run growth benefits from stabilization packages that correct previous distortions between the domestic and external sectors.[17] She identifies two dimensions of trade distortion: bias in the price ratio of tradables to nontradables, and bias in the price ratio of import substitutes to exports. An open trade deficit involves too low a price for tradables; an external imbalance with the deficit suppressed by import quotas or tariffs also involves bias toward import substitution and against exports. Krueger notes that the inflationary consequences of devaluation will depend on whether the external influence was open or suppressed. If it was open, devaluation will mean higher prices for imports and inflationary pressure; but if the influence had been suppressed by protection, higher import prices will already have affected the economy, and a package devaluing the currency while jointly

[17] Anne O. Krueger, "Interactions between Inflation and Trade Regime Objectives in Stabilization Programs," in Cline and Weintraub, *Economic Stabilization*, pp. 83–114.

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removing protection need not worsen inflation. One might add, however, that, in the more severe cases where stabilization is required, there are open trade deficits that urgently require correction even though protection is also high.

Krueger also notes that inflation may be viewed as essentially separate from trade bias; indeed, the crawling peg exchange rate can be used to neutralize the external sector from domestic inflation and to ensure that trade bias does not arise solely because domestic inflation exists.

Eliminating trade bias in the application of a stabilization package has large benefits, according to Krueger. However, because correction of the bias alters resource allocation, it may also cause some temporary growth loss. Output will fall in the sectors formerly favored by the bias, while it may take some time for investment and activity to respond in the newly favored sectors, especially if economic agents do not consider the government's program to be credible. Nevertheless, Krueger holds that such growth losses are usually much smaller than the longer-run growth gains achievable by eliminating trade bias. Based on National Bureau of Economic Research studies, stabilization packages that include correction of trade bias can raise long-term growth rates by two or three percentage points annually, while reducing short-run growth by perhaps only one to two percentage points over 18 months. Moreover, the short-run losses may be ameliorated by special stimulus.

Considering anti-inflationary measures per se, Krueger maintains that, outside of a few exceptional cases, there typically has been some recessionary cost of reducing inflation. However, if external finance can be arranged, increased imports can help reduce inflation while reducing the trade bias at the same time.

Carlos Diaz-Alejandro presents a more adverse account of the growth effects of stabilization.[18] As applied in the Southern Cone of Latin America, past stabilization programs have often been so negative in their growth impact that, according to Diaz, one may ask whether the cure was worse than the disease. His stylized facts depict a sequence in which a populist government embarks on social and developmental spending that outstrips the tax base, while raising wages. The initial effects are a deceivingly buoyant economy, as the distortions only gradually wreak their eventual havoc. At that time increasingly harsh populist rhetoric alarms the private sector, and the

[18] Carlos Diaz-Alejandro, "Southern Cone Stabilization Plans," in Cline and Weintraub, *Economic Stabilization*, pp. 119–141.

military intervenes. The orthodox stabilization measures that then typically follow involve severe monetary contraction, devaluation, and sharp reductions in real wages. The results usually involve serious loss of production, and little progress against inflation; although the balance of payments improves, it does so mainly because of reduced income and import demand (although Diaz-Alejandro judges that trade elasticities typically have been adequate for devaluation to be effective). Contrasting the more favorable growth results during stabilization in Brazil with experience in Argentina and Chile, Diaz-Alejandro broadly favors an approach of gradualism rather than shock treatment. He favors price guidelines; less credit restriction with lower interest rates and less capital inflow; and greater use of taxes for equity. He also notes that the growth costs of stabilization will be smaller if the government's measures are credible; the worst stagflations tend to occur when, because of repeated failure to stick to stabilization programs in the past, new stabilization efforts lack credibility. Despite his general critique of the radical free-market stabilization strategy in the Southern Cone, Diaz-Alejandro applauds the long-overdue liberalization of trade.

Other participants in the Brookings conference more familiar with the Asian experience argued that there was scope for expansionary stabilization. Papanek cited the examples of Indonesia (1967–70) and Bangladesh (1974–76).[19] In Indonesia, a shock treatment reduced inflation from 1,000 percent to 10 percent. Output expanded as a result of improved efficiency in macroeconomic management, increased double-shift operation of industry, response of exports to devaluation, increased saving and reduced capital flight, and improved use of fertilizer and irrigation. Increased foreign aid, especially in food aid, was an important factor contributing to expansionary stabilization. Similarly, in his analysis of the case of Pakistan, Guisinger emphasizes the expansionary impact of government policy. However, for Pakistan in the mid-1970s the problem was not a classic stabilization problem but instead one of stagnation in the face of declining exports and investment, and Guisinger maintains that the stimulative government policy adopted was appropriate even though it had some cost in terms of inflation and balance of payments deterioration.[20]

[19] Gustav F. Papanek, "Comments," in Cline and Weintraub, *Economic Stabilization*, pp. 399–405; p. 233.

[20] Stephen E. Guisinger, "Stabilization Policies in Pakistan: The 1970–77 Experience," in Cline and Weintraub, *Economic Stabilization*, pp. 375–99.

Harberger and Edwards have recently conducted research indicating that substantial disinflation can be accomplished without cost in real growth rates (and, indeed, often in conjunction with accelerated growth). Using a selection criterion of initial inflation of 50 percent or more followed by a cut in inflation of at least one-half within seven years, the authors identified 10 disinflation episodes in seven countries and found that in the great majority of cases growth held steady or accelerated during the disinflation period.[21] The monetarist inference would be that monetary restraint can reduce inflation without loss of real output (a proposition put to test by the hybrid of rational expectations and supply-side economics dominating US policy in 1981 and, at least by the early election returns, found wanting). It is worth noting that the Harberger-Edwards sample is almost entirely composed of Latin American countries, suggesting that the contrasting views of Diaz-Alejandro and Papanek are not necessarily attributable to their respective focuses on Latin America and Asia. However, the Harberger-Edwards study makes no attempt to relate the disinflation experiences to actual monetary policy, and even if it did so the experience of seven countries would be a rather limited basis for concluding that monetarist stabilization is painless. Moreover, as Williamson has pointed out, by the nature of its selection the sample is likely to be biased toward cases where there were favorable exogenous supply developments; such exogenous factors would contribute to observed declines in inflation while biasing the test of the influences of monetary restraint on output.[22]

The stabilization-growth trade-off became more complicated in the 1970s because of the need for long-run adjustment to a changed external environment (the oil shock and slower growth in industrial country markets), as opposed to simple correction of internal disequilibria. At the aggregate level, the 1970s experience showed sur-

[21] Arnold C. Harberger and Sebastian Edwards, "International Evidence on the Sources of Inflation," paper presented at the Conference on Inflation, Rio de Janeiro, December 15–16, 1980, Getulio Vargas Foundation (Rio de Janeiro: Getulio Vargas Foundation, 1980).

[22] See Chapter 7, this volume. The logical implication of Williamson's critique is that not only should a proper test use a random sample to compare, among countries with high inflation, one group that imposed monetary restraint against another group that did not; but in addition, in evaluating the growth difference between the two groups, growth should be normalized to remove the influence of exogenous factors (weather, abrupt changes in international markets, etc.).

prisingly little growth cost of stabilization (and/or adjustment). While the average growth rate of industrial countries fell from 5.1 percent in 1960–70 to 3.2 percent in 1971–80, that of oil-importing developing countries only fell from 5.7 to 5.1 percent.[23] To the extent that developing countries did not adjust but merely borrowed abroad, this performance would not be particularly relevant to the growth costs of adjustment and stabilization. However, considerable adjustment and stabilization did take place. From 1974 to 1977 the real volume of imports of non-oil developing countries rose by only 2 percent while the real volume of exports rose by 23 percent.[24] There was less progress on stabilization of inflation: non-oil developing countries reduced average inflation only from 25 percent to 22 percent from 1974 to 1977 (although in Asia the reduction was from 28 percent to 9 percent).[25] Broadly, however, considerable adjustment cum stabilization appears to have taken place. Combined with the fact that growth fell very little, the aggregate experience of the 1970s suggests that the growth costs of stabilization need not be high.

In sum, the currently available analysis and evidence on the trade-off between stabilization and growth suggest the following: (a) In the short run, growth losses are likely to accompany stabilization, as the newly favored sectors take time to respond while newly disfavored sectors contract; (b) longer-run benefits of stabilization are likely to outweigh these costs, especially where trade-regime bias is eliminated; (c) despite this dominant pattern (and evidence of serious growth loss in some Southern Cone cases), a surprising amount of country-specific evidence seems to be emerging suggesting that the "exceptional" cases of stabilization without growth loss may not be so rare; and (d) at the aggregate level, the non-oil developing countries appear to have accomplished considerable adjustment in the 1970s at little cost in terms of growth. There is a need for more empirical work on the stabilization-growth trade-off, merely to clarify the stylized facts. Moreover, little work has been done on a broad empirical basis distinguishing between the growth effects of gradualist and shock-treatment strategies.

[23] World Bank, *World Development Report 1981* (New York: Oxford University Press, August 1981), pp. 15, 137.

[24] David P. Dod, "Bank Lending to Developing Countries: Recent Developments in Historical Perspective," *Federal Reserve Bulletin* (September 1981), p. 648.

[25] Excluding Argentina, Chile, and Uruguay. Cline and associates, *World Inflation*, p. 3.

Stabilization and Income Distribution

An important policy issue is whether stabilization measures as commonly practiced tend to cause a disproportionately heavy burden of adjustment on the poor, concentrating the distribution of income. The related theoretical issue is whether adverse distributional effects are necessary.

In the model developed by Ahluwalia and Lysy, income distribution depends on the elasticity of substitution and the direction of change of output. If the elasticity of substitution is less than unity, increased output (with capital fixed and labor variable) raises the share of capital, and reduced output lowers it; if the elasticity of substitution exceeds unity, the reverse occurs in each case (a standard neo-classical conclusion). The distribution thus depends on the direction of stabilization's impact on output, although the authors have no particular opinion on the likely size of the elasticity. They emphasize that factor shares are not likely to change much and that the important question is the absolute level of output (and therefore absolute income of the poor).[26]

Alejandro Foxley describes a more pervasive process of concentration of income during stabilization on the basis of Latin American experience.[27] He emphasizes that stabilization programs in Brazil in the 1960s—and in Argentina, Chile, and Uruguay in the 1970s—tended to reduce real wages (by 20 percent to as much as 40 percent in Chile in 1975) and the share of wages in GNP. Unemployment rose in at least two of the four cases. Where data are available, they show a decline in the share of low-income groups in the family distribution of income and a rise in the share of the top 20 percent of families.

The forces Foxley identifies as leading to income concentration are the following.

(1) Corrective price policies allow sharp price increases following repressed inflation, while controls are kept on wages. Nor do wages keep pace with inflation induced by devaluation. (However, in his comment on Foxley's paper, Fishlow noted that, although the critics have chronicled the adverse distributional consequences of stabili-

[26] Ahluwalia and Lysy, "Employment, Income Distribution," p. 169.
[27] Alejandro Foxley, "Stabilization Policies," pp. 191–225.

zation, they have not dealt with the question of whether the pre stabilization wage level was unsustainably high.)[28]

(2) Financial reforms free interest rates, which reach high levels (40 percent in real terms over a three-year period in Chile). Returns to capital rise, along with its share in income. Assets tend to concentrate in large firms with access to foreign capital, which are well positioned to buy up undervalued assets of financially stressed medium-size firms.

(3) Reduction of the fiscal deficit through cuts in government spending can cut back labor-intensive public works and housing construction (as in Chile), contributing to unemployment. Spending cuts inevitably hit social programs: health, education, housing, social security. Tax increases can be either regressive or progressive; in the Chilean case, uniform value-added taxes were imposed while wealth and capital gains taxes were eliminated.

Adverse distributional consequences of stabilization may occur in practice but need not occur on the basis of theory, and even their predominance as a stylized fact is subject to dispute. My study on Peru for the Brookings conference suggested that the stereotype of stabilization on the backs of the poor had been overdrawn in the case of Peru.[29] Attention has focused on sharp decreases in real wages, but a closer examination showed that the most severe declines were for white collar workers well above the median income; higher food prices may have helped low-income farmers, and reduction of gasoline subsidies was almost certainly borne by the upper portion of the income distribution. In his study of Mexico, Sidney Weintraub emphasized that it is the poor who tend to be hurt by inflation, so that the alternative to a stabilization program may be even more inequitable. Moreover, income distribution data from Mexico indicate that the expansive government programs under Echeverria that eventually destabilized the economy did not achieve a more equal income distribution.[30]

There appears to be considerable scope for taking distributional considerations into account in stabilization programs. The extent to which distribution is considered depends fundamentally on the po-

[28] Albert Fishlow, "Comments," in Cline and Weintraub, *Economic Stabilization*, p. 232.

[29] Cline, "Economic Stabilization in Peru, 1975–78," in Cline and Weintraub, *Economic Stabilization*, pp. 271–326.

[30] Weintraub, "Case Study of Economic Stabilization: Mexico," in Cline and Weintraub, *Economic Stabilization*, pp. 271–92.

litical forces dominating government. In Malaysia, where the indigenous Malays have a majority population, dominate the government, but have relatively low income compared with the Chinese and Indians, policy response to external inflationary shocks in the mid-1970s was consciously tailored to achieve stabilization on an equitable basis that would not forfeit the socioeconomic goals of the New Economic Policy formulated in response to race riots in the late 1960s.[31]

Both internal and external factors caused Malaysia's inflation to surge from 4.3 percent at the end of 1972 to 21.4 percent in early 1974 before it was brought down again to 4.5 percent in 1975. The government employed severe monetary restraint as one measure, but it exempted loans to small borrowers and to the Malay community from ceilings on credit growth. Export taxes were increased, but through an increase in progressivity rather than on a neutral basis. At the same time, fiscal policy was designed to relieve the impact of price increases on the poor. Government subsidies were provided for rice, fertilizer, flour, milk, and school textbooks—belying the axiom that social spending is inevitably the first to be cut in fiscal restraint. To be sure, a relatively favorable external balance (given improved prices for rubber and other exports) facilitated the stabilization exercise. Terms of trade rose by 6 percent from 1972 to 1974, and Malaysia was actually able to obtain an anti-inflationary boost through floating and appreciating the exchange rate by approximately 20 percent. Nevertheless, the policy orientation toward "progressive" stabilization would probably have been followed even if external developments had been neutral or even unfavorable.

The sharp contrast between equity-oriented stabilization in Malaysia and the portrait of inequitable stabilization drawn by Foxley for Argentina, Brazil, Chile, and Uruguay suggests the dominance of the political orientation of the regime in determining the distributional consequences of stabilization programs (although the economic failure of the reformist variant of military rule in Latin America, the Velasco regime in Peru, and the economic mishaps of populist regimes described by Diaz-Alejandro, suggest that equitable orientation may be accompanied by technically unviable policies). Nevertheless, there are purely economic factors that also determine the distributional impact of stabilization.

[31] R. Chander, C. L. Robless, and K. P. Teh, "Malaysian Growth and Price Stabilization," in Cline, *World Inflation*, pp. 208–27.

Johnson and Salop have attempted to set forth the major economic forces determining distributional effects.[32] They note that direct effects of fiscal measures (such as a reduction in food subsidies) will be influenced by the political power of different groups. However, indirect effects associated with the transition to external balance will depend on economic structure. The authors stress the key role of raising relative prices of traded to nontraded goods. Factor rewards in the export sectors (and, by implication, import substitutes) will tend to rise at the expense of those in nontraded goods. The resulting distributional effect will depend on whether the export (and import-competing) sectors are dominated by upper or lower income groups (relative to the nontraded sectors). They note that, with capital fixed but labor mobile, these distributional effects through sectoral shift in demand are especially concentrated in capital income, so that the difference between concentrated capital income in some sectors and dispersed capital in others (for example, smallholder export crops) affects the distributional impact. They are relatively optimistic about distributional consequences of a market-oriented stabilization package. The alternative of controls invites allocation of windfall gains to the (rich and) powerful; export expansion often provides opportunities for employment growth; and reduction of inflation will tend to benefit the poor, whose assets are most likely to be in money rather than in other assets that keep pace with inflation.

To recapitulate, stabilization (including that along orthodox lines) does tend to affect the distribution of income, but not inevitably in the direction of concentration. In the range of discretionary measures, especially fiscal, stabilization can be progressive or regressive, depending on political choice of the regime. The more structural forces will be driven mainly by the distributional consequences of raising prices and activity in tradable goods relative to those in nontradable goods. To be sure, the overall level of economic activity will be important: if the stabilization package reduces output and employment (as the neo-structuralists fear, under the orthodox package) real income of the poor will decline, although it may be argued that, because profit share tends to be procyclical, the distribution of income will become more equitable during recession. As for the distributional outcome in practice, the variety of experience suggests that (ortho-

[32] Omotunde Johnson and Joanne Salop, "Distributional Aspects of Stabilization Programs in Developing Countries," *IMF Staff Papers*, vol. 27(1) (March 1980), pp. 1–23.

dox) stabilization can either concentrate or equalize the income distribution, for the reasons enumerated above.

Capital Flows and Exchange Rates

In addition to providing an update on new theories about old problems, the Brookings conference drew attention to new problems in stabilization. A broad new problem is the more hostile international economic environment that began in the 1970s (discussed in the next section). A more specific new development concerns interaction of the exchange rate and capital flows. Diaz-Alejandro notes that in the Southern Cone the new emphasis on liberalization of trade and exchange regimes and of domestic financial markets, combined with domestic credit restraint, has meant that large capital inflows have occurred in response to high domestic interest rates.[33] These inflows have caused appreciation of the real exchange rate, working at cross-purposes to the need to stimulate exports and adversely affecting the import-competing sector, already hard pressed by the dismantling of protection. In the process, large foreign debt is accumulated. Capital inflows also engorge reserves and expand the domestic money supply.

Diaz-Alejandro also criticizes the reliance on preannounced and decelerating exchange rate devaluations as the key instrument for reducing inflation. The logic behind the strategy is that preannouncing will reduce inflationary expectations. Moreover, domestic producers will be forced to reduce price increases in the face of foreign competition, and domestic inflation will necessarily fall to the international rate plus the (preannounced) rate of devaluation. But, as Diaz-Alejandro notes, persistent inflation in nontraded goods can lead to overvaluation. In his comment, McKinnon agrees with Diaz-Alejandro on the problem of excessive capital inflow in response to high domestic interest rates, and on the danger of overvaluation in the strategy of preannounced devaluation as an anti-inflationary device.[34] But McKinnon maintains that there is an unavoidable dilemma because the alternative of setting a crawling peg that wholly neutralizes domestic inflation destabilizes the monetary system if trade liberalization is complete; variations in the crawl induce fluctuations in the demand for money, causing inward and outward surges of capital.

[33] Carlos Diaz-Alejandro, "Comments," Chapters 11–14, this volume.

[34] Ronald McKinnon, "Comment" in Cline and Weintraub, *Economic Stabilization*, pp. 141–46.

McKinnon suggests that the complete liberalization of exchange rates should come last in the sequence of liberalization, and that trade and domestic financial liberalization should come first.

Blejer and Mathieson have analyzed the strategy of preannounced devaluation as an anti-inflationary device that was adopted by Argentina, Chile, and Uruguay beginning in 1978.[35] To the extent that the measure reduces inflationary expectations, it increases demand for real money balances, relieving inflationary pressure (reducing the excess of money supply over money demand). However, the gain in expectations occurs only if the preannounced schedule of devaluations is credible. On the side of product markets, the authors note that trade liberalization does not guarantee equalization of domestic and international prices (for traded goods) because of initial costs of organization and marketing in entering external trade. On capital flows, they note that, by reducing exchange rate uncertainty, preannouncement induces a once-for-all capital inflow until the previous divergence between domestic and external interest rates declines to reflect the now lower uncertainty. But after a long period of capital control, the domestic capital market is unlikely to achieve immediate integration with the world capital market (keeping the domestic interest rate premium relatively high). At the same time, the increased capital inflow puts pressure on money supply. Indeed, in so doing, it undermines the credibility of the preannounced schedule of devaluations. More generally, the authors conclude that preannouncement can be destabilizing when the other elements of the stabilization package, especially fiscal policy, are inconsistent with the deceleration of inflation implied by the preannounced crawl. Preannounced schedules that involve growing departure from purchasing power parity are destabilizing.

In practice, the instrument of preannounced devaluation led to a dramatic exchange rate collapse in Argentina in 1981, when there were three successive devaluations of 30 percent within three months following a break in confidence and large reserve losses. The mechanism had led to a wildly overvalued peso, sustained solely by the foreign capital inflow in response to high domestic interest rates and by mushrooming external debt. The same phenomenon appeared to be taking place in slow motion in Chile in 1981 under a fixed-rate version (fixed rates are a preannounced crawl at zero rate) as declining

[35] Mario I. Blejer and Donald J. Mathieson, "The Preannouncement of Exchange Rates as a Stabilization Instrument," *IMF Staff Papers*, 28(4) (December 1981), pp. 760–42.

copper prices and an overvalued exchange rate led to a current account deficit larger than exports, sustained only by large borrowing induced at the expense of real interest rates of 40 percent. The recent record on preannounced crawling for stabilization bears out the misgivings expressed by Diaz-Alejandro (and McKinnon) two years earlier.

The International Environment

The Brookings conference addressed the question of the role of external shocks in causing balance of payments and inflationary problems in the 1970s. Stanley Black has analyzed the relative weight of external and internal disturbances using discriminant analysis.[36] He classifies developing countries into five groups, from the most stable externally to the least, based on criteria such as their ability to issue international bonds or borrow abroad commercially, on the one hand, or their need to resort to IMF drawings, stand-by arrangements, or even default (debt rescheduling), on the other. By its nature, Black's classification scheme focuses on the external dimension of stabilization, omitting domestic price stability. Black identifies three sets of factors determining a country's classification: country characteristics (size, development, openness, concentration of trade); external factors (import prices, terms of trade, changes in reserves, export volume, oil prices, wheat prices); and internally determined factors (controls, debt service and maturity, consumer prices, reserves relative to imports, money growth, real interest rate, and real exchange rate).

Black's fivefold discriminant classification achieves good statistical explanation using these variables. Of the total distance separating the country groupings, 47 percent is explained by the country characteristics (especially development and trade concentration), and 35 percent is explained by the internal variables (the highest weight being on inflation). Only 17 percent is explained by external variables, of which terms of trade and exports are the most important. Black concludes that, although external factors have been important, internal factors have been dominant in causing stabilization problems. Accordingly, he advocates retention of meaningful conditionality in IMF lending, to ensure satisfactory domestic policies.

[36] Stanley W. Black, "The Impact of Changes in the World Econor on Stabilization Policies in the 1970s," in Cline and Weintraub, *Economic Stabilization*, pp. 43–77.

In his comment on Black's study, Sidney Dell draws upon his cross-country analysis for the United Nations' Development Program and Conference on Trade and Development in emphasizing that the bulk of stabilization problems in the 1970s were caused by external shocks: inflationary impulses from the industrial countries, followed by oil shock, followed by recession in industrial countries and contracting export markets.[37] Accordingly, Dell advocates much greater international financing to facilitate developing country adjustment, and less conditionality of this financing. Dell notes the precedent of the IMF's compensatory financing facility (CFF) for fluctuation in export prices.

Analysis of transmission of inflation into developing economies in the 1970s confirms the point made by both Black and Dell that international developments played a substantial role in the stabilization problems of this period. Cross-country regression analysis by Bhalla, using a basic monetarist model enhanced by variables for import prices and food supply, confirms the systematic process of inflationary transmission.[38] The transmission worked mainly through the monetary channel of reserve inflows (corresponding to US dollar outflows in the early 1970s) and expansion of the domestic monetary base (with a widespread and sharp acceleration in 1972), and through the channel of prices of imported goods (especially in the commodity price boom of 1973–74 and in the oil shock of 1974). A case study of Guatemala and El Salvador (by Gabriel Siri and Luis Raul Dominguez) illustrates the disruptive effect of world inflation on a traditionally price-stable country.[39] A case study of Brazil indicates that, even in a country with an inflationary tradition, the external shocks of the mid-1970s precipitated a reacceleration of inflation (in a three-stage sequence: reserve and money expansion; import price shock, especially oil; and price-push from Brazil's own increases in protection induced by balance of payments stress), and the world recession depressed export earnings. Both cross-country and case-study analyses thus support the common sense proposition that it was international transmission of inflation (not a simultaneous spree of fiscal irresponsibility) that swept developing country inflation from an av-

[37] Sidney Dell, "Comment," in Cline and Weintraub, *Economic Stabilization*, pp. 77–81.

[38] Bhalla, "The Transmission of Inflation into Developing Economies," in Cline, *World Inflation*.

[39] Gabriel Siri and Lewis Raúl Dominquez, "Central American Accommodation to External Disruptions," in Cline, *World Inflation*.

erage of 10 percent in 1967–72 to 22 percent in 1973 and to 25 percent in 1974.[40]

Even though the external sources of instability confronted a wide array of developing countries, internal policies were important, even dominant, in many cases. The choice of higher protection in Brazil probably heightened inflation (compared with the alternative of devaluation) by increasing distortions in resource allocation. In the case studies of Mexico and Peru for the Brookings conference,[41] Weintraub and I found domestic disequilibria to be considerably more important than external shocks in explaining inflationary and balance of payments problems in the mid-1970s.

Furthermore, even though the external shocks were common to many developing countries in the mid-1970s (at least those importing oil), the policy responses to them differed. Some developing countries succeeded in stabilization and adjustment, and others did not. A striking pattern of the subsequent policy response is that in Asia most countries succeeded in bringing inflation back down from its 1974 peak (from an average of 27.8 percent in 1974 to 8.8 percent in 1977) while those in Africa (18.6 percent in 1974 versus 25 percent in 1977), Latin America (25 percent versus 34 percent, excluding Argentina, Chile and Uruguay), and the Middle East (21.8 percent versus 24.2 percent) did not. A stylized fact from the 1970s is that Asia achieved price stabilization after external shock while other regions did not.

Given the differences in stabilization performance despite common external shocks, the implication is that different degrees of effectiveness in policy response were crucial in determining the outcome. Although it is a good debating point to cite the external shocks of recent years as grounds for increased unconditional financing from the industrial countries and the Organization of Petroleum Exporting Countries (OPEC), the logic of the recommendation of reduced conditionality depends on one's views of its effect on domestic policies. If conditionality is viewed as improving the chances that the right domestic policies will be adopted, it is a disservice to the developing countries themselves to couple a recommendation for increased financing with a recommendation for decreased conditionality. Removing conditionality will tend to cause a run-up in debt to sustain

[40] Cline, "Brazil's Aggressive Response to External Shocks," in Cline, *World Inflation*.

[41] Cline, "Economic Stabilization in Peru," and Weintraub, "Case Study of Economic Stabilization: Mexico," in Cline and Weintraub, *Economic Stabilization*.

poor policies. If conditionality is viewed as a nuisance that causes hardship for borrowing countries and that serves primarily to soothe international bureaucrats and bankers, then it makes sense to attach nonconditionality to the plea for more international financing based on the allocation of much of the responsibility for instability in the 1970s to international forces.

Another feature of the international economy in the 1970s represented an impressive response of market institutions to the new external shocks: private banks greatly increased their lending to developing countries. Irving Friedman has examined the role of private banks in international financial recycling.[42] Friedman emphasizes that banks consider the long-term development prospects of countries, not just short-term circumstances; that their portfolios are diversified among many borrowing countries; that indicators such as debt relative to exports or GNP do not show widespread deterioration, despite large growth in nominal debt; and that the IMF "seal of approval" for countries in difficult circumstances is an important signal for banks, magnifying the IMF's role far beyond provision of its own resources. Friedman contends that banks have seldom lent where the IMF would have preferred a prior agreement with the country (a view some IMF staff would probably dispute: "Why do countries wait so long before coming to the Fund?" is usually answered, "Because the banks let them.") He also urges that banks receive first priority in repayment. Yet the moral hazard problem suggests that this rule would be undesirable, and the experience of Peru and some other countries seems to show that the banks have sometimes exercised insufficient caution because they already assume they will be bailed out by the international community.

IMF Programs in Operation

The Brookings conference examined the theory and experience of stabilization rather than policies of the IMF. Nevertheless, the appropriateness of IMF conditionality practices is an issue implicit in several of the conference studies and in other recent literature on stabilization.

The Brookings conference included three case studies on countries where IMF programs had been applied (Mexico, Peru, and Tanzania),

[42] Irving S. Friedman, "The Role of Private Banks in Stabilization Programs," in Cline and Weintraub, *Economic Stabilization*, pp. 235–65.

as well as judgments by some of the other authors on the theory and practice of IMF conditionality.

Sidney Weintraub has examined Mexico's stabilization in the period 1977–79, which involved the IMF extended Fund facility (EFF) and conditionality.[43] Under Echeverria, expansive government spending unmatched by tax increases caused an average fiscal deficit of 5.7 percent of GDP (1971–76), rising to 9.5 percent in 1976. Money supply grew at an average of 19 percent annually in 1971–76, and wholesale prices rose at 14.5 percent compared with 2.9 percent in 1965–70. The fixed peso-dollar exchange rate—a fetish in Mexico, where the United States accounts for about two-thirds of trade and tourism earnings—meant that the peso became increasingly overvalued. In August 1976, massive capital flight precipitated a devaluation from 12.5 to 23 pesos to the dollar.

The IMF agreement involved a three-year program from 1977–79. Its conditions included a cutback on external borrowing from $4 billion to $3 billion yearly, reduction of the public sector deficit and targets for increased reserves, and limits to increases in the net domestic assets of the Bank of Mexico. Mexico was also committed to reducing import-licensing requirements and some tariffs. Thus, the package was conventional (considering that devaluations had already occurred), except that it covered three years rather than the more traditional one-year period.

Mexico achieved the various targets of the agreement. Economic performance was favorable except in inflation. Real output rose by 3.2 percent in 1977 and by 6.6 percent in 1978; the current account deficit fell from $4 billion in 1975 to $1.8 billion in 1977 (even though oil exports were still small); and the public sector deficit fell from 9.5 to 7.5 percent of GDP by 1978. However, inflation surged from 15.8 percent in 1976 to 28.9 percent in 1977 and remained at 17.5 percent in 1978; the sharp devaluation played a substantial role in the temporary acceleration of inflation.

Weintraub concludes that the IMF agreement was broadly successful except in its anti-inflationary objectives. It did involve a reduction in real wages, but the burden of stabilization was probably not greater than that of the destabilization period for the unemployed and underemployed. In his comment, Saul Trejo Reyes emphasizes the difficulty of achieving distributional objectives, rather than economic management, as the key to understanding the Echeverria pe-

[43] Weintraub, "Case Study of Economic Stabilization: Mexico," in Cline and Weintraub, *Economic Stabilization.*

riod.[44] He also suggests that the arrival of oil is the single most important factor in Mexico's economic turnaround. While this caveat is surely relevant in explaining the sharp improvement in growth in 1978, it does not explain the largely pre-oil recovery on the external current account, and it should not take away credit for a largely successful stabilization program with IMF participation.

The case of Peruvian stabilization in 1975–78 is one of the most controversial episodes of IMF involvement. My review of the case recounts the policy distortions under the military government that led to economic crisis: neglect of exports, growing overvaluation of the sol, mismanagement in state enterprises, increased government investment unmatched by taxes (leading to a fiscal deficit at 10 percent of GNP by 1975), and high expenditures on military imports.[45] Bad luck made matters worse: the anchovies disappeared off the coast, the price of copper plummeted in 1975, and expected oil discoveries failed to materialize. The current account deficit reached 123 percent of exports in 1975, and Peru rapidly accumulated external debt as private banks lent munificently in the expectation of bright oil prospects.

Sporadic stabilization attempts began in 1976 after an intramilitary coup, but the political onus of going to the IMF led Peru to conclude an unusual stabilization package with a syndicate of international private banks, on terms not very different from what the IMF might have advocated. The bank package failed within the year as Peru missed the targets, and the banks then insisted on IMF participation. Negotiations with the IMF from March to May 1977, and a false start at an actual agreement in November 1977, repeatedly failed for the essential reason that important segments of the government were unwilling to accept budgetary restraints. But by the second quarter of 1978 the country was near external bankruptcy, imports were freezing up for lack of trade credit, and there was little alternative to a firm stabilization program. The new economic team devalued the sol by 15 percent, imposed increases in prices of fuel and bread, eliminated most subsidies, raised interest rates, and restricted government spending. The measures precipitated strikes, riots, and some deaths.

The targets of a new IMF agreement negotiated in July 1978 were substantially met by Peru. Debt was successfully rescheduled. For 1978 as a whole the external deficit was down to only 10 percent of

[44] Saul Trejo Reyos, "Comment," Cline and Weintraub, pp. 292–95.

[45] Cline, "Economic Stabilization in Peru, 1975–78," in Cline and Weintraub, *Economic Stabilization*, pp. 297–334.

exports (although severe restrictions on imports early in the year played a role in the turnaround). However, inflation accelerated from approximately 35 percent in 1975–76 to nearly 60 percent in 1978. Strong export prices caused a large external surplus in 1979, and real growth averaged 3.5 percent in 1979–80 after a 1.8 percent decline in 1978, although inflation remained in the range of 60 percent.[46]

Regression analysis for Peru shows responsiveness of both exports and imports to the real exchange rate, contrary to the fears of some structuralists. And although Schydlowsky's comment criticized the IMF's (and government's) diagnosis of excess demand and recommended double shifting and export incentives as an alternative to demand restraint and devaluation, further examination tends to confirm the view that large fiscal deficits reflected excess demand, and a socioeconomic change in shifting patterns seems dubious as a feasible measure for cyclical adjustment.[47] The discussion earlier in this essay has addressed the common critique that the IMF package was disproportionately hard on the poor.

The Peruvian case illustrates the problems caused by excessive private bank lending followed by the wrenching outflows once banks lose confidence. It illustrates paradigmatically a widely recognized problem: countries that wait too long before reaching a stabilization agreement with the IMF typically reach a crisis of such proportions that there is little alternative to seemingly draconian measures. And the Peruvian case may also illustrate a political learning process by the IMF: the terms of the July 1978 package appear to have been more gradualist than those of the November 1977 package and those the IMF urged in March 1977. Broadly, however, the Peruvian case represents the more or less effective workings of the normal IMF stabilization package (once adopted) rather than a proof of structuralist criticisms of such programs, although (as in the case of Mexico) success on the external account and in growth was not matched by the results on inflation.

The case of Tanzania has also raised controversy about IMF policies; moreover, it raises questions about IMF policy approaches in socialist countries. Weaver and Anderson describe Tanzania's experience of relatively steady growth (5 to 6 percent) but intermittent

[46] IMF, *International Financial Statistics*, (Washington: January 1982).

[47] See the comment by Daniel M. Schydlowsky and my reply in Cline and Weintraub, *Economic Stabilization*, pp. 326–55.

balance of payments crises in the 1970s.[48] The current account deficit reached 50 percent of exports in 1971, over 70 percent in 1974–75, and 99 percent in 1978 (recovering between each episode). The study focuses on the 1974–75 crisis. Drought, the oil price shock, and world recession played an important role in that crisis. In addition, the Ujamaa process of villagization had disrupted food production, causing heavy imports of food.

The government's response to the crisis managed to reduce the external deficit while provoking critiques from right and left. Imports were strictly controlled. The government rejected devaluation on grounds of inelastic trade response. It abandoned communal farming efforts, raised agricultural prices, and carried out an ideological campaign to produce more food. It raised minimum wages by 40 percent but held higher wages to smaller increases. It increased prices on state services, raised taxes on cigarettes and beer, and tried to cut back government spending. Altogether, then, Tanzania's package was one of compromises that might be called socialist realism.

The package did not suit the IMF. Although the IMF responded to the 1974 crisis with loans averaging 10 percent of exports during 1974–76, these were in relatively unconditional programs: oil facility, first credit tranche, CFF. The IMF did not make disbursements of conditional second tranche funds, because the government failed to reduce government spending and money growth. For its part, the World Bank extended program loans in 1974 and 1977 amounting to 1 percent and 0.4 percent of exports, respectively.

Weaver and Anderson indicate that Tanzania overcame the balance of payments crisis in an equitable, if unorthodox, way. The rural-urban differential was probably reduced. The authors ask whether the multilateral institutions are sufficiently flexible to deal with socialist countries.

In his comment, Helleiner emphasized that, if the Tanzanian government did achieve equitable stabilization and the IMF did refuse to extend conditional support, the case would be an important instance where the IMF was proved wrong.[49] He highlights the point by citing the seeming conflict between the IMF and the World Bank; representatives of the latter reportedly were more favorable to the

[48] James H. Weaver and Arne Anderson, "Stabilization and Development of the Tanzanian Economy in the 1970s," in Cline and Weintraub, *Economic Stabilization*, pp. 335–69.

[49] Gerald K. Helleiner, "Comment," in Cline and Weintraub, *Economic Stabilization*, pp. 369–74.

government's strategy. But Helleiner raises doubts about the conclusion that stabilization was equitable and nonrecessionary. Stephen O'Brien of the World Bank clarified in the discussion that there was no disagreement between the Bank and the Fund; both had responded to Tanzania's needs in 1974, and the absence of second tranche IMF lending in 1975 was the result of Tanzania's failure to meet targets that the government itself had accepted.[50]

In view of the widespread documentation of the inefficiencies caused by import controls as a basic development strategy,[51] it would seem premature to conclude that the Tanzanian case shows the merits of controls over devaluation and other market-oriented mechanisms of adjustment, even accepting for the moment that Tanzanian results were at least temporarily successful (although that assessment is ambiguous). As a lender of revolving funds rather than grant aid, the IMF must calculate the likelihood of repayment in its decisions. In instances where the policy package involves import controls, a large minimum wage increase, and minimal exchange rate correction and spending cuts, there is a reasonable question whether the IMF would be meeting its fiduciary responsibility to the international community in making a loan, given the likelihood of future repayment difficulty. Indeed, many questions whether the much accelerated lending program of the IMF in 1980–81 did not involve several cases where the policy conditions were so weak and the underlying development strategies so questionable that the loans could de facto be turned into grant aid by the inability of borrowing countries to repay and by the lack of any alternatives to rolling over loans.

Two other authors in the Brookings conference had express views on IMF lending practices. While Diaz-Alejandro notes "modest" movement of IMF analysis "beyond the simplest versions of the monetary approach to the balance of payments," he indicates that the IMF still appears to favor outdated ideas (such as a preference for large, once-for-all devaluation rather than the crawling peg found effective in South America), and he criticizes IMF secrecy, pleading that at least documents older than 10 years be open to scholarly examination. He adds that in any event the large countries (Argentina, Brazil) are unlikely to place themselves at the mercy of IMF

[50] Cline and Weintraub, *Economic Stabilization*, p. 374.

[51] The extensive studies by the Organization for Economic Cooperation and Development, the World Bank, and the National Bureau of Economic Research have amply demonstrated the point. See Anne O. Krueger, *Liberalization Attempts and Consequences* (Cambridge, Mass.: Ballinger, 1978).

recommendations, however much modified (presumably, though not explicitly, because the game is not worth the candle in terms of available lending magnitudes, a view possibly now bypassed by the larger IMF quotas and higher multiples of quota for lending limits).[52] Lance Taylor is more abrupt, merely appending to his theoretical analysis a summary critique of the IMF's "draconian measures," "the fiscal stringency/credit contraction/devaluation/wage repression packages so beloved of orthodoxy and the IMF."[53]

Popular attacks on the IMF from the left are well known; the analytical critiques of the neo-structuralists have added a more sophisticated dimension to the attacks. However, two of the three country studies in the Brookings conference suggest that the IMF is miscast as the villain, and that the underlying ills of the patient have often been confused with the ministerings of the doctor. These case studies (Mexico and Peru) suggest that the IMF has not been guilty of violating the Hippocratic oath that the physician not make his patient worse off than he would otherwise be. It is worth adding, finally, that the most recent phase of the policy cycle has been toward an attack on the IMF from the right (in particular, from the Reagan administration) as being too soft in its lending conditions.[54]

Conclusion

It is evident from this survey that controversy remains abundant on the issue of stabilization. Several stylized facts have emerged, however. Balance of payments stabilization has proved easier than reducing inflation. Country experience in reducing inflation (after the shocks of the 1970s) has been considerably more favorable in Asia than in other regions. External forces caused considerable destabilization in the 1970s, but so did internal policies, and domestic policies were important in determining the degree of success in response to international shock. Countries have often waited too long before adopting stabilization measures, making adjustment more severe.

The perimeter around theoretical consensus would probably include the need to raise prices of tradables relative to nontradables in achieving external stabilization, with resulting resource shifts and

[52] Diaz-Alejandro, "Southern Cone Stabilization Plans," in Cline and Weintraub, *Economic Stabilization*, p. 140.

[53] Taylor, "IS/LM in the Tropics: Diagrammatics of the New Structuralist Macro Critique," in Cline and Weintraub, *Economic Stabilization*, p. 502.

[54] *Washington Post*, 28 September 1981.

income distributional consequences. Trade regime bias imposes heavy long-run costs, and its correction is usually a bargain despite transitional costs. Many income distributional effects of stabilization are determined more by the political choice of the regime than by any inevitable dynamic of stabilization.

The salient areas of dispute include whether trade elasticities are sufficiently robust to enable devaluation to work or whether they are so low that devaluation will have perverse contractionary effects. The mounting evidence is that the elasticities are sufficiently high for the standard case to hold. Also in dispute is the impact of monetary restraint on inflation, although the neo-structuralist assault on the issue seems chiefly relevant in the short run and consideration of longer run effects seems to vindicate the more traditional causal direction (from monetary restraint to reduction, rather than an increase, in inflation). Also in dispute is whether the IMF in practice has been overly rigid in the application of orthodox measures. New areas of analytical dispute include the relative merits of the crawling peg to offset domestic inflation as opposed to those of a preannounced, decelerating schedule of devaluations as an anti-inflationary device.

An area with high priority for more research is the time path of optimal stabilization policies. Despite the long-standing issue of the relative merits of gradualism versus shock treatment, and notwithstanding the modeling efforts of neo-structuralists, we have yet to see a carefully designed analysis of the alternative time paths of output, inflation, and external balance (for example, quarter by quarter) under alternative policy strategies (in particular, abrupt and severe credit restraint and devaluation as opposed to a gradual phasing-in of such measures). More generally, the neo-structuralists have yet to propose a viable alternative to the more traditional policy package. Although the logic of at least one version of their critique implies that in the face of stabilization problems governments should not devalue and should increase credit (and money expansion) rather than reduce it, they have (wisely) refrained from drawing the policy conclusion explicitly and have limited their policy conclusions to the negative stance that traditional policies have involved overkill. The less extreme among the neo-structuralists merely advocate more gradual doses of traditional medicine, but this approach implies again the need for analysis of the time paths of results under such policies. Similarly, some have advocated export subsidies as the alternative to devaluation, but, in view of the costs of trade regime bias and budgetary constraints, it is unclear how effective this alternative can be. (Moreover, if exporters will not respond to devaluation, why should they respond to subsidies?)

A new area of consensus on policy appears to be emerging. In the face of external shocks such as those of the 1970s, developmental adjustment may be more appropriate than short-term stabilization. New investment may be needed to expand production of exports and import substitutes. In this area the policy community has more than kept pace with the academic community. Without the aid of new theoretical models, the international financial institutions have sensibly extended the terms of IMF lending (up to five years for credit tranche borrowing and 10 years for the EFF), while the World Bank has introduced a modest amount of program lending for structural adjustment. Because developing country debt is high, external deficits are likely to remain high even if the OPEC surplus declines,[55] and because prospects seem likely for continued slow growth and high interest rates in the international economy, the need for these facilities is likely to increase over the medium term. Analytical understanding of stabilization policy is essential to the proper implementation of these international instruments. The extensive methodological work on stabilization issues in recent years, and the growing body of case studies, have done much to improve that understanding, but the task is far from complete.

Chapter 1

Policy-Based Program Lending: A Look at the Bank's New Role

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Gerald K. Helleiner

Short-term demand-oriented approaches to resolving balance-of-payments difficulties, such as are typically recommended by the IMF, have been reasonably successful when applied to short-term problems originating in over-expansion of domestic demand. They have been noticeably less effective, however, in dealing with prolonged and continuing difficulties—largely external in origin—facing many developing countries in the 1980s. The Baker plan appears to signal a new perception on the part of the U.S. government that longer-run supply-side approaches are now required in the major debtor developing countries and in the low-income countries of Sub-Saharan Africa. To this end, many suggest a new leading role for the World Bank in stabilization and adjustment programs.

The International Monetary Fund (IMF) has seen its function as assisting countries to achieve "sustainable growth,"[1] leaving to the World Bank and to aid donors the pursuit of rates of growth that are "desirable" or at least "adequate." Now, however, the IMF says that, for the major debtor countries and Sub-Saharan Africa, "an appropriate adjustment strategy must pay attention to the form as well as the size of external adjustment so that growth—which is so vital to the stamina needed for adjustment—does not suffer."[2] The Fund agrees that this will require, among other things, an "enhanced role for the World Bank and other multilateral development banks reflected in increased and more effective structural adjustment lending."[3]

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Those now advocating an expanded World Bank role in program lending include some who have always seen program support as particularly productive for developing-country borrowers and/or as providing useful opportunities for external policy leverage. Most of those currently favoring relative expansion of medium- and long-term program lending do not, however, see this as a permanent shift in the Bank's approach to development lending as much as a temporary response to unusually severe balance-of-payments pressures. The period during which this temporary shift is required will vary from country to country, but it is likely to range from five years in Latin America to ten years in Africa.

Sustained restoration of external balance at acceptable levels and rates of growth of domestic output requires restructuring of production—toward tradables and away from non-tradables. Such restructuring requires not only appropriate domestic incentives but also sector-specific investment. The costs of too short-term an approach and inadequate external financing have been shortfalls in the investment required for such medium-term adjustment. Demand restraint has hit investment particularly hard, both because the import content of investment spending is typically higher than that of consumption and because government recurrent expenditures and private consumption are inherently difficult to cut. Additionally, in many cases, particularly in Sub-Saharan Africa, cutbacks have meant import-strangled economies operating well below existing capacity. In Sub-Saharan African countries, where both human and physical capital stocks are depreciating under the current severe foreign-exchange constraints, high immediate returns are obtainable from the provision of foreign exchange for the rehabilitation and full utilization of efficient existing capital, prior to any prospect of fresh net investment.

Growth requires increased investment and/or increased productivity. The Baker plan provides for increased conditional program lending by the World Bank, with conditionality associated with growth objectives as well as short-term stabilization. Unfortunately, IMF and World Bank experiences with longer-term policy-based program lending—notably through the Extended Fund Facility (EFF) and the Structural Adjustment Loan (SAL) experiments—have been mixed at best. The IMF has been unable to shift significantly from its traditional demand-oriented and short-term modalities. A recent study of EFF lending found that over half these loans were cancelled for non-compliance with IMF conditions, while several more had otherwise unsatisfactory outcomes.[4] The World Bank's SAL program has had fewer cancellations, at least in part because the performance conditions are more ambivalent; but

the countries covered and the record of fostering appropriate policy reform have been limited.

It is not evident that the Bank's resources, knowledge, or lending procedures are any better suited to overcoming today's deep-seated adjustment problems than those of the IMF have been in the past. It looks as if adjustment finance will continue to fall short of the required amounts. There is still only limited professional understanding of adjustment processes and of the interactions between short-term and longer-term objectives—either in terms of theory or in terms of available evidence.[5] Optimal policies for growth have long been a matter for particularly vigorous professional disagreement, whatever the apparent self-assurance of some economists within the Bank.

This chapter explores the outlook and possibilities for an expanded World Bank role in policy-based program lending. It reviews the principal instruments of such lending and their prospects. It addresses the substantive issues in medium-term adjustment policy formation and seeks to identify what is and is not agreed among professionals. Some of the institutional aspects of an expanded Bank role in policy-based program lending are considered, as are some of the implications for the Bank's research program.

Instruments of Policy-Based Program Lending

Although structural adjustment loans (SALs) have received the most attention since their inception in 1980, "sector adjustment loans" have been more important over the past two years (see Table 1). In fiscal 1985, thirteen sector adjustment loans made up 10.3 per cent of total World Bank/IDA commitments, while three structural adjustment loans accounted for less than 2 per cent of the total (down from an average of 8 per cent in the 1980–84 period). The Bank's current three-year projections suggest that, in the 1985–87 period, sector adjustment loans will account for 10–15 per cent of commitments, whereas SALs will account for only about 4 per cent.

The distinction between SALs and sector loans is not always clear. Both seek major reforms in policies and institutions,[6] with the latter typically, but not always, more narrowly focused upon specific sectors. Issue coverage in sector adjustment lending has been extremely broad in some instances, for example, in reconstruction in Ghana and Guinea-Bissau, or in trade policy in Colombia and Morocco. More usually, however, it is related to more narrowly defined areas, such as export development, agriculture, industry,

Table 1. World Bank/IDA Commitments by Major Category of Lending Instrument FY1980–85 (percentages)

	1980	1981	1984	1985
Specific Investment	60.5	49.3	41.3	49.6
Sector Operations				
Sector investment and maintenance	16.9	20.6	26.5	24.9
Financial intermediaries	15.4	18.8	13.2	11.1
Sector adjustment	0.6	1.1	8.5	10.3
Structural Adjustment and Program Loans	2.7	7.1	8.2	1.6
Technical Assistance	1.1	2.3	2.1	1.4
Emergency Reconstruction	2.3	0.6	0.3	1.0
Total	100.0	100.0	100.0	100.0

Source: World Bank and author's calculations.

energy, fertilizer, or public enterprises. Policy reforms required under the conditions of these loans typically relate to liberalization, rationalized pricing, and other efficiency-raising measures.

Sector adjustment loans are generally seen as both less complex and less intrusive than structural adjustment loans. A comprehensive SAL simply may be too complicated to negotiate in a country like Brazil, but quite feasible in Ghana or Niger. Moreover, the degree of intrusion in domestic policies that a SAL implies may be politically intolerable today for larger and more powerful countries, particularly those with major debt "leverage." It is noteworthy that, although there have been no SALs in major Latin American countries, there have been large sector adjustment loans to Brazil, Colombia, and Mexico, among others. The Bank has thus been quite pragmatic and flexible in its utilization of these alternative lending instruments in its various member countries.

Other, even larger "sector operations" include "sector investment and maintenance" loans, and loans to local financial intermediaries. Non-project loans are also available for technical assistance and for emergency reconstruction after disasters. In all, lending for specific projects now accounts for less than half of total World Bank/IDA commitments, as against 60 per cent in 1980.

The Bank has also proven adept at modifying its usual project

and sector lending procedures in response to its members' changing needs. Under the fast-disbursing Special Action Program that operated from 1983 to 1985, for instance, the Bank altered the time profile of its normal lending for forty-four countries facing particularly severe balance-of-payments adjustment pressures; some of these procedures subsequently have been incorporated into regular Bank lending practices. Not all of the Bank's program finance is appropriately described as "policy-based lending"; at the same time, both program *and project* loans can be consciously directed at policy change in support of structural adjustment. Categorizations such as those of Table 1 therefore can be misleading, and the data based on them should not be taken too literally.

Since non-SAL forms of policy-based non-project finance are now of greater significance, formal, self-imposed constraints upon the proportion of Bank lending devoted to SALs (10 per cent of total lending, 30–40 per cent to any one country) no longer serve any purpose. The need for rehabilitative and adjustment-oriented program lending relative to the funding of traditional development projects varies across countries and over time. At present and for the next five to ten years, program loans are likely to be particularly productive in Latin America and Sub-Saharan Africa. Unless major modifications are made in the character of the remainder of the Bank's lending program, it is difficult to see how, in current circumstances, SAL and sector adjustment lending can sensibly be projected at only 15–20 per cent of total lending over the next few years. One could easily imagine structural adjustment and sector adjustment loans together making up 75 per cent of Bank lending in countries severely constrained by scarcity of foreign exchange. Assuming that the geographic composition of its lending remains roughly the same, this would imply that program lending of these two types alone would rise to roughly 40–45 per cent. Relaxation of limits on the extent of local-cost financing permitted in the Bank's project loans is another device that could be employed more liberally to meet the current need for more balance-of-payments finance. At the same time, the Bank should be exercising maximum influence on commercial banks, bilateral aid donors, and other sources of external finance to provide credit or assistance in *program* form. As current adjustment difficulties and debt pressures ease, the relative importance of program finance can return to more normal levels.

Overall country-level needs for external resources for medium-term adjustment programs must be assessed in a holistic fashion. Debt-servicing obligations to all creditors, including the IMF and World Bank, must be considered in their entirety and in the context of the anticipated overall balance-of-payments position. Debt re-

structuring and relief in which all creditors are treated equitably (though not necessarily uniformly), should continue to be elements in the external financing programs of individual countries. Indeed, debt restructuring and relief, which in effect provides immediate *program* support, should be considered as just another instrument of program lending. There is no logic in the separate convocation of Paris Club meetings and aid donor consultations. Aid agencies should meet together with Paris Club creditors, the Fund, and the Bank to consider jointly country programs and their financing requirements.

Policies for Medium-Term Adjustment and Development: How Much is Agreed?

Unlike IMF lending, the inter-country distribution of World Bank lending is not governed by rules or quotas. Whereas not all countries have a short-term balance-of-payments 'need,' presumably all could claim that they deserve and require development finance. How inter-country distribution is decided within the Bank is not obvious; and perhaps it should be made obvious.

It is possible that the Bank's shift from traditional project lending toward policy-based program lending serves to rationalize a redistribution of resources toward major debtors and/or others of whose policies the Bank approves. If such countries are to receive a 'premium,' so to speak, above the resources that they would otherwise obtain from the Bank, then such a policy should be embarked upon deliberately and openly rather than slipped in under the guise of a new approach to lending. Undoubtedly it makes sense to redirect some Bank resources to those in particular balance-of-payments difficulties. But if resources are also to be redirected toward those pursuing what the Bank considers to be appropriate adjustment policies, it will be crucial to ensure that the Bank's assessments of local policies are soundly based and do not appear to be politically or ideologically biased. Policy-based program lending will ultimately stand or fall on the credibility and effectiveness of the Bank's conditions.

What *are* the key elements of a sound macro-economic framework for structural adjustment and development? There can be general agreement on the desirability of maintaining an appropriate real exchange rate, appropriate incentive structures more generally, adequate rates of domestic savings and productive investment, and responsible fiscal and monetary policies. Typically it is not as easy, however, to achieve agreement on *how* best to move from disequilibrium situations to those of greater internal and external

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balance—and, therefore, on the precise meaning of "appropriate," "adequate," and "responsible" policies.

The economics profession is much more comfortable with the analysis of alternative equilibrium or steady states than it is with analysis of transitions between them. The *dynamics* of change—within which market imbalances and alterations of behavior are of the essence—are extremely difficult to model. In fact, there is no *agreed* methodological framework for analyzing the medium-term macro-economic adjustment process that is now the prime object of policy.[7] Nor is there complete understanding of the complex interactions between financial and real variables in different kinds of countries—particularly not in the current confused circumstances of rampant inflation, debt crisis, and capital flight. In short, while macro and development economists know and agree on the sorts of macro-economic conditions at which they would like to arrive—that is, sustainable external balance with reasonably stable prices and growth—they have no agreed route for getting there.

At least as important to the longer-run restoration of external (and internal) balance is the ongoing process of economic growth and development. Countries that have pursued less-than-perfect development policies (and presumably all have some room for improvement) may be able to "tighten up" under the current pressure. Improvements in allocative efficiency and x-efficiency (better management), utilization of previously underutilized resources, and encouragements to longer-run savings and productive investment may all increase medium-term and longer-term growth. Unless there are reasons for believing that previous constraints on policy have been eased, however, there may not be room for much maneuver in these respects.

Beyond these generalities concerning the requirements for structural adjustment and more rapid growth, matters become considerably more controversial. While there can still be widespread agreement on the need for greater selectivity and care in public investment and for greater efficiency and consistency in economic management in general, there are major debates about strategy and tactics in particular country cases. And both in general and in the case of particular countries, there is fundamental political as well as professional disagreement on matters such as the appropriate overall role of the state, the scope for private enterprise, the degree of "outward orientation," and the distribution of income. The heart of the problem lies in the fact that the quasi-technical (though quite difficult enough) issues relating to medium-term balance-of-payments adjustment inevitably overlap in the Bank's policy-based program lending with much more controversial and highly political issues of development strategy.

Despite these complexities, the World Bank possesses a fairly consistent approach to policy-based lending. Like the IMF, it stresses monetary and fiscal orthodoxy, appropriate real exchange rates, positive real interest rates, and avoidance of administrative controls on external transactions. As far as longer-term development strategy is concerned, the Bank urges export expansion and overall outward orientation as against import substitution; liberalization of import barriers and movement toward unified import incentives; and maximum reliance upon markets rather than government ownership or direction in the domestic economy. The Bank's primary emphasis is on price incentives and "getting the prices right," and its obvious presumption is that, even in a world of pervasive imperfections, markets can normally be trusted to achieve that objective better than governments. Even in the world of the second-best, its approach is consistently to liberalize that which can be liberalized.

Just as the IMF has been criticized for the oversimplicity and inflexibility of its short-term models and approaches, the Bank now attracts criticism for the generalized character of the development policies it recommends. Certainly its general approaches can be defended only if they are flexibly applied; as universal rules they are neither economically sound nor politically acceptable. Improved incentive systems, for instance, generate the desired responses only in an appropriate overall context. Non-price impediments may severely constrain performance *whatever* the incentive structure. In African agriculture, short-run improvements in performance are limited by inadequate marketing systems, inability to obtain key inputs or sufficient credit, absence of consumer goods on which to spend earnings, and deficient transport and storage arrangements—while inadequate land and technology frequently set bounds to longer-run prospects.[8] Where total agricultural supply response is small, as is frequently the case, the main impact of food price increases may simply be to increase poverty.[9] In any case, it is not always easy to engineer or sustain real price changes through changes in nominal variables. Price inflation can be expected to offset nominal exchange-rate devaluation substantially, and the most cost-effective route to a sustainable new real exchange rate may not be to seek to reach it in one fell swoop.

The role of interest rates also remains uncertain. Increased real rates may improve the allocative efficiency of investment, reduce capital flight, and even attract savings from abroad in economies with relatively developed financial markets. The IMF research department itself concludes, however, that: "Despite the amount of research expended on the interest responsiveness of savings in general, and in developing countries in particular, it is

still uncertain whether an increase in interest rates will, on balance, raise the savings rate."[10] Nor are the advantages of full financial liberalization over "financial repression" unambiguously favorable.[11]

Few would quarrel with the aspiration to remove or reduce import controls wherever possible. They tend to introduce inefficiency and corrupt practices when they are long maintained. But the timing of their removal and/or rationalization must be determined in the overall context of the economy's circumstances. To advocate liberalization during periods of foreign-exchange crisis is to risk the imposition of even greater economic costs upon an economy already operating under stress and below capacity. Premature and ill-timed liberalization episodes will set back the prospect for greater efficiency and improved overall economic performance in the longer run.

Similarly, few would quarrel with the aim of expanding exports from foreign-exchange-constrained economies. But the prospect of all developing countries simultaneously expanding export volume in similar products, whether primary or manufactured, is one that must be analyzed in detail. Primary-product prices are likely to suffer and protectionist barriers to manufactures to increase as a result of concerted efforts at export growth. Export strategy must therefore be quite carefully constructed, and information about market prospects coordinated and made more widely available. (However difficult such contingent projections may be, the Bank has a special obligation to offer holistic assessments of market prospects under various stipulated supply-side as well as demand scenarios.) It is not good enough to argue, as some do, that only a relatively few countries will actually act on the advice to expand exports, and that the adding-up problem therefore can be ignored. Nor is it sufficient to argue, as do others, that since world prices are 'given' for small countries, they can do nothing about them and should respond to current prices as best they can. Nor does the much-cited correlation between export growth and GNP growth—never applicable to the poorest countries anyway[12]—tell very much about the direction of causation or appropriate policies for countries that seek both.[13]

The role of foreign direct investment is another source of controversy. Increased incentives and receptivity to foreign investors may simply generate quasi-rent from them if, as much of the recent evidence suggests, their investment decisions are based primarily on more fundamental locational characteristics and long-run factors.[14] In recent years, direct investment in developing countries, which has always been highly concentrated in the same countries that attracted commercial bank lending, has dropped just as far and

as fast as commercial lending, and it is unlikely to resume until the overall economic outlook in these countries improves. Quite apart from the sensitivities of many countries regarding foreign ownership and control of domestic industries--and however desirable increased equity, or equity-like, finance might be—the elasticity of response by direct foreign investors to improved investment incentives in developing countries is, for the present, likely to be low.

The relative roles of prices, markets, and governments in development are particularly controversial and politically sensitive. To acknowledge the importance of prices and incentive structures is certainly not the same as to advocate the universal use of markets. In a second-best world, there can be no theoretical presumption that even "well-functioning" markets will render signals conducive to the achievement of static efficiency, let alone developmental efficiency. There can certainly be wide agreement that governments should be selective in their activities and, where possible, more efficient in managing their own enterprises. Divestment is undoubtedly appropriate in many cases; as a universal prescription, however, it is of dubious merit. Market imperfections and failures, distributional and "non-economic" objectives, and political pressures of various kinds are likely to continue to generate significant government intervention in developing-country economies; indeed, contrary to Bank orthodoxy, there is some evidence that government participation is associated with more rapid growth.[15] The political and economic efficacy of markets and governments varies across countries and in individual countries over time. Policy generalizations based on ideologically or experientially rooted perceptions can only be viewed with skepticism.

By far the most pervasive and consistent conclusion in the increasingly sophisticated economic analyses of adjustment policy alternatives is the impossibility of offering generalized prescriptions to fit all country circumstances. A recent survey of World Bank macro-economic models of developing countries sought to explore the consistency of their policy implications with the Bank's own 'conventional wisdom' regarding appropriate adjustment policies.[16] Many of the most important policies typically advocated—such as nominal devaluation and monetary and interest-rate policies—could not be analyzed at all because most of the models dealt only in real variables. That in itself reflects the relatively undeveloped state of the macro-economic modeling art in the countries in question. More striking still, however, is the inconclusiveness of many of the results.

Trade and exchange-rate policies generally "perform" as expected, although the dynamics of transitions—for example, the

efficacy of nominal devaluations of various dimensions to achieve a desired real devaluation—are not addressed. "Getting prices right" (that is, in accordance with world prices) in the energy and agricultural sectors, on the other hand, may or may not be sensible structural adjustment policy. Thus in one model, of an oil-exporting country (Nigeria), Bank advice on energy prices seemed appropriate. But in another model, of a different oil-exporting country with severe absorptive capacity problems and an imperfect public investment expenditure system (Indonesia), it appeared preferable not to raise domestic energy prices with world price increases; the allocative losses deriving from energy subsidies to the private sector were less than those resulting from the inefficient public investment that would otherwise result. And in one oil-importing country (Thailand), adjusting domestic energy prices so as to 'track' international prices also seemed unhelpful because of its indirect effects upon domestic savings rates and external borrowing. Similarly, "getting prices right" for rice seemed appropriate adjustment policy in rice-exporting Thailand but exacerbated adjustment difficulties in rice-importing Korea (where domestic rice prices were above world prices).

Inconclusive results were also found in the case of fiscal policy: "Is fiscal austerity a good structural adjustment policy? It depends."[17] In one case where real/financial interactions were analyzed and the distinction between "curb" and regulated financial markets was explicitly provided for—the case of Korea—the modeling of monetary and interest-rate policies generated "unconventional" results. In combination, higher (regulated) interest rates and monetary restraint led to a serious slowdown in investment and growth, the effects of which exceeded any positive effects for household savings.

How much improved economic performance—measured in terms of growth or broader measures of development—can reasonably be expected from policy reforms alone, assuming that they are in the right direction? Much of the international rhetoric and recent World Bank writing suggests that it would be great.[18] In fact, there is very little evidence to support such a presumption. A recent study of thirty-one developing countries found that growth experience in the recent past can be significantly related to only two major categories of price "distortion"—exchange rates and real wages—with some limited further relationship to the degree of protection of manufacturing.[19] No association was found between growth and the degree of taxation (or protection) of agriculture, the pricing of capital (interest rates), the rate of price inflation, or energy pricing.[20] Evidently not all pricing-policy changes are likely to be equally productive. Wages are self-evidently among the most

"political" of prices, and policies relating to them are likely to be part of a broader political-economic strategy. In short, "the correctness of the prices must be decided by reference to a comprehensive development strategy, and not independently of it. . . . Getting policies right is more than a matter of getting prices right."[21]

In its recent emphasis on improved policies for efficiency, the Bank has noticeably downgraded its previous concern for equity and the alleviation of poverty, as Sheldon Annis shows in this volume. Lip service is still paid to the social impact of adjustment programs, but in the Bank's own *ex post* country-level assessments of their effects, details have been conspicuously missing. Difficulties in agreeing upon appropriate approaches and finding reliable data may explain some of the failures in this area; but if there had been more will, more progress undoubtedly would have been made. UNICEF has expressed serious concern about these issues; in only one case—that of Ghana, and then only to a limited extent—has the Bank thus far availed itself of UNICEF offers of assistance, in association with interested governments, in the development of adjustment programs emphasizing both growth and a more "human face."

John P. Lewis's recent survey of the state of development economics notes that there is a "new orthodoxy" about, composed of what is probably a minority of "mainstream" development economists "headquartered at the World Bank." Lewis notes that "Their 'orthodoxy' is, as to economics, neoclassical. It carries forward with redoubled vigor the liberalizing, pro-market strains of the thinking of the 1960s and 1970s. It is very mindful of the limits of governments. It is emphatic in advocating export-oriented growth to virtually all comers. And it places heavier-than-ever reliance on policy dialoguing, especially between aid donors and recipients."[22] Members of the more eclectic majority are typically much more concerned to differentiate approaches between different countries and circumstances; many retain interest in distributional equity and the alleviation of poverty as important conscious policy objectives; most are also more interested in and concerned with political processes and constraints on policy action.[23]

A "pragmatic neo-structuralism" (the phrase is Albert Fishlow's[24]) seems to be gaining ascendancy not only in Latin America, but also in Sub-Saharan Africa. Recognition of the inadequacy of overly aggregative approaches to macro-economic analysis is coupled with that of the need to differentiate carefully among countries with different structural characteristics. The important role of markets and incentives is accepted; and there is a new skepticism about the capabilities and interests of governments. At the same time, however, the potential for a productive—if more carefully selective—role for the state is recognized. Simplistic recommendations

for reliance upon the 'magic of the marketplace' are seen as ideology rather than analysis.

There are no 'quick-fixes' or easy answers to the current debt and financial problems of Latin America and Africa. To play to the gallery that suggests that there are quick solutions would risk later disillusion and discredit. The World Bank must foster an image and role of continuing and flexible support for economic development in whatever ways are appropriate and politically acceptable in particular countries, periods, and circumstances. Increased program lending should be directed to countries making serious efforts to restructure their production for the purpose of medium-term external balance—*regardless* of whether their overall development strategies accord closely with the professionally controversial preferences of some of the Bank's major member governments and some of its staff.

Institutional Aspects of Policy-Based Lending

Development-oriented conditions are not only more complex and more intrusive than IMF-style demand management conditions; they are also much more time-consuming to develop, achieve agreement on, and eventually monitor. It is in the nature of the funds at present available from the Bank in the form of program loans that they cannot be disbursed as quickly as IMF funds. (Table 1 shows the fall in the share of program loans in Bank lending in 1985, despite the obviously increased need for them.) Nor can performance be monitored as effectively and quickly. The data required for reliable assessment of real development performance typically take much longer to assemble than do the Fund's financial variables, if they are available at all; and tradeoffs among the various elements of developmental performance must somehow be considered in an agreed manner. Consequently Bank-style (SAL) conditionality has often engendered more delay and controversy than IMF conditionality, both at the outset of a Bank-backed adjustment program and subsequently. Therefore, conditioning the disbursement of installments on structural adjustment and sector adjustment loans ("tranching") would normally be most efficient if based upon a relatively few indicators—ones relating, above all, to balance-of-payments management and/or sector-specific objectives rather than to controversial overall objectives on matters such as the size of government or market liberalization.

Developing countries have long argued for longer-term and more supply-oriented approaches to current adjustment problems—and hence, implicitly, for a greater role for the World Bank relative to the IMF—but many are now having second thoughts. Concern

about the Bank's inappropriate mixing together of *temporary* adjustment issues with more controversial matters of *long-term* development strategy have led to nervousness about an expanded Bank role in program lending. IMF conditionality, however imperfect and inappropriate, may be seen as less intrusive and less potentially damaging to development than that imposed by a World Bank with convictions of its own as to a universal recipe for growth. IMF conditionality also tends to be more consistent and predictable in its country-level application.

A significant Bank shift from project to program lending raises fundamental questions about the appropriate relationship between the IMF and the World Bank. The Bank's developmental concern obviously involves a longer time horizon than does the Fund's stabilization mandate; on the other hand, there is bound to be some overlap—and therefore some potential for mutually inconsistent approaches. At present, country-level consistency is achieved on an ad hoc basis. The World Bank is being brought into the picture more centrally in those cases where the Fund's relatively short-term approach has failed to restore balance; in such countries, the Bank is perceived as "bailing out" the Fund, and it is not clear what the continuing role of the Fund may be. In general, it would seem important to agree, on a country-by-country basis, as to which of the two should be the "lead institution" during a medium-term adjustment period.[25] The presumption must be that the Bank should "lead" in Sub-Saharan Africa and in the "Baker 15" (of the Baker plan) for at least the next five years. Whether or not such formal "lead" arrangements can be agreed, the Bank and the Fund must effectively synchronize their independent approaches to the same countries. "Cross-conditionality" is particularly counterproductive and annoying when its details are inconsistent and unpredictable. The evident incapacity of the Fund and Bank to work out joint approaches that are satisfactory both to the major shareholders and to borrowers suggests the potential usefulness of an independent high-level review of the appropriate mode for future Fund-Bank relationships. Such a review might also consider the best means of developing a single authoritative forum for the integrated consideration of the medium-term balance-of-payments prospects and financing requirements of individual developing countries.

The one point on which virtually all those with experience in the attempt to impose policy conditions in IMF and Bank lending agree is that the required policies do not hold if there is not serious commitment to them on the part of borrowers. If the relevant policies are not fully understood and supported by the government—or if they cannot carry domestic political support (or if opposition cannot be repressed)—agreement will only be transitory

and the adjustment programs ineffectual. There can be external education and persuasion concerning appropriate policies. But there cannot be effective external imposition. When all is said and done, borrowing governments must, above all, pursue their own interests. Policy-based program lending is therefore best seen as a device for encouraging overall policy dialogue, as Joan Nelson argues in this volume.

Within the Bank, just as outside it, there is probably a majority who advocate support for step-by-step changes in the appropriate direction, avoidance of unproductive confrontation over less important issues, and attempts to influence only a few major policies at a time rather than more dramatic reforms. Even those who might be expected to give vigorous support to orthodox Bank policies advocate lower expectations and longer time horizons.[26] The qualities of the Bank personnel most directly involved in the negotiation and monitoring of policy-based loans are therefore likely to be more important than generalized prescriptive proclamations. Knowledge of the details of country-level practices and experience, and sensitivity to them, are crucial in the elaboration of appropriate and credible policy packages.

Tensions between the Bank and debtor governments may by eased by expanding the practice of involving 'neutrals' in bilateral dialogue. Outside experts have been involved in controversial cases from time to time in the past (for example, in India in the 1960s, and in Tanzania in the 1980s[27]), and they have been liberally drawn upon in Bank research and other consultancies. The Bank's traditions in this respect have involved far greater openness to independent assessments and utilization of external research and opinion than has been typical of the Fund. These traditions should now be drawn on, both for overall assessment of Bank policies and, in individual country cases, for the assessment of adjustment programs and external resource requirements. An outside review panel has recently been suggested to examine the appropriateness of the conditionality attached to SALs[28]; such a panel could be more useful if it addressed the broader issue of policy-based program lending of all kinds in conjunction with a review of Bank-Fund relations such as that suggested above. At the country level, resort to knowledgeable authorities not in the employ of the Fund or Bank to produce 'neutral' background papers for consultative groups and debtor-creditor mediation efforts could also prove valuable.[29]

Implications for the Bank's Research Programs

Outward orientation, the use of markets, and a limited role for the state are constant themes in Bank conditionality. It is perhaps

surprising that neither the Bank nor the economics profession knows any more than it does about the differential circumstances in which these approaches are conducive to development. But these matters are theoretically complex—as is the reality posed by over one hundred different sovereign entities.

The uncertainties and disagreements in these spheres suggest room for productive theoretical and empirical research. The Bank's research activities, which deserve more funding than they have received, have been imperfectly integrated with the Bank's own internal evaluations of its lending programs or with emerging developing-country needs. In recent years, the Bank's research has also gained a reputation for reduced diversity of approach and increased predictability of results. It has devoted quite disproportionate effort to the documentation of the errors of governments and the advantages of reliance upon markets. Predictably, in these activities, the Bank's research has altered few opinions but annoyed many. Part of the renewed assault upon adjustment and development on the part of the Bank should be a research effort that is both more balanced and more integrated with the rest of the Bank's activity.

The most striking imbalance in recent Bank research effort is the scarcity of positive analysis of the costs of imperfections and failures of markets relative to the host of projects seeking to measure the costs of governmental interventions and mistakes. Rationalization of this as rectification of reverse imbalance in the professional literature of development economics is unpersuasive. Balanced and parallel efforts on both tracks would improve credibility in the professional community.

