A.I.D. Policy Paper

APPROACHES TO THE POLICY DIALOGUE

U.S. Agency for International Development
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"We should be careful to get out of an experience only the wisdom that is in it, and stop there; lest we be like the cat that sits down on a hot stove lid. She will never sit down on a hot stove lid again—and that is well; but also she will never sit down on a cold one any more."

Mark Twain, *Following the Equator.*

The U.S. interest in the soundness of the economic policy of developing countries stems largely from the concern with promoting long-term, broad-based economic growth in these countries. The policy dialogue which flows from this concern is in large measure a process of sharing information and ideas regarding economic policy actions and options which impact on the development performance and prospects of the developing country. It is important to state at the outset of this paper that donor suggestions concerning the economic policy of recipient countries must rest on familiarity with the recipient country situation, sympathy for its objectives and problems, and a valid economic development case for the policy suggestion being advanced. Only on such a basis can a policy dialogue bear fruit in terms of the recipient country's own development and the effectiveness of utilization of external economic assistance.

I. Introduction

A. Purpose and Structure of the Paper

Individual aid projects can sometimes reach their intended goals and accomplish some good even if the overall economic policy environment is less than optimal. As a general proposition, however, the United States has emphasized over the last year that even an integrated set of well planned and well executed economic assistance projects may fail to have a significant developmental impact in the absence of a favorable economic policy environment, for:

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.[1]

This common sense principle bears constant repetition and frequent re-statement, for it has been periodically forgotten in the practice of aid and development. It is not the purpose of this paper to discuss the types of policies considered desirable for economic stability, growth and development. These are discussed ably and articulately elsewhere.[2] Nor can this paper articulate adequately the variety of important connections between country policies and AID's major cross-sectoral emphases on the private sector, the building of institutions and the transfer of technology. The express purpose of this paper is instead limited to outlining and discussing a comprehensive framework for systematic AID interaction with other donor institutions and with developing countries' governments, addressed to support their economic policies when they are deemed effective, and to promote their improvement when they are deemed defective. It is this *interaction* which forms the core of the "policy dialogue"

This paper is a review and synthesis of the AID experience and of the principal points of consensus and of disagreement in the important subject of how best to manage this interaction from the viewpoint of the U.S. bilateral assistance program. It is organized along the following lines. The remainder of this introductory section clarifies some important terms, sets the limits to the subsequent discussion, and outlines the general characteristics of the approach to the policy dialogue. Section II discusses the principal determinants of the effectiveness of the policy dialogue through bilateral economic assistance, and Section III pulls together the major considerations on the conduct of the dialogue in practice. Section IV deals with the issue of coordination between AID and the other major participants to the dialogue to promote sound economic policies by the developing countries — and hence the effectiveness of economic assistance to those countries. An annex discussing AID experience concludes the paper.

The current stress on the importance for long run development of the economic policy of the developing countries themselves — and thus on the need for a dialogue with aid recipients concerning the soundness of their policies — represents a significant shift in emphasis relative to U.S. aid thinking through much of the 1970s.[3] It also constitutes,

[1] *Development Issues 1982*, p. 43. (Footnote references are shown in abbreviated form in the text. Full references are given in the Bibliography.)

[2] *Development Issues 1982*, Chapter II.E.; T. Morrison and L. Arreaga-Rodas, *Economic Liberalization in Developing Countries; Some Lessons From Three Case Studies — Sri Lanka, Egypt, and Sudan*, A.I.D. Discussion Paper No. 40, October 1981.

[3] This does not imply that our assistance programs in the 1970s did not encourage or promote specific LDC policy actions and approaches. However, it is generally recognized that less explicit emphasis was given during this period to economic policy considerations than is given currently or was given during the 1960s.

however, a renewal of an interest that had been strongly felt and articulately expressed in AID for the first ten or so years of the Agency's existence.[4] The activities of the 1960s generated a substantial written record, which was useful in preparing this paper. This record, and much of the literature on efforts to foster improvements in economic policies through foreign aid, frequently suffers from a lack of clear definition of the basic terms at issue — from a kind of semantic fog so pervasive that it is essential, at the risk of being pedantic, to begin with the clearest possible definition of the principal terms. This need for clarification also derives from the negative connotations and confusion which have been associated with such terms as influence, leverage, dialogue and self-help, each of which have been used to refer to widely differing relationships and processes and sometimes have been used interchangeably. The lack of clarity, coupled with inappropriate usage of these terms, has led to unintended and undesirable interpretations of the objectives and nature of the donors' concern with the economic policies of developing countries.

