

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

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MEMORANDUM

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FROM: AAA/PPC/EA, Jerome R. La Pittus 

SUBJECT: Paper on the Economic Return from Policy Based Assistance Programs

The attached paper represents part of the on-going effort within A.I.D. to develop criteria for providing policy based assistance.

Your comments, suggestions and criticisms are sought and will be welcomed.

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**THE ECONOMIC RATE OF RETURN FROM POLICY BASED
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THE ECONOMIC RATE OF RETURN FROM POLICY BASED ASSISTANCE PROGRAMS

I. Introduction

The rapid growth in policy based assistance activities by AID and other bilateral and multilateral donors has underscored our concern, as DAC members, to develop an appropriate analytical framework for providing such assistance. From a practical viewpoint, we have to convince our respective legislatures that support of such intangibles as policy reform makes sense, that it does provide value for money. We also have to demonstrate to our host country counterparts that the policy reforms we seek to support make objective economic sense and, as such, should be an important component of their own development effort.

The technical demands of achieving the practical aims outlined above raise four basic questions. What are the benefits from policy based assistance programs and how can those benefits be measured operationally? What are the policies that produce those benefits and how can they be measured operationally? In essence, the answers to these questions would permit the calculation and use of an economic rate of return as a screen to both judge and compare initiatives for providing programme assistance. To illustrate, if \$100 million in policy based assistance were provided and would produce benefits whose value in constant dollars would be \$20 million per year for 10 years, the economic rate of return would be 15%. The key questions, of course, are how can the benefits be measured and what is the content of the policy program that will generate these benefits.

AID has recently completed a study that should be helpful in achieving the practical and technical objectives outlined above. The purpose of this paper is to share this study and its implications with you. Part II of this paper summarizes the results of the AID study. Part III explains how the study can be helpful in our joint efforts to derive appropriate principles for programme assistance. The study is regarded in A.I.D. as a working paper in our own ongoing efforts to better inform our assistance activities. It is part of a broad effort within A.I.D. to assess and test the practicability of developing policy performance indicators on regional as well as on a world wide bases.

II. Summary of the A.I.D. Study

a. Overview

The AID study was designed to address four specific questions concerning the linkage between economic policy and economic growth. The questions were these. Do the economic policies of AID recipient countries promote or suppress the role of competitive market forces in resource allocation? To what degree do they do so? Do countries whose economic policies promote competitive market forces in resource allocation achieve, on average, higher per capita growth rates than countries whose economic policies suppress competitive market forces in resource allocation? How sensitive are per capita growth rates to changes in the market orientation of economic policies?

The questions were addressed in straightforward fashion. The procedures that were followed are worth summarizing briefly at this point. First, an Economic Policy Orientation Questionnaire was devised as a way to obtain a numerical score for the market orientation of a country's economic policies. The Questionnaire was then applied to a sample of 42 AID recipient countries in order to obtain policy scores for them. Two time periods were covered, 1980-1983 and 1984-1987. In each of these time periods a policy score was obtained for each country. In order to provide a standard against which to measure the policy score of the sample countries, Singapore and the United States were selected as reference countries and their policy scores were also calculated.

To complement the policy score data set, average per capita GDP growth rates were then calculated for the 42 countries in each of the two time periods. The policy score and growth rate data sets for the two time periods provided a sample size of 84 paired observations consisting of 42 for the period 1980-83 and 42 for the period 1984-87. The next step was a simple econometric exercise. Finally, per capita GDP growth rates were regressed on the policy scores. The regression results provided two primary pieces of information, the percentage of the variation in growth rates explained by variation in policy scores and the size and reliability of policy score as a contributor to per capita GDP growth rates.

For statistical estimation purposes, the simple linear relationship $y = a + bx + u$ was used. In this equation, y represents per capita GDP growth rates, x represents policy score, u represents the influence on growth of factors other than policy score and the parameter b represents the sensitivity of growth rate to policy score. The econometric analysis yields three statistical estimates that have economic meaning relevant to the questions posed in the study: the coefficient of determination (R^2), the parameter estimate for b (b^{\wedge}) and the "t" statistic for the estimate of b . The R_2 statistic measures the

percentage of the variation in growth rates that is explained by variation in policy score. The b^* and t statistics are estimates of the size of the quantitative link between policy score and growth rates and of its reliability. Each of the components of the study summarized above, and its results, are reviewed more fully below.

b. How economic policy was measured

The complete questionnaire used to obtain policy scores is set forth as Annex I. It consists of 39 questions and was designed with content and scoring objectives in mind.

With respect to content, the questionnaire focuses on the efficiency with which policy allocates resources in seven areas. These seven areas are (1) monetary and credit policy, (2) taxation, (3) policies with respect to the determination of prices, (4) policies that characterize the foreign trade and payments regime (5) the legal, regulatory and judicial environment for economic transactions, (6) the responsiveness of macro and micro policy adjustments to external shocks requiring attention and (7) the track record in meeting policy commitments.

With respect to facilitating scoring, each question was designed to permit a "yes" or "no" response. A "no" response is indicative of a policy choice that promotes efficient resource allocation. A "yes" response is indicative of a policy choice that suppresses efficient resource allocation. For scoring purposes, "yes" responses were given a value of -1 and "no" responses were given a value of +1. With this scoring convention, a country's aggregate policy score could range between -39 and +39. A country whose policy framework promoted competitive market forces in resource allocation would achieve the maximum score of +39. A country whose policy framework suppressed competitive market forces in resource allocation would register the minimum score of -39.

A few examples of the questions have been extracted from the questionnaire in each of the policy areas and are set forth below. The sample questions illustrate the key design and content features of the questionnaire:

Is credit allocation by administrative regulation greater than 20% of total credit?