In current circumstances, research efforts within the Bank would benefit from considerable redirection—toward analysis of alternative adjustment-policy packages and the complexities of alternative sequencing of policies. The Bank's research on policy sequencing has thus far devoted disproportionate attention to trade liberalization. Analysis of overall distributional effects of alternative development policies has recently been resurrected; these issues should be addressed in the context of medium-term adjustment programs, and greater resources should be devoted to them. As has been argued, the analytical framework for the Bank's policy-based lending is not as developed as that for the Bank's project lending—or for IMF lending, for that matter, however controversial it may be.[30] Efforts to intensify Bank research on adjustment processes deserve strong support. Further research is needed on the following subjects among others: interrelationships between real and financial variables, determinants of savings and the efficacy of different savings-investment processes, the role of expectations, the relative

efficacy of sharp and gradual policy changes, the size of capital flight and measures to harness it, potential for increased utilization of capacity, the role of selective as opposed to "blunt" policy instruments, and improved understanding of differential supply elasticities and their determinants.

In donor agencies and the World Bank, as well as in developing countries themselves, too much attention has been devoted to project evaluation and not enough to overall policy frameworks and strategic planning. The redirection of Bank concerns toward the appropriateness of overall country-level policies suggests the relevance of further research on governmental economic decision-making systems. The development and sustainability of appropriate overall policies require sound systems for the provision of relevant and up-to-date information, both for daily decision making and for longer-term policy planning. Bank research might contribute to the development of such systems.

The Bank's current research program appropriately provides for investigation of the interaction between developing countries and industrialized countries within the world economy. Under this rubric, immediately relevant research effort could be directed toward balanced analysis of global requirements in support of successful adjustment and publicization of individual industrial-country performance in meeting these requirements. It is now conventional wisdom that adjustment success is significantly affected by such external circumstances as OECD growth, interest rates, market access, and adequate continuing capital flows. Adjustment of the dimensions now required in the developing world places obligations upon the industrialized countries. Large current-account surpluses can only be earned by major debtor nations if others permit or encourage their own deficits. Yet nowhere is the performance of individual industrialized countries vis-à-vis the requirements for successful developing-country adjustment set out against the background of either their own promises or of overall requirements. The Bank could play a useful role by documenting protectionist measures, new policies affecting the quality of aid and other capital flows, and other relevant policy changes—both positive and negative—undertaken by the industrialized countries—and in estimating their impacts on developing countries attempting adjustment. Such an effort by the Bank could usefully draw on other sources (Development Assistance Committee of the OECD, IMF, GATT, UNCTAD) to produce an integrated and comprehensive assessment of creditor as well as debtor performance in global adjustment. This material could be made available for country-level consultations between debtors and creditors and for consultative group meetings, and, on a more global basis, in the annual *World*

Development Report. Such an initiative might begin to restore the currently somewhat tarnished image of the Bank as an advocate of global development—rather than merely a disciplinarian for Northern banks and other interests.

Conclusions

An expanded role for the World Bank in policy-based program lending involves far more than structural adjustment lending. Sector adjustment loans are already more important than SALs, and greater flexibility in the use of other instruments may also be significant in the support of adjustment. Current Bank projections of program lending at 15–20 per cent of total lending do not appear to allow sufficiently for the expanded need for program lending over the next five to ten years. Program-lending decisions should be coordinated with those concerning debt restructuring and relief, and holistic approaches should be pursued to individual developing-country financing needs. If expansion of policy-based program lending is intended or likely to redistribute the overall flow of Bank lending among its member countries, this should be embarked upon explicitly rather than achieved as a by-product of the new policy.

There is general professional agreement on the need for supply-side restructuring toward tradables through appropriate realignment of real incentives, responsible fiscal and monetary policies, and expanded savings and investment. Disagreements remain, however, concerning the timing and sequencing of the required policies and such matters as the role of non-price constraints, links between real and financial variables, the role of interest rates, and the role and timing of import or financial liberalization. More fundamentally, there are profound political and professional disagreements concerning appropriate longer-run development strategies—including differences as to the degree of openness and the role of export expansion, the role of markets versus governments, the role of foreign investment, and the distribution of income.

Generalizations across countries are unlikely to be helpful; in fact, they are likely to arouse suspicions about the Bank's motivations. The Bank's conditions for program lending are therefore best confined to those relating to agreed medium-term balance-of-payments adjustment needs or, in some cases, to sector-specific issues, rather than to more controversial aspects of overall developmental strategy. Efforts should nevertheless be made to protect the welfare of the most vulnerable groups in overall adjustment programs.

Longer-term and development-oriented conditions are inherently more intrusive and more difficult to agree upon and monitor than are the traditional IMF conditions. There is concern that the Bank may be illegitimately mixing its own preferred brand of development policies with medium-term balance-of-payments adjustment policies. There is risk that agreed approaches to medium-term adjustment and necessary capital flows may be impaired by Bank efforts to pressure unwilling and unpersuaded borrowers.

Bank and Fund approaches must in any case be consistent. It would be helpful to assign one institution or the other a "lead" role at the individual country level—presumably the Bank in the major debtor countries and Sub-Saharan Africa for at least the next five years. An independent review of IMF-Bank interrelationships and policy-based lending might be highly productive.

Adjustment policies cannot be successful without both understanding and commitment at the country level. Dialogue rather than arm-twisting is the appropriate mode for Bank-member interaction. Knowledge of, and sensitivity to, country-level details are both critical to the development of appropriate adjustment programs. Step-by-step changes in the appropriate direction should be supported. 'Neutral' commentary on issues between the international financial institutions and borrowing members could be helpful in smoothing their relationships. The Bank has more of a tradition of using outside expertise than does the Fund, and it could now usefully draw on it.

The Bank's research program has been imperfectly integrated both with its own internal evaluation processes and with current developing-country needs. It has recently acquired a reputation for consistently pro-market approaches and would benefit from a more eclectic program. Much positive analysis remains to be done on adjustment processes and policies as well as their effects upon growth and distribution. The Bank might also develop an expanded role as monitor of policies and performances of industrialized countries as these relate to adjustment in developing countries.

Notes

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Structural Adjustment Lending
A First Review of Experience

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Operations Evaluation Department

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04

STRUCTURAL ADJUSTMENT LENDING
A FIRST REVIEW OF EXPERIENCE

EXECUTIVE SUMMARY

Introduction

i. The Bank responded quickly to the rapidly worsening international economic situation and the difficulties facing developing countries when it introduced Structural Adjustment Lending (SAL) in 1980. With the SAL, the Bank devised a new instrument to help address fundamental adjustment needs, which began to be clearly perceived in 1979/80. With the concept of SAL, the Bank foresaw what subsequent events have demonstrated, that achievement of financial stability and growth would require adjustment efforts to be sustained over the medium term. SALs have played an important role both in focusing the attention of governments on structural adjustment needs and in providing the Bank with a better instrument to help achieve comprehensive, economy-wide reforms which could not be effectively addressed through individual projects alone. SALs have also started within the Bank a process of rethinking policy analysis and its relationship to lending, with potentially lasting value for increasing its effectiveness.

ii. This report evaluates structural adjustment lending on the basis of the fifteen SALs to ten countries on which OED has completed Project Performance Audit Reports (PPARs). All but three of these reports have been issued during the past 15 months. SALs have been developing rapidly and by the end of FY1986, 38 SALs had been approved by the Executive Directors; a further 25 are in the pipeline for FY1987-88. In addition, sector adjustment lending has substantially increased.

iii. The design of reform programs under SALs in the ten countries reviewed in this report was directly related to the current economic situation in these countries. Seven countries were facing severe macro-economic problems when the SAL was first discussed—faltering exports, heavy current account deficits in their balances of payments, a high debt service ratio and declining or even negative growth of per capita GDP. In the other three countries major problems were looming on the horizon. All ten were finding it difficult to adapt to the changing international environment, and these difficulties were often compounded by a whole range of country-specific domestic problems. Also common to all ten SAL countries were severe liquidity constraints.

iv. Using the first fifteen SAL audit reports as the foundation of the study poses certain limitations even after some account is taken of other OED studies to reinforce the findings. The experience with those SALs does not fully reflect the learning process set in motion in the Bank, although attempts have been made to give some examples of the lessons learned from the early SALs which have been applied in later policy-based lending. Moreover,

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it is difficult to distinguish the impact of a SAL from the effects of other policy measures undertaken by the government, or from the effects of changes in the global economic environment and major unforeseen events in the country, such as prolonged drought or sudden changes in government.

Implementation and Impact of SALs

v. A number of borrowers experienced difficulties in carrying out major elements of their programs within the agreed time-frame. None of the ten countries succeeded in fully implementing its program on schedule. However, in four of them (Côte d'Ivoire, Jamaica, Thailand and Turkey) there was clear and substantial achievement; in four other countries (Kenya, Pakistan, Philippines and Senegal) performance was satisfactory in some areas but less so in others; and in two countries (Bolivia, Guyana) the program was not implemented.

vi. Expectations of Bank staff about the pace of improvements in export performance were too optimistic in a majority of the countries reviewed. With hindsight, this is not surprising, since the level of exports not only depends on timely implementation of export promotion measures, including incentives and institutional change, but also on market penetration and the global environment. For most countries, ensuring the right combination of demand management and nominal exchange rate policies to achieve a sustained depreciation of the real exchange rate necessary to stimulate exports turned out to be a difficult task, (see para. xxiii).

vii. While the authorities of most countries were aware of the importance of reducing the effective level of protection and the bias towards domestic production, entrenched domestic forces dependent on protection as well as the persistence of trade restrictions in developed countries acted as serious deterrents to the effective implementation of import liberalization programs. Although in many countries quantitative restrictions were reduced somewhat and, in some cases, so was the average rate of nominal protection, progress in liberalizing imports has in general been insufficient to put real competitive pressure on local industries.

viii. During the first two or three years following approval of their initial SALs, only two countries substantially reduced their budget deficits. The initial relatively poor budgetary performance in the other countries has mainly reflected inadequate implementation of the policies envisaged in Bank and IMF programs, but also in part an underestimation of the time required for such reforms and difficulties in maintaining the real value of revenues in weak economies experiencing inflation. However, preliminary indications are that by 1985 budgetary performance had improved in most countries.

ix. The experience with pricing policies was more positive. Structural adjustment programs for most countries provided that producer prices for key food and export crops would be increased to (or near to) their international

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market price equivalents, and that subsidies on fertilizer and other agriculture inputs would be reduced or phased out. Most of these policy changes were implemented effectively, though in some cases with some delay. When real prices of crops have been increased this has led to increased production. Energy prices were adjusted successfully in line with the SAL programs, encouraging energy conservation and development.

x. Rationalization of public investment has been an important component of the structural adjustment program for each of the ten countries under review except the Philippines. Public investment reviews have improved the quality and composition of public investment programs in most SAL countries, but the administrative and institutional support frameworks are still fragile. Permanent improvement will require continuing vigilance on all aspects of institutional structure, including retention of capable staff, use of economic criteria for project selection and evaluation in operating agencies, and inter-ministerial planning and budget coordination.

xi. It is difficult to evaluate the implementation and impact of institutional reform programs, because of the extended period required for their successful completion. Though the management of public enterprises has been strengthened in most countries, the process of institutional reform has been slow. Even the relatively less complicated institutional development activities, such as financial and management audits of public enterprises, were often difficult to accomplish. Despite this, experience in SAL countries suggests that inclusion of institutional issues in SALs can be very fruitful in getting governments to address basic issues.

xii. Although the primary objective of SAL is to support programs of policy and institutional change, it has also proved to be an efficient instrument to provide quick-disbursing resources. In most countries SALs have been processed and disbursed fast, and in years of SAL disbursements the proceeds from SALs financed on the average 10 percent of balance of payments current account deficits in the countries reviewed.

Lessons Learned and Implications

xiii. When the first SALs were made the Bank had little practical experience in this type of lending, and there were few precedents. It is thus not surprising that some difficulties arose and that there were disappointments as to the speed with which the intended reforms were implemented and the measures took effect.

xiv. In almost all SALs reviewed the process of preparing, legislating and executing reforms took much longer than anticipated. In general, institutional reforms were even more difficult to implement than policy reforms.

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On the whole, the implementation capacity of most countries was overtaxed by the complexity and the wide-ranging conditionality of many of the first SALs. The capacity of governments to implement reform measures was usually inadequately assessed. Also, the audit reports often noted overoptimism on the part of Bank staff as to the degree of the government's commitment to, and understanding of the reform measures.

xv. In the preparation and appraisal of SALs, insufficient attention was paid to implementation processes and how to go about achieving the agreed objectives. Consequently, there was limited discussion between the Bank and governments on the detailed steps and plans to be followed, increasing the probability of unexpected difficulties.

xvi. Partly as a result of the slower than anticipated implementation of reforms, the impact of the structural adjustment programs on a country's economic performance has generally remained below expectations. Another important reason is that the world economic environment deteriorated to a much larger extent than foreseen. Sluggish demand for the exports of developing countries, worsening terms of trade and high international interest rates all led to a situation in which the external capital requirements were much larger than presented in the adjustment packages. The greater scarcity of foreign exchange often resulted in an import capability lower than anticipated with obvious negative effects on capacity utilization, production and exports.

Impact on Governments

xvii. An important conclusion of the review is that in most countries SALs have played a major role in focusing the attention of governments on structural problems and the links between various policy instruments. In spite of the delays and difficulties, in most of the countries reviewed a worthwhile reform process has been set in motion, and there is a growing awareness of the need for a better balance between market-oriented "indirect" policies and direct government intervention.

xviii. In the SALs reviewed the Bank could have contributed more to enhancing the process of policy formulation and execution in the countries. One of the most important services the Bank can provide is to help ensure that the process of policy reform is "internalized" in the country as quickly as possible, so that the reform program is designed by the country itself and integrated into its longer-term development program. The basis for this must be laid at the preparation stage, by seeking the active participation of the most important parties involved in diagnosing the problems and designing solutions, ideally with the Bank in an advisory capacity. Such active participation of relevant parties has been successfully sought in later SALs, such as in the second SAL in Senegal.

Impact on the Bank

xix. Well before the introduction of SAL it was recognized in the Bank that deficient policies and inefficient institutions often stood in the way

of an effective use of resources for development. But fully satisfactory instruments to address the need for economy-wide reform did not exist. SAL has provided the Bank with an additional instrument to help achieve comprehensive policy reform which it previously was unable to address adequately through normal project lending alone. It has helped to focus other lending operations on the achievement of policy objectives so that various lending instruments can be used in a coordinated fashion. On the other hand, project and sector lending and the associated sector analyses and knowledge of the countries' investment programs have been indispensable building blocks in the design of SALs.

xx. SAL has also given the Bank an instrument through which country economic and sector work (CESW) can be used more effectively, and can assume major operational significance. To develop the potential of SAL more fully, continuing improvements are needed in the design and implementation of CESW. Good CESW should provide analysis useful not only to the Bank in the design of programs, but also to the countries themselves. This analysis should be practical and concrete. It should address questions such as: "Where else have the proposed reforms worked?" "What will be the economic implications in other sections of the economy?" and "What are the possible negative social implications?" Answers to those questions can be more satisfactorily formulated when there is active country participation in the design and execution of CESW. In addition, the implementation experience underscores the need for further policy analysis and research to improve the Bank's understanding of the complex interdependence of policy measures and the link between changes in policy measures and expected improvements in economic performance variables.

xxi. From the experience it is apparent that technical assistance associated with SALs can better be handled in free-standing projects, rather than in SAL packages themselves. This is a lesson that has already been learned and applied in later SALs. The skills required of Bank staff who prepare and supervise institutional and technical assistance elements are very different from those needed to supervise the implementation of policy reforms. An important advantage of free-standing technical assistance projects is that they can be prepared, appraised and supervised by specialized staff.

Bank-IMF Cooperation

xxii. The close cooperation with the IMF before making a SAL underscores the importance the Bank attaches to a reasonable degree of stability as a prerequisite for growth. In the ten countries reviewed consultations took place between the IMF and the Bank in the design of their respective programs. The increasing cooperation between the Bank and IMF is improving the quality and consistency of policy advice, though further improvements are needed in some areas, particularly in exchange rate policies.

xxiii. In accordance with the existing understanding between the managements of the two institutions, negotiation of exchange rate adjustments is

the responsibility of the IMF, and Bank staff are instructed to refrain from discussing with country officials specific levels of adjustments required. The experience in most of the ten SAL countries suggests that real exchange rate changes have not been been sustained sufficiently for the programs for export promotion, import liberalization and tariff rationalization to be carried out successfully. Bank staff would like to see exchange rate policies pursued more vigorously to ensure medium-term growth in output and exports in addition to a sustainable balance of payments situation. Improved coordination between the Bank and IMF should ensure that exchange rate policies (which are prescribed in terms of nominal rates) are consistent with the other policies in Bank and IMF programs in order to reach the desired level of exchange rates in real terms.

Adequate and Coordinated Preparation and Supervision

xxiv. A more concerted preparation and supervision effort is necessary, requiring greater interdepartmental coordination and flexibility to take full advantage of the skills available within the Bank. In particular, greater effort by Bank staff is required to analyze and discuss with governments in detail how, in the country's specific circumstances, the proposed reforms can be implemented best. This would help avoid unexpected difficulties at a later stage and build up the government's own implementation capacity. The broad scope of some SALs has often overextended the Bank's supervision capacity, and the intersectoral nature of SALs has at times strained regional management structures and procedures. Not infrequently, the preparation of new loans and other work appears to have taken precedence over supervision.

Cofinancing and Donor Coordination

xxv. Aid coordination and co-financing have not featured prominently in the first SALs, but there appears to be considerable scope for involving other donors in the structural adjustment process. Greater impact and better harmonization of aid programs could have been achieved in many countries through concerted efforts to discuss the SAL objectives and strategies with other donors. It might have helped to avoid situations in which the availability of alternative sources of finance caused governments to postpone much-needed policy reforms. Cofinancing in a formal sense may not be necessary or even desirable to achieve this aim; the important issue is to ensure that various parties providing finance do so in support of common policy objectives agreed with the government. This is another lesson that has been learned and is being practiced in later SALs.

Social Implications

xxvi. There was very limited attention in the first group of SALs to the social implications of the proposed policy changes. SALs, however, were not intended to address poverty and social issues in a direct manner. Implicitly, the Bank expected the lower income groups to benefit in the medium and longer term from the policy reforms. The Bank uses other lending instruments which are more efficient than SALs, to address poverty issues directly.

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Nevertheless, it has gradually become apparent that there were social costs associated with adjustment programs which should have been analyzed and selectively addressed, either in SALs or, if more appropriate, through other lending instruments.

xxvii. Demand management measures caused frictional unemployment from job changes and temporarily lower standards of living for some people. Urban wage earners have suffered losses to the extent that their wage increases were lower than inflation rates. Public sector employees seem to have been especially hard hit, through wage freezes, in virtually every country. Moreover, previously subsidized or regulated prices of basic consumer goods and services have risen faster than other prices as government subsidies have been substantially reduced or eliminated. Gainers in the resulting income redistribution appear to have been farmers. However, in considering those facts it should be borne in mind that some of the unemployment and income losses were in fact the intended objectives of the stabilization and adjustment programs. It is also probable that these costs would have become much more severe at a later date had the downward spiral of increasing external payments and debt problems, the inability to pay for vital imported inputs, and the resulting further declines in production and exports been allowed to continue.

Ex-Ante and Ex-Post Conditionality

xxviii. The reform process is more likely to be sustained and the commitment to it reinforced if the SAL is made dominantly in support of key reform processes that have already been initiated, and less against promises of future action. In the two cases (Thailand and Turkey) where the key reforms were made before Board approval, the programs were implemented best. Prior initiation of reforms reduced the vulnerability of the governments concerned to charges by the opposition of yielding under duress to Bank imposed prescriptions, and for the Bank it demonstrated commitment to the reform process. Countries which placed the greatest reliance on commitments to future actions experienced greater delays in implementation. They also tended to face a large number of complex conditions, which could not realistically be expected to be fully implemented.

Conclusion

xxix. In conclusion, it can be said that the SALs have provided the basis for assisting a country's long-term restructuring efforts and at the same time substantially reinforcing the "development dialogue". The implementation of reforms has been slower than expected and the impact on the economic performance of the countries involved less than hoped for. It is difficult to be definitive about the conclusions that can be drawn from the limited number of the early SALs that have been evaluated because SALs as an instrument of lending have been evolving rapidly. For the Bank, this has been a learning process just as much as for the countries themselves. Some of the major lessons learned, and which are being incorporated in current Bank practice, have been discussed above. In particular, it has become apparent

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that the Bank needs to assess the commitment of the important agencies concerned and, to the extent possible, assist countries to forge a consensus on the reforms that are to be undertaken. Second, SALs are by no means the only way of providing policy-based lending, and sometimes sectoral adjustment loans or projects supported by free-standing technical assistance operations can serve the purpose. Such an approach, with SALs, sector and project loans designed to address focused policy objectives, may be better geared to the implementation capacity of many countries and help to avoid the temptation of the early SALs to load the operation with a multitude of complex conditions which could not realistically be expected to be implemented fully.

xxx. More narrowly focused SAL operations, complemented by sector and project operations, make it easier for the Bank to combine the specific skills required for adequate preparation and supervision. In terms of preparation, they would allow the appropriate focus on implementation requirements or implications in the careful detail that is necessary to avoid unexpected difficulties at a later stage. An additional advantage of these operations, if well understood and agreed to by the government, is that they may lead to a greater degree of "up-front" conditionality. Supervision missions would then be less preoccupied with the adherence to conditions, and have more time for assistance with the country's implementation difficulties.

xxxi. Improving CESW, associating country officials more systematically with Bank staff in designing reform programs, "internalizing" the process of policy formulation, supporting SAL implementation more intensively and improving the understanding of the complex interdependence of policy measures and of their impact on economic performance should all contribute to better analysis, appraisal and implementation of SALs. Better analysis should help Bank staff to avoid overoptimism and to press only for those conditions that address critical areas. For the Bank, all of the above suggestions are labor intensive, requiring a sustained effort at efficient marshalling of resources into priority areas in support of this important dimension of the Bank's activities. In many cases the time-consuming nature of these objectives may well lead to the need for delaying the commitment of funds till the operations are prepared adequately.

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World Bank Support for Structural Adjustment in Developing Countries: Structural and Sectoral Adjustment Lending

In the late 1970s and early 1980s, after the second oil shock, many developing countries faced a serious balance of payments crisis. Among the immediate reasons contributing to this development were a sharp increase in the import bill and recession in OECD countries, high interest rates on external debt and a sharp reduction in availability of external credit from commercial sources. However, the problems of the developing countries were only partly due to the worsening of the international economic environment. The crucial factor was the distortions and weaknesses in the economic policies which had evolved in many of these countries in the previous 10 to 15 years. The worsened international economic environment eventually brought out in the open the weaknesses of these policies. Distortions and inefficiencies which were acceptable in a favorable economic environment involved costs which were unbearable in the new situation.

IMPORTANCE OF POLICY FRAMEWORK FOR DEVELOPMENT

The Bank has traditionally been involved in supporting the developing countries by loans for specific investments as well as sectoral investment programs. The bulk of the Bank's lending has been for specific investments, i.e. projects. Experience, however, shows that there is a very intimate relationship between the success of a project and the policy environment: good projects in a poor policy environment are not necessarily good. In other words policies matter even for success of projects. The interaction of the policy environment and the productivity of projects can be illustrated by two examples. Consider a project evaluation loan for an irrigation project which is evaluated to be technically and economically a sound. However, the increase in agricultural production that was expected from the expansion of irrigation may not be realized if the country is following a policy of keeping low producer prices for farmers in order to provide cheap food for the urban population. In this situation, the sound irrigation project would not lead to the increase in agriculture production because price incentives were not there. It follows that it is important to deal with agricultural price policy first or at least at the same time as providing finance for the irrigation project.

Another similar example can be given in the context of an energy generation project. On the basis of the expected growth of demand for energy and the installed generation capacity it is concluded that immediate investment in power generation is needed in order to prevent shortages in power say 5 years late. However, the country's energy prices are significantly lower than the world prices. (They are either being subsidized, or the country is an oil producer not charging the opportunity cost to its local population.) As a result energy intensive patterns of production and consumption are encouraged. The reason why demand is expected to outstrip installed capacity 5 years in the future is a policy failure. Therefore, this project, which may look like a good project in terms of providing the needed energy efficiently is actually required only because of the distorted energy pricing policy. Correcting the policy distortion on energy prices will lead to a more effective utilization of energy and reduce the rate of growth of demand. The power project could be delayed

several years and resources used for other high priority projects, necessary at the present time.

Examples like these emphasize the need for a broader approach in viewing the role of projects in development. If significant policy failures are allowed to persist, looking at projects in isolation from the policy framework and evaluating them even using sophisticated techniques of project evaluation may not result in the "correct" investment decisions. This was why adjustment lending or policy based lending was adopted by the World Bank in 1980 as an important instrument for supporting development in member countries.

CHARACTERISTICS OF ADJUSTMENT LOANS

The objective of an adjustment loan is to support an adjustment program, i.e. to a program of policy and institutional reform. The loan is explicitly linked to the implementation of an agreed adjustment program. and not to investment, either at the sector or project level.

The adjustment program is a medium-term program, covering a period of, say, 5 years. The first year or two are spelt out in greater detail and include a time table for certain specific measures which the country is expected to undertake. The implementation of the program is monitored and the disbursement of the loan is linked to the undertaking of these specific time-bound measures. The loans, therefore, are usually tranched. A part of the loan is made available when the loan is approved; then 6, 8 months or sometimes a year later the remainder of the loan is released after certain agreed measures have been undertaken. The tranching process is an incentive for the country to continue with the agreed adjustment program. However, there is allowance made in the monitoring of implementation and in tranche release for unforeseen developments, both domestic and international. The monitoring is, therefore, not a mechanistic one but involves judgements and incorporates the possibility of mid-term corrections.

A third characteristic of adjustment loans is that these loans are usually considered part of a series of loans. This reflects the judgement that in many countries the structural problems, distortions and weaknesses are deep seated and the adjustment process is likely to be an extended one. This may be the situation especially in sub-Saharan Africa and other low-income countries.

A fourth important characteristic of adjustment loans is that they usually finance the import of raw material and intermediate goods. There is no a priori reason that this be so. In principle the disbursement of such loans could be linked to expenditures on an ongoing investment program. In practice there are few cases where this has been done. There are two reasons for this. First, adjustment loans have usually been made to countries that are facing acute balance of payments difficulties. The priority at the time was not to undertake new investment and build new capacity but to use existing capacity which was idle because of shortage of imported inputs. Secondly, disbursement against raw materials permits some benefits of the loan, in terms of production, to be available in the short period. Because of the increased availability of raw materials and intermediate goods made possible by the loan production increases and employment is maintained. This helps contain the burden of adjustment and helps the country to adhere to the adjustment program.

Sometimes it is argued that since adjustment loans often finance the import of raw materials and intermediate goods they are not productive. They add to debt but they do not add to the repayment capabilities of the economy. This criticism is incorrect, because one should not look at what the loans are disbursed against, but at the adjustment program the implementation of which the loans are supporting. The fact that the adjustment loans are financing import of raw materials is subsidiary. The important point is that they are supporting the implementation of a program of policy and institutional reform. The improved policy framework reduces waste, improves the efficiency of resource allocation and supports the re-emergence of viable growth. Project loans add to repayment capacity by adding to creating a productive asset. Adjustment loans add to repayment capacity by improving the policy framework.

There are broadly two kinds of adjustment loans. Economy-wide comprehensive adjustment programs are supported by structural adjustment loans. Less comprehensive adjustment programs, more limited in scope, are supported by sector adjustment loans. The sector can be defined functionally such as agriculture, industry or energy sector or as an area such as trade and export development. In the latter case the sector covers trade across the whole economy. Initially the Bank focused more on structural adjustment loans. The countries that approached the Bank were often in deep economic difficulty and were prepared to undertake comprehensive adjustment programs. In FY1980 3 SALs were approved to Kenya, Turkey and Bolivia. In FY1981 the number increased to 7 and has been around 6 or 7 per year since then. In later years sector adjustment loans increased dramatically as more and more countries undertook adjustment but were not quite ready to embark on a comprehensive program. Initiating sector adjustment programs may eventually generate a momentum for reform and the initial adjustment program can spread to other sectors and eventually embrace the whole economy. For example, in Ghana the Bank started with a reconstruction and import credit. Then an export restructuring operation was followed by a second reconstruction import credit and now a structural adjustment loan in support of a comprehensive adjustment program is under preparation. Similarly in Morocco adjustment lending started with a program for industrial and trade policy reform. This was followed by support for adjustment in the agriculture sector and in education. Now a structural adjustment loan is under preparation.

In other cases the Bank started with a structural adjustment loan and then the adjustment process in individual sectors was deepened by sectoral adjustment loans. This happened in Turkey where sectoral adjustment loans followed a series of structural adjustment loans, as well as in Korea.

Adjustment loans are part of the country assistance strategy of the Bank. In a country undertaking an adjustment program, the Bank supports policy reform and adjustment not only through policy loans but also through project and other types of loans. Project loans stimulate the resource shifts and supply responses which the adjustment process is designed to bring about. For instance, an adjustment loan may support the improvement of the policy environment for industry by reducing the levels of protection, thus, improving the efficiency of the industrial sector. The reduction of protection will have some negative effects on inefficient firms and activities. An industrial rehabilitation and restructuring loan may support specific investments in specific industries to help firms take advantage of the new improved policy

environment. Thus there is a complementarity between project lending and our policy lending. Both are part of an overall effort by the Bank to help the country carry out its adjustment process. In fact in many countries if an adjustment program were not undertaken, the Bank may not be able to continue with project lending in the face of economic crisis.

CHARACTERISTICS OF ADJUSTMENT PROGRAMS

The fundamental objective of the adjustment programs is to improve th efficiency of resource allocation and increase the domestic resource mobilization in the economy. This is expected to help the reestablishment of the economy onto a viable growth path.

The common themes present in almost all adjustment operations reflect the common nature of the distortions prevalent in many developing countries. First, almost all programs include measures to reduce the role of government intervention and increase the role of the private sector. In many developing countries the public sector, over the past 15 or 20 years has taken on functions that it is not efficient at. It has also absorbed too large a share of savings and crowded out the private sector. In many countries we believe that the government should be doing more in providing good economic and social infrastructure for the economy - transportation, telecommunications, primary education and health. On the other hand, they should not be excessively involved in directly productive activities which can often more efficiently be undertaken by the private sector on the basis of this infrastructure. Therefore, adjustment programs attempt to create conditions for an increased role for the private sector. Secondly, the adjustment programs encourage the economy to rely more on market forces and less on administrative intervention and control. Administrative regulations and price controls in many countries - have contributed to inefficient resource allocation and waste of resources. Quantitative restrictions and import licensing, for example, create large rents for importers and generate corruption, "rent seeking" and directly unproductive activities. Price controls affect incentives and inhibit supply while subsidies strain the budget and may lead to wasteful consumption of the items subsidized. Many programs undertaken ostensibly for the poor provide benefits for the rich and powerful. In those situations a move towards greater market orientation may contribute significantly to resource mobilization and efficient resource allocation.

Almost all the adjustment loans in the early years focused largely on trade policy reform. The fact that countries were facing acute balance of payments helps explain this focus. Many of them had extremely high rates of protection through quantitative restrictions, import licensing and foreign exchange controls. This had led to the development of inefficient industrial structures geared to selling in the domestic markets because they were too inefficient to compete abroad. Overvalued exchange rates added to the anti export bias of policy. Trade policy reforms aim to reduce the level of protection and increase the relative attraction of export sales as compared domestic sales. Realistic exchange rate policies are a key element in any program for encouraging exports. Schemes for duty-free access of imported inputs are also used to create a "free trade situation" for exporters.

Another important area is the reduction of trade barriers. The first priority is for an elimination of quantitative restrictions and import licensing, usually in stages. On tariffs the approach usually adopted is to seek (a) a lower average level of tariffs and (b) a reduced variability of the tariff structure. With this objective agreement is reached on a maximum tariff. This requires that outlying very high tariffs be reduced to this maximum. Then over time efforts are made to reduce the maximum itself. Secondly, tariffs on items like capital goods and intermediate goods which often enter duty free as an incentive to industry are sought to be increased. The long-term objective--the ideal--which guides these changes is to move towards a uniform tariff at a reasonable level.

Reform in the trade policy area also includes measures to strengthen the institutional basis for export promotion, e.g. marketing structure, export promotion centers and design and quality enhancement efforts.

A second area where the Bank puts a lot of importance in its policy loans is rationalization of the public investment and expenditure program. In many countries these programs are too large given the available resources and implementation capabilities and are absorbing too much of the savings of the economy. In order to reduce the size of the investment program the first step is to eliminate, delay or reduce in size the most obvious white elephants and low priority projects. Secondly, the relative sectoral balance of the program is shifted towards the sectors like energy and infrastructure which are seen to be of high priority. Often a core investment program consisting of the highest priority projects is distinguished and its implementation protected against unforeseen circumstances. Thirdly, very often in periods of stringency there is a tendency to cut expenditure on goods and maintain employment. For example in education the teachers' salaries may be protected but expenditure on textbooks, paper and supplies may not be. Thus the quality of service may be drastically reduced even though overall expenditure on education is roughly maintained. Therefore, it is important to also focus on the balance in expenditure within broad sectors to reduce negative impact of expenditure reductions.

A third area of importance is the liberalization of prices so that they can reflect real scarcities in the economy. Clearly elimination of price controls is important for greater market orientation of the economy. Adjustment loans may have agreements to raise the level of producer prices for agriculture or raise energy prices, or decontrol industrial prices. For instance, in Madagascar - the industrial sector loan - one of the key elements is the gradual elimination of government price controls on industrial products. In this context the rationalization of the subsidy system is also important. In many countries low producer prices for agriculture coexist with subsidized prices for the consumers. As a result agriculture production stagnates and demand for agricultural commodities increases. Consequently, the country may have to increasingly resort to imports which puts more strain on the balance of payments. A more rational price structure helps increase agricultural production and contributes to the balance of payments.

The fourth area for policy action is domestic resource mobilization and savings. In many countries the public enterprise sector is a big absorber of government funds. In some countries with large budget deficits almost half of the total deficit may be traced to the public sector enterprises. Often the

prices of the output of public enterprises are controlled while their expenditures--particularly investments--are not. However, public enterprise reform is not simply a matter of raising prices and tariffs for public utilities but also requires measures to improve their efficiency. This requires programs for management improvement; restructuring of some enterprises; closing down some plants; and privatization. A second important set of measures for resource mobilization relate to interest rate policy. The establishment of realistic interest rate policies with positive real interest rates increases financial savings and the channelling of resources for productive investment.

Structural adjustment programs need to emphasize institutional reform. An important objective of adjustment is the institutionalization or internalization of the reform process. Measures like those raising agricultural and energy prices or rationalizing the public sector investment program are not once for all measures. It is important to create institutions and processes which would lead to automatic consideration of these questions in the country itself without any external stimulus. For example, to encourage rational public sector investment units which have the capability of reviewing, evaluating and prioritizing new projects may be created or strengthened either in the planning ministry or in the individual line ministries. A process where these units make recommendations for the cabinet to consider before projects are approved needs to be established. Similarly, in agriculture, units in the agriculture ministry may be established with the responsibility to study price and cost trends and make recommendation for price adjustments in the light of changing conditions.

Finally, countries need technical assistance at all stages of the adjustment process--programs formulation, implementation and evaluation. Therefore, most of adjustment operation either have a parallel technical assistance loan or include a technical assistance component within the operation itself.

TRENDS OF ADJUSTMENT LENDING

First, there has been an increase in the number of adjustment loans and amount of funds committed under them. Initially there about 5 or 6 loans per year. During FY1983-85 the number averaged about 15 loans per year. In FY1986 it increased to 25 loans. In FY1987, we expect the number to go up to about 35 loans. In FY1981 total commitment for adjustment lending was $854 million. In FY1986 the Bank committed about 3 billion dollars in adjustment lending; in FY1987 the figure is expected to go up to nearly $4 billion. The increase in adjustment lending reflects the fact that more and more countries are undertaking serious adjustment programs. Many countries were not ready initially when they faced difficulty to undertake adjustment programs expecting that the problems would be short-lived or that they would have access to external funds to tide them over without adjustment. Now, most countries have come to realize that the problems are going to persist and that the costs of poor economic policies are high. Therefore, there is a resolve in the countries to undertake adjustment programs. This is the main reason why there has been a rapid increase in the number of adjustment loans.

Second, within the adjustment loans the number of structural adjustment loans has remained roughly constant, about 5 or 6 per year. There has been a has been in the number of sector adjustment loans partly because it

is a more flexible instrument than SALs. As stated earlier many countries are reluctant to start off with a comprehensive adjustment program. They are prepared to start with modest and limited reform confined to one or two sectors. Often the modest program builds up a momentum for reform which results in time in a comprehensive program.

Thirdly in sector adjustment lending, initially trade policy loans were most common. There were also loans for the directly productive sectors like industry and agriculture where also trade policy issues were important. Now, new sector loans are increasingly focusing on areas like the public sector, financial sector and tax policy. Partly this reflects the fact that progress on trade policy is well in hand following early adjustment operations. It also reflects the growing realization that financial, fiscal and public sector issues inhibit the progress of structural adjustment following from trade policy changes.

As a proportion of the Bank's total lending, the share of adjustment operations has been increasing. It was about 3 percent in FY80, 8 percent in FY82, 15 percent in FY84 and 18 percent in FY86. In FY87, it is expected to reach 24 percent. However, this upward trend is not expected to extrapolate further, with the proportion of adjustment lending to total lending remaining in the region of around 20-25 percent. There are two reasons for this. First, while certain countries undertaking adjustment programs are coming in, others (e.g. Korea, Turkey) that have already taken the major steps, can now go back to project or sector investment lending. For these countries it is now a matter of being able to adhere to and fine-tune the policy framework in an environment of growth and stability. Secondly, there is a complementarity between project lending and policy lending which has been mentioned earlier. In fact, an increase in policy lending has usually been associated with an increase in project lending. For example in Turkey adjustment lending started in 1980-81 within a total program of about $250 million a year. Total lending per year to Turkey increased to $700-$800 million a year. The bulk of the increase was in policy-based loans but there was also an increase in loans for specific investments for sector investment programs. Project lending, is an important part of the Bank's support to the adjustment process.

SOME ISSUES

One of the lessons that have emerged from the Bank's experience with adjustment lending is the close and intimate link between structural adjustment and stabilization. Structural adjustment and stabilization are mutually supportive. Structural adjustment cannot take place if financial stability has not been restored. If a country has inflation of 100 percent per year, one can not expect relative prices that have been freed from price controls to give private investors the right signals for investment. The interaction between stabilization and adjustment involves close working relationship with the IMF. The Bank-supported adjustment program needs to go hand in hand with the Fund-supported macro-economic program. Unless a sensible macro-economic policy is in place, it is difficult for the adjustment process to be successful. However, if stabilization measures result in deep recession and reductions in investment and consumption structural adjustment is inhibited. This was the experience of Phase I of the adjustment process during 1982 to 1985. As a result, the need for growth-oriented adjustment programs is now more widely recognized. However,

growth-oriented adjustment programs require more external resources. Commercial banks along with bilateral donors and multilateral institutions need to provide these resources. The developing countries have to play their role in undertaking a rapid reform process if these sources come forward with sufficient resources. This mutually reinforcing role of external resources and adjustment programs is very important. What is required is a clear and strong link between the implementation of the adjustment process and the availability of resources. The Bank's policy loans provide a vehicle in which this link can be established and effectively monitored. Adjustment loans help ensure that the external resources are directly linked to adjustment and are not a substitute for it. Thus cofinancing by aid agencies with the policy lending of the Bank is an effective way of ensuring the progress of policy reform and the reestablishment of viable growth in developing countries.

The issue of the social costs of adjustment has also become increasingly important as it has been realized that a quick resumption of growth in many countries is unlikely. Adjustment programs have often been accompanied by a reduction in living standards, incomes, and consumption. Most of these social costs are transitional, however, incurred as aggregate demand is brought in line with aggregate supply and as some workers become temporarily unemployed as the economy is restructured. Many of these costs also are unavoidable. However, they can be moderated by well-designed adjustment programs and by special measures to protect the poor.

Adjustment programs help the poor over the long term principally by establishing a more favorable policy environment that will promote growth and generate productive employment. Over the shorter term, adjustment programs benefit the poor by eliminating policy-induced distortions which limit the mobility of resources, suppress agricultural prices and subsidize capital. There is thus less of a conflict than is generally believed between an adjustment program's goals of efficiency and its effects on the poor.

While adjustment programs clearly benefit the poor over the long term, there may be transitional costs, some of which bear on the poor. If the adjustment process is expected to be a protracted one there is an important need to focus on measures to ameliorate these costs without undercutting the adjustment program. Two areas offer the most scope for doing this: ensuring that social expenditures, such as those in health and education, are cost-effective and focused on the poor; and compensating the poor directly.

Redirecting Social Expenditures. By reducing subsidies for many services, governments can free resources for programs that are more socially productive, including those that provide greater benefits to the poor. An example of this is charging more for higher education and using the additional funds to expand primary education. Another is to charge people more for curative health services and to use the funds for expanding and subsidizing preventive services. Such measures can also lay the basis for more efficient programs in the longer term.

Compensating the Poor Directly. One way of compensating the poor who are affected by adjustment programs is through employment schemes. Direct employment in public works and services can generate work primarily for the poor, but such schemes can be expensive and therefore have to be well targeted to be cost-effective. Food-for-work schemes can also help.

Well targeted compensatory programs to lower food costs and improved nutrition can also help greatly in reducing the social costs of adjustment. Another possibility is selling food to target groups at a subsidized but still substantial price, often through food stamps or coupons. Yet another is through general food subsidies. To be cost-effective, these subsidies should target the poor -- by focusing on nutritional foodgrains that the poor consume or on regions where the poor are concentrated.

Vinod Dubey
4/29/87

Summary Abstract
Policy-Based Cash Transfer Programs
The Case of Costa Rica

Summary

This report is the first in a series of CDIE evaluations of policy-based cash transfer assistance. It examines how A.I.D. applied conditionality to support Costa Rica's economic development during the period 1982-1987.

Costa Rica's economy suffered some minor ups and downs but had grown at a healthy 6-6.5 percent a year for the 20 years prior to 1980. However, with the doubling of oil prices in 1979 and the major world-wide recession that followed, Costa Rica's economy suffered major problems. Government policies failed to face the new economic realities. Inappropriate prices, subsides, and controls only made matters worse. The result was rampant inflation, rapidly falling GDP, declining investment and a major buildup of commercial foreign exchange debt. A massive, multi-year infusion of ESF cash transfers (averaging 3.8 percent of yearly GDP) helped lay the groundwork for change. A.I.D. worked closely with the IMF and World Bank to gain agreement with the government on a long list of policy reforms. The government recognized the seriousness of the problems it faced and introduced a broad range of economic reforms. The evaluation noted that some policy actions had not been taken. However, on balance the government put the correct set of policy incentives in place, the Costa Rican economy responded, and economic growth resumed at a modest, but healthy pace.

Background of the Problem

During the late 1970s, the terms of trade started to turn against Costa Rica. The price of coffee (the major export crop) fell sharply and petroleum prices doubled. Rather than taking the necessary restructuring actions, Costa Rica attempted to maintain its growth performance through heavy internal and external borrowings. A policy of strong monetary expansion maintained existing levels of public and private consumption but caused inflation, an overvalued exchange rate and a reduction of net foreign exchange reserves to negative levels. In July 1981, the GOCR unilaterally suspended principal and interest payments on an external debt whose servicing requirements it could no longer meet. Cut off from external financing, Costa Rica's economy rapidly deteriorated. GDP growth, which had averaged 6-6.5 percent a year from 1960-1980 fell to -4.8 percent during 1981 and 1982. Open unemployment reached 9.5 percent in 1982 and inflation soared above 100 percent.

A.I.D.'s Assistance Approach

A.I.D.'s general strategy was based on the four principal goals of the National Bipartisan Commission on Central America (The Kissinger Commission): economic stabilization; laying the basis for long term growth; spreading the benefits of growth; and strengthening democracy. Central to this strategy was the need to maximize the involvement of the private sector in the development process, allowing it to take the lead in fostering export-led growth, and to achieve structural change through policy dialogue.

With its strong tradition of democracy and social justice, Costa Rica's success was important to the U.S. goal of establishing free, stable, democratic nations throughout Latin America. The country's dedication to democracy did not falter in the face of reduced living standards and the growing threat of neighboring Nicaragua. The social and political risks of a stagnant or even declining economy were contrary to U.S. interests in the region. In particular, with the turmoil in Nicaragua, it was important to prove that a country following a democratic, free market model could succeed. U.S. political interests could be achieved through a process of economic stabilization and then sustained, broad-based economic growth.

A.I.D., in conjunction with the World Bank and IMF, supported a major stabilization effort and then moved to support macroeconomic reforms essential to achieving sustainable long term growth. From 1982-1987 the reforms included:

1. A major reduction in the number of agencies and programs which received subsized credit. While previously there were dozens of programs, now there is only one small, directed credit program in agriculture

2. A unified, market-based exchange rate. The Colone/Dollar rate of exchange was progressively devalued from C8.57=$1 in 1979 to C64=$1 in 1987. Multiple rates were eliminated and the rate is now set by market supply and demand forces. The foreign exchange black market and capital flight are now non-existent.

3. The maintenance of positive real interest rates on both savings and loans. Interest rates are high, at 20 to 30 percent, but they are well above the rate of inflation.

4. A substantial reduction in the public sector deficit. The central government deficit averaged 6.2 percent of GDP in 1978-81 and peaked at 8 percent in 1980. It has been steadily reduced and averaged only 2.8 percent in 1984-86.

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5. Passage of a monetary reform law which improved the competitive ability of private banks in a state bank dominated system. The private banks have proven to be more efficent than the state banks and this competition should help to reduce the costs of financial intermediation.

Central to A.I.D.'s strategy was the need to increase economic growth by shifting the Costa Rican economy from an orientation emphasizing import substitution to one of export-led growth. A.I.D. policy reform efforts focused on removing constraints to private sector investment and private sector exports, particularly of new, non-traditional exports. Non-traditional exports responded to policy incentives and increased at a 23 percent annual rate during 1983-1987. Gross private investment growth, which averaged near 8 percent during 1960-1980 had fallen to -32 percent in 1981/82. In 1983 to 1986 it was 16.5 percent.

The final elements of the A.I.D. strategy concentrated on equity--the need to make sure that the process of restructuring also spread the benefits of growth. This equity focus included increasing the involvement of the private sector in areas where it could be more efficient than the government, increasing employment opportunities, improving housing, and improving educational opportunities.

Issues and Impacts of the Costa Rica Cash Transfer Program

Following is a brief outline of evaluation findings covering the economic impacts and management issues relevant to the Costa Rica cash transfer program. The issues and impacts have been divided into the three impact areas of the program -- dollar transfers, conditionality, and local currency expenditures.

Transfers of Dollar Funds

1) The basic goals of the program in terms of transitional stabilization and structural adjustment support have been met. In particular the ability to import goods necessary for export development has been sustained and the negative domestic social effects of "austerity" have been avoided.

2) Certain elements of macroeconomic adjustment have not been achieved, though the economy appears to be moving in the right direction. For example: (a) effective tariff rates have not been reduced substantially, though there is some downward movement and dispersion has decreased; (b) public sector expenditure has not decreased, nor has the size of

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the public work force, though the deficit as a percentage of GDP has fallen; and (c) foreign debt management has not improved significantly, though a new IMF standby may soon be signed.

3) The complaint by the IMF that A.I.D. funding has allowed the GOCR to "escape" conditionality may have some basis, though the program nevertheless appears to have been successful. The A.I.D. statement that the GOCR was following the "spirit" of the standby arrangement is countered by the fact that the IMF was unwilling to award an agreement.

Conditionality

1) In general A.I.D. conditionality was well-designed, reasonable, and complied with. Private sector support, including founding CINDE (to support private sector investment and export development) and encouraging the CODESA divestiture of public sector firms were particular successes.

2) The encouragement of the private banking sector was the object of 33 of the 105 covenants and has been quite successful. Private sector representatives would like to see the gains institutionalized, however

3) The timing of nearly all covenants, and especially that of the more important ones, has been overly ambitious.

4) Some covenants have apparently not been met, including the CODESA divestiture timetable, several items of port development, and several items of reporting. Mission followups in some of these areas is not evident.

5) The number of covenants and conditions placed on the program may be excessive. An effective monitoring system for this program would require a larger staff than that justified by the benefits involved.

6) A fairly successful policy dialogue seems to have been established with respect to conditionality, though every Costa Rican we interviewed would like to see it improved.

Local Currency Expenditures

1) Most Local Currency projects appear to have been successful in economic terms, including CINDE, PIE, and (eventually) CODESA.

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2) Some programs have not been successful in economic terms, including the EARTH agriculture college, the price checking unit, and several attempts at port developments.

3) The IMF complaint of excess credit creation is unfounded. A.I.D. local currency monetization has remained well within the agreed IMF ceilings.

4) The issue of ownership of local currency funds should be left "constructively ambiguous" as long as possible. If the government of Costa Rica assumes sole ownership and responsibility for the funds, budgetary, monetary, polictical and operational problems may develop.

5) Individual project plans, programming, and expenditures should be better documented at the PAAD level.

6) Interest changes on the Special Account are a useful incentive to expend funds, but they are a needless addition to the central bank deficit. They should be periodically sterilized, and the accumulated interest "overhang" should be treated the same way.

Not all the positive results mentioned above can be proven to result from the A.I.D. cash transfer program, though the evaluation shows that most of these and others are direct A.I.D. accomplishments. The same is true for the negative results, though many of those are beyond the control of the Mission.

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PPC/CDIE, 10/26/87

Method of Approach

The basic elements of the analytical methodology employed in this study, and intended to be employed in the remaining studies in this series, are as follows.

Policy Categories: The covenants, conditions precedent, local currency expenditures, and economic impacts associated with the CT program are classified into seven basic policy categories, including (1) production and private sector policy, (2) international trade policy, (3) fiscal policy, (4) financial policy, (5) development equity, (6) agricultural policy, (7) other policy types. Rather than attempting to trace the separate impacts of specific expenditures or items of conditionality, this study addresses economic change and policy impact in this limited and manageable set of categories.

Performance Indicators: Within each of the above policy categories, a limited number (usually one to three) of measures of performance are identified. These indicators are often specified in the Country Action Plan, but are otherwise elements of common usage and concern for the programs involved.

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Interrelated Policy Programs: The policy agenda of AID, the IBRD, the IMF, and the GOCR are very closely related and on many points are identical. Disentagling the impacts of these separate programs would be impossible both statistically and conceptually in most cases. Where possible, separate impacts of A.I.D.'s CT program will be identified, but in general CT impacts are not separable from those of complementary stabilization and structural adjustment program.

Public Policy vs. Economic Development Impact: The public policy of the GOCR is likely to change in response to stabilization and structural adjustment programs before concrete economic changes occur. Policy change itself is a goal of the programs, but economic development impact is the ultimate objective. Since economic change lags policy change in a variable manner, the former may be difficult to identify and to relate to policy programs. Therefore, this study attempts to identify and analyze policy change separately from economic development impacts.

Appendix A describes in more detail the methodology employed for this evaluation. We now turn to a full synopsis of the findings of the Costa Rica Cash Transfers Evaluation.

Summary of Results

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NOTES FOR A LECTURE ON COSTA RICA'S EXPERIENCE WITH POLICY-BASED LENDING, 1978-1981

Costa Rica is a small country in Central America. It is a link in the bridge that unites North America and South America. Physically it is a 20,000 Sq. Mi. narrow strip of land (at points less than 100 miles across from the Atlantic to the Pacific) with a chain of mountains down the middle. It lies around 10 degrees north of the equator which makes its climate tropical and hot. It borders Panamá on the south and Nicaragua on the north.

Population in 1980 was 2.1 million, GNP per capita was 15 hundred dollars per annum with a relatively good distribution of income. There is a significant concentration of population in the central highlands where altitude moderates the tropical climate (43% of Costa Ricans lived in urban areas). In 1980 its people were healthy, literate, well fed and with relatively good access to services. Life expectancy at birth was 70 years, close to the U.S's. Adult functional literacy was over 90%. The per capita calorie consumption was 114% of daily requirements and 77% of the population had access to safe water.

Costa Rica is a democracy in the best Jeffersonian sense. It is a nation of small freeholders, independent, participating and tolerant. With two exceptions (1974 and 1986) during the last 50 years the

opposition has always won the elections. As a result the use of power in Costa Rica is very moderate. Costa Ricans in power take special care not to be perceived as arbitrary or arrogant, after all, in four years they are very likely to be private citizens. The policy implications of this are of consequence. In order to implement a new policy a substantial degree of acceptability or consensus must exist. Change only comes about after an extended period of soft-sell. This manner of implementing policy is many times expensive and painful.

In addition, in the constitutional division of functions between branches of government, Congress is clearly dominant. This is not bad in itself as anyone familiar with parliamentary democracies is aware. The trouble is that members of Congress cannot be re-elected and cannot serve as ministers. As a result Congress has no initiative and is powerful only in a very negative sense. In this kind of environment complying with the schedules, timetables, and limits required by IMF or World Bank conditionality is very difficult. For example, the tax reform bills proposed to Congress by our Government in 1979 were finally approved one year into the next administration (four years later.) Congress is sometimes negative even with evidently popular bills as was the case with a commercial bank loan syndicated by Chase Manhattan with the best conditions ever obtained by Costa Rica which was never approved by Congress. (Much to the delight of the lenders as things eventually developed.)

Another institutional reality that has to be taken into consideration is Costa Rica's membership in the Central American Common Market. The CACM was at the time (1978) a showcase example of successful integration (the pride of many development agencies.) Funds were readily available for projects designed on a regional level. The fact is that the five Central American countries had erected a protectionist tariff around the region while practically liberating all restrictions to the movement of goods amongst them. Under this protectionist shelter the Costa Rican economy had experienced important changes, developing into new fields and grown for over 15 years. Consider the following: in 1960, 95% of Costa Rican exports were primary commodities (all agricultural commodities for the Country exports no fuels or minerals) and a full 93% of exports was destined to industrialized markets. It was typically a producer of primary products with no industrial base. By 1977 primary commodities accounted for only 76% of exports, while manufactures were 24%. In addition, the share of exports destined to developed countries had declined to 68%. Many policy changes that could be supported by development agencies either had to take into account this institutional reality or required concerted action by the other integrated partners. Trade policy is the obvious example.

When the Carazo Administration took office in 1978 the economic authorities had an agenda. It called for a reduction of interference with market prices, a straightening of relative indicators; a moderation of the government's role in the economy, specially of the then

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mushrooming state-owned enterprises; and a streamlining of the budgeting/expenditure control system of the non-financial public sector. Let's review this in some detail for its implications in policy implementation and the possible policy support by international development agencies.

Since 1955 Costa Rica had initiated a process of import substitution through tariff protection of manufactures. At the beginning, the policy was implemented on a case by case basis, but with the creation of the Central American Common Market in 1963 the process was generalized. The rationale that justified the new policies was predictably an infant industry argument applied to manufacturing. Developing countries, we were told, are condemned to the production and export of primary products subsequently transformed in the industrialized countries; the lion's share of the profit made in the industrial stage. The constant decrease in the prices of primary products, and the increasing trend in the prices of manufactures resulted in a secular deterioration of the developing countries' terms of trade. This deterioration, in turn, prevented the accumulation of capital necessary for the development of a manufacturing base. In addition, the absence of services and complementary industries further locked the vicious circle in place.[4]

In the case of Central America a two pronged attack would be necessary. One one hand, a protectionist barrier would be put in place around the whole region, to give local manufacturing a chance

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and on the other hand restrictions to intra-regional trade would be eliminated, so as to enlarge the market these industries would supply. With both in place the economies would take off on a new positive trend from a higher base.

What followed was over 15 years of accelerated growth in the region, a quantum leap in intra-regional trade, but, at the same time the entrenchment of some of the main obstacles for sustained growth after this initial thrust tapered off. Costa Ricans, as well as the other Central Americans learned to live in a new world and to work with new technologies; new processes had to be followed, sophisticated machinery used, different materials handled. In addition, a modern kind of manager emerged. I personally believe that the main contribution of this concerted effort was the enrichment of human resources throughout the region.

At the same time, a bias in favor of manufacturing and against commerce, finance and specially agriculture emerged. This status quo was supported by a complete network through which pressure groups became active in forming public opinion, in influencing policy determination, in participating in Government, all to perpetuate their advantage. This shift in terms of trade in favor of manufacturing and against agriculture was furthered also by the covert, but no less real competition, that developed among the "Ministries of Industry" of the member countries to attract industries to their particular country no matter what privileges had to be offered.

Finally, directed credit and additional fiscal benefits as income tax exemption for reinvested income further accentuated the intersectoral bias.

By the late 1970s a huge proportion of investment had been diverted to manufacturing activities that operated with considerable inefficiency and were profitable only because of the generous margins created by the tariff and away from other activities that would thrive without protection but appeared less attractive given the administered prices. This is not surprising, it was an intended result. It was clear to us that the approach had run its course and that the possibilities of sustained growth had become nil. The issue was that the model of import substitution -cum- integration had become entrenched, economically, popularly and politically. It was time for a much more liberal trade policy, a more aggressive exchange rate policy and the enhancement of the competitive capacity of the manufacturing sector. Both the IMF and th World Bank acknowledged the adequacy of reducing protection and liberalizing trade. But IMF insisted on short-term demand management policies (which were undoubtedly correct) and it took us three years of persuasion and pressure (at every level we could utilize) to obtain an Extended Fund Facility (EFF) agreement in support of a program that addressed development issues. The World Bank went further and prepared an excellent document articulating our liberal policies. Such a document could have been the basis for an Structural Adjustment Loan in support of our proposals. The only

problem was that the document was issued in the third year of a four year administration, when a crisis was already at hand and the issue was how to stabilize the economy and not what development strategy to follow. Notwithstanding, without the financial support of the development institutions the Government reduced protection in non-integrated industries, such as assembly operations and requested from the other Central American Governments an early negotiation of a new tariff.

Relative international prices were out of alignment, the exchange rate was clearly overvalued. We recognized that and advocated a devaluation early in the Administration's term. This would discourage imports, but just as important at that point in time, it would encourage exports. To some extent, the anti-export bias created by the import substitution policy could be compensated by maintaining competitive a exchange rate. The World Bank clearly recommended such an approach, but the IMF was only lukewarm. The President, influenced by the business community decided against devaluation. He believed that the impact on prices and employment would be very severe given the imported input dependance of the manufacturing sector. The social and political repercusions could be very dangerous given the war in Nicaragua, Somoza's threat of attacking our territory, and the general instability of the region. Eventually, floating the exchange rate when the Central Bank had run out of reserves and capital inflows had ceased was a very painful way of adjusting. But, what if he was right?

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The relative cost of resources was also being manipulated. Interest rates were generally subsidized and the resulting excessive demand for credit allocated through rationing devices (this in itself added incentive for the operation of pressure groups.) The real relative scarcity of capital and labor was being masked and as a result investment in the manufacturing sector (the principal beneficiary of subsidized credit) tended to employ technologies which were generally capital intensive. In addition, low interest rates meant inadequate mobilization of domestic financial savings and the need for additional external resources. One of the first decisions of the Carazo Administration was to significantly reduce subsidized credit establishing a system that would tend to maintain real positive interest rates. The importance of such a policy was acknowledged by the World Bank which in the terms of an Industrial Credit Loan insisted that real positive interest rates be charged to the end borrowers. The Administration introduced a bill in Congress which was designed to increase the cost of holding idle land, through a reform in land taxes. The purpose was not only fiscal, but also to increase the attractiveness of financial savings as opposed to saving in land that would be used very marginally, if at all.

Between 1970 and 1978 the Government's direct involvement in business had become overwhelming. Traditionally, the Costa Rican Government had run certain monopolies: the distillation of alcohol (for all uses, industrial, pharmaceutical, and beverages,) practically all insurance (life, accident, property, health, automobile,) and

sight deposits in banks. But in those 8 years the Government bought a railroad and started construction of sugar plantations and a sugar mill, several cement factories, an aluminum mill and several other such ventures as ferry boats and bus lines. In fact, so big was the investment program in state owned enterprises, that from 1978 through 1980 they accounted for over 20% of the deficit of the non-financial public sector. When the Carazo Administration took office in 1978, most of factories were being built with turn-key contracts. Efforts were made to try to stop the construction, but it was legally impossible. One was inaugurated and closed in the same ceremony and the idea of returning them to the private sector started being entertained.

The third important item on the administration's agenda was public expenditure control. The issue derives from the fact that over half of the public sector revenues are earmarked, and that a very large proportion of public expenditures is made by decentralized agencies. The result was a very limited capacity by the economic authorities to manage expenditures from a consolidated point of view . In fact, the Central Government would have shown an overall surplus had it not been for the transfers to decentralized agencies. To address this issue the Government created a budgetary authority which would approve the budget of the decentralized agencies in addition to preaparing the budget of the Central Government. The idea was to control the level of expenditure of the agencies themselves in order

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to accomplish macroeconomic targets, even if through their own operations or through transfers they had funds available. It was a good beginning, but simply not enough. The truth is that the bureaucracy did not have the managerial competence to be able to control expenditure. The information base was very small, and the administrative machinery to monitor public expenditures was only being created. For example, the state enterprises escaped the Budgetary Authorities's control. In addition, an important part of public expenditure is legally mandated and very difficult to compress. Both the IMF and the World Bank repeatedly pointed out the difficulties the public sector's overall deficit would create. Because of the inability of Congress to address the fiscal issue either on the revenue or the expenditure side, agreements with IMF were always based on public sector adjustments that could be implemented through Executive authority alone and which explains why policy tools of necessity and not of choice were used.

In 1981 the convergence of several forces brought the economy to its worse crisis ever. In addition to the imbalance in public sector finances which was resulting in pressure on the balance of payments, the country had suffered a loss of 20% in international terms of trade from 1977 to 1979 and the trend was continuing. The Central Bank had lost all its foreign exchange reserves (in fact it was accumulating arrears) and real international interest rates had skyrocketed to their highest level. At this point in time pressure from the

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organized business community convinced the President that he could not continue to implement the program agreed with IMF on an EFF. (It was at this time that I resigned as Minister of Finance, my belief was that the Government's credibility with the international development agencies and the international financial community in general had been seriously compromised.) Out of compliance with IMF, commercial funds stopped flowing and Costa Rica announced to the world that the debt crisis was here. The magnitude of the exogenous factors (terms of trade, level of real international insterest rates, and the interruption of the flow of funds from commercial banks) was such that in a couple of years all Latin American countries (with a couple of exceptions) underwent violent recessionary adjustment and a debt crisis. Some had been liberalizing their economies, others had become more interventionist, some were managed with fiscal prudence, others ran deficits, some were oil-rich and others dirt poor, but they all got caught in the crisis.

Hernán Sáenz Jiménez

Washington, D.C.

18 August 1987.

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AFRICAN ECONOMIC POLICY REFORM PROGRAM

The AEPRP offers AID a unique opportunity to provide a new and independent voice in policy dialogue issues in Africa. This program has energized our Missions to redirect and expand the policy dialogue component of our programs; acted as a magnet in attracting other donor programs in support of policy reform objectives; and provided AID with an important entree with African governments in the policy dialogue process.

BACKGROUND

A.I.D.'s assistance strategy in Africa is based on the belief that a fundamental cause of economic stagnation in Africa has been the practice of most African states of following unsound economic policies. These policies derive from a belief that economic development in general, and a just distribution of economic goods in particular are best achieved when the economy is closely guided and directed by the State. The result has been highly regulated, inflexible economies which have not only wasted resources through unsound investments, but have stifled human initiative by providing inadequate incentives for work, investment and risk-taking. As a result Africa's economies have experienced neither growth nor equity.

Economic restructuring is the centerpiece of our assistance effort -- helping African governments restructure their economies to make them more open, more liberal, more decentralized, more flexible. And the centerpiece of our economic reform program is the African Economic Policy Reform Program (AEPRP). The AEPRP, a new initiative to help African countries reform policies which were causing economic stagnation, was announced by the President in 1984, with an FY 1985 program level of $75 million. One of the most important aspects of the AEPRP is that country allocations are separate from normal budgetary procedures. This allows us to develop fairly sizable, discrete programs which are additional to normal budgetary levels. For example, the FY 1985 programs in Malawi, Zambia, Mali, Rwanda and Mauritius led to a doubling of the total assistance levels (including P.L. 480) into those five countries. (See Table I) Such a dramatic change in funding leads to the AEPRP being highly valued by recipient countries.

COUNTRY ELIGIBILITY

The following criteria were developed for determining the types of programs that could be designed for the AEPRP.

1) Programs were preferably to be non-projectized;
2) Programs could be developed in any sector, as long as there was an important relationship to A.I.D.'s strategic objectives;
3) All programs would be designed so as to assist in the implementations of key policy changes.

As for country selection criteria, the AEPRP was to be limited, in FY85, to those countries with a demonstrated commitment to policy

reform. Excluded, because they were already receiving a large share of U.S. assistance, were the four largest recipients of U.S. assistance (Sudan, Somalia, Kenya and Liberia). There was no per capita income or IDA-eligible limitation.

The application of the country selection criteria led to the development of a list of 16 countries that were eligible for the first tranche of assistance:

Senegal	Mali	Niger	Guinea
Madagascar	Cameroon	Zaire	Uganda
Malawi	Zambia	Rwanda	Zimbabwe
Botswana	Ghana	Togo	Mauritius

In the second year, after a number of intense discussions within the USG, it was decided to limit eligibility for FY86 to those countries which were eligible for assistance from the World Bank's special facility for Africa. The purpose of this restriction was to support the Special Facility, which at that time (Fall, 1985), had not yet received a U.S. contribution. As a result Cameroon, Botswana, Zimbabwe, Mauritius, and Swaziland were excluded from consideration.

With the expiration of the Special Facility in June, 1987, there was no longer any need to link the AEPRP to special facility eligible countries, and countries such as Cameroon and Botswana are back on the eligibility list.

As originally planned, $75 million was allocated in FY 1985 to five AEPRP programs; budget stringencies limited A.I.D. to four programs totaling $47.85 million in FY 1986 and to three programs totaling $27 million in FY 1987. The existing programs are:

	COST IN MILLION $	POLICY AREAS
	FY 1985	
Zambia	25.0	Agricultural Marketing
Mali	18.0	Public Finance
Malawi	15.0	Fertilizer Subsidies
Rwanda	12.0	Industrial Incentives
Mauritius	5.0	Trade Policy
	FY 1986	
Senegal	15.0	Tax and Tariff Reform
Zaire	15.0	Trade Reform
Guinea	10.0	Agricultural Input Marketing
Togo	7.8	Export Liberalization
	FY 1987	
Tanzania	12.0	Road Maintenance
Cameroon	9.0	Fertilizer Subsidies
Gambia	6.0	Financial Sector

BROAD PROGRAMMING COMMONALITIES

CONDITIONALITY AND TRANCHING: Each of the AEPRPs is divided into several tranches. Before any tranche can be disbursed, recipient Governments must provide AID with proof that the Conditions Precedent (CPs) to that tranche have been met. These conditions vary from announcing new prices which reduce subsidy levels (Malawi and Zambia) to passing legislation or announcing administrative decisions to increase access to certain credit guarantees (Rwanda) to changing tax and tariff policy (Zaire and Senegal) to privatization activities (Guinea and Tanzania).

IMPACT OF AEPRP ON PRIVATE SECTOR: All of the AEPRPs are aimed at either reducing government activity in the productive sectors of the economy, reducing or rationalizing government controls on the private sector, or both:

-- In Zambia and Guinea, the entire program is designed to reduce the Government's role in agricultural marketing to the level needed to ensure competition.

-- In Cameroo the program is designed to privatize agricultural input delivery.

-- In Rwanda, the program is designed to reduce government price controls, to broaden access to credit, and to rationalize the tax system.

-- In Mali, while the major thrust of the program is to improve fiscal policy, a concommitant part of this initiative is to improve the investment climate for private sector activity through tax reform, reduction of price controls, and changes in the investment code.

-- In Mauritius, Senegal, and Zaire, the major objective of the program is to increase efficient private sector activity by reducing tariffs and marginal tax rates.

-- In Malawi, major studies are to be undertaken examining the role of ADMARC, the marketing parastatal, with particular emphasis on developing a capacity to privatize many of ADMARC's current functions.

LESSONS LEARNED: While we are still implementing these proposals, the process of design and early implementation has led to some important observations.

EFFECT ON NORMAL BILATERAL PROGRAM: The AEPRPs will have an impact well beyond the programs themselves. These programs have tended to be more directed at broad development issues and our development strategies in each of these countries are being redirected to take advantage of the new opportunities offered by the AEPRP. There are two reasons for this phenomenon:

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(1) Missions saw the AEPRP, because it was funded out of ESF, as being available for broad strategic programs. Indeed, three of the AEPRP programs concentrated on either the industrial sector or the broader issue of public vs. private sector.

(2) The nature of the AEPRP, a concentrated and dramatic increase in program levels, attracts considerable attention from recipients. It gives us a basis for a continuing policy dialogue as well as a seat at the policy table which we wouldn't otherwise have.

THE IMPORTANCE OF PROCESS: Perhaps as important as the product in each of the AEPRP countries is the policy dialogue process which these programs have engendered.

-- In Rwanda, the Government set up a special inter-departmental committee to develop and review policy reform proposals as part of their discussions with AID. As a result, the GOR is concentrating on policy reform issues for the first time.

-- In Mali, our program is central to the start of a long-term process to reduce the role of government in the economy. Our program may be the catalyst needed to energize that process.

-- In Malawi, we have moved from a minor donor to a major influence on agricultural policy. As part of the Malawi EPRP, we are entering into studies and discussions that may lead to major reforms in agricultural marketing, in agricultural pricing policy, and in divestiture of some major parastatal activities.

DONOR COORDINATION: The AEPRPs have been developed in close coordination with key donors, particularly the World Bank. Taken together, the AEPRPs and the Bank's structural adjustment programs have achieved a significant synergism not present when each was developed in isolation. Significantly, the AEPRPs have generally moved beyond what the Bank was doing, and advanced the reform process more quickly and probably more broadly than would have been the case without our presence. Equally important, the nature of these programs differs in important ways from IBRD policy reform programs, in that we have designed them to alleviate the political stress that policy reform brings.

-- In Mali, we are the catalyst that has lent the necessary impetus to implementing reforms previously agreed to. Drawing on technical work done by the IMF and the UNDP, our program was the mechanism which concentrated the energies of the Malian Government, drew together different Ministries, and consolidated a number of different, and halting reform efforts.

-- In Malawi, our program is part of a multi-donor effort connected to the World Bank's SAL (other donors include Great Britian, Japan, and Germany). The fertilizer policy reform is one element of the SAL. Because we concentrated on this issue alone, because we emphasized actions to help implement reforms, and because we contracted excellent technical staff our program was instrumental in making reform in this sector possible.

-- In Mauritius, our program has been closely associated with the IBRD's trade reform program. In fact several Mauritian officials felt that the U.S. had shown far greater awareness of the exigencies of adopting economic reform measures within a changeable world economy and a democratic country than had the World Bank.

In Senegal, we have designed our program to complement the World Bank Structural Adjustment Credit (SAC). The Bank's SAC dealt in part with elimination of quantitative import restrictions and tariff rationalization. The Bank's program established a plan for trade reform in three separate stages but only provided conditioned funding for the first stage. The AEPRP then funded the remaining reform steps.

In Zaire, our program parallels that of the IBRD. We have adopted similar conditionality, and limited uses of the funds to those imports that will improve capacity utilization in the industrial sector.

DESIGN ISSUES: These programs have turned out to be more complicated than we first expected, because we have designed them in such a way as to put great emphasis on reducing the political costs associated with any changes. This has led us to associate our program funds with technical assistance so as to improve implementation and to target the use of our non-project assistance resources carefully thus leading us to get deeply involved in complicated local currency programming issues. For example:

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In Malawi, the political problems associated with the removal of fertilizer subsidies led us to emphasize the need to change the types of fertilizer being used. This led to involvement in agricultural research and extension, in improving the capacity of the Ministry of Agriculture to test soils, and to examining the feasibility of building a fertilizer bulk blending plant in Malawi.

In Mali, the program required substantial technical and commodity assistance to monitor compliance.

In Zambia, our resources are being used to enable private sector traders and transporters to compete with the parastatal marketing Agency. Some of our local currencies will be used as carefully targetted subsidies to reduce the adverse impact of food price increases on the poorest urban dwellers.

In Togo, we have worked closely with the Government in designing market forecasting mechanisms that will enable the GOT to determine an appropriate number of export licenses.

In Guinea, we have had major difficulties in working with private banks in developing a loan program for the local currencies. At first, the banks were reluctant to assume any risk connected with the loan program, and it took a great deal of discussion to convince them that a sound financial system required risk-taking on the part of lenders.

STAFFING: The first generation of AEPRPs were identified and designed with substantial inputs of Washington staff, particularly economics staff. This was not the case with the FY86 programs, which were largely designed by Field staff. These programs require highly talented analytic staff in their design, but even more importantly, in their implementation. The ability of small Missions to monitor and implement these programs remains weak, and we continue to review their performance closely.

FAST DISBURSING?: AEPRPs are fast disbursing, once conditions have been met, but they should not be thought of as balance of payments support in the short-run. Rather, they are sources of flexible, relatively untied assistance, but have been designed to disburse over two to three years, depending on the speed of policy reform implementation (see Table II).

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EVALUATION

It is much too soon to evaluate the performance of the AEPRPs. Since the first set were obligated in September 1985, we have only 24 months' experience. Given the political costs and the difficulty of implementation, policy reform efforts in Africa have not followed a smooth one-directional path. There have been some setbacks. Moreover, we have learned that some programs were too complicated, with too many reforms and very difficult implementation requirements, while others had conditionality that was too general. Of the nine programs in place during FY87, six (Mauritius, Zaire, Mali, Togo Guinea, and Senegal) are proceeding successfully and three (Malawi, Zambia and Rwanda) may be in need of substantial restructuring.