A discussion of the use of aid to foster improvements in the recipient country's economic policy logically presumes some initial disagreement between donor and recipient on the direction, the scope, the degree, or the timing of policy change. *The ability to affect views and policies is best understood as a continuum,* from the logical extreme of total control over the resolution of the difference, to the opposite extreme of utter inability to affect the outcome in any way.

The process of seeking to foster improvements in host country policies within this continuum can encompass, among other things, two different concepts: leverage and dialogue. Given that the parties' viewpoints differ, *"leverage" refers to the capacity to have one viewpoint predominate over the other. "Dialogue" on the other hand is better understood as a mechanism incorporating the interchange of ideas and information whereby either viewpoint or both can change to bridge the initial difference between the two.* Through a "dialogue", then, the aid recipient comes to view the policy advice as genuinely in the interest of its own economic progress. In contrast, through the application of "leverage", the aid recipient agrees to enact a certain policy in response to positive or negative incentives by the donor, and not because it concurs with the other party's views of the policy's desirable effects. In actual practice, leverage and dialogue need not be mutually exclusive since the use of leverage does not usually entirely rule out the possibility of a dialogue — that is, of a change in either party's viewpoint, and a policy dialogue almost always entails the *possibility* that donors might alter their assistance or take other action in the future in light of the policies and actions taken by the recipient.

However, focusing attention on the *availability* of potential leverage as a means of fostering improved economic policies can be badly misleading. *Potential leverage is at best only a possible facilitator of the policy dialogue, and is neither a sufficient nor a necessary condition for the success of a policy dialogue.* On the contrary, if exercised clumsily, it may in the longer term be counterproductive.

Indeed, experience has shown that constructive results are more likely to occur where the recipient countries are aware of the existing potential of such action but the potential is not actually used. Reflecting this fact, this paper and AID policy focus on the establishment of an ongoing *policy dialogue* with the host country.

Another term often used without clear definition is *"self-help"*. Self-help can be defined, as in the AID program lending practice of the 1960s, to encompass a recipient government's policies to affect positively those development variables over which it has some control. Since self-help effort is difficult to prove or disprove, much less to measure, the "effort" dimension of self-help should where possible be complemented with some assessment of its "results". At least, self-help must mean that the recipient country's policies have not allowed, as a result of aid, a reduction in the amount of financial resources mobilized domestically for development purposes. (The question of what constitutes development expenditures is itself a fit subject for the policy dialogue.) At best, self-help entails recipient country policies that yield — as a result of, or at least concomitant to, the provision of aid — greater mobilization of domestic resources for development and/or improvements in the efficiency of their allocation and utilization. In current parlance, aid then acts as a "catalyst".

B. The Concept of Conditionality

The discussion throughout this paper is grounded on two basic principles, to which

[4] Edward Mason, a principal academic advisor to AID in the 1960s, had occasion to state, in an internal memorandum of April 8, 1968, that "Current AID doctrine holds that the inducement effect of aid on development can be more important than the effect of resource transfers."

reference shall be made again and again. The first principle, discussed above, is that the donors' ability to affect host country policy is a continuum. The second, discussed here, is what we may call the *principle of appropriate conditionality*, i.e., that the formulation and implementation of any conditions to be attached to aid, in any form, depends on the objectives of the aid.

Clearly, there can be no "conditionality" that does not *imply* the provision of incentives — whether of the positive or the negative kind. It is not sensible to ask "whether" economic assistance does or should carry conditions. The sensible questions are instead "which" conditions, "how and by whom defined", and — the most important question of all — "why".

The term "conditionality" refers to policies which a lender/donor expects or requests the recipient to follow (or to avoid), in order to use the former's resources. The use of such resources, in turn, must be in furtherance of, or at least in keeping with, the lender/donor objective(s) in providing the resources.[5] Thus, *conditionality is a device to promote use of the resources in conformity with the purpose of providing them.* The concept of conditionality of assistance is utterly meaningless if divorced from the objectives the assistance is meant to achieve. If follows that a change in the goals of assistance will normally require a change in conditions as well. Further, to the extent that one of the several objectives of a bilateral assistance program may be inconsistent with another, this will necessarily be reflected in a conflict between specific conditions.