Do interest rate ceilings exclude/preclude some borrowers from formal banking system?

Is interest earned on government bonds exempt from taxes?

Are taxes that distinguish between origin and destination of production greater than 20% of total tax revenue?

Are economically important input or output prices subject to

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controls, public marketing channels?

Is over 20% of CPI basket subject to price controls?

Are exchange rates not uniform across products, across exporters, importers?

Is access to foreign exchange for imports importantly dependent upon availability of domestic substitutes?

Are domestic prices not permitted to track international price developments for key tradeables (petroleum, energy, grains, etc.)?

Are payments arrearages important source of supplementary external financing?

Stabilization policies not rapidly introduced and not in correct mix/amounts?

Judicial system does not guarantee property rights?

Are licenses/approvals for economic activity common and subject to abuse or provide rent to holder?

Is IMF compliance record poor?

Is World Bank compliance record poor?

c. Principal results

The policy scores and regression of growth on policy scores were used to answer the basic empirical questions addressed in the study. How do the policy scores of the sample countries compare with the policy scores of such relatively market oriented countries as Singapore and the United States? Are the gaps large and by how much would growth rates improve if the gaps were closed by policy reform programs that made the appropriate market oriented policy reforms?

The study provides clear answers to these questions. There is substantial room for improvement in the policy scores of the sample countries and compelling evidence that such improvements would result in significant improvements in their per capita GDP growth rates. These conclusions of the study are reviewed in order below.

c.1 Policy scores for 42 A.I.D. assisted countries

Table 1 records the policy scores and per capita GDP growth rates of the 42 countries and for reference purposes, Singapore and the United States, in the two time periods, 1980-83 and 1984-87. For presentational purposes, the countries are ordered in table 1 by policy score results, beginning with lower ranking countries and ending with higher ranking countries. To put these numbers in perspective, recall that raw policy scores could range between -39 and +39, an approximately 80 point range. Figure 1 summarizes the policy score information contained in table 1 in graphical form. The bar chart in figure 1 shows average policy scores for four policy score groups, the 10 countries with the lowest policy scores, the 10 countries with the highest policy scores and two intermediate policy score groups consisting of 11 countries each. Finally, additional information on the policy scores is contained in annex table 2. This table provides a breakdown of the aggregate policy scores by the seven policy subregimes for each country.

The policy scores recorded in table 1 and figure 1 clearly indicate that there is considerable scope for improving the market orientation of the sample countries' economic policies. If policy scores are conceived of as a ladder with 80 steps, the United States and Singapore are above the 70th step and each of the 10 lowest scoring countries are below the 20th step. The 10 countries in the highest score group are on about the 50th step of the ladder. While this places them 30 steps above the lowest scoring group, they are still 20 steps below the reference group. In sum, policy scores for the 42 sample countries are low, widely dispersed and well below the standard for market orientation represented by Singapore and the United States.

c.2 Sensitivity of per capita growth rates to policy scores

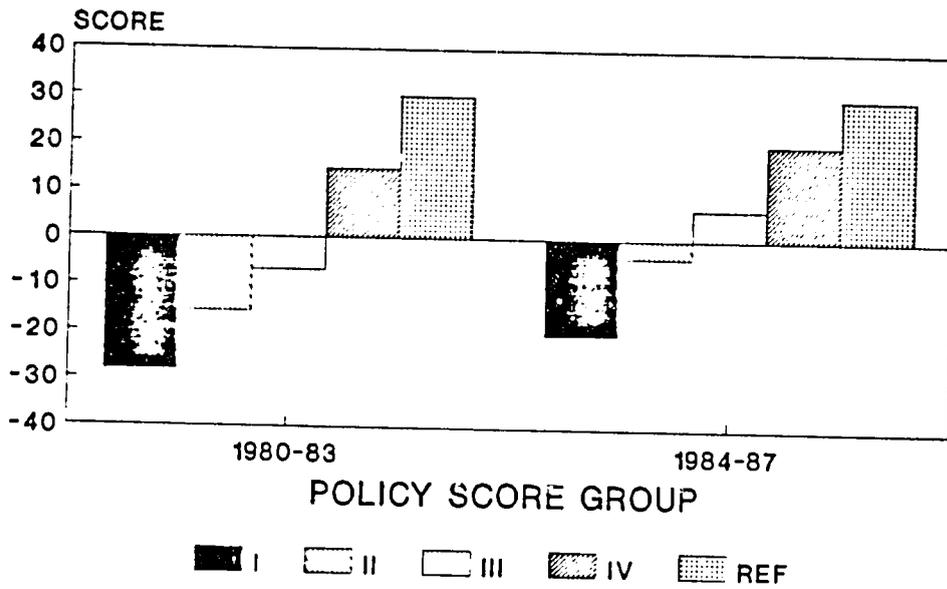
The scope for improving policies would be of little relevance if there were no gains from doing so. Thus, while there may be large scope for improving policies, the critical question is whether the pay off from improving policies is also substantial. This question is answered by the estimation of Equation (1) below. Figure II provides a graph of the estimated equation and serves as a useful aid in explaining some key aspects of the role that policy score plays in determining growth.