Among the accomplishments to date:

-- Rationalization of tariffs in Zaire and Mauritius;
-- tax reform and improved investment climate in Mali;
-- tariff reform in Senegal;
-- reduction of controls on agricultural exports in Togo.

By and large, we are pleased with recipient country responses. We knew that these programs would be high-risk, high-gain propositions. But they are designed with a very important monitoring and evaluation component which would allow for sufficient flexibility in revising the program.

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AIDAC

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NAIROBI PASS TO AA/AFR GLADSON AND DAA'S BOLINGER
AND SAIERS; AFR/DP GOJAN AND WOLGIN; AFR/SA FISCHER;
AND AFR/PD PEASLEY

E.O. 12356: N/A
SUBJECT: MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM
(612-0225/612-K-601) EPRP I RECAP

1. SUMMARY. DURING THE FIRST TWO YDDEFTET.2.1CDTYIFZIWNRXCNQXHE BA
LANCE OF PAYMENTS (BOP) COMPONENT
WAS RELEASED. DUE TO POLITICAL AND ECONOMIC
CONSIDERATIONS, HOWEVER, THE GOVERNMENT OF MALAWI (GOM)
WAS NOT ABLE TO ACHIEVE THE THIRD YEAR SUBSIDY REDUCTION
TARGET. NONETHELESS, THE PROGRAM HAS MADE A SIGNIFICANT
CONTRIBUTION TO REDUCING THE GOM'S CRITICAL BUDGET
DEFICITS, PROMPTED THE SHIFT TO NEW CONCENTRATED
FERTILIZERS, AND INFLUENCED OTHER IMPORTANT POLICY
CHANGES, INCLUDING A LARGE MAIZE PRODUCER PRICE INCREASE
AND REORGANIZATION OF THE NATIONAL DE FERTILIZER SUPPLY
SYSTEM. FURTHERMORE, THE DOLS 1.9 MILLION TECHNICAL
ASSISTANCE/TRAINING/STUDIES (TATS) COMPONENT HAS HELPED
STRENGTHEN THE GOM'S PLANNING, MANAGEMENT AND BUDGETING
CAPACITIES AND IMPROVE THE AGRICULTURAL DEVELOPMENT AND
MARKETING CORPORATION'S (ADMARC) OPERATIONAL
EFFICIENCY. USAID/MALAWI BELIEVES THE PROGRAM
OBJECTIVES HAVE BEEN MET AND, DESPITE THE FALTERING IN
YEAR THREE, CONSIDERS EPRP I TO HAVE BEEN A SUCCESSFUL
INVESTMENT.

WE WOULD LIKE TO EXPLORE WITH THE GOM OTHER AREAS OF
POLICY REFORM WHICH COULD BE SUPPORTED THROUGH
REPROGRAMMING THE UNDISBURSED DOLS 5.1 MILLION IN THE
TOP COMPONENT. END SUMMARY.

. INTRODUCTION. THE MFSRP, A DOLS 15.0 PROGRAM
INITIATED IN SEPTEMBER 1985, HAS TWO COMPONENTS:

DOLS 13.1 MILLION TO SUPPORT REMOVAL OF GOM
SUBSIDIES ON FERTILIZERS OVER A THREE YEAR PERIOD WHILE
SIMULTANEOUSLY INTRODUCING AND INCREASING THE SUPPLY OF
MORE COST EFFICIENT, CONCENTRATED FERTILIZERS.

DOLS 1.9 MILLION FOR TECHNICAL ASSISTANCE, STUDIES
AND TRAINING IN SUPPORT OF THE FERTILIZER SUBSIDY
REMOVAL PROGRAM AND OTHER ELEMENTS OF THE GOM'S
STRUCTURAL ADJUSTMENT PROGRAM.

THE PROGRAM'S OBJECTIVES AND PERFORMANCE TARGETS WERE AS
FOLLOWS:

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(A) PHASED REDUCTION OF FERTILIZER SUBSIDIES PAID BY THE
GOVERNMENT: MAXIMUM 22.6 PERCENT AVERAGE SUBSIDY LEVEL
IN 1985/86; MAXIMUM 17 PERCENT IN 1986/87; MAXIMUM 12
PERCENT IN 1987/88 (INCLUSIVE OF 5 PERCENT IMPORT LEVY).

(B) PROGRESSIVE INCREASES IN THE PROPORTION OF
CONCENTRATED FERTILIZERS TO BE IMPORTED ANNUALLY FOR THE
SMALLHOLDER FERTILIZER SUPPLY PROGRAM: MINIMUM 10
PERCENT OF TOTAL IMPORTS IN 85/87; MINIMUM 25 PERCENT IN
87/88; MINIMUM 45 PERCENT IN 88/89.

(C) IMPROVED VIABILITY OF SMALLHOLDER FERTILIZER
REVOLVING FUND THROUGH ADDITIONAL CAPITALIZATION AND
INITIATION OF REFORMS OF THE CURRENT FERTILIZER
DISTRIBUTION AND REVENUE MANAGEMENT SYSTEMS.

(D) IMPROVED EFFICIENCY OF ADMARC OPERATIONS AS A RESULT
OF TECHNICAL ASSISTANCE TO FACILITATE DIVESTITURE AND
TRAINING IN FINANCIAL MANAGEMENT, LOGISTICS, OPERATIONAL
PLANNING AND GRAIN STORAGE MANAGEMENT.

(E) STRENGTHENED PUBLIC SECTOR PLANNING AND BUDGETING
CAPACITIES THROUGH PROVISION OF IN-COUNTRY AND OFF-SHORE
TRAINING.

3. PROGRESS AND ACCOMPLISHMENTS TO DATE: THROUGH THE
MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM, A.I.D. HAS
MADE EXCELLENT PROGRESS IN ENCOURAGING THE GOVERNMENT TO
PURSUE POLICIES THAT CONSERVE SCARCE FINANCIAL RESOURCES
AND ACHIEVE GREATER EFFICIENCY. PERFORMANCE TARGETS
WERE MET OR EXCEEDED IN THE FIRST TWO YEARS; AVERAGE
FERTILIZER PRICES WERE INCREASED BY A TOTAL OF 65
PERCENT DURING THE THREE YEARS RESULTING IN SIGNIFICANT
RECURRENT BUDGET SAVINGS; HIGH ANALYSIS FERTILIZERS WILL
COMPRISE THE MAJORITY OF THE INPUT SUPPLY RESULTING IN

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AND AFR/PD PEASLEY

E.O. 12356: N/A
SUBJECT: MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM

SAVINGS OF SCARCE FOREIGN EXCHANGE; A MAJOR INCREASE IN MAIZE PRODUCER PRICES -- THE FIRST IN FOUR YEARS -- WAS REALISED; AND THE NATIONAL FERTILIZER SUPPLY SYSTEM HAS BEEN REFORMED.

A. FERTILIZER PRICE INCREASES AND SUBSIDY REMOVAL. FROM THE BEGINNING, THERE WAS STRONG RESISTANCE IN VARIOUS GOM DEPARTMENTS, MOST NOTABLY THE MINISTRY OF AGRICULTURE, TO THE SUBSIDY REMOVAL PROGRAM. DESPITE THE STRONG INTERMINISTERIAL DIFFERENCES, THE GOM SIGNIFICANTLY INCREASED FERTILIZER PRICES OVER THE PAST THREE YEARS IN AN EFFORT TO REDUCE THE SUBSIDY. THE MALAWI KWACHA (MK) PRICE PER 50 KG OF VARIOUS TYPES OF FERTILIZERS, BEGINNING IN 84/85, THE YEAR IMMEDIATELY PRECEDING THIS EPRP, AND ENDING IN 87/88, THE THIRD YEAR OF THE PROGRAM, ARE AS FOLLOWS:

1	84/85	85/86	86/87	87/88
20:20:0	17.50	20.50	21.00	21.00
CAN	15.50	19.00	19.50	24.50
S/A	13.50	17.50	18.00	23.00
UREA	-	-	26.00	27.00
DAP	-	-	24.00	31.50
AVG. PRICE	16.00	19.50	20.50	26.50
ANNUAL AVERAGE PERCENT INCREASE	-	21.0	5.1	29.3

NOTE: UREA AND DAP, THE HIGH ANALYSIS FERTILIZERS INTRODUCED AS A CONSEQUENCE OF THE PROGRAM, WERE FIRST MARKETED IN 86/87.

DESPITE THESE INCREASES WHICH TOTALLED 65 PERCENT OVER THE THREE YEARS OF THE PROGRAM, THE GOM WAS NOT ABLE TO SUCCESSFULLY CONCLUDE THE PROGRAM. PERFORMANCE AGAINST PROGRAM TARGETS (CONDITIONS PRECEDENT) WAS AS FOLLOWS:

	TARGET	ACTUAL
YEAR 1 (85/86)	22.6 PERCENT	22.26 PERCENT
YEAR 2 (86/87)	17.0 PERCENT	14.96 PERCENT
YEAR 3 (87/88)	12.0 PERCENT	22.6 PERCENT

THE SIGNIFICANT PRODUCER PRICE INCREASES HAVE BEEN

OFFSET BY INCREASES IN THE LANDED COST OF FERTILIZERS DUE TO FACTORS LARGELY BEYOND THE GOM'S CONTROL:

- INLAND TRANSPORT COSTS CONTINUE TO CLIMB DUE TO REGIONAL POLITICAL AND ECONOMIC INSTABILITY;

- THE WORLD PRICE OF OIL REBOUNDED IN YEAR TWO OF THE PROGRAM, RESULTING IN HIGHER FERTILIZER PRICES; AND

- THE MALAWI KWACHA WAS DEVALUED 33 PERCENT IN 86/87, INCREASING STILL FURTHER THE LOCAL CURRENCY PRICE TO THE SMALLHOLDER.

NOTE: IT WAS THESE FACTORS, COMBINED WITH AN UNANTICIPATED JUMP IN ADMARC'S FEE FOR STORAGE AND DISTRIBUTION, THAT RESULTED IN AN ADJUSTED 86/87 SUBSIDY LEVEL (22.91 PERCENT) WHEN IT WAS RECALCULATED A YEAR LATER. THIS OCCURRED DESPITE A 5 PERCENT CONTINGENCY FACTOR WHICH WAS INCLUDED IN THE INITIAL CALCULATION.

TO SUCCESSFULLY COMPLETE THE PROGRAM THE GOM WOULD HAVE HAD TO RAISE 87/88 FERTILIZER PRICES ON AVERAGE, AT LEAST 45 PERCENT. THIS WAS DEEMED TO BE POLITICALLY UNFEASIBLE. (FYI PRICES ANNOUNCED BY THE GOM FOR THE UPCOMING YEAR ARE ALMOST 30 PERCENT HIGHER THAN LAST YEAR). THE SHARP DOWNTURN IN MARKETED MAIZE (271,569 MT IN 1985 TO 112,688 MT IN 1986 TO 50,981 MT IN 1987 AND THE DRAMATIC JUMP IN SALES (FROM 115 450 MT IN 1985 TO 275,888 MT IN 1986) DUE TO DROUGHT, HEALY BIG INFESTATION AND THE MOZAMBICAN REFUGEE PROBLEM MEANT THAT, FOR THE FIRST TIME IN SIX YEARS, MALAWI FOUND ITSELF IN A SERIOUS FOOD DEFICIT SITUATION.

FACED WITH SUCH A SITUATION, MANY IN GOVERNMENT WERE INCLINED TO IMMEDIATELY SUSPEND THE PROGRAM A HIGH

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TO SECSTATE WASHDC IMMEDIATE 2356
INFO AMEMBASSY NAIROBI IMMEDIATE

UNCLAS SECTION 03 OF 06 LILONGWE 05665

AIDAC

FOR AFR/DP, AFR/SA, AFR/PD
NAIROBI FOR REDSO/ESA AND RIG/A
NAIROBI PASS TO AA/AFR GLADSON AND DAA'S BOLINGER
AND SAIERS; AFR/DP GOVAN AND WOLGIN; AFR/SA FISCHER;
AND AFR/PD PEASLEY

E.O. 12356: N/A
SUBJECT: MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM

LEVEL POLICYMAKER TOLD US IN JUNE 1987 THAT A POLITICAL DECISION HAD ALREADY BEEN MADE TO FREEZE 87/88 FERTILIZER PRICES AT THE 86/87 LEVELS. THE MISSION BELIEVES THAT THE IMPACT STUDY WE HAD PUSHED TO BE CONDUCTED WAS ABLE TO INFLUENCE THE POLICY DECISIONS THAT WERE SUBSEQUENTLY ANNOUNCED. THE ANALYSIS CONCLUDED THAT: THE MFSRP PER SE HAD HAD A NEGLIGIBLE IMPACT (ABOUT 10 PERCENT) ON THE PRICE OF FERTILIZER, THE RATE OF UPTAKE OF FERTILIZER AND THE AMOUNT OF MAIZE MARKETED; WHILE IT WAS STILL PROFITABLE TO APPLY FERTILIZER TO MAIZE, THE RELATIVE PROFITABILITY HAD DECLINED DRAMATICALLY VIS-A-VIS ALTERNATIVE CASH CROPS WHICH WAS THE PRINCIPAL CAUSE OF THE FALL-OFF IN MARKETED MAIZE; AND THE BUDGETARY INTERVENTION REQUIRED IF FERTILIZER PRICES WERE FROZEN WAS UNBEARABLE BY THE GOM'S RECURRENT BUDGET.

B. HIGH ANALYSIS FERTILIZER IMPORTATION. A SECOND OBJECTIVE OF THE PROGRAM WAS TO SAVE SCARCE FOREIGN EXCHANGE THROUGH THE INTRODUCTION OF MORE COST EFFICIENT, CONCENTRATED FERTILIZERS. THE PERFORMANCE TARGETS (CONDITIONS PRECEDENT) IN THIS REGARD HAVE BEEN EXCEEDED IN ALL THREE YEARS. HIGH ANALYSIS FERTILIZERS HAVE DRAMATICALLY INCREASED AS A PART OF THE TOTAL SUPPLY PROGRAM:

-	TARGET	ACTUAL
PRE-PROGRAM	N/A	NIL
YEAR 1 (86/87)	10 PERCENT	12.2 PERCENT
YEAR 2 (87/88)	25 PERCENT	33.1 PERCENT
YEAR 3 (88/89)	45 PERCENT	OVER 60 PERCENT

THIS SHIFT TO CONCENTRATED FERTILIZERS HAS ALSO HELPED THE MINISTRY OF AGRICULTURE FURTHER ITS GOAL OF INCREASING FERTILIZER APPLICATION RATES. IN THE 86/87 SEASON, DESPITE A SLIGHT DROP IN TOTAL TONNAGE OF FERTILIZER PLACED, THE TOTAL NUTRIENTS APPLIED WAS THE HIGHEST EVER. MOREOVER, BECAUSE THEY ARE MORE COST EFFICIENT, THE HIGH ANALYSIS FERTILIZERS CLEARLY HELP OFFSET SOME OF THE PRICE INCREASES TO THE SMALLHOLDER.

C. RECURRENT BUDGET SAVINGS: POLICYMAKERS HAVE TOLD US THAT IN THE ABSENCE OF TMBVBJQVPCSUPPORT WOULD

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HAVE BEEN REQUIRED TO COVER THE FERTILIZER SUBSIDY:
- 85/86: MK 9.6 MILLION
- 86/87: MK 9.8 MILLION
- 87/88: MK 15.9 MILLION
- TOTAL: MK 35.3 MILLION (APPROXIMATELY U.S. DOLS 17.5 MILLION) SAVED OVER THE THREE YEAR LIFE OF PROJECT. THIS ADDITIONAL SUBVENTION WOULD HAVE INCREASED THE ALREADY CRITICAL RECURRENT BUDGET DEFICIT BY ABOUT 8.5 PERCENT OVER THE PERIOD.

THIS IS A CONSERVATIVE ESTIMATE OF THE SAVINGS RESULTING FROM THE PROGRAM. HAD FERTILIZER PRICES BEEN HELD CONSTANT, BY THE THIRD YEAR OF THE PROGRAM (87/88) THE AVERAGE SUBSIDY RATE WOULD HAVE CLIMBED TO 43.5 PERCENT (AS COMPARED TO 22.9 PERCENT). IN SUCH A SITUATION, GIVEN PRICE ELASTICITY, THE RESULTANT SUBSIDY WOULD BE 2 TO 3 TIMES HIGHER IF FERTILIZER DEMAND WAS FULLY SATISFIED. FURTHERMORE, SUBSTANTIAL FOREIGN EXCHANGE SAVINGS HAVE BEEN REALIZED BECAUSE OF THE GREATER NUTRIENT VALUE AND CHEAPER TRANSPORT COSTS OF THE NEWLY INTRODUCED HIGH ANALYSIS FERTILIZERS.

D. MAIZE PRODUCER PRICE INCREASE AND MARKETING LIBERALIZATION. AS A RESULT OF THE SUBS DY REMOVAL PROGRAM, A.I.D. HAS ALSO BEEN ENGAGED IN PRODUCER PRICE DIALOGUE WITH THE GOM. THE JUNE 1987 IMPACT EVALUATION, FOLLOWED BY A MISSION PROGRAM IMPLEMENTATION LETTER, RECOMMENDED THAT MAIZE PRICES BE INCREASED BY ALMOST 35 PERCENT TO REGAIN ITS RELATIVE PROFITABILITY AND STIMULATE PRODUCTION. GOVERNMENT ACCEPTED THE RECOMMENDATION AND ACTUALLY RAISED PRICES RETROACTIVELY; THIS WAS THE FIRST INCREASE IN FOUR YEARS. IN ADDITION, A.I.D., IN COLLABORATION WITH THE WORLD BANK, HAS

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ACTION AID-00

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FM AMEMBASSY LILONGWE
TO SECSTATE WASHDC IMMEDIATE 2357
INFO AMEMBASSY NAIROBI IMMEDIATE

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AIDAC

FOR AFR/DP, AFR/SA, AFR/PD
NAIROBI FOR REDSO/ESA AND RIG/A
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AND AFR/PD PEASLEY

E.O. 12356: N/A
SUBJECT: MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM

ENCOURAGED THE GOM TO FORMALLY PERMIT PRIVATE TRADERS TO BUY DIRECTLY FROM THE PRODUCER. AS A RESULT OF THIS REFORM, THIS YEAR FARMERS IN SOME AREAS ARE RECEIVING 50-100 PERCENT MORE FOR THEIR MAIZE THAN THE OFFICIAL FLOOR PRICE. GIVEN THAT FERTILIZER DEMAND IS CURRENTLY UP 120 PERCENT OVER LAST YEAR, IT WOULD APPEAR THAT, GIVEN FAVORABLE WEATHER CONDITIONS, THESE POLICY REFORMS SHOULD HELP INCREASE FOOD PRODUCTION SIGNIFICANTLY. THE HIGHER PRICES BEING PAID BY PRIVATE TRADERS ARE ALSO RESULTING IN HIGH CREDIT REPAYMENT RATES (ONE OF THE LARGEST EXTENSION SERVICES, BLANTYRE ADD, IS REPORTING 80 PERCENT REPAYMENT BY SMALLHOLDERS).

E. CAPITALIZATION AND REFORM OF THE INPUT SUPPLY SYSTEM. AT THE OUTSET OF THE MFSRP, THE SMALLHOLDER FERTILIZER REVOLVING FUND (SFRF) WAS EXPERIENCING SERIOUS FINANCIAL AND ADMINISTRATIVE PROBLEMS. LOCAL CURRENCY GENERATIONS EQUIVALENT TO DOLS 8.0 MILLION WERE CHANNELED TO THE SFRF TO CAPITALIZE THE INPUT SUPPLY SYSTEM. THIS ASSISTANCE, HOWEVER, WAS CONDITIONED ON THE GOM REVIEWING THE FERTILIZER DISTRIBUTION AND REVENUE MANAGEMENT SYSTEMS AND TAKING ANY NECESSARY CORRECTIVE ACTIONS.

DURING THE LIFE OF THE PROJECT A NEW CREDIT RECUPERATION AND REMITTANCE SYSTEM HAS BEEN INSTITUTED AND ADMARC'S INDEBTEDNESS TO THE SFRF HAS BEEN SUBSTANTIALLY REDUCED. ACTING ON THE RECOMMENDATIONS OF AN A.I.D.-FINANCED STUDY, THE GOM HAS COMPLETELY SEPARATED THE NATIONAL FERTILIZER SUPPLY SYSTEM FROM ADMARC, ESTABLISHED IT AS AN INDEPENDENT TRUST, AND TAKEN STEPS TO STRENGTHEN ITS ADMINISTRATION AND OPERATIONS.

F. FINALLY, GOOD PROGRESS HAS ALREADY BEEN MADE TOWARDS ACHIEVING THE PROGRAM'S SECONDARY OBJECTIVES OF IMPROVING ADMARC OPERATIONS AND STRENGTHENING PUBLIC SECTOR PLANNING AND BUDGETING CAPACITIES. THROUGH THE DOLS 1.9 MILLION TECHNICAL ASSISTANCE, STUDIES AND TRAINING COMPONENT, THIRTY KEY OFFICIALS, INCLUDING FOUR PRINCIPAL AND DEPUTY SECRETARIES, ARE RECEIVING TRAINING IN SUCH DIVERSE, CRITICAL FIELDS AS: PROJECT ANALYSIS AND PROGRAM MANAGEMENT; PERFORMANCE AUDITING; PUBLIC TAXATION POLICY; NATIONAL BUDGETING, DEBT MANAGEMENT AND

CONTROL; FOREIGN INVESTMENT NEGOTIATIONS; FOOD AND AGRICULTURAL POLICY; AND PUBLIC ENTERPRISE POLICY AND MANAGMENT.

4. LESSONS LEARNED: IN REFLECTING ON OUR TWO YEARS OF EXPERIENCE WITH THE FERTILIZER SUBSIDY REMOVAL PROGRAM, THERE ARE CERTAIN LESSONS TO BE GLEANED WHICH SHOULD BE CONSIDERED IN THE DESIGN OF FUTURE SUCH PROGRAMS.

A. IN A COUNTRY WHICH HAS AN AGRICULTURE-DOMINATED ECONOMY, AN INPUT SUBSIDY REMOVAL OR SUPPLY REFORM PROGRAM HAS POTENTIAL POLITICAL LIABILITIES, FOR THE HOST COUNTRY GOVERNMENT, RESPONSIBLE POLICY REFORMERS AND THE DONOR.

WHEN THE GOM LAUNCHED ITS FORMAL REQUEST FOR FOOD AID, IT EXPLICITLY TARGETTED THE AID-FINANCED MFSRP AS A MAJOR CAUSE OF THE FOOD PRODUCTION SHORTFALL. ALTHOUGH THE MISSION ANTICIPATED THIS VULNERABILITY EARLY ON AND PUSHED GOVERNMENT TO SUPPORT THE IMPACT STUDY, IT HAD NOT YET BEEN COMPLETED. THIS EXPERIENCE DEMONSTRATES THE IMPORTANCE OF SUCH EVALUATIONS BEING DONE EARLY ENOUGH TO FACTOR INTO THE ONGOING REVIEW/DIALOGUE PROCESS. FURTHERMORE, ALTHOUGH POLICY REFORMERS UNDERSTOOD THE LIMITED IMPACT THE MFSRP HAD ON FOOD SECURITY, NON-TECHNOCRAT POLITICAL LEADERS MUST ALSO BE "EDUCATED" AND SOMEHOW INCLUDED IN THE POLICY REVIEW/DIALOGUE PROCESS.

B. IT IS IMPORTANT TO EXPLICITLY DEFINE THE METHODOLOGY TO BE USED IN CALCULATING THE SUBSIDY, INCLUDING THE ELEMENTS IN THE CALCULATION, THE BASIS FOR ATTRIBUTING A NUMERICAL VALUE, AND THE POINT IN TIME AT WHICH THE CALCULATION IS MADE.

C. IT IS ALSO IMPORTANT TO MORE EXPLICITLY DEFINE "ECONOMIC VALUE" OF FERTILIZER. THE MISSION AND GOM

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ACTION AID-00

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FM AMEMBASSY LILONGWE
TO SECSTATE WASHDC IMMEDIATE 2358
INFO AMEMBASSY NAIROBI IMMEDIATE

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AIDAC

FOR AFR/DP, AFR/SA, AFR/PD
NAIROBI FOR REDSO/ESA AND RIG/A
NAIROBI PASS TO AA/AFR GLADSON AND DAA'S BOLINGER
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AND AFR/PD PEASLEY

E.O. 12356: N/A
SUBJECT: MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM

CHOOSE TO DEFINE IT AS ACTUAL REPLACEMENT COST, RATHER THAN ATTEMPTING TO PROJECT WHAT PRICES IN A VOLATILE WORLD MARKET AND DOMESTIC ECONOMY WOULD BE TWELVE MONTHS INTO THE FUTURE. THE LATTER, STRICTER INTERPRETATION PROVIDES GREATER INSURANCE AGAINST DECAPITALIZATION BUT IT ALSO PLACES A DOUBLE BURDEN ON THE SMALL FARMER IN THE FIRST YEAR OF THE PROGRAM -- HE PAYS THE ADDITONAL PRICE FOR THE SUBSIDY REDUCTION AND THE THEORETICAL PRICE INCREASE AT THE SAME TIME.

D. THERE NEEDS TO BE BETTER ANALYSIS OF THE POTENTIAL ADVERSE EFFECTS OF SUCH A REFORM PROGRAM ON THE SMALLEST FARMER, PREFERABLY BEFORE IT BEGINS, AND IDENTIFICATION OF COMPENSATORY MEASURES WHICH CAN BE TAKEN TO LIMIT THE NEGATIVE IMPACT ON INCOME AND FOOD SECURITY OF THE RURAL FARM FAMILY. THIS IS PARTICULARLY CRITICAL IN A COUNTRY SUCH AS MALAWI -- 85 PERCENT OF THE POPULATION ARE DEPENDENT ON AGRICULTURE; THE MAJORITY OF THESE FARM LESS THAN 1 HECTARE BECAUSE POPULATION IS DENSE AND ARABLE LAND IS SCARCE; AND THERE IS A DESPARATE NEED TO INTENSIFY PRODUCTION IN ORDER TO RAISE SMALL FARM FAMILY NUTRITION LEVELS, ENSURE NATIONAL FOOD SELF-SUFFICIENCY AND PERMIT CROP DIVERSIFICATION.

3. NEXT STEPS. GIVEN THE CURRENT POLITICAL CLIMATE AND FOOD SECURITY PROBLEMS, MISSION AND GOM POLICYMAKERS AGREE THAT IT WOULD BE ADVISABLE TO SUSPEND THE MFSRP. IT IS WORTH NOTING THAT THE GOM IS STILL COMMITTED TO THE SUBSIDY REMOVAL PROGRAM. ALTHOUGH PRICES WERE FROZEN THIS YEAR (87/88) FOR REASONS STATED ABOVE, IN RECENT DISCUSSIONS WITH THE IMF THE GOM INDICATED ITS INTENTION TO ELIMINATE THE REMAINING SUBSIDY OVER THE NEXT TWO YEARS (BY 89/90). BECAUSE THE GOM IS STILL CLEARLY COMMITTED TO A BROAD STRUCTURAL ADJUSTMENT PROGRAM, WE ARE INTERESTED IN EXPLORING TOGETHER HOW THE UNDISBURSED DOLS 5.1 MILLION COULD BE REPROGRAMMED TO REINFORCE ONGOING REFORM EFFORTS OR ENCOURAGE NEW REFORM INITIATIVES. WE SEE THREE POSSIBILITIES AT THIS TIME:

A. REINFORCE ADMARC DIVESTITURE AND RESTRUCTURING (EPRP II: 612-0227) WITH ADDITIONAL DOLS 5.1 MILLION. THIS PROGRAM IS PROGRESSING WELL. FIVE HOLDINGS HAVE ALREADY BEEN DIVESTED AND A DETAILED RATIONALIZATION AND DIVESTITURE PLAN HAS BEEN PREPARED BY DELOITTE, HASKINS

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AND SELLS. AS A RESULT OF THEIR ANALYSIS IT WOULD NOW APPEAR THAT THERE IS POTENTIAL FOR MORE THAN MK 38.0 MILLION IN DIVESTITURE BY JUNE 1988. IF THIS WERE TO OCCUR THE PRESENT PROGRAM WOULD BE FULLY DISBURSED -- ONE YEAR BEFORE THE CURRENT PACD. ONE OF THE INNOVATIVE (FOR MALAWI) RECOMMENDATIONS PUT FORTH IS THE ESTABLISHMENT OF A TRUST OR FUND INTO WHICH SEVERAL BLUE CHIP ASSETS COULD BE TRANSFERRED FOR PUBLIC OFFERING OF SHARES.

THE ADVANTAGE OF THIS REPROGRAMMING OPTION IS ITS EASE AND TIMING. A PAAD SUPPLEMENT COULD BE DEVELOPED BASED ON MORE DETAILED OP AND S ANALYSIS AND ADDITIONAL IMPLEMENTATION PROGRESS OVER THE NEXT SIX MONTHS.

B. SUPPORT TO LIBERALIZATION OF AGRICULTURAL MARKETING. THE WORLD BANK HAS TAKEN THE LEAD IN ENCOURAGING THE GOM TO FORMALLY OPEN PRODUCE MARKETING TO PRIVATE TRADERS. A.I.D., HOWEVER, HAS BEEN INVOLVED IN THE DIALOGUE PROCESS AND IS COMMITTED TO FINANCE AN ASSESSMENT OF EXPERIENCE TO DATE.

THE WORLD BANK IS CURRENTLY DEVELOPING A DOLS 25.0 MILLION AGRICULTURAL MARKETING PROGRAM. ITS AIM WILL BE TO DEVELOP A MULTI-CHANNEL MARKETING SYSTEM BY PROVIDING: TRAINING AND FINANCING FOR PRIVATE SECTOR PARTICIPATION IN MARKETING, TRANSPORT AND PROCESSING; AND TECHNICAL ASSISTANCE TO SUPPORT THE GOM'S REGULATORY, PROMOTIONAL AND MONITORING FUNCTIONS AND TO RATIONALIZE ADMARC'S MARKETING SYSTEM. AN APPRAISAL MISSION IS SCHEDULED FOR FEBRUARY 1988 AND THE PROJECT IS TO BE PRESENTED TO THE BANK'S BOARD IN AUGUST 1988. THE BANK HAD TENTATIVELY IDENTIFIED A NEED FOR DOLS 6.5 MILLION IN CO-FINANCING AND INITIAL DISCUSSIONS WITH THEIR STAFF INDICATE A KEEN INTEREST IN A.I.D.'S PARTICIPATION.

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AIDAC

FOR AFR/DP, AFR/SA, AFR/PD
NAIROBI FOR REDSO/ESA AID RIG/A
NAIROBI PASS TO AA/AFR GLADSON AND DAA'S BOLINGER
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AND AFR/PD PEASLEY

E.O. 12356: N/A
SUBJECT: MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM

THE ADVANTAGES, HERE AGAIN, ARE THE EASE AND THE TIMING. WE COULD BUILD ON THE BANK'S DOCUMENTATION AND THE PROPOSED TIMEFRAME IS CONSISTENT WITH OUR DESIRE TO REPROGRAM THE REMAINING MNSRP FUNDS BEFORE THE 9/24/88 TERMINAL DISBURSEMENT DATE. THE POTENTIAL DRAWBACKS, HOWEVER, ARE THREE-FOLD: (1) UNLESS AID/W WOULD APPROVE CO-FINANCING, WE WOULD HAVE TO IDENTIFY A DISTINCT ACTIVITY FOR PARALLEL FINANCING; (2) IT IS UNCLEAR HOW QUICKLY SUCH A PROGRAM CAN BE IMPLEMENTED/FUNDS DISBURSED, AND (3) IT DOES NOT PROVIDE US AN INVESTMENT OPPORTUNITY TO BUILD ON WITH FY 89 FUNDS -- AN IMPORTANT CONSIDERATION IN LIGHT OF THE PROPOSED DOLS 15.0 MILLION MALAWI OYB UNDER THE DEVELOPMENT FUND FOR AFRICA (PER STATE 378538).

C. A NEW AGRICULTURAL SECTOR POLICY REFORM PROGRAM. THE MISSION HAS IDENTIFIED A NUMBER OF CRITICAL ISSUES, SOME OF WHICH WILL ALSO BE ADDRESSED BY THE BANK IN THEIR AGRICULTURAL MARKETING PROGRAM DESCRIBED ABOVE, WHICH COULD SERVE AS THE FRAMEWORK FOR AN EPRP III: (1) ENCOURAGING A MORE FLEXIBLE PRODUCER PRICING POLICY, INCLUDING DOWNWARD MOVEMENTS AND SEASONAL ADJUSTMENTS; (2) STRENGTHENING HIGH ANALYSIS FERTILIZER EXTENSION EFFORTS AND ENSURING A SOUND INPUT PRICING STRUCTURE TO ENCOURAGE THEIR UPTAKE; AND (3) SUPPORTING POLICY FORMULATION AND TECHNICAL PACKAGE DEVELOPMENT AIMED AT STIMULATING THE SMALLEST SMALLHOLDER PRODUCTION.

WE HAVE ALREADY INFORMALLY BRIEFED WITH THE GOM THESE AGRICULTURAL POLICY UNDERTAKINGS WHICH COULD BE EMBODIED IN A NEW INITIATIVE.

GOM POLICYMAKERS WERE OPEN TO THE IDEAS AND WORLD BANK STAFF WERE VERY SUPPORTIVE. THE ADVANTAGES OF SUCH AN APPROACH ARE THAT: (1) IT TACKLES SOME OF THE MOST CRITICAL ISSUES CONFRONTING SMALLHOLDER AGRICULTURAL DEVELOPMENT; (2) IT PROVIDES A BROAD BASE FOR POLICY DIALOGUE; AND (3) IT PROVIDES A PROGRAMMING FRAMEWORK FOR THE UNDISBURSED MNSRP FUNDS AS WELL AS THE FY 89 OYB AUGMENTATION. THE BASIC DRAWBACK IS THE MANAGEMENT BURDEN OF SUCH A DESIGN, INCLUDING INITIAL POLICY ANALYSES.

6. DIRECTOR NICKS WILL DISCUSS THE VARIOUS PROGRAMMING OPTIONS WITH BUREAU MANAGEMENT DURING THE UPCOMING AFRICA MISSION DIRECTOR'S CONFERENCE. WE WOULD LIKE TO MAKE A TENTATIVE DECISION ABOUT HOW TO PROCEED BY DECEMBER 15 IN ORDER TO PROVIDE REVISED BUDGET ESTIMATES AS REQUESTED STATE 378538. JETT

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ANNEX IV

AN ECONOMIC ANALYSIS OF THE USE OF FERTILIZER IN SMALLHOLDER AGRICULTURE

PART I: TRENDS IN FERTILIZER UPTAKE AND CROP PRODUCTION

A. Trends in Fertilizer Uptake and Prices

From 1972/73, the first year for which we have a fertilizer uptake figure, to 1980/81, there was a rapid growth in the use of fertilizer by smallholders in Malawi. Table IV-A-1 gives the data. The average rate of growth over those eight years was 12.5 percent per year, the one dip occurring in 1974/75 during the first energy crisis.

Since 1980/81 total sales of fertilizer material have stayed in the range of 56,000 to 69,000 metric tons a year. In some years sales have been determined by supply limitations rather than by demand. In 1981/82 and 1982/83, for example, ADMARC was experiencing liquidity problems and the transport routes through Mozambique were breaking down. The SFRF began operations in 1983/84 and supplies began to improve, reaching a record year in 1984/85. When sales fell in 1985/86 there were ample supplies and the reason

The Impact of the Fertilizer Subsidy Removal Program on Smallholder Agriculture in Malawi, a report by Robert Nathan Associates, June 30, 1987, Annex IV, pp. 10-31.

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TABLE IV-A-1 — TOTAL UPTAKE OF FERTILIZER, 1972/73-1986/87
(metric tons)

	20:20:0	S/A	CAN	Urea	DAP	Other	Total Matrl	Phos-phate	Nitro-gen	Total Nutrients
1972/73	2328	18752	2668	84		1353	25185	466	5136	5601
1973/74	4265	23017	3277	873		307	31739	853	6940	7793
1974/75	1636	11412	666	732		401	14847	327	3234	3561
1975/76	2567	17456	1312	210		804	22349	513	4617	5130
1976/77	4148	23611	1351	133		1293	30536	830	6200	7030
1977/78	6374	33835	3181	177		999	44566	1275	9289	10563
1978/79	8971	31839	3992	113		873	45788	1794	9570	11364
1979/80	9170	35239	4166	202		364	49141	1834	10410	12244
1980/81	13469	43630	4748	240		2361	64448	2694	13201	15895
1981/82	10619	42508	2789	673		—	56589	2124	12085	14209
1982/83	22928	24845	9912	74		4	57763	4586	12414	17000
1983/84	21813	3232	31964	—		—	57009	4363	13352	17715
1984/85	26107	5444	36965	37		501	69054	5221	15993	21214
1985/86	25485	3585	35547	—		331	64948	5097	15092	20189
1986/87	21925	6699	32422	5444	813	—	67303	4759	17521	22280

Note: 1986/87 sales are provisional, and the figure for "Other" in 1985/86 includes some urea.
Nutrients do not include "Others". CAN was 26 percent till 1985/86 and 28 percent in 1986/87.
Source: Government of Malawi, Ministry of Agriculture, Agriculturalist's Report No. 1", 20 June, 1986

for the decline is thought to be the increase in fertilizer prices of that year, especially for S/A and CAN. The second largest year was 1986/87.

The table also shows total uptake in terms of nutrients. There has been a decline in phosphates in the most recent years, but this has been more than offset by the upward trend in nitrogen. The result is that the record year for the quantity of nutrients purchased was 1986/87.

Table IV-A-1 shows clear changes in the kinds of fertilizer used by smallholders. Sulphate of ammonia (S/A) was bought in earlier years for application to maize. Because the soils on which it was used tended to become acidic, a decision was made to phase it out in favor of calcium ammonium nitrate (CAN) except in those locations where sulphur deficiencies were of particular concern. This changeover was fairly easy to accomplish because application rates were the same. Sales of 20:20:0 fertilizer increased as hybrid maize varieties were introduced[1]. What farmers are now accustomed to doing for maize is apply 20:20:0 as a basal dressing and follow it later with CAN as a top dressing.

1986/87 was the first year of a scheduled changeover from the traditional fertilizers, S/A, CAN and 20:20:0, to high analysis blends. The latter are diammonium phosphate (DAP, the formula of which is 18-46-0) and urea (46 percent nitrogen). The purpose of this switch is to reduce transport costs per unit of nutrient by importing more concentrated fertilizer. This changeover will not be as easy as that from S/A to CAN because the very different concentration levels mean that farmers will have to learn different application rates.

Up to now most of the fertilizer sold to smallholders has been used on maize. Most of the rest has been put on tobacco. Other crops which would benefit from fertilizer - groundnuts and sorghum to name only two - have traditionally not been fertilized in this country. Of the maize, it is customary to distinguish between three different classes: local, composite and hybrid. The following figures indicate how fertilizer is distributed among these crops and what effect it has on yields:[2]

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[1]. The numbers describing the fertilizer refer to the percentages in it of nitrogen (N), phosphorus (P) and potassium (K). As these add up to 40 in this case, the implication is that this fertilizer contains 60% inert material, or filler.

[2]. Note that in the crop estimates submitted by ADD's for 1984/85 the hectarage figures are somewhat larger for the three classes of maize. However, this would be at least partly accounted for the fact that figures for

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Only 24.2 percent of land growing local maize in this year was fertilized, but because it took up so much of the total amount of land being farmed it actually accounted for more land fertilized than all other crops put together. It also took up more tonnage of fertilizer than any other single crop. The yield figures in Table IV-A-2 demonstrate that hybrid maize responds very much more to fertilizer applications than the other varieties, and in fact is not worth growing unless it is fertilized. Thus it is not surprising that nearly all the land in hybrids was fertilized. However, in 1984/85 these varieties only accounted for 5.9 percent of the hectares in maize. This proportion has since fallen.

TABLE IV-A-2 -- USE OF FERTILIZER AND YIELDS FOR SELECTED CROPS, 1984/85

	% of All Farm Land	% of Crop Fert'd	% of Fert'd Land	Av Fert Put On (Kg/Ha)	% of Fert Use	Average Yields Fert'd (Kg/Ha)	Average Yields Unfert' (Kg/Ha)
MAIZE							
Local	58.9	24.2	54.8	83	39.5	1390	822
Composite	1.5	52.7	3.1	160	4.4	2040	706
Hybrid	5.9	85.2	19.4	163	27.4	2785	1146
Mixture	16.6	19.0	12.1	116	12.2	1436	912
TOBACCO	3.0	77.7	9.1	180	14.2	10	0
OTHERS	32.5	1.1	1.4	186	2.3	n.a.	n.a.
			---		---		
			100.0		100.0		

Source: ASA weighted sample, National Worktable 8.1
Note that the column showing percent of all farm land adds up to more than 100 percent because intercropped acres are included more than once.

As the amount of hectares sown to hybrid maize fell, and the total uptake of fertilizer nutrients was the highest ever, the fertilizer that would have been used on the land taken out of hybrids had to go somewhere else. If farmers were cutting back hybrid production, there was no reason for them to put more fertilizer on what hybrid grain they were growing. Perhaps leakages and application rates were higher, but it is just as likely that local maize received more fertilizer than in previous years.

Table IV-A-3 shows what has happened to the prices of the various kinds of fertilizer since the early 1970's. The price increases which took place in the earliest part of the series were connected with the onset of the energy

mixtures (intercropping) are not included in the estimates. In any case, the percentages calculated from the estimates are not far off these: locals 63.5%, composites 1.3%, and hybrids 4.5%.

TABLE IV-A-3 — PRICES OF FERTILIZERS TO SMALLHOLDERS, 1972/73 TO 1986/87
(Kwacha per 50 Kg bag)

	20:20:0	S/A	CAN	Urea	DAP
1972/73	3.45	2.75	3.30		
1973/74	3.45	2.75	3.30		
1974/75	9.00	6.70	8.50		
1975/76	8.50	5.50	7.75		
1976/77	8.50	5.50	7.75		
1977/78	8.50	5.50	7.75		
1978/79	8.50	5.50	7.75		
1979/80	8.50	5.50	7.75		
1980/81	8.50	6.50	10.50		
1981/82	8.50	9.00	10.50		
1982/83	12.60	10.50	13.00		
1983/84	14.50	12.00	14.00		
1984/85	17.50	13.50	15.50		
1985/86	20.50	17.50	19.00		
1986/87	21.00	18.00	19.50	26.00	24.00

Sources: Up to 1985/86: Government of Malawi, Ministry Agriculture, Agriculturalist's Report No.1, June 20, 1986, Table 1.5. 1986/87 prices: SFRF

crisis, affecting both raw material costs and transport. The more recent increases have been due to the large jump in transport costs following the closure of the Nacala and Beira railway lines, and to currency devaluations. Finally, since 1985/86, a further reason for higher prices has been the removal of the fertilizer subsidy.

The distribution of farm holdings by size for Malawi is shown in Table IV-A-4. The median size is in the 0.5 to 1.0 hectare range, and less than 5 percent of all smallholdings are over 3 hectares. The largest farm found anywhere was 8.7 hectares and the average size of farms in the largest category was 4 hectares.

Table IV-A-5 shows how fertilizer use is distributed by farm size. With certain exceptions and taking into account tobacco as well as maize, the proportion of land fertilized generally rises with farm size, though not

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TABLE IV-A-4 — SIZE DISTRIBUTION OF SMALLHOLDINGS

Hectares	<0.5	0.5-1	1-1.5	1.5-2	2-2.5	2.5-3	>3
% of all Holdings	23	32.3	19.9	10.9	6.3	3.5	4.2

Source: 1984/85 ASA Summary Table 1.

TABLE IV-A-5 -- USE OF FERTILIZER AND YIELDS FOR SELECTED CROPS BY HOLDING SIZE

Holding Size & Crop	% of Area Fert	Fert per Ha (Kg)	Average Yields Fert (Kg/Ha)	Average Yields Non-Fert (Kg/Ha)	% of Area Fert	Fert per Ha (Kg)	Average Yields Fert (Kg/Ha)	Average Yields Non-Fert (Kg/Ha)
<0.5 Ha					2.0-2.5 Ha			
Maize L	31.6	20	1050	680	30.0	102	1403	963
M	8.4	252	1314	635	27.1	114	1668	694
C	45.9	472	2674	1251	49.6	113	2669	1106
H	61.1	544	3259	68	84.9	155	3090	850
Tobacco	16.8	119	0	0	69.3	202	0	0
Other	0.2	331	2559	280	3.1	116	1517	475
0.5-1.0 Ha					2.5-3.0 Ha			
Maize L	11.0	128	1589	782	25.9	104	1251	1097
M	11.0	152	1304	695	32.4	107	1611	979
C	75.6	199	2116	890	61.2	165	2244	750
H	62.9	266	2767	1233	83.8	166	2864	1029
Tobacco	52.7	199	0	0	83.7	214	0	0
Other	3.8	198	1996	380	0.4	192	155	471
1.0-1.5 Ha					>3.0 Ha			
Maize L	19.3	100	1305	833	39.7	61	1518	898
M	21.0	113	1462	733	33.2	74	1317	703
C	34.4	167	2265	1108	57.9	140	1023	1248
H	85.0	221	2655	742	89.9	115	2656	966
Tobacco	74.3	207	0	0	88.5	122	50	0
Other	2.4	219	1521	473	0.8	24	920	405
1.5-2.0 Ha					TOTAL			
Maize L	25.9	114	1358	928	24.2	83	1390	822
M	15.8	101	1450	741	19.0	116	1436	706
C	65.5	100	2048	1525	52.7	160	2040	1146
H	82.8	218	2713	1129	85.2	163	2785	912
Tobacco	80.5	199	0	0	77.6	180	10	0
Other	0.6	208	883	386	1.1	186	1744	405

L: local M: mixture C: composite H: hybrid

Source: 1984/85 ASA, Worktable 8.1

continuously. There appear to be two dividing lines: the first separates farms of less than one hectare from the rest. These generally fertilize a substantially smaller proportion of their land than the larger categories. I particular, large proportions of hybrid maize and tobacco are left unfertilized, although the significance of this must not be exaggerated. The amount of land devoted to these crops by the smallest farmers is very slight. The second division places holdings over 3 hectares in a group apart which puts the input on a notably larger percentage of their land than do smaller scale farmers. The third group is in the middle, from one to three hectares. It contains 40 percent of all farmers, but it is hard to pick out any clear distinctions among them in terms of fertilizer use.

There is, then, an increase in fertilizer use as farm size grows, though it goes in steps rather than continuously. The correlation is not surprising. Smaller farmers usually find a larger proportion of their income devoted to basic needs such as food, clothing and school fees, leaving little over to invest in their farms. However, this is not a good situation, for if these smaller landholders are to build up their incomes, and they have no off-farm job, increasing the productivity of their land is their major hope, and preventing its decline a problem.

B. Patterns and Trends in Different Kinds of Crop

Data on crop hectarages and production are not available for as many years back as they are for fertilizer. Figures on hectarages taken from the Ministry of Agriculture's estimates are given in Table IV-B-1. The clearest fact is that most land is devoted to maize: never less than two-thirds of it. The proportion has been falling, from 73.9 percent in 1982/83 to 66.6 percent in 1986/87. However, this is not because the amount of land under maize is lower but because the total amount of land included in these estimates has been rising; (which may or may not mean that the total amount of land being brought under cultivation has been growing, depending on what crops are left out of the ASA).

Over 90 percent of land under maize is grown from local types. The dominance of such varieties is explained by the fact that they are much preferred by

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TABLE IV-B-1 -- HECTARAGE TRENDS, 1982/83 - 1986/87

	1982/83	1983/84	1984/85	1985/86	1986/87
MAIZE	1169402	1182601	1144853	1193275	1182415
local		1067527	1048441	1104583	1131540
composite		26069	21477	20100	13780
hybrid		89005	74935	68592	37095
RICE	20309	21917	20807	22874	18803
G'NUTS	146314	144935	135966	176293	209938
TOBACCO	27587	44999	46939	38045	39872
COTTON	32597	51059	60824	51910	34504
CASAVA	59351	81497	80262	72904	63174
SORGHUM	22649	21302	32725	32059	30626
PULSES	82932	91322	79971	113663	140476
MILLET	10870	15340	17413	17424	18163
CASHEW	53	12	12	6546	24103
COFFEE	0	2	0	0	14108
SWT POT	n.a.	21340	22717	22447	25698
OTHERS	8487	8096	7682	7952	10288
TOTAL	1580498	1684408	1650159	1748846	1773957

Source: Agricultural Development Divisions
NOTE: The figures for cashews and coffee refer to numbers of trees and are not included in total hectares.

TABLE IV-B-2
MAIZE PRODUCTION AND ADMARC PURCHASES (1)

	1982/83	1983/84	1984/85	1985/86	1986/87
MAIZE PRODUCTION					
Total maize	1369403	1397948	1355202	1294564	1211157
Hybrid maize	n.a.	245391	233123	201729	102108
ADMARC PURCHASES	244916	296443	272275	111331	
PURCHASES/PRODUCTION					
Purch/Total Prodn		0.21	0.20	0.09	
Purch/Hyb Prodn		1.21	1.17	0.55	

Sources: ADD's and ADMARC

(1) Years refer to crop years. Crops grown in one year are purchased in the next. Hence purchases shown here under the 1982/83 column, for example, appear under 1983/84 in ADMARC's tables.

Malawians when it comes to selecting grain for their own consumption. The locals are flints, the hybrids are dents, and the losses in storing the grain and preparing it for food are significantly less for the locals. That this is the major reason for growing local varieties is shown by the fact that when farmers plan to grow for the market, they do not choose the locals.

The data on composites are somewhat problematic in that the distinction between them and locals is not necessarily a clear one. Local seeds have become improved over the years by cross pollination with better varieties. In addition, farmers who are growing maize from composite seed bought two, three or four years ago may not necessarily be included in figures of composite maize production. (After four years they commonly would have degenerated to the quality of most local seed). Composites combine both flint and dent characteristics and what proportions are grown for home use and for sale is not certain. Hybrids, with their greater fertilizer response and profitability are virtually always grown for sale.

Table IV-B-1 shows that the composite and local hectarages declined 23 percent from 1983/84 to 1985/86 and then this year fell dramatically, by 33 percent for composite and 48 percent for hybrid maize. The hectarage under local maize has changed very little in percentage terms. This is because, while farmers continue to ensure their own subsistence needs by keeping up their cultivation of local maize, their interest in maize as a cash crop has declined.

Other crops which have had the opposite trend and risen considerably have been groundnuts, pulses and, to a lesser degree, millet and sorghum. That groundnuts and pulses are both purchased by ADMARC makes them alternative cash crops to hybrid maize, and there is a fear that these crops may continue to supplant the maize and jeopardise the nation's self-sufficiency in its most important staple food.

Adding to the effect of the fall in hectarage devoted to hybrid maize is the fact that in 1986/87 the proportion of the hybrid maize crop purchased by ADMARC was much lower then than in earlier years, as is shown by the numbers in Table IV-B-2. In fact, the proportion fell by almost half. Why this occurred is not yet clear. One possible contributing factor was that last year, owing to cashflow difficulties, ADMARC did not begin purchasing maize from smallholders as soon as they were ready to sell it. Some of the crop spoiled, but this would explain only a small part of the decline in sales. It is possible that rather than wait longer and suffer more storage losses, many farmers either sold hybrid maize privately or consumed it at home. It is also

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possible that the estimate of hybrid maize production for 1985/86 was above what was actually grown.

No one can know now what proportion of this season's maize crop will be sold to ADMARC, but as total production of hybrid maize will be much lower, it can be expected that total sales will also be far down on their levels of two and more years ago. As recently as 1986 this might not have seemed a bad thing, because ADMARC's opening stocks of maize for 1986/87 amounted to 299,000 tonnes, or well over a year's national consumption. The concern then was not to have these stocks increase, for they were very expensive to maintain. However, the situation is now vastly altered, with ADMARC selling 318,439 tonnes of maize in the 1986/87 marketing year and buying only 111,332 tonnes. The explanation for the large outgoing of maize is apparently the increased maize necessary to feed the refugees from Mozambique, numbered now in the hundreds of thousands. All of a sudden the concern over surpluses has been converted to a fear that the nation will not be able to feed everyone within its borders.

C. Reasons for the Decline in the Production of Improved Maize Varieties

As there has been a large fall in the production of improved varieties of maize which has been taking place at the same time as the subsidy on fertilizer has been reduced, an obvious hypothesis is that there is a causal connection between the two. The argument would be that the subsidy removal has caused an increase in the price of fertilizer, thereby reducing the profitability of growing hybrid maize which requires a good deal of this input. If this hypothesis holds up when examined in more detail, the case for keeping a fertilizer subsidy would be regarded as strengthened.

Testing this hypothesis against the facts and the logic of what has occurred requires that several questions be considered:

1. To what extent has the increase in the price of fertilizer been due to the removal of the subsidy?
2. What has been the effect on fertilizer uptake?
3. What happened to the profitability of growing maize, especially hybrid maize?
4. How has the profitability of growing hybrid maize compared with that of growing competitive cash crops?

The Effect of Subsidy Removal on the Price of Fertilizer

Table IV-A-3 showed prices by type of fertilizer for as far back as

1972/73. The upper line in Table IV-C-1 gives the cost of fertilizer in terms of what a farmer would have had to spend over the past six years to buy the amounts typically purchased to fertilize a hectare of hybrid maize (which is less than the amounts recommended by the research station). The quantities, taken from the assumptions behind the gross margins worked out by the MoA's Planning Section, are 100Kg of 20:20:0 and 150Kg of CAN. The increase in cost is plain: a doubling over the period, with all but 2.6 percent of the total increase taking place by 1985/86.

The subsidy removal schedule dictates that the rate had to be no higher than 22.6 percent in 1985/86, 17 percent in 1986/87, 12 percent in 1987/88, and 6 percent from 1988/89 (just offsetting the import levy of 5 percent). In order to gauge the impact of this schedule on prices, a reasonable assumption has to be made about what the level of the subsidy would have been in the absence of the program. We only have data on what the subsidy has been since the creation of the SFRF. Until shortly before that time ADMARC subsidised fertilizer from its own funds, and when it did begin to receive government subventions their amounts were influenced by losses on more than just fertilizer.

For the first two years of the SFRF's operation the net government subsidy as a percentage of the cost of fertilizer sales amounted to 28.6 percent and 23.4 percent. Since then the subsidy removal schedule has been in force. For the purposes of this excercise we have assumed a subsidy of 25 percent as being

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TABLE IV-C-1 -- COST OF FERTILIZER PACKAGE FOR HYBRID MAIZE, ACTUAL AND WITH 25% SUBSIDY, 1981/82-1986/87

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87
Actual cost to farmers	48.50	57.20	71.00	81.50	98.00	100.50
Cost with subsidy cont'd at 25% past 1984/85	48.50	57.20	71.00	81.50	94.96	90.81

Costs are for a package of 100 Kg of 20:20:0 and 150 Kg of CAN. These are the quantities used by the Planning Division of the MoA in calculating gross margins for crops.

Actual subsidies assumed to be 25 percent or more till 1982/83, calculated to be 28.6 percent in 1983/84 and 23.4 percent in 1984/85, and assumed to be 22.6 percent (as per USAID schedule) in 1985/86. For 1986/87 the basis for calculation was the prices which would have satisfied the USAID agreement, using a 17 percent subsidy and USAID's weighting among types of fertilizer. These were all adjusted down by the same factor (0.9036) to increase the subsidy to 25 percent. The prices before adjustment were K21.00 for 20:20:0

and K19.25 for CAN.
Source for prices: see Table IV-A-3

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indicative of the level that would have been maintained.

As the level of subsidy allowed by the schedule in 1985/86 was 22.6 percent, its effect on the price level that year was only about 3 percent. In 1986/87, following the methods of calculation used here[3], the impact was greater, around 10 percent. The calculations show that had the subsidy remained at 25 percent there would actually have been a slight price fall last year. This is because there was a decrease in the cost of importing fertilizer between 1985/86 and 1986/87 (of about 9 percent for both 20:20:0 and CAN, which together made up 78 percent of all purchases). Another factor is that in 1986/87 the burden of subsidy removal was borne by urea and DAP, which do not enter into the package of fertilizers assumed here.

The conclusion to this section must be that the subsidy removal program did not have an appreciable impact on the prices of the fertilizers until last year, when it might have prevented a price fall and did bring about a large increase in the prices of urea and DAP: the types of fertilizer to which farmers are supposed to be adapting. There is no doubt that prices of fertilizer have been rising, but until last year factors other than the FSRP were responsible, namely the increases in transport costs and the currency devaluations referred to earlier.

The Effect of Subsidy Removal on Fertilizer Uptake

Table IV-C-2 shows what total fertilizer uptake has been over recent years. The tonnages have varied up and down but last year, 1986/87, they were the second highest ever. It is at least easy to see why there should not have been a significant decline because the actual increase in the prices of traditional fertilizers was only small, and the main impact of the FSRP was to prevent a slight fall. The target of 10 percent sales of the new fertilizers was

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TABLE IV-C-2 -- FERTILIZER UPTAKE, 1982/83 - 1986/87

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87
Material	56589	57763	57009	69054	64948	66196

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3. Another method of calculating what the cost of the fertilizer package would have been would be to start with the full, unsibsidised cost, which was K129.03 and take 25% off of that. This would have resulted in a cost of K96.77.

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Nutrients	14209	17000	17715	21214	20189	22280

Source: See Table IV-A-1

almost met, the actual level being 9.1 percent. It is not unlikely that the target would have been fully met if the price for these types had not been so high, and had bags sizes smaller than 50 Kg, introduced for the first time last year, been more available.

However, even this slight shortfall was not an inevitable result of the FSRP. For one thing, the overall subsidy was reduced to 14.7 percent, which was lower than the 17 percent required by the USAID agreement. Secondly, this agreement stipulated that the weighting of the available subsidy be the opposite of what actually happened; i.e. the prices of urea and DAP should have been kept lower than they were at the expense of the traditional fertilizers.

The only conclusion which can be justified on the basis of these facts is that the FSRP cannot have caused a reduction in the uptake of traditional fertilizers, though it might have prevented a larger amount of purchases (providing the supplies were available). Where the new fertilizers are concerned, subsidy removal could have slowed down their adoption.

It is important to see that this conclusion is <u>not</u> the same thing as saying that the demand for fertilizers is insensitive to prices (i.e. that it is demand inelasitic). On the contrary, it is acknowledged that demand could have been higher under a subsidy continued at a level of 25 percent. Fertilizer prices would have been 12 percent lower ([1-(75/85.3)]x100 = 12 percent). If the elasticity of fertilizer demand were equal to -1, then fertilizer demand would have been that much higher.

The Profitability of Maize Production

Table IV-C-3 shows what the gross margins per hectare have been over the past six years for all kinds of maize.[4] Gross margins except for local,

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[4]. The most reasonable assumption where cash crops is concerned is that farmers are profit maximizers. It is also safe to assume that for most farmers the amount of land they have at their disposal is fixed. When they and their families do most of the labor and have no alternative off-farm sources of income, the appropriate measure of profitability is the gross margin per hectare. If the farmers are paying others to do most of the labor or have job opportunities off the farm, then the appropriate measure is net income per hectare, where this is the gross margin less labor cost. Except under a very narrow set of circumstances, not defined here, to maximize

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unfertilized maize have all been falling. The magnitude of the decline, comparing the first year in the series with the last, is almost the same for each: about 30 percent (31.3 percent for local, 26.2 percent for composite and 29.4 percent for hybrid).

The fertilizer price increases cannot be blamed for all of this deterioration in profitability. All other costs also rose over these years by a greater or lesser extent, though indices are given in Table IV-C-3 which show that they did not go up by as much: while fertilizer costs increased by just over 100 percent, other costs only went up by a little more than 50 percent. (One of the implications of this is that the percentage of total costs accounted for by fertilizer has been going up; it was 43.1 percent in 1981/82 and 50.3 percent in 1986/87).

Another critical variable here is the producer price of maize. The second row at the top of the table shows that there has not been a change in

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returns per manhour or manday is not profit maximizing behaviour.

TABLE IV-C-3 — HYBRID MAIZE PROFITABILITY

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87
GROSS MARGIN CALCULATION FOR HYBRID MAIZE						
Yield/Ha (Kg)	2750	2750	2750	2750	2750	2750
Price (t/Kg)	11.11	11.11	12.22	12.22	12.22	12
GROSS RETURN (K/Ha)	305.53	305.53	336.05	336.05	336.05	336.05
COSTS						
Fert. (150 Kg)	48.50	57.20	71.00	81.50	98.00	100.50
Seed (25 Kg)	20.83	20.83	20.83	25.00	25.00	26.25
Actellic	6.10	6.10	6.10	6.10	6.71	6.71
Transport	26.40	29.06	31.53	35.10	42.36	48.02
Finance	7.54	8.41	9.79	11.26	12.97	13.35
Depreciation	3.18	3.51	3.77	4.08	4.45	4.90
TOTAL NON-LABOR COSTS (K/Ha)	112.55	125.11	143.02	163.04	189.49	199.73
GROSS MARGIN Hybrid Maize	192.98	180.42	193.03	173.01	146.56	136.32
GROSS MARGINS: OTHER MAIZE						
Local, no fert	82.19	79.98	88.46	86.87	84.46	82.42
Local, fert.	92.18	81.08	90.77	83.50	68.11	63.31
Composite	131.65	119.61	132.43	120.29	104.29	97.21
INDICES OF COST INCREASES						
Fertilizer	100	118	146	168	202	207
Other non-labor costs	100	106	112	127	143	155
RATIO OF VALUE OF HYBRID MAIZE OUTPUT TO COST OF FERTILIZER	6.3	5.3	4.7	4.1	3.4	3.3
CONTINUATION OF 25 percent SUBSIDY past 1984/85						
Cost of Fert.	48.5	57.2	71	81.5	94.96	90.81
Gross Margin	192.98	180.42	193.03	173.01	149.60	146.01
Value/Cost	6.3	5.3	4.7	4.1	3.5	3.7

Source: Author's calculations and gross margin tables prepared by Planning Section of the Ministry of Agriculture, April 1987.

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this price for four years. The considerable fall in the ratio of the value of maize output to the cost of the fertilizer inputs, shown in the lower part of the table, is attributable to this as well as fertilizer price increases.[5]

The little movement in the maize producer price illustrated here must be seen in the context of a very large increase which took effect just before the first year reported in the table; the maize producer price was 6.6 tambala per Kilo in 1980/81, implying a 68 percent increase to the 11.1 tambala price of 1981/82. Following this increase, ADMARC purchases of maize grew from 91,205 metric tons in 1980/81 to 136,591 tons in 1981/82 and 246,086 tons the next year. ADMARC's maize stocks went up, causing the concern over maize surpluses alluded to earlier so it is not surprising that further price increases were thought inappropriate. However, now that the concern is now completely reversed and food deficits are in the offing, there is room for maize prices to rise again, as one measure among others, to restore the attractiveness of growing maize for sale.

The final calculation made in Table IV-C-3 is to show what some of these figures would have been had the subsidy been kept at 25 percent. This is done in the bottom rows. Having already concluded in earlier subsections that the FSRP only had much of an impact in 1986/87, and this was not large, it is not surprising here to see that removing the subsidy would have had only a modest effect on these indicators of profitability.

The Profitability of Maize Compared with Other Crops

As farmers regard hybrid maize as a cash crop, they will make their decisions about how much to grow based not only on what the gross margin is for hybrid maize, but on how it compares with the gross margins of other crops they could grow for cash. Table IV-C-4 gives gross margins for the major crops grown for cash in this country. It is not to be inferred from this that any farmer can choose to grow any one of these crops, because variations in

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5. It would be a more accurate indication of the increase of the cost of fertilizer to use the price per unit of nutrient, and this would change last year's slight fall in the ratio to a slight rise, because the concentration of CAN went up from 26% to 28% and the price rose only 50 tambala per 50 Kg. This improvement in fertilizer quality is ignored in the table on the grounds that most farmers would have been unaware of it, and we are endeavoring here to look at relative prices through their eyes.

TABLE IV-C-4 — PROFITABILITY OF MAJOR CASH CROPS

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87
GROSS MARGINS FOR MAJOR CASH CROPS (Kwacha/Ha)						
MAIZE						
Local, no fert	82.19	79.98	88.46	86.87	84.46	82.42
Local, fert.	92.18	81.08	90.77	83.50	68.11	63.31
Composite	131.65	119.61	132.43	120.29	104.29	97.21
Hybrid	192.97	210.94	193.03	173.01	146.56	136.32
G'NUTS chalim.	76.32	86.34	164.18	236.26	247.25	243.66
RICE faya	85.64	68.39	81.22	152.64	159.03	151.84
TOBACCO nddf	87.87	107.57	185.35	269.39	251.55	243.60
COTTON	14.08	106.03	151.26	192.20	147.44	142.88
BEANS	30.35	-8.33	26.03	55.78	56.06	62.60
PRODUCER PRICES (t/Kg)						
MAIZE	11.11	11.11	12.22	12.22	12.22	12.22
G'NUTS chalim.	37	55	60	70	75	75
RICE faya	10	11.5	15	17	19	22
TOBACCO nddf	44	77	84	97	97	97
BEANS	14.5	20	30	40	42	
INDICES OF PRODUCER PRICES: SELECTED CROPS RELATIVE TO MAIZE						
MAIZE	100	100	100	100	100	100
G'NUTS chal.(1)	67	99	98	115	123	123
RICE faya (2)	59	68	81	92	103	119
TOBACCO nddf(3)	59	104	103	119	119	119
BEANS (4)	62	85	116	154	162	0

These indices were created in two steps: (a) time series indices were calculated for each crop taking 1980/81 as base year; (b) the index for each crop was divided by the index for maize for the same year (and then multiplied by 100). Prices chosen to make up these indices refer to grade for each crop accounting for largest proportion of total sales. (1) Grade A; (2) Grade I; (3) Grade G2; (4) White haricot.

Source of prices: Ministry of Agriculture

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regional climatic conditions limit the choice. In addition, the quantity of tobacco grown is controlled severely, placing a further restriction on theopportunity farmers have to grow it.

Even with these cautions in mind, the evidence in Table IV-C-4 that the profitability of hybrid maize has been overtaken by other crops is striking. This is especially so for groundnuts, and it can be no accident that it is the

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TABLE IV-C-5 — PRODUCTION AND ADMARC PURCHASES OF MAJOR CROPS GROWN FOR BOTH FOOD AND CASH (1)

	1982/83	1983/84	1984/85	1985/86	1986/87
HYB MAIZE					
prodn	n.a.	245391	233123	201729	102108
purch	244916	296443	272275	111331	
prch/prdn		1.21	1.17	0.55	
RICE					
prodn	25948	34886	34265	37407	28961
purch	8810	10201	10799	11878	
prch/prdn	0.34	0.29	0.32	0.32	
G'NUTS					
prodn	53991	54766	62240	88297	91637
purch	10218	9867	18251	53049	
prch/prdn	0.19	0.18	0.29	0.60	
PULSES					
prodn	18026	29479	28132	39099	59166
purch	3203	6071	16931	24998	
prch/prdn	0.18	0.21	0.60	0.64	

Sources: ADD's and ADMARC
(1) Years refer to crop years. Crops grown in one year are purchased in the next. Hence purchases shown here under the 1982/83 column, for example, appear under 1983/84 in ADMARC's tables.

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hectarage of groundnuts which Table IV-B-1 showed had increased the most. The other crops which have increased notably in hectarage are pulses as represented by beans, and these too have grown in profitability. These trends were not undesirable as long as there were fears of worsening maize surpluses, but now there is room to reestablish the relative profitability of commercial maize production. Figures in table IV-C-4 demonstrate that the prices of both groundnuts and pulses have increased much more over the past six years than the corresponding price for maize, adding weight to the suggestion in the last section that raising the maize producer price might be at least part of the remedy.

A further indication that the inducement to sell maize has fallen relative to other crops is found in Table IV-C-5, which shows how ADMARC purchases have compared with production recently. The 1983/84 and 1984/85 figures imply that maize purchases included varieties other than hybrids (because purchases were greater than hybrid production), whereas, if the 1985/86 production estimate is not too large, only a little over half of it was purchased. This situation does not repeat itself among the other food crops in the table. Rice purchases remain at about a constant percentage of production, while the proportions purchased of groundnuts and pulses have risen remarkably.

An additional factor helping to explain this year's decline in hybrid maize hectarage has to do with last year's marketing problems, already referred to in section B.2. In 1986 ADMARC was short of funds for buying crops from smallholders and consequently began to purchase maize much later than in previous years. This produced not only frustration for farmers (which would presumably have attached itself to all the crops they sold to ADMARC) but losses, because some of their hybrid maize became infested with weevils before they could sell it. It is shown clearly in the annex of this report which deals with ADMARC that this kind of experience must cause farmers to discount the maize producer price by the probability that they will not be able to sell their grain, and thereby reduce their incentive to grow it.

D. Conclusions

Sales of fertilizer have risen considerably since the early 1970's. The trend has been less certain since 1980/81 if we look at tons of fertilizer material bought, but in terms of total nutrients 1986/87 was a record year. That more fertilizer has not been taken up recently has been due to a combination of factors including a shortage of supplies under ADMARC and a great increase in prices following the closure of the rail lines through Mozambique. In order to reduce the burden of transport costs, a changeover from tradtional low analysis fertilizers to higher analysis urea and DAP is being implemented.

Maize accounts for most of the fertilizer used and, though most hybrid maize is fertilized, local maize accounts for more tons of fertilizer applied because so much more local than hybrid grain is grown. Until hybrid types are developed which do not suffer the pounding and storage losses of the present varieties, local maize will continue to be produced for subsistence and hybrids only for cash sale, in spite of the large yield advantage which hybrids have.

A worrying trend is that the hectarage of hybrid maize has been declining, with a large fall occurring in 1986/87, or a year earlier if the 1985/86 production estimate was too high. The question arises as to whether the fertilizer subsidy removal program could be responsible for this, by increasing the price of fertilizer and reducing the incentive to grow fertilizer-intensive crops, of which hybrid maize is a prime example. However, this hypothesis does not hold up when closely examined, for the following reasons:

1. There have been only two years for the FSRP to have an effect on

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prices. In the first of these, 1985/86, the required reduction in the subsidy was not large, leaving the rate at 22.6 percent, and the impact on prices correspondingly modest. In the second year, 1986/87, there was very little increase in the selling price of the traditional fertilizers anyway, resulting in an increase in the cost of the fertilizer package typically bought by farmers of less than 3 percent. The main effect of the FSRP on prices was to raise very high the cost of urea and DAP, to which the farmers were supposed to be adapting. However, this pattern of prices was an ad hoc decision and actually in conflict with the FSRP agreement.

2. Fertilizer uptake in total last year was up on the previous year, and was actually the second highest on record. The sales of urea and DAP fell just short of the target of 10 percent of total sales, and part of the reason was no doubt their high prices.

3. Because the subsidy removal program has not so far raised the prices of traditional kinds of fertilizer very much, it cannot be the major cause of the decline in the profitability of growing maize as a cash crop which has undoubtedly taken place. On the other hand, it is clear that increases in the price of fertilizer have done much to reduce these margins. Fertilizer is the largest cost item in growing maize and its prices have risen the most.

4. The decline in the profitability of maize production must also be attributed to the fact that maize producer prices have not risen for four years. This is in contrast to the prices of competing cash crops which have risen, bringing the gross margins up with them. In the light of these price trends, which have so far been only slightly affected by the subsidy removal, it is easy to see why farmers have been substituting other cash crops, especially groundnuts and pulses, for hybrid maize.

5. The profitability of all kinds of maize production has been declining, hybrid maize not more than the others in percentage terms. It is clear that the increases in the price of fertilizer have had a good deal to do with this, but not the subsidy removal program because it has so far raised the cost of the traditional fertilizer package only slightly.

PART II: THE IMPACT OF REMOVING THE FERTILIZER SUBSIDY

E. The Problem

The aim of this part of the annex is to gauge the impact of the fertilizer subsidy removal program on agriculture. The effect on the gross margins of maize production will be evaluated first, then the importance of the cash constraint faced by farmers. The effects of changing from low to high analysis fertilizer are examined later, but until then the analysis is carried out assuming traditional fertilizer. This will allow certain points to be established without the danger that they might depend in some way on an assumption of cheaper high analysis fertilizer.

The following, sometimes conflicting considerations, will be kept in mind throughout the discussion:

1. The nation has an aim of maintaining self-sufficiency in the production of maize, its major staple crop. In view of the uncertainty and expense importing any item with a low value to weight ratio, the net benefits of a self-sufficiency program are accepted.
2. Any increase in the price of fertilizer, without other compensations, will adversely affect the incomes of many smallholders, not only of those who have used it in the past but also of those who would have used it in the future had the price not gone up. If reduced use of fertilizer results in more land being devoted to subsistence maize production, then the loss of incomes includes the fall in non-maize output, whether for cash or consumption.
3. The cost of procuring fertilizer for the coming season is very much higher than in earlier years: over 35 percent more than last year except for DAP the cost of which is almost 45 percent higher. These increases will not take the unsubsidized cost of fertilizer above predictions made at the time when the FSRP was being put into place. The left hand portion of Table IV-E-1 shows that except for DAP the unsubsidized costs for 1987/88 will probably be about a kwacha less than the predicted costs. The right hand section of Table IV-E-1 demonstrates that if next year's prices are subsidized at the 12 percent average weight farmers will have to pay up to 50 percent more.