Whether in the specific case conditionality is in keeping with the objectives of the assistance is partly a matter of interpretation. Just as commercial bank and business borrower may be in perfect agreement on the objective — safe and profitable use of the loan — but differ in their assessment of such safety and profitability, so aid donor and recipient may hold identical views on the economic objectives to be pursued but disagree sharply on whether a particular condition is in keeping with those objectives. The likelihood of such a disagreement, other things being equal, increases with:

— the ambiguity of the objective;
— the time span over which the objective is to be achieved;
— the number of different objectives.

C. Scope of the Economic Policy Dialogue

Of the myriad possible conditions on the provision of economic assistance, the discussion of the policy dialogue entails an examination only of those related to the twin objectives of fostering the economic stability and improving the prospects for sustained long-term economic development of the recipient country (primarily the latter). The remainder of this paper shall not, therefore, concern itself with the conditionality needed to prevent fraud, theft, abuse of misuse of aid funds[6], nor with the use of aid for short-term foreign policy objectives, for purely commercial goals (such as the tying of aid to purchases from the U.S.), or for long-term political development (except insofar as economic development may itself be conducive to political liberalization and institutional growth).

Finally, the notion of the policy dialogue is centered on the sphere of *discretionary* conditionality, and not on statutory prescriptions or prohibitions. Every donor's assistance program is subject to a set of statutory conditions.[7] These are usually taken as a given in the policy dialogue, but it should be noted that in the long run statutory conditionality is *not* a given, and all prescriptions are variable, including charter provisions.

D. Approaches to the Use of Aid to Foster a Policy Dialogue

The use of aid to foster improved economic policies may be approached in two general ways: in an "ex post" approach, good economic performance by the aid recipient justifies financial support; in an "ex ante" approach, the provision of aid is linked to a future policy change. These approaches are not mutually exclusive, and may even be complementary in certain circumstances.

The principal advantages of the *ex post approach* are alleged to be that it does not generate accusations of interventionism — and that it does not run the risk of causing damage to the aid recipient if the policy advice happens to be wrong.[8] These advantages are illusory, however. For, offsetting the absence of the "interventionism" charge,

[5] See Joseph Gold's *Conditionality.*

[6] Chapters 2 and 3 of AID's Handbook 3 contain a detailed listing and discussion — running to well over 100 pages — of the criteria and procedures to optimize the administration of aid funds in practice.

[7] The State Department's Legal Adviser lists about 120 specific prohibitions concerning the use of U.S. economic assistance, mainly on grounds of security, and other foreign policy considerations — such as human rights, combating terrorism and nuclear proliferation, and other non-economic grounds.

[8] For an elaboration, see the AID Discussion Papers by C. Gulick and J. Nelson, and by J. Nelson and G. Ranis. See also Nelson's *Aid, Influence and Foreign Policy.* (The Bibliography contains the full references.)

there is the inevitable charge of "paternalism" in the judging of economic performance; and, the damage caused a country by wrong policy advice may be no greater than the consequences to that country of an incorrect donor assessment of past events. The advantages of the *ex ante approach* include the possibility of having some beneficial effect through specific microeconomic policy decisions (while the ex post approach is in practice more applicable to macroeconomic performance). Equally important is the capacity to support desirable policy changes as they are occurring; many such changes do need external support in order to become feasible. (The classic example is the need for assisting with the financing of a surge in imports caused by a liberalization of import restrictions urged by the donor as a desirable policy measure.)

The policy dialogue usually involves an element of negotiation. Generally, the outcome of a negotiating process may involve: (i) a loss to both parties; (ii) a zero-sum game whereby one party's loss corresponds to the other party's gain; and (iii) a gain to both parties. An example of the first negotiating situation would be demands by labor which lead to bankrupting the company and thus also to eliminating the union members' jobs. An example of the second situation might be negotiations on royalties to be paid to the owner of mineral deposits. An example of the third situation — where both sides can gain — is the dialogue between aid donor and recipient concerning the latter's economic policies. An adversarial approach is characteristic of the first two types of negotiating situations; this approach rests on a narrow linear perspective, by which it becomes a truism that, the closer the outcome is to the position of one party, the farther away it must be from the position of the other party.