TABLE 1
INTERNAL POLICIES AND ECONOMIC GROWTH:
AN EMPIRICAL EXAMINATION OF THE LINK BETWEEN THE POLICY FRAMEWORK
AND GROWTH RECORD FOR 42 A.I.D. RECIPIENT COUNTRIES IN THE 1980'S

POLICY SCORE GROUPINGS	PERIOD 1980 -- 1983			PERIOD 1984 -- 1987		
	COUNTRY	POLICY SCORE	GROWTH RATE	COUNTRY	POLICY SCORE	GROWTH RATE
GROUP I: LOWEST POLICY SCORE	Mozambique	-32.0	-0.95	Egypt	-30.5	-1.14
	Bolivia	-31.0	-4.95	El Salvador	-27.0	1.62
	Ghana	-30.0	-7.15	Peru	-26.5	2.69
	Guinea	-30.0	0.88	Dom. Repub.	-20.5	-3.60 a
	Egypt	-28.5	3.31	Sudan	-20.5	-4.04
	Dom. Repub.	-27.5	0.16	Mozambique	-20.0	-3.65 b
	El Salvador	-26.0	-5.50	Honduras	-15.5	-0.59
	Ecuador	-25.5	-3.25	Liberia	-14.5	-3.27
	Pakistan	-25.5	1.89	Ecuador	-13.5	-1.40
	Zaire	-25.0	-3.55	Tanzania	-13.5	-1.46
	AVERAGE	-28.1	-1.91		-20.2	-1.46
GROUP II: MEDIUM POLICY SCORE	Sudan	-24.0	1.71	Somalia	-9.0	-8.66 b
	Jamaica	-23.5	0.25	Uganda	-9.0	-0.54
	Tanzania	-23.0	-4.44	Pakistan	-6.5	3.90
	Costa Rica	-19.0	-5.33	Guatemala	-6.0	-3.48
	Somalia	-14.0	-1.38	Mali	-3.5	1.07
	Madagascar	-14.0	-5.63	India	-2.0	3.03
	Mali	-12.0	-2.10	Haiti	-1.0	-1.83
	Kenya	-11.0	-2.74	Senegal	-1.0	0.64
	Gambia	-11.0	1.77	Rwanda	-1.0	2.17
	Senegal	-11.0	2.19	Zaire	-1.0	0.09
	Honduras	-10.5	-4.58	Jamaica	-0.5	-1.58
AVERAGE	-15.7	-1.84		-3.7	-0.47	
GROUP III MEDIUM HIGH POLICY SCORE	Burundi	-10.0	-0.91	Kenya	1.5	-0.06
	India	-10.0	4.07	Burundi	2.0	0.90
	Uganda	-9.0	3.99	Bangladesh	3.5	5.06
	Guatemala	-9.0	-4.50	Indonesia	4.0	0.56
	Niger	-8.5	-4.43	Zambia	7.0	-3.36
	Peru	-6.0	-3.97	Madagascar	7.5	-1.35
	Haiti	-6.0	-3.63	Ghana	8.0	-0.02
	Rwanda	-5.0	1.30	Niger	8.0	2.48
	Philippines	-5.0	0.83	Gambia	9.5	-3.16
	Bangladesh	-4.0	0.80	Philippines	10.5	-2.85
	Indonesia	-3.5	5.47	Costa Rica	11.0	0.44
AVERAGE	-6.9	-0.09		6.6	-0.12	
GROUP IV: HIGH POLICY SCORE	Zambia	-3.0	-3.07	Belize	13.5	-0.02 b
	Liberia	4.5	-2.41	Guinea	18.0	-3.62 b
	Belize	7.5	-0.04	Jordan	18.5	0.24
	Jordan	12.0	2.52	Thailand	18.5	1.62
	Thailand	14.5	3.18	Botswana	20.0	6.66
	Malawi	16.0	-3.82	Bolivia	20.0	-4.30
	Lesotho	20.5	-2.01	Lesotho	20.5	6.43
	Botswana	22.0	4.59	Malawi	21.5	-1.53
	Cameroon	24.0	6.30	Cameroon	22.0	2.50
	Swaziland	28.5	-1.73	Swaziland	29.5	9.06 b
	AVERAGE	14.7	0.35	AVERAGE	20.2	1.70
AVERAGE OF 42 COUNTRIES		-9.1	-0.88		0.8	-0.10
REFERENCE GROUP	SINGAPORE	33	7.61	SINGAPORE	33	4.72
	U.S.A	30	0.55	U.S.A.	30	2.05