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TABLE IV-E-1 PROJECTED AND ACTUAL COSTS OF FERTILIZER
(Kwacha per 50 Kg bag)

	UNSUBSIDIZED				12% SUBSIDY		
	1986/87		1987/88		1986/87	1987/88	Percent Increase
	Predicted	Actual	Predicted	Actual			
20:20:0	37.72	26.41	37.63	36.19	21.00	31.49	50.0
CAN	27.20	22.07	31.28	30.52	19.50	27.80	42.6
Urea	31.63	25.66	36.37	34.69	26.00	28.79	10.7
DAP	36.28	30.26	41.72	43.78	24.00	36.34	51.4

Sources: Predicted:USAID/Malawi, "Malawi Economic Policy Reform Program", September 1985, Annex C, "Impact of Full Cost Pricing for Fertilizer", Appendix 1. Actual and subsidized: SFRF

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4. The subsidy for next season is scheduled to be 12 percent according to the fertilizer subsidy removal program. This is not much lower than the 14.7 percent which was the actual average subsidy in 1986/87, so the subsidy reduction by itself and as planned would not have much impact. But in order to contrast the subsidy/no subsidy situations clearly, this study will continue to compare a zero subsidy case with what would have prevailed had there been no subsidy removal program. As in the earlier sections of this annex it will be assumed that the subsidy would have been 25 percent without the FSRP. This takes into account that there would have been some constraints imposed by the Government of Malawi in order to control its budget deficit.

5. The subsidy does not come free of charge, and its cost cannot be judged by its effect on the government's budget alone. As a subsidy will lower the price of fertilizer to farmers and increase demand for it, more resources, including capital funds raised by government taxation and foreign exchange, will be directed into agriculture from other sectors of the economy. In other words, a fertilizer subsidy is paid for by non-agricultural enterprises such as manufacturing, and their role in the development of the Malawian economy is diminished. Any subsidy must, therefore, be judged according to the benefits and costs for the economy as a whole, and the macroeconomic annexes of this report consider the fertilizer subsidy in this light. In this annex we must ask whether

there are not measures which could supplement or replace the subsidy in tackling the problem of maintaining food self-sufficiency and smallholder incomes.

The Elasticity of Demand for Fertilizer

Before embarking on the analysis in this annex, a word must be said about the elasticity of demand for fertilizer. Two elasticity estimates were made for fertilizer in Malawi by Kirchner and Kandoole: -0.74 and -1.04. An elasticity of demand of -1 implies that the percentage change in the quantity purchased will be the same as the percentage change in the price. This figure would be as good a one as any to assume until further econometric work has been done.

However, there is also a conceptual problem here. The elasticity of a product is derived from its demand curve and the assumption must be that the purchasers of the product are on it. For fertilizer, as for any input, the demand curve is identical with value of the marginal product curve. A profit maximizing farmer would carry on applying fertilizer until its price intersects the VMP curve.

Using the gross margin calculations made by the Planning Section then farmers are generally well short of this point. For an individual farmer this behaviour could be explained by a shortage of cash and credit, preventing him from buying all the fertilizer that would be profitable. There is also a quite different reason, applying to farmers in the aggregate. There have been several years when supplies of fertilizer have not been adequate at certain time and in some places. This would result in total purchases being below the level dictated by the aggregate demand curve, which would distort any results based on aggregate data.

As farmers operate below their demand curve for fertilizer, it can be questioned exactly what an elasticity of demand means here. Certainly there is an empirical relationship between the price of fertilizer and the quantity purchased. This could be regarded as the elasticity of demand in practice, but strictly speaking it has nothing to do with the value of the marginal product curve. What the empirical measure has really told us about is the effect of farmers' cash constraints on purchases, though even this result is distorted by supply shortages. If this effect were fairly consistent through time it would be as valuable as an elasticity derived from the behaviour of farmers operating in markets which behave in a text book manner. However, the supply shortage problem has certainly been different from year to year, and

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most likely the severity of the cash constraint has too, quite independently of fertilizer prices.

The conclusion is that econometric results might be quite different depending on what years are included in the data. The implication is not that econometric studies of fertilizer must be valueless, but that the elasticities they yield should be regarded as subject to considerable change through time. It also explains why the simple analysis which follows, based on gross margins, is regarded as a worthwhile substitute.

F. The Gross Margins of Maize Production

The gross margins in the production of hybrid maize are important because this commodity must be grown to supply all food-deficit households, and because it uses the most fertilizer per hectare. As the price of fertilizer rises, and if the producer price of maize remains unchanged, the gross margin of producing maize must fall.* If the gross margins of other crops remain unchanged because they do not include fertilizer, some farmers will grow one or more of them instead and the output of hybrid maize will go down. In order to preserve the level of hybrid maize output, its gross margin must at least be prevented from falling.

Table IV-F-1 illustrates the situation for hybrid maize, based on

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* The fall in the gross margin will actually be somewhat greater than the increase in the price of fertilizer, because the cost of financing will also increase. In the gross margins used here, which are based on those developed by the Planning Division of the Ministry of Agriculture, the finance cost is reckoned at 10% of the cost of material inputs. This applies whether credit is taken out or not, because the farmers' own funds have some opportunity cost attached to them.

TABLE IV-F-1 — GROSS MARGINS FOR HYBRID MAIZE, UNDER VARYING FERTILIZER SUBSIDIES
(Figures in Kwacha, except where specified otherwise)

	Actual Prices 1986/87	1987/88 Zero Subsidy	1987/88 12% Subsidy per USAID	1987/88 25% Subsidy per USAID
Yield (Kg/Ha)	2750	2750	2750	2750
Price Maize (t/Kg)	12.22	12.22	12.22	12.22
Tot. Revenue	336.05	336.05	336.05	336.05
Fertilizer	100.50	163.94	146.38	124.76
Seed	26.25	26.25	26.25	26.25
Actellic	6.71	6.71	6.71	6.71
Finance	13.35	19.69	17.93	15.77
Transport	48.02	48.02	48.02	48.02
Fixed costs	4.90	4.90	4.90	4.90
Total Cost	199.73	269.51	250.19	226.41
Gross Margin	136.32	66.54	85.86	109.64
Increases in Maize Producer Price				
To maintain 1986/87 Margin		14.76	14.06	13.19
% Increase over 12.22 t/Kg		20.8	15.0	7.9
Return to Margin of K193.03		16.82	16.12	15.25
% Increase over 12.22 t/Kg		37.6	31.9	24.8
Obtain Margin of K245		18.71	18.01	17.14
% Increase over 12.22 t/Kg		53.1	47.4	40.3
Percentage Subsidies for Fertilizer				
To maintain 1986/87 Margin		38.7		
Return to Margin of K193.03		70.1		
Obtain Margin of K245		99.0		

Source: Calculations by author based on gross margin table devised by Planning Section, Ministry of Agriculture, April 1987.

fertilizer prices for 1987/88, assuming varying subsidy rates.[7] Prices of inputs other than fertilizer are kept the same so that attention will not be

[7] Note that the cost of fertilizer at the 12% subsidy is not exactly 12% less than the zero subsidy cost. This is because the FRSP agreement with USAID specifies that different kinds of fertilizer should receive varying subsidy rates, with only the weighted average being 12%. The traditional fertilizers would receive less than the average.

The cost of fertilizer with a 25% subsidy is arrived at by reducing the 12% subsidy figure by a factor of (75/88).

diverted to them. To the extent that other input costs rise, the adjustments to the maize price or the fertilizer subsidy will have to be that much greater than described below. However, increases in the costs of other inputs are likely to be very much less than the rise in the cost of fertilizer.

If the subsidy next season is 12 percent, following the FRSP schedule, and there is no change in the producer price of maize, the gross margin would fall from K136.32 this year to K85.86. With no subsidy at all the margin would be K66.54 and with a 25 percent subsidy it would be K109.64. The following are additional inferences to be drawn from the table:

a) Even with a 25 percent subsidy the gross margin would be lower next year than in 1986/87 because the increase in the procurement cost of fertilizer is a good deal more than that (63.1 percent).

b) The percentage increase in the producer price of maize needed to maintain a gross margin equal to that of 1986/87 is very much less than the percentage increase in fertilizer prices. Under the FSRP schedule the maize price would have to go up by only 15 percent, to 14.06 tambala per kilo, and if there were no subsidy at all the price would have to rise by 20.8 percent.

The explanation for this is that the maize price rise depends on the proportion of total revenue accounted for by the cost of fertilizer. In 1986/87 the proportion is about 30 percent (K100.50 as a percentage of K336.05). If the subsidy were removed entirely the increase in the cost of fertilizer would be 63 percent, so the required maize price increase would be about 30 percent of that. (The exact figure depends also on the change in the proportion of total revenue accounted for by fertilizer and on the increase in finance costs).

c) In order for there to be national self-sufficiency in the production of maize, it will probably be necessary to increase the gross margin for hybrid maize above the level prevailing in 1986/87. This is because, as was pointed out in Part 1, the gross margins of competing cash crops have overtaken it. For the sake of illustration the price increases for two larger gross margins have been calculated: for K193.03 which was the profit level in 1983/84 and the largest ever for hybrid maize; and for K245, which would make the profit on hybrid maize similar to the current level on groundnuts.

The price increases vary from 7.9 percent to 53.1 percent, depending on the level of the subsidy. Naturally the largest rises are for the zero subsidy case, but it must be remembered that these are adequate to cover the full, combined effect of the increase in fertilizer procurement costs, the total removal of the subsidy <u>and</u>, in the most extreme case, an 80 percent gain

in net profits. Even in this last instance the price rise to the 18 tambala per kilo range is less than the 68 percent change that took place in 1981. Nor would the price necessarilty have to be high enough to produce a gross margin of K245 in these tables. In practice farmers' costs vary widely, and enough of them may increase output to a level adequate for national self-sufficiency at a price significantly below 18 tambala per kilo.

d) For the sake of comparison, the percentage subsidies on fertilizer needed to obtain the 1987/86 and higher gross margins are shown. They are necessarily much greater than the percentage increases in maize price because fertilizer cost is only a percentage of total revenue. The producer price of the output simply has more leverage on the gross margin than any input price.

e) No adjustment in the quantity of fertilizer used has been allowed for in response to the price increase. In effect, the elasticity of demand for fertilizer has been assumed to be zero. In the next sub-section, where the cash constraint problem is dealt with, it is assumed that farmers will reduce their purchases of fertilizers as their prices rise.

The reason why no alteration in fertilizer usage is incorporated in Table IV-F-1 is that, taking the gross margin by itself, farmers would have no incentive to reduce their fertilizer inputs, even if the price of maize did not rise. If farmers did lower fertilizer applications, they would only aggravate the decline in the gross margin. This is because the value of the marginal product of fertilizer implied by the figures in this table is constant and the price of fertilizer is well below it. In other words, the prices and the fertilizer response rate of maize imply that every kilogram of fertilizer being applied more than pays for itself. However, if the average price of fertilizer, taking 20:20:0 and CAN together, rose high enough, then it would become entirely unprofitable and none would be applied at all.[8]

The justification of these figures is that the amount of fertilizer assumed here to be put on hybrid maize is well below the quantity that would produce maximum yields per hectare. Even the recommended application rates (92 Kg of nitrogen and 40 Kg of phosphate) are considered conservative, and they are well above what is assumed here (62 Kg of nitrogen and 20 Kg of phosphate). At these levels the fertilizer response curve is steep and not very curved, which means that the response rate is high and only slightly

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[8] This does not mean that all farmers would cease using fertilizer at the same price. The gross margin tables used here are only representative. In practice farmers have widely differing costs and would stop buying fertilizer at varying prices.

downward trending.[9]

f) If the price of fertilizer rises and the producer price of maize remains unchanged, there will be a point at which unfertilized local maize as a cash crop will become more attractive than fertilized hybrid maize. The gross margin for unfertilized local maize at 1986/87 prices is K82.11 and this would be unaffected by any change in the fertilizer price next season. This figure is above the gross margin for hybrid maize with a zero subsidy on fertilizer and little below that for a 12 percent subsidy. Allowing for the extra work entailed in hybrid maize would then make it even more unattractive.

It might be wondered whether local maize would then supplant hybrids as a cash crop. However, this comparison between hybrid and unfertilized local maize is not in practice very relevant, because there are other crops such as groundnuts which are much more profitable than unfertilized local maize and are the real competitors of hybrid maize. Providing hybrids are made attractive relative to the non-maize cash crops, and fertilizer prices do not rise to levels not foreseeable at present, farmers who are interested in maximizing their net cash returns will grow it.[10]

Local maize is here assumed to be grown only for subsistence. Some local maize is sold, both privately and to ADMARC, but the proportion of the total must be very small. Table IV-F-2 shows the gross margins for production of this crop.[11] Note that these are calculated using the consumer price of maize to figure total revenue (with a slight additional gain because the farmer does not have to pay for transport). The consumer price is appropriate because if

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[9] If farmers, using the same practices, would obtain 850 Kg of hybrid maize per hectare without any fertilizer, the marginal physical product would be (2,750 - 850)/250 = 7.6 Kg. The value of the marginal product would be (12.2 x 7.6) = 93 tambala, compared to the average price of fertilizer of 163.94/250 = 66 tambala. (The assumption that the farmers are using the same practices with and without fertilizer eliminates the possibility that the marginal products of these practices would account for part of the yield increase).

[10] If farmers maximized returns per manday and found that hybrid maize takes up a very great deal more time per hectare than unfertilized local, they might decide to grow the latter for sale in preference to the former. However, this would imply that they are not profit maximizers, for they would be giving up some net cash income to do this.

[11] The fertilizer response rate implied by the figures in the table is [illegible] Kg of maize to one Kg of fertilizer. This is too low, judged by ASA data, but it is the assumption adopted by the Planning Section of the Ministry of Agriculture in calculating its gross margins, and it is not changed here because it does not alter the conclusions drawn from the table.

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a farmer does not grow enough maize to feed his family, he will have to pay the consumer price to purchase what he needs. It is also the price that would yield the proper opportunity cost if a farmer were wondering whether to devote his land to a non-maize cash crop and use the proceeds to buy maize. The following are the conclusions to be drawn from the figures:

a) At consumer prices the gross margins, which here represent not net earnings but net savings, are large even at full 1987/88 cost, confirming what one would expect: that farmers are a great deal better off growing their own maize than buying it. (It is not to be concluded that local maize is a more profitable proposition than hybrid maize, for the notional gross margins for hybrids would be enormous at consumer prices).

b) At full fertilizer cost the notional gross margin is slightly lower than for unfertilized local maize, and it is not much higher at either of the 1987/88 subsidized prices. However, this does not mean that farmers would be better off growing their maize without any fertilizer at all. If they did

TABLE IV-F-2 -- GROSS MARGINS FOR LOCAL MAIZE,
UNDER VARYING FERTILIZER SUBSIDIES
(Figures in Kwacha, except where specified otherwise)

			--------1987/88----------		
	No Fert.	1986/87 With Fert.	Zero Subsidy	12% Subsidy per USAID	25% Subsidy per USAID
Yield (Kg/Ha)	850	1300	1300	1300	1300
Price Maize (t/Kg)	21.59	21.59	21.59	21.59	21.59
Tot. Revenue	183.52	280.67	280.67	280.67	280.67
Fertilizer	0.00	58.50	91.56	83.40	71.08
Seed	3.06	3.06	3.06	3.06	3.06
Actellic	0.00	0.00	0.00	0.00	0.00
Finance	0.31	6.16	9.46	8.65	7.41
Transport	0.00	2.30	2.30	2.30	2.30
Fixed costs	1.90	4.90	4.90	4.90	4.90
Total Cost	8.27	74.92	111.28	102.31	88.76
Gross Margin	175.25	205.75	169.39	178.36	191.91

Source: Calculations by author based on gross margin table devised by Planning Section, Ministry of Agriculture, April 1

Maize price is consumer price plus transport saved.
This is {[(18.00/90)x850]+13.49} where K18.00 is the consumer price per 90 Kg bag, and K13.49 is the savings on transport.

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that they would have to devote more land to produce their target maize consumption. If a family had been growing 1300 Kg of maize using fertilizer, and then grew the same amount with no fertilizer at all, then the amount of extra land they needed would be 53 percent [(1300-850))/850]. They would then lose either the cash or the added consumption benefit from whatever they would have produced instead of the maize.

Composite maize is evaluated in Table IV-F-3 as both a cash and a subsistence crop. The inferences to be drawn from these gross margins are:

a) At any given level of fertilizer subsidy, composite maize is less attractive than hybrid as a cash crop.

b) As a subsistence crop, composite maize is a much better proposition

TABLE IV-F-3 -- GROSS MARGINS FOR COMPOSITE MAIZE, UNDER VARYING FERTILIZER SUBSIDIES
(Figures in Kwacha, except where specified otherwise)

	1986/87 With Fert.	1987/88 Zero Subsidy	1987/88 12% Subsidy per USAID	1987/88 25% Subsidy per USAID	1987/88 Subsistence Zero Subsidy
Yield (Kg/Ha)	1750	1750	1750	1750	1750
Price Maize (t/Kg)	12.22	12.22	12.22	12.22	21.59
Tot. Revenue	213.85	213.85	213.85	213.85	377.83
Fertilizer	60.00	97.23	87.09	74.22	97.23
Seed	13.75	13.75	13.75	13.75	13.75
Actellic	0.00	0.00	0.00	0.00	0.00
Finance	7.38	11.10	10.08	8.80	11.10
Transport	30.62	30.62	30.62	30.62	0.00
Fixed costs	4.90	4.90	4.90	4.90	4.90
Total Cost	116.65	157.60	146.44	132.29	126.98
Gross Margin	97.21	56.25	67.41	81.56	250.85

Source and Note: See Table IV-F-2.

than local maize. This holds true even if a comparison is made between composite maize at a zero fertilizer subsidy and local maize with a 25 percent subsidy. The hardest composites are not as close to being pure flint as the hardest local varieties, but the difference is not great. A lot of maize, called local by farmers, has been improved over the years by cross pollinati with other varieties and where this is so, Table IV-F-2 will be a better gui than Table IV-F-3.

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Conclusions

An increase in the price of fertilizer without any other adjustments would necessarily reduce the profitability of maize production. In the case of hybrid maize this would cause other cash crops to appear more attractive to farmers, endangering the production of supplies for food-deficit households. The gross margin could be restored to an attractive level with an increase in the producer price of maize which is well below the percentage increase in the price of fertilizer. The maize price excercises much more leverage on profits than the price of fertilizer. In fact, the rise in the maize price needed to cover a complete removal of the fertilizer subsidy, the large jump in fertilizer procurement costs for 1987/88, and a restoration of the record gross margin of 1983/84, would have to be 38 percent. The fertilizer subsidy needed to achieve the equivalent result would be 57 percent.

Local maize production is properly evaluated at consumer prices because production takes the place of purchasing. This being so, local maize production is profitable (i.e. better than buying maize) even at a zero fertilizer subsidy. However, farmers producing for home consumption would be very much better off if they could grow composite maize. For commercial production hybrid maize is much the best choice. The reasons farmers may not choose these options is that they do not have the necessary cash. It is to this question that we now turn.

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chapter seven

Food Assistance: Implications for Development and Trade

Edward J. Clay

Food aid policy, from the inception of PL-480 in 1954, has been a Janus-faced creature. One face reflects the complex humanitarian, developmental, and political concerns that characterize all bilateral and internationally mediated aid flows. The other face reflects agricultural trade policy. Food aid has always been used to manage exportable agricultural surpluses and to promote long-term agricultural trade development. There are internationally negotiated rules on surplus disposal to ensure that food aid is managed as an orderly part of agricultural trade. The Food Aid Convention (FAC), part of the International Grains Agreement, establishes minimum annual commitments. A representative of USDA, not of the United States Agency for International Development (AID) or the State Department, heads the U.S. delegation in meetings to supervise the operation of these international arrangements. Other food aid donors have administrative practices that accord a less-visible role to their agencies responsible for agriculture trade. But the management of exportable surpluses in relation to domestic agricultural policy, particularly as that management expresses itself in political administrative practices, separates food aid from other forms of developmental and humanitarian assistance.[1]

Given that complex interests and policy concerns influence all aid policy practices, it must be asked to what extent food aid has been and can be both a significant resource for development (and humanitarian assistance) and an important instrument of agricultural trade policy. The economic policy model associated with Tinbergen suggests the need for a multiplicity of instruments to manage multiple policy objectives. Can food aid be simultaneously an active instrument of these different sets of policy concerns? An alternative approach regards agricultural trade concerns as constraints within which food aid policy could be formulated for developmental and humanitarian goals in a frankly political context.

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The difference in approach can be illustrated by examples. In a review of Swedish and some other donor policies it was suggested that agricultural concerns act as constraints on the food aid program. Domestically available commodities for export are expected to be programmed, and commodity levels are determined in a classic bureaucratic policy process. However, the formulation of policy, including country programming and choice of commodities, is the concern of the Swedish International Development Agency (SIDA) and the Foreign Ministry.[2] A contrasting model is provided by agricultural export agency practice, which regards food aid as one of a range of possible export options that can be combined in a bilateral agricultural export agreement. This implies that at the level of the individual food aid agreement trade policy objectives could override other concerns. Sri Lanka's food aid relationship with donors, examined by this author in the early 1980s, appeared to have some such elements.[3] Likewise, a number of donor food aid agreements with Egypt often are considered to have such a complexion.

This chapter is concerned primarily with the developmental and humanitarian objectives of food aid. The trade promotion objectives of food aid are considered important insofar as they indicate potential areas of tension in policy practice. As much of the support for food aid (and probably substantial, additional resource flows) results from support by agricultural interests, it is appropriate to ask to what extent the record suggests food aid has contributed simultaneously to trade policy goals.

Food Aid and the Recipient Economy

Trade Case Studies

There are few areas in the development literature more controversial than the impact of food aid on the general, and in particular the agricultural, economy of recipient countries. Food aid has had both proponents and detractors who have identified a range of potentially positive (incentive) and negative (disincentive) effects on recipient economies. A taxonomy of the potential effects most commonly identified in the literature provides some indication of the complexity of the issues and the opportunity for confusion.[4] For every positive effect identified as an illustrative case, it is possible to provide a contrasting negative case and vice versa.

The direct disincentive effects that occur when food aid imports lower prices for domestic food producers have received the most attention.[5] But some observers, in turn, point to circumstances in which such effects are absent, noting that, in any case, a counteracting effect encourages growth in consumption of basic foodstuffs from lower prices.[6] Potentially positive or negative effects of food aid on income distribution and poverty also often are identified.[7]

Food aid may bring about long-term changes in consumer tastes, either by creating a dependence on imports or, alternatively, by providing a market that makes possible the expansion of domestic production of previously little-consumed commodities.[8] The technological basis of import dependence is also important.[9] Capital- or labor-intensive technologies, with their positive or negative employment effects, can be promoted.[10] These potentially contradictory effects all concern prices and interventions in agricultural markets by governments.

There are also budgetary, public expenditure implications of food aid, which include the dangers of becoming fiscally dependent on the sale of aid commodities, although such sales also can relieve otherwise unsustainable budgetary pressures on a government that has little scope for increasing domestic taxation in the short run.[11] Reliance on concessionary food imports may have disincentive complacency effects by reducing the priority accorded to agricultural policy. Alternatively, the direct use of food as wage goods and of revenue from the sale of food imports can provide resources for investment in agriculture.[12] Many observers have stressed the macroeconomic growth and anti-inflationary possibilities of food transfers.[13] Others see in such transfers the dangers of enabling governments to avoid adjustment to overvalued exchange rates. They also see distortions in the internal structure of prices that in the long run inhibit growth.[14]

When confronted with such a range of possibilities and in reviewing frequently contradictory interpretations of evidence from the same experiences,[15] some observers, myself included, conclude that the debate is intrinsically indeterminate. Judgments rest on the interpretation of unavoidably selective, and often different evidence. Food aid does offer positive opportunities for development, but realization of these depends on the adoption of constructive policies by recipients and donors and on effective implementation.[16]

Surveys covering the period up to the late 1970s reflected both the sense of the opportunity provided by food aid and the concomitant need for appropriate policies.[17] Subsequently, there has been a growing interest on the part of researchers and policy analysts in the economic and, in particular, the agricultural impact of food aid. There also have been two other important developments. First, since the early 1970s most recipients have received aid from a number of sources, whereas in the earlier period, the bulk of food aid was provided by the United States. Most members of the Western or Organization for Economic Cooperation and Development (OECD) donor community now have some interest in food aid. Second, there has been a dramatic shift of flows from the newly industrialized countries (NICs) in South America and Asia to a large number of smaller economies in sub-Saharan Africa.

Two important analytic implications proceed from these developments. First, it is difficult to isolate the role of PL-480 flows, and it is necessary from

a developmental perspective to assess the impact of all food aid. As there is at least informal partial coordination of PL-480 and other aid to individual countries, this is simplified by actual policy practice. Second, the evaluation record tells us little about many of the currently important countries. Faced with the need for selectivity, I have chosen here only to examine recent writings that have minimized confusion and clarified conflicting findings and to search for any shift in the evidence on the actual effect of food aid emerging from recent impact assessments.

Additionality or Balance-of-payments Support?

The apparent confusion regarding the economic impact of food aid indicates that any discussion of these issues should begin with a careful restatement of the macroeconomics of food aid.[18] An intentionally simplified, analytic exposition helps to identify the important relationships and interactions that must be taken into account both in impact assessment and in prescriptive policy analysis. This analytic exposition also provides the basis for a review of the donor/export trade implications of food aid transactions.

Additional Food Imports. The potentially negative effect on domestic production and the counteracting positive consumption effects of food aid are illustrated most clearly in the introduction of food aid imports that are wholly additional and without direct substitution effects on commercial imports or exports. The shift to the right in the supply curve (more food available at any given price) has a depressive effect on domestic prices and production. However, such a reduction in prices also would have a partially or wholly compensating positive effect on demand. This consumption or demand effect will be maximized where government intervenes to segment the market and target food subsidies (or in the extreme case, provide food free) to low-income households with the highest income elasticity of demand for basic foods.[19] The direct disincentive effect will be greatest where government engages in open-market, unsubsidized sales.

Some of the potential, indirect effects of food aid in the pure additionality case also should be noted. In general, the highest real income effect of the transfer to final recipients, assuming decreasing marginal utility, will be achieved by perfectly targeting freely distributed food to the poorest households.[20] Where the structure of asset holding and production results in undernutrition of children in poor households, the positive impact on human capital formation through improved nutritional status will be maximized in this special case.[21] If there is underemployment of labor for technological or structural reasons (such as the seasonality of agricultural operations or the way control of land is distributed between small and large farms and estates), then the use of food aid commodities to create additional employment would have multiplier effects on aggregate demand, including food consumption, and would allow investments that reduce the costs of production.[22]

Local currency proceeds from sales of food aid by governments (counterpart funds) generate revenue.[23] This budgetary support is maximized at market clearing prices, indicating a tradeoff between the potential, direct consumption income transfer to beneficiary households and financial support to the government.[24] This support is fungible and available for any purpose, developmental or otherwise.[25] It is possible simultaneously to lower food prices to consumers, pay higher prices to producers, or reduce their costs through input subsidies, agricultural investments, or intensified extension services. The developmental impact depends on government policy. Donor desire to obtain commitments and to monitor actual uses of revenues has led to the establishment of special accounts for sales proceeds.[26]

Balance-of-payments Support. In the other boundary case of an open economy, where domestic prices are set by the world market, food aid would substitute for commercial imports by providing balance-of-payments support.[27] The impact would depend on the use of the freed foreign exchange, which in practice is a function of general development policy including the strategy for the agricultural sector. *There can be no direct disincentive effects through prices.* Balance-of-payments support, on the one hand, can have a potentially important, positive impact on a country's overall development effort, and, on the other hand, can have complacency effects on policy, particularly in avoiding adjustments in exchange rates and reducing the financial and political pressures to invest in domestic food production capability.

The mythology of good neighborly agricultural trade policy, as enshrined in the Food and Agriculture Organization's (FAO) Rules on Surplus Disposal, is that food aid is not supposed to substitute for usual commercial imports. Historically, much of the opposition to food aid being used explicitly as balance-of-payments support and thereby militating against the proper planning of such aid has come from agricultural interests. The recent U.S. Food Security Act contains only a minor concession on the formal operation of the rules of surplus disposal, which require countries to maintain the usual marketing requirement (UMR) provision of commercial imports as a condition of food aid. The UMR is the responsibility of USDA, and in the European Economic Community (EEC), of the Directorate General for Agriculture, rather than of food aid administrators. The EEC Council of Ministers also explicitly rejected the objective of balance-of-payments support put forward in the EEC Commission discussion paper on food aid in 1983. Yet the practical reality is that a large proportion of food aid imports is being channelled into urban and formal sectors of national food systems in Africa, and the underlying rationale is that this aid is intended to reduce the burden of imports, thereby providing balance-of-payments support. Whether that is

the real intent of food aid imports is a sensitive question in donor/exporter agricultural circles. Such sensitivity inhibits research and explicit policy analysis of the balance-of-payments issue.

A Widespread Donor Aspiration: To Have Your Cake and Eat It Too

An important implication of the one-to-one substitution case for policy analysis is that there is no net budgetary gain to the recipient government, whether foreign exchange savings are used to finance other, possibly nonfood imports (an expansionary policy) or to reduce other foreign borrowing (a disinflationary alternative). Relatively simple analysis of the substitution case therefore provides another criterion for discriminating between logically consistent and inconsistent writing on the impact of food aid.

Even though the provision of balance-of-payments support and additional budgetary resources are logically alternative, mutually exclusive consequences of food aid, in both impact assessment and policy prescription the practice of considering these effects sequentially and independently remains widespread.[28] The criterion given for assessing the impact of food aid for balance-of-payments support is the performance of the whole economy.[29] There is a further policy implication. Where food aid provides even partial balance-of-payments supports, a donor who enters into a policy dialogue about the uses of revenue from all local sales is seeking to influence the allocation of the government's existing revenue.

Neither boundary case is typical.[30] The opportunities for trade, legal or otherwise, open up the possibilities for alternative outlets that dampen the direct effects. First, entirely additional cereal imports may promote smuggling of domestically produced food into neighboring economies, thus leaving foreign exchange in private hands. This issue is probably most significant in sub-Saharan Africa where traditional trade patterns do not conform at all to postindependence political boundaries. Second, government interventions in domestic agricultural markets are pervasive with or without food aid.[31] These can increase the aggregate demand for food, dampen the disincentive impact of additional imports, or, alternatively, intensify balance-of-payments pressures where imports are the marginal source of supply. Third, food aid can free foreign exchange or act as an additional means to relax constraints on economic growth, which, in turn, increases demand for food staples and other agricultural commodities. Alternatively, these resources may provide a cushion for "bad," nondevelopmental policies. Fourth, the uncertainties of programming food aid have resulted in correlated movements in both commercial and concessional imports where risk-averse governments have sought to manage the food system with imports (examples are Bangladesh and Kenya).

There are two distinct responses to the problems of assessing the food aid record when confronted with these potential effects. Many analysts consider it necessary to model the food sector and intersectoral interactions formally with econometric techniques or at least consider effects within a conceptual framework that recognizes intersectoral interactions.[32] However, the greater part of the assessment literature, even for the recent past, consists of studies in which there is partial analysis of each separately identified aspect of the food aid transaction. The advantage of this approach is that it includes the effects of policy, commodities, and technology that rarely are considered explicitly in sectoral modeling research.[33]

The Disincentive Question: Agricultural Sector Models

The overall impact of food aid is a priori indeterminate, but theory provides a number of alternative hypotheses. This complex but real set of possibilities implies that meaningful quantitative estimates of the impact of food aid can be obtained only through multiequation models that can handle simultaneously the direct and indirect supply and demand side effects on production of the imported goods (wheat in wheat-growing economies for example), close substitutes (maize or rice where food aid is received as wheat), and alternative land use (including export crops). This consideration also provides criteria for assessing attempts to estimate the overall macroeconomic and narrower agricultural (disincentive) effects of food aid on recipient economies. There are no formal procedures for testing models that are equivalent to those provided by statistical theory for scientific experimentation. Rather, a model reflects judgments by the analysts based on a priori reasoning drawing upon statistical exploration of the characteristics of the particular economy and the particular forms of public intervention. The results of modeling exercises may be interpreted as plausible quantitative values where analysis otherwise provides only qualitative assessment. Some of the desirable features of satisfactory models have been identified by writers making a critical analysis of the earlier literature on the economic effects of food aid, particularly for India and some previously important recipients of cereals aid, in per capita and total terms.[34] These cases provide evidence on the impact of PL-480 until the early 1970s.

India, 1954–1970. Much of the earlier modeling literature on the economic effects of food aid was formulated within a partial equilibrium of the framework focusing on national supply and demand relationships for cereals only. Within the restricted assumptions of these models the implied cumulative effect on cereal production ranged from a 15 to 31 ton reduction in domestic production, and the additional food grain consumption ranged from 59 to 93 tons, for every 100 tons of food aid shipments within the reference period of the models. This variation in results contributed to wider confusion on the impact issues.[35] Blandford and Plocki show the importance of clear specification of the way in which government intervention through

dual-price operations affects price determination and output. They also demonstrate the sensitivity of results to analysts' choices, such as the sample periods and specification, underlining the lack of robustness of such models. The issue cannot be determined on a head count of modeling exercises, therefore, but has to be decided in terms of the realism with which models characterize the strategic interrelationships within the agricultural sector and linkages to the general economy.[36] More recent studies for India and other countries that were formerly or are currently large-scale recipients of food aid indicate the ways in which earlier work has been superseded.

Colombia, Brazil, and Tunisia. These three countries are graduates from large-scale food aid where controversy surrounds the impact of U.S. PL-480 shipments. For Colombia, Goering originally argued that wheat food aid in effect provided balance-of-payments support while counterpart funds (budgetary support) contributed to investment.[37] Dudley and Sandilands subsequently challenged these conclusions, finding a dramatic impact of imports and low prices on domestic wheat production.[38] Analyzing within a restrictive partial equilibrium framework and focusing only on wheat, they concluded there was a severe tradeoff between food imports, aid-supported policies and low prices in terms of the negative effects on wheat production. A subsequent reanalysis by Hall, still modeling only the agricultural sector but disaggregating to consider other commodities, reached a contradictory conclusion. The negative impact of wheat pricing policies was outweighed by higher relative prices of rice. Hall also noted a finding generalized in many more recent impact assessments—that the role of food aid was relatively restricted and was only a small proportion of total wheat imports.[39] A parallel study for Brazil by Hall showed how food aid resources were used to help finance a dual-price system, which supported producers, subsidized consumers, and resulted in both higher production and consumption.[40] Tunisia also successfully operated a dual-price system involving imported and domestically grown cereals as well as imported soybean oil and domestically produced olive oil. These policies were favored by the high-income elasticity of demand for imported products.[41] A pattern begins to emerge from these country experiences of food aid imports used as part of a relatively complex food pricing policy that involved, depending on local circumstances, discrimination between commodities and two-tier pricing for consumers and producers. In the long run, these countries ceased to be dependent on large-scale food aid, relative to the size of their food system.

Such agricultural sector models can be criticized as too restrictive in treating government expenditure, nonagricultural production, and foreign exchange as, in effect, exogenous, when these variables are likely to be influenced heavily by food aid resources and also to have significant effect on agricultural sector productivity.[42] The earlier Indian models, for example, ignored substitution possibilities in both production and consumption, as did the earlier Dudley and Sandilands model for Colombia.[43] Changes in the composition of agricultural output can have important implications for farm incomes, trade (and therefore foreign exchange), and the price structure of agricultural and nonagricultural commodities.

Intersectoral Linkages: Agricultural-nonagricultural Interactions

Recent studies for Bangladesh, Egypt, and India illustrate the two ways in which analysts have sought to transcend the restrictions of working within a partial equilibrium framework when measuring impact on the agricultural sector and on food consumption. The first approach, exemplified by Mellor[44] on India and Nelson[45] on Bangladesh, may be characterized as partial analysis within a general equilibrium framework. Mellor explored the differential effects of food price changes in India on consumer incomes, producer incomes, the level of agricultural production, and employment up to 1970/71. He found that both real consumer and producer incomes in the lowest two deciles diminished significantly with a rise in food prices. In a parallel study, he also concluded that the accelerated rate of increase in employment in the early 1960s was sustained by food imports. Contrary to the assumptions of earlier studies, food aid probably provided significant balance-of-payments support and sustained growth by forestalling massive diversion of foreign exchange from capital goods to food imports in poor crop years.

Nelson, adopting a broadly similar approach, undertook a reassessment for Bangladesh that questioned the widespread view that food aid had had adverse effects on domestic agriculture. The advantages of this informal approach is that it permits analysis where the time period under study is too short for satisfactory econometric modeling (in this case Bangladesh for a period of less than a decade since independence and the end of large-scale emergency relief). It also allows the analyst to consider structural and technological constraints as well as difficult-to-quantify tensions in macroeconomic and agricultural sector policy. Nelson's cautious conclusion, which might be generalizable to a number of other low-income countries during periods of severe economic and food system disruption, is that it is difficult to envisage a sustainable counterfactual scenario in which significantly lower levels of food aid would have resulted in more rapid, equitable agricultural development.

Bangladesh and Egypt, the largest recipients of food aid through the 1970s, have displaced India as the most discussed cases. The divergence of opinion on the overall economic impact of food aid on the economy, particularly agriculture, indicates the limitations of the informal factor by factor approach.[46] First, the data, particularly regarding policy and implied counterfactual scenarios to historical levels of food aid, are susceptible to differences of interpretation. Second, in a qualitative analysis, unless all the indi-

cators are consistently positive or negative, the overall assessment becomes a matter of judgment and disagreement.[47]

The alternative formal approach is to explore output and price behavior in a general equilibrium model in which behavior in the agricultural and other sectors of the economy is linked. The potential power of such an approach is illustrated by Ahluwalia's relatively simple model of the Indian economy, which explores output and price behavior in two sectors (agricultural and nonagricultural), thereby quantifying the broader economic implications of food imports that only can be handled qualitatively in an informal approach.[48] Simulations suggest that a relative decline in the price of food grains (prima facie evidence of a disincentive effect) is compatible with an overall marginally positive impact on agricultural output through the effects of lower wage rates in the manufacturing sector and a shift away from food grains to other crops. The simulation approach inevitably precludes empirical verification but obliges the analyst to quantify relationships. A whole generation of models comparable to that of Ahluwalia is now being developed.[49] These models offer the opportunity to explore the role of food imports (supported by food aid) in a wider macro context. This would be an advance because the lesson from the literature on former recipients and countries, such as Bangladesh, Egypt, and Sri Lanka,[50] which continue to be significant recipients, is that partial and sectoral analyses seem likely to sustain an inconclusive debate. But, as Blandford and Plocki show in their careful review of Indian sectoral models, the results of such econometric exercises are likely to be sensitive to choices in model specification and data.[51] The serious questions that surround the reliability of food production as well as import and export data for many recipient countries (particularly sub-Saharan Africa) will continue to hamper all quantitative and qualitative analyses.

Some Current Recipients: A Provisional Stocktaking

The formal impact assessments of countries such as Brazil and India, which have ceased to be important recipients of cereals food aid in absolute or per capita terms, provide one form of evidence that is inconsistent with strongly negative disincentive critiques of food aid. In the case of these two countries, food aid has been a resource for growth, and relatively sophisticated management of agricultural systems has limited, if not eliminated, direct disincentive effects.[52] But to what extent is it appropriate to generalize from the experience of earlier decades to the low-income countries, particularly in sub-Saharan Africa, to which food aid now has been reallocated?[53] There have as yet been few systematic assessments of the impact of food aid for many currently important recipient countries.[54] But recent impact assessments for agency programs as well as independent research are beginning to suggest some important issues. These studies consider the implications of three important changes in food aid relationships since the early 1970s: a

reduction in volumes of assistance, a reallocation between continents (to Africa) and between countries (from India to Bangladesh within Asia), and an increase in project and emergency uses at the expense of bilateral program assistance.

The impact assessment of PL-480 Title I concessional credits to five countries—Bangladesh, Egypt, Jamaica, Peru, and Sri Lanka—indicates the reduced significance of what historically has been the most important food aid channel and the most researched in terms of economic impact.[55] With the possible exception of Bangladesh, the scale of food transfers has been modest in relation to food imports and public food system operations for all five countries. But in the low-income African countries, food aid has been increasing in relation to food imports.[56] This raises a question about the relevance of the historical experience. To what extent is the debate on disincentives and the macroeconomic growth implications of food aid out of proportion to the current scale of transfers to many recipient countries?

These evaluations, studies of the EEC program, and some other country case studies reconfirm earlier findings that program food aid acts as a source of balance-of-payments support.[57] An expected corollary of this result is that the exact magnitude of any production disincentive effect that can be traced directly to food aid has proved difficult to determine. Evaluators therefore have emphasized the critical role of domestic food policy in their prescriptive conclusions.[58] Food aid can provide a recipient government with food resources to withstand pressure to alter food policies that imply disincentives to producers. This also may bring significant positive and widespread nutritional and income benefits to consumers, as noted in the AID evaluation for Egypt.[59] But by implication such policies only are sustainable while food imports are concessional. Alternatively, a food aid agreement can contribute to an overall food import policy that provides appropriate incentives to general policy reform, as in Jamaica,[60] Mali,[61] and possibly Bangladesh.[62] There is growing interest in such models in staple food import-dependent economies such as Madagascar, Mauritania, and Senegal.

Consumer Tastes and Dietary Patterns

Changes in consumer preferences, particularly the acquisition of tastes for imported foods to the disadvantage of locally produced commodities, have been widely identified as a potentially serious long-run disincentive effect of food aid.[63] The analysis of this issue has distinguished between observed changes brought about by rising incomes, urbanization and socioeconomic change and the effects of changes in relative prices.[64] As rising food imports are associated with economic growth, urbanization, and the expansion of the secondary and tertiary sector throughout almost the whole developing world, a separate effect of food aid has proved difficult to isolate.[65] However, in the short run, food aid has been observed in cross-section to be positively

correlated with differences in levels of cereal imports,[66] largely wheat and rice, especially by low-income countries.[67] To the extent that these imports are additional, there would be some opportunity for impact, depending on importing country pricing and distribution policies or dietary patterns.

For example, food pricing policies have contributed to steadily increased per capita consumption of imported wheat in Bangladesh, Indonesia, and Sri Lanka, where little was consumed previously. Without differential pricing, wheat consumption would not have expanded at the expense of the major staple, rice, as well as various coarse grains and tubers.[68] In general, overvalued exchange rates supported by food aid may favor increased consumption of imported commodities even where there is no explicit policy of subsidizing consumption.[69]

There is wider evidence that socioeconomic change, urbanization, and rising energy costs have favored increased consumption of convenience foods.[70] Myriad factors contribute to the growth in consumption of processed foods using imported cereals. The accidents of colonial history and trade explain the relative significance of different bread wheat, durum wheat products, and rice types in particular countries.[71] Food processing technologies transferred from developed countries are specific to particular products and raw materials.[72] The evidence from country case studies is consistent with the view of critics that the availability of surplus bread wheat, rice, soybean oil, and dairy products on highly concessional terms has encouraged imports and increased consumer acceptance of these specific commodities.[73] Market development, long an objective of food aid policy, implies a higher level of demand than does the absence of such measures.[74]

Some analysts suggest that the growth in imports of food is an inevitable part of industrialization and tertiary sector and urban growth.[75] According to this view, local agriculture in the early phase of development has a low overall short-run elasticity of supply. The growth in effective demand for marketed staples and, with real income growth, demand for animal products, edible oils, and so on therefore will outpace the capacity of local agriculture to respond in the short run unless the intersectoral terms of trade rise to levels that directly choke off the transformation process or induce political and economic instability. What is at issue, therefore, is the extent to which import, price, and investment policies for the food sector have increased import dependence and reduced the positive intersectoral linkage effects of a growing domestic food market. This is illustrated most clearly in the controversy about appropriate patterns of investment in the food industry and food sector infrastructure. Is the observed low elasticity of supply partially a consequence of failure to invest in infrastructure and the integration of local markets?

Food Marketing, Storage, and Processing

The growth of food imports, which are financed in part by food aid and which create a set of food system linkages, has been identified in a number of recent country studies as having far-reaching negative development implications. The growth of large-scale, capital-intensive, centralized storage and processing can lead—as in Bangladesh,[76] Egypt,[77] and Indonesia[78]—to an absolute decline in food industry employment and to the redistribution of income from wage labor to capital and from rural to urban areas. These technical changes concern domestically produced staples as well as imports. Once made, the opportunity for profits on such investments linked to imported supplies, as in the case of wheat processing in Egypt and Sri Lanka, can shift the balance of private and public sector financial (but not necessarily social) return toward continued reliance on imports.

An asymmetrical set of food system linkages frequently has been observed even in least-developed countries. These linkages involve an efficient import sector, large relative to total market supply, able to handle a high inflow of commodities and stocks, which exists side by side with a poorly articulated food marketing, storage, and processing system for domestically produced food. This asymmetry has various negative developmental implications. Development is inhibited in peripheral regions.[79] The poor internal infrastructure contributes to the inelasticity of domestic marketed supply.[80] Large-scale imports that stabilize consumer prices, especially in urban areas, force adjustment effects of production instability onto domestic producers and rural consumers (who are not integrated into national markets) and intensify disincentive effects and rural food insecurity.[81] Systems that are well geared to handle imports, and even the marketing and processing of domestically produced food, typically do not readily allow exports.[82] This set of concerns about the longer-term implications of developments in the food industry are stated succinctly by Dunlop and others in an overview of the five country impact assessments of PL-480 Title I program food aid—where food processing, storage, and distribution are uncoupled gradually from the agricultural sector, the backward and forward linkages critical to development fail to grow.[83]

Food Assistance and U.S. Agricultural Exports

There is a long tradition of separating the policy discussion of aid as an instrument of development (and its foreign policy and trade environment) from questions of aid as an instrument of donor country export policy. Characteristically, the analysis of aid policies takes as given the scale, the commodity composition, and the terms on which resources are available.

Table 7.1 World and U.S. Trade and Aid in Cereals, 1983/84 (million tons)

	Wheat/ Products	Rice/ Products	Coarse Grains/ Products	Total Cereals
Trade				
World trade	103.3	12.5	92.5	208.3
U.S. exports	38.3	2.1	55.8	96.2
(%)	(37%)	(8%)	(60%)	(46%)
Food Aid				
World Total	7.433	1.134	1.265	9.832
(% Total)	(7%)	(9%)	(1.4%)	(5%)
U.S. (PL-480)	4.375	0.223	0.792	5.390
(% Food Aid)	(59%)	(20%)	(73%)	(55%)

Sources: FAO (data); White et al. in this volume.

But in asking what margin of maneuverability exists for making food aid a more effective developmental resource, it is critical to take account of the evolving trade policy context. Food aid continues to represent a significant resource transfer in kind to developing countries because of the existence of large-scale exportable surpluses in the major donor countries (the United States, Australia, Canada, and the EEC). In the context of this chapter, which is also concerned with the prospects for U.S. agricultural trade to developing countries, four issues regarding food aid and trade policy are considered: (1) the changing relationship between food aid and trade policy, a historical perspective necessary because of the lag in perceptions among those outside the small professional community of aid and trade analysts; (2) a brief review of the significance of PL-480 food aid in the 1980s, including recent legislative changes; (3) the potential tension between the developmental and trade promotion objectives of food aid, particularly the import-substitution versus additionality and commodity composition issues (attention is focused on food aid as conventionally defined by the OECD Development Assistance Committee, which in effect means transfers under Public Law 480); and (4) the projection of food aid requirements.

The Changing Relationship of PL-480 to U.S. Trade Policy

After a cursory glance at the trade and aid statistics (Table 7.1), it is legitimate to ask why give much attention to food aid in a discussion of agricultural trade policy. Food aid on a large scale began primarily as a surplus disposal operation in the 1950s following the Marshall Plan aid to postwar Europe. From that time until the mid-1960s, PL-480 exports amounted to some 25 percent or more of all U.S. agricultural exports, and about two-thirds of all U.S. wheat exports and nearly one-half of all U.S. rice exports were shipped

Table 7.2 Shipments of Food Aid in Cereals by Donor Country[a]

Donors	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86[b]
Argentina	—	15	32	30	38	67	20	33	30	51	35
Australia	261	230	252	329	315	370	485	349	460	482	400
Austria	—	—	—	—	—	32	20	34	11	13	20
Canada	1,034	1,176	884	735	730	600	600	843	817	943	900
China	64	12	68	3	25	2	6	6	31	92	—
EEC	928	1,131	1,374	1,159	1,206	1,278	1,580	1,571	1,890	2,468	1,580
Finland	25	33	47	8	19	29	9	28	40	20	20
India	—	—	100	295	80	51	1	10	—	100	—
Indonesia	—	—	—	—	—	—	—	—	5	—	68
Japan	33	47	135	352	688	914	507	517	445	330	300
Norway	10	10	10	10	11	40	36	36	17	43	30
OPEC special fund	—	—	—	—	—	—	37	30	14	—	—
Saudi Arabia	10	—	—	26	10	31	32	14	29	71	—
Spain	—	—	—	—	—	14	22	25	27	31	20
Sweden	47	122	104	104	98	94	119	87	83	88	80
Switzerland	36	33	32	32	32	16	22	29	30	39	27
Turkey	—	20	14	5	5	15	4	5	5	—	—
United States	4,273	6,063	5,992	6,238	5,339	5,212	5,341	5,375	5,655	7,536	7,200
WFP purchases	22	63	56	72	21	13	24	4	16	17	30
Others[c]	102	62	116	102	270	165	275	198	226	200	200
Total	6,846	9,017	9,216	9,501	8,887	8,943	9,140	9,194	9,831	12,524	10,910

Source: Compiled by FAO from data provided by donors, the International Wheat Council, the World Food Program, and other international organizations.

[a]Calculated in thousand tons, grain equivalent, July/June. To express cereal food aid in grain equivalent, wheat, rice, and coarse grains are counted on a one-to-one basis.

[b]Estimated on the basis of minimum commitments under the Food Aid Convention 1980, budgetary allocations, and other sources.

[c]In addition, according to unofficial reports, the USSR provided emergency aid to Asian countries amounting to 200,000 tons in 1977/78 and 1979/80 each and 400,000 tons in 1978/79.

Table 7.3 U.S. Food Aid Flows by Channel (in million dollars/% of total)

Year	Bilateral Grant	Bilateral Loan	Multilateral	Total	Total as percentage of ODA from OECD Countries	Total as percentage of ODA from U.S.
1970	360	n.a.	1	n.a.	n.a.	n.a.
1971	373	430	2	805	10.7	25.9
	(46.3)	(53.4)	(0.3)	(100.0)		
1972	360	494	124	978	10.6	24.7
	(36.8)	(50.5)	(12.7)	(100.0)		
1973	251	313	54	618	6.8	23.3
	(40.6)	(50.7)	(8.7)	(100.0)		
1974	238	400	90	728	6.3	19.8
	(32.7)	(55.0)	(12.3)	(100.0)		
1975	375	800	91	1,266	9.1	30.4
	(29.6)	(63.2)	(7.2)	(100.0)		
1976	565	600	45	1,210	8.7	27.8
	(46.7)	(49.6)	(3.7)	(100.0)		
1977	432	700	78	1,210	7.7	25.8
	(35.7)	(57.9)	(6.4)	(100.0)		
1978	406	637	75	1,118	5.6	19.7
	(36.3)	(57.0)	(6.7)	(100.0)		
1979	480	745	77	1,302	5.7	27.8
	(36.9)	(57.2)	(5.9)	(100.0)		
1980	471	687	149	1,307	4.8	18.3
	(36.0)	(52.6)	(11.4)	(100.0)		
1981	430	693	139	1,262	4.9	21.8
	(34.1)	(54.9)	(11.0)	(100.0)		
1982	387	628	119	1,134	3.8	12.8
	(34.1)	(55.4)	(10.5)	(100.0)		
1983	557	656	137	1,350	4.5	15.5
	(41.3)	(48.6)	(10.1)	(100.0)		
1984	651	733	158	1,542	4.9	16.4
	(42.2)	(47.5)	(10.2)	(100.0)		

Source: OEDC (data).

under PL-480. A decade later PL-480 exports represented only 5 percent of total farm exports.[84] In the early 1980s, PL-480 represented only 5 percent of U.S. grain exports, 11 percent of wheat and rice, and a little more than 1.4 percent of coarse grains, the growth area in cereal trade of recent years. The African food crisis has resulted in a large but possibly temporary increase in total aid flows (Table 7.2). Food aid also has steadily declined in significance as a proportion of development assistance since the early 1970s (Table 7.3).

Other legislative and internationally agreed regulatory changes have led a number of analysts to suggest that food aid is now more a resource of humanitarian and developmental aid policy than a resource of foreign policy.[85] These changes are paralleled by the declining significance of the United States as a provider of food aid. Before 1970, the United States was in effect the only significant provider of food aid. Following the establishment

of the World Food Program (WFP), there was an informal understanding that the United States would provide one-quarter of the resources to this program of wholly grant food aid, including shipping costs, for projects and emergencies. Following the 1967 Food Aid Convention, a broad group of donors also agreed to minimum contributions of cereals food aid.[86]

In the decade following the World Food Conference of 1974, food aid flows were quite stable at 9 million tons of cereals and 500,000 tons of other commodities. At the 1980 Food Aid Convention, minimum commitments close to recent, expected programmed levels of cereals were made by most donors. The United States contributed more than one-half of all commodities. Only the United States and Japan provided food aid on a concessional credit basis. All other donors provided aid on a grant basis, and some included all associated costs, so that the overall U.S. contribution, when calculating commodity costs at national world market prices, was closer to 40 percent of the aid transfer.[87]

The implication of these changes is that officially designated aid under PL-480 and other donor programs ceased to be a policy instrument for managing the changing export surplus situation for the most important commodity groups, particularly wheat, maize, and oilseeds.[88] Rather, from the point of view of export trade managers in the USDA and other exporting countries, official food aid is a relatively more predictable, intramarginal element in their market management strategy. A fuller understanding of this role requires an examination of commodity determination. But prior to reviewing this question it is important to ask why the role of food aid has changed so significantly.

The changing role of food aid, not only for the United States but also for other donors, probably lies in the multiplicity of food aid objectives and the decreasing flexibility from a market management viewpoint that this aid eventually produced. Food aid flows increasingly have become institutionalized. The establishment of the World Food Program and other smaller-scale multilateral programs has resulted in what are in effect politically mandated commitments of resources to agency programs and the channelling of aid into project uses. The voluntary agency program under Title II probably has undergone a similar institutionalization. There are powerful developmental, programmatic, efficiency arguments for making forward commitments on a multiannual basis; even where these are not formalized, strong informal pressures exist to maintain annually programmed commitments in relation to past levels.

The 1975 Foreign Assistance Act was an important landmark in mandating food aid; according to the act, the larger share of such aid was to be used for developmental purposes.[89] A minimum level of resources was to be committed to the Title II Nongovernmental Organization (NGO) multilateral and emergency program. In addition, a minimum share of Title I agricul-

tural credits was to be programmed to the World Bank's International Development Association (IDA)-defined low-income countries. The subsequent development of the Title III food-for-development legislation further mandated the flow of Title I commodities.[90] Program management also was required to take account of "self-help" legislative requirements and, subsequently, the Bellmon determination of avoidance of recipient country agricultural disincentive effects.[91]

The cargo preference sections of the legislation and the associated Merchant Marine Act mandating a share of gross tonnage for U.S. bottoms further decreased the flexibility of food aid as an agricultural trade policy instrument. The implications of those provisions may be more serious in the highly competitive dry cargo shipping markets of recent years.

Since the mid-1970s, side by side with the broad stability in PL-480 flows, there has been a significant increase in other purely agricultural, "soft" credit measures to manage markets.[92] More recently, Section 416 of the Agricultural Act of 1949 has been employed at the margin in preference to PL-480 for the use of surplus commodities in international programs. The subsequent administrative issues raised by this add-on tactic are reflected in the extensive legislative provisions of the 1985 Food Security Act (Section 1109 of PL99-198) concerned with S416 donations.

The evolution of agricultural export policy and aid policy practice in light of legislative and other regulatory action since the 1960s suggests an important lesson for the legislature and for aid lobbyists. The original legislation reflected not easily reconcilable trade and foreign policy as well as developmental objectives. The progressive introduction of regulatory constraints intended to prevent a repetition of Vietnam War–style foreign policy abuse and damaging (to low-income countries) short-run, trade-motivated behavior (1971–1974) has encouraged a multiplication of policy instruments. An important question for policy analysis is whether giving increased priority to developmental and humanitarian goals within the official food aid program (i.e., PL-480) is justified by the significantly lower level of food surpluses moving through this channel. What are the developmental implications of a larger share of subsidized exports flowing through agricultural channels? During the period in which world markets for temperate zone commodities are overhung by surpluses, this question concerns the United States as well as food aid policy more generally.

PL-480 and U.S. Agricultural Exports in the 1980s

The scope for short-run programming flexibility of food aid has been very substantially reduced under the 1980 Food Aid Convention (Table 7.4).[93] This convention is likely to be extended until the end of the decade, at least at existing levels. The experience of the years since 1980 has shown that a capacity also exists to increase commodity flows substantially beyond these

Table 7.4 Total U.S. Cereals Food Aid and Contributions Through the Food Aid Convention

Year	FAC Minimum Contribution (000 tons)	Total Cereals (000 tons)	Food Aid as % of Minimum FAC Contribution
1970/71	1890	9039	478
1971/72	1890	9220	488
1972/73	1890	6948	368
1973/74	1890	3186	168
1974/75	1890	4722	250
1975/76	1890	4273	226
1976/77	1890	6068	321
1977/78	1890	5992	317
1978/79	1890	6238	330
1979/80	1890	5339	283
1980/81	4470	5242	117
1981/82	4470	4791	107
1982/83	4470	5862	131
1983/84	4470	6453	144
1984/85	4470	6976	156

Sources: FAO, Food Aid in Figures; International Wheat Council.

"normal" levels in response to emergency conditions. Whether or not the scale, direction, and timing of the response was strongly countercyclical (thereby dampening the short-run effects of reduced production in sub-Saharan Africa) is an issue for review.

The establishment of a food aid wheat reserve of 4 million tons by the Carter administration represented another form of commitment to making food aid a more stable element of foreign assistance and global food security. The reserve was created in a weakening market as stocks accumulated in 1979 following the restriction on sales to the Soviet Union. The practical significance of earmarking wheat to sustain commitments and to allow for high levels of shipments in food crisis in weaker market conditions generated some initial skepticism. But this move appears justified retrospectively by the comparative ease with which the United States could expand emergency food aid levels during the African emergency (see Table 7.2). This measure, which in many ways could have been a model for other donors in establishing exporter-managed food security stocks, underscores an important lesson. It is precisely in a weaker market that conditions favor such forward-looking measures.

There have been no significant changes in the procedures and practices for determining the commodity composition of either credit sale Title I or the grant Title II program. The programs continue to depend on USDA determination of "available" commodities. The practical consequence of these procedures is apparent in the lack of any significant trend prior to the African

emergency in the pattern of cereals and the buildup of milk powder aid. There has been substantial short-term fluctuation in the level of individual commodities "made available" and programmed under both grant and credit programs (Tables 7.5 and 7.6).

Within the cereals group, the most significant fluctuations have been in rice (Table 7.5). A more detailed breakdown of other cereals that distinguishes types of wheat and coarse grains probably would reveal similar short-term movements. These fluctuations indicate a possible tension between short-run export market and surplus management objectives and tighter and predictable medium-term programming in relation to developmental criteria. If allowance is made for a few large, more predictable country programs, especially to Egypt, the year-to-year fluctuations imply that many marginal countries and projects do not know with any certainty whether they will get assistance and what commodities will be available. As discussed earlier, this cannot foster constructive programming.

The cereals part of the program is also significant for particular producer, processor, and trader interests. For example, the proportion of agricultural exports in fiscal year (FY) 1981 accounted for by food aid ranged from less than 2 percent of coarse grains to 68 percent of wheat flour and 76 percent of bulgar wheat exports (Table 7.7).

Vegetable oils have remained the most important noncereal commodity group. Shipment again has fluctuated as availabilities have been determined by changing internal market conditions and stock levels (see Table 7.6). There apparently has been little investigation of the consequence of this

Table 7.5 Commodity Composition of U.S. Cereals Food Aid (000 tons)

Year	Wheat	Coarse Grains	Rice	Total Cereals
1970/71	6,566	1,550	923	9,039
1971/72	6,408	1,750	1,062	9,220
1972/73	4,071	1,828	1,050	6,948
1973/74	1,421	1,124	641	3,186
1974/75	3,473	501	747	4,722
1975/76	3,321	442	511	4,273
1976/77	4,737	486	845	6,068
1977/78	4,284	1,007	702	5,992
1978/79	4,806	950	481	6,238
1979/80	3,879	967	494	5,339
1980/81	3,402	1,382	429	5,212
1981/82	4,077	1,042	223	5,341
1982/83	4,[illegible]21	594	492	5,375
1983/84	4,375[a]	792[b]	488	5,655

Sources: FAO, *Food Aid in Figures*; International Wheat Council.

[a]Includes 209,000 tons of bulgar wheat.
[b]Includes 158,000 tons of cereal component of blended foods.

Table 7.6 Commodity Composition of U.S. Noncereal Food Aid (tons)

Year	Solid Milk Products	Other Dairy Products [a]	Butter Oil	Vegetable Oil
1977	57,041	14,726	—	171,679
1978	74,443	17,541	—	229,955
1979	63,315	10,050	—	150,678
1980	63,634	26,320	—	234,350
1981	98,[illegible]58	24,450	—	275,347
1982	111,676	15,095	2,460	299,722
1983	126,206	41,709	—	290,108
1984	163,341	33,133	64	270,593

Sources: FAO, *Food Aid in Figures*; International Wheat Council.

[a]Includes the dairy component of blended foods.

fluctuating supply for either credit sales or project use.[94]

After a sharp drop in levels of dairy products aid by the early 1970s, there has again been a gradual buildup of supplies, especially of dried skimmed milk, or DSM (see Table 7.6). This is one of the few apparent, sustained movements in the commodity composition of the program. In FY 1981, shipments under PL-480 accounted for 90 percent of U.S. exports of DSM (see Table 7.7). The use of aid channels to dispose of surpluses subsequently has been carried further by provision for donations under Section 416 of the Agricultural Trade Act of 1949. Some processed products, such as soya-sorghum grits, that have export outlets and, indeed, are only marketed through Title II have been among the most stable elements in the program. Yet it is important to recall that the introduction of these blended products resulted from the search for substitutes (in nutritional projects) for shrinking supplies of milk powder in the 1960s.

When the commodity composition of the program is considered in cross-section, in FY 1981 for example, a clear relationship emerges between channels and commodity types (Table 7.8). The credit sales under Title I are heavily concentrated in widely traded wheat and coarse grains, although these form a relatively small proportion of the market in commodities. For wheat in particular, year-to-year movements are small in relation to total quantities programmed for export. However, where food aid represents a more important segment of the market, as in the case of rice or soybean oil, then the relative scale of annual fluctuations has been much larger. The program is much more sensitive to, and perhaps plays a more important role in, market management.

The grant program Title II is disproportionately significant in comparison with Title I for less widely traded commodities, such as DSM, bulgar wheat, and blended foods, where the United States has had no significant commercial export trade. Wheat flour and vegetable oils appear to be intermediate cases, important in both programs and relatively significant within

Table 7.7 U.S. Commodity Composition of PL-480 and Multilateral Aid Programs, Fiscal Year 1981 (000 tons)

Commodity	PL-480 Title I	PL-480 Title II	PL-480 Total	AID (Mutual Security)	PL-480 Percentage of Total Agricultural Exports	PL-480 + Aid Percentage of Total Agricultural Exports
Animals and Products	—	91.4	91.4	103.8	5.0	10.6
Inedible tallow	—	—	—	88.8	—	6.6
Poultry meats fresh/frozen	—	—	—	15.0	—	3.9
Nonfat dry milk	—	91.4	91.4	—	90.0	90.0
Grains and Products	3,663.4	1,473.6	5,137.0	448.0	4.4	4.8
Wheat	2,203.0	266.5	2,469.5	4.2	5.8	5.9
Wheat flour	664.8	217.5	882.3	—	68.1	68.1
Bulgar wheat	0.5	354.4	354.9	—	75.7	75.7
Rice	242.0	104.6	346.6	—	10.9	10.9
Coarse grains and products[a]	553.1	325.2	878.3	443.8	1.3	1.9
Blended food products	—	185.1	185.1	—	90.9	90.9
Soya-sorghum grits	—	20.3	20.3	—	100.0	100.0
Oilseeds and Products	130.4	121.7	252.1	—	0.8	0.8
Soybean oil	126.7	121.4	248.1	—	33.6	33.6
Cottonseed oil	3.7	—	3.7	—	1.2	1.2
Pulses	—	8.0	8.0	15.5	1.0	2.7
Cotton	4.2	—	4.2	—	0.4	0.4
Tobacco	—	—	—	3.6	—	1.4
Other	—	—	—	0.6	—	b

Source: USDA, *Report on Food For Peace* (Washington, D.C.: USDA, 1981).

[a]Includes maize, sorghum, and products.
[b]Negative commercial exports.

U.S. agricultural trade. There is a large international market for flour, but the United States has faced severe competition, especially from the EEC, and thus the relative share of food aid in total flour exports probably fluctuates sharply from year to year. Flour and oil also have an important role in emergency assistance and direct distribution projects so that large allocations would be required for Title II. Broadly, where recipient countries are contributing directly to commodity and associated costs of credit sales under Title I, they show a revealed preference for widely traded commodities. Where, as under Title II, commodities are made freely available, then less widely traded commodities and, indeed, some commodities that have found a niche only in the food aid program are much more significant. This discrepancy between the outcome of decisions reflecting the greater influence of recipients and suppliers on commodity selection is suggestive of a tension between recipient/developmental and supplier/internal agricultural interests. From the donor viewpoint this raises questions about the cost effectiveness of the aid transfer.[9]

Tensions Between Developmental and Agricultural Trade Concerns

In the first fifteen years of PL-480, the United States in effect could act almost

Table 7.8 U.S. Cereals Food Aid by Country, 1981/82

Country	Quantity (000 t)	As Percentage of Total Cereals Aid	Country	Quantity (000 t)	As Percentage of Total Cereals Aid
Angola	14.4	19.3	Kampuchea	17.3	34.7
Bangladesh	453.6	45.1	Kenya	50.3	39.5
Barbados	0.2	100.0	Korea, Rep. of	160.3	37.3
Benin	2.4	28.9	Lesotho	28.3	82.7
Bhutan	1.1	100.0	Liberia	40.9	96.5
Bolivia	14.2	32.1	Madagascar	87.1	40.4
Botswana	6.3	96.9	Malawi	0.9	45.0
Brazil	1.0	33.3	Mali	5.9	8.9
Burundi	7.2	80.0	Mauritania	24.9	28.8
Cameroon	6.7	63.8	Mauritius	32.5	76.5
Cape Verde	25.3	47.0	Morocco	414.1	86.7
C.A.R.	0.3	15.0	Mozambique	22.0	14.8
Chad	11.2	39.2	Nepal	9.8	42.2
Chile	8.3	45.4	Nicaragua	1.5	1.4
China	10.3	13.1	Niger	19.3	27.0
Comoros	2.0	25.3	Pakistan	131.6	37.9
Congo	0.1	25.0	Panama	3.1	100.0
Costa Rica	43.2	95.6	Paraguay	1.1	100.0
Djibouti	5.2	46.0	Peru	61.2	50.3
Dominican Rep.	57.1	100.0	Philippines	49.0	89.9
Ecuador	5.3	63.9	Poland	397.3	95.2
Egypt	1,695.4	86.7	Rwanda	6.2	49.2
El Salvador	125.2	97.0	Sao Tome	0.1	3.2
Ethiopia	7.6	4.0	Senegal	31.8	38.5
Gambia	4.4	21.0	Seychelles	0.5	38.0
Gaza Strip	4.7	79.7	Sierra Leone	5.6	19.4
Ghana	31.1	72.2	Somalia	63.2	34.0
Guatemala	10.6	100.0	Sri Lanka	116.4	57.5
Guinea	17.3	44.8	Sudan	111.8	57.6
Guinea Bissau	6.6	21.8	Tanzania	39.9	13.0
Guyana	0.3	23.1	Togo	4.6	100.0
Haiti	84.4	93.9	Tunisia	66.0	68.8
Honduras	24.9	73.7	Turkey	0.3	100.0
India	310.0	91.8	Uganda	26.0	53.6
Indonesia	90.6	85.0	Upper Volta	44.6	55.1
Jamaica	71.5	86.4	Zaire	79.5	100.0
Jordan	5.2	7.2	Zambia	73.2	73.2
			Total	5,393.3	58.4

Sources: FAO, *Food Aid in Figures*; International Wheat Council.

Note: Includes indirect U.S. contributions through multilateral programs and NGO activities.

as a discriminating monopolist operating on the demand for agricultural export commodities, particularly wheat. In retrospect, there was some significant consistency of interest between the United States as an exporter and developing countries with a growth potential. Overhanging surpluses with little value were disposed. The extent to which imports were truly additional, or involved substitution of concession for hard currency imports, is a matter for speculation. The scarcity of hard currency probably implied that a high proportion of such imports were additional, especially in the case of the largest recipient, India,[28] and at least to some extent in the case of the now middle-income countries in East Asia and Latin America. Where food aid provided balance-of-payments support, the transfers promoted the growth process and indirectly promoted the market for imported cereals. South Korea was such a case.[29] The global distributional impact may have been higher prices to commercial importing countries. Since the collapse of that trade regime, food aid, it is argued, has come to play a different role.

Flows are more predictable overall, but in quantitative terms they are smaller. The higher share of aid from non-U.S. sources implies a higher degree of concessionality; thus, assessing the changing value of the total resource transfer is less clearcut. Official food aid has been reallocated toward the least-developed countries in sub-Saharan Africa and to Bangladesh. Egypt, not a least-developed country but the largest recipient, is the outstanding exception (see Table 7.8). The fragmentary evidence suggests that most program food aid is only partially additional to commercial imports.[30] A balance of unfavorable factors beyond the control of low-income countries, particularly the world recession since 1979, have put all these countries under severe economic stress. In these circumstances food aid flows have represented an income transfer in kind. The considerable degree of fungibility implies support for policies both good and bad. The chapters on food strategies and agricultural policy reform in this volume reflect these issues.[31] Yet food aid remains an inherently second-best way of providing such support. The long-standing justification for such aid always has been that at least part of the food aid is an additional resource transfer reflecting the strength of agricultural support. But clearly, the tension still remains between developmental and agricultural influences on food aid flows.

In an aggregate sense official food aid has become a more predictable resource. There is an opportunity for a greater degree of predictability at a country level through programmatic innovations, such as Title III, that offered multiyear commitments. There is greater concessionality, again exemplified by Title III, larger-scale emergency aid, and significant government-to-government aid under Section 206 of Title II to Africa. Yet in contrast to other aid, the complexities of controls and commodity timing that reflect exporter agricultural interests are more severe. The process of commodity selection, which is strongly sensitive to short-run surplus disposal considerations, involves the acceptance of a potentially significant tradeoff between developmental and market management concerns. This issue is exemplified by the rapid expansion of DSM exports through PL-480 and subsequently under S416 as well. Since the early 1970s until 1985, the EEC has been the most important source of food aid in dairy products, directly and through the WFP. The record does not justify the United States becoming a significant supplier of DSM as food aid.

Dairy Food Aid

World markets of dairy products are depressed by large, overhanging surpluses. Most developed country producers are dumping into developing country markets. Food aid has been used to facilitate the development of local dairy production (this is called "project food aid"). The best-known example is Operation Flood in India, and there have been other projects in Kenya and Tanzania. More recently, the United States has supported a similar "project" in Sri Lanka. Other aid resources have been used to support dairy development through complementary capital investments and technical cooperation.

With seasonally fluctuating local supply, dairy production in most tropical and semitropical developing countries typically depends for at least a proportion of its inputs on imported dairy products for reconstitution. Food aid therefore can facilitate the development of local production by financing the import of such inputs. Attention always has focused on the local generation of revenue, called counterpart funds. These funds can be used for local dairy development or for subsidizing local processing capacity. With markets overhung by surpluses, the profitable reconstitution of commercially acquired inputs may be difficult at import parity prices for full-cream milk powder. What is at issue is not just the prices at which domestic producers can be encouraged to supply milk, but also the operating costs of the local dairy processing industry. Are local prices to final consumers set at a level that ultimately allows the profitable expansion of local dairy production? In present market circumstances tariffs or other restrictions may be required on commercial inputs of products in a form readily salable to the final consumer. The real danger is that food aid will be used to subsidize both consumer and local processing capacity by making possible sales of locally reprocessed commodities at or less than input parity levels established by dumping.

Dairy aid is meeting the balance-of-payments costs by providing more materials to a local industry. Consumers are being subsidized. But are these desirable beneficiary groups or middle- and upper-income urban households? More importantly, is the aid being provided in a context in which a local production capacity will develop that can be based on local milk production or efficiently can utilize commercially purchased imports in the fu-

ture? Evaluation of EEC-supported projects was pessimistic as to the developmental value of most such programs (except Operation Flood).[100] With dairy products, the scope for policy dialogue is far less than is the case of cereals that have macroeconomic significance. The donor of course can withdraw, but this is a difficult decision when larger levels of commodities are being programmed.