The alternative is a *cooperative approach to negotiations,* which rests on a more realistic view of the complexity of the parties' different sets of objectives, leading each party to define its subjective gains in a significantly different way from the other. The cooperative approach has the potential of yielding a perceived gain to both parties. It is especially well suited to a negotiating situation in which the fundamental objective is shared by both sides — as in the case of the policy dialogue between aid donor and recipient to improve the prospects for the economic development of the latter.[9]

The key to a successful policy dialogue is mutual respect and familiarity with (and sympathy for) the other party's objectives, possibilities, and constraints. In particular, unless the donor understands the country situation well enough to identify the important policy measures at issue, it is impossible to provide valuable and relevant advice. And if the donor does not have such advice to offer, the recipient obviously will have no interest in listening to the donor's viewpoint.

II. The Effectiveness of the Policy Dialogue Through Bilateral Economic Assistance

In macroeconomic policy issues, the lead in engaging developing countries in a dialogue is usually taken by the International Monetary Fund (IMF) or the World Bank (IBRD). These issues are also discussed in the context of IBRD-led consultative groups and in the Board meetings of the Multilateral Development Banks (MDBs) and the IMF. U.S. views are articulated both through its Executive Directors to the MDBs and the IMF, and in the context of its own bilateral programs. These policy issues, however, also affect every part of the U.S. bilateral economic assistance program.[10]

As noted earlier, little attention was paid during much of the 1970s to the overall economic policy context in developing countries, and the explicit stress of the 1960s on using economic assistance as a vehicle for the long-term improvement of the overall macroeconomic policy landscape has only recently reappeared. This should not be interpreted to mean that no interaction on policy issues was taking place in the 1970s between AID officials and the host governments. On the contrary, many specific AID programs have continued to have a significant policy dialogue component, and notable successes have been achieved in a number of instances. While the policy issues that are addressed in project preparation are rarely macroeconomic in scope, they often do go beyond the narrow scope of the project, and have country-wide implications.

Experienced aid practitioners agree that the "receptivity" of the host country government is an essential ingredient of the success of the

[9] As only one illustration among many, the A.I.D. Policy Paper on Recurrent Costs (May 1982) concluded that inefficient or shortsighted macroeconomic policies by the aid recipient or the donor can given rise to a recurrent-cost problem. When this is inadvertent, an ongoing dialogue on a cooperative basis can do much to improve the situation in a manner conducive to the achievement of *both* parties' objectives.

[10] The AID experience of the 1960s is discussed in the Annex.

use of aid to foster improvements in economic policies. But what does such receptivity depend on? For starters, there naturally needs to be valuable economic advice for the host government to be receptive to; in the absence of a constructive contribution by the donor the dialogue cannot have substance. Beyond that, the effectiveness of the dialogue depends to a large extent on the practical conduct of it and on the tone and history of U.S.-recipient country relations. The conduct of the dialogue, the administrative implications and the personal elements are discussed in section III. This section examines the more concrete determinants of the dialogue's effectiveness.

A. **Assessing the Potential of Aid as a Vehicle for the Policy Dialogue**

The potential of aid as a vehicle for the policy dialogue depends on several interrelated elements — many of them factual, including:

— the size of the U.S. aid program *relative* to the magnitude of the recipient country's financial needs, to the inflows of assistance on comparable terms from other sources, and to the country's access to private lenders;
— the specific country circumstances, e.g., the urgency of its needs for additional external financial resources;
— the existence and importance of U.S. foreign policy goals other than the recipient country's own economic stability and development, e.g., strategic, human rights, etc.

With reference to the first point, there is no doubt that the quantitative weight of U.S. bilateral economic assistance has declined in relative terms from the peaks of the late 1960s.[11] It is thus probable that, in the aggregate, the potential of U.S. aid to promote sound LDC economic policies is not as high today as it was in the 1960s. However, the actual effectiveness of U.S. aid in this direction can be preserved, or even increased, with respect to the specific (fewer) countries to which it applies, by greater selectivity in the issues to be discussed and greater persuasiveness of the case being advanced.