FIGURE 1

POLICY SCORES BY GROUPS 1980-83 AND 1984-87



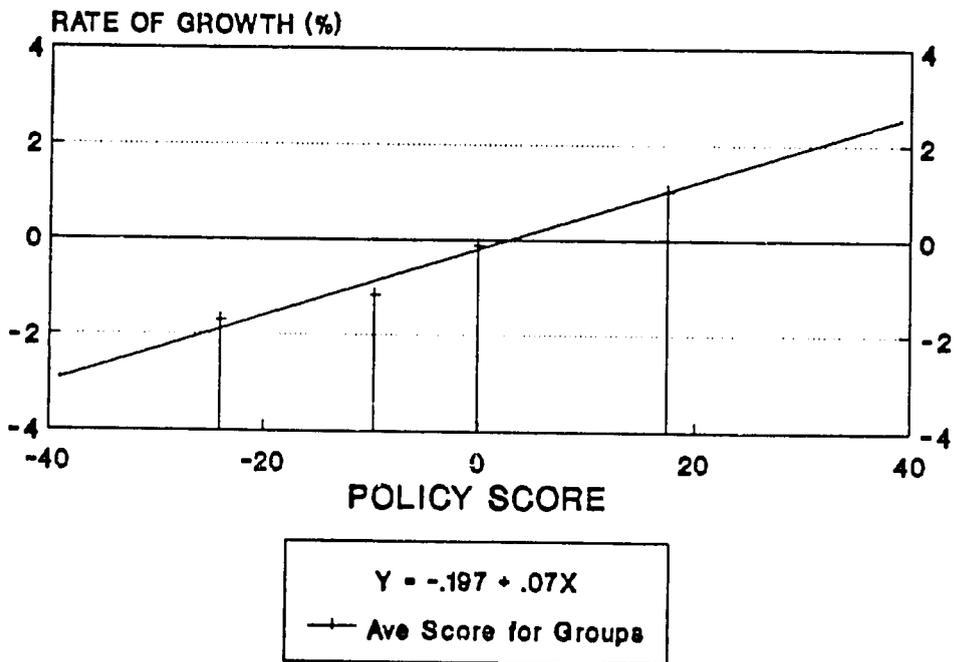
Source: TABLE I

(1) GDP growth rate p.c. = a + b*policy score

parameter	estimate	T value	std. error
a	-.197	-.54	.363
b	.070	3.26	.021

R-Square = .11

Figure 2
Regression of Growth on Policy Score



<u>POLICY SCORE GROUP</u>	<u>AVERAGE SCORE</u>	<u>RECORDED AVERAGE GROWTH RATE</u>	<u>PREDICTED POLICY CONTRIBUTION TO GROWTH</u>
I	-24.15	-1.695	-1.888
II	-9.7	-1.155	-.876
III	-0.15	-0.105	-.208
IV	17.45	1.025	1.025

The basic information contained equation 1 and figure II can be easily summarized.

Variation in policy scores explains only 11% of the variation in per capita growth rates. This means that factors other than the policy framework explain the remaining 89% of the variation in growth rates.

While small relative to the size of all other factors determining recorded growth rates, the policy contribution to growth is first, reliable, and second, potentially large in absolute size. The reliability of the impact of policy on growth follows from the fact that the parameter estimate for b (.07) is over 3 times the size of its standard error (.02). The potentially large size of the contribution of policy to growth follows from two factors. The first factor is the low policy scores recorded for the sample countries and hence the large room for improvement. The second is how, from equation 1, policy score improvements translate into higher growth rates.

To illustrate, Table 1 and Figure 1 divide the 42 countries into four policy score groups and calculates the average score for each group. The difference in average score for the top policy score group and the bottom policy score group was approximately 40 points in both time periods. By how much might growth rates improve if this policy gap were to be narrowed?

On the basis of equation 1, every 10 point improvement in policy score translates into a .7 of 1% rise in the per capita GDP growth rate. A 40 point rise in policy score translates into a 2.8 percentage point improvement in per capita growth. More generally and as shown in figure II, movements up and down the policy score ladder can significantly raise and lower the rate of growth of per capita gdp.

In this connection, it is also well worth noting that policy scores below 2.8 yield negative contributions to per capita growth rates while policy scores above 2.8 yield positive contributions to per capita growth rates. Few of the countries met the minimum standard required for policy to make a positive contribution to growth. Only 9 of the 42 countries met this standard in 1980-83. Only 18 of the 42 countries met this minimum policy standard in the 1984-87 period. In sum, policy scores are actually a drag on growth in the majority of the sample countries and policy improvement could make an enormous contribution to helping these countries achieve high, positive growth rates.

d. Why policy has special importance

The fact, noted above, that only 11% of the recorded variation in per capita growth rates is explained by variation in policy scores has some important implications. First, it

strengthens rather than weakens the importance of attention to policy as a source of growth. Second, it underscores the need not to oversell the importance of policy to both ourselves and our host country counterparts. It does both by emphasizing that a host of factors besides internal policies determine recorded economic growth rates. These points are briefly taken up in order below.

Paradoxically, the fact that only 11% of the recorded variation in per capita growth rates is explained by variation in policy scores strengthens rather than weakens the importance that needs to be attached to high policy scores. The reason is simple. The policy framework that LDCs choose to allocate resources is virtually the only factor affecting growth that is under their direct control. LDC governments do not, for example, control weather and other natural phenomena affecting output. They equally do not control the buoyancy of demand in the countries to which they export or international price developments for the products they import.

As these examples illustrate, there are a host of factors affecting growth that are exogenous to LDC control. Under these circumstances, the positive contributions to the per capita growth rate provided by high policy scores are a form of insurance policy against adverse developments from all other factors affecting growth.

To illustrate, actual recorded growth rates will always be a composite of the contribution from policy and the contribution from all other factors. To the extent that the balance of all other factors are making a positive contribution to growth, recorded growth rates will always be above the line representing the policy contribution to per capita growth in Figure II. To the extent that all other factors contribute negatively to growth, recorded growth rates will be below the line representing the policy contribution to growth in figure II. Under these latter circumstances, high policy scores will be better capable of keeping recorded per capita growth rates at positive levels or at least minimizing the fall in recorded per capita growth rates.

This is not just an academic argument devoid of practical meaning. Its practical significance is directly reflected in table I. The ten countries with the highest policy scores in 1980-83 recorded a per capita growth rate 2.44 percentage points above the per capita growth rate recorded by the ten countries with the lowest policy scores. In 1984-87, the ten countries with the highest policy scores recorded a per capita growth rate 3.18 percentage points above the per capita growth rate recorded by the ten countries with the lowest policy scores.

e. Policy contributes to but does not determine growth

A distinction needs to be made between policy as a contributor to growth and policy as the determining factor in

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Figure 3: Internal Policy and Economic Growth:
The Perverse Cases

<u>Policy Framework Group</u>	<u>Growth Results</u>	
	Positive Growth	Negative Growth
Lowest Policy Performance Group	Egypt 1980-83	
	Peru 1984-87	
	Pakistan 1980-83	
Middle Policy Performance Groups		
Highest Policy Performance Group		Malawi 1980-83
		Zambia 1980-83
		Bo'ivia 1984-87

Source: Table I

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producing high recorded growth rates. Many of the complaints all of us have heard about policy reform programs undertaken under multilateral sponsorship are partly due to inflated promises about the magnitude and timing of the benefits that would result from their implementation. The fact of the matter is that there are a host of factors whose effects on growth may reverse, neutralize or reinforce the effects of policy on growth.