The other common use of dairy aid is in supplemental nutrition programs. This again is a highly controversial area. There are lactose intolerance problems. The desirability of organizing nutritional programs around commodities that are not widely consumed locally by poor, vulnerable groups has been questioned. Except where these commodities are widely consumed among potential beneficiary groups or have a local market resale value approximate to import parity prices, the use of such commodities may not be cost effective. Finally, these are more difficult commodities than grains to store and distribute. The EEC, in part bowing to the considerable weight of criticism, progressively has been reducing the scale of dairy aid. An EEC Commission policy paper on food aid described DSM as a "difficult" commodity and proposed a reduction in the levels at which it can be used effectively.[101] From a developmental point of view it would probably be more cost effective for the EEC to dispose of these commodities in some other way and substitute other, more appropriate commodities or nonfood aid.[102] What then is the developmental rationale for U.S. intervention on a large scale?

The Additionality Issue

A long-standing concern of agricultural interests has been to safeguard the sale through commercial sources of all transfers less concessional ones. This concern was reflected in the strict requirement that commodities provided through NGOs or international programs under Title II would not be sold on local markets. In circumstances where practically no other external resources were provided to support local projects, this imposed a severe restriction on project design and finance. The whole evaluative experience is that project food aid, both food for work and nutritional programs, has been constrained severely in its effectiveness by a lack of complementary resources, including finance for the local movement of commodities, payment of staff, purchase of equipment, maintenance, and the like. Of course, any local sale of commodities raises difficult management and accounting issues, which could be handled on a case-by-case basis. Blanket restrictions reflect an overwhelming concern for agricultural trade interests that severely reduce the developmental possibilities of food aid as a resource. It is encouraging that this has been recognized in recent years, and there is more willingness to allow the monetization of a proportion of commodities to meet local costs. A positive feature of the 1985 Food Security Act is the requirement that monetization must become a normal feature of voluntary agency nonemergency projects (Section 1104).

However, PL-480 budgetary practice still falls short of the flexibility of some other donors in terms of their capacity to program locally available commodities into emergency or developmental action (local purchase) and swap arrangements (exchange of imported for local food). Little attempt is being made to utilize triangular actions (importing food from another developing country). This issue of flexibility is highlighted by the recent experience in sub-Saharan Africa. As noted previously, local staples, such as white maize and indigenous varieties of sorghum and millet, often are preferable, particularly for rural projects and relief operations. Where projects are funded on an annual basis, local purchase and swaps offer the opportunity to respond to fluctuating local food supplies. For example, the WFP is currently purchasing grain in Burkina Faso—which has recently been in serious food deficit—for local projects. Maize surpluses in Kenya, Malawi, and Zimbabwe might be similarly utilized in-country (in the case of Kenya) or to meet the food requirements of neighboring countries. The budgetary framework and policy practices of PL-480 are in this respect apparently less flexible than those of other food aid donors such as Australia, Canada, Japan, and most European countries. The multiplication of policy instruments to manage agricultural markets has not reduced the tension between developmental and agricultural trade objectives in the budgetary and policy framework of PL-480. Is this because other donors characteristically fund food aid as part of their aid programs?

Future Requirements for Food Aid

Globally, the projection of recent trends indicates a continually rapid increase in the demand for imported cereals by developing countries.[103] Such projection exercises are fraught with difficulties. More recently, rates of growth have declined, and many developing countries have experienced a sharp fall in per capita national income levels. Consequently, income-related expansion in demand may be less than implied by projections reflecting trends since the mid-1960s. The most recent movements in oil prices and currency rates are a reminder that the international distribution of growth in demand in the Third World may be different from that of the past decade or so. Exercises in projections into the future are difficult, and the estimation of food aid requirements is no exception. Nevertheless, in the context of a volume looking at prospects for development and agricultural trade, these questions require consideration.

In reviewing projection exercises by FAO, the International Food Policy Research Institute (IFPRI), WFP, and USDA, two general results were noted.[104] First, food aid requirements reflecting various assessments of capacity to finance imports are typically in excess of current levels and are ex-

panding. Second, estimates based on World Health Organization (WHO)/FAO nutritional guidelines—which are a reminder of the urgent need to improve nutritional status in many countries beyond current abysmal levels—produce far higher requirements than projections reflecting demand, whether based on past trends or improved growth scenarios.

Some analysts are much more optimistic about the future. For example, Bale and Duncan, using the dictum that "we know that the future will be similar to the past because in the past the future has been similar to the past," argue that the trend has been for agricultural prices to decline and crop yields to increase in developing countries and that there is no reason why these trends should be suddenly reversed.[105] Indeed, if developing countries have "pricing policies that remove the existing distortion under which agricultural production labors," then the positive trend in food consumption they observe would be accelerated. In this optimistic, highly aggregated view, no mention is made of aid requirements, although the authors' implicit view is that food aid would be temporary, which does not accord with the various projection estimates on the need for greatly increased allocations in the future.

Such highly aggregated assessments are not consistent with the results of FAO's disaggregated exploration of greater-than-trend growth scenarios.[106] Other analysts also stress that although short- to medium-run projections of food production may not look too bad for many countries, longer-run projections show the importance of continued attention to sustain supply increases.[107] It also has been suggested that optimistic assessments confuse the micro and macro question. Some countries will succeed in being less dependent on food transfers, if not on food imports more generally, but many others will fail to do so. This is not readily apparent with aggregate figures, but it means that in terms of actuarial risk increased concessional financing for food imports probably will be required and should be taken into account in planning U.S. food aid policy. The onus is upon those who argue for maintaining or reducing levels of food aid to ensure that alternative financial mechanisms exist to meet the unavoidable food import bill of low-income countries. The notional actuarial risk provides a useful metaphor for the problem. Just as insurance companies do not know exactly who will be making claims, they nevertheless can anticipate that the level of claims during several years will be such that adequate resources must be set aside to meet these as they arise. Some projections made in the early 1980s for food aid requirements in sub-Saharan Africa in 1990 already have been exceeded in the crisis period of 1984/85.

The record on the recipient and donor side indicates that there are not only choices but constraints on what is institutionally and politically possible in the foreseeable future. The requirements estimates should be interpreted, therefore, as an upper limit to the amount of food aid that can be

used effectively. Food aid is a resource with the potential for powerful positive and negative impacts on recipient countries. To grasp the opportunity to use food aid positively requires not just the political will to follow difficult policies, but considerable planning and management sophistication in recipient countries. The evidence is that development will create significant markets for agricultural exports. But there are risks especially when agriculture generally or particular agricultural sectors are under pressure. In these situations the shortsighted assertion of narrow interests over developmental and humanitarian concerns can undermine the credibility of an aid resource that requires flexibility and sensitivity on the donor side.

Notes

1. For example, within the EEC, food aid policy involves a sharing of responsibility between DG6 (agriculture) and DG8 (development). DG6 is represented in the aforementioned international agreements. There is a Food Aid Management Committee chaired by the commission, but many representatives of member governments are from the Ministries of Agriculture. The role of DG6, Ministries of Agriculture, and members of the European Parliament who represent agricultural areas in the formation of policy (in particular, the size of the food aid program and the balance of commodities and noncommodity resources) is far from clear but widely acknowledged as very powerful. A review of other donor programs would show similar influences, except perhaps for the few small food aid donors that do not have agricultural commodities for export. See E. J. Clay, *Review of Food Aid Policy Changes Since 1978*, Occasional Paper no. 1 (Rome: World Food Program, Public Affairs and Information Unit, 1985).

2. Ibid., Chapter 6.

3. E. J. Clay, "Sri Lanka: Food Aid as a Resource Transfer," *Food Policy* 8, no. 3 (August 1983a).

4. See S. J. Maxwell and Hans Singer, "Food Aid to Developing Countries: A Survey," *World Development* 7 (1979):225–247.

5. T. W. Schultz, "Value of U.S. Farm Surpluses to Underdeveloped Countries," *Journal of Farm Economics* 42, no. 5 (December 1960):1019–1030. Much of the import literature continues to look for evidence of such direct price effects that occur locally. See T. Jackson, *Against the Grains* (Oxford: Oxfam, 1982). For literature concerned with evidence of direct price effects that occur nationally, see D. W. Dunlop and C. Adamczyk, *A Comparative Analysis of Five PL 480 Title I Impact Evaluation Studies*, Aid Impact Evaluation Discussion Paper no. 19 (Washington, D.C.: AID, 1983).

6. See P. J. Isenman and H. W. Singer, "Food Aid: Disincentive Effects and Their Policy Implications," *Economic Development and Cultural Change* 25, no. 2 (January 1977).

7. Lower cereal prices might favor poor landless rural households at the expense of richer surplus producers in Bangladesh (interhousehold distribution). See R. Ahmed, *Agricultural Price Policies Under Complex Socioeconomic and Natural Constraints: The Case of Bangladesh*, Research Report no. 27 (Washington, D.C.:

IFPRI, October 1981). For a discussion on urban consumers gaining at the expense of rural small-scale producers in Zambia (sectoral distribution), see R. Chambers and H. W. Singer, *Poverty, Malnutrition and Food Insecurity in Zambia*, Staff Working Paper no. 473 (Washington, D.C.: World Bank, August 1981).

8. D. Steinberg et al., *Sri Lanka: The Impact of PL 480 Title I Food Assistance*, AID Impact Evaluation no. 39 (Washington, D.C.: AID, October 1982). Also see H. Alderman and C. P. Timmer, "Consumption Parameters for Sri Lankan Food Policy Analysis," *Sri Lankan Journal of Agrarian Studies* (January 1981).

9. There is widespread concern that food aid will encourage a special, technical pattern of investments in food handling, processing, and storage that is geared to bulk imports rather than to more widely dispersed, domestic production. See, for example, Dunlop, *A Comparative Analysis*. Also see E. J. Clay, "Food Aid and Food Policy in Bangladesh," *Bangladesh Journal of Agricultural Economics* 1, no. 2 (1979):107–120.

10. Relatively lower food prices dependent on targeting have been seen as reducing (rural) employment opportunities by encouraging relatively capital-intensive, urban industrial employment. See M. Lipton, *Why Poor People Stay Poor* (London: Croom Helm, 1977). Alternatively, there is a positive employment opportunity offered if lower food prices, especially direct use of food as wage goods, can favor relatively labor-intensive production throughout the economy and especially labor-intensive rural works. See Isenman, "Food Aid."

11. For example, Clay, "Food Aid and Food Policy," and J. R. Stepanek, *Bangladesh—Equitable Growth?* (New York: Pergaman Press, 1979), were concerned about the fiscal dependency of Bangladesh on food aid.

12. For example, contrast the negative assessments of C. P. Timmer, "The Political Economy of Rice in Asia: Lessons and Implications," *Food Research Institute Studies* 14 (1975):419–432; R. Blue et al., *PL 480 Title I: The Egyptian Case* (Washington, D.C.: AID, February 1983); Clay, "Food Aid and Food Policy"; Stepanek, *Bangladesh*; and Q. K. Ahmed, *Contribution of Food Aid to Equitable Growth: The Case of Bangladesh* (Amsterdam: WFP/Government of Netherlands, 1983), with the more positive view of G. O. Nelson, "Food Aid and Agricultural Production in Bangladesh," *IDS Bulletin* 14, no. 20 (1983) Institute of Development Studies, University of Sussex; and B. C. Richardson et al., *Bangladesh: Food Aid: PL 480 Title I and Title III*, Project Impact Evaluation (draft) (Washington, D.C.: AID, January–February 1983).

13. See review by Isenman, "Food Aid"; and J. W. Mellor, "Food, Employment and Growth Interactions," *American Journal of Agricultural Economics* 64, no. 2 (1982):304–311.

14. See, for example, T. W. Schultz, "Effects of the International Donor Community on Farm People," *American Journal of Agricultural Economics* 62, no. 5 (December 1980):873–878; and G. E. Schuh, "Food Aid as a Component of General Economic and Development Policy," in ADC, *The Developmental Effectiveness of Food Aid in Africa* (New York: ADC, 1982).

15. For example, striking contrasts in the interpretation of the impact of food aid on the Bangladesh economy are noted in notes 5-10.

16. See S. J. Maxwell, ed., *An Evaluation of the EEC Food Aid Programme*, Commissioned Study no. 4 (Sussex: IDS, University of Sussex, 1982); and E. J. Clay and H. W. Singer, *Food Aid and Development: The Impact and Effectiveness of Bilateral PL 480 Title I Type Assistance* (IDS, University of Sussex, Brighton, February 1982); B. Huddleston, *Closing the Cereals Gap With Trade and Food Aid*, Research Report no. 43, (Washington, D.C.: IFPRI, 1984); and C. Stevens, Food Aid and the Developing World: Four African Case Studies (London: Croom Heim, 1979).

17. H. W. Singer, *Food Aid Policies and Programmes: A Survey of Studies of Food Aid* (Rome: FAO, 1978).

18. See P. C. Abbott and F. D. McCarthy, "The Welfare Costs of Tied Food Aid," *Journal of Development Economics* 11, no. 1 (1982); Huddleston, *Closing the Cereals Gap*; Isenman "Food Aid"; J. W. Mellor, "Food Aid and Nutrition," *American Journal of Agricultural Economics* 62, no. 5 (December 1980); and Nelson, "Macro-Economic Dimensions."

19. Abbott "The Welfare Costs"; and Huddleston, ibid. Formally this approximates a closed economy into which food aid is introduced without any direct repercussions on agricultural imports or exports. Despite the unrealism of this case, many models—for example, those for India—chose to assume away any trade effects. See D. Blandford and J. Plocki, "Evaluating the Disincentive Effect of PL 480 Food Aid: The Indian Case Reconsidered" (Ithaca: Dept. of Economics, Cornell University, New York, July 1977).

20. See S. Reutlinger and J. Katona-Apte, *The Nutritional Impact of Food Aid Criteria for the Selection of Cost-Effective Foods*, Discussion Paper no. 12 (Washington, D.C.: Research Unit, Agricultural and Rural Development Department, World Bank, September 1983). These authors provide the most systematic analysis of income effectiveness of food transfers, although they are concerned primarily with supplementary feeding and food-for-work projects. The choice of commodity is critical because the cost effectiveness of the income transfer is maximized at local prices and, for a given level of costs, only where the food aid substitutes directly for purchases or home-produced food of similar unit value. The transfer is reduced where households incur transaction costs in resale or consume or otherwise substitute in use for lower-cost commodities (e.g., animal feed).

21. Schuh, *Food Aid as a Component*; and Schuh, "Increasing the Effectiveness of Food Aid: Offsetting the Opportunity Costs of Schooling" (Paper for the WFP/Government of the Netherlands Seminar on Food Aid, The Hague, October 2–5, 1983).

22. Mellor, "Food, Employment and Growth Interactions."

23. See Stevens, *Food Aid and the Developing World*. The author argues in the case of four African countries that if food aid were distributed freely—for example, as meals or take-home food in schools where government would otherwise have made provision—then this also would give budgetary support.

24. S. Reutlinger, *Project Food Aid and Equitable Growth: Income Transfer Efficiency First*, Report no. 13 (Washington, D.C.: Research Unit, Agriculture and Rural Development Department, World Bank, 1983).

25. H. W. Singer, "Use and Abuse of Local Counterpart Funds," *International Development Review* 3, no. 3 (October 1961).

26. See Canadian International Development Agency, *A Review of CIDA's Counterpart Fund Policy and Practices* (Ottawa: CIDA 1984). The practice of requiring the recipient countries to account separately for revenue from sales proceeds of

commodity aid has its origins in the Marshall Plan. Such revenues were supposed to be used for reconstruction and development. Other developed country donors also adopted this practice; as early as 1951/52 Canada employed this practice in making grants under the Colombo Plan.

27. Abbot, "The Welfare Costs"; Huddleston, *Closing the Cereals Gap*; and Nelson, "Macro-Economic Dimensions."

28. For example, the scope of work for the five evaluations of PL 480 Title I country programs asked for sequential consideration of the balance-of-payments effect and uses of local currency sales without linking discussion of these questions. See Dunlop, *A Comparative Analysis*, Appendix A.

29. Nelson, "Macro-Economic Dimensions"; and Huddleston, *Closing the Cereals Gap*.

30. Huddleston, ibid.

31. For a critical analysis of interventions in agriculture, see T. W. Schultz, "Effects of the International Donor Community on Farm People," *American Journal of Agricultural Economics* 62, no. 5 (December 1980):873–878; and T. W. Schultz, ed., *Distortion of Agricultural Incentives* (Bloomington: Indiana University Press, 1978). A survey of the agricultural price policy literature may be found in FAO, *Expert Consultation on Agricultural Price Policies*, (Rome: FAO, 1983).

32. See Isenman, "Food Aid"; Mellor, "Food Aid and Nutrition," and "Food, Employment and Growth Interactions"; and Nelson, "Macro-Economic Dimensions."

33. See, for example, the country impact assessments undertaken since 1980 by various bilateral donors such as those for PL-480 Title I in Dunlop, *A Comparative Analysis*. For an examination of the EEC action program, see S. J. Maxwell, ed., *An Evaluation of the EEC Food Aid Programme*, Commissioned Study no. 4 (Sussex: IDS, University of Sussex, 1982). For a country impact assessment of Australian aid, see Australian Development Assistance Bureau, *Food Aid to Bangladesh: A Review of the Australian Programme* (Canberra: ADA, 1983).

34. This section draws heavily on unpublished doctoral research by Nelson and the survey article of models for India in Blandford, *Evaluating the Disincentive Effect*.

35. Opponents of food aid have cited less-favorable results. See, for example, F. M. Lappé et al., *Aid as Obstacle: Twenty Questions About Our Foreign Aid and the Hungry* (San Francisco: IFDP, 1980).

36. Blandford, *Evaluating the Disincentive Effect*.

37. T. J. Goering, "PL 480 in Colombia," *Journal of Farm Economics* 44 (1962).

38. L. Dudley and R. J. Sandilands, "The Side Effects of Foreign Aid: The Case of PL 480 Wheat in Colombia," *Economic Development and Cultural Change* 23, no. 2 (January 1975).

39. L. Hall, *The Effects of PL 480 Wheat in Latin American Countries*, Working Paper no. 62 (Berkeley: Giannini Foundation of Agricultural Economics, University of California, 1978).

40. L. Hall, "Evaluating the Effects of PL 480 Wheat Imports on Brazil's Grain Sector," *American Journal of Agricultural Economics* 62, no. 1 (February 1980). Also see G. C. Williamson, *Food Consumption Parameter for Brazil and Their Application to Food Policy*, Research Report no. 32 (Washington, D.C.: IFPRI, 1982).

41. M. Bezunch and B. J. Deaton, *Food Aid Disincentives: The Tunisian Experience* (Richmond, VA: Virginia Polytechnic Institute and State University, 1983). Also see Stevens, *Food Aid and the Developing World*; and *Reviews of Selected National Experiences With Food Aid Programmes and Policies: The Tunisian Experience* (Rome: WFP/CFA, September 1983).

42. Isenman, "Food Aid"; and Mellor, "Food, Employment and Growth Interactions."

43. Nelson, "Macro-Economic Decisions."

44. Mellor, "Food Aid and Nutrition."

45. Nelson, "Food Aid and Agricultural Production."

46. For Egypt, contrast the conclusions of Blue, *PL 480 Title I*, which identifies serious negative disincentive effects of food import policy sustained by food aid on wheat production, with the inconclusive results of G. M. Scobie, *Government Policy and Food Imports: The Case of Wheat in Egypt*, Research Report no. 29, (Washington, D.C.: IFPRI, 1981); G. M. Scobie, *Food Subsidies in Egypt: Their Impact on Foreign Exchange and Trade*, Research Report no. 40 (Washington, D.C.: IFPRI, 1983); and J. Van Braun and H. de Haen, *The Effects of Food Price and Subsidy Policies on Egyptian Agriculture*, Research Report no. 42 (Washington, D.C.: IFPRI, 1983). See Nelson, "Food Aid and Agricultural Production," for positive conclusions in the pre-1971 period in Bangladesh. For negative assessments of the period 1972–1978, see Clay, "Food Aid and Food Policy"; and Stepanek, *Bangladesh*. See Richardson, *Bangladesh: Food Aid*, for positive results since 1978.

47. Clay, *Food Aid and Development*, Chapter 3.

48. See I. J. Ahluwalia, "An Analysis of Price and Output Behavior in the Indian Economy: 1951–1973, *Journal of Development Economics* 6, no. 3 (1979). The earlier sectoral studies were concerned only with the cereals sector, including any cross-price effects between commodity sectors in agriculture. This probably contributed to the overestimation of the overall disincentive effect. The Green Revolution technology, which reduced unit costs, and associated positive pricing policies, which favored wheat relative to pulses and oil seeds, resulted in significant substitution of wheat for these crops. See J. G. Ryan and M. Asokan, "Effect of Green Revolution in Wheat on Production of Pulses and Nutrients in India," *Economic Programme* Occasional Paper no. 18 (Hyderabad, India: ICRISAT, 1977). Presumably, higher relative prices for cereals in the years 1950–1965 would have had a similar substitution effect, excluded by the assumption from sectoral models of the impact of cereal (food aid) imports on agricultural production.

49. A series of modeling studies for Egypt are being developed at IFPRI relating to different facets of the food system. For trade, see Scobie, *Government Policy*, and *Food Subsidies*; for consumption, see H. J. Alderman et al., *Egypt's Food Subsidy and Rationing System: A Description*, Research Report no. 34 (Washington, D.C.: IFPRI, 1982); and H. Alderman and J. Van Braun, *Welfare and Distributional Impact of the Egyptian Food Ration and Subsidy System* (Washington, D.C.: IFPRI, forthcoming); for agriculture, see Van Braun, *The Effects of Food Price*. For a useful guide to such macro models, including an illustrative model for the Egyptian food system, see L. Taylor, *Macro-models for Developing Countries* (New York: McGraw-Hill, 1970).

50. On Sri Lanka, see Steinberg, *Sri Lanka: The Impact of PL 480*; Clay, "Sri

Lanka"; and P. A. S. Dahanyake, "Disincentive Effects of Food Aid on Food Production in Sri Lanka," Central Bank of Ceylon Occasional Papers 1978–79 (Colombo: Central Bank of Ceylon, 1978).

51. Blanford, *Evaluating the Disincentive Effect.*

52. See Agricultural Development Council, *Implementation of United States Food Aid—Title III*, Seminar Report no. 20 (New York: ADC, August 1979); ADC, *The Developmental Effectiveness of Food Aid*; E. J. Clay, "The Changing World Food Aid System: Some Implications of the Proliferation of Donors and Recipients," *IDS Bulletin* 14, no. 2 (April 1983b); and Isenman, "Food Aid."

53. See C. Christensen and E. Hogan, "Food Aid as an Instrument of Development: A Seminar Report," in ADC, *The Developmental Effectiveness of Food Aid in Africa* (New York: ADC, 1982); Clay, ibid.; and H. W. Singer and S. J. Maxwell, "Development Through Food: Twenty Years' Experience" (Paper for the Twentieth Anniversary Conference of the World Food Program, The Hague, October 1983).

54. See ADC, ibid. Concern about the political as well as economic implications of food aid dependency are exemplified by R. Vengroff, "Food Aid Dependency: PL 480 to Black Africa," *Journal of Modern African Studies* 20, no. 1 (March 1982): 27–44. For case studies of Botswana, Lesotho, and Upper Volta, see Stevens, *Food Aid and the Developing World.* For other examples of exploratory analysis of food aid's macroeconomic role and the effect in other important recipient countries in Africa, see J. F. J. Holt, "Ethiopia: Food for Work or Food for Relief," *Food Policy* 8, no. 3 (August 1983); M. Mitchell and C. Stevens, "Mauritania: The Cost-Effectiveness of EEC Food Aid," *Food Policy* 8, no. 3 (August 1983); and A. M. Thomson, "Somalia: Food Aid in a Long-Term Emergency," *Food Policy* 8, no. 3 (August 1983). The growth of interest in food strategies can be expected to affect the interrelationships between food policy and food imports including food aid.

55. Summarized in Dunlop, *A Comparative Analysis.*

56. Clay, "The Changing World Food Aid System," Table 3.

57. See IDS/CEAS, *The European Community's Cost of Food Aid Study*, vols. 1 and 2 (Sussex: IDS, University of Sussex/CEAS, University of London, 1982); Clay, "Sri Lanka"; and Scobie, *Government Policy* and *Food Subsidies.*

58. Dunlop, *A Comparative Analysis*; Maxwell, *An Evaluation of the EEC Food Aid Program.*

59. Blue, *PL 480 Title I*; and A. M. Thomson, "Egypt: Food Security and Food Aid," *Food Policy* 8, no. 3 (August 1983).

60. Sidman et al., *Jamaica: The Impact and Effectiveness of the PL 480 Title I Program*, AID Project Impact Evaluation Report no. 51 (Washington, D.C.: AID, 1984).

61. "The Lesotho Experience," *Review of Selected National Experiences With Food Aid Programs and Policies* (Rome: WFP, 1984).

62. Richardson, *Bangladesh: Food Aid.*

63. See, for example, Maxwell, "Food Aid to Developing Countries"; Clay, *Food Aid and Development*; and Jackson, *Against the Grains.*

64. Dunlop, *A Comparative Analysis.*

65. See FAO, *Agriculture Towards 2000*, Economic and Social Development Series no. 23 (Rome: FAO, 1981).

66. For an analysis of the factors associated in cross-section with levels of cereal import dependence, see T. K. Morrison, "Cereal Imports by Developing Countries: Trends and Determinants," *Food Policy* 9, no. 1 (1984): 13–26.

67. Huddleston, *Closing the Cereals Gap.*

68. For example, Ahmed, *Agricultural Price Policies*; C. P. Timmer, "Food Prices and Food Policy Analysis in LDCs," *Food Policy* 5, no. 3 (August 1980); Alderman, "Consumption Parameters"; and Steinberg, *Sri Lanka: The Impact of PL 480*

69. Schuh, "Food Aid as a Component"; and Schultz, "Effects of the International Donor Community."

70. Mellor, "Food, Employment and Growth Interactions."

71. See, for example Thomson, "Somalia."

72. J. James and F. Stewart, "New Products: A Discussion of the Welfare Effects of 16 Introductions of New Products in Developing Countries," in F. Stewart and J. Jones, eds., *The Economics of New Technology in Developing Countries* (London: Frances Pinter, 1982), 225–255.

73. For example, F. M. Lappé and J. Collins, *Food First—Beyond the Myth of Scarcity* (Boston: Houghton Mifflin, 1979); S. George, *How the Other Half Dies* (New York: Penguin, 1970); and C. Tudge, *The Famine Business* (New York: Penguin, 1977).

74. For a historical review of market development as a food aid policy objective, see M. B. Wallerstein, *Food for War—Food for Peace: United States Food Aid in a Global Context* (Cambridge, Mass.: MIT Press, 1980); and J. Cathie, *The Political Economy of Food Aid* (Aldershot: Gower, 1982).

75. See Mellor, "Food, Employment and Growth Interactions", and P. A. Yotopoulos, *Middle Income Classes and Food Crisis: The Food-Feed Competition*, Food Research Institute Discussion Paper no. 3 (Palo Alto, Calif.: Stanford University, 1983).

76. See B. Harris, "Appraisal of Rice Processing Projects in Bangladesh," *Bangladesh Journal of Agricultural Economics* 1, no. 2 (1978); and *Bangladesh Selected Issues in Rural Employment* (Washington, D.C.: World Bank, March 1983).

77. Blue, *PL 480 Title I*; and Alderman, *Egypt's Food Subsidy.*

78. C. P. Timmer, "Choice of Technique in Rice Milling in Java," *Bulletin of Indonesian Economic Studies* 9, no. 2:57–76.

79. See T. Johnson et al., *The Impact of PL 480 Title I in Peru: Food Aid as an Effective Development Resource*, Project Impact Evaluation no. 47 (Washington, D.C.: AID March 1983).

80. The limited responsiveness of domestic food supply to prices in many African countries is attributable in part to the lack of infrastructure and consequently poor integration of markets. See C. Christensen et al., *Food Problems and Prospects in Sub-Saharan Africa*, Foreign Agricultural Research Report no. 166 (Washington, D.C.: USDA, 1981); and C. Christensen and L. Witucki, "Food Problems and Emerging Policy Responses in Sub-Saharan Africa," *American Journal of Agricultural Economics* 64, no. 5 (December 1982).

81. See, for example, Zimbabwe Maize Train Operations: An Information Note (Rome: WFP, October 7, 1981). Also see Chambers, *Poverty*

82. Dunlop, *A Comparative Analysis.*

83. Ibid.; ADC, *Implementation, The Developmental Effectiveness of Food Aid*; WFP/Government of the Netherlands, "Report of the Netherlands Seminar on Food

Aid" (The Hague, October 3–5, 1983); Maxwell, *An Evaluation of the EEC*; and World Food Council, *The World Food and Hunger Problem: Changing Perspective and Possibilities: 1974–84* (draft) (Rome: World Food Council, 1983).

84. Wallerstein, *Food For War*.

85. See R. F. Hopkins, "What More Can You Say About Food Aid?" *Food Policy* 8, no. 3 (1983); and Schuh, "Food Aid as a Component."

86. J. H. Parotte, "The Food Aid Convention: Its History and Scope," *IDS Bulletin* 14, no. 2 (1983)

87. Clay, *Review of Food Aid*; and Huddleston, *Closing the Cereals Gap*.

88. Food aid as officially defined by the DAC as part of official development assistance involves commodity assistance with concessionality of at least 25 percent, the programming of aid in relation to explicit developmental or humanitarian objectives, and the involvement of official channels.

89. Schuh, "Food Aid as a Component"; and Clay, *Food Aid and Development*.

90. J. M. Garzon, "Food Aid as a Tool of Development: The Experience of PL 480, Title III," *Food Policy* 9, no. 3 (1984).

91. AID, *Background Paper and Guide to Addressing Bellmon Amendment Concerns on Potential Food Aid Disincentives and Storage* (Washington, D.C.: Office of Food for Peace, 1985).

92. See Chapter 6 of this volume.

93. Clay, *Review of Food Aid*.

94. For example, the Title I evaluations undertaken in 1981/82 focused almost exclusively on cereals, and so Dunlop, *A Comparative Analysis*, has little to say on vegetable oil credits.

95. For a general theoretical framework on the costs of tied food aid, see Abbott, "The Welfare Costs." The issue of cost-effective resource transfers for EEC dairy aid is explored in E. J. Clay and M. Mitchell, "Is European Community Food Aid in Dairy Products Cost-Effective?" *European Review of Agricultural Economics* 10, no. 2 (1983). Also see National Science Foundation, *Nutritional Analysis of Public Law 480 Title II Commodities* (Washington, D.C.: National Academy Press, 1982); and Reutlinger, *The Nutritional Impact*.

96. J. W. Mellor, *The New Economics of Growth: A Strategy for India and the Developing World* (Ithaca, N.Y.: Cornell University Press, 1976).

97. Cathie, *Political Economy*.

98. See Clay, *Food Aid and Development*; and Maxwell, *An Evaluation of the EEC*.

99. See Chapter 2 in this volume.

100. Clay, "Is European Community Food Aid Cost Effective?"; and Maxwell, *An Evaluation of the EEC*.

101. European Communities Commission, "Food Aid for Development," COM (83) 141 final (Brussels: EEC, April 6, 1983).

102. Clay, "Is European Community Food Aid Cost Effective?"; and A. Mathews, "EC Food Stocks and African Hunger" (Paper prepared for the Irish Council of European Movement Seminar, Dublin, March 21, 1986), provide empirical substance for the theoretical argument of Abbot, "The Welfare Costs."

103. See Chapter 1 in this volume.

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104. E. J. Clay, "Food Aid Forecasting: The Literature on Needs and Requirements," *Food Policy* 11, no. 1 (1986).

105. M. D. Bale and R. C. Duncan, "Food Prospects in the Developing Countries: A Qualified Optimistic View," *American Economic Review* 73, no. 2 (1983)

106. FAO, *Agriculture Towards 2000*.

107. G. Fox and V. W. Rultan, "A Guide to LDC Food Balance Projections," *European Review of Agricultural Economics* 10, no. 4 (1984).

TITLE III: FOOD FOR DEVELOPMENT PROGRAM

FY-1986 EVALUATION OF THE BANGLADESH PROGRAM

DRAFTED BY: Helen Gunther, AID/Washington

and

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DATED: October, 1986.

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II. Synoptic History of PL-480 Program

Bangladesh is a seriously food deficit country with annual domestic foodgrain production currently of roughly 16.1 million metric tons. If FAO/WHO minimum calorie requirements were to be available for consumption, an additional 4.8 million tons or over 21 million metric tons would be required. In recent years, BDG has been able to supplement availability through concessional and commercial imports, effectively levelling out "status quo" requirements but at a level roughly 15-20 percent below nutrition based needs.

Taking into account fluctuations in national and local food crop production (which can be very large due to drought, floods and cyclonic storms) food production has been growing at roughly 2.4 percent per annum -- or roughly the rate of population growth.

While "food self sufficiency" was the goal of both the BDG Second Five Year Plan (1980-85) and the current plan 1986-1990, it is not likely that Bangladesh can achieve either "self-sufficiency" or food self reliance within the next decade. This has obvious consequences for the administration and planning of US food aid to Bangladesh.

A. 1978 Agreement

The first Title I/III Program in Bangladesh started in FY 73 with a Title I program which was primarily a famine relief program using wheat. This Title I program was in effect from FY 73 to FY 80. The Title I program was followed by a Title III program in FY 78 when there was increasing realization of the need for a longer term objective of foodgrain security and an expanded foodgrain production system. During this first Title III program (FY 78 to FY 81), wheat was the sole commodity except in the final year when a shipment of soybean oil was included. (See Table III D.1).

B. 1982 Agreement

The Second Title III program began in FY 82 and concluded in FY 86. This program continued the longer term objectives of the first Title III program. It was also characterized by greater commodity flexibility with wheat, rice, cotton, and soybean oil being included in the commodity mix. (See Table III D.1).

The major initiatives under this second Title III program were: agricultural production, food security, and special commodity activities.

1. Agricultural production: The agreement spelled out the need for BDG to maintain an effective procurement program, including setting procurement prices at a level that would provide an incentive to farmers. Thus each year the government would analyze the structure of the foodgrain production system, taking into account the costs of production and relevant factors including consumer and world price trends, and establish procurement prices for rice, paddy and wheat.

2. Food Security: An integral part of the second Title III agreement dealt with the reduction of subsidies in the Public Food Distribution System (PFDS) and the use of the Open Market Sales (OMS) program to moderate food grain price instability. Also, the maintenance and management of reserves for food security was actively encouraged in the agreement.

II. Special Commodity Activities:

a. Soybean Oil included in the agreement was to be sold only through private sector wholesale and retail outlets and not through the ration system. The amount of vegetable oils in the PFDS ration system was not to be increased.

b. Cotton provided under the agreement was to be used for rural development purposes. The yarn spun from the raw cotton was to be sold to the rural based handloom industry to provide employment and income to rural dwellers, most of whom are women in this sector.

III. A. General Situation in the Agricultural Sector in FY86

According to the latest World Bank analysis the agricultural sector in Bangladesh grew by 3.8% in FY 86, up from 1.8% in the previous year. This growth is attributed to the 50% increase in jute production, although overall agricultural incomes were depressed due to a 50% decline in the jute prices and falling foodgrain prices. The Aman rice crop had an outstanding year in FY 86 -- up 600,000 tons to over 8.5 million tons -- but overall foodgrain production remained stagnant at 16.1 million tons due to a 30% drop in wheat production and a small drop in the Boro rice crop. This drop in wheat and boro production is attributed to drought like conditions in the surplus wheat/boro areas of the country during the boro season. Also for Boro rice, planting was reduced in the wake of a bumper Aman rice crop which affected farmers' decisions on Boro planting.

Relative price shifts, input use, and credit availability all played important roles in the FY-86 production picture. Low paddy prices dampened incentives for boro and wheat production and, in combination with buoyant prices for some of the minor crops, stimulated some substitution. Input purchases which declined for the first time in many years, were discouraged by lower rice prices, low cash incomes from jute, and the squeeze on agricultural credit. Fertilizer sales were also lower in comparison to that in FY 85, partly because FY 85 fertilizer use was high as a result of additional use on replanting of crops. Gross credit extended to agriculture fell from the equivalent of $280 million in FY 85 to $215 in FY 86. Recoveries, amounting to $210 million, rose slightly in absolute terms from FY 85, but as a proportion of outstanding loans fell from 38% to 26%. Partly as a result of this, as well as serious institutional problems, sales of irrigation equipment slumped badly; only 400 shallow tubewells were sold in comparison with 19,700 in FY 85, and sales of deep tubewells fell from 2170 to 670. The growth in irrigated area was thus only 2% in contrast with 8% in FY 85. This will undoubtedly influence the output in both FY 86 and FY 87.

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III. B. Public Food Distribution System

The origins of the Public Food Distribution System (PFDS) and food policy in Bangladesh have been summarized in Annex A of the proposed Agreement PAAD. Initiated in response to famine conditions -- which necessitated rationing -- it has grown to include twelve official food distribution channels. As recently as 1974, "large farmers' were required to sell a portion of their production to the PFDS at a fraction of free market prices. This food was then distributed through a ration card system at highly subsidized rates. Measured against this base point, policy and program modifications have been extraordinary and positive while chronic food deficits remain.

The principal policy objectives of the first Title III Agreement, continued in the second, were various measures designed to phase out subsidized distribution channels over a period of time and move toward the use of Open Market Sales from PFDS stocks as the preferred mechanism to buffer market prices (and consumer income) against increases in food prices, caused by supply shortages. Simultaneously, purchases at pre-announced price levels during peak harvest seasons, were to be expanded to (a) stimulate the expansion of domestic foodgrain productions through producer incentives and (b) buffer open market farmgate prices against temporary local market supply gluts.

To summarize, the PFDS system has multiple (and on occasions) conflicting program functions:

- To reduce wide swings in (wholesale and consumer) foodgrains prices (and farmers' income) not justified by normal seasonal availability and marketing costs, by distributing commodities from foodgrain reserves when consumer prices exceed a preset trigger price.

- To support producer prices (and farm income) through purchase of wheat and rice when market prices fall below a preset price level. The trigger (floor) price is to be announced prior to the planting season.

- To set floor prices for wheat and rice purchases at a level adequate to cover all farm input costs plus a margin for profit, to encourage investment such that farmers will be able to take advantage of high yielding varieties (self-help measure No. 2 and Annex A).

- Following assessment of availability and forecasts of expected yields, to document the need for concessional food aid (including Title I and II) and/or seek BDG authority to buy foodgrains from commercial sources.

- To continue phasing down the ration system by (a) gradually moving (ration) prices upward toward the open market price levels (b) by reducing the rice portion of rations, to be substituted by wheat, which provides equal calories at a lower price and (c) by gradually lowering the ration quota for individual card holders (SHM 4).

- To maintain adequate levels of food security reserves and to expand the average level of food security reserves to 900,000 metric tons on November 1st (just prior to the principal aman rice harvest and to 1.1 million metric tons on July 1st (just prior to the most risky supply period).

1. PFDS Marketing Channels

The PFDS acquisition of wheat and rice (and offtake) in recent years has varied from 1.5 to 2.5 million metric tons. Typically it handles somewhat less than 15 percent of all rice moved through marketing channels but approximately 50 percent of all wheat. Most of the rice consumed (over 95 percent) is produced within Bangladesh while roughly half of all wheat is imported. Because it handles such a small share of all rice, fine tuning purchases and disbursals to support farm level prices while capping price increases (taking into account four marketing seasons and local yield variabilities) is a formidable task. The BDG deserves credit for the relatively good success it has achieved in levelling out producer and consumer prices.

The PFDS, the major wholesaler of wheat and rice, has had and will continue to have a major impact on the wholesale and retail profit margins of the marketing trade. PFDS official distribution channels are the following:

A. Statutory Rationing (SR) -- Sales through licenced, privately owned ration shops to ration card-holders in six major urban centers at a controlled price set by the MOF.

B. Other Priorities (OP) -- Sales under similar to SR, a ration card system, for public employees and other categories in non-SR areas.

C. Essential Priorities (EP) -- Ration card system for personnel of police and military services. Price remains at FY 74 levels, providing a valuable "perk" to these employees.

D. Modified Rationing (MR) -- Ration-price sales in peri-urban and rural areas. Food allowances are supposed to favor persons with low incomes.

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E. Large Employees (LE) -- Wholesale sales to employers of 50 persons or more who compensate employees partly in kind.

F. Flour Mills (FM) -- Wholesale sales of wheat to both large and small scale white-flour millers.

G. Market Operations (MO) -- Sales category used to dispose off surplus stocks at the SR ration price currently in effect.

H. Open Market Sales (OMS) -- Sales of grain to local wholesale and retail outlets at a price which should cover acquisition and handling costs.

I. Free Sales (FS) -- Sales of damaged stock at whatever price is warranted by stock condition.

J. Food For Work (FFW) -- Distribution of Food as a wage in kind through: World Food Program (WFP), Title II (CARE) and BDG managed programs, targetted to under-employed persons.

K. Vulnerable Group Feeding (VGF) -- Mother/child feeding.

L. Gratuitous Relief (GR) -- Distribution to destitute persons.

M. Emergency Feeding (EF) -- A special category of SR with distribution to persons temporarily without food due to natural disasters.

The Public Food Distribution System (PFDS) offtakes by Channel for the period 1978/79-1986/87 BDG/FY is shown in Table III B.1.

2. Evaluation of PFDS Performance

The 1978 and 1982 project documents looked forward to a future date when Bangladesh was projected to achieve food self-sufficiency. It assumed, without supporting analysis, that self-sufficiency would be achieved by the end of the second five year plan which corresponds with the fourth year of 1982 Agreement. At that point, the PFDS, it was argued, would need to have only three distribution channels. These were to be:

1. Open Market Sales (OMS);
2. Food For Work (FFW); and
3. Gratuitous Relief (GR).

The PFDS system is a very large and very complex system. Among other things, it maintains offices in 64 districts and roughly 460 sub districts (Upazilas), administering, buying, and wholesaling activities and ration card programs for some 10 millions families. On the operations side, it manages 4 silos at key points with good transportation network, 12 central

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storage depots used for storing foodgrains for longer periods, 600 permanent local storage depots, which may increase as buying centers, and 200 temporary procurement centers.

The MOF Food Budget: The basic management tool of the MOF is a Food budget. Data inputs to the budget include estimates of demand (offtake) by channel for each commodity, estimates of supply (acquisitions) based on crop yield estimates and offering price, and the current levels of operations and security stock. After estimates of concessional food commodity arrivals for the period are factored in, the balance may be met through commercial purchases. Good data is available for each of the major net surplus and net deficit districts such that the purchase and movement of commodities takes place on a rational and timely basis under normal conditions.

The MOF foodgrain budget intake of commodities over the 1981-85 period has averaged roughly 19 percent local purchases, 26 percent commercial purchases and 55 percent concessional food aid including PL 480 (Table 5.1.) Concessional and commercial food imports have averaged roughly 15 percent of total national foodgrain availability. Title III shipments have averaged roughly 14 percent of the MOF food budget over the 1981-85 period and about 2 percent of total food availability.

These simple statistical analyses illustrate the importance of concessional food aid in the MOF food budget. The levels and sources of commercial and concessional food commodities for the period 1981 - 1986 are shown in Table 2.321. Some donors do not place conditions on the channels through which the MOF can utilize their commodities, while others, like the USG do. The BDG/MOF uses commercial importations according to its own priorities.

The Title III 1982 agreement is unique in requiring that the MOF allocate, in preference, PL 480 wheat and rice to the unsubsidized channels of the MOF food budget. A specific commitment contained in the 1982 agreement was that the BDG could only "earn" Taka to be used for currency use offset by proof that commodities (equivalent to the tonnage of each years agreement) had been marketed through the open market sales (OMS) channel. A corolary condition was that the official OMS sales price was to be established at 15 percent above the official acquisition price in order that as much of the subsidy element as possible is eliminated from PFDS operations. The 1982 agreement was amended to permit the MOF to earn currency use offset from sales through other channels where the sales price was set at the current OMS price. This amendment also fixed the mark-up to cover administrative costs at 15 percent of the base acquisition price for wheat.

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The origin of the pipline problem discussed in more detail in section III D is derived from the fact that the MOF has not been able to sell all of Title III foodgrains provided each year through the full price/cost recovery distribution channels as was projected in the 1982 agreement, as amended.

Detailed information on the historical and projected offtake by channel are published by the MOF. The World Food Program (WFP) maintains independent records as a cross check for the food donor community. A very significant and growing portion of the total PFDS offtake is made through the targetted FFW, VGF and other relief channels with the percentage increasing from 21 percent in 1981/82 to 44 percent in 1985/86 III B.1. This growth has been offset by a corresponding decrease in offtake from the ration channels from 62 to 38 percent of total offtake.

Over the same BDG/FY 81/82 to 85/86 period, rice as a share of the ration channel offtake decreased from 45 to 26 percent. Rice as a share of all PFDS offtake declined from 37 percent to 24 percent.

The impact of concessional and grant food on offtake patterns is large and growing. Wheat dominates concessional and grant food aid. In addition, donors are increasingly targeting their grant aid on FFW and VGF channels.

Of some interest to the market development contribution of the PL 480 program, almost no wheat was produced or consumed in Bangladesh prior to 1965. Today, wheat is consumed by all economic groups and roughly 50 percent of consumption is produced in Bangladesh as a complementary dry-season crop. Because of large MOF commercial purchases of wheat, a UMR of 100 thousand metric tons will be added to the 1987 Agreement.

3. <u>Producer Price Support and Disincentive Analysis</u>

The MOF food budget (and corresponding fiscal budget) is derived from projections of domestic production (supply) and projected offtake. MOF officials generally recognize the relationship between established floor prices or producer incentives, and expected domestic production in future periods.

The 1982 agreement contained a commitment that the MOF announce its procurement price for each crop harvest season in advance of normal planting dates. We understand that on occasions procurement price announcements have been tardy but this has been rare.

Monthly market, procurement, ration and open market sale prices for wheat and rice by month over the period July 1983 to September 1986 are shown in Annex Tables 9.11 and 9.1 respectively. Prices are in Taka per maund.

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The MOF procurement prices, which apply to all buying centers throughout the country, are set in consultation with the Ministry of Agriculture.

The market price is the average retail market price per unit for Bangladesh markets. The initial open market sales (OMS) price is set by the MOF at a level (15 percent above the procurement price) that will presumably cover all costs associated with the marketing of foodgrains through this channel.

The ration price is the price per maund which ration card-holders must pay to receive their ration allowance. With the ration price being raised close to the open market price, use of the ration channels has declined sharply.

The relationship of monthly open market wheat and rice prices with the official procurement price is shown in Figure 1 and 1a. According to the data, the MOF procurement price of rice has at no time exceeded the average open market price since January, 1981. That for wheat has exceeded the market price in each of the three previous harvest seasons.

Despite this ratio, the MOF has been able to purchase some rice in surplus districts in peak harvest seasons. As it is required to purchase all grains offered which meets minimum standards, MOF officials state that their purchases are often of less than average market quality. This contributes to storage problems and to the difficulty the PFDS has in marketing wheat and rice at the price mark-up stipulated in the Title III Agreement.

We note that both under the present combined US bilateral assistance and PL-480 programs and the proposed program, the SDG-MOF has and will continue to receive assistance to improve crop forcasting and to enhance its efficiency in the management of stocks. We highly endorse these complementary planned activities and projects.

In summary offtake through the Open Market Sales channel fell to a five year low in BDG/FY-1985-86 seriously limiting Taka generations. Some compensatory generations occured from sales to millers and large employers. The MOF was forced to offer some inferior quality rice through the MO and Free Sales channels at less than the OMS sales price. These events illustrate some of the management problems experienced by the MOF in buying, storing and rotating stocks.

Producer Price Supports: The Team examined the performance of the MOF in establishing and maintaining a floor price adequate to cover farm input costs.

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We found no data which would conclusively establish that the acquisition price, set by the MOF in consultation with the Ministry of Agriculture, was adequate to cover all input costs. MOF officials candidly noted that they are not prepared to incurr financial loss by procuring sub-standard wet paddy that does not store for a long time in warehouses.

Data on foodgrain prices for the 1982-86 period are shown in Annex Table 9.1 for Rice and Table 9.11 for wheat. Both show some expected normal seasonal variability but deep drops in post harvest prices which were formarly large have been moderated. Procurement prices have been raised 23 percent for rice and 33 percent for wheat since July 1983.

This is not to say that the FFDS always is able to support market prices in all markets during all harvest seasons (three rice harvests and one wheat harvest season occur). Informants indicated that MOF local acquisitions had been cutoff on occasions when stocks were larger than the food budget balance sheet warranted. This aspect of the MOF management system still needs improvement.

We also examined data series comparing the price of wheat and rice in relation to the whole sale price index (Table 3.9). Both have trended upward at exactly the same rate. By these crude measures, the BDG has at least not allowed wheat and rice price levels to lag behind general inflation.

4

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from Health, Nutrition, and
Economic Crises: Approaches to
Policy in the Third World,
Dover: Auburn House, 1988

A UNICEF Perspective on the Effects of Economic Crises and What Can Be Done

Richard Jolly

The 1980s will almost certainly be recorded by future development historians as a decade of rising poverty and malnutrition in many if not most countries of the world. Certainly this is true for the vast majority of countries in Africa and Latin America. It is probably true also for many of the better-off countries in the Middle East. Even the US, Britain and some of the other industrialized countries have experienced increases in poverty—and possibly in malnutrition among the poorest as well. Only in the economically dynamic Asian countries can one be reasonably sure that malnutrition and poverty are declining rather than increasing—in both the proportion of the population affected and the depth of poverty and malnutrition they experience.

What has been happening in the majority of countries is a widespread and marked *deterioration* in the human condition.[1] Poverty and malnutrition are worsening, not merely persisting as for so long before. Nor, as often before, is it a matter of worsening poverty in some countries with improvements in others. The early 1980s have produced a strong, sustained, and systematic set of downward international pressures on the majority of developing countries, with the consequence that living standards have very seriously deteriorated. There is still time for change, but without it, the second half of the 1980s will be little better.

*A version of this paper was originally prepared for a conference in honor of Prof. H. W. Singer and will be published in *Poverty, Development and Food: Revisited*, edited by Edward Clay and D. John Shaw.

This chapter will focus on the situation and the need for offsetting action in that majority of countries whose economies are open to global influences, especially the economic repercussions of world recession. In most cases, it is extremely difficult to disentangle the effects of global influences from national influences and to distinguish causes from the effects of policy actions they often engender. Such disentangling, while not without interest, is not essential for deciding that remedial action needs to be taken both nationally and internationally. Action is the concern here, just as action for development has been the focus of most of Hans Singer's life work. For this reason, this chapter shows what a broader approach to adjustment policy would involve and how this content relates directly to earlier development concerns with basic needs and redistribution with growth. This is done in five parts:

- The context—rising malnutrition and economic decline in the 1980s
- The impact of adjustment policy
- Adjustment with a human face
- Links with basic needs and redistribution with growth
- Monitoring of the human dimension of adjustment

The Context—Rising Malnutrition and Economic Decline in the 1980s

The increase in the levels of severe and moderate malnutrition of children under age five in six African countries is shown in Figures 4.1 through 4.6. These figures are of double interest. In the first place, they show the seasonal fluctuations in the levels of child malnutrition—a typical situation in predominantly rural countries where for poor families food shortages become increasingly common in the pre-harvest period. For young children, the period of food shortages is often compounded by seasonal patterns in the incidence of diseases like measles or diarrhea, with their own downward pressures on growth and weight gain.

In the second place, the figures highlight the increasing pressures on child nutrition in all parts of Africa in recent years—the starting point of this discussion. Ghana showed the most serious increase of those recorded. The proportion of children moderately or severely malnourished almost doubled from 1980 to 1983. Fortunately, the situation improved somewhat during 1984, though malnutrition levels remained well above those for 1980–81. Botswana and Burundi also record clear increases in the proportion of children malnourished.

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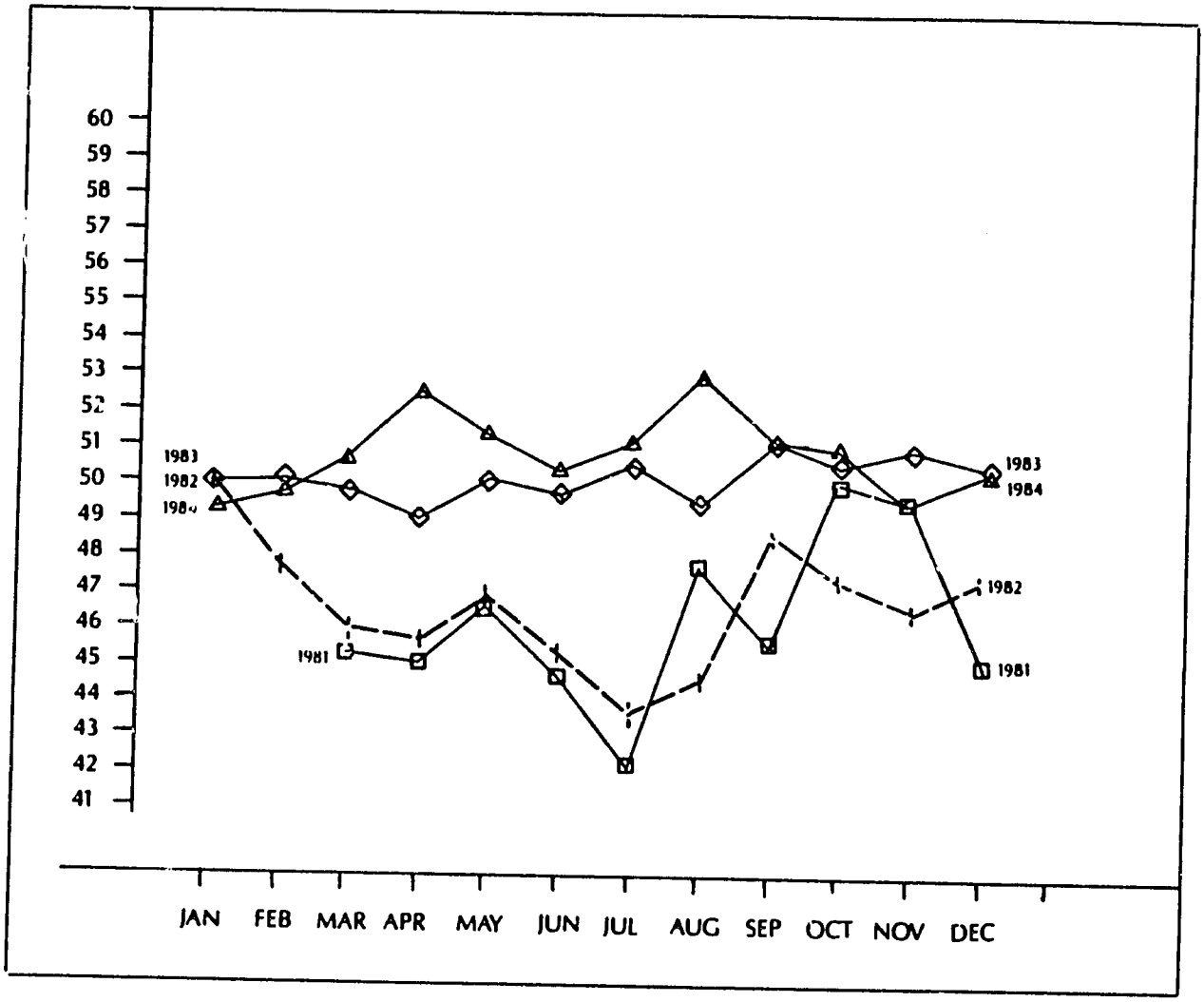

Figure 4.1. *Burundi: Percent of under 5's below 80 percent of Harvard Standard Weight for Age.*

Although the changes in Lesotho, Madagascar and Rwanda are relatively small, one should note that in every case the changes are upward and from unacceptably high base levels—20 percent or so in Lesotho, 30 percent in Rwanda, and 45 percent in Madagascar.

These figures also show the possibility of regularly monitoring nutrition, one of the most basic indicators of the human conditions. But for the moment, let us return to the economic pressures creating or contributing to much of the human deterioration observed.

The forces at work can be illustrated in graphs and references. Figure 4.7 shows schematically the movement over time of per capita consumption (the C curve) in a hypothetical developing country—one highly dependent on primary commodities with an economy open and highly sensitive to changes in the world economy. With deteriorating terms of trade for primary commodities, sluggish world demand for manufactures, rises in interest rates and debt servicing, stagnation in private capital flows, often compounded by other influences, it is not surprising that per capita income has fallen and with it per capita consumption.

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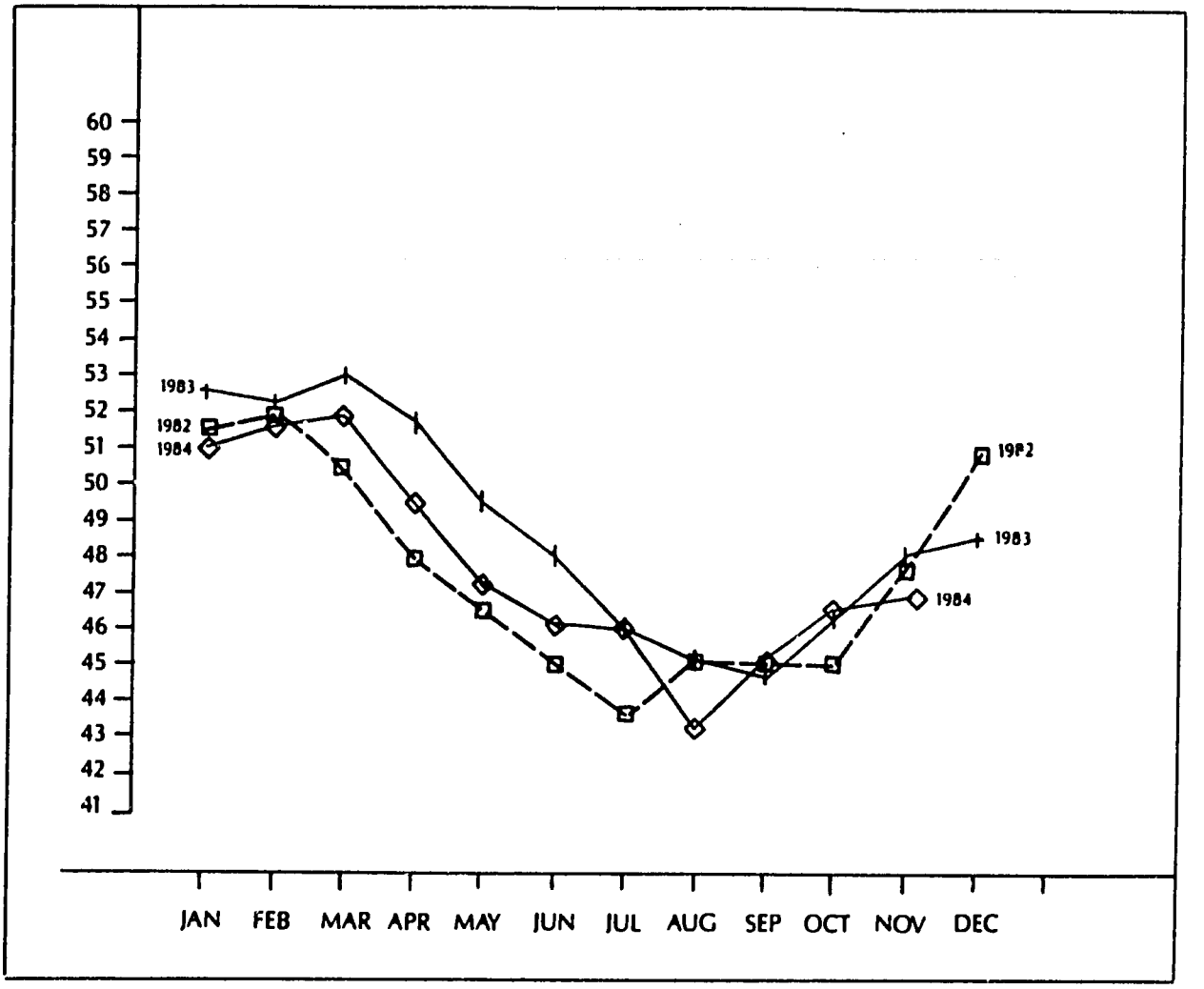

Figure 4.2. *Madagascar: Percent of under 5's below 80 percent of Harvard Standard Weight for Age.*

There are, of course, many possible variations in the decline in income (GNP) and consumption per capita. In Figure 4.7, C^0v shows a sharp fall followed by unmitigated long-term decline. If we assume that "adjustment policy measures" are taken nationally or internationally, and that domestic policies are severely inadequate, without major corrections the downward path of production and per capita consumption seems likely to continue. In other cases, as C^iv, there may be hope of some future upturn if external conditions improve.

A 1983 UNICEF study explored the impact of world recession on children, especially the poor and vulnerable, using data from a dozen country case studies. It showed that the impact was usually magnified rather than diminished in the process of transmission from rich to poor countries and from rich to poor within countries. In general, and in the absence of special offsetting action, world recession took its greatest toll on children. Two major reasons account for this result.

The mechanisms of international transmission usually magnify the economic effects of global recession on the poorer countries. These countries in turn have a greater proportion of their populations poor,

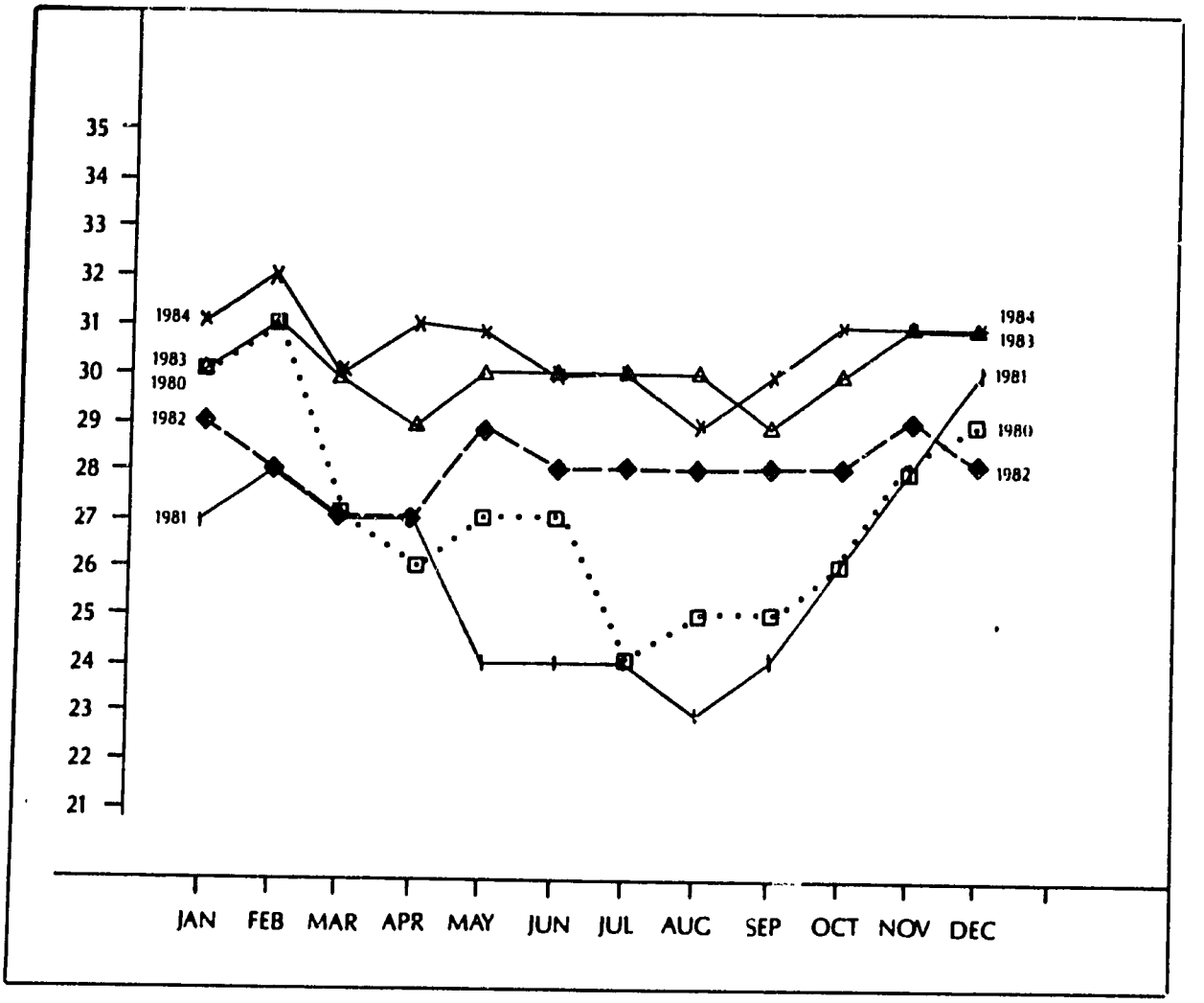

Figure 4.3. *Botswana: Percent of under 5's below 80 percent of Harvard Standard Weight for Age.*

young and in the vulnerable groups. The extent of this multiplied impact is often disguised by referring to *average annual* growth rates for the main regions of the world rather than rates per capita of total *decline since peak year* for individual countries. Table 4.1 summarizes the number of developing countries recording declines in per capita income each year since 1980.

In addition, another six or so countries (twelve in 1985) recorded per capita growth of less than 1 percent per year. Over the period shown, almost two-thirds of the developing countries recorded negative or negligible per capita growth. The lowest income countries of Africa were affected the worst.

The net effect was cumulative decline of a substantial magnitude (over 20 percent, 1980–85) in eighteen of the seventy-nine countries for which we have data and of 10–20 percent in another seventeen. Altogether fifty countries experienced negative growth from 1980–85. These economic setbacks, because of their size and sustained effect, stand in sharp contrast to the slow but mostly positive growth of the industrial countries over the same period.

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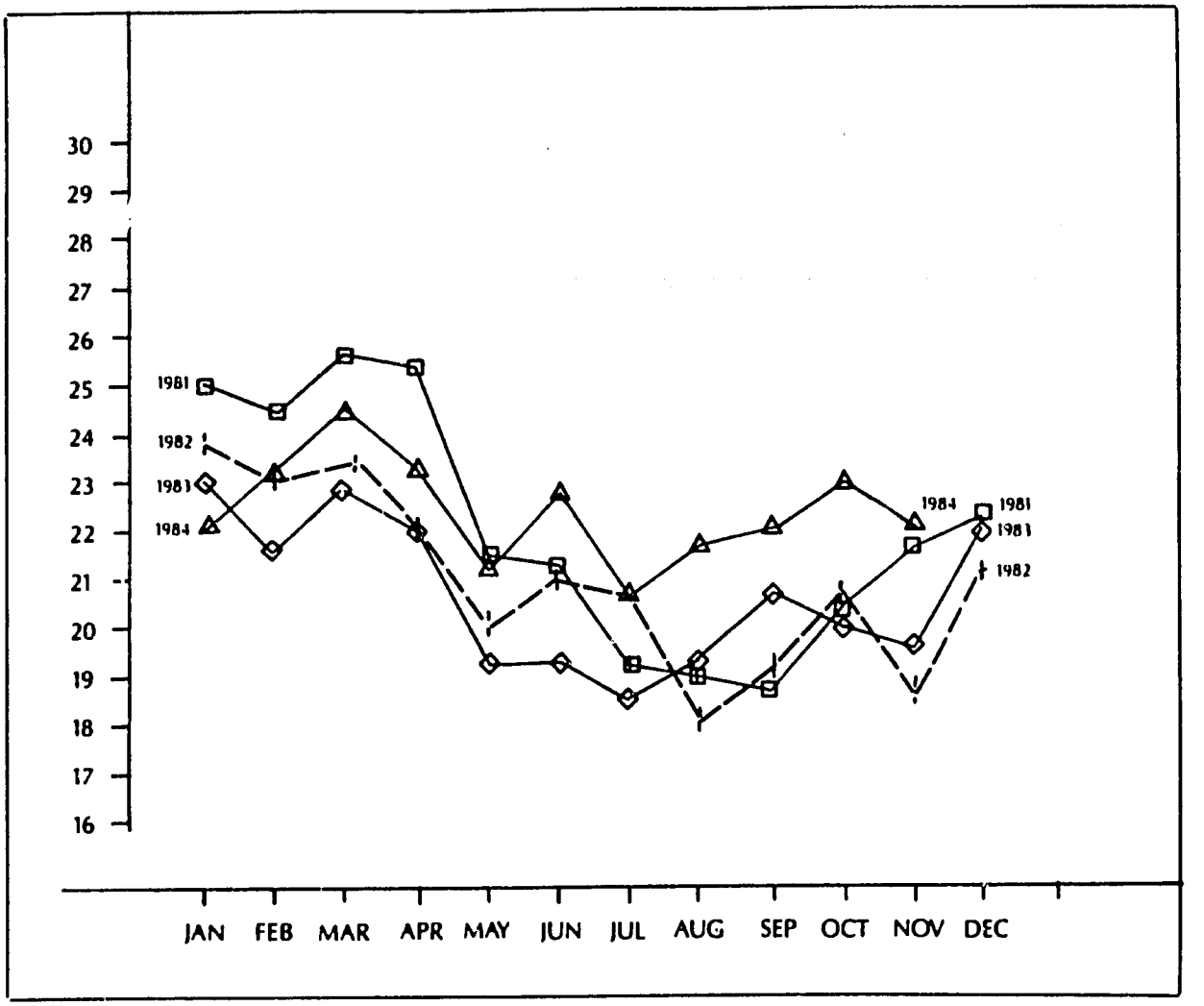

Figure 4.4. *Lesotho: Percent of under 5's below 80 percent of Harvard Standard Weight for Age.*

Within countries, this decline in average per capita income has a magnified impact on the poor and on children. There are three main factors at work:

1. the tendency for cutbacks in employment and wages to hit the poor more severely than the better-off
2. the tendency for health education and other social sectors to be cut back more than the so-called productive sectors of government spending
3. the tendency for poorer families to have larger numbers of children and others who are vulnerable

The effects of declining income are offset for some of the rural population because the more remote rural areas are comparatively insulated from government and the urban and international economy. Just as this part of the rural population commonly received only limited benefits from the expansion of government services, so also it has suffered relatively less from the cutbacks and withdrawal of these services.

Table 4.1
Number of Developing Market Economies with Growth Rates of Real GDP At or Below the Rate of Growth of Population,* 1979–85

	Total Number of Countries	*Number of Affected Countries*						
		1979	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*
All developing market economies	83	26	32	38	55	51	45	49
Africa	32	14	15	21	25	21	25	21
Latin America	23	6	8	12	21	19	11	18
West Asia	14	4	5	5	7	8	8	7
South and East Asia	14	2	4	0	2	3	1	3

*Excluding India.

In Brief, GDP per capita has been declining or stagnating for between half and two-thirds of the eighty-two developing market economies included in the sample, while in 1985, 718 million people, or 42 percent of the population of the developing market economies (excluding India) were affected by negative growth rates of GDP per capita. In Africa 84 percent of the population experienced a negative growth rate in GDP per capita in the same year.

The cumulative decline in GDP per capita experienced by many developing market economies over the 1980–1985 period has been very large in many cases. In about one-fifth of the eighty-two countries the cumulative decline was extremely large (greater than 20 percent). In the next fifth it was also quite severe (between 10 and 20 percent). Only in a little more than a quarter of the countries has there been sustained growth from 1980 to 1985.

Source: United Nations Department of International Economic and Social Affairs, Table II-2. New York: UN-DIESA, 1986.

However, too much should not be made of this insulation. The truly subsistence economy is rare, and subsistence economies have always left much to be desired in the area of basic health and nutrition—especially when land is limited and population has grown. Nevertheless, the change in per capita consumption conveyed in Figure 4.7 may overstate the extent of decline in the subsistence sector where consumption will probably have fluctuated less but around a lower level. The major setbacks in this sector will be more the result of drought and much less the result of national and international factors.

But for major parts of the population, national and international forces will have had a marked effect on household incomes—especially on the incomes of the poor and vulnerable groups, shown as Cv in Figure 4.7. This figure also shows consumption in relation to a minimum level of basic needs (BN) consumption, defined in reference to the minimum requirements for nutrition, clothing, shelter, health and education. The declines of income and consumption soon reduce consumption to levels below minimum requirements, as Figure 4.7 illustrates.