[11] In FY 81, U.S. bilateral economic assistance to countries with a 1981 per capita income lower than $2,000 amounted to about $4.5 billion, of which about $1.7 billion was for Development Assistance; in CY 1981, by comparison, the combined current account deficit of these countries was 22 times as large, $99 billion. For a specific illustration, the large U.S. economic assistance program in Pakistan will over the next few years account probably for less than 5% of that country's import bill, compared to an FY 1962-68 average of over 11% from U.S. program lending *alone*.

What if it is concluded that U.S. aid has very low scarcity value to the specific recipient country? Recalling the earlier definition of a ''dialogue'' as leading to an acceptance of the policy advice on being in the recipient's own economic development interest, the vast potential of a genuine policy dialogue is not necessarily compromised by the lower relative volume of aid.

In the final analysis, economic policy improvements will be implemented on a lasting basis (however they may have been initially induced) only by successfully demonstrating to the host government the validity of the economic development case for policy reform. Hence, a relatively small size of the U.S. assistance program in a particular country does not by itself rule out all possibilities of a constructive impact on the country's policies. The very presence of a resident AID staff is evidence of U.S. interest in the country's economic progress. The aid program, even if fairly small, is a useful entree, a sort of calling card, a ''proper introduction'' without which discussion would be difficult to initiate and maintain. Beyond this, as noted, the success or failure of the dialogue rests on the persuasiveness (and, ultimately, the real economic validity) of the arguments. But, as argued earlier, this is true even if the aid program is very large.

B. **The Nature of the U.S. Aid Program**

U.S. bilateral economic assistance is composed mainly of three distinct though interrelated programs, each with its own characteristics and a different mix of objectives: Economic Support Fund (ESF), Development Assistance (DA), and P.L. 480 food aid. (Other small programs include the Housing Guarantee Program and the Trade and Development Program.) While the constituency, characteristics, motives, and mix of objectives differ in the three major components of the U.S. economic assistance program, the *uses* of the assistance are in all cases expected to be consistent with long-term economic development goals. These goals may occasionally be overriden by other considerations, but should never be disregarded. Consequently, *there is almost always a point in discussing possibilities for a constructive dialogue on the recipient country's economic policy, regardless of the specific aid program in question.* Naturally, the limits and shape of the policy dialogue do, among other things, depend on the specifics of the aid program.

In a sense, the aggregate AID program in a particular country can be used as the vehicle to discuss policy issues. However, the difference in emphasis and scope among ESF, DA, and PL 480 means that each offers different opportunities and constraints in serving as a vehicle for the policy dialogue and is worth discussing separately.

1. **Economic Support Fund (ESF)**

While foreign policy motivations are clearly dominant in the provision of ESF, the functions of the assistance may include short-term stabilization as well as longer-term developmental results. The kinds of activities financed through ESF also vary, from those with a heavy project orientation (e.g., Jordan and Pakistan) to straight balance of payments support (e.g., Israel). The strength of ESF as a vehicle for a dialogue on a wide range of macroeconomic policies thus depends on the specific program under consideration. Generally, though, ESF is provided in more quick-disbursing and flexible form.

Since ESF assistance is usually provided for the economic stability and development of the economy as a whole, its effectiveness naturally depends mainly on the soundness of the country's overall macroeconomic policies, i.e., those concerning aggregate production, employment, taxation and public spending, interest rates, foreign trade, and exchange rate policies. This, too, is likely to be viewed as a reasonable connection by the recipient government, which is therefore much more likely to be receptive to such a dialogue. This does not rule out, of course, the possibility of using an ESF program to affect positively some economic policy affecting a specific major sector, especially where the ESF program is heavily project- or sector-oriented.

The main constraint on use of ESF for the policy dialogue is the U.S. basic political commitment of support to the country, of which the host government is obviously very much aware. This was thought by many to virtually rule out an effective impact on the recipient's economic policies.[12] The U.S. economic assistance experience of the 1950s and 1960s shows that the emphasis on economic self-help has tended to increase whenever the program motivation shifted from security or short-term political objectives to longer-term development goals. This tendency may not be irresistible, however. Some current programs show promise — notwithstanding the security and foreign policy importance of the assistance — to continue to develop a substantial and useful interaction with the government concerning economic policy in several major sectors and in certain macroeconomic areas as well.