Two general cases need to be distinguished. There are instances where recorded per capita growth rates are high and where the policy contribution to per capita growth rates is negative. There are equally instances where the policy contribution to growth is high and recorded growth rates are negative. Each of these cases illustrates one side of the same coin: resource abundance can produce high growth in spite of bad policies and resource shortfalls can produce negative growth in spite of good policies. Examples are easy to find and a number of them are shown in figure 2.

Egypt in the early 1980s provides a classic example of how policies that do not promote competitive market forces in resource allocation can combine with temporarily supernormal foreign exchange abundance to produce high positive growth. Thus, Egypt could record an average per capita growth rate of 3.3% in the 1980-83 period in spite of a policy score (-28.5) that yields a policy contribution to per capita growth rate of -2.4% on the basis of equation 1. Peru in the mid 1980s provides another example. In the period 1984-87 Peru recorded a per capita average growth rate of 2.7% with a policy score of -26.5. In contrast, the contribution to the per capita growth rate predicted by this policy score when it is inserted in equation 1 is -2.1%. How did Peru achieve such good growth results with such poor policies? It simply ran down a large net international reserve position and supplemented further its external resources by unilaterally limiting payments on foreign debt to a small portion of its scheduled debt service obligations.

Bolivia provides a timely example of the other side of the coin. Bolivia made major improvements in policy between the early and mid 1980s. This is reflected in a 50 point movement up the policy ladder between 1980-83 and 1984-87. Bolivia's policy score of 20 in 1984-87 yields a policy contribution to the per capita growth rate of 1.2%. The recorded per capita growth rate was, at -4.30%, markedly below the growth rate predicted on the basis of policy score alone. In essence, Bolivia suffered a major resource shortfall of exogenous origin. Bolivia's improved policy performance coincided with the collapse of the international tin market and delays in receiving payment for natural gas exports to Argentina. The negative effects on growth of reduced resource availability simply outweighed the positive effects on growth of improved policy performance--i.e., improved efficiency with which available resources were allocated.

III. Principles for Providing Policy Based Assistance

The A.I.D. study is relevant to a number of issues and topics dealt with in the Draft Principles for Programme Assistance (DCD/DAC(91)5). In this connection, there is one primary lesson from the A.I.D. study.

Policy based assistance programs have traditionally been exempted from the comparative rigor that has accompanied the preparation and appraisal of project level assistance. This need not and should not be the case. First, economic theory certainly provides guidance on the macroeconomic and the microeconomic policy environment that will promote efficiency in resource allocation. It should be possible to use the guidance provided by economic theory to develop an objective policy environment standard against which the policy environments of individual countries could be compared. Such standards would be immensely valuable. They would permit cross country comparisons to be made at a point in time and would permit progress evaluations to be made over time. Handled with discretion, they would facilitate the development of a policy dialogue based on objective economic criteria for sound policy making. This could greatly facilitate local ownership and participation in the development of economically sound policy based assistance programs. The A.I.D. study is clearly an experiment in the direction of developing such a standard.

Second, economic theory provides guidance on the benefits that will derive from policies that improve efficiency in resource allocation. The payoff is a value of output that will be larger, perhaps partly through a more efficient production of the existing output mix and partly through producing a higher valued output mix. Using GDP as a proxy for this theoretical notion of output, the A.I.D. study then estimates the payoff to good policies by their contribution to GDP growth rates.

While certainly subject to criticism, the A.I.D. study begins to face up to an important need. At least in the U.S., policy based assistance does not have a "good name". It is often associated with making poor people even worse off or with political conditionality. The only way to deal with this guilt by association is to develop policy based assistance programs whose content and impact can be shown to compare favorably with the economic returns available to alternative uses of limited assistance resources. Other DAC members may not have to be concerned with this "image" problem but it is a major concern for A.I.D.

In this connection, the A.I.D. study suggests a deceptively simple two step process for assessing the value of providing policy based assistance resources. First, calculate the country's policy score. Next, use the country's policy score to calculate the economic rate of return anticipated from providing policy based assistance. The procedure is easy to illustrate.

Suppose a country has a GDP per capita of \$100 and an assessment is needed of providing policy based assistance equal to \$5 per capita. With a policy score of 2.8, the economic rate of return to providing \$5 in policy based assistance is zero. With a policy score of 10, the economic rate of return is in excess of 12%. With a policy score of -4, the economic rate of return is less than -12%. In each of these cases, the figure for the economic rate of return is simply the discount rate which makes the present value of the policy contribution to per capita income equal to \$5 per capita.

The purpose of this simplistic exercise is not to advocate any particular instrument or approach to measuring policy performance and the returns from improved policy performance. Rather, it is to suggest that greater transparency and discipline is both possible and desirable.

ANNEX I

Economic Policy Orientation Typology

	<u>Average over period</u>		<u>Trends/Explanations</u>
	<u>1980-83</u>	<u>1984-87</u>	
I. <u>Credit/Monetary Policy</u>			
a) Deposit rates less than inflation.			
b) Credit allocation by administrative regulation greater than 20% of total credit.			
c) Preferences accorded public sector: (1) cost of credit, (2) allocation of credit.			
d) Banking system nationalized			
e) % of total credit from public banks greater than 20%.			
f) Central Bank rediscounts on specialized credit lines are greater than 20% of total credit extended by banking system			
g) Interest rate ceilings exclude/preclude some borrowers from formal banking system.			
OVERALL CHARACTERIZATION/SCORE			
II. <u>Taxation</u>			
a) Income taxes less than 20% of total taxes.			
b) Effective rate of protection in excess of 20%.			
c) Interest earned on government bonds exempt from taxes.			
d) Public Sector entities enjoy exemptions from import, export, other taxes.			
e) Taxes that distinguish between origin and destination of production greater than 20% of total.			
OVERALL CHARACTERIZATION/SCORE			

Average over period1980-831984-87Trends/ExplanationsIII. Prices

- a) Economically important input prices subject to controls, public marketing channels.
- b) Economically important output prices subject to controls, public marketing channels.
- c) Energy prices held significantly below other domestic prices.
- d) Significant distortions in the structure of relative prices.
- e) Over 20% of CPI basket subject to price controls.