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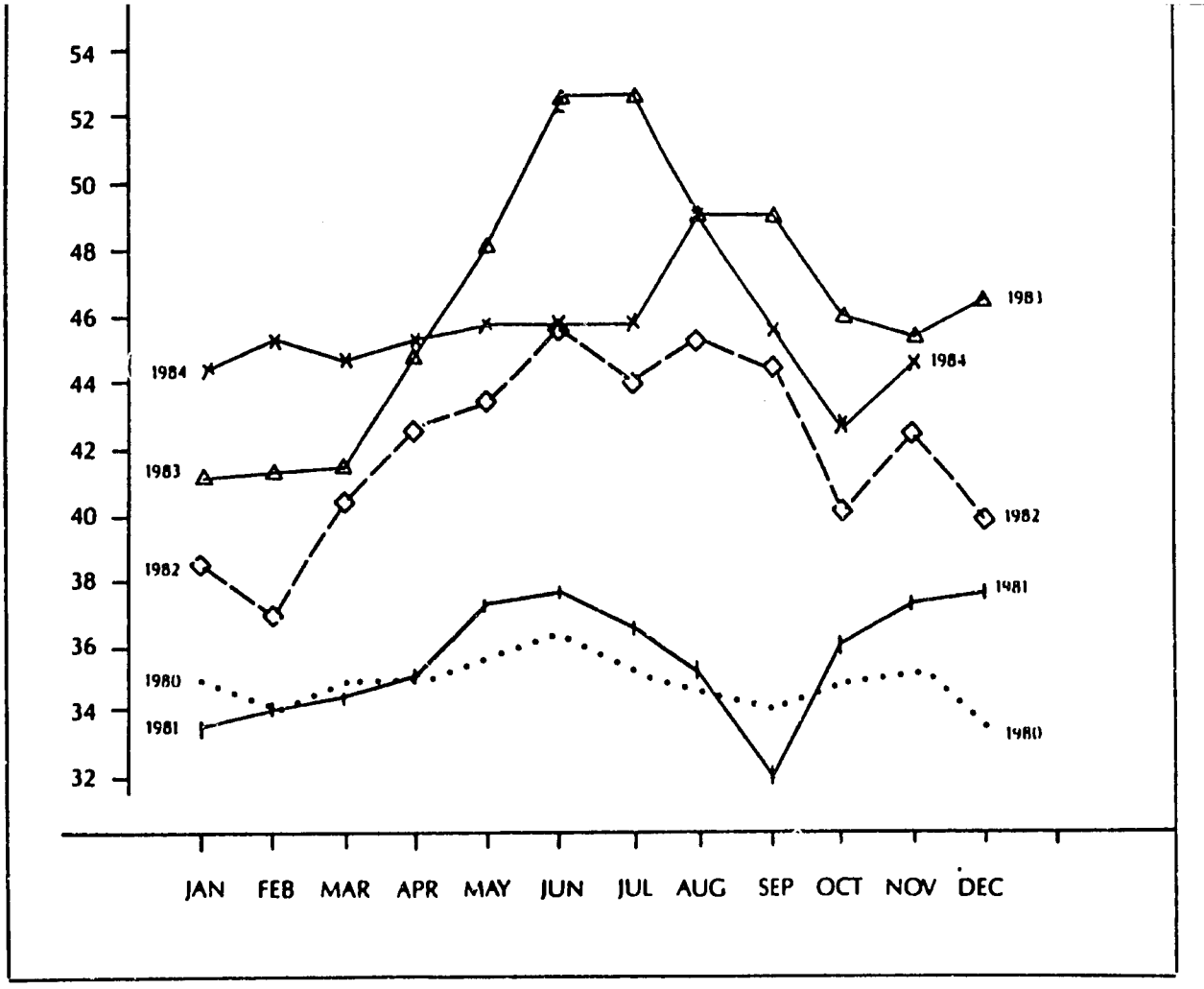

Figure 4.5. *Ghana: Percent of under 5's below 80 percent of Harvard Standard Weight for Age.*

Note that because there is a certain arbitrariness about the precise line, numbers below it may be imprecise—but there is less doubt about changes.

There are, of course, many possible trends in Cv. Figure 4.7 shows perhaps the most favorable of the likely options, in the absence of special action. In this scenario, the consumption pattern of the vulnerable changes pro-rata with per capita income--implying unchanged factor shares and unchanged income shares by income group. However, if all the tendencies listed earlier were operating, Cv would decline even more than shown.

The Impact of Adjustment Policy

So far—at least conceptually—the argument has tried to portray the direct impact of world recession against some background of broadly unchanged domestic and international policy. In practice, there will almost always be some immediate policy adaptations to the worsening

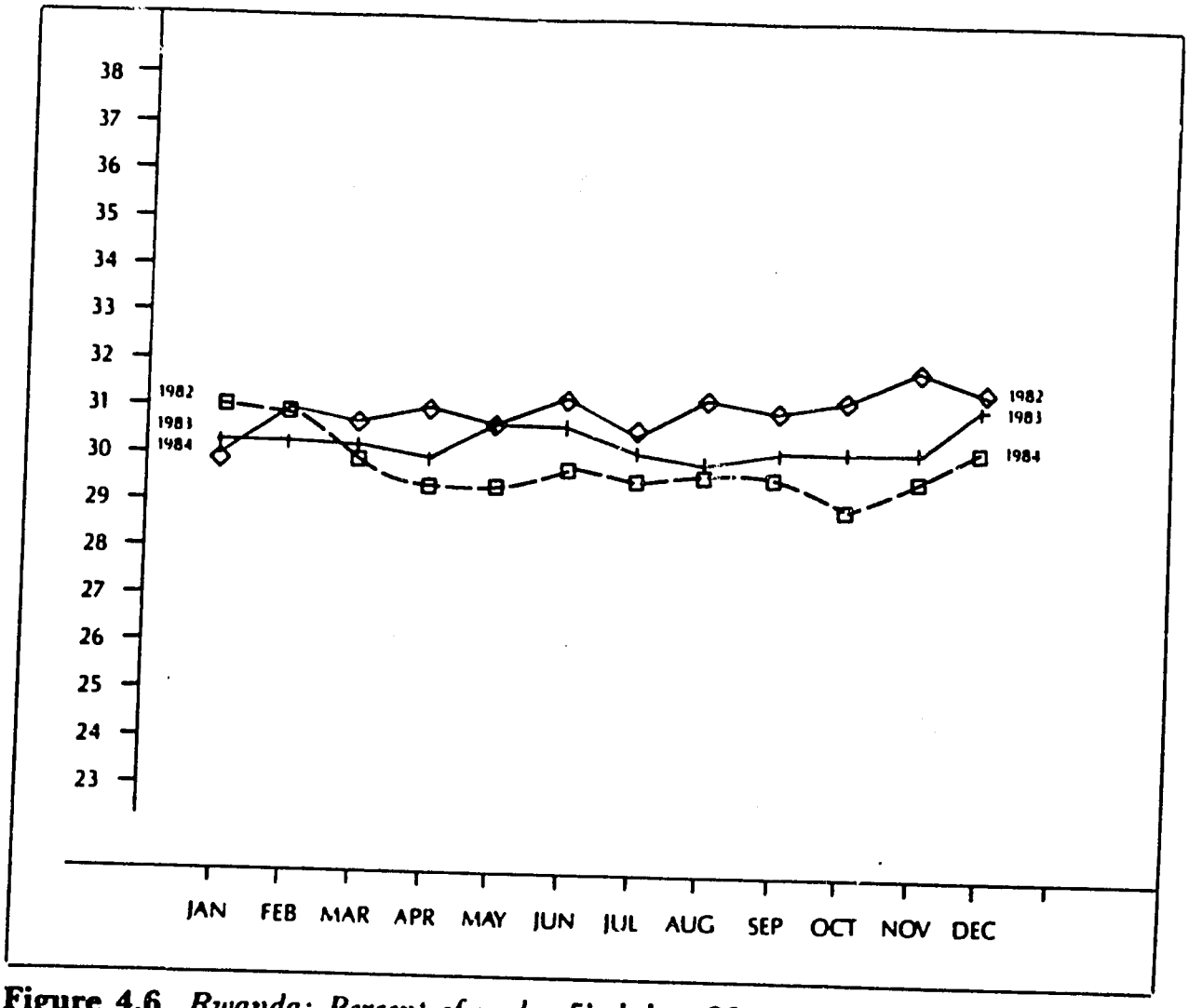

Figure 4.6. *Rwanda: Percent of under 5's below 80 percent of Harvard Standard Weight for Age.*

international situation, but as a frame of reference it will be convenient to ignore them.

What now of national "adjustment policies," that set of domestic policy changes and international pressures and support consciously designed to curb the macro deficits in the balance of payments and the government budget and to restore a pattern of non-inflationary economic growth over the medium term?[2]

These measures of domestic adjustment policy may be adopted independently of any international *quid pro quo* or as part of some formal or informal international agreement, whereby the domestic measures are part of a total package of reform and international financial support. Either way they will further affect the level of consumption and living standards of the population. Usually these measures involve some conscious reduction of consumption in the short run in the hopes of restoring balance, investment, and growth of the economy in the medium to longer run.

This is shown in Figure 4.8 as the curve C'v—a reduction of the consumption curve in the short run and, after a period, some return

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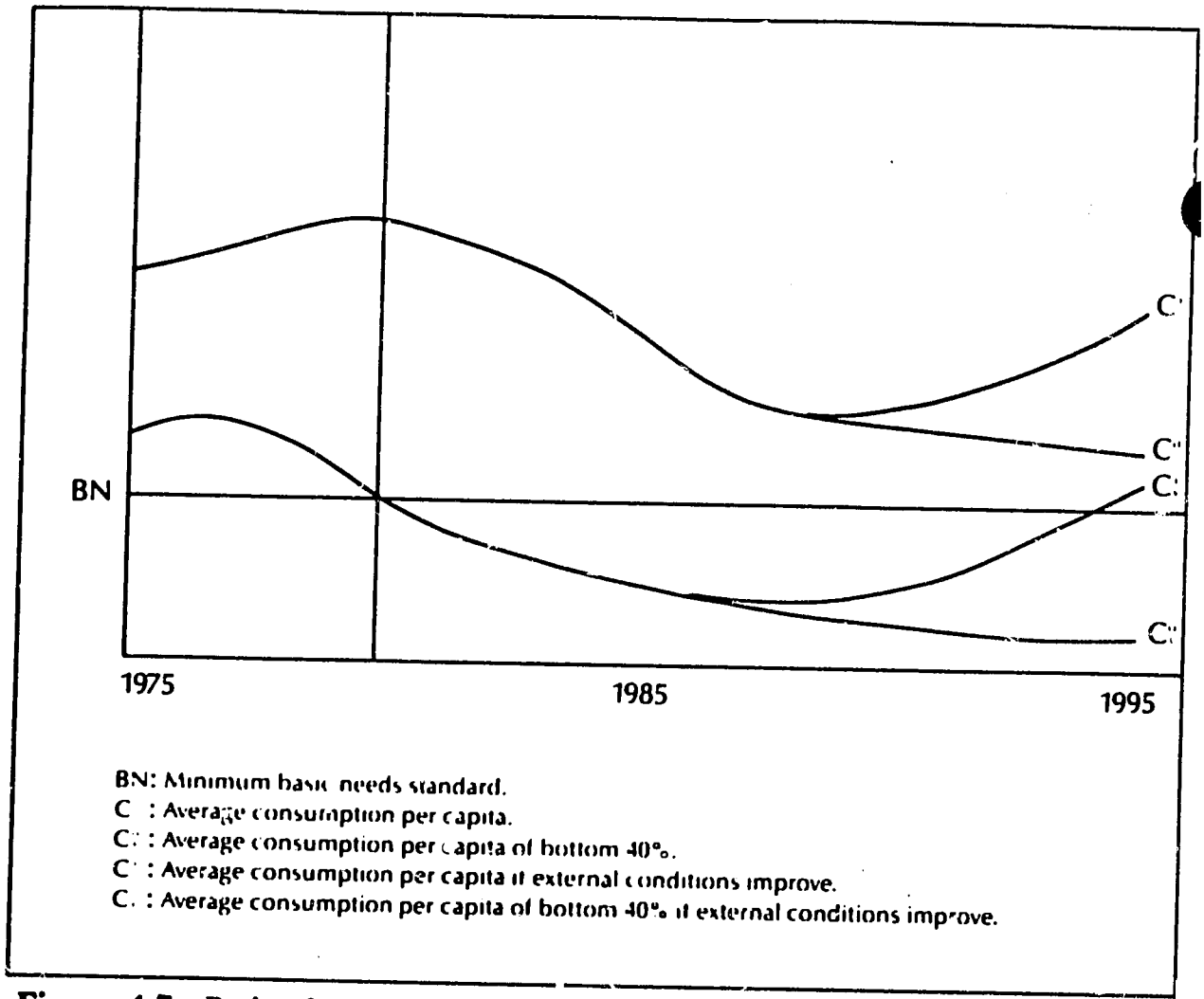

Figure 4.7. *Paths of average per capita consumption and average per capita consumption of bottom 40 percent when no adjustment measures are taken.*

to growth of income and consumption. This addition to growth will result, in principle, both from restructuring the economy and from an extra inflow of funds from abroad. In practice, as the controversy over orthodox adjustment policy shows, neither in theory nor in actual achievement is it clear that the orthodox policies generally have led to such an acceleration or "restoration" of growth.

Recently there have been calls for more growth-oriented adjustment, giving more conscious attention to policies and measures to stimulate growth during and as an objective of the process of adjustment. Figure 4.8 illustrates a more growth-oriented adjustment path as $C^{ii}v$, corresponding to the emerging orthodoxy of a more conscious concern with accelerating growth in the adjustment process. Note that if the adjustment process is accompanied by a marked increase of net foreign exchange inflow from abroad, both $C^{i}v$ and $C^{ii}v$ could be somewhat shifted upwards.

But for the present the purpose of the diagram is to illustrate a separate and simpler point. How are the consumption and the living standards of the poor and vulnerable affected by the process of adjust-

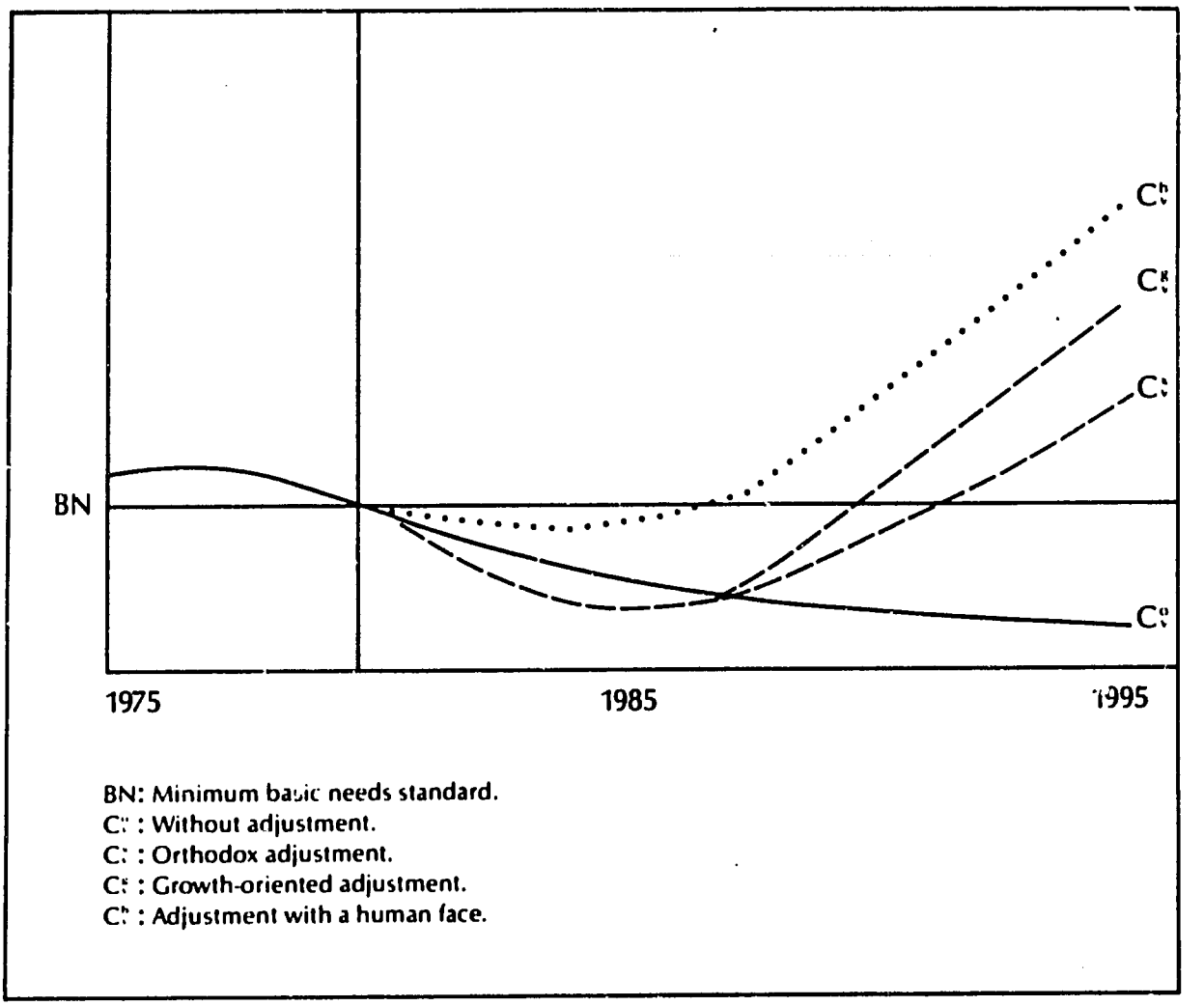

Figure 4.8. *Paths of average per capita consumption of bottom 40 percent under different adjustment policies.*

ment? There are three basic possibilities, corresponding to whether the income distribution effects of the adjustment policies followed are positive, neutral or negative.[3] If neutral, the consumption levels of the poorest will fall by the same proportion as the consumption levels of other groups; if positive, by not so much; if negative, by more.

However, I argue that the critical issue is not whether income distribution as such is worsened or unchanged, but where the consumption and living standards of the population are left in relation to their basic needs. If the proportion of the rural or urban population whose basic minimum needs for nutrition, food, or health are unmet is increased, and if the deficiency between their needs and their actual levels of consumption is also growing, there will be growing numbers in the country who are less and less able to support the process of economic revival and participate in its achievement. In economic parlance, there will be a disinvestment of human capital, affecting both the short and the longer run. In the short run, low levels of nutritional intake and probably increased levels of illness will take direct tolls on productivity

and the informal urban sector. Even in the small scale agricultural sector, where most farmers will have access to their own production, there are likely to be some repercussions as the result of cutbacks in agricultural equipment and materials, essential drugs such as antimalarials, and other things needed for basic services.

The longer-run effects may be even more serious, especially for children under five years old. This is the age group most vulnerable to short-term health and nutritional deficiencies and the period of life over which critical needs cannot be postponed without considerable risk. If the purpose of adjustment policy is to lay the foundations for sustained growth in the economy over the longer term, it is senseless to ignore the most basic needs of the population in the process. Yet if nutrition standards fall or basic health and basic education services are cut back, this is precisely what is being done.

Adjustment with a Human Face

We have now provided the frame within which a broader policy of adjustment with a human face can be illustrated. Such an approach would combine the basic economic elements of adjustment policy with conscious efforts to ensure that the basic nutrition and health and education needs of the entire population are satisfied. This is shown in Figure 4.8 as the curve $C^{iii}v$, which includes special measures to raise the consumption levels of the most vulnerable to the basic needs minimum during the periods of adjustment when consumption levels in general are most constrained. In this respect, the consumption path of the most vulnerable would be kept as near as possible along the horizontal BN line until point BN′, after which it would rise along the curve $C^{iii}v$ as shown.

As I have explained elsewhere (Jolly, 1985), this would involve three types of policy action:

First, a clear acknowledgment in the goals of adjustment policy of concern for basic human welfare and a commitment to protect the minimum nutrition levels of children and other specially vulnerable groups of a country's population.

Second, the implementation of a broader approach to the adjustment process itself, comprising four components:

1. Actions to maintain a minimum floor for nutrition and other basic human needs, related to what the country can in the long term sustain.
2. Restructuring within the productive sectors—agriculture, services, industry—to rely more upon the small-scale, informal sector pro-

ducers and to ensure their greater access to credit, internal markets and other measures which will stimulate growth in their incomes.

3. Restructuring within health, education and other social sectors, to restore momentum and ensure maximum coverage and benefits from constrained and usually reduced resources. Already, there are important examples of what can be done to reach all of a country's population, but still at relatively low cost.
4. More international support for these aspects of adjustment, including more finance, flexibly provided and with longer term commitments. The extremes of the present situation will often require a ceiling on outflows of interest and debt amortization if the protection of human needs is to be feasible in the short run.

Third, a system for monitoring nutrition levels and the human situation during the process of adjustment. We should be concerned not only with inflation, balance of payments, and GNP growth—but also with nutrition, food balances and human growth. The proportion of a nation's households falling below some basic poverty line should be monitored and treated as one of the most relevant statistics for assessing adjustment.

There is one point about adjustment with a human face which is frequently misunderstood. Because the focus is on human need, there is a common tendency, almost a reflex of the economic mind, to think of the program as a welfare program. I would stress that it is primarily a program of enhancing production and investment—in an area of production and investment often overlooked and downplayed in spite of clear economic evidence of the positive and often high economic returns accruing to these activities.

This is not the place to summarize the literature, but it may help to remind readers of the basic points and evidence in the key areas concerned.

Economic Efficiency of the Small-Scale Producer

Many studies have documented the relative efficiency of the small-scale producer, rural or urban. In terms of productivity per acre, use of resources and equipment, and returns to capital, the small-scale farmer usually achieves much better economic efficiency than the large-scale farmer. The same is frequently true of the small-scale urban producer in both the formal and informal sectors, though here the evidence is more limited. A strong case can be made, therefore, for expecting that a shift of emphasis in production to the small-scale producer will increase, not reduce, productivity and growth. There is overwhelming

evidence that increasing production by the small-scale producer is the most effective way to increase incomes in the producer's household.

Labor intensive investment generally is both efficient and employment creating. This was the basis of the East Asian success. It is not, therefore, just a question of *adding* some small-scale production to the existing industrial structure but of changing the industrial structure radically and also shifting to rural industrialization by:

1. promoting small-scale production throughout the economy
2. fostering linkages between the agricultural sector and rural industry and processing

Productivity

Alan Berg (1981) writes:

> Overcoming deficiencies in nutrition produces stronger, more energetic workers, reduces the number of work days lost because of illness, lengthens the working lifespan, and increases cognitive skills. The flow of earnings is thereby increased above what it would have been in the absence of improved nutrition and health. (Berg, 1981: 14).[4]

The same publication summarizes the links between improved nutrition and increases in the benefits to children and society from education family planning programs, anti-poverty programs and, in general human well-being and the capacity "to enjoy whatever sources of human satisfaction are available."

It is important also to recognize that these nutritional benefits accrue to workers in the recognized (or formal sector) part of the labor force but also to others, especially but not only women, who are engaged in household activities which may not be counted in national income but which greatly influence economic production and household living standards.

Investment

Investment, the long-run contribution to enhancing productivity, may be even more important, especially in the case of children. The failure to provide adequate nutrition during the first five years of life may lead to lifelong impairment of all the human and productive capacities mentioned above. The economic evidence of positive returns to basic levels of human investment has been frequently documented. For instance the World Bank's *World Development Report 1980* gives estimates from sixty developing countries showing that the social returns to primary education averaged 22 to 27 percent higher than the typical returns to physical investment. Moreover, the rates of return to primary education

were significantly higher than the returns to secondary and higher education and showed only a mild tendency to decline over time as education expanded. In addition, investment in primary education also tends to be redistributive towards the poor, thus enhancing income distribution *and* poverty alleviation. These direct estimates are supported by the evidence of education's long-run, qualitative benefits to worker productivity: for instance, the effects of primary education of women in improving child care, reducing infant and child mortality rates, and reducing fertility and thus population growth rates.

Evidence of the economic return from basic health services and expenditure is more limited. But there are impressive examples of the high cost-effectiveness of preventive health services over curative, precisely the sorts of health actions to which a basic needs approach would give priority.

The Impact of Adjustment with a Human Face on Economic Growth

With these reminders of the positive contributions to productivity and investment of expenditures on basic needs, it is time to return to the effects of an adjustment strategy protecting human needs on the subsequent path of economic growth and consumption. Figure 4.8 showed this as $C^{iii}v$, in which the upturn took place sooner and the rate of consumption growth was higher than for any of the strategies which omitted direct attention to the human factor.

This, however, is only one of several possible growth paths. It corresponds to a case in which basic needs expenditures strongly and immediately enhance productivity—as, for instance, when the initial deficiencies in health, nutrition and incentives of the active labor force are very considerable. To redress these deficiencies will then have an immediate effect on production.

At the other extreme, if the basic needs expenditures have a weak immediate effect on productivity but the long-run investment effects are strong, the total adjustment package will still help to accelerate economic growth, but only after an interval. In this case, the upward shift of consumption will occur later, as shown in $C^{iii}v$ (b), Figure 4.9.

The relationship of the various C^{iii} paths to the conventional or more growth-oriented adjustment paths (C^{i} or C^{ii}) will also depend on the sources of support for the basic needs measures. If they are taken from consumption of higher income groups, from "unproductive" uses of government expenditure, or from additional foreign aid, the adjustment with a human face path will at every point do as well as the growth-

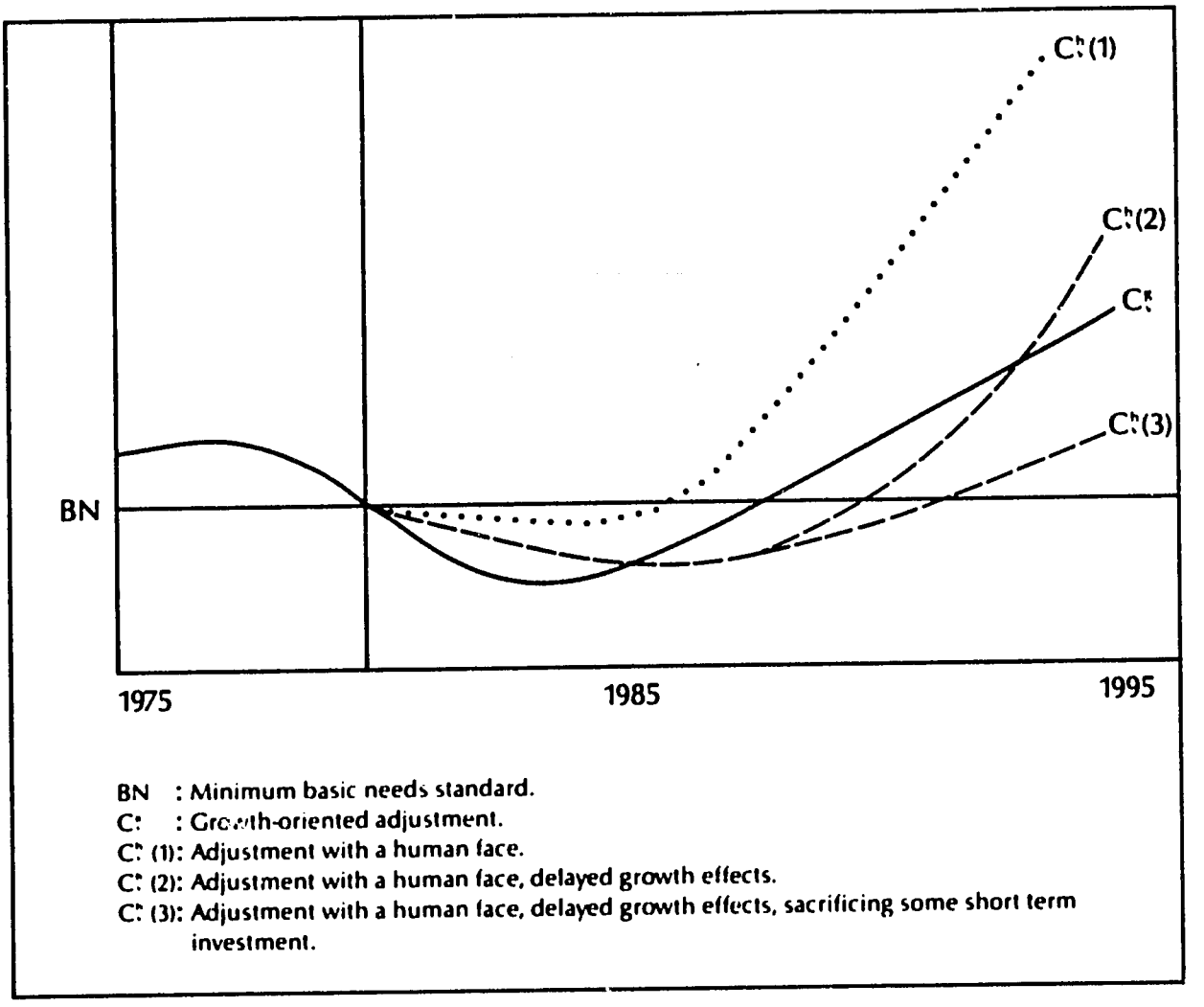

Figure 4.9. *Paths of average per capita consumption of bottom 40 percent under growth-oriented adjustment and alternative options of adjustment with a human face.*

oriented path, and at some point it will accelerate and do better—following some path like $C^{iii(a)}$ or $C^{iii(b)}$. If, however, the sources of support for the basic needs measures are taken from resources which would otherwise have supported the conventional adjustment program, long-run growth may be accelerated, assuming the rates of return on the human investment are higher than those on the foregone investment in physical investment—but it may take longer for the higher returns to materialize. In this case, the curve $C^{iii(c)}$ might start its upward acceleration later than C^{i} or C^{ii} but after a point cross over to produce the greater long-run growth which it promises.

Obviously these are only the polar cases of possible combinations. And it must be emphasized that they are analytical abstractions from a real world in which many other factors, economic, political, social, inevitably enter. But with appropriate attention to the right conditions, it should be possible to aim for a $C^{iii(a)}$ path with as much probability of success as any of the other paths sketched out.

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In the short run, this is likely to be the significant tradeoff, relievable only to the extent that additional outside support is provided to ease it. In the long run, by making more rapid growth possible, this tradeoff can be greatly eased if not made to disappear.

And this is the parallel with the arguments for redistribution with growth or for a basic needs growth strategy. Within a considerable margin of options, one can show that over the long run a country can pursue a positive-sum growth strategy in which all groups can be better off than they would otherwise be, especially but not only the poor. One can identify a number of countries which have in fact achieved just such a combination of growth and increasing basic needs satisfaction, sometimes with considerable redistribution, over the post-war period.

I have stressed the need for restructuring *within* the social sectors, in addition to the continued concern with restructuring the economic sectors. Here I must make another general point of fundamental importance. Adjustment policy with a human face will remain a sham—an attempt to paint a smile on a face with tears—if it is seen only as a matter of a change in the macroeconomic policy of government. Instead it must involve a move to a more people-focused process of adjustment, a more fundamental restructuring—a shift to much greater self-reliance, to decentralization, small-scale production and community action, empowerment of people and households. These are the groups and approaches which in fact provide the goods and services and generate the incomes for the low-income sections of most populations. These are also the sectors which more often than not are squeezed by adjustment approaches as conventionally implemented. Yet for sheer cost-effectiveness, as well as protection for the poor, these are the approaches that matter.

Antecedents

Precisely because this broader approach to adjustment differs from much current thinking, it may be helpful to set it within the context of earlier development thinking. The obvious links, as explained, are with strategies of redistribution with growth and of meeting basic needs. Both were part of the rethinking of development strategy in the early 1970s and both are closely associated with the work of Hans Singer.

Singer himself played an important part in the evolution of redistribution from growth thinking, initially in his contributions to the ILO Kenya Mission report, *Employment, Incomes and Equality*. Later these ideas were generalized and developed more formally in the IDS/World Bank study, *Redistribution with Growth*, which explored both the economic rationale and the approaches for such strategy.

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As Paul Streeten has aptly summed up in the World Bank Study, *First Things First*, the emergence of basic needs thinking in the 1970s was in one sense a

> homecoming. For when the world embarked on development thirty years ago, it was primarily with the needs of the poor in mind. Third World leaders wanted economic as well as political independence, but independence was to be used for man's self-fulfillment. The process got sidetracked. . . . (Streeten, 1981).

Streeten points out the compelling logic of basic needs. It is not only a strategy for efficiently meeting the needs of the poorest 40 percent of the population but of increasing their productivity and thereby enabling them to contribute efficiently to their own development and the alleviation of their own poverty.

In the same book, Mahbub ul-Haq sums up the core of the argument (Streeten, 1981).

> It is true that the only way absolute poverty can be eliminated on a permanent and sustainable basis, is to increase the productivity of the poor. But direct methods to increase the productivity of the poor need to be supplemented with efforts to provide their unmet basic needs, for at least the following four reasons:
>
> - First, education and health are required—in addition to machines, land, and credit—to increase productivity. Sufficient empirical evidence is now available to suggest that education and health services often make a greater contribution to improving labor productivity than do most alternative investments.
> - Second, many poor people have no physical assets—neither a small farm nor a small industry. They are the landless or urban poor. The only asset they possess is their own two hands and their willingness to work. In such a situation the best investment is in human resource development.
> - Third, it is not enough to enable the poor to earn a reasonable income. They also need goods and services on which to spend their income. Markets do not always supply wage goods, particularly public services. Greater production of wage goods and the expansion and redistribution of public services become essential if basic needs of the majority of the population are to be met.
> - Finally, it may take a long time to increase the productivity of the absolute poor to a level at which they can afford at least the minimum bundle of basic needs for a productive life. In the interim, some income groups—particularly the bottom 10 to 20 percent—may need short-term subsidy programmes.

This quotation underlines again the basic argument for making the protection of basic needs the highest priority in the adjustment process.

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With this priority, the living standard of the poor will not only be protected, but their productivity will be considerably enhanced. Indeed, without concern for the human dimension, not only will productivity be set back, but investment in the next generation will also decline.

Monitoring the Human Dimensions of Adjustment

If human concerns are to be given proper attention during the process of adjustment, it will be essential to develop some monitoring system to ensure that some indicators of the extent to which human needs are met or unmet are regularly and rapidly collected, analyzed and published in a form which policymakers can take into account in devising remedial action. Experience suggests this is less momentous a task than might at first appear, even in data-weak, low-income countries. Many of the indicators required are already being collected in the course of day-to-day operations by the government departments or private organizations working at the grassroots level and in touch with poor and vulnerable communities. The statistical reliability of this information may not be perfect—but, almost by definition, it matches the administrative capacity and outreach of the services available to play some role in remedial action. The challenge is therefore to develop ways to ensure that this data is used for monitoring and policymaking at the regional and national level, not only at the level at which the data are originally collected.

The data on nutritional status given earlier in Figures 4.1 through 4.6 provide an excellent example. In the case of Botswana the data are collected as part of regular and largely routine nationwide child health activities, whereby each child is weighed monthly at a health clinic, the weight recorded on weight charts and the clinic takes remedial action as necessary including the distribution of food supplements. In Ghana and the other four countries presented, the data on nutritional status are obtained directly from the food distribution services run by the Catho- lic Relief Services. In these cases, because only a fraction of the country's children are covered by the services and because child weighing is used to determine eligibility for free food, the sample of children covered by the data is undoubtedly biased. But for purposes of monitoring *changes* in the nutritional status of the poorest, including the adequacy of remedial action, the data are both highly relevant and well focused. Some 250,000 children in Ghana are covered by the data, and tabulations are available separately for all ten provinces. Even if coverage is partial, the picture presented of the month-by-month and year-by-year changes in nutritional status is highly indicative and probably much less biased statistically as an indicator of the position of the poorer

sections of the population than most of the other statistical indicators available.

In addition to these data, the need for two other classes of information can be identified. First, there is the range of more conventional social indicators already widely collected, analyzed and used—such as school enrollment data, basic health care service data, consumer price and income data, production data from farms and small-scale producers, urban and rural. Here the issue is timeliness and focus. Unlike most of the economic data used for adjustment policy, where collection, processing and often publication is expected and achieved in two or three months, the statistical lag between collection and publication for the human indicators is usually two or three years—if that. The result is that even when willing, economic policymakers seeking to include human concerns into their adjustment deliberations are starved of the data which they need to do so. A priority in every country should be to develop a system for producing a core of human indicators with the same urgency and priority as is routinely accorded to some of the core economic statistics.

The second class of data required relates to the functioning of the key parts of government administration which support the poor and vulnerable. One needs indicators of the adequacy and effectiveness of these services in reaching out to the poor and in responding to their needs. Sample surveys and the routine statistical services have an important part to play in all this.

Even with increased timeliness and a sharper focusing on a critical core of indicators, there will still be a lag between data availability and the indicators needed for policymaking. It is here that the world of social concerns needs to borrow from the world of economic concerns. Some short set of leading social indicators is needed, akin to the leading economic indicators regularly compiled and considered in many of the industrial countries. These should be available some six to nine months ahead to indicate likely trends in the human situation, based on such statistics as:

household foodstocks at end of last harvest

forecast rainfall

planned government expenditures in key areas such as primary health care

vaccines and essential drugs

maintenance of village water supplies

credit for small farmer inputs and small-scale industrial producers

As before, the issue is not the lack of data or the intrinsic difficulty of devising appropriate weights for an effective system of leading indicators. The essential issue is one of perceptions and priorities. To recognize that the human dimension is central to the formulation of all economic policy and, especially at times of severe economic constraint and adjustment, cannot be assumed to follow as an inevitable by-product of general economic policy. There is a need for conscious attention to the human dimensions and for indicators to guide this.

Interestingly, this was the Keynesian lesson of the 1930s out of which grew direct concern with the level of unemployment in the formulation of macroeconomic policy and from which, in turn, grew the present system of national accounts which provides a focus and priority of much of the economic statistical work in most countries. Ironically, it was this original *social* and *human* concern underlying GNP which is now being lost in the over-preoccupation with GNP and the neglect of the human dimensions of the people involved in its creation and use.

Notes

1. Paradoxically, the sheer size of China and India, accounting for almost 40 percent of the world's population, makes it difficult to be sure whether (in terms of the total number of persons affected) worldwide *poverty and malnutrition* is growing, constant or declining. The economies of China and India by their size and structure are relatively insulated from world economic repercussions, their populations therefore being more affected by domestic changes of policy, the results of which in terms of poverty and malnutrition are not yet clear.
2. This is an orthodox and optimistic view of the *goals* of adjustment policy. Critics would point out that the actual measures of adjustment adopted often fail to achieve these goals—as some of the IMF's own evaluations have made clear. There is also the matter of *international* adjustment policy, international action (or inaction) to correct major imbalances in the pattern of trade or income flows between countries, or of deficiencies in the total level of global economic activity. We return to this point later.
3. The measurement of income distribution is complex. Here I refer to the effects of income distribution on consumption levels of the poor and vulnerable, that is, on Cv.
4. See also World Bank, *Poverty and Hunger*, 1986.

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The Impact of Economic Adjustment Programs

Jere R. Behrman

Difficulties in Analyzing the Impact of Economic Adjustment Policies on Health and Nutrition

The analysis of the impact of economic adjustment policies on health and nutrition is very difficult for a number of reasons:

1. There is considerable disagreement about the impact of standard economic adjustment policies on macroeconomic outcomes such as aggregate demand and supply, imports, exports, international financial flows, inflation, and employment.

2. Whatever the impact on such basic aggregate macroeconomic indicators, the effects on health and nutrition depend critically on changes in composition at various levels, including the nature of income and asset distributions, the breakdown of governmental expenditures and revenues, and relative prices. The health and nutrition effects are likely to be most deleterious if the real resources available to the poorest members of society are reduced by adjustment policies. The poorest groups typically include landless rural laborers, subsistence and small farmers, informal sector urban workers, and disabled or elderly individuals and children. Real output reductions or cuts in social services due to adjustment policies may hit some of these groups hard, but others—such as subsistence farmers—may be unaffected. Moreover, relative price movements may benefit some of these groups at the same time they disadvantage others—e.g., increases in relative food prices may harm poor urban dwellers and at the same time give poor rural producers and agricultural laborers increased purchasing power.

3. The proximate determinants of health and nutrition are the decisions of individuals and households, given their assets and the prices (broadly defined) that they face. But individuals and households have considerable capacities for substitution among products and activities given changes in relative prices. Well documented examples include short-run and longer-run migration in response to employment options, substitution of lower cost sources of nutrients in response to adverse relative price or income shifts, substitution over time by dissaving, sub-

stitution of informal for formal sector activities, and even human energy expenditure adaptations to nutrient intakes.

4. The effects of the components of stereotypical adjustment programs on health and nutrition may partially offset each other and may appear with differential lags. The so-called J-curve response in the balance of payments to devaluation, in which there is observed an initial deterioration and then an improvement, is but one of many possible examples.

5. The empirical basis for monitoring and assessing health and nutrition outcomes and the many complicated links in the overall process is very weak or almost nonexistent in many cases. Therefore deductions often are made on the basis of very imperfect information such as indices of inputs rather than of outputs.

6. The phenomena under examination are complex and are embedded in a complicated, dynamically evolving context. This makes it difficult to maintain *ceteris paribus* assumptions. But without such assumptions, it is almost impossible to identify the health and nutrition impact of economic adjustment policies or to ask the appropriate hypothetical questions, i.e., what would have been health and nutrition without the adjustment policies or with a different economic adjustment policy package?

FIRST DRAFT
COMMENTS WELCOME

THE SOCIOECONOMIC IMPACT OF MACROECONOMIC ADJUSTMENT

Center for Development Technology
International Science and Technology Institute

December 1, 1987

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Macroeconomic Services

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V.B Findings of Existing Studies

V.B.1 Degree, Duration and Distribution of Hardship Associated with Adjustment

For a variety of reasons, getting out of the "transition" and into the "sustained growth" has taken much longer than expected in most countries undergoing systematic adjustment. External conditions remain unfavorable. The weight of debt overhang is consequently very heavy. Often implementation of adjustment programs has not proceeded as planned due to rapid changes in external factors, political tensions associated with reform, unexpected bad weather, etc. Private sector response to adjustment measures has been cautious, partly due to considerable uncertainties about government commitment to reform.

Existing studies largely document the hardships of the transition, particularly during (a) initial contractionary periods associated with stabilization, and (b) ensuing and often extended periods of recovery. Here we report the findings of existing studies on related socioeconomic trends, particularly trends in employment, incomes, consumption, poverty incidence, health and nutrition, and access to social services.

Before we turn to specific findings, it is worth stressing that the studies reveal significant variation between countries

[4] Thus the main questions in the debate prompted by UNICEF: was deterioration caused by the nature of the adjustment strategy and therefore could have been avoided? or did it result from continued adverse developments in external conditions? or was it exacerbated by the government's failure to implement the adjustment program as planned? or were non-policy factors such as weather and civil unrest integrally involved?

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:

(1) 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 Subsaharan Africa.

(2) 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).

(3) 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 into 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.

The distribution of hardship varies across countries according to the adjustment strategy and its interaction with patterns of employment, income generation, asset ownership and other aspects of the socioeconomic structure. But, in general, **urban groups are far more likely to experience acute difficulties than their rural counterparts.** Urban-based sectors of the economy tend to be much more dramatically affected by adjustment measures. Lay-offs occurring in the early phases of adjustment

are concentrated in urban-based formal sector firms, public enterprises and government. Urban consumption patterns tend to have higher import content than rural patterns, so purchasing power of income is more strongly eroded by measures raising prices of imports, notably food. Contraction of formal sector employment and incomes, as well as spill-over of laid-off workers into informal sector activities, can depress incomes of informal sector workers through a multiplier process.

Concentration of adjustment-related hardship in urban areas is therefore said to have an equalizing distributional effect, since (a) urban residents have higher incomes on average than their rural counterparts, and (b) the incidence of absolute poverty tends to be lower in urban than in rural areas.[5] This is of little consolation for two reasons. First, the relatively high urban average often derives from a very unequal urban income distribution, where a large share of total income is concentrated in middle- to upper-income groups. Thus, the information content of the average may be low.

Second, relatively lower incidence of poverty in urban areas does not mean that the incidence of poverty is low in absolute terms. On average, rural poverty incidence is 15 to 25 percentage points higher than urban poverty incidence in Asia, Latin America and the Caribbean, and Subsaharan Africa; the difference is much narrower in North Africa. Nonetheless, one-quarter to one-third of urban populations are poor. Moreover, after decades of rapid urbanization, urban areas are now home to large shares of the population, especially in Asia, Latin America and the Caribbean, and North Africa. Consequently, in these regions one-quarter to one-half of all poor people live in urban areas. In Subsaharan Africa, in contrast, only 15% of all poor people are found in the cities and larger towns.

In short, the urban concentration of negative effects of adjustment may indeed equalize rural/urban income distribution. But of and within itself, equalization of incomes is not desirable since, especially during contractionary phases of adjustment, equalization may be associated with serious deterioration in the absolute living standards of lower-income groups.

V.B.2 Adjustment and Employment

Unemployment. As expected, unemployment has tended to increase in the early phases of adjustment when fiscal and monetary contraction are being used to stabilize the economy. In Chile, unemployment rose from 6% to 17% in the mid-1970s when the

[5] This is the case in 24 of 32 countries for which data are available in the World Bank's Social Indicators of Development 1987.

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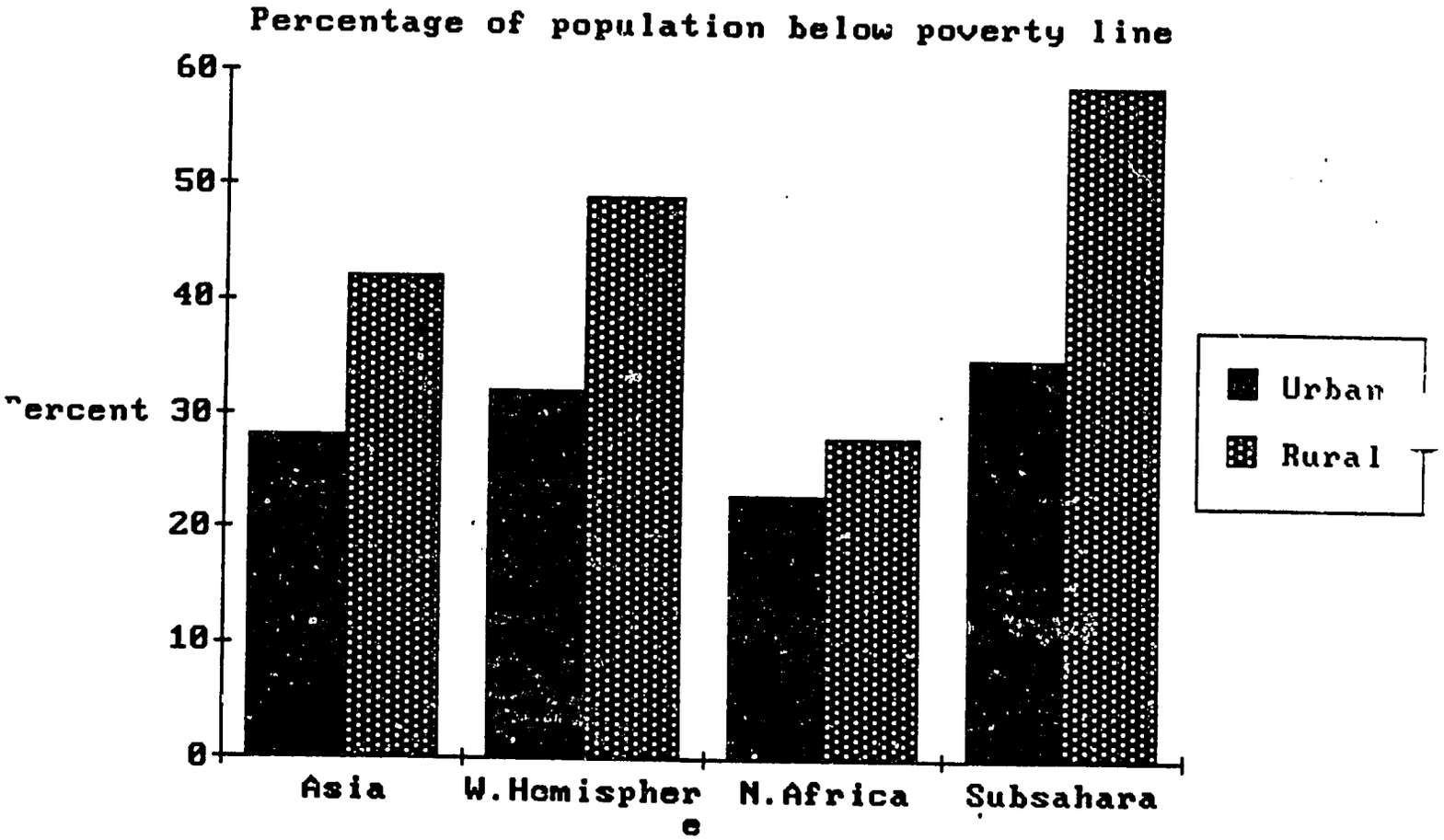
Percentage of population below poverty line
60
50
40
30
20
10
0
Percent
Asia
W.Hemisphere
N.Africa
Subsahara
Urban
Rural

country's long-standing orthodox stabilization efforts were initiated . Elsewhere in Latin America, systematic adjustment began around the time of the 1980s world recession when net capital inflows dried up. Where resulting contraction was severe, unemployment increased substantially.[6]

Urban-based unskilled workers were particularly affected by contraction in job opportunities.[7] Investment levels declined sharply in the adjustment process since (a) the brunt of government spending cutbacks fell on the investment budget, and (b) private investment also contracted due to depressed aggregate demand, considerable economic uncertainty, and incentives for capital flight.[8] The associated slowdown in construction activity sharply reduced jobs for manual laborers, many of whom tended to be recent migrants to the cities and only casually employed.

In Subsaharan Africa, unemployment trends cannot be documented. Labor market statistics cover only the 10% or so of the labor force employed in the formal sector. However, data from a handful of countries - Cote d'Ivoire, Malawi, Zambia - do show reductions in total formal sector employment during contractionary phases of adjustment. Very little can be said with precision about this reduction except that three factors are involved. First, as in Latin America, deficit reduction efforts have involved sharp cutbacks in public investment and related drying up of construction jobs for unskilled laborers.

Second, in selected countries,[9] efforts are being made to scale back employment in government and public enterprises to reduce government expenditures on wages and salaries and transfers to PEs. In general, government staff reduction programs have focused on trimming back the ranks of lower-level employees since overstaffing was perceived to be most pronounced at this level. Particularly affected have been those without tenure in the civil service.

Third, reductions in current account deficits have been realized through severe reductions in imports, given perceived difficulties in increasing export revenues in the short run. In some places, this has given rise to "import strangulation", i.e. private firms' inability to get imported intermediate inputs

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[6] Pfeffermann (1986); Altimar (1985).

[7] Pfeffermann (1986); Altimar (1985); Ffrench-Davis and Raczynski (1987).

[8] Thus, for Latin America as a whole, real per capita investment fell by 33% between 1978 and 1984 (Musgrove 1987).

[9] C.A.R., Gambia, Ghana, Guinea, Guinea-Bissau, Mali, Nigeria, Somalia, Zambia.

necessary for production. Lay-offs have resulted, again apparently concentrated among lower-skilled workers since firms have tried to hang onto experienced, skilled workers till crises pass.

Shifting employment patterns. Few studies or statistical sources permit documentation of how employment patterns have shifted over time following initiation of systematic adjustment. Available information is therefore primarily suggestive.

In the absence of government-provided safety nets, many urban workers laid off from paid jobs take up casual work or informal sector activities. In Costa Rica, this produced an increase in underemployment: the share of the work force classified as "underemployed" rose from 8% to over 13% during the 1980-82 crisis. In Chile, the crisis of the early 1980s exacerbated employment instability among the lower echelons of the work force: a study of the slums of Greater Santiago found that less than 50% of the economically active population had a stable job. However, in many Latin American countries, this trend reversed itself as recovery proceeded, i.e. people were drawn out of low-income informal or casual activities back into better-paying, more stable jobs.[10]

Elimination of price controls appears to have created new opportunities in informal sector commerce in some Subsaharan countries; for example, in Ghana, the "renaissance of legal trade" attracted many of the laid-off workers from the civil service and public enterprise. In Ghana and Nigeria, increased involvement in informal sector food processing is reported to have accompanied higher prices of food imports, as consumers shifted to lower-priced domestic substitutes (e.g. cassava).

Rural-urban migration decelerated in Brazil and Mexico, as urban job opportunities contracted. In Costa Rica, employment in agriculture increased during the worst year of the crisis, partly because the extent of erosion in real wages made it attractive for farm owners to hire more workers (see below). However, this trend reversed itself when recovery was underway. In some Subsaharan African countries (e.g. Ghana and Nigeria), urban contraction - as well as improvements in the rural sector's terms of trade - reportedly provoked some urban-rural migration, though this trend has not been statistically documented.[11]

The labor force participation rate increased markedly in Costa Rica during the crisis, as non-heads of household entered

[10] Fields (1986); Ffrench-Davis and Raczynski (1987); Pfeffermann (1986).

[11] Pfeffermann (1986); Collier (1985); West Africa, various issues.

the labor force to compensate for sharp reductions in family income. Poorer households were particularly likely to intensify their labor force involvement as a coping strategy: among this group, 12% more household members of economically active age joined the labor force, of which three-quarters found work. But again this trend reversed itself as the economy recovered.[12]

In some countries, governments and donors have set up emergency employment programs to buffer hardships of economic contraction and related displacement of workers. The Chilean programs have provided work for 5-13% of the labor force. Pay is set at below minimum income to avoid creating incentives for permanent dependence on government assistance, but the programs have played an important role in supplementing and reducing the variability of poor households' incomes. Few Subsaharan African countries have such safety net programs in place. International agencies have therefore been more involved in setting up and financing schemes to alleviate hardships in worker displacement. The ILO in particular is supporting schemes to help laid-off public sector employees resettle in private sector activities via training and small business credit programs, agricultural resettlement schemes, and emergency public works programs.

V.B.3 Adjustment and Incomes

Trends in GDP per capita. In many countries undergoing adjustment, GDP per capita declined in the early- to mid-1980s, reflecting the combined influences of economic contraction or stagnation with continued high rates of population growth. In 1986, per capita GDP was 15% lower than it was in 1978 in Subsaharan Africa and almost 10% lower in the 15 heavily-indebted countries. In contrast, it was 25% higher in countries primarily exporting manufactured goods.[13]

Of and within themselves, these trends suggest declining living standards of worrisome proportions in countries with adjustment problems. Of course, trends pick up the multiplicity of factors influencing aggregate economic performance, including all the adverse external developments discussed above. Indeed, very simple statistical analysis confirms intuition about the severity of the adjustment problem and trends in per capita income: **GDP per capita has tended to decline more rapidly in countries facing heavy debt burdens and significant terms of trade deterioration than it has in countries facing less adverse external developments.**[14]

[12]Fields (1986); Altimar (1985).

[13]IMF World Economic Outlook 1987.

[14]See Appendix Table to be inserted.

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There is still a considerable amount of "noise" left in data on trends in per capita GDP, i.e. these external conditions explain only a small part of the variance between countries in trends in per capita GDP. No doubt more variance could be explained through incorporating factors connected to adjustment strategy and other exogenous developments (e.g. rainfall), though such a task is clearly beyond the scope of this paper. Nonetheless, it is clear that, in the 1980s, acute adjustment problems have been associated with marked compression in average living standards, whether on a short-lived or persistent basis.

Other information on incomes. Of course, trends in GDP per capita do not provide any information on two issues of key concern: (a) how reductions in income are distributed among socioeconomic groups, and (b) how the incomes of the poor have been affected by economic stagnation or contraction. Labor market and household surveys provide important supplementary information in this regard.

Data on real wages for Latin America and Subsaharan Africa show that, for urban wage earners, nominal wage increases have lagged far behind rates of inflation in the 1980s, resulting in marked erosion of real wages.[15] In Mexico, real wages fell by over 25% between 1981 and 1983. In Brazil, unskilled workers' wages dropped by almost one-third between 1980 and 1985. In Costa Rica, average wages fell nearly 40% between 1979 and 1982 due to a bout of severe inflation. Real wages have recovered somewhat as countries pulled out of the crises of the early 1980s. But for the most part real wages remain below their pre-crisis level.

In Subsaharan Africa, governments have exercised high degrees of restraint in adjusting public sector pay scales for inflation, first as part of ad hoc adjustment strategies and now in accordance with terms of IMF agreements. Given the rapid rates of inflation prevailing until recently, nominal wage restraint has resulted in prolonged and sometimes severe real erosion of public sector and legislated wages.[16] Though there is substantial variation between countries, on average, the official minimum wage now commands one-half of the purchasing power it commanded fifteen years ago.

There is no clear pattern across countries as to how income reductions have been distributed within the urban wage-earning work force. Altimar (1985) documents trends between 1979 and 1982 in five Latin American countries. In Chile during this period, households at the bottom and the top of the income distribution experienced the largest percentage reductions in

[15] Bianchi et al (1986); Pfeffermann (1986).

[16] Lindauer et al (1985); Harris and Starr (1987).

income, whereas those in upper-middle income categories did much better than average. In Panama, the exact opposite pattern emerged: middle-income groups suffered the largest percentage reductions in income, while those at the tails did better than average. In Colombia, incomes of blue collar and self-employed workers fell by less than incomes of employers, professionals, and managers. A similar pattern occurred in Costa Rica. In Venezuela, low-income households experienced larger than average reductions in income in Caracas but smaller than average reductions in agricultural regions.

Little can be said about the incomes of those outside of the urban wage-earning sector in Latin America. Real agricultural prices increased in Brazil, Chile and Mexico. At least in Brazil, the terms of trade shifted in favor of farmers and against the urban sector. While this benefited farmers, it had an adverse impact on the poorest group within society: landless farm laborers. For this group, higher food prices contributed to significant reductions in their real wages, in the order of 30% in Brazil and Mexico.[17]

In Subsaharan Africa, there is some evidence that (a) income reductions have been most pronounced among mid- to upper-income groups, and consequently (b) the degree of dispersion in incomes has narrowed since the mid-1970s. Within the public sector, salaries of higher-level staff have received much less protection from inflation than those of lower-level staff. This has significantly squeezed skill differentials, as the real salaries of the former have fallen substantially more than those of the latter in relative terms.[18]

At the same time, restraint in adjusting legislated wages for inflation appears to have eroded differentials between formal sector wages and incomes in the informal or agricultural sectors. For example, between 1970 and the mid-1980s, the average differential between the minimum wage and average agricultural income was cut in half. Indeed, in a number of countries in the mid-1980s, real legislated wages virtually collapsed, falling to 10-20% of their value 15 years earlier (Ghana, Somalia, Sudan, Zaire). In these places, minimum wage workers - once a relatively privileged group - received paychecks below the average agricultural income. However, most no doubt had extensive involvement in other income-generating activities to supplement their meager paycheck.[19]

While it is probable that formal sector incomes fell more rapidly than other incomes, it is not so clear what has happened

[17]Pfeffermann (1986).

[18]Lindauer et al (1985).

[19]Harris and Starr (1987).

to the latter. Of particular concern is the incomes of small farmers, who make up the majority of the poor in Subsaharan Africa. Nominal prices of export and food crops have increased to varying degrees in most countries. But it is difficult to tell what has happened to farmers' real incomes, particularly because consumer price indices are based on urban consumption bundles and therefore are unlikely to be suitable for measuring the purchasing power of rural incomes.

The only hard statistical evidence comes from Cote d'Ivoire during the 1980-1984 period, when a serious stabilization effort provoked marked economic contraction. Overall, real per capita incomes declined by almost 7% per year during this period. But rural incomes were much less severely affected, declining by only 1.2% per year. Urban incomes dropped by almost 11% per year, though low-income urban households fell at a rate of 4% per year, i.e. by much less than the urban average.[20] Thus, for Cote d'Ivoire at least, the dramatic negative effects of adjustment were concentrated among those groups best able to withstand hardship, while poorer groups were better buffered from the effects of aggregate contraction.

V.B.4 Adjustment and Poverty Incidence

Regularly-collected statistics on poverty incidence are not available for Subsaharan Africa. Some studies have reported trends in poverty incidence in Latin American countries between the late 1970s and mid-1980s. Overall, they confirm what one would expect: poverty incidence tends to increase during periods of economic contraction, with larger magnitudes of contraction associated with larger increases in poverty incidence. For example, Altimar (1985) reports that, in the period 1979-1982, poverty incidence increased markedly in three places experiencing significant recessions (Chile, Costa Rica, and urban Venezuela). In contrast, incidence continued to decrease in three places where the effects of recession were mild (Colombia, Panama, and an agricultural region of Venezuela).

Altimar's data also suggest that households with large numbers of children were particularly vulnerable to becoming poor in periods of generalized economic downturn. In the places where poverty incidence increased, increases were concentrated among households with larger numbers of children. In fact, in Caracas, the increase was almost exclusively among households with 3 or more children. Conversely, where poverty incidence declined, decreases were also concentrated among households with larger numbers of children.

Overall, female-headed households, like households with large numbers of children, experienced higher rates of poverty

[20] Noel (1986).

than other households. But the connection between female-headedness and vulnerability to cyclically-induced poverty was less clear than it was in the case of households with large numbers of children. In Chile, female-headed households tended to have more difficulties contending with recession than their male-headed counterparts. The opposite was true in Costa Rica. In two of the three places where poverty incidence declined, female-headed households lagged behind (Colombia and the agricultural region of Venezuela). In the third, poverty incidence actually decreased more rapidly among female- than among-male households (Panama).

V.B.5 Effects of Adjustment on Consumption.

Trends in private consumption. In many countries undergoing adjustment, expenditure reduction has emphasized compressing investment rather than consumption. Thus, while many countries registered declining per capita consumption in the 1980s, often private consumption per capita fell less rapidly than than investment per capita. The strategy of placing a larger burden of adjustment on investment does provide some measure of protection to current living standards. But this protection is in part at the expense of future growth and consumption.[21]

Of course, trends in private consumption derived from macro data tell us nothing about the magnitude, composition, distribution or significance of consumption reductions accompanying adjustment. Yet better information is scarce. In assessing the links between adjustment and consumption, the key concern is changing quality and quantity of food intake, particularly among poorer households. Sources of information useful to varying degrees in this regard include (1) caloric intake per capita, and (2) household-based consumption and expenditure surveys.

Caloric intake per capita. Data on daily caloric intake per capita need to be taken with a large dose of salt, for all the reasons described in Chapter IV. Data suggest that, in heavily-indebted middle-income countries, levels of per capita caloric intake increased steadily in the 1970s but fell by an average of 2% between 1980 and 1984. In 8 of 15 countries, however, levels prevailing in the mid-1980s remained above those of the early 1970s.[22]

In Subsaharan Africa, per capita intake levels also declined by about 2% on average in the 1980s, though their initial levels

[21] Development Committee (1987).

[22] Ibid.

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were lower than those in the middle-income countries.[23] In Africa, however, declining per capita intake did not start in the 1980s. In fact, 1985 intake levels were below levels prevailing 20 years earlier in 17 of 23 low-income Subsaharan countries for which data are available.[24] These trends may well signal an alarming situation. But they do not tell us much at all about the link between adjustment and food intake in Subsaharan Africa, since they clearly also pick up the full range of longer-term problems facing agriculture on the continent (recurrent drought, increasing demographic pressure, declining productivity, etc).

Other information on consumption. The few household-based surveys covering consumption trends over time tend to confirm a correlation between declining caloric intake and periods of economic downturn, particularly among low-income households. They also suggest significant changes in the composition of food expenditures when the level of real expenditure declines, with diets becoming less varied and more dominated by staple foodstuffs.

In Chile over the course of the 1970s, the poorest 20% of all households reduced their real expenditures on meat, oils, milk, eggs, vegetables, and sugar by 20-30%. In contrast, real expenditures on flour and flour products increased slightly. Moreover, the average daily caloric intake among this group was 17% below the FAO norm in the late 1960s. In 1978, the average had dropped to 30% below the norm.[25]

In Mexico, the depression caused lower-middle income people to shift the composition of their diets in favor of cheaper foods (e.g. chicken, eggs and potatoes, substituted for beef, milk, pork, sugar, and canned goods).[26] In Costa Rica, there was a slight reduction in per capita intake of calories, protein, fat, carbohydrates, and calcium, especially in rural areas.[27]

V.B.6 Adjustment and Access to Social Services

Public expenditures on social services. In the absence of measures of consumption of various types of social services, most studies attempting to get at the connection between adjustment and access to social services focus on public spending levels in health, nutrition and education. Real compression in social

[23] Ibid.

[24] World Development Report 1987.

[25] Ffrench-Davis and Raczynski (1987).

[26] Pfeffermann (1986).

[27] Ibid.

spending per capita has accompanied deficit reduction measures, with the degree of compression varying across countries. In general, social spending has been less severely squeezed than other types of expenditure, notably investment and productive programs.[28]

How compression in real social expenditure has affected the level and composition of social services provided, particularly to the poor, is not clear but appears to vary across countries. In Subsaharan Africa, it seems that the worst-case scenario has often arisen: the efficiency with which available resources are used has deteriorated at the same time that the total resource availability declined.[29] In particular, in terms of the economic classification of expenditure, public expenditures on materials and supplies have been compressed much more severely than wage expenditures. Thus, not only are social service personnel poorly-paid, but they very often lack complementary inputs needed to perform their work: clinics lack drugs and clean water; schools lack books, paper, chairs and desks, etc. In some extreme cases, social service delivery has virtually collapsed as a result. For example, in Ghana, real health expenditure per capita declined by almost 80% during the years of chaotic adjustment and economic decline. Thus, between 1979 and 1984, attendance at hospitals and clinics dropped by almost one-third.[30]

In Latin America, there is no evidence that declining efficiency in social service provision has accompanied real expenditure reductions. For example, a study of health care in Central America found that, although total health care funding levels had stagnated, the balance between personnel and operating cost expenditure was more or less maintained.[31]

However, in some cases, the composition of social services provided has been altered in the course of real expenditure reductions. There is debate as to whether this has increased, decreased or left unchanged the access of the poor to social services. The evidence is ambiguous. In general, it seems programs most heavily utilized by low-income groups have been better protected from real expenditure reductions than other programs. In Brazil, for example, funding for preventive and ambulatory health care has done better than expenditure on higher cost services like hospitalization.[32] Similarly, in several

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[28]See for example Kubisch and Hicks (198).

[29]Starr (1987).

[30]See Cornia and Stewart (1987).

[31]Musgrove (1987).

[32]Ibid.

countries, spending on primary education has suffered less than spending on higher education. However, it is unclear whether this has succeeded in maintaining lower-income groups' access to social services or whether it has provided them with some degree of differential protection from the full impact of real expenditure reductions.

In Chile, deliberate efforts were made to target social services to poorer groups.[33] Aspects of health care had been privatized in the 1970s. But functions remaining in the government domain were streamlined to address the needs of poorer groups, particularly mothers and children at nutritional risk. Intensification of mother-child health care programs did contribute to continued progress in reducing infant mortality and malnutrition, despite the extremely difficult circumstances poorer families were facing.

Also to better address the needs of the poor, public spending on education in Chile was reoriented from secondary to primary school programs. However, this reorientation has not been particularly effective: primary school enrollment rates sagged and drop-out rates increased. Addison and Demery (1987) place considerable emphasis on improving returns to assets owned by the poor as a means of alleviating poverty in the course of adjustment. Unfortunately, the Chilean experience with attempting to improve the human capital of young poor people illustrates that such efforts do not always take hold in difficult economic periods: day-to-day pressures to make ends meet, bleak medium-term job prospects, etc. can make education look like a very uncertain investment that takes too long to yield.

[33] Ffrench-Davis and Raczynski (1987).

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The Political Economy of Policy Reform in Developing Countries

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The Political Economy of Policy Reform in Developing Countries

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The development message of the 1980s is clear: little can be accomplished to enhance growth and welfare unless major policy and institutional reforms are undertaken and sustained by developing country governments. The bearers of this message--international aid and lending agencies, development advisors, academic specialists, and industrial country governments--have become increasingly convinced of: 1) the importance of macro-policy constraints on economic performance; 2) the need for adjusting sectoral policies to encourage efficiency and responsiveness to market forces; and 3) the imperative to lessen bureaucratic constraints on economic interactions. The debt crisis in Latin America and the food crisis and apparent failure of two decades of development in many African countries, contrasted with the apparent success of a number of Asian countries in achieving and sustaining high rates of growth, have helped focus extensive attention on the issue of appropriate macroeconomic, sectoral, and institutional contexts for development.[1]

For many years, capital scarcity was considered the primary constraint on development, a shortage that could be alleviated

directly through foreign aid. In contrast, policy and institutional changes are domestic matters that donors could only hope to affect indirectly. USAID gave official recognition to the new focus in a 1982 policy paper stating that, "The soundness of domestic economic and social policies is in general the dominant long term influence on development. Economic assistance in support of ill conceived policies would be a poor investment indeed".[2] The World Bank came to a similar conclusion about the centrality of policy to development. Its 1982 policy paper on Africa concluded that, "The task before donors is therefore clear and urgent. If donors increase their support for policy reforms and basic programs, they will help Africa overcome its immediate economic and financial crisis. They will also be building the propsect of a better, more hopeful future."[3] As a result of this concern for domestic policy change, donors had to ask how they could influence policy decision making. A new set of concepts began to emerge based on the idea of leverage, that is, to provide aid if certain desirable policies are adopted. Terms such as conditionality, conditions precedent to disbursement, policy dialogue, and structural adjustment lending became prominent in donor vocabularies.

Despite leverage, policy dialogue, conditionality, and structural adjustment lending, donor efforts to encourage significant macroeconomic, sectoral, and institutional changes are not necessarily persuasive to the policy makers who decide the direction and scope of public activities in developing countries. Although techniques of policy analysis to generate recommendations about needed economic and organizational reforms are well developed, the process by which reforms are effectively promoted is much less

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well understood. The gaps in our understanding of the dynamics of policy and institutional reform reflect the complexity and frequent ambiguity of the political and bureaucratic issues that influence the readiness of policy makers to adopt and sustain reform initiatives.

Those who have been participants in policy reform initiatives in developing countries often have unique insights into the dynamics of change, but rarely are their experiences tapped as part of analyses of policy reform. As a result, assessments are frequently hindered by the lack of information about events and decisions made inside the "black box" of government decision making. This is particularly true in developing countries where processes of decision making tend to be relatively closed to public scrutiny or widespread participation by interested citizens. The purpose of this paper is to explore issues of policy and organizational change by building on the experience of participants in reformist initiatives in several developing countries.

During the academic year of 1986-1987, the Harvard Institute for International Development sponsored a workshop series on "Promoting Policy Reform in Developing Countries" through the Employment and Enterprise Policy Analysis Project. At each session, individuals who were intimately involved in reform initiatives as part of their overseas professional experience described processes of change in which they participated.[4] The reform experiences span the range of macroeconomic change, sectoral initiatives, and organizational innovation:

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Macroeconomic policy

Devaluation in Ghana

Structural adjustment in South Korea

Sectoral policy

Agrarian reform in the Philippines

Health care in Mali

Rice price policy in Indonesia

Organizational change

Decentralization in Kenya

Planning in Colombia

Planning in Argentina

In six of these cases, significant changes were introduced and sustained; in one case, sustainable reform was not successfully introduced, and in one case, although reform was introduced, it contributed to a major regime change. In making presentations about their experiences with reformist initiatives, we asked participants in the workshop to discuss: 1) how the issue of reform got on the agenda of government decision making; 2) what political, bureaucratic, and technical criteria were important in promoting or inhibiting the process of change; and 3) what factors led to the sustainability or abandonment of reformist initiatives.[5] Reflecting this set of questions about the policy process, this paper discusses what has been learned about agenda setting, decision making processes, and implementation from the case histories. First, however, the insights into the criteria utilized in decision making that emerged from the case histories are used to reflect on the way political science and political economy have traditionally dealt with issues of policy and institutional reform.

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I.

Explaining Policy and Institutional Change

At the outset of the workshop, we presented a summary of perspectives on decision making that appear in the literature of political science and political economy. Interestingly, while participants were generally aware of the ways in which political scientists and political economists have traditionally explained policy choice, they found such explanations of limited applicability in their analyses. Instead, case presenters found the literature more useful in explaining why policy does not change than in accounting for how reform occurs. In addition, they identified a series of factors that appear to influence decision makers that are not always accounted for by traditional models of policy choice.

In this section of the paper, we first review the literature in political science and political economy to indicate how issues of policy and institutional change are dealt with. Then, we describe four hypotheses about government decision making that emerged in the workshop cases as participants attempted to highlight the factors that influenced decision makers and shaped their responses to specific reform initiatives. We believe these offer important correctives to the more conventional explanations by indicating what occurs inside governments and by suggesting the factors that account for the acceptance of reform as well as for failures to adopt important changes. Because of the limited number of case studies presented in the workshop, the propositions we develop are presented with the intention of providing ideas for further study about the

process of policy and organizational reform.

Explaining Policy Choice: The Literature

The literature of political science and political economy provides several alternative responses to the question, "How can we account for policy (or organizational) change?" Among those most frequently encountered are: 1) a class analytic (Marxist) approach; 2) a pluralist approach; 3) a bureaucratic politics approach; 4) a state interest approach; and 5) a public choice approach. Each of these models focuses our attention on different sets of variables and processes of political and economic interaction. Each has been influential in shaping perceptions among scholars and others about how change does or does not occur in public policies and institutions. Nevertheless, traditional explanations frequently provide little insight into the activities or perceptions of the decision makers, those who emerged in our case studies as influential actors in shaping responses to significant public problems in a variety of developing countries.

The Class Analytic Approach

The distance between current political economy models and the "black box" of decision making is clearest in the class analytic approach. This explanatory model indicates that policy decisions are the result of alliances among dominant classes or class "fractions" in a society.[6] In such a conceptualization, policy makers are instruments of dominant class interests and have little independent input into the policy process. When scholars use this approach, they explain policy change by searching for shifting

alliances among dominant classes, by indicating how a sociopolitical crisis alters existing class structures (as in the aftermath of a revolution), or by demonstrating how an economic crisis (such as a depression) presents the state with increased independence to shape responses to public problems. Under normal conditions--that is, except in the rare event of a sociopolitical or economic crisis--policies are derivative of social class formations. Marxist and dependency approaches are frequently argued with theoretical sophistication and complexity to analyze issues of inequity and exploitation in developing countries and to characterize the relationship between domestic elites and elites in developed economies. Such class analytic perspectives are particularly useful in indicating the constraints that limit the options available to policy makers. In considering the issue of policy choice, however, they treat the actual process of decision making as unimportant for explaining outcomes. They also discount the importance of political leadership in shaping issues and managing the political pressures that result from reform efforts.