2. **Development Assistance (DA)**

In DA, the sectoral emphases of AID on agriculture and human resource development carry an inevitable policy component. DA is mainly project-oriented, but with somewhat more flexibility than in the recent past, and with a new accent on improved economic analysis in support of programs and policies. One limit to the policy dialogue through development assistance can be that in some countries the amount of aid is very small. However, as argued earlier, a constructive dialogue can still take place based on the entree provided by even a small (but not insignificant) aid program. Also, as the following table shows, the number of countries where U.S. bilateral economic assistance is significant is rather large. In FY 1981, 32 developing countries received over $20 million each in total U.S. bilateral economic assistance. Of these, U.S. assistance accounted for over 5 percent of imports in 10 cases.

In DA, the formulation of a specific aid-assisted project is incomplete if it does not include explicit consideration of the economic policy environment within which it is expected to function, and which has an inevitably large effect — positive or negative — on the developmental impact of the assistance. It follows that negotiations with the host government concerning the project can and should serve as an opening for at least an exchange of views on how the economic policy environment directly affects the efficiency of the project, and consequently the effectiveness of U.S. assistance in helping with the country's economic development. Project assistance can be a good vehicle for the dialogue on the country's microeconomic policies — i.e., those affecting the demand, availabilities, and prices of the products in the specific sector under consideration, and of the resources needed to produce them, as well as policies affecting the competitiveness of the product and resource markets in question.

The dialogue through project assistance need not be limited to a discussion of the policies that directly influence the efficiency of the particular project. It occasionally may even serve as an entree for the discussion of broader policy issues. Such discussion will be

[12] Indeed, the argument is often heard that the magnitude and strength of commitment of U.S. support may enable a recipient to avoid the need for painful needed policy adjustment, which would otherwise be insisted upon by the international financial institutions.

facilitated to the extent that the project assistance is substantial, and/or that the U.S. aid program in the aggregate is large. Equally, if not more important, the connection between the efficiency of the project itself and the macroeconomic policy being discussed cannot be too indirect — if the host government is to be at all receptive to a discussion of the policy. In any event, discussions with the host government concerning the overall U.S. bilateral assistance program also provide the opportunity to address important macro as well as micro policy issues, even if the various components of the assistance program are in the form of project assistance.

3. **P.L. 480 Food Aid**

Since 1967, P.L. 480 food aid has been explicitly linked to developmental objectives, and greater emphasis has been placed recently on the use of P.L. 480 assistance to promote more effective agricultural and rural development policies in the recipient countries. P.L. 480 assistance can potentially serve as a vehicle for a discussion of either or both macroeconomic policies and specific rural development policies (including therein measures in the areas of nutrition, population planning and education, in addition to policies affecting pricing, production and marketing of agricultural products). This is, of course, because P.L. 480 carries general balance-of-payments implications at the same time as it affects food availabilities and rural development in the recipient country.

The U.S. emphasis on the developmental impact of food aid is evident in the relevant legislation. Titles I and III of P.L. 480 are obviously much more suitable vehicles for the policy dialogue than is Title II, although a policy dialogue on the effectiveness of non-emergency Title II programs (e.g., maternal-child health, food-for-work, and school feeding) deserves more emphasis than it is usually given. Title I loans are made on condition that the recipient countries undertake self-help measures to improve the efficiency of agricultural production and marketing. And Title III, too, provides for multi-year food aid commitments and forgiveness of dollar repayment obligations, as incentives to low-income developing countries to mobilize resources for development and to undertake development-oriented economic policy reforms.[13] The main constraint on the use of food aid as a vehicle for promoting sound recipient country policies appears to be assurance of sufficient availability of commodities to permit program continuity.

[13] On this and related points see the AID Policy Paper on Food and Agricultural Development, May 1982.