OVERALL CHARACTERIZATION/SCORE

IV. Foreign Exchange Regime

- a) Divergence between official and market exchange rates in excess of 20%.
- b) Exchange rates not uniform across products, across exporters, importers.
- c) Public sector enjoys preferential cost/access to foreign exchange.
- d) Over 20% of foreign exchange transactions outside of primary official rate.
- e) Access to foreign exchange for imports importantly dependent upon availability of domestic substitutes.
- f) Country deemed to have multiple currency practices.
- g) Tariffs, quotas, etc., significantly distort import prices.
- h) Rationing techniques are used to allocate at least 20% of foreign exchange.
- i) Exporters are obligated to sell at least 20% of foreign exchange to Central Bank/Monetary Authority.

OVERALL CHARACTERIZATION/SCORE

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Average over period1980-831984-87Trends/ExplanationsV. Policy Response to Exogenous Shocks
and Other Adverse Impacts

- a) Domestic prices not permitted to track international price developments for key tradeables (petroleum, energy, grains, other).
- b) External borrowing excessive relative to debt service capacity.
- c) Payments arrearages important source of supplementary external financing.
- d) Stabilization policies not rapidly introduced and not in correct mix/amounts.

OVERALL CHARACTERIZATION/SCORE

VI. Bureaucratic Impacts on Economic Activity

- a) Licenses/approvals for economic activity common and subject to abuse or provide rent to holder.
- b) Administrative rules/regulations are costly in terms of time, fees, procedures.
- c) Judicial system does not guarantee property rights.
- d) Bribery important factor in gaining approvals.
- e) Government does not permit decentralized decisions on local taxes or on revenue collected locally.
- f) Fee for service not established practice in any major area.
- g) Public sector heavily involved in management/ownership of activities that can be run at least as efficiently by private sector.

OVERALL CHARACTERIZATION/SCORE

VII. Overall Measures

- a) Is IMF compliance record poor?
- b) Is World Bank compliance record poor?
- c) Are few influential gov't policymakers committed to market liberalization?
- d) Your overall assessment of antipathy toward markets.