2 The Pluralist Approach

Decision making also occurs within a "black box" in the approach most frequently adopted by analysts to explain policy decisions in the United States. In the pluralist model, public policy is the result of the pressures placed upon decision makers by large numbers of competing groups in society.[7] These groups form around common interests, many of which are economic but which also may be based on regional, ethnic, religious, value, or other concerns. The state provides a more or less neutral institutional and procedural framework in which conflicting groups form coalitions

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and do battle over policy output. For pluralists, the principal role of policy makers is to cope with a large number of conflicting pressures; they do not have the capacity to set agendas for action nor to shape outcomes in any significant way. Policy change occurs because different coalitions of interests manage to gain power and to impose their favored solutions on society. In this approach, then, policy is derivative of the competition for power among societal groups. As with the class analytic approach, a pluralist understanding of policy choice tells us little about the actual process of decision making and does not accord any degree of independence to political leaders or policy makers in shaping alternatives. Moreover, the approach tells us little about the role of information, technical advice, or learning in the decision making process.

3. The Bureaucratic Politics Approach

This approach to analysis permits more insight into the operational aspects of decision making; perhaps because of this, it also emerged as a useful tool of analysis in our case studies. A bureaucratic politics approach indicates that state policy is the outcome of competing activities among bureacratic entities and actors.[8] Bureaucratic and policy actors are considered to have different views on what policy should prevail and their views are shaped by their positions within government. In this approach, linkages to society are left unaccounted for or are considered to be part of bureaucratic "games" in which public agencies acquire support groups to press for organizational or suborganizational interests. The independence of decision makers is potentially very great, limited only by the diverse interests of bureaucratic

"players" themselves and by the influence of the regularized channels of interaction that are set by institutional frameworks. In significant contrast to the class analytic or pluralist models, in the bureaucratic politics approach policy originates in the bureaucratic and policy making apparatus, not in societal relationships of power and domination. At the same time, the approach is weak in its capacity to account for contextual and historical constraints on policy options or in its ability to explain the role of technical analysis or professional consensus that can shape the decisions of policy makers.

4. The State Interest Approach

This framework is increasingly used in explaining policy choice in developing countries because it is able to account for the large and often leading role played by government in the process of economic development in such countries. A state interest approach indicates that the state has identifiable and concrete concerns about the definition and pursuit of "national development."[9] These concerns are independent of the immediate interests or welfare of any particular group, class, class fraction, coalition, or alliance in society, although state interests may coincide with the interests of any of these entities at any particular historical moment. In this model, policy makers seek to expand the independence of the state from societal actors in order to have greater flexibility and power to pursue policies that will engender economic growth and social stability and help legitimize and prolong the life of the regime they serve. Policy makers therefore play active roles in adopting theories of development, attempting to put together supportive coalitions, legislating reforms, and creating new

bureaucratic entities. In this approach, then, policy or institutional reform comes about because of the interaction of policy makers attempting to generate responses to public problems and the constraints placed upon them by political, economic, and social conditions and by the legacy of past policy. This approach was to some degree reflected in our case studies in efforts to explain how technical information or models of economic development fit into decision making processes. At the same time, this approach remains almost as distant from the "black box" of actual decision making as the class analytic and pluralist frameworks.

5) The Public Choice Approach

The issue of public choice focuses attention on the political rationales that underlie the selection of economic policy options by decision makers in developing countries. It seeks to explain policy by considering the desire of political elites to develop their countries and to remain in power.[10] According to the model, they are led initially to select policies that will extract resources from society to fuel efforts to industrialize. With time, these same elites will come under increasing pressure to extract and then "spend" public resources to maintain the political support of economically powerful actors. In a process that generates increasing economic inefficiencies and even irrationality, policy makers become trapped in a cycle of flagging support and legitimacy but are unable to alter policies because of the political power of the beneficiaries of the status quo. The public choice approach, adapting economic concepts to political interactions, demonstrates the barriers to reform that are created by preexisting policies. While this is an important accomplishment, the model suffers in not

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being able to explain how or why reform does occur. Moreover, although it indicates the importance of the motivations of decision makers, it tells us little about how their motivations are developed or altered over time.

The models of policy choice described above have proved useful to scholars and others in describing aspects of change and stasis in developing countries. The case presenters in the workshop also incorporated elements of these approaches in their analyses. However, they also made clear that the models had little predictive value. Instead, the cases suggested that other considerations were often more powerful in determining whether policy changed, and presenters emphasized the importance of an incremental process of policy making, starting with the setting of a policy agenda and continuing through the long term implementation of policy. Our case studies confirm the importance of understanding the interactions that occur during the entire process of policy making and implementation. Therefore, in the next section, we use the cases to outline several critical elements of decision making that focus greater attention on what occurs during the process of decision making and on the criteria adopted by policy makers in assessing options available to them. We believe an understanding of these factors can stimulate thinking about the process of reform and the perceptions of decision makers in making choices about policy and organizational change. In addition, insight into a variety of factors that influence decision makers can illuminate the strengths and weakness of how conventional models have explained why they make the decisions they do.

Four Critical Elements of Decision Making: Views from Inside the "Black Box"

Implicit--and at times explicit--in our cases of policy and institutional reform in developing countries were a set of propositions or assumptions about why decision makers behave as they do when they are confronted by the issue of change. Although we did not impose any theoretical framework on the case presentations, patterns of explanation emerged during the workshop that were consistent enough to allow us to propose a series of generalizations about four factors that appeared to have been influential in explaining decisional outcomes. The four elements--technical analysis, bureaucratic motivation, regime maintenance, and international leverage--are briefly described in the following pages. Important characteristics of these factors are summarized in Table 1. As we will see, in the cases of actual reform decision making, more than one element is often adopted to explain change. Our underlying purpose is to enhance understanding of how processes of policy and institutional change work and to generate insights that will enable participants in the process to be more effective in the future.

Table 1 About Here

(1) The Influence of Technical Analysis

In the case histories, decision makers were sometimes portrayed as rational actors confronted by a difficult issue. In this situation, they were strongly influenced by technical analyses of the problem area and advice about how best the particular problem could be solved. Important to the explanation of reform outcomes,

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therefore, was the insistence that technical analytic tools and advice based on sound problem analysis were persuasive to decision makers and central to the issues they considered. In explaining a reform initiative from this perspective, the reliance of decision makers on their technical advisory teams and the quality of information available to them is therefore stressed. The important role of technical analysis in policy choice may reflect the fact that technocratic elites are often central figures in policy making circles in developing countries and the process of decision making itself is relatively closed and even secret. A supporting factor may be the complexity of the issues that political leaders are expected to address in shaping development policies in their countries, and in the need to explain their decision in terms of the promotion of the national goal of development.

The importance of technical analysis in decision making is often reflected in discussions of reform. For example, it is apparent in statements such as, "The minister of finance became an early advocate of devaluation when his economic team demonstrated persuasively the impact the country's overvalued exchange rate was having on the capacity to generate foreign exchange through exports," or, "The prime minister, convinced of the need to increase agricultural production, called on the national planning agency to assess the problems of the sector and make recommendations for reform." The influence of technical advice is also reflected in a recent study of structural adjustment in Korea. "...[T]he structural adjustment of the Korean economy stemmed from the initiatives of highly motivated and competent technocrats and economists working with the core economic ministry."[11]

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In our case studies, the following statements reflect influence of technical analyses and advice on the choices made by decision makers:

On the decisions to pursue export-led growth in South Korea--"[a]s early as 1961, American-trained Koreans understood export-led growth strategies but were not in positions of power....Later, a foresighted deputy prime minister brought these young number crunchers up through the ranks, often skipping them past more senior people."

On the decision to devalue in Ghana--Poor judgement about the consequences of devaluation resulted in part from the fact that "the cabinet understood very little of the economic information given them, information intended for more sophisticated readers at the central bank....Simpler memos with fewer recommendations should have been prepared to offer clear alternatives to the cabinet."

On rice price policy in Indonesia--"With solid evidence of the correspondence between consumption and price, the Indonesians adopted a pricing policy that helped finance the development budget....This relatively simple work legitimized price analysis to the minister of trade, the director of trade research, and [the food logistics agency]."

In these specific cases, technical analysis and advice were combined with other factors to explain a fuller range of influences on the decisions made by policy makers. Synopses of each of the eight cases are presented in a later section of the paper and indicate the

use of several sets of decision criteria at once and the relative importance ascribed to each by the decision makers.

b) The Power of Bureaucratic Interactions

A second perspective that emerged in the workshop series suggested that technical problem analysis is less important than the bureaucratic politics that surround the selection of policy and institutional changes. This explanation corresponds to the bureaucratic politics model effectively developed by Graham Allison and implicit in his addage, "Where you stand depends on where you sit."[12] In this bureaucratic motivation model, outlined in the previous section, decision makers within government are primarily concerned with making decisions or supporting positions that will enhance their own career opportunities and/or the fortunes--in terms of budgetary resources, influence over programs, prestige, or clienteles--of the bureaucratic entities they lead or are part of. Our cases suggest that individual and organizational interests internal to the bureaucracy were important factors explaining the decisions made in several instances.

Bureaucratic motivations--at both the individual and organizational level--are implicit in statements such as, "The minister of trade was opposed to any reform that would weaken his agency's capacity to issue licenses, grant tax exemptions, pass on tariff regulations, or in any way lessen the rent-seeking capacity made possible by extensive regulatory power." From a more positive perspective, a study of reform decision making in Mexico indicated why high level officials in the government's marketing agency were willing to support change. "An expansion in the agency's activities implied a large increase in the amount of financial support it would

need...A higher budget, in turn, introduced the possibility of enhancing the impact of the agency's programs. Concomitantly, as its activities affected more people in a beneficial way, CONASUPO could expect to become increasingly important to the government...Acceptance of the new policy was also attractive because it might easily result in presidential support and lead to improved career opportunities for the agency's management."[13] Similarly, in explaining a specific case of choice of irrigation technology, Thomas concludes that technical criteria were eschewed in favor of issues more directly related to the internal dynamics of bureaucratic agencies. "Ultimately, it was the organizational requirements of the implementing agencies, including the aid donors, that determined choice of tubewell technology for East Pakistan."[14]

In the case histories, this element of decision making was given centrality by several presenters. Statements such as the following indicated the adoption of the expalantion provided by bureaucratic motivations to account for the behavior of decision makers:

> Building a planning agency in Colombia "evoked antagonism from other ministries because such a new agency might challenge their influence."

> On planning reform generally--"To become a premiere technical agency, someone in power needs to turn to the planning agency and enhance its prestige, because of the weaker position it usually occupies in relation to the ministry of finance."

On decentralization in Kenya--"A minister or other senior official builds up his group of followers within the organization and these people don't want to disappoint him, so they don't send bad news up the ladder. Hence, information useful for change does not reach decision makers."

On health policy in Mali--"The Mali Health Project was part of a weak ministry...If changes in laws or regulations were needed, cabinet approval was required. With such a weak ministry, this process took too long and was oftentimes unsuccessful."

Again, the bureaucratic explanations for decision making behavior were combined with others in the case presentations. However, in several of the case histories, bureaucratic motivations appeared to have had central analytic importance in the interpretation of how reform occurred or did not occur.

C. <u>The Significance of Maintaining the Regime in Power</u>

A third element of decision making that emerged in the case histories stressed the importance of regime maintenance as a criteria applied by political leaders and policy makers. In this explanation, policy reform options are assessed by decision makers in terms of how reaction to them will affect the longevity of the regime in power or the particular leadership group wielding authority in a society. Thus, explicitly political criteria are applied to decision making and they tend to indicate the importance of building or maintaining coalitions of support for incumbent political elites. At times, regime maintenance goals have been adopted as a way of explaining why certain policy options are

"off-limits" in a particular political systems because they impose heavy costs on important groups in the society.[15] They are also used to explain how government actions are employed as "pay-offs" to maintain the loyalty of important groups or interests.[16] Clientelism in the allocation of public resources is frequently cited as a result of such systems. This element of decision making may be appropriate for explaining policy choice in many developing countries because of the fragility of the coalitions that support incumbent regimes and because of the limited legitimacy that makes them vulnerable to the performance expectations of supporters.

Regime maintenance explanations are implicit in statements such as, "The prime minister's principal support comes from the "X" ethnic group. How could he make a policy decision that would be so detrimental to their control over marketing in the country?" As in this case, the adoption of a regime maintenance criteria can explain why changes are not made in long-standing government policies. Thus, regime maintenance criteria are also implicit in the statement, "The military would not permit any modification of the structure of the state-owned enterprises they consider to be essential to national security goals." Similarly, an argument indicating the infeasibility of significant economic liberalization often focuses on the negative reaction of industrial elites who have benefited greatly from protectionist policies. At the broadest level, Robert Bates has argued that regime maintenance becomes the single most important factor in explaining the perpetuation of economically irrational development policies. "Governments want to stay in power. They must appease powerful interests. And people turn to political action to secure special advantages--rewards they

are unable to secure by competing in the marketplace."[17]

In the case studies, regime maintenance goals were important to decision makers considering major policy changes:

On devaluation in Ghana--"The prime minister and cabinet decided to undertake the higher devaluation, which meant more revenues from export taxes to buy off urban elites and cocoa farmers. [It was not clear how much they understood of economics], but it seemed clear that they did know that the greater the devaluation the more money available to offer supporters."

On structural reform in South Korea--"Park was trying to consolidate his power within the power structure and at-large. Moving the economy was a surrogate for consolidation of power."

On health policy in Mali--"The project sites were selected on the basis of political criteria. The Malians had recently fought a 'soccer war' with Burkina Faso (then Upper Volta), and wanted to have a presence in the border area. [In another area], the government wanted to...forestall any shifts in political loyalty."

On agrarian reform in the Philippines--"Adoption of an agrarian reform was considered by some leaders of the government to be central to weakening the appeal of the insurgent National People's Army, but the fact that top leaderhsip saw it as potentially disruptive of its support coalition meant that it was consistently given low priority in the government's policy agenda."

d. <u>The Persuasiveness of International Leverage</u>

A fourth factor that was useful in the workshop case histories to explain reform initiatives emphasized the role of international actors and international economic and political dependency relations in determining the outcome of decision making about reform. The international leverage element is of considerable importance in a period of international economic crisis when foreign donors, governments, or international agencies can put extensive pressure on developing country governments to make recommended choices. It is also encountered in efforts to explain such issues as technology choice and institutional reform that becomes conditional on "rewards" from the international actors.

The persuasiveness of international leverage lies behind such statements as "The IMF forced the government to accept a cut-back in public sector investment of 'X' percent," or, "USAID made it clear that no further aid would be forthcoming unless immediate steps were taken to devalue." In a discussion of the politics of adjustment in several countries, for example, Stephan Haggard writes of Haiti that, "President Jimmy Carter's human rights policies placed new political constraints on the regime, forcing Jean-Claude Duvalier to reduce some of the more flagrant abuses in return for American

support."[18] In our case studies, explanations for reform included reference to the strong influence of international actors or international dependency relations:

On structural adjustment in South Korea--"In early 1963,...the U.S. Ambassador was withholding PL480 food aid to put pressure on Park to quit politics and to get the Koreans to commit to a stabilization program. This pressure was decisive.

On rice price policy in Indonesia--"Indonesia experienced credit problems in the late 1960s and early 1970s. The IMF pressured the ministry of finance to tighten up on credit."

On health policy reform in Mali--"The Mali Health Project...originated at the request of the Mali government which was seeking funds for medical inputs. USAID wanted to look at the entire health care system....AID took the lead on the project at the outset."

On planning reform in Argentina and Colombia--"Planning reform was pushed in Argentina and Colombia by the Alliance for Progress to deal with problems of the 'two-gaps' model: the savings/investment gap and the foreign exchange gap."

Technical analysis, bureaucratic interactions, regime maintenance, and international leverage were factors that emerged repeatedly in the explanations offered by "insiders" in reform experiences to explain a variety of outcomes. As we have suggested, presenters of the cases often utilized more than one factor to explain the choices that were made by decision makers. Of course,

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these factors, taken singly or together, do not provide us with an alternative to the models current in the literature of political science and political economy. However, by providing greater insight into the process of decision making, they enable us to assess and amend conventional models for understanding reform.

A review of the cases presented in section VI indicates that decision makers were frequently influenced by technical analyses and advice and appeared to have had variable capacities to assess goals and priorities in terms of their understanding or acceptance of technical aspects of decision making. However, only the state interest model explicitly recognizes that policy makers may have goals and perceptions about national development that are not reducible to self-interest (pluralist approach), class interest (class analytic approach), or positional games (bureaucratic politics approach). But even the state interest model does not tell us how goals for national development are identified nor how technical advice is factored into choices and options. The case histories emphasize the importance of this process and suggest that reformers need to know under what conditions information or analytic input would be taken seriously by decision makers. In similar fashion, the case histories suggest the utility of the bureaucratic politics model for understanding how a multiplicity of competing agendas within a bureaucratic apparatus can shape decisions. They also provide us with evidence that to understand the way decisions are made, we need to look outside the bureaucracy for additional political and situational inputs and inside it to assess such factors as the technical information and advice that is available. To some degree, then, a number of the cases indicate how

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non-bureaucratic factors are introduced into decision making contexts that correspond closely to the bureaucratic politics model.

Regime maintenance goals figure prominently in several of the cases, much as a state interest or public choice model would predict. To a considerable extent, then, the cases affirm the theoretical assertions that underlie these two models. But the cases, by focusing on the process of decision making, demonstrate--in a way that neither of the models can--how regime maintenance goals actually influence the policy process and how judgements are shaped and altered by such concerns. International leverage is also important in determining the outcome of decisions in several cases, cases that indicate how dependency relations are reflected or altered within the "black box" of decision making. As a factor in decision making, international leverage also indicates how donors become engaged in bureaucratic games in developing countries, suggesting the appropriateness of including them within a bureaucratic politics analysis.

Thus, our brief foray inside the "black box" suggest that conventional models of policy choice ignore much of the complexity and variability of decision making and that they are not sufficiently process-oriented to explain change as well as stasis. The process of policy and institutional reform can be thought of as an interlinked and interrelated chain of agenda setting, decision making, and implementation. In the next section of the paper, we suggest that the four important factors that infuenced decision makers tended to vary depending on whether the reforms affected macroeconomic issues, sectoral policy, or organizational reform, an outcome that is itself the result of the way these reforms tend to

get on the agenda for decision makers.[19] Thus, we use the case studies to indicate that different types of reform--macroeconomic adjustment, sectoral reform, or organizational change--tended to get on the agenda for decision making in different ways and that decision makers are influenced by the agenda setting process in selecting among sets of decision criteria. Here we attempt to link the process of agenda setting to the factors that appear to have the greatest influence on decision makers. A subsequent section of the paper considers implementation in terms of an ongoing process of decision making linked to agenda setting and decision making.

II.

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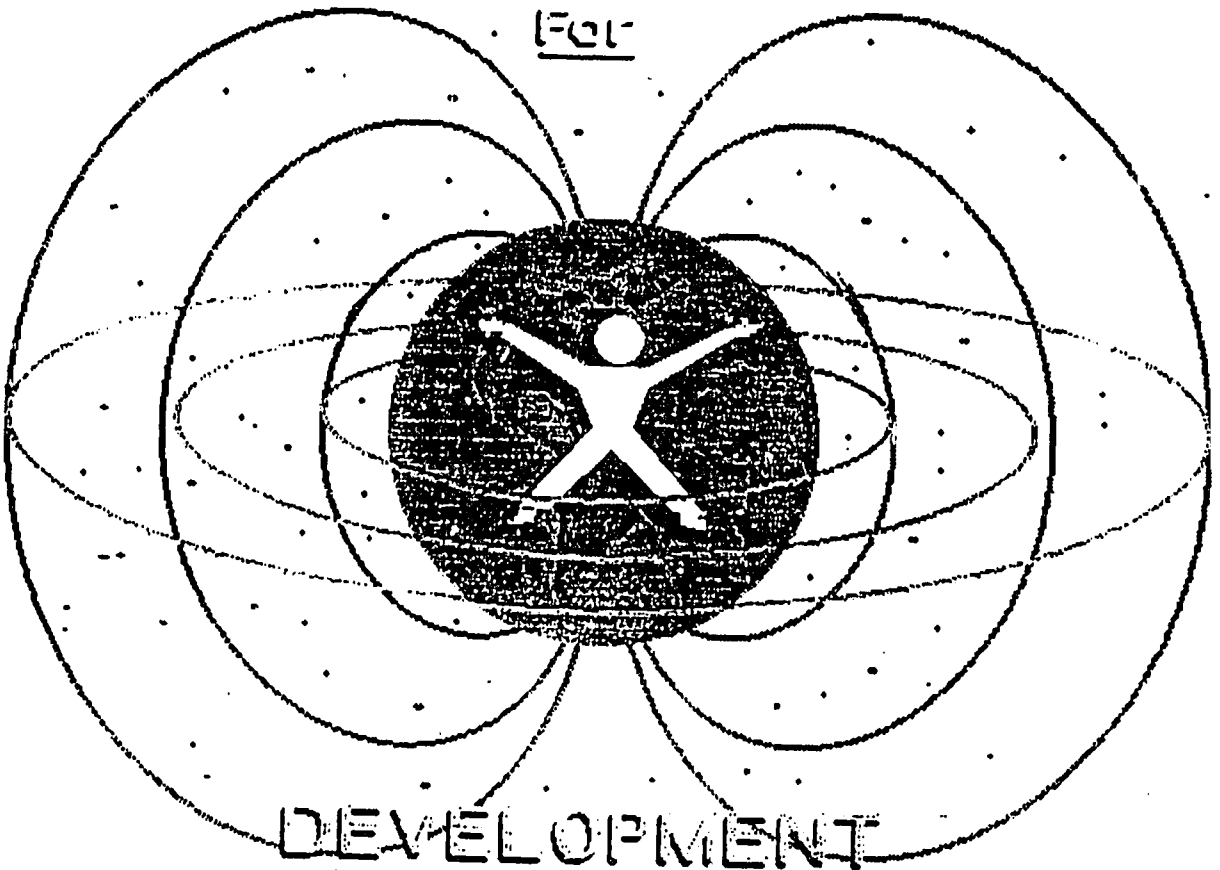
ORGANIZING

For



DEVELOPMENT

William E. Smith Ph.D

FIRST FULL DRAFT NOVEMBER 1987

NOT FOR CIRCULATION WITHOUT PERMISSION

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PART I: DEVELOPMENT ORGANIZATION EXPERIENCE AND CONCEPTS

CHAPTER 3: BUILDING A NEW THEORY OF ORGANIZING

A. The Concept of Power.

The concept of power on which this book is based came about serendipitously. In the 1978-80 period the author and a group of colleagues from the World Bank discovered that Bank projects paid too little attention to linkages with their environments. At that time we used Trist and Emery's concepts of three levels of environment, internal, transactional and contextual. The internal environment dealt with processes internal to the organization, the transactional environment dealt with exchanges between the organization and its environment. The contextual environment referred to processes through which parts of the environment are related to each other - its "causal texture". As we began to diffuse the findings of our studies one of the project officers, in particular, had difficulty with the language used to describe the concepts. He reacted particularly strongly to the use of words like "internal", "transactional", and "contextual".

> This is academic jargon I can't use words like that in the field, and if you have to use words like that to explain your concepts then they are no good for what we need: practical ways to teach people in the field how to do a better job.

Our first reaction was somewhat defensive as we tried to explain that new concepts required new language. However, after others made

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similar, but more veiled comments, we began to search for alternatives. It was this incident that helped us to realize the importance of the actor's perspective. Our interpretation of the officer's difficulty was that the language we used was developed by social scientists who were responding to observations from an external perspective. What we needed to do was to look at the same phenomena of three environments from an internal actor's perspective. We were encouraged in this by David Silverman's (1971) call for organization theory that is more actor than observer centered.

We began to search for the "action" implications of the three environments. We asked ourselves what did the actor actually do in his relations to the three environments?. It was relatively easy to find the action words that described action in the first two environments. The actor "controls" elements in the internal environment and "influences" elements in the transaction environment. It was much more difficult to find the appropriate action word for the contextual environment. We eventually we borrowed the term "appreciate" from Vickers (1966) who in turn derived it from the British military. Military strategists would carry out "appreciations" of the enemies situation. Such appreciations included not only their physical and geographical disposition but social, psychological and political profiles. One such appreciation, for example, forecast the likely suicide of Hitler. The word appreciation, though commonly used to express liking or satisfaction, contains the same root as the word "price", it contains a connotation of valuing, as well as, understanding. The actor tries to understand and value the impact on him of eleme

of the "appreciated" environment.

Although the search for alternative words began as a palliative to Bank critics, once we began to use the words, a transformation of perspective took place. The simpler active words had a very powerful effect. Instead of looking externally at a set of environments, the words conjured images of active organizing, they unfolded a process of action rather than a process of external analysis of the structure of environmental relations. The actor "controls" events in the internal environment, he "influences" elements in the transactional, and "appreciates" elements of the contextual environment. We also realized that these words had in common a connotation of power. Each expressed a different degree of power. The actors perspective became a powerful tool for reducing complexity. Whereas the scientific observer has to examine all variables in all possible configurations, the actor limits his perspective to those variables relevant to his purpose at a specific point in time and space.

We then returned to the literature on power to see what practical help we might obtain in developing our insight and its application to the problems of organizing for development. Early attempts at relating power to organizations had given up concluding that power is such a pervasive concept that it was not very useful in explaining organizational phenomena. Very recent literature has a renewed interest in power as exemplified by Pfeffer's (1977) work. He examines how power is acquired and used in organizations. Since this research began there has been a significant increase in the number of articles and books using power concepts. (See, for

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example, Noel Tichy, "Managing Strategic Change",1983). Our conclusion from a review of the literature was that there is no general agreement on what power is and that different types of theory are needed for different purposes.

The concept that seemed most relevant to our purpose was that of power as a form of causation. (See Nagel 1975). Organizing is a form of causation. We organize in order to make things happen that otherwise would not happen. The power concept consists of three components, an actor with a purpose, an outcome he seeks relative to that purpose and the relationship between the actor's purpose and the outcome. The actor could be any individual, group organization or system.

Power is a relationship between the actor's purpose and the outcome he seeks. (See Chart 3.1)

a) Control - the highest degree of power, defines a relationship in which the actor causes or produces preferred outcomes directly. Controlled outcomes are those he can predict to occur with 100% reliability. For example, in a development program, baseline activities subject to the control of project staff, the selection of objectives, strategies, and actions, the construction of roads under a highways project, the planting of seed under an agricultural project, the provision of health services in a health project.

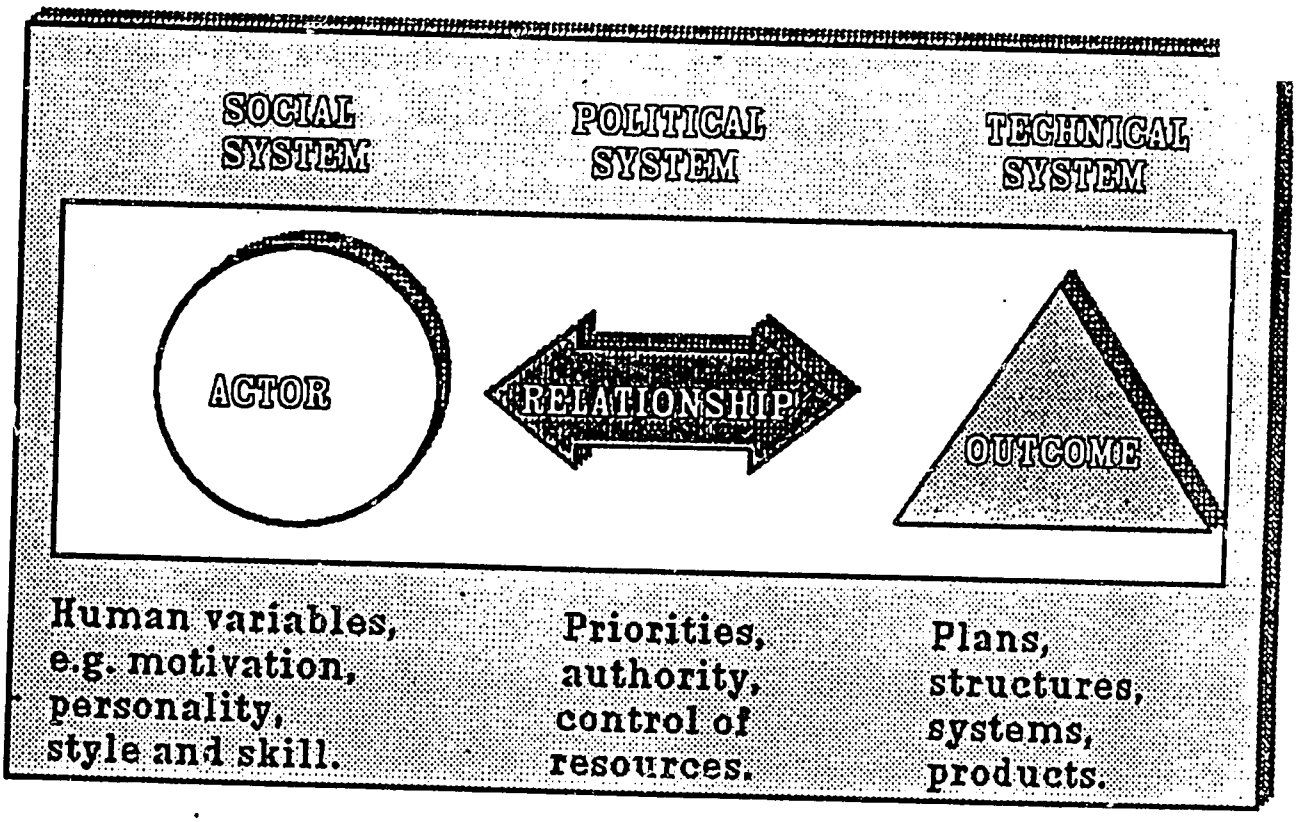
b) Influence - the second degree of power, defines a

relationship in which the actor is a co-producer, rather than a producer of preferred outcomes, through influence he can increase the probability of preferred outcomes occurring, for example, activities of mutual influence between agencies that provide inputs or receive outputs from the project organization, e.g., in the case of an agricultural project, a credit bank, farmers' associations, a marketing board, other government agencies.

c) Appreciation - the weakest form of power, defines a relationship in which the actor understands and values the impact of events on the achievement of his preferred outcomes, but can neither control nor influence them. For example, in an agricultural project, the manager can neither control nor influence government price policies which affect incentives to produce, nor can he influence established government finance and procurement procedures. He is often subject to political interference, e.g. in selection of staff that he cannot control or influence. He may have to adapt to traditional land tenure systems and their impact on farmer motivation without being able to influence them.

Chart 3.2 uses arrows to illustrate the different nature of the three types of power. Appreciative power is represented by arrows moving towards the center symbolizing its receptive nature. Influence power is represented by two headed arrows symbolizing its characteristic 'give and take' nature. Control power is illustrated by an arrow moving outward from the center indicating its direct

THE BASIC ELEMENTS OF ORGANIZATION



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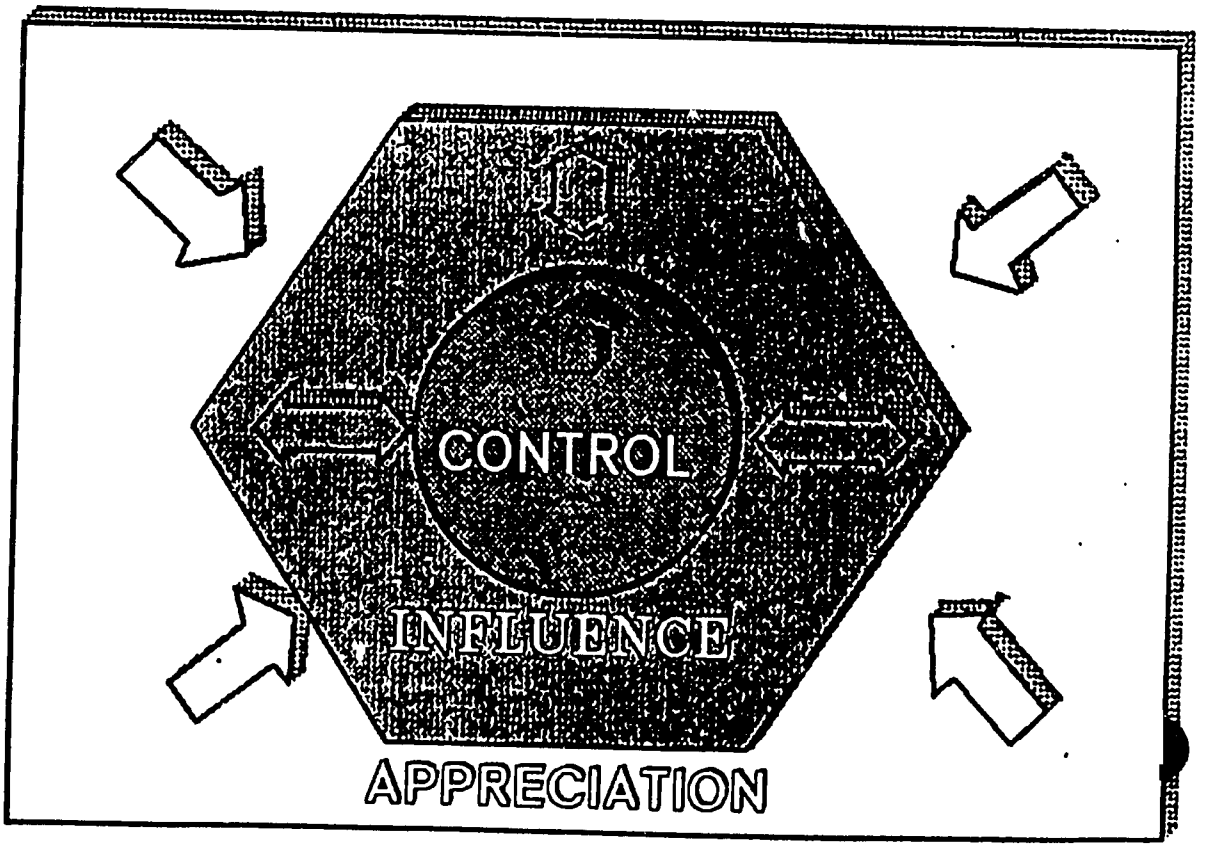
POWER FIELD



impact on its immediate environment.

Power is the "umbrella" concept, and appreciation, influence, and control are different degrees and qualities of power under that umbrella. (See Chart 3.3). **Power is not absolute it is always relative.** E.g. We may have power relative to persuading someone to go fishing; we may not have power to persuade the same person to give up his job. Our power is always relative to an outcome we desire. Chart 3.4 illustrates the relative nature of the three types of power. If the actor,i.e. manger has control over all the necessary elements he can produce the desired outcome directly. For example, he controls the budget and resources allocated to him. If he has influence he can only co-produce the outcome either with the help of others or after other outcomes have been achieved. He can only influence extension agents who do not work directly for him to increase their schedule of visits in order to improve project performance. The nature of influence is indirect causation. In the case of appreciation the outcome is produced by other people or events but affects the actor or manager. The same manager of an agricultural project can only appreciate the work of agricultural researchers who produce products that in the future might completely change the way such projects are carried out. The manager's power consists of understanding the likely affect of the elements on his performance. To the extent that he appreciates the nature of the effect he is more powerful than if he had no appreciation.

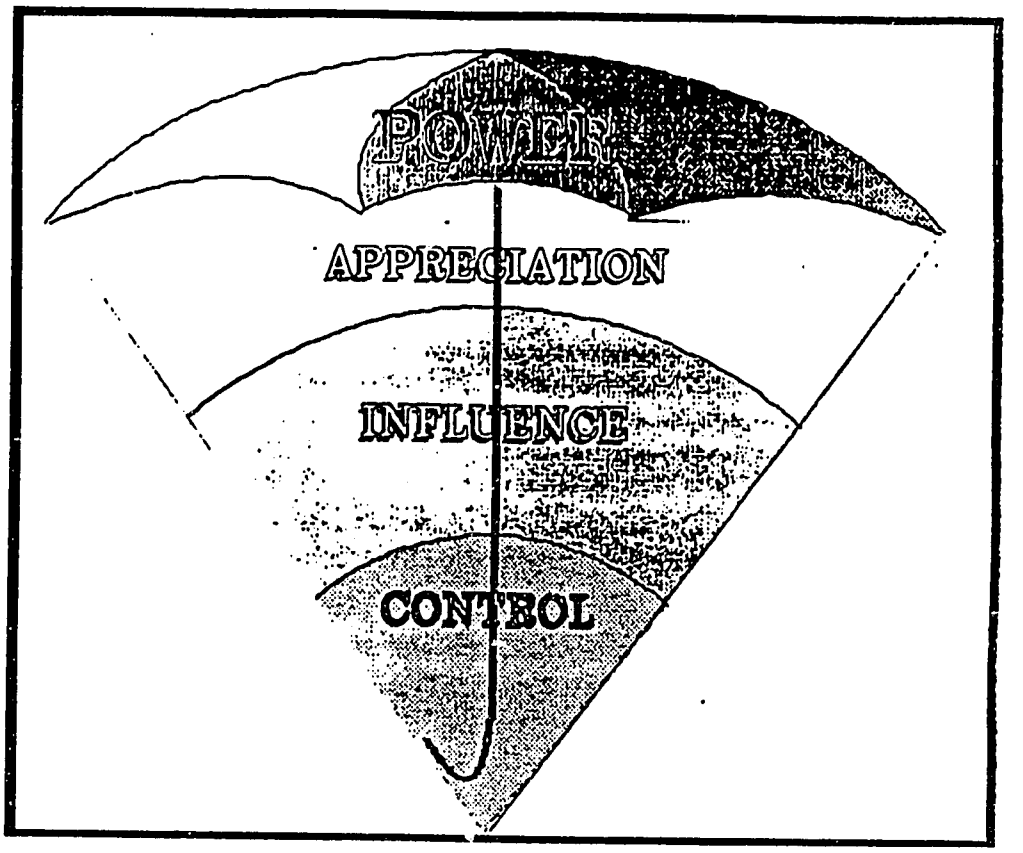
The power of any actor consists of the sum of his appreciation, influence and control (P=E (A.I.C.)). Even though the manager does

not control all elements that affect performance he does have some degree of power over all elements.

The actor's power field defines his relationships with his environment. He has control over his internal environment, he has influence over part of his external environment and has to appreciate the remaining part over which he has no influence but which still affects his performance. In practice this concept of power is very liberating because we generally equate power with control. If we do not have control we believe we are powerless. Such thinking pushes us towards the "bureaucratic" or autocratic forms of management in which we try to control everything. We ignore the environment because we know we cannot control it. We give up our powers of influence and appreciation.

Though control provides us with the greatest degree of power there are relatively few things we can control. Control is our most limited, though most intensive source of power. We have many more sources of influence, every relationship we have both of an informal and formal nature is a source of influence. Appreciation, though the weakest form, provides an infinite source of power. The potential for creating a better understanding of our environment and the factors that affect the achievement of our goals is virtually unlimited. Appreciative power is the source of new visions, of innovation and creativity.

3 3


POWER
APPRECIATION
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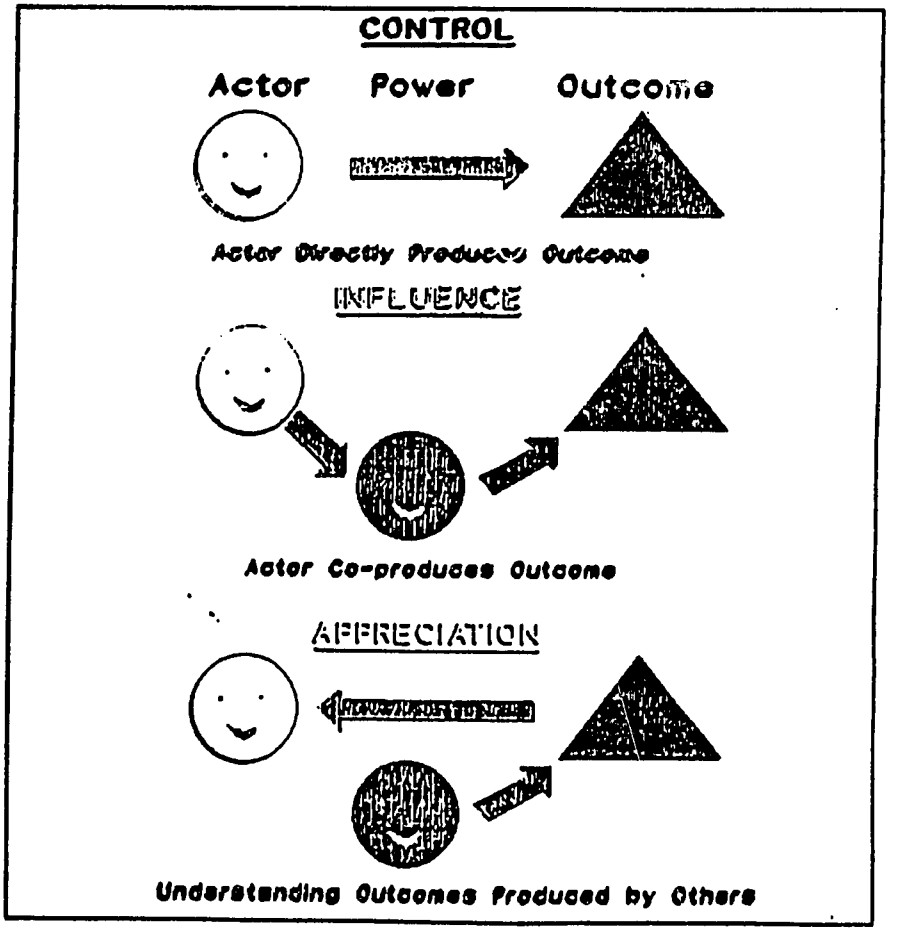
CONTROL
Actor
Power
Outcome
Actor Directly Produces Outcome
INFLUENCE
Actor Co-produces Outcome
APPRECIATION
Understanding Outcomes Produced by Others

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PART III: TECHNOLOGY FOR ORGANIZING

CHAPTER 7: APPRECIATIVE APPROACHES

(Learning)

In the three chapters of Part I we developed an understanding of the current state of organizing for development and outlined a new theory of organization more suited to the nature of development work. In the three chapters of Part II we elaborated the theory into a general model of organizing which consisted of three levels, the superior, focal, and subordinate, linked by three processes, learning, politics and planning. In the last three Chapters of Part III we will provide illustrative technology for putting the theory and model into practice. Because the learning, political and planning processes have a great deal of similarity at each of the organizing levels, Chapter 7 will discuss technology for the learning phases at all levels of organization, Chapter 8 will concentrate on power relationships or the political phases, and Chapter 9 will provide a summary of all phases and recommendations for action, what can be done to implement the theory, model and technology in the current state of development.

A. Technology for Design of the Appreciated Phases

Selection of technology to carry out appreciative work has to take full account of the special purpose of appreciation and the characteristics of appreciative power. The purpose of the apprecia-

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tive phases is to create a climate in which it is possible for the organizers to understand the reality of their situation and its potential free from the constraints of their own interests, roles and agendas. Its objective is to draw meaning and a sense of direction from an understanding of the image of reality that emerges. The organizers have to be very receptive to ideas and possibilities that could be strange and even threatening to their own particular point of view or interests in the situation.

Power differences and attempts at control are the greatest enemies of appreciative work. A climate of fear or caution because of the presence of power differences in the group destroys the necessary free flow of ideas and the receptivity to learning. The function of control is to close down options to apply constraints and is equally inimical to the process of appreciation. A key criterion in choosing appreciative technology is its ability to overcome power differences and avoid premature attempts at control. A second criterion is the ability to open creative potential, to enable organizers to see the realities they face in a broader, deeper and richer perspective.

The appreciative process creates new images of reality, shares and tests them, and then reduces them to parameters of action. Because new appreciations call for creativity, we look to the creative arts for inspiration. Art, in fact, fulfills an appreciative role for society. Artists help us to see reality in a more profound or enriching way. Thus in the world of mind we can use our imagination, our artistic and poetic skills to envision, describe and communicate

new possibilities. In the human world we can use role-playing and simulation (the performing arts) to create richer appreciations of actual and potential interrelationships. In the physical world we can experiment, research new forms and build new models. We can change our physical setting, as in the case of the Colombians who, when trying to appreciate the possibilities for integrated rural development, made a trip to Mexico to actually see a program in action. The use of soap operas in Mexico to convey the message of birth control is another example of creative appreciation in the service of development objectives. The possible modes and techniques for improving the appreciative process are virtually limitless.

In practice our use of appreciative techniques is fairly limited because of our bias towards the rational and the controllable. We rely primarily on investigative research and formal evaluation to provide appreciation, on books and reports for dissemination and on experts to delineate lines of action. In practice, it is possible to bring a much wider variety of techniques to our policy making. Extensive use, for example, can be made of group process to tap into social and political appreciations. The group processes themselves can bring in aesthetic and spiritual dimensions through the use of imaginative techniques, idealization, drawing images, and use of metaphors and myths.

The importance of diplomacy and reduction of power differences to effective appreciation implies considerable use of face to face meetings, because these are the most effective in developing accurate inferences about real purposes and levels of commitment. Yet, it is

amazing how many development organizations and plans are created without major stakeholders being consulted. Because in large projects, the designers may not be able to meet individually, face to face with every stakeholder, alternative means of group meeting, large seminars and conferences should be considered where possible.

Search conferences, as described by Emery 1974 provide one approach for solving this problem. An essential component of the Search concept is tnat there is no attempt to move towards a prearranged output. The task is to better understand the nature of the issue under discussion. The participants are anyone who has shown active leadership in relationship to some relevant aspect of the problem area. The design of the process is fairly staff intensive and moves systematically to develop a shared appreciation of the problem. In effect, it places the problem(s) in the center stage and develops a view of the appreciated, influenced, and controlled environments of the problem set. It might involve the participants developing an image of how ideally they would like to see the problems resolved. The constraints to implementing such ideals are then examined, and the whole notion tested against reality. The Search conference does not move on to planning for actual problem solution, but might identify the stakeholders with the interest to pursue further action. (The Search Conference is specifically a learning process at the appreciative level i.e. an (e)valuative process)

R.L. Ackoff's (1974) process of "idealization" or interactive planning shares many of the same roots as Emery's work. However, be

cause it deals with the redesign of a specific system, it can more readily be used where a Search Conference leaves off. Although it is designed to generate an appreciation of the system and as a means to identifying and involve stakeholders its emphasis is on planning, i.e. specifying the outcomes of the process. (Thus interactive planning moves from "evaluation" to "policy" it also includes steps to continue the process through to implementation, "operations") The process has been used extensively to facilitate policy planning for Corporations or specific agencies of government.

The basic idea behind idealization is to free the planning process from the constraints of the past and present (i.e. free ourselves from control). If we free ourselves from such constraints we can, in effect, create or "redesign the future". The system being planned is created as though from scratch in accordance with the ideals and values of those taking part in the design. Ackoff's work sets out the premises of the design philosophy, a rationale for its use, and suggested procedures for implementation.

The Search Conference and Idealization are processes useful for the opposite ends of the design of the appreciated level of organizing. The Search Conference emphasizes the learning part (evaluation) and Interactive Planning the controlled part (policy).

B. Planning as Organizing :- The Approach to Energy in Colombia

The most complete use of the organizing framework has been

ironically, in the power (i.e. electricity sector) of Colombia. The process used succeeded in re-designing the environment of the sector by linking reforms to the whole energy sector and its relationship to macro-economic planning. In this sense it provides an example of development organization, the re-design of environments to contribute to productive enterprise. Workshops based on the organizing framework and used to carry out the "evaluation" and "appraisal" phases of the approach were particularly successful and drew considerable attention from other sectors. Similar efforts have been begun in the Information and Transportation Sectors. In the following section we will describe the overall approach used in the Energy Sector and then concentrate in particular on the design of appreciative workshops using the Information Sector workshop as the concrete example. We do not mean to indicate that the particular approach or choice of technology is the best or only way to do appreciative work the examples illustrate one way that incorporates all of the principles of the theory outlined in this book. The extensive use of workshops reflects the tentative nature of support for innovation. It is much easier to obtain support for a discrete organizing event lasting three days than it is for a new organizing process that might last three months or three years. Like most innovations, the experience in Colombia has been a grass roots process with no formal backing or resources. Resources for the innovative part have come from the extra time and risk that practitioners and 'believers' have contributed. However, from the point of view of demonstration of the theory in action, a workshop is a complete organizing event, and because of the holographic nature of the organizing cycle, illustrate all levels, processes and phases of organization.

C. The International Energy Background - The Appreciated Environment.

Prior to the oil crisis of the early seventies few developing countries paid attention to planning of the energy sector as a whole. Until the late 70's planning consisted of a compilation of the sub-sector plans, electricity, coal, petroleum, gas etc. Within these sub-sectors the electricity sector, because of the long lead times required for its investments, generally had the most sophisticated planning system. In most developing countries, even to day, the countries' best planners are generally found in the power sector. The emphasis of such planning, however, is primarily technical. It concerns itself with forecasts of demand, supply by sources, plant utilization, reserves etc. There is no attempt in such planning to deal with non-technical issues such as institutional development, social, political or environmental impact. Similarly, the emphasis is on the production of the plan rather than on the organizing process to moving from plan to implementation.

The oil crisis forced most developing countries, who were hard hit by the increased costs of imported oil, to look at the energy problem as a whole. The initial attempts consisted primarily of aggregation of the plans of the sub-sectors at the national level. In many countries this was the first time that entities involved in oil and coal were involved in planning.

The aggregation of the plans of the various sub-sectors is even to-day the most prevalent form of planning for the energy sector.

There has been a growing awareness of the limitations of this approach, particularly, that too much reliance is placed on the enterprises and the demand side of energy planning. Several author (e.g. Del Valle 86) have tried to shift the focus of energy planning in two additional directions at the same time:-

a) from the sector to the national level where the supply side of energy can be planned for and where energy policy formulation can be better driven by the more general national social, economic. and politic values of the country as a whole and

b) to the local level where energy planning can become more driven by the needs of local users in their natural habitats and where non-traditional and non-commercial forms of energy can be tapped.

These ideas are just now beginning to be put into practice and only in the most innovative of settings. In most developin countries the attempts to develop a holistic approach to energy planning, such as envisaged by the organizing framework, are fairly rudimentary. They lack the basic information on which to formulate policy (appreciation), governments lack the institutional means to resolve the conflicts between the interests of the various sub-sectors and the national interest (influence) as well as the institutional capacity to ensure that the energy enterprises are acting in the national interest,(control).

The international agencies have found themselves with similar limitations, they too tend to be organized along sub-sector lines. Recognizing the problem they started to create new energy department which attempted to develop aid along more holistic lines. However

the new energy departments have found themselves in the same position as their counterparts in the countries. they have relatively little power to overcome the rivalries between the powerful sub-sectors.

In terms of the organizing framework the emphasis has been on the planning process at the control level. The development of overall managerial capacity for policy and strategy formulation has received much less attention.

D. The Colombian Energy Experience: The Influenced Environment

The Colombian experience with energy planning has not been too different from that of other developing countries. It has one of the longest traditions in planning but has been no more successful in pulling together economic plans to guide sectoral activity than most other countries. (Urutia 1986).

Planning for energy has been carried out on a sub-sector basis. The electricity sector is probably the shining example of this type of planning. Up until the early 1970's planning for the sector consisted largely of the independent investment plans of the utilities of the three major cities, Bogota, Medellin and Cali. A second phase of planning encouraged physical interconnection and coordination between the enterprises and resulted in the creation of ISA, (A Corporation to manage interconnections between the utilities). The degree of coordination, however, has not yet been extended to include financial integration. The enterprises resisted the loss of control brought about by the creation of a new level of coordination and it

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took pressure from the World Bank to ensure the formation of ISA, in 1967. Even then the decision was only accepted by allowing the major utilities to have veto power over any decisions made by ISA's Board. Today several agencies are legally assigned the function of participating in the preparation and approval of plans for the sector; ISA, the Division de Energia Electrica of the Ministry of Mines and Energy and the Consejo Nacional de Planeacion Economica y Social, CONPES. In practice it has been ISA's Shareholders General Assembly who approved the plans which were automatically approved by the Departmento Nacional de Planeacion (DNP) and included in the national Plan for Development by the CONPES.

It was probably the double punch created by the discovery of substantial over capacity in the sector and the devaluation of the peso, from 90 to the dollar to 190 in 1982 (effectively doubling the external debt of the sector), that signaled the death toll for the narrow sub-sectoral and technical approach to energy planning. It dramatized the effect of the external environment on sector plans and revealed its faulty assumptions on demand, on the opportunity cost of capital and the inflexibility of supply built into the heavy dependence on large hydroelectric projects.

The Estudio Nacional de Energia,(ENE) was the principal Colombian response to the energy crisis. The study was carried out by a firm of Colombian consultants with technical assistance from German experts financed by FONADE. The study carried out an extremely thorough analysis of the energy sector as a whole and of each of its component parts. It created models for analysis of the interaction

between each of the sub-sectors. However, the principal effect of the report seems to have been in improvement of the country's informational and analytical capacity. It did not succeed in having the institutional problems that are at the heart of the sector addressed. Nor was it successful in linking the process of carrying out the study to the political decision making process within the government. Thus when the government changed its findings were largely ignored.

In April 1985 the Colombia Division of the World Bank, in seeking to assist the Government of Colombia in addressing these issues decided to try a new approach based on the organizing framework. The resulting approach was used by the Senior Loan Officer for Colombia (Turid Sato) as a conceptual framework to guide her work with the Colombians to deal with the crisis in the power sector.

E. Learning at the Policy Level

In January 1985 the Minister of Finance appealed to the Bank for help in what he perceived to be a serious financial and institutional problem in the sector. The Senior Loan Officer convened a meeting of all the Bank stakeholders to carry out a systematic "learning" process to decide how the Bank should respond. The meeting tried to evaluate the real causes of the present situation and develop preferred future scenarios. The meeting concluded that the root causes of the present crisis lay in the lack of national leadership, in the weakness of the national level to deal with the powerful regional forces and produce coordination between them in the national

interest. A number of solutions were proposed but the meeting recognized that any outcomes had to be "valued" by the Colombians themselves before their commitment to action could be obtained. The group then recommended that Colombians should go through their own learning or evaluation exercise and come up with their own outcomes.

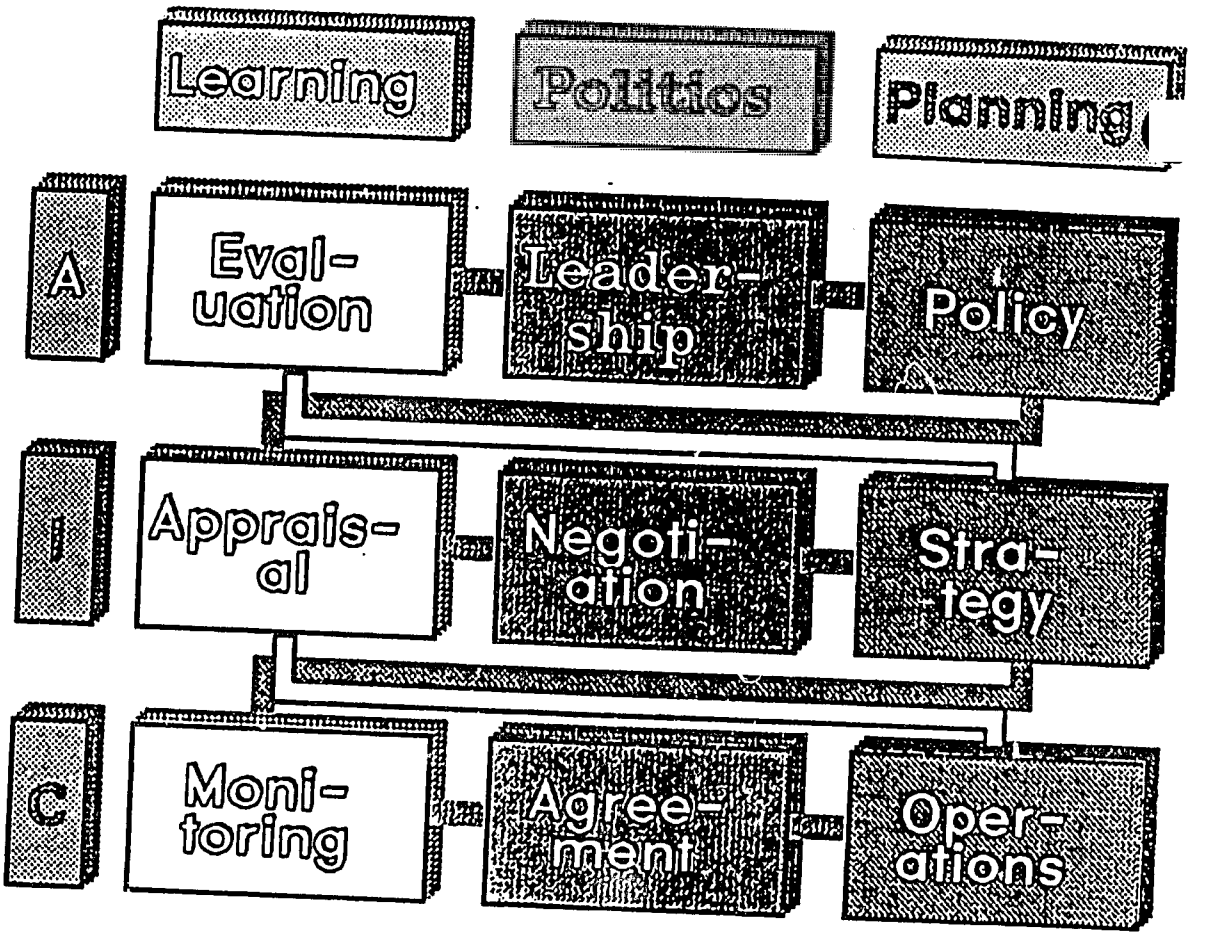
They decided to ask the Colombians to organize a workshop and to invite stakeholders from all three levels of environment affecting performance of the sector. The Colombian officials and the then Resident Representative expressed enthusiasm for the idea of a workshop and indicated who should be invited. The Ministers of Finance, National Planning and Mines and Energy decided to jointly sponsor the workshop. The Bank's role was confined to designing the workshop and engaging outside facilitators to run it. Approximately sixty particpants attended the workshop. They were drawn from a bipartisan list to represent three levels, the superior or national policy level, consisting of the three sponsoring Ministries,(the appreciated environment) the collateral level consisting of the Heads and key staff members of other energy sub-sectors, Carbocol, Ecopetrol etc.(the influenced environment), and the subordinate level consisting of representatives of the key institutions within the power sector e.g. the Regional utilities (the controlled environment). Consumers were represented by several Congressmen and Senators. Similarly several academics and consultants with knowledge of the sector were invited. Three members of the World Bank and the IMF were invited as observers.

The workshop took place in Santa Marta in June 1985. It was

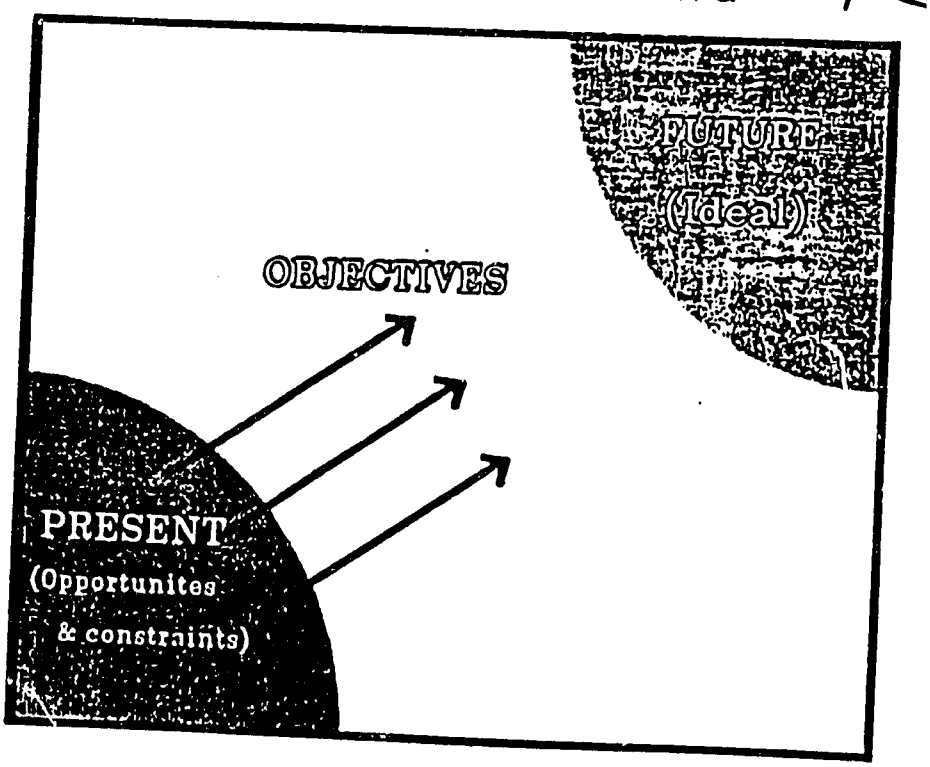
designed as the first of the three steps of the policy making process. (See Chart 7.1). It was an evaluative or learning exercise rather than a decision making meeting. The workshop was organized into three basic parts illustrated in Chart 7.2 (The rationale for the design of the workshop will be discussed in the next section.) The creation of an ideal future for the sector, an examination of the present situation to determine the constraints and opportunities for moving in the desired directions, and then a search for options to move in the direction of the ideal.

To achieve these objectives with sixty people required work in sub-groups and a high degree of structure. It was the first time such methodology had been used in Colombia. Initially, there was a considerable resistance from the more technical level of the Colombian counterpart team, they believed that the Ministers, especially, would not conform to the discipline required by the systematic approach and group work. The facilitators appealed to the particpants for cooperation with the design for twenty four hours of the three day design and offered to change it then if it did not work. Primarily due to the example set by the Minister of Mines and Energy, the participants did accept the discipline of the systematic approach and the workshop was a success. The workshop provided a mini example of the whole organizing process. It had its own learning, political and planning phases and tried to take into account the social, technical and political factors affecting the participants. For example, during the idealization exercise the sector was figuratively destroyed and the participants stripped of their formal status and asked to play the role of concerned Colombian citizens, with equal status, trying to

ORGANIZING PHASES



IDEALIZED PLANNING 7.21



produce the best design possible for their country. The design helped minimize dysfunctional political conflict while succeeding in dealing with political issues. The idealization exercise enabled participants to bring their ideals and values into play. It enabled each to be involved in acts of leadership in which he overcame his own parochial interest for the good of Colombia. It developed a deeply felt appreciation of the problems and hope for the future.

The broader environmental perspective taken was able to reveal that most of the problems could not be solved by measures taken within the internal or controlled environment of the power sector, they had their roots in and could only be resolved through participation with external actors or stakeholders. For example, the sector was organized along regional lines and was unable to take into account a national perspective. A new "rector" was required to mediate between the interests of the sector and those of the nation. In effect the participants recognized the need for an "influence" level between the the "appreciated" level of macro-economic policy formulation, and the "controlled" level of energy sector operations provided by the enterprises. The new level would provide the missing level of strategic planning between macro-economic planning, and the operational and investment plans of the enterprises. For this approach to succeed the National organizations involved in planning or regulation of the sector would have to be strengthened, e.g. Ministry of Mines and Energy, the Planning Department, and the Ministry of Budget.

Attention to the social, political and symbolic aspects of the design process helped to raise the emotional and spiritual level of

participation and produced a powerful ground swell of energy and support for the new policy directions that was referred to as the "Spirit of Santa Marta".

The second or political phase of work at the policy level relies on diplomacy and leadership. In this phase the various stakeholders begin to formulate their positions as a result of their new appreciation. The issue of how much leadership each will take and how much they are willing to commit to or oppose the directions indicated are addressed in very subtle ways. It is a phase that cannot easily be formally managed. Basically, one waits to see if the challenges of leadership posed in the first phase are accepted. The personal and political nature of the activities also makes it a difficult to record or describe. Much of the relevant information never becomes public knowledge. We can only indicate the apparent outcomes of the phase and occasionally infer reasons. Often the outcomes are revealed as much by what the stakeholders choose not to do as much as by what they actually do. In terms of leadership DNP (Planning) appeared to pull back from taking a lead. It recognized its limitations in contributing to energy sector planning and requested the Bank for assistance in improving its approach to energy sector planning. The Minister of Mines and Energy took the principle leadership role and went forward as far as he could with the recommendations from Santa Marta. He carried out three off-site workshops within the sector to review the findings and obtained commitment to putting them in practice. He moved to strengthen the government role by reorganizing the Boards of ISA, ICEL, (the poorest performing entity in the sector, the institute responsible for rural and small town

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electrification) and the utilities. He ordered ISA to create a plan for reorganization of markets and submitted a bill to Congress to establish a separate regional utility for one of the poorer regions of the country.

The World Bank tried to resolve its own internal difficulties of developing a common approach between the five groups concerned with energy and also to come to terms with the new approach which had been received with a mixture of reactions that moved from hostility, to skepticism, curiosity and eventually qualified support.

There was some fear both in the Bank and Colombia, from those who did not understand that the workshop was only the first step of a total process of organizing, that all future actions in developing policy and strategy would be handled in open workshop forums. They feared that groups without responsibility might end up taking decisions for Ministers and managers who had responsibility; or that the World Bank might use such meetings to insert its own views on policy and strategy. The Bank, however, agreed to maintain its posture of taking leadership in facilitating the process of policy and strategy formulation but not to have direct input on the content of those policies and strategies.

The Minister of Mines and Energy (Ivan Duque de Escobar) took up the next steps of leadership.

a) He asked the Bank for support of a study to formulate policy for the Energy Sector, and

b) He requested a loan to deal with the financial and institu-

tional problems of the sector. (It is interesting to note that two years earlier the Colombians had turned down an offer for participation in the Bank/UNDP Energy Assessment program. Ironically it was these funds that were activated to meet the request)

c) He decided to set up a Technical Energy Board, (the "rector" suggested by the Santa Marta workshop). It would contain as suggested by the organizing process, representatives of three levels; the macro or national level (appreciative), the sector level (influence) and the enterprise or institutional level (control) - (ISA, Carbocol, Ecopetrol etc.))

It was at this point that the effort to solve the problems of the power sector were formally elevated to include the problems of its influenced environment, the energy sector. From this point on the the effort became "developmental" in the sense that we define in the book. The problem was one of re-designing the energy environment to improve the productive capacity of the enterprises in the national interest. The task involved making better bridges, to obtain improved mediation, between legitimate national interest and productive efficiency of the energy sector enterprises.

F. Learning at the Strategic Level

The principle function of the strategic level is to identify the most influential technical, social and political factors that affect movement in the directions identified at the policy level and decide on a strategy and structure for addressing them. Many

strategies and multiple structures need to be examined before the best fit can be obtained.

The complete organizing cycle at the strategic level involves movement across the three phases of learning, politics and planning. The learning phase called an "appraisal" (See Chart 7.1), was carried out, initially, within the Bank. The Country Programs Division brought together staff from the five separate divisions in the Bank working on Colombia to identify the most critical factors involved at each of the three levels, macro, sector and enterprise. These ideas were then shared with the Bank's Colombian counterparts who in turn added their own list of critical factors.

Agreement was reached on conducting a study. During two meetings held in Bogota the objectives of the study , its role in serving as a strategic appraisal of the energy sector, its linkage to macro-economic policies and to plans for implementation by the operational institutions, were outlined. There were three primary objectives for the study:-

a) To test the basic directions indicated by the Santa Marta workshop and formalize the decisions that need to be made by the national government with respect to the sector.

b) To examine strategic alternatives for the role of the sector in relationship to the national economy, as well as the role and relationships of each of the four sub-sectors.

c) The third objective was to test the different organizing approach to carrying out the work, i.e. by developing a different working relationship between the World Bank and the Colombians.

1 *MICRO-ENTERPRISE DEVELOPMENT*

2 *Of the funds appropriated by this Act to carry out part I*
3 *and chapter 4 of part II of the Foreign Assistance Act of*
4 *1961, not less than $50,000,000 shall be made available for*
5 *programs of credit and other assistance for micro-enterprises*
6 *in developing countries: Provided, That local currencies*
7 *which accrue as a result of assistance provided to carry out*
8 *the provisions of the Foreign Assistance Act of 1961 and the*
9 *Agricultural Trade Development and Assistance Act of 1954*
10 *may be used for assistance for micro-enterprises: Provided*
11 *further, That such local currencies which are used for this*
12 *purpose shall be in lieu of funds reserved under this heading*
13 *and shall reduce the amount reserved for assistance for micro-*
14 *enterprises by an equal amount.*

15 *SUB-SAHARAN AFRICA, DEVELOPMENT ASSISTANCE*

16 *For necessary expenses to carry out the provisions of*
17 *sections 103 through 106 and section 121 of the Foreign As-*
18 *sistance Act of 1961, $500,000,000, for assistance only for*
19 *Sub-Saharan Africa, which shall be in addition to any*
20 *amounts otherwise made available for such purposes: Provid-*
21 *ed, That any of the funds which are appropriated under this*
22 *heading may be used for assistance for Sub-Saharan Africa*
23 *to carry out any economic development assistance activities*
24 *under the Foreign Assistance Act of 1961: Provided further,*
That assistance made available under this heading shall be
26 *used to help the poor majority in Sub-Saharan Africa through*

Report Language from the Conference Committee on the African Development Fund

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1 a process of long-term development and economic growth that
2 is equitable, participatory, environmentally sustainable, and
3 self-reliant: Provided further, That these objectives may, in
4 part, be achieved through the integration of women in the
5 development process, appropriate consultation with private
6 voluntary organizations, African and other organizations
7 with a local perspective on the development process, and in-
8 clusion of the perspectives and participation of those affected
9 by the provision of assistance: Provided further, That assist-
10 ance made available under this heading shall be provided in
11 accordance with the policies contained in section 102 of the
12 Foreign Assistance Act of 1961: Provided further, That as-
13 sistance made available under this heading should be provid-
14 ed, when consistent with the objectives of such assistance,
15 through African, United States and other private and volun-
16 tary organizations which have demonstrated effectiveness in
17 the promotion of local grassroots activities on behalf of long-
18 term development in Sub-Saharan Africa: Provided further,
19 That assistance made available under this heading should be
20 used to help overcome shorter-term constraints to long-term
21 development; to promote reform of sectoral economic policies
22 to support the critical sector priorities of agricultural produc-
23 tion and natural resources, health, voluntary family plan-
24 ning services, education, and income generating opportunities;
25 to bring about appropriate sectoral restructuring of the Sub-

1 *Saharan African economies; to support reform in public ad-*
2 *ministration and finances and to establish a favorable envi-*
3 *ronment for individual enterprise and self-sustaining devel-*
4 *opment: Provided further, That assisted policy reforms*
5 *should take into account the need to protect vulnerable*
6 *groups: Provided further, That assistance made available*
7 *under this heading shall be used to increase agricultural pro-*
8 *duction in ways which protect and restore the natural re-*
9 *source base, especially food production; to maintain and im-*
10 *prove basic transportation and communication networks; to*
11 *maintain and restore the renewable natural resource base in*
12 *ways which increase agricultural production; to improve*
13 *health conditions with special emphasis on meeting the health*
14 *needs of mothers and children, including the establishment of*
15 *self-sustaining primary health care systems that give priority*
16 *to preventive care; to provide increased access to voluntary*
17 *family planning services; to improve basic literacy and math-*
18 *ematics especially to those outside the formal educational*
19 *system and to improve primary education; and to develop*
20 *income-generating opportunities for the unemployed and un-*
21 *deremployed in urban and rural areas: Provided further,*
22 *That the Administrator of the Agency for International De-*
23 *velopment should target the equivalent of 10 percent of the*
24 *funds appropriated under this heading for each of the follow-*
25 *ing: (1) maintaining and restoring the renewable natural re-*

1 *source base in ways which increase agricultural production,*
2 *including components of agriculture activities which are con-*
3 *sistent with this objective, (2) health activities, and (3) volun-*
4 *tary family planning: Provided further, That local currencies*
5 *generated by the sale of imports or foreign exchange by the*
6 *government of a country in Sub-Saharan Africa from funds*
7 *appropriated under this heading shall be deposited in a spe-*
8 *cial account established by that government: Provided fur-*
9 *ther, That these local currencies shall be available only for*
10 *use, in accordance with an agreement with the United States,*
11 *for development activities which are consistent with the policy*
12 *directions of section 102 of the Foreign Assistance Act of*
13 *1961 and for necessary administrative requirements of the*
14 *United States Government: Provided further, That in order*
15 *to carry out the purposes of this heading, section 604(a) of*
16 *the Foreign Assistance Act of 1961, and similar provisions of*
17 *law, shall not apply with respect to the implementation of*
18 *assistance activities consistent with the purposes of this head-*
19 *ing: Provided further, That the funds made available under*
20 *this heading shall be provided only on a grant basis.*

21 *SOUTHERN AFRICA, DEVELOPMENT ASSISTANCE*

22 *For necessary expenses to carry out the provisions of*
23 *sections 103 through 106 of the Foreign Assistance Act of*
24 *1961, $50,000,000, which shall be made available, without*
25 *regard to section 518 of this Act and section 620(q) of the*
26 *Foreign Assistance Act of 1961, only to assist sector projects*

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1 *supported by the Southern Africa Development Coordination*
2 *Conference (SADCC) to enhance the economic development*
3 *of the nine member states forming that regional institution:*
4 *Provided, That at least 50 percent of that amount shall be*
5 *made available for the transportation sector and the remain-*
6 *ing amount shall be made available for one or more of the*
7 *following sectors: manpower development; agriculture and*
8 *natural resources; energy (including the improved utilization*
9 *of electrical power sources which already exist in the member*
10 *states and offer the potential to swiftly reduce the dependence*
11 *of those states on South Africa for electricity); and industrial*
12 *development and trade (including private sector initiatives):*
13 *Provided further, That amounts made available under this*
14 *heading shall be in addition to any amounts otherwise made*
15 *available for such purposes and shall be in addition to*
16 *amounts made available for Africa under the heading "Sub-*
17 *Saharan Africa, Development Assistance": Provided further,*
18 *That none of the funds appropriated under this heading may*
19 *be made available for activities in Angola: Provided further,*
20 *That none of the funds appropriated under this heading may*
21 *be made available for activities in Mozambique unless the*
22 *President certifies that it is in the national interest of the*
23 *United States to do so, ~~and until the President reports to the~~*
24 *~~Committees on Appropriations that:~~*

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The Administrator shall appoint an advisory committee composed of individuals from nongovernmental organizations who have experience in implementation of micro-enterprise credit projects in developing countries to assist the Administrator in developing the guidelines for this program. The conferees expect the Administrator to report to the Committees on Appropriations on the Agency's plans and proposals for implementation of this program no later than March 31, 1988.