C. **Project and Program Assistance[14]**

Few topics raise the temperature of a discussion on economic assistance as quickly as the project/program controversy does. It may be useful to begin, therefore, with a reminder that this section does not touch on any aspect of the relative effectiveness of project or program aid other than their potential as a vehicle for the improvement of economic policies in the recipient country. Secondly, it is well to underline that project and program assistance are not mutually exclusive. On the contrary, they are complementary tools, in the context of the policy dialogue as much as in the broader context of the contribution of economic assistance to international development and other U.S. foreign policy goals. Thirdly, it is always salutary to keep in mind the familiar distinction between the *ostensible* linking of aid to specific projects and *effective* project-tying.[15] Nevertheless, there are three major categories of advantages of program aid.

— Program aid has a *higher scarcity value,* both because the amounts provided are typically larger and because few donors are willing to provide it.
— Program aid is a *flexible* instrument. It is quick disbursing, it can be increased or decreased at the margin or delayed in timing, and can be released in tranches. One can therefore support economic policy changes as they occur, as well as monitor their implementation. Project assistance, by contrast, cannot be turned on and off easily, and its potential leverage on economic policies is correspondingly weaker.

[14] This section draws heavily from Schiavo-Campo and Singer's *Perspectives of Economic Development.*

[15] If the recipient country's own resources are not entirely absorbed by the aid-financed project "A", *and* project "A" is of sufficiently high priority for the recipient country to be otherwise undertaken with the country's own resources, then clearly the aid enables the release of the country's resources to finance some other project "X". In such a case, notwithstanding the various possible good reasons for still going ahead with the nominal linking of aid to project "A", the fungibility of financial assistance means that in reality the donor has given program aid, whether it is realized or not. However, despite fungibility, the donor probably has more of an impact on the sector it is actually assisting. Also, as noted earlier, the policy dialogue presumes some disagreement between donor and recipient on desirable economic policies — and hence probably also on the composition of the development budget. It then becomes quite possible that project "A" will be carried out only because aid is available for it specifically, and the linking of assistance to project is effective.

— Program aid is *more directly relevant* to a discussion of macroeconomic policies; to link program aid to broad policy changes is more likely to appear reasonable to the host government, and thus increases its receptivity to the dialogue.

A review both of the AID experience of the 1960s (see the Annex), and of the World Bank's influence on LDC policies in its three decades of project-oriented assistance might lead to the conclusion that program assistance is the most effective form of aid for influencing macroeconomic policies. Two important qualifiers, however, take some of the wind out of this conclusion:

— To identify a form of aid as the most effective for a particular purpose is not equivalent to ruling out the usefulness of other forms of aid for that purpose, nor to assuming that the most effective form will actually be available under the specific circumstances.
— The first two of the three categories of advantages of program aid (higher scarcity value, and flexibility) belong more in the realm of strict conditionality than of dialogue. Thus, if a decision is made in the particular case to formulate and implement precise performance criteria, then program aid is unquestionably the superior instrument.[16] If the dialogue aspect is instead stressed, the choice is far more equivocal.

D. The Formulation of Conditionality

Conditionality is the most controversial aspect of the effort to promote improved economic policies through a bilateral assistance program, perhaps because it is in this area that the need for painful policy choices or a disagreement between the parties usually comes to the surface. It helps to frame the following discussion if we refer back to the principle of appropriate conditionality, i.e., that conditionality is meaningless without consideration of the objectives of the assistance and of the country situation. The first proposition is thus that *the formulation of conditions must always be consistent with the purposes of the assistance.* A second general proposition is the obvious one that it is important to *acquire familiarity with the recipient country's political, economic, social, and ideological landscape* prior to deciding whether to set conditions concerning economic policy, and if so, which specific conditions to ask for.

[16]Thus, the World Bank's introduction in 1980 of Structural Adjustment Lending (SAL) added a significant new policy and conditionality dimension to the Bank's assistance.

1. Positive and Negative Conditions

In purely economic terms, the distinction between positive and negative conditions is hollow. In principle, there is no difference between causing a loss and causing the cessation of a gain.[17] It is a matter of esthetics, not of economics. Causing a country to become less rich is the same as causing it to become more poor; the only relevant question concerns the quantitative impact of the intervention. However, the major political and diplomatic dimension of the policy dialogue calls for a very delicate handling of the positive versus negative formulation of conditions.