OVERALL CHARACTERIZATION/SCORE

ANNEX TABLE 2

COUNTRY POLICY TYPOLOGY: TOTAL SCORES BY PRINCIPAL POLICY COMPONENT AND BY GEOGRAPHIC REGION

REGION	COUNTRY	CREDIT/MONETARY				FOREIGN TRADE AND				POLICY RESPONSE		BUREAUCRATIC		POLITICAL RECEPTIVITY/		TOTAL	
		POLICY		TAX REGIME		PRICING REGIME		EXCHANGE REGIME		REGIME		REGIME		IMPLEMENTATION RECORD		SCORE	
		80/83	84/87	80/83	84/87	80/83	84/87	80/83	84/87	80/83	84/87	80/83	84/87	80/83	84/87	80/83	84/87
ANE	Egypt	-3.0	-3.0	-1.0	-1.0	-5.0	-5.0	-5.0	-7.0	-4.0	-4.0	-6.5	-6.5	-4.0	-4.0	-26.5	-30.5
	Indonesia	-3.5	-0.5	0.0	0.0	-3.0	-3.0	5.0	5.0	2.0	2.0	-5.0	-3.0	1.0	3.5	-3.5	4.0
	Jordan	5.0	7.0	-3.0	-3.0	5.0	5.0	5.0	5.0	2.0	3.0	-5.0	-1.5	3.0	3.0	12.0	18.5
	Pakistan	-5.5	-5.5	-5.0	-5.0	-4.5	-4.5	-6.0	5.0	-2.0	4.0	-3.0	-1.0	0.5	0.5	-25.5	-6.5
	Thailand	7.0	7.0	3.0	3.0	-0.5	-0.5	5.0	5.0	-1.0	3.0	-2.0	-2.0	3.0	3.0	14.5	18.5
	Philippines	-5.0	5.0	0.5	1.0	0.0	2.0	-1.0	1.0	4.0	4.0	5.0	-5.0	1.5	2.5	-5.0	10.5
	Bangladesh	-3.5	2.0	-1.5	-1.5	0.0	1.0	-3.0	-3.0	3.0	4.0	-2.0	-2.0	3.0	3.0	-4.0	3.5
	India	-3.0	-1.0	-0.5	-0.5	-5.0	-1.0	-1.0	1.0	1.0	2.0	1.0	1.0	-2.5	-3.5	-10.0	-2.0
	AVERAGE	-1.4	1.4	-0.9	-0.9	-1.6	-0.8	-0.1	1.5	0.6	2.3	-3.4	-2.5	0.7	1.0	-6.3	2.0
LAC	Belize	5.0	5.0	-1.0	-1.0	1.0	1.0	3.5	3.5	2.0	4.0	-2.5	-2.0	-0.5	3.0	7.5	13.5
	Costa Rica	-5.0	1.0	-2.0	0.0	1.0	1.0	-7.0	3.0	-2.0	2.0	-1.0	1.0	-3.0	3.0	-19.0	11.0
	Dom. Repub.	-3.0	-3.0	0.0	0.0	-5.0	-5.0	-7.0	-3.0	-4.0	-2.0	-5.0	-4.0	-3.5	-3.5	-27.5	-20.5
	Ecuador	-5.0	-5.0	-5.0	-5.0	-4.0	0.0	-1.0	1.0	-1.5	0.5	-5.0	-5.0	-4.0	0.0	-25.5	-13.5
	El Salvador	-6.0	-6.0	-2.0	-4.0	-4.0	-4.0	-3.0	-5.0	-4.0	0.0	-6.0	-6.0	-1.0	-2.0	-26.0	-27.0
	Guatemala	1.0	1.0	-2.0	-2.0	-1.0	-1.0	-7.0	-7.0	0.0	2.0	0.0	1.0	0.0	0.0	9.0	-6.0
	Jamaica	-3.0	0.0	-3.0	-3.0	-4.0	-4.0	-5.0	3.0	-4.0	2.0	-3.0	-1.0	-1.5	2.5	-23.5	-0.5
	Peru	-4.0	-5.0	-2.0	-2.0	1.0	-3.5	1.0	-3.0	1.0	-2.0	-7.0	-7.0	4.0	-4.0	-6.0	-26.5
	Bolivia	-3.0	5.0	-4.0	-1.0	-5.0	5.0	-7.0	7.0	-4.0	2.0	-4.0	-2.0	-4.0	4.0	-31.0	20.0
	Haiti	-1.0	1.0	1.0	1.0	-3.0	-1.0	1.0	-1.0	0.0	2.0	-5.0	-5.0	1.0	2.0	-6.0	-1.0
	Honduras	2.0	2.0	-3.0	-3.0	-0.5	1.5	0.0	-6.0	-2.0	-3.0	-4.0	-4.0	-3.0	-3.0	-10.5	-15.5
	AVERAGE	-2.0	-0.4	-2.1	-1.8	-2.1	-0.9	2.9	-0.7	-1.7	0.7	-3.9	-3.1	-1.4	0.2	-16.0	-6.0
AFR	Botswana	3.5	1.5	0.0	0.0	3.5	3.5	7.0	7.0	4.0	4.0	2.0	2.0	2.0	2.0	22.0	20.0
	Lesotho	3.5	3.5	2.0	2.0	0.0	0.0	7.0	7.0	4.0	4.0	3.0	3.0	1.0	1.0	20.5	20.5
	Kenya	-3.0	3.0	1.0	1.0	-3.0	-3.0	3.0	3.0	0.0	2.0	-5.0	-4.5	-4.0	0.0	-11.0	1.5
	Liberia	3.0	1.0	2.0	2.0	-0.5	-0.5	7.0	-4.0	0.0	-2.0	-7.0	-7.0	0.0	-4.0	4.5	-14.5
	Malawi	-1.0	3.0	1.0	1.0	-1.0	-1.0	7.0	6.5	2.0	4.0	4.0	4.0	4.0	4.0	16.0	21.5
	Mozambique	-7.0	-7.0	-4.0	-2.0	-5.0	-5.0	-3.0	-1.0	-4.0	-2.0	-5.0	-1.0	-4.0	-2.0	-32.0	-20.0
	Niger	-3.0	-1.5	0.5	1.0	-3.0	1.0	3.0	4.0	-2.0	1.0	-3.0	-0.5	-1.0	3.0	-8.5	8.0
	Swaziland	5.0	5.0	4.0	4.0	3.5	3.5	7.0	7.0	4.0	4.0	3.0	3.0	2.0	3.0	28.5	28.5
	Tanzania	-6.0	-6.0	-2.0	-2.0	-5.0	1.0	-1.0	-0.5	-4.0	-1.5	-4.0	-3.5	-1.0	-1.0	-23.0	-13.5
	Zaire	-3.0	-1.0	-3.0	-1.0	-5.0	5.0	-1.0	5.0	-4.0	-4.0	5.0	-5.0	-4.0	0.0	-25.0	-1.0
	Zambia	3.0	3.0	2.0	2.0	-3.0	-1.0	1.0	5.0	-4.0	-2.0	0.0	2.0	-7.0	-2.0	-3.0	7.0
	Cameroon	5.0	5.0	0.0	0.0	3.0	3.0	7.0	7.0	2.0	0.0	3.0	3.0	4.0	4.0	24.0	22.0
	Uganda	1.0	1.0	-4.0	-3.0	-1.0	-1.0	-7.0	-6.0	-3.0	-2.0	1.0	0.0	4.0	2.0	-9.0	-9.0
	Burundi	-2.0	0.0	1.0	1.0	-3.0	-3.0	0.0	3.0	0.0	0.0	-6.0	1.0	0.0	0.0	-10.0	2.0
	Gambia	-2.5	1.5	-1.0	-1.0	-3.0	0.5	2.0	4.0	-4.0	2.0	-1.5	-0.5	-1.0	3.0	-11.0	9.5
	Ghana	-5.0	-2.0	-4.0	-2.0	-5.0	4.0	-5.0	1.0	-2.0	4.0	-5.0	-1.0	-4.0	4.0	-30.0	8.0
	Guinea	-7.0	5.0	0.0	0.0	-5.0	5.0	-3.0	7.0	-4.0	0.0	-7.0	-3.0	-4.0	4.0	-30.0	18.0
	Madagascar	-3.0	1.0	0.0	1.0	-3.0	0.5	1.0	3.5	-4.0	2.0	-3.0	-2.5	-2.0	2.0	-14.0	7.5
	Mali	-2.5	-3.0	0.0	0.0	-3.0	-1.5	1.0	0.5	-4.0	2.0	-4.0	-2.0	0.5	0.5	-12.0	-3.5
Rwanda	-1.0	1.0	-1.0	-1.0	-1.0	-1.0	-5.0	-3.0	2.0	2.0	-3.0	-3.0	4.0	4.0	-5.0	-1.0	
Senegal	0.5	0.5	-1.0	-1.0	-4.0	-2.5	2.0	2.5	-4.0	-0.5	-4.0	-2.0	-0.5	2.0	-11.0	-1.0	
Somalia	-3.0	-3.0	1.0	1.0	-3.0	3.0	-3.0	-3.0	-2.0	-2.0	-3.0	-3.0	-1.0	-2.0	-14.0	-9.0	
Sudan	-2.0	-2.0	-2.0	-2.0	-5.0	-5.0	-5.0	-5.0	-4.0	-4.0	-2.0	-2.0	-4.0	-0.5	-24.0	-20.5	
	AVERAGE	-1.2	0.4	-0.3	0.0	-2.2	0.2	1.0	2.2	-1.3	0.5	-2.2	-1.0	-0.5	1.2	-8.8	3.6
		-1.4	0.4	-0.9	-0.8	-2.1	-0.3	-0.3	1.3	-1.1	0.8	-2.8	-1.8	-0.5	0.8	-6.1	0.8