Sub-Saharan Africa, Development Assistance

The conferees agree to provide $500,000,000 in direct appropriations for Sub-Saharan Africa, Development Assistance. The House had provided $450,000,000 in transfers for this account.

The first twenty-five years of independence has seen little real improvement in the quality of life for the vast majority of Africa's people. Indeed, of all the regions of the world, the economic performance of Sub-Saharan Africa has brought the least in terms of economic results over this period of time. The causes for Africa's poor economic performance are varied. Any listing of those causes would have to include the pursuit of inappropriate economic policies, often exacerbated by donors and adverse developments in the world economy over which African nations have little control; rapid population growth; recurring natural disasters and the resulting erosion of the natural resource base; resource constraints that have inhibited the full development of human resources; conflict and instability; and the legacies of colonialism.

The need for a process of long-term development in Sub-Saharan Africa that is equitable, participatory, environmentally

sustainable, and self-reliant remains compelling. To achieve these objectives, the conferees are in agreement that there must be fundamental changes in U.S. assistance programs for Africa. Two types of changes seem especially urgent:

1. First there must be an assured and stable source of funding for Africa. To achieve this objective, the conferees agree to establish a separate funding account for Africa.

2. Second, there must be authority to implement programs in Africa in a more flexible fashion. To achieve this objective, the conferees agree that these funds may be used for any economic development assistance activities under the Foreign Assistance Act of 1961. The language of the bill specifically refers to "critical sector priorities." In addition, the conferees have provided greater flexibility in the procurement of goods and services with these funds.

In addition, two other points need to be reemphasized:

1. First, the role of voluntary agencies and international organizations should be emphasized. Thus, in programming funds for Africa, the conferees expect AID to consult on a regular basis with African and American private voluntary organizations that have demonstrated their effectiveness in helping to address the development problems of Africa at the community level, and to involve these and other international organizations in U.S. programs, projects and activities to the extent appropriate. In addition, emphasis should be placed on programs, projects and activities that help the poor majority of Africans in addressing their own problems.

2. Second, there is a continuing need for better international cooperation and coordination of African aid programs generally. While this issue is not addressed directly in our recommendations, the conferees encourage A.I.D. to coordinate its programs closely with those of the Multilateral Development Banks, United Nations agencies, other government donors, and private voluntary organizations.

Because of the expanded flexibility accorded in the use of these funds, the conferees wish to emphasize a number of points. We believe assistance for Sub-Saharan Africa should focus on certain critical sectoral priorities, including: environmentally sustainable agricultural production, with special attention to the role of women; health; voluntary family planning; education; public administration and finance; and income and employment generation. Assistance under this heading should be provided in the form of direct interventions to enhance human welfare as well as indirectly through sectoral support designed to alleviate specific policy, institutional or resource constraints in a recipient country's economy. It is expected that these approaches would be integrated into a single country strategy

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whose different components complement one another and where the potential short-term adverse affects of a change in policy are appropriately taken into account.

The conferees do not earmark funds for particular uses. However, since most of these funds will be used for projects that primarily address long-term constraints to development, it is the conferees' expectation that AID will allocate at least the equivalent of 10 percent of the funds appropriated by this provision for Sub-Saharan Africa for the following activities: (1) maintenance of the natural resource base, including agricultural activities which directly support this purpose, (2) improvements in health conditions, with special emphasis on the needs and education of mothers and children, and (3) voluntary family planning. The conferees encourage AID to use resources available from this funding as well as its centrally funded programs to achieve these levels.

The conferees also recognize that effective long-term development requires the support and development of indigenous institutions, especially agricultural education institutions, to train and educate Africans to address their own problems. In using amounts appropriated for Sub-Saharan Africa, the conferees expect AID, in consultation with the Board for Food and Agricultural Development, to support programs that would strengthen and develop such educational institutions.

African governments themselves have recognized that one major cause for poverty in Africa has been the adoption of inappropriate economic policies. Thus, the conferees agree that up to 20 percent of the funds available under this heading may be used for non-project assistance to support sectoral policy reform programs. In addition, if, during the consultative process with the Committees on Appropriations, the Agency for International Development justifies a requirement for using up to an additional 10 percent of the funds made available under this heading for non-project assistance in support of sectoral policy reform programs, the Committees on Appropriations will look favorably on such justifications.

Assistance for the Sahel will be funded under this heading. The conferees agree that there are continuing needs in the Sahel, and encourage AID to address those needs within the funding recommended in this bill.

It is the intent of the conferees that provisions of law that make specific reference to the development sections of the Foreign Assistance Act shall apply to these funds also. Thus, for example, provisions of law that make reference to any one or all of sections 103 through 106 and section 121 of the Foreign Assistance Act will apply to funds made available from this appropriation. For example, section 105 of the Foreign Assistance Act designates funding for assisting victims of

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apartheid in South Africa. Funding for such activities would be derived from the ESF and Sub-Saharan Africa accounts rather than the ESF and education and human resources development assistance accounts.

If this development effort in Sub-Saharan Africa is going to achieve its objectives, the conferees believe it must be a joint undertaking on the part of the Congress and the Executive Branch. The conferees expect AID to regularly consult with the appropriate Committees on the economic situation in Sub-Saharan Africa and the efforts being made to enhance the ability of those countries to achieve self-sustaining and equitable economic growth.

In particular, AID is directed to consult with the Committees on Appropriations on proposed country and regional allocations of funds prior to the submission of the report required by section 653(a) report or as part of the annual congressional presentation, which explains the proposed functional allocation of funds in Sub-Saharan Africa for each assistance recipient, the objectives to be achieved from such assistance, and the interrelationship among the various components of the AID portfolio for a country as they related to the achievement of overall program objectives. Since a large amount of funding for Africa is non-country specific, the report should also explain the purposes for which regional funds will be allocated and the specific countries that are expected to benefit from such funding. Finally, the report should address, in light of the flexibility in the procurement of goods and services provided, the steps being taken to procure AID-financed commodities from the United States to the extent consistent with program objectives.

The conferees wish to encourage a consultative process that is informal and self-critical. Consultations should take place on a quarterly basis, and the Committees on Appropriations are prepared to jointly participate in these informal consultations so that the concerns of each Committee are better understood by the other.

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February 5, 1988
John Westley

A.I.D. "NICHE" IN THE POLICY REFORM ARENA

I. Emergence of Concerns with Structural Adjustment

- Policy reforms needed for sustainable development can take place in a short-term, medium-term or long-term context, at the macro, sectoral or project level.
- The primary concern in the 1980s has been with a change in key economic parameters in medium term, or structural adjustment: particularly changes in prices (exchange rates, interest rates, food and energy prices, etc.) to reflect true scarcities, adoption of more outward-oriented trade policies, and reduction in role of government.
- Trend in IMF operations toward medium-term (3 years) agreements with broader objectives; increase in IBRD adjustment lending (SAL's and SECAL's) from 3% of total in 1980 to 24% (4 billion) in 1987.

II. Structural Adjustment and Equitable Growth

- For AID, "sustainable development" is equitable growth (i.e., growth which reduces poverty, as measured by the percentage of the population below the "poverty line"), on a sustainable basis
- For most countries, renewed growth will not be possible without successful structural adjustment.
- Structural adjustment, if successful, should bring about more rapid growth; more importantly it will also result in more equitable growth, since the price shifts involved will favor agriculture and the rural areas (where the majority of the poor

live), and will also favor labor - intensive and small scale production generally.

- Sructural adjustment is a necessary condition for equitable growth on a sustainable basis, and support for structural adjustment is fully consistent with AID's basic objective of promoting sustainable development.

III. What does this mean for A.I.D.?

- The issue for AID is not whether to support the kind of policy reform involved in structural adjustment, but how, and to what extent.
- Except in a few cases where AID has atypically large resources (e.g., ESF in Central America), AID can most effectively support structural adjustment as the sector and project (rather than macro) levels.
- For the short term, AID can support programs to offset some of the negative effects of adjustment on vulnerable groups (e.g. Title II targeted feeding programs), although programs of this type must be assessed carefully.
- For the medium term, AID can support sectoral and sub-sectoral policy reform (e.g. reforms in fertilizer pricing and distribution) through sector loans and grants.
- For the long term, AID can support restructuring in the productive and social sectors to provide better access for larger numbers of people, particularly in the rural areas; this is the purpose of the most current project assistance.
- AID has a comparative advantage in all of these areas, and in the ability to integrate various resources (ESF, food, local

currencies) in a coherent program of support for policy and institutional reform.

POLICY REFORM LEXICON

ECONOMIC POLICIES: Any of a series of governmental rules, regulations, laws, institutional practices and directed resource allocations that affect economic behavior. These policies include:

MACROECONOMIC POLICIES: Policies which affect the entire economy such as economy-wide prices (exchange rates, wages, and interest rates), regulations (e.g., investment and tax codes, including tariffs), and public sector resource allocations (public sector investment plans, fiscal policy, etc.);

SECTORAL POLICIES: Policies which have an impact only on a more narrowly defined sector, such as industry, agriculture, or health. These policies affect the prices of sectoral outputs (agricultural priceing policies, e.g.), public sector resource allocations within the sector, and the division of output between public and private sector entities.

POLICY REFORM: A generic term: the changing (hopefully improving) any of the macroeconomic or sectoral policies defined above.

STABILIZATION PROGRAMS: Programs designed to bring an economy back to external or internal equilibria, largely by reducing demands to available supplies. Thus a stabilization program seeks to reduce the demand for foreign exchange (thus reducing balance of payments disequilibria) and reduce aggregate demand (thus reducing inflation). These programs tend to be short-run (one to three years) depending on the size of the disequilibria.

STABILIZATION POLICIES: Stabilization programs are macroeconomic in nature; they work on exchange rates (to reduce imports and increase exports), fiscal policy (to reduce government deficits) and monetary policy (to reduce private sector credit and thus private consumption and investment.

STRUCTURAL ADJUSTMENT: Changing the structure of an economy to make it more efficient in a new global economic environment. In general this means making an economy more open, more market-oriented, and improving the efficiency of the public sector. Structural adjustment is aimed at increasing the supply of goods and services (at increasing economic growth).

STRUCTURAL ADJUSTMENT POLICIES: These are <u>both macro and sectoral</u> in nature. They include "getting the prices right," in particular, the relationship between international and internal prices (exchange rate and trade policies); labor and capital prices (financial sector policies); and various product prices (price decontrols). They also include regulatory reform for increased efficiency (land titling, investment and tax codes, for example), as well as public sector reforms to improve efficiency (parastatal reform, improvements in budgeting and planning, improved efficiency within a sector, e.g, agricultural extension services, etc.) Also included are reforms in government spending allocations both between sectors and within sectors (universities vs. primary education).

Structural adjustment programs thus includes all policy reforms aimed at increasing supply and long-term growth. These programs are likely to be long-term and depending on the size of the adjustment could take as long as ten years.

Macroeconomic Indicators for Selected Adjusting Countries

	1973-80	1981	1982	1983	1984	1985	1986	Adjustment Period
Costa Rica								
Adjustment operations				SEC		SAL		
GDP growth	5.3	-4.6	-5.0	2.3	8.0	1.1	2.9	4.0
Export growth	4.6	11.1	-5.5	-1.3	7.4	-4.9	2.4	1.5
Cur. acct. balance/GDP	-11.0	-15.6	-10.4	-9.2	-7.2	-8.1	-5.1	-
Gov. bdgt. balance/GDP	-3.5	-2.9	-9.3	-3.6	-1.7	-2.0	1.5	-
Côte d'Ivoire								
Adjustment operations		SAL		SAL			SAL	
GDP Growth	7.1	1.2	-3.6	-4.2	-4.1	4.9	5.4	-0.5
Export growth	3.3	-6.0	-6.0	-10.7	21.9	9.0	7.6	3.7
Cur. acct. balance/GDP	-10.8	-17.4	-13.4	-13.3	-1.0	1.1	-1.2	-
Gov. bdgt. balance/GDP	-9.6	-9.8	-13.6	-7.2	-5.3	-0.8	-	-
Ghana								
Adjustment operations				SEC	SEC	SEC	SEC/SEC	
GDP growth	-1.0	-1.8	-7.2	0.7	8.6	5.1	5.3	6.3
Export growth	n.a.	-8.9	15.2	-29.4	-15.6	21.0	15.0	5.5
Cur. acct. balance/GDP	0.1	-1.6	-2.7	-4.1	-2.8	-3.9	-3.9	-
Gov. bdgt. balance/GDP	-6.7	-6.5	-5.6	-2.7	-3.1	-3.8	-4.4	-
Jamaica								
Adjustment operations		SEC	SAL	SAL/SEC	SAL			
GDP growth	-2.6	2.5	1.0	2.0	-0.4	-4.7	2.3	0.0
Export growth	-2.4	-1.2	-3.3	1.9	1.9	-15.1	3.5	-2.5
Cur. acct. balance/GDP	-6.6	-12.5	-13.7	-11.1	-14.0	-14.9	-7.9	-
Gov. bdgt. balance/GDP	14.0	-13.7	-14.7	-13.7	-4.0	-3.1	-1.7	-
Kenya								
Adjustment operations	SAL		SAL				SEC	
GDP growth	5.1	3.8	0.6	2.3	0.4	3.7	6.5	2.8
Export growth	0.1	-4.2	-0.4	1.6	1.9	5.9	10.2	2.8
Cur. acct. balance/GDP	-7.9	-8.4	-4.7	-0.7	-1.9	-1.6	-1.3	-
Gov. bdgt. balance/GDP	-6.9	-9.5	-6.5	-3.6	-3.9	-5.3	-5.6	-
Korea								
Adjustment operations		SAL		SAL		SEC		
GDP growth	8.6	7.4	5.7	10.9	8.7	5.4	11.9	8.5
Export growth	19.7	15.0	6.5	15.5	10.1	2.1	26.6	11.8
Cur. acct. balance/GDP	-5.2	-6.7	-3.7	-2.0	-1.6	-1.0	4.7	-
Gov. bdgt. balance/GDP	-1.7	-3.4	-3.3	-1.0	-1.1	-1.5	-1.6	-

Note: All figures are percentages; 1973-80 and Adjustment Period figures are averages.
SAL/SEC indicates that SAL/sector adjustment loan approved in that year.
Adjustment Period is year after approval of first adjustment loan to 1986.
Growth Rates are from constant price data.

	1973-80	1981	1982	1983	1984	1985	1986	Adjustment Period
Malawi								
Adjustment operations		SAL		SEC/SAL		SAL		
GDP growth	4.9	-5.0	3.1	3.5	4.5	4.2	2.2	3.5
Export growth	8.5	-19.2	-7.4	2.4	27.8	-3.9	3.0	3.7
Cur. acct. balance/GDP	-12.7	-10.8	-10.6	-11.8	-1.4	-8.2	-6.1	-
Gov. bdgt. balance/GDP	-6.4	-10.2	-12.9	-10.3	-9.0	-9.2	-11.7	-
Mauritius								
Adjustment operations		SAL		SAL				
GDP growth	5.9	4.8	5.3	0.8	4.8	7.1	8.4	5.2
Export growth	5.0	-24.0	11.2	0.8	1.5	14.6	9.1	7.3
Cur. acct. balance/GDP	-6.4	-13.4	-3.9	-2.0	-5.2	-2.8	7.3	-
Gov. bdgt. balance/GDP	-12.1	-13.3	-9.6	-6.8	-6.4	-5.0	-4.4	-
Morocco								
Adjustment operations					SEC	SEC/SEC	SEC	
GDP growth	6.0	-1.3	6.8	2.3	2.1	4.4	5.8	5.1
Export growth	2.7	1.1	0.8	5.6	7.5	0.1	7.2	3.6
Cur. acct. balance/GDP	-9.3	-12.4	-12.5	-6.7	-8.3	-7.2	-1.5	-
Gov. bdgt. balance/GDP	-10.4	-10.2	-14.5	-12.6	-11.8	-8.4	-5.5	-
Pakistan								
Adjustment operations	SEC		SAL			SEC	SEC	
GDP growth	5.4	7.9	6.1	6.3	5.5	7.5	7.2	6.6
Export growth	7.0	6.4	-16.6	15.5	3.8	-0.9	1.7	4.8
Cur. acct. balance/GDP	-5.4	-3.6	-5.0	-1.8	-3.2	-5.5	-3.8	-
Gov. bdgt. balance/GDP	-7.8	-5.3	-5.3	-7.1	-6.0	-7.8	-7.9	-
Panama								
Adjustment operations				SAL			SAL	
GDP growth	4.6	4.2	4.7	0.4	-0.4	4.7	2.9	2.4
Export growth	6.5	1.3	-1.1	-5.2	-6.5	9.6	-	-
Cur. acct. balance/GDP	-9.1	-8.7	-9.5	-4.6	-5.2	-4.9	-	-
Gov. bdgt. balance/GDP	-8.1	-8.6	-11.2	-4.9	-4.9	-1.9	-1.2	-
Philippines								
Adjustment operations	SAL			SAL		SEC		
GDP growth	6.2	3.9	2.9	1.0	-6.1	-4.4	1.1	-0.3
Export growth	7.5	1.1	-1.1	9.0	8.3	-7.2	11.9	3.4
Cur. acct. balance/GDP	-4.7	-5.4	-8.0	-8.0	-3.9	0.0	3.3	-
Gov. bdgt. balance/GDP	-1.0	-1.3	-4.0	-4.2	-1.9	-1.9	-4.5	-

Note: All figures are percentages; 1973-80 and Adjustment Period figures are averages.
SAL/SEC indicates that SAL/sector adjustment loan approved in that year.
Adjustment Period is year after approval of first adjustment loan to 1986.
Growth Rates are from constant price data.

	1973-80	1981	1982	1983	1984	1985	1986	Adjustment Period
Thailand								
Adjustment operations			SAL	SAL				
GDP growth	7.5	6.3	4.1	5.8	6.2	3.2	3.5	4.7
Export growth	7.3	13.1	9.8	-4.5	13.3	7.9	7.7	6.1
Cur. acct. balance/GDP	-5.1	-7.1	-2.8	-7.2	-5.0	-4.1	0.6	-
Gov. bdgt. balance/GDP	-3.4	-3.2	-5.7	-4.3	-4.2	-5.0	-5.2	-
Togo								
Adjustment operations				SAL		SAL		
GDP growth	3.7	-3.5	-3.8	-5.4	0.7	3.6	3.1	2.5
Export growth	8.5	-29.7	-3.4	-14.3	1.0	1.7	1.0	1.2
Cur. acct. balance/GDP	-9.9	-4.9	-1.8	-6.3	-3.3	-16.9	-19.0	-
Gov. bdgt. balance/GDP	-	-5.7	-8.7	-7.8	-7.3	-6.6	-9.3	-
Turkey								
Adjustment operations	SAL	SAL	SAL	SAL	SAL	SEC	SEC	
GDP growth	4.6	4.4	5.0	3.7	5.7	5.1	8.0	5.3
Export growth	1.2	67.5	37.7	0.4	29.6	15.3	-5.4	21.9
Cur. acct. balance/GDP	-4.0	-3.3	-1.8	-3.7	-2.8	-1.9	-2.6	-
Gov. bdgt. balance/GDP	-4.2	-2.7	-1.8	-2.6	-5.4	-2.9	-3.2	-
Yugoslavia								
Adjustment operations				SAL				
GDP growth	6.3	1.4	0.5	-2.5	3.0	0.5	2.7	2.1
Export growth	4.5	4.7	-6.2	0.0	11.4	9.4	-0.5	6.6
Cur. acct. balance/GDP	-3.0	1.3	-1.0	0.5	2.0	0.7	0.5	-
Gov. bdgt. balance/GDP	-1.0	-0.1	0.5	0.5	1.0	0.3	0.4	-
Memo Item:								
GDP Growth								
All Developing Countries	5.4	3.2	2.1	2.3	5.2	4.7	5.1	-
Low-Income Africa	2.1	1.5	1.4	0.7	-0.1	1.1	3.4	-
Middle-Income Countries	5.7	2.6	0.8	0.2	3.7	2.8	3.9	-
Highly-Indebted Countries	3.4	0.4	-0.6	-2.9	2.3	2.9	2.9	-
Export Growth								
All Developing Countries	4.7	2.0	0.9	6.0	11.9	2.2	4.3	-
Low-Income Africa	0.7	-4.8	-4.6	-3.8	0.6	1.3	4.0	-
Middle-Income Countries	4.7	1.6	0.4	6.3	12.7	1.9	3.8	-
Highly-Indebted Countries	1.2	0.5	-4.9	0.7	13.0	-0.2	-3.8	-

Note: All figures are percentages; 1973-80 and Adjustment Period figures are averages.
SAL/SEC indicates that SAL/sector adjustment loan approved in that year.
Adjustment Period is year after approval of first adjustment loan to 1986.
Growth Rates are from constant price data.

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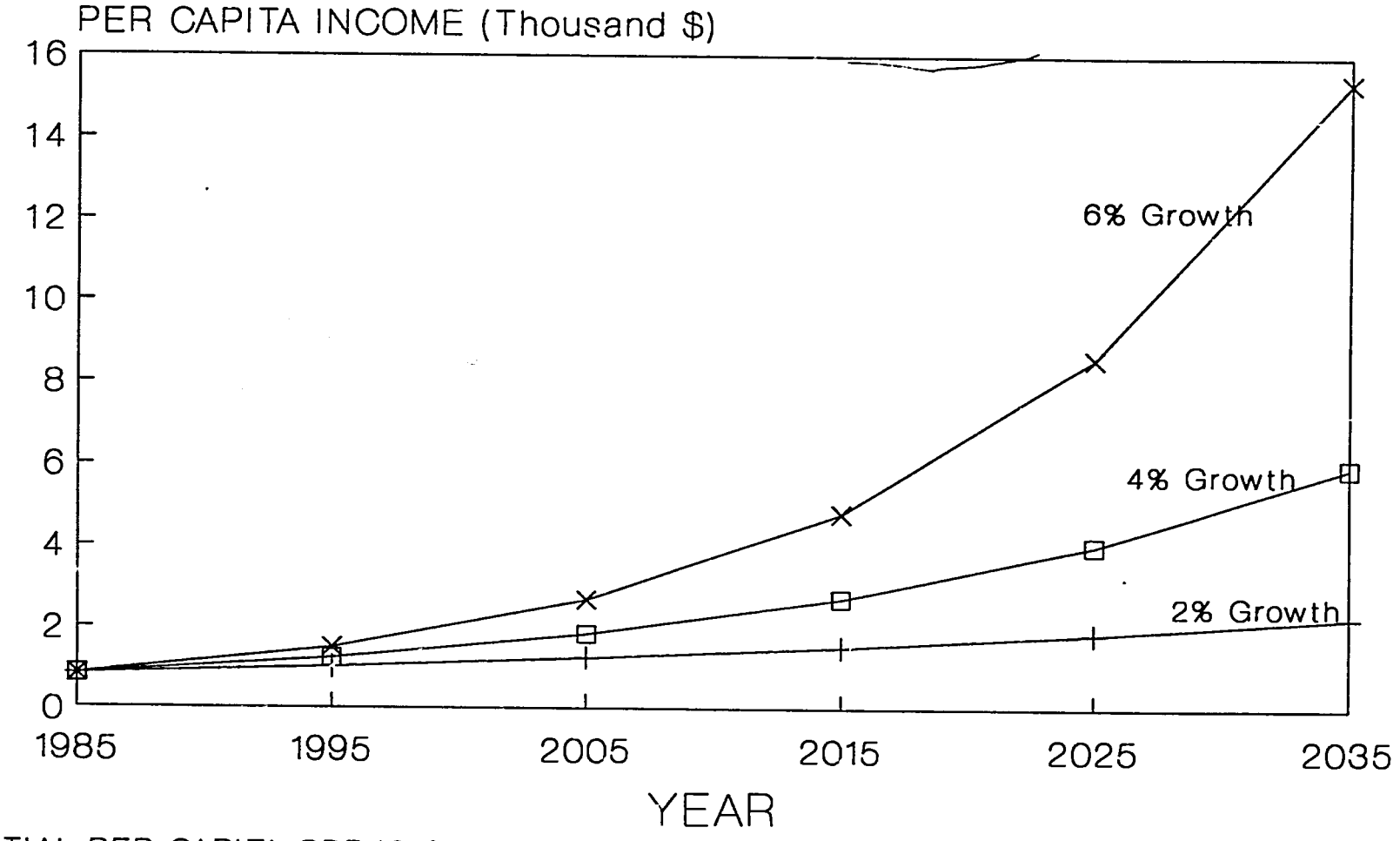
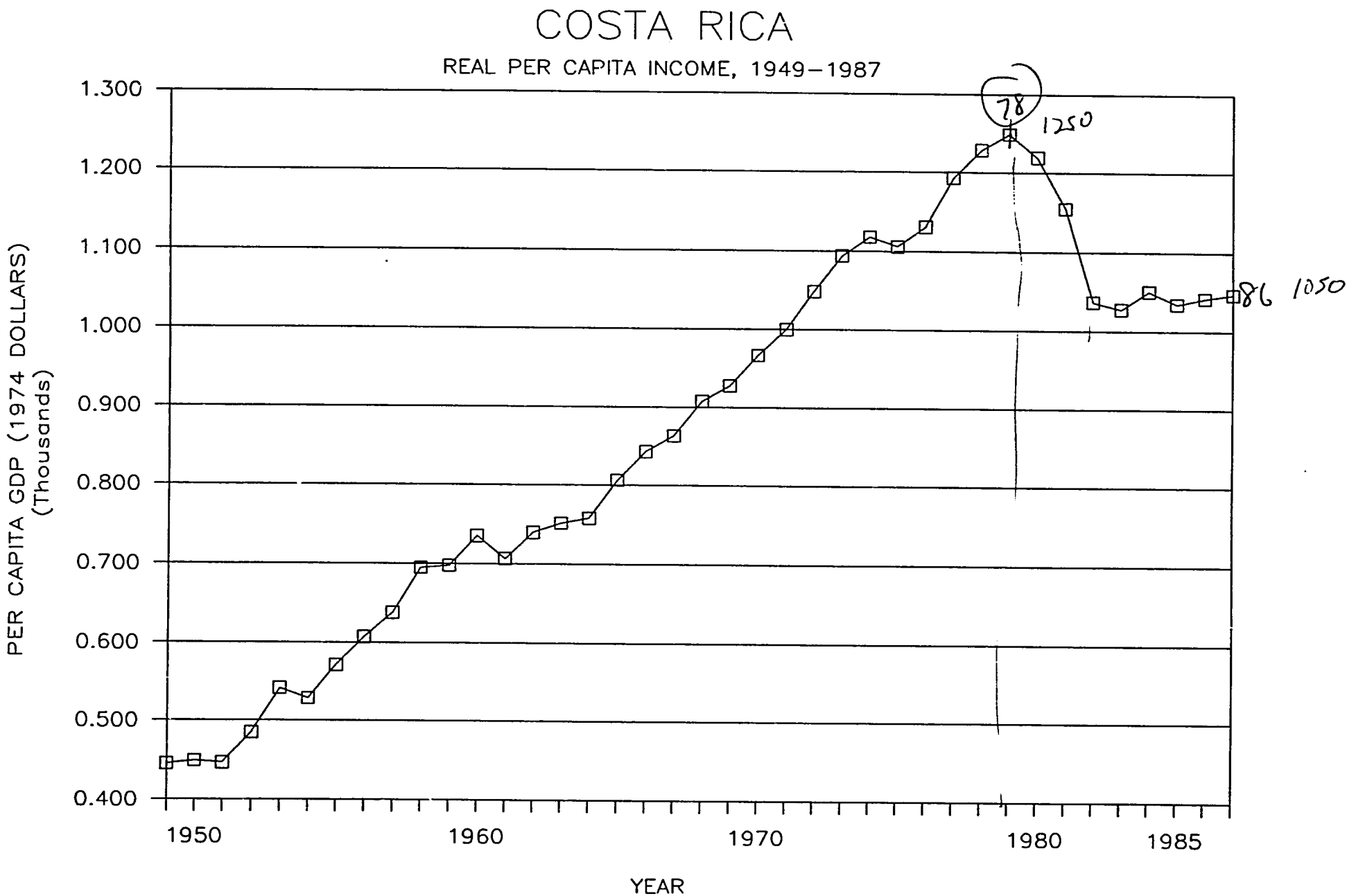
PER CAPITA INCOME GROWTH
UNDER ALTERNATIVE GROWTH RATES

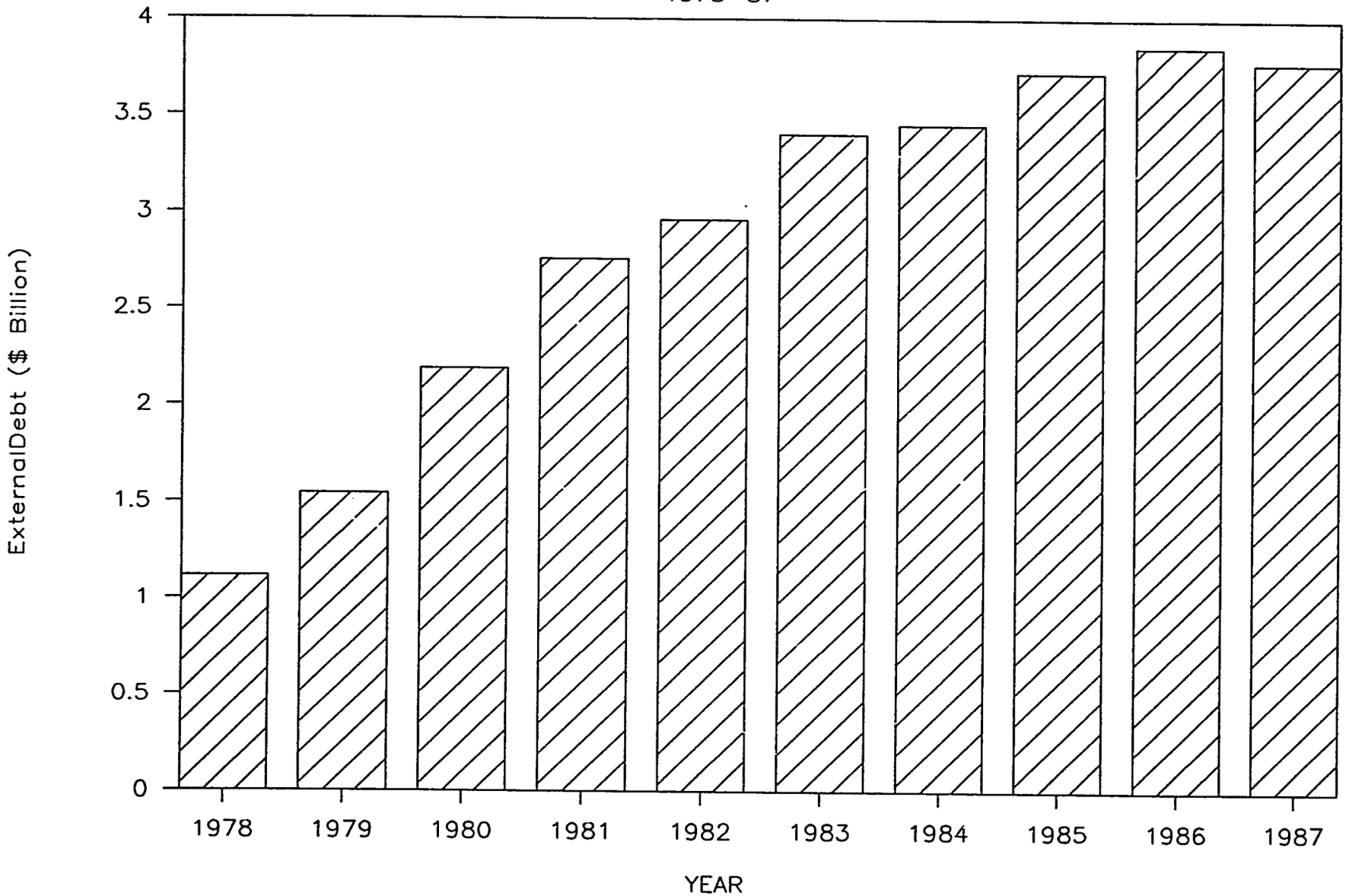


INITIAL PER CAPITA GDP IS $835


COSTA RICA
REAL PER CAPITA INCOME, 1949–1987
PER CAPITA GDP (1974 DOLLARS)
(Thousands)
1.300
1.200
1.100
1.000
0.900
0.800
0.700
0.600
0.500
0.400
1950
1960
1970
1980
1985
YEAR
78
1250
86
1050

COSTA RICAN EXTERNAL DEBT

1978–87



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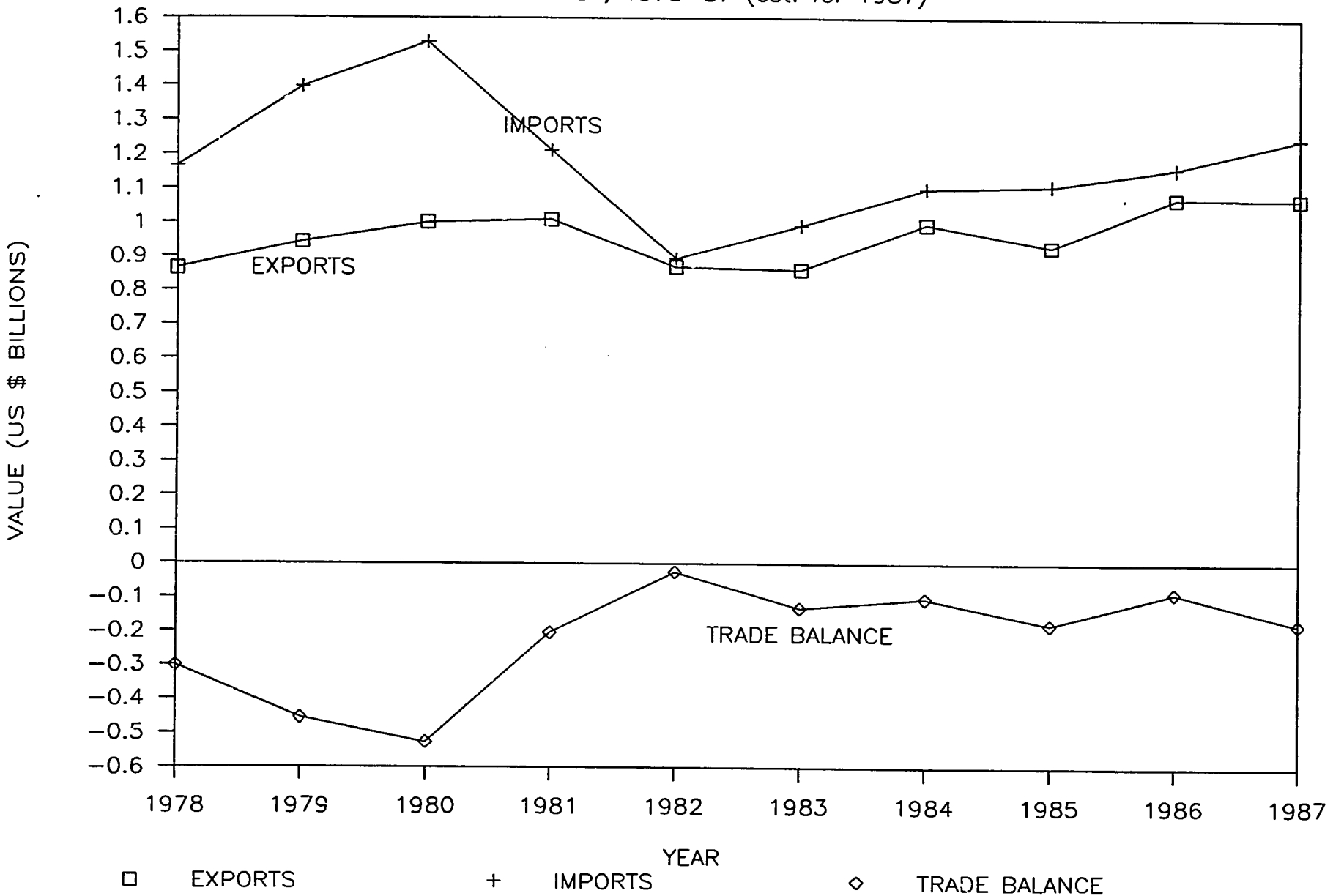
EXPORTS, IMPORTS AND TRADE BALANCE

COSTA RICA, 1978–87 (est. for 1987)



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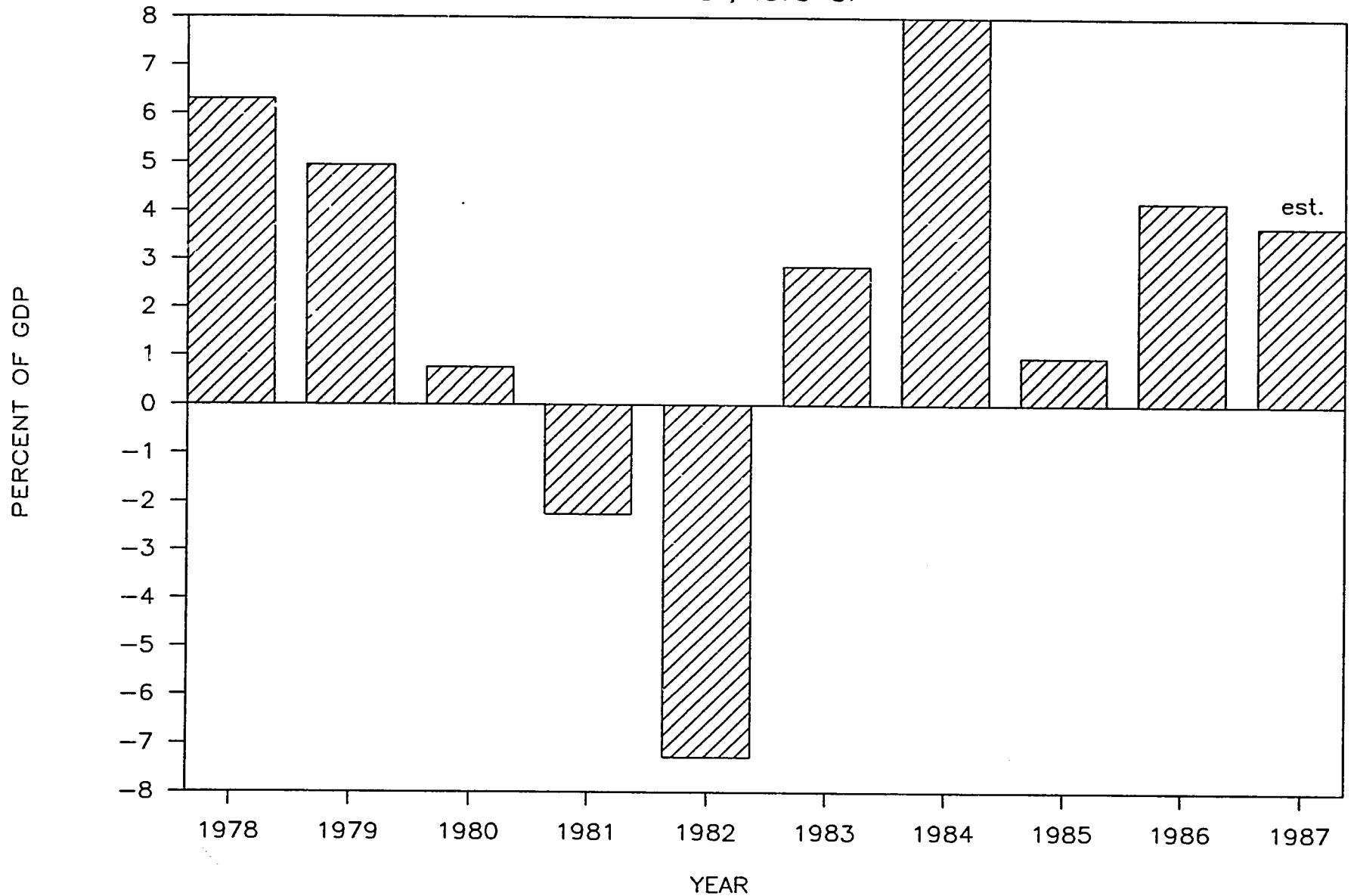
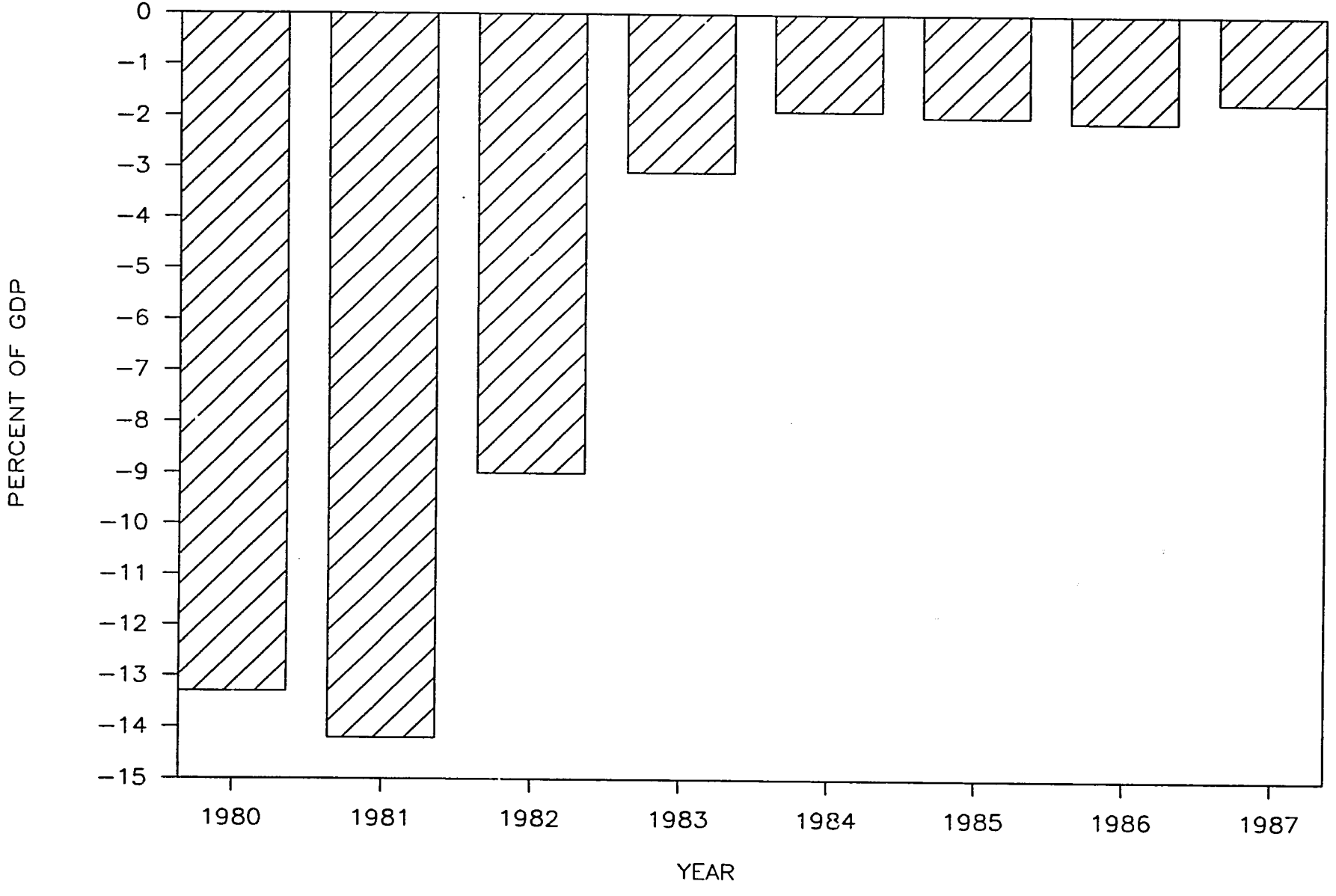
ANNUAL REAL GDP GROWTH

COSTA RICA, 1978–87



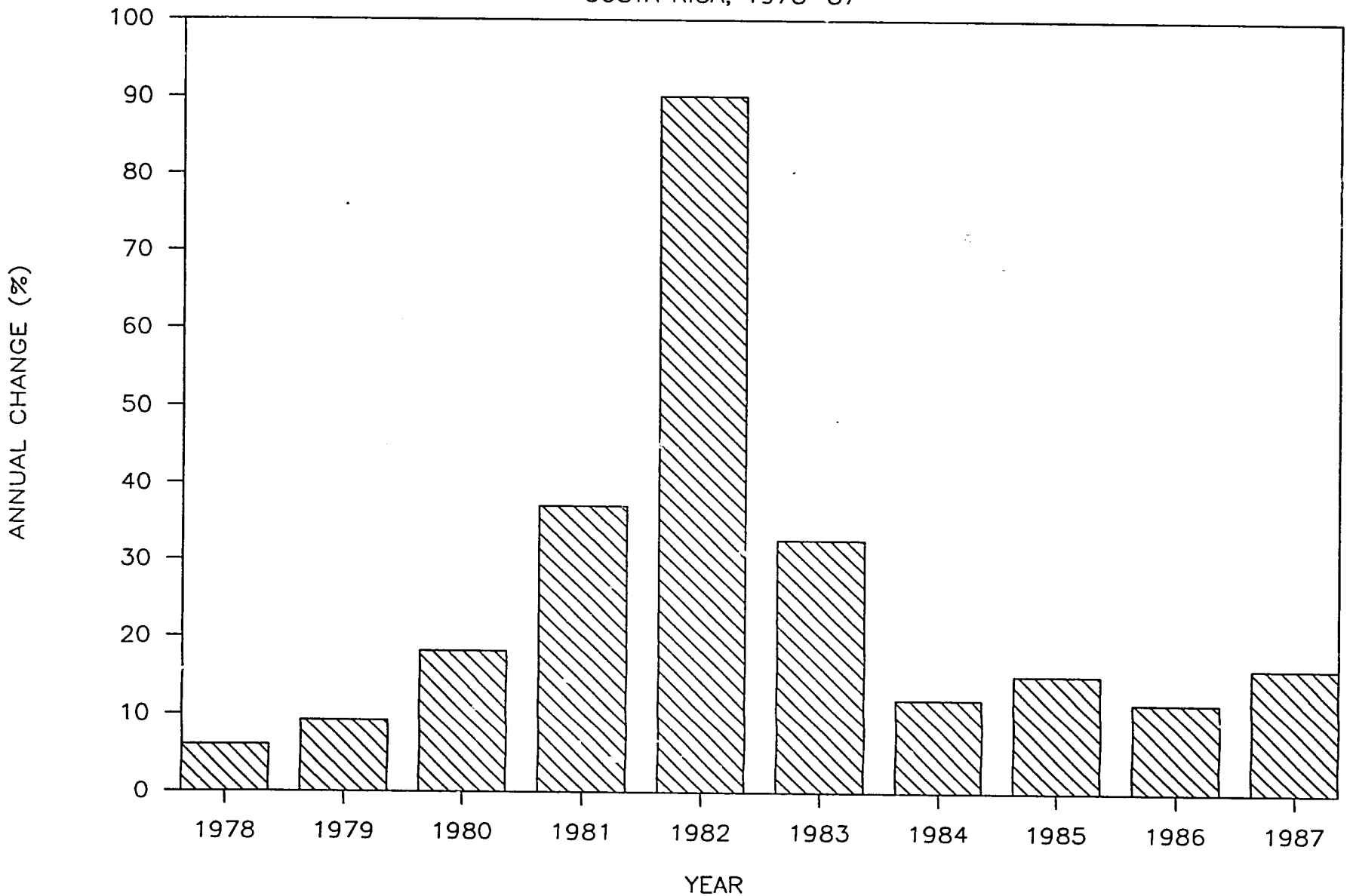
COSTA RICA: PUBLIC SECTOR DEFICIT

AS PERCENT OF GDP



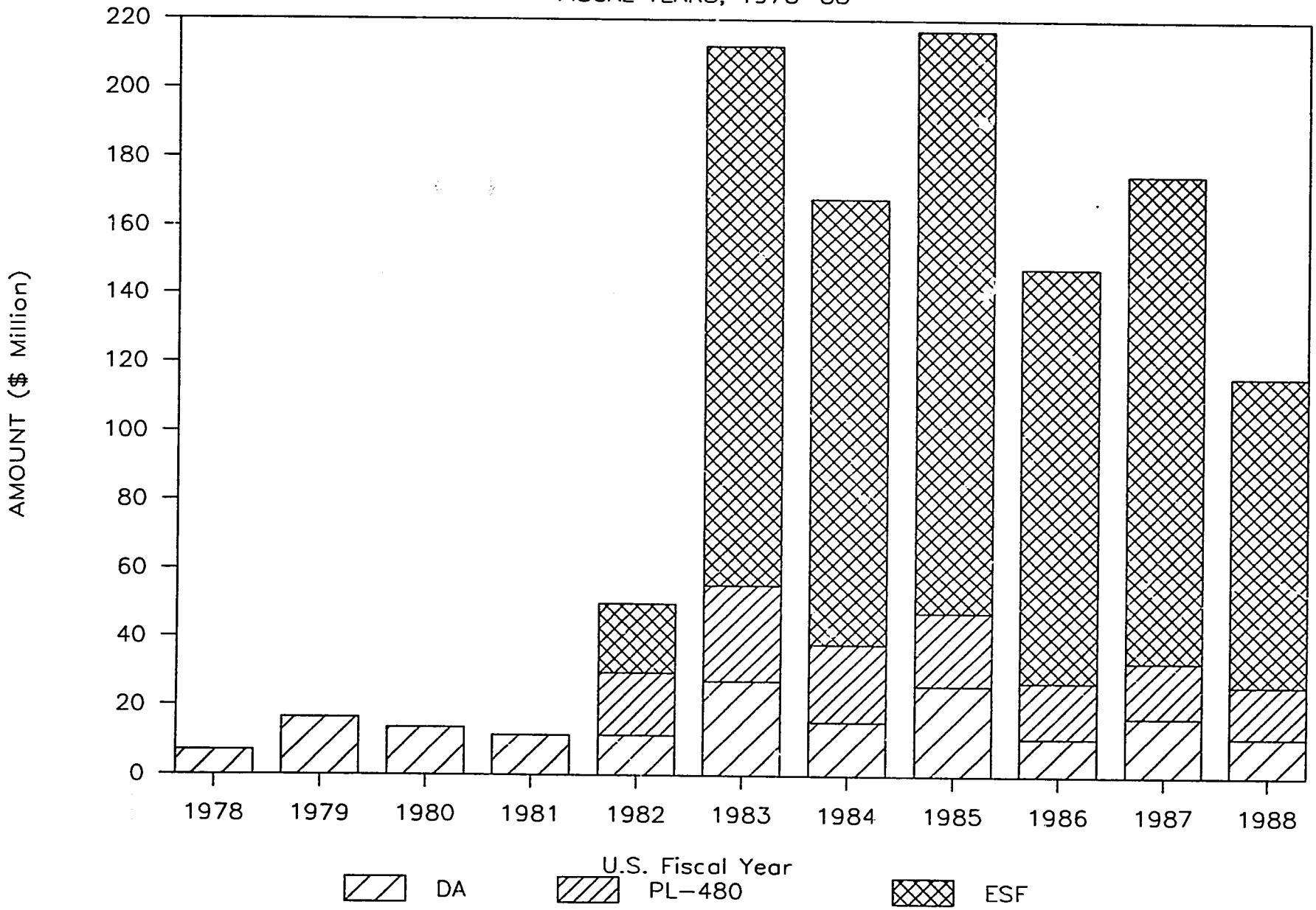
CHANGES IN CONSUMER PRICE INDEX

COSTA RICA, 1978–87



U.S. ECONOMIC AID TO COSTA RICA

FISCAL YEARS, 1978–88



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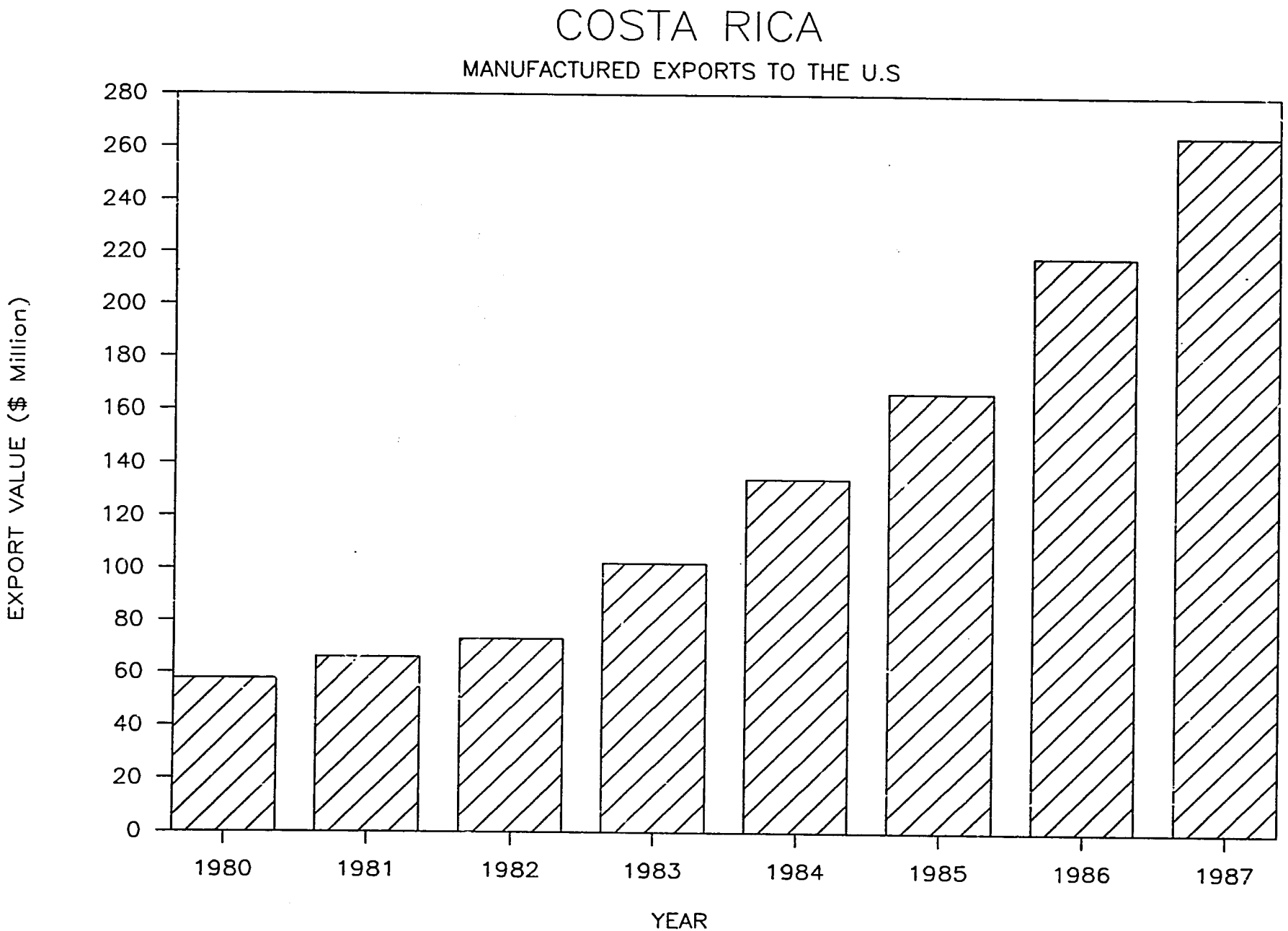
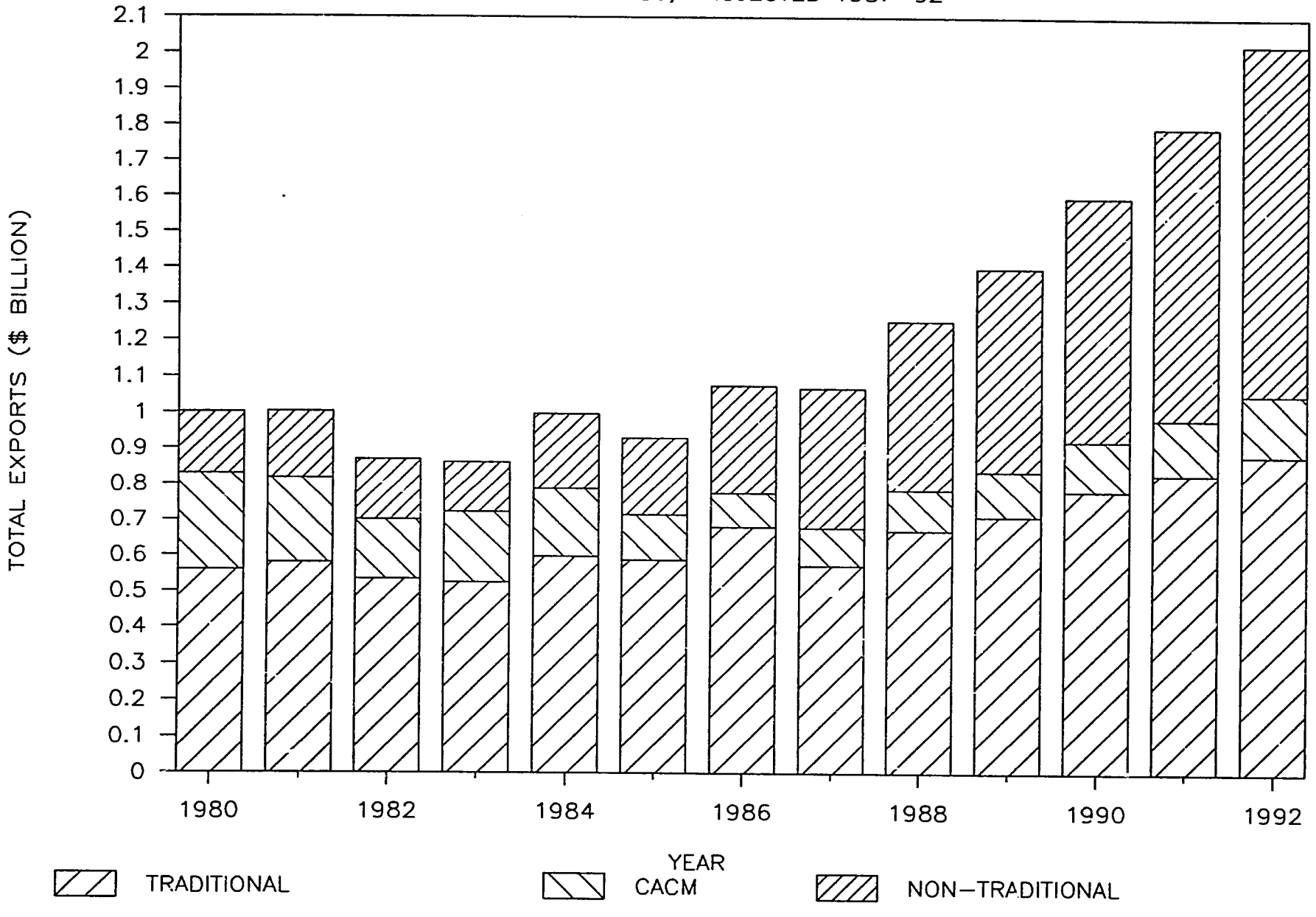

COSTA RICA
MANUFACTURED EXPORTS TO THE U.S
EXPORT VALUE ($ Million)
280
260
240
220
200
180
160
140
120
100
80
60
40
20
0
1980
1981
1982
1983
1984
1985
1986
1987
YEAR

224

COMMODITY EXPORTS, COSTA RICA

ACTUAL 1980–86, PROJECTED 1987–92



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THE ALLEVIATION OF POVERTY UNDER STRUCTURAL ADJUSTMENT

Lionel Demery
Tony Addison

A World Bank Publication

For the past decade and a half the developing countries have been increasingly obliged to adjust their economies to an adverse international economic environment of oil shocks, world recession, and deteriorating terms of trade. These difficulties have been compounded in many cases by inadvisable domestic policies, which have aggravated macroeconomic imbalances. Yet concern over the effects of adjustment policies on the welfare of poor or vulnerable groups has only recently become evident.

In their attempts to assist the poor under structural adjustment, policymakers have not been particularly well served by theoretical or applied economics. Economic theory has neglected the tradeoffs between macroeconomic balance and distributional balance, and applied analyses have faced methodological difficulties. In this booklet we review a variety of programs that have tried to help the poor under structural adjustment and propose a simple framework in which they can be analyzed.

Adjustment policies may adversely affect the poor in two ways. In the short run such policies may reduce the real income and consumption of poverty groups. A World Bank study compared such initial adverse effects to a "crossing of the desert," in which those who are least able to cope with the crossing require some temporary relief to tide them over. Second, even over the long term, some poverty groups may not benefit from the processes set in motion by the adjustment effort. Adjustment policies will shape development and influence the distribution of income for years into the future and will have different effects on the poor. The relationship between adjustment and poverty therefore extends beyond a notion of social cost that features only short-run effects. In this review, we try to give as much attention to the potential for poverty alleviation through adjustment in the longer term as to poverty problems during the transition.

Because it is so difficult to measure the net effects of gains and loses among different groups of poor people (Addison and Demery 1985), we do not attempt an overall assessment of the effects of adjustment on poverty. But we do assume that it is possible to identify the particular

poverty groups whose living standards are most vulnerable to adjustment and, in some cases, to take corrective action. Although our examples are drawn mainly from World Bank experience and documentation, we have not tried to assess the overall effects of Bank operations.

The experiences reviewed here are meant only as illustrations of the kinds of programs that have been undertaken to assist the poor under structural adjustment. Our purpose is to show that efforts are being made to alleviate the problem and that in many cases World Bank assistance has played an important part. But the examples are not presented as necessarily typical of Bank-supported adjustment programs. Examples are also presented of programs undertaken by other agencies, where these hold important general lessons.

Finally, we seek to demonstrate the technical feasibility of an equitable approach to adjustment. Although the thornier issue of political feasibility is outside our scope, we recognize that political constraints are important in circumscribing policy choice, particularly during difficult periods of adjustment. Those groups that are favored by systems of market intervention are certain to exert their political energies to prevent a move toward market liberalization. These pressures will be critical in determining the implementation and pace of adjustment.

Analytical Framework

This section defines terms and develops a simple analytical framework with which to organize empirical material on the alleviation of poverty under adjustment. The term "adjustment" has come to be used in a loose and sometimes misleading fashion (Killick 1986). It can refer to the objective of adjusting the balance of payments deficit itself, but it has also been used to describe the accommodating changes needed in the domestic economy to correct the external deficit. We shall take the latter definition as the basis of discussion.

A distinction is also made between "stabilization" and "structural adjustment." The former refers to short-run policies that realign domestic absorption with domestic supply; the latter, to policies designed to influence the equilibrium configuration itself (Buiter 1986, p. 1) by making structural reallocations and changing some of the ground rules of production and exchange (through institutional reform or privatization, for example).

As our starting point we take Stewart's distinction between the primary and secondary distributions of income. She distinguishes between "*primary* claims on resources which arise directly out of the productive process of work and accumulation, and *secondary* claims which result from the transfer of primary claims" (1983, pp. 4–5). This distinction helps to direct our attention to the potential role of adjustment in alleviating poverty. Insofar as the poor are economically active, a potential exists for raising their primary incomes through their direct involvement in the process of structural adjustment. Benefits may also extend to some of the nonworking poor who receive transfers from family members who work. But if the poor are not economically active or do not receive family transfers, the only means of aiding them would be through their secondary claims: by increasing their income and consumption transfers.

The advantage of a strategy that seeks to alleviate poverty by improving primary claims is that it can be broadly consistent with the objectives of structural adjustment. A strategy that relies on transfer payments, in contrast, is likely to encounter the problem that the resources for such schemes are at their most limited in times of austerity. Furthermore, transfer schemes can divert resources from structural adjustment objectives. If existing transfer schemes are modified in the adjustment process, however, to be better targeted to the poor, then resources might be saved overall and the potential conflict between transfers and fiscal restraint reduced.

A guiding principle therefore would be to increase the productive capacity of the poor to the greatest extent possible, taking recourse to transfers only when a strategy of adjusting primary claims is not feasible. In this booklet we distinguish five broad approaches to assisting the poor under adjustment:

- Increasing their access to productive assets
- Raising their return on assets
- Improving their employment opportunities
- Ensuring their access to education and health services
- Supplementing their resources with transfers.

The first four are intended to raise the primary incomes of the poor, while the fifth increases their secondary incomes. Conversely, each approach identifies a way in which adjustment measures may harm the poor.

Increasing Access to Productive Assets

Possession of productive assets plays a crucial role in getting people onto "income escalators," a principal theme of the "redistribution with growth" strategy (Chenery and others 1974, pp. 43–44). The primary claims of the poor can be raised by increasing their access to productive assets. This approach, though not central to a structural adjustment program, might be consistent with its objectives, in that output and productivity may be raised in the process.

Raising the Return on Assets

The primary claims of the poor can also be increased by raising the return on the assets they hold, especially by increasing output prices and productivity and reducing input prices. This approach may be implemented through specific policy interventions or broad measures under structural adjustment to dismantle market distortions.

Improving Employment Opportunities

If the poor possess few productive assets other than their labor, increasing their wages or access to employment may be the only means of raising primary claims. Measures to increase wages (such as minimum wage legislation), however, may conflict with the objectives of the adjustment effort. Not only would minimum wage legislation usually fail to benefit most of the poor in developing countries, it would also tend to reduce total employment. Thus, the thrust of a policy to raise the labor incomes of the poor during adjustment should be to increase their access to productive employment. Increasing the geographic and occupational mobility of the poor may be necessary to ensure that they benefit from the expansion of employment, particularly in sectors producing tradable goods, that may result from the structural adjustment program. In addition to such measures to improve the operation of the labor market, emergency employment schemes may be necessary.

Ensuring Access to Education and Health Services

The human capital of the poor can be protected by guaranteeing their access to health and education services. Such interventions, by "investing" in the poor, will yield returns in the form of higher productivity and incomes. But they will also confer gains in consumption and thus will partly consist of secondary income claims.

Supplementing Resources with Transfers

The preceding approaches assist those among the poor who are both economically active and are, or could be, engaged in the production of traded goods. But in many cases the poor are not economically active or are locked in the nontradable sector. Even in working households, some family members—young female children, for example—may not share equally in the family's resources. In such cases, income or consumption transfers may be the only effective means of assistance.

Before considering these measures in detail, it is important to emphasize the context that structural adjustment provides for the alleviation of poverty. First, if structural adjustment reduces price distortions, enhances competition, and erodes monopoly profits and economic rents, the incomes of the wealthy are likely to fall and those of the poor to rise. The reduction in market distortions brought about under adjustment may therefore enhance both efficiency and equity.

Second, if structural adjustment ultimately promotes economic growth, the alleviation of poverty will undoubtedly be an easier proposition. But unless adjustment strategies are well designed, the benefits of economic growth will bypass some poverty groups. The challenge facing policymakers, especially in countries with chronic poverty, is to direct structural adjustment toward the poor—to identify a strategy of adjustment with equitable growth.

Increasing the Access of the Poor to Productive Assets

Poor people can share in the process of structural adjustment if their access to productive assets is increased. Policies to this end can help both to alleviate poverty and to achieve structural adjustment because they increase not only consumption but also investment. Our review of this approach highlights land reform as an important means of alleviating rural poverty. In many developing countries poverty is principally a rural problem, and landlessness is a prime cause (Griffen and Khan 1977, Lipton 1985). Improving the availability and terms of credit are also discussed here as important means of increasing the access of the poor to capital assets. Our discussion is confined to material assets; the provision of health and education services, which can be considered as asset transfers of human capital, are discussed later.

At first sight land reform may seem to be too administratively

Box 5.9 Agricultural policy improvements in Bangladesh

Bangladesh shows how the types of policy reforms discussed in Chapters 4 and 5 can bear fruit on a large scale in even the poorest countries. Bangladesh is one of the most densely populated countries in the world, and its 100 million people had an average per capita income of only $130 in 1983. It has fertile soils and a relatively abundant supply of water, but few other natural resources. Situated in the world's largest active delta, the country is prone to floods and cyclones during the monsoon and droughts during the dry season. Agriculture is the heart of the Bangladesh economy, generating about 50 percent of GDP and accounting for about three-quarters of employment and exports.

The government's policy reforms began in the late 1970s under exceptionally difficult circumstances. After the war for independence, agricultural production declined, domestic food prices rose well above world market prices, and rural wages fell in real terms between 1971 and 1975. There was a famine in 1974, and Bangladesh became heavily dependent on food aid. Although growth in annual agricultural production picked up to 3 percent in the late 1970s, output increased only slightly faster than population, which was growing at the rate of 2.6 percent a year. Another famine occurred in 1979, after a serious drought.

The government responded to these difficulties by expanding public investment in agriculture, concentrating on small irrigation projects with low costs and quick returns, increasing the role of the private sector, and improving the effectiveness of public agencies. The allocation to agriculture in the development budget, excluding the fertilizer subsidy, was restored to 28 percent on average between 1978-79 and 1984-85. It had fallen from 34 percent in 1973-74 to only 19 percent in 1977-78. The acreage covered by modern irrigation facilities doubled, at a rate of expansion about three times faster than during the previous five years.

The increase in public investment in agriculture would have been impossible without a sharp reduction in subsidies, particularly the fertilizer subsidy. Between 1978-79 and 1984-85, the fertilizer subsidy was reduced from about 10 percent of the development budget to 2.4 percent. The unit subsidy fell from 50 percent of cost to 17 percent. Yet, despite this, fertilizer sales have continued to grow by more than 10 percent a year. One reason is that retail distribution of fertilizer was transferred to the private sector, which found it profitable to distribute fertilizer throughout the country at the right time—a marked contrast to the frequent shortages of the 1970s, which often meant that fertilizers could be had only at prices far higher than the official prices. Similarly, the entry of the private sector into the distribution of minor irrigation equipment has been an important reason for the rapid growth in farm mechanization over the past few years.

Similar successes have been achieved in the distribution of food grains. The government suspended antihoarding laws, abolished the accreditation system whereby grain dealers were designated to procure grains on behalf of the government, and lifted restrictions that prevented the private sector from importing food grains. The private sector now handles about 85 percent of the internal marketing of grains. Aided by the construction of adequate storage facilities, the private sector has been particularly effective in limiting temporary increases in food-grain prices between harvests. The reduction of subsidies to urban consumers enabled the government to expand rural investment and relief programs rapidly, providing food-for-work and nutrition schemes for the poor. The investments have provided rural jobs equivalent to the full-time employment of close to 1 million landless laborers and have been used to maintain roads, canals, and embankments, which are essential to agricultural growth.

The government combined its reduction of subsidies and expansion of rural assistance schemes with more appropriate exchange rate policies and the provision of export incentives. It reduced or abolished export taxes on jute, tea, shrimp, and other agricultural exports, which helped to sustain growth in agricultural exports. As a result:

- Agricultural production has grown at about 3.5 percent a year.
- Agriculture has directly or indirectly generated most of the growth in employment, and rural wages have risen about 15 percent more than food-grain prices.
- The adoption of high-yielding varieties has increased, fertilizer consumption has grown by more than 10 percent a year, and irrigation, drainage, and flood control facilities now cover nearly one-quarter of the cultivated area, as compared with less than 10 percent in the early 1970s.
- Agriculture has become more resilient to natural disasters. In four of the past five years, the grain crop has set new records, despite bad monsoons, floods, and drought.
- Food-grain imports, though still high, have fallen as a proportion of total consumption, and Bangladesh is now less dependent on food aid. A large and growing proportion of such aid, currently about 50 percent, goes to finance programs specially aimed at helping the rural poor.
- Farmers have diversified away from rice to wheat. Wheat is grown during the dry season between rice crops, when fields would otherwise lie fallow; it is less expensive to produce and is better nutritionally. Over the past decade production of wheat has risen from almost nothing to nearly 10 percent of total food-grain production. Consumption has increased from about 10 percent to nearly 20 percent of total grain consumption.
- Exports have increased and become more diverse. Jute exporters have won a higher world market share, despite slumping prices and declining demand. Exports of other agricultural commodities, such as shrimp, tea, and leather, have grown by more than 10 percent a year and now account for 30 percent of total exports, compared with about 15 percent in the early 1970s.

11:45 to 1:45

Review With The Administrator

1. Summary of the week.

A. Love ten minutes.

10 minutes

2. A.I.D. "Niche" in the Policy Reform Arena

John Westley - 10 minutes.

Discussion - 20 minutes.

30 minutes

3. The perspective from congress and the PVO's.

Charles Sykes/Margaret Goodman - 15-20 minutes.

Discussion - 10-15 minutes.

30 minutes

4. Implementation, obstacles and alternative approaches.

Peter Askin - 5-10 minutes.

Discussion - 15-25 minutes.

25 minutes

5. Where do we go from here?

Summary - 5 minutes.

Discussion - minutes.

20 minutes

6. Administrators closing thoughts.

Woods - 10 minutes.

10 minutes

125 minutes