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Economic Principles for Legal, Regulatory and Judicial (LRJ) Reform

Background

A.I.D. provides assistance to a politically and economically diverse group of countries in Latin America, Eastern Europe, Africa, the Near East and Asia. Many of the countries in these regions have initiated or want to initiate strategies that emphasize the role of competitive market forces in resource allocation. Price liberalization is one key element in this strategy. Another key element is turning out to be institutional reform. Quite simply, markets operate in the context of institutions and many of the countries that have requested assistance from A.I.D. in developing market oriented economic policies have legal, regulatory and judicial (LRJ) systems that are ill-suited to promoting efficient resource allocation through private competitive markets. The LRJ environment is defined for the purposes here as the set of provisions, norms and standards that govern how rules for economic transactions are established and enforced and how disputes are settled or prevented from occurring.

There is considerable diversity among the LRJ systems in place in countries in Latin America, Asia, Africa, the Near East and Eastern Europe. In some cases, central governments dominate the LRJ environment. In other cases, the LRJ environment is decentralized and these decentralized systems may be based on tribal, religious or indigenous practices that are highly localized. In still others, the LRJ environment may be largely private and informal and have little to do with "formal" government. In spite of outward dissimilarities, economic transactions between firms and individuals are governed by an LRJ environment in every country. These LRJ environments do, moreover, differ in the extent to which they promote or suppress efficiency in resource allocation in private competitive markets.

Based on A.I.D. discussions and experience to date, problems appear to be concentrated in three key areas of the LRJ environment: (1) property rights, (2) contractual obligations and (3) codes governing commercial, capital and labor markets. To take a single example, the LRJ environment in the area of contractual obligations may not provide for procedures or outcomes that can be regarded as timely or transparent or predictable or equitable. Utilization of procedures may involve high information costs and transactions costs. Both the utilization of procedures and outcomes may discriminate on the basis of such economically irrelevant criteria as gender, personal wealth and membership in a special group. To the extent that contractual obligations do not meet appropriate standards for these and other criteria that can be used to characterize efficiency in resource allocation, the result will be to raise the costs and/or risks of private sector

production and investment.

As suggested by example above, a country's LRJ environment may promote or suppress efficiency in resource allocation through private competitive markets. In order for A.I.D. to assist those countries seeking help in developing LRJ environments that will effectively support private competitive markets, A.I.D. needs a way to measure how the LRJ environments of different countries stack up against a common, desired standard for promoting efficiency in resource allocation. This, in turn, will permit A.I.D. to compare the LRJ environments of different countries relative to each other and to identify shortfalls that can be remedied.

Objective

To this end, A.I.D. seeks a handbook or primer on LRJ reform. The target audience consists of A.I.D. officials involved in project and program design and in our policy dialog with host country officials. The target audience also includes host country individuals in both the public and private sectors. There are two basic objectives for this primer. It will enhance the understanding by host country individuals and A.I.D. officials of the role that the LRJ environment plays in promoting or suppressing private competitive market forces. It will help A.I.D. in designing LRJ policy reform programs that support efficient resource allocation through private competitive markets. It will also pinpoint areas for remediation.

In order to permit A.I.D. to develop appropriate LRJ reform programs, the primer must meet four criteria. It must identify a limited number of areas of the LRJ environment that are of greatest importance for promoting private competitive markets. It must lay out a common set of normative criteria that A.I.D. officials can use for evaluating how well the LRJ regime performs in each area. It must lay out a desired standard for each element in this set of criteria. On the basis of these components, it must lay out a questionnaire, checklist or similar instrument that A.I.D. officials can use to compare the LRJ environments of different countries relative to a common standard for promoting efficient resource allocation through private competitive markets and, hence, relative to each other.

Based on discussions to date, we believe that the handbook can limit itself to dealing with three areas of the LRJ environment: property rights, contractual obligations and codes governing the functioning of labor, capital and commercial markets. Whatever the final selection of areas covered, the contractor will be expected to explain why the areas are critical and provide examples illustrating their importance.

We believe it should be possible to develop a small but appropriate set of normative criteria to assess performance in each of the areas covered in the primer. These might include

transparency, predicatibility, timeliness, non discrimination by economically irrelevant criteria (e.g., gender), information and transactions costs. This is not meant to be a definitive list. There may be others or better assessment criteria. The contractor will be expected to develop an appropriate set of criteria, define them, explain their importance, develop a common desired standard for each criteria and operationalize them by devising a questionnaire, checklist or related instrument for applying to individual country settings.