2. Explicit and Implicit Conditions

There appears to be a consensus and a wealth of precedent within AID that explicit and formal understandings openly incorporated into aid agreements are preferable to informal agreements, unless there are very good reasons for not insisting on doing so in an individual case.[18] The same is true of the choice between *specific or general* conditions, with specific and measurable conditions generally preferred to vague and generic criteria, both from the U.S. viewpoint and in order to provide a clear benchmark to the recipient country. It should be noted, however, that specific and precise conditions can be either *quantitative or qualitative.* This is important to stress, for — when shifting to new and different objectives of assistance that are less capable of quantification — there is often the temptation to accept vagueness or even to forego the elaboration of performance criteria concerning the new objectives. Again, it is perfectly possible to spell out precisely certain conditions even though they may be expressed qualitatively rather than quantitatively. Qualitative conditioning may include dated commitments to undertake actions defined in generic terms, or undated commitments to undertake specific actions. In more recent practice, U.S. bilateral aid has included precise but qualitative conditions (such as "strong and concrete measures to curtail the tendency to capital flight" by a specified date) but has generally tended to rely on the IMF for a specification of quantitative conditions.

[17]This principle has been recognized for centuries. For example, the medieval escape clauses to the prohibition of usury rested on either *lucrum cessans* (cessation of a gain), or *damnum emergens* (emergence of a loss).

[18]In countries where a charge of external interference is considered a total disaster for a politician, oral agreements may be far more easily reached than formal written ones. Depending on the judgment concerning the seriousness of the government's efforts at policy reform, the quiet, informal approach may not necessarily imply a weaker policy dialogue.

E. The Implementation of Conditionality

Implementation can be exercised through performance reviews, loan negotiations, and tranche releases. The twin objectives should be to: (i) establish credible consequences flowing from nonperformance, and (ii) decide on the type of implementation best suited to the specific country situation. Credibility can be established through a combination of tact with firmness, along with refraining from threats or promises unless it is certain that, if needed, they can be made good. A decision on the type of implementation naturally depends on the particular circumstances. The effectiveness of implementation is a function of three important elements:

— the quality of conditions,
— the number of conditions, and
— the phasing of the assistance.

1. The "quality" of conditionality

Performance criteria should, ideally, be both necessary and sufficient for the achievement of the policy and economic objectives of the assistance. As a rule, this is extremely difficult to achieve, frequently owing to unforeseen external economic changes. The international financial landscape is littered with the remains of bilateral and multilateral loan agreements that were formally abided to without any amelioration of the economic problems their conditionality was meant to address. It is, of course, important to be confident at the negotiation stage that conditions will prove to be at least necessary, if not sufficient. The establishment of conditions which turn out to be basically irrelevant to the purposes of the assistance and to economic policy improvements only discredits the policy dialogue. It is also important, as discussed later, to build in a mechanism for frequent review of conditions and of country performance.

2. The number of conditions

Common sense as well as the practice of multilateral and bilateral institutions indicate clearly that more conditions do not necessarily mean greater impact on policy improvement. On the contrary, there is — beyond a certain small number — an inverse relationship between the number of conditions and the effectiveness of their implementation. The consensus is that it is far better to insist on a few key points, and make sure that it is known to all concerned that the U.S. will follow through. Often, the most practical course may be to explicitly state *one* major criterion (as, for example, food price changes in a specified degree and on a clear timetable) and incorporate a *discussion* of other self-help conditions related to the major criterion.

3. The phasing of the assistance

Whenever applicable and practically feasible, the assistance should be disbursed in installments — "tranches" — taking care that sufficient time elapses between tranche disbursements to allow for at least minimal assessment of country performance. "Backloading" (later installments larger than earlier ones) increases the credibility of conditionality, though obviously it also delays the economic impact of the assistance. This, and the various other practical aspects of the phasing of assistance, can be determined only in light of the circumstances of the specific case. Generally, however, tranching has a number of advantages. It allows a flexible adaptation of the agreement to possible major changes in economic circumstances — tightening, slackening, or changing performance criteria in pursuit of effective implementation of the purposes of the initial conditionality. Also, it builds in a mechanism for periodic review of country policies, that is, *for the policy dialogue itself*. This is such an important feature that it may be by itself suffice to justify the tranching of assistance.

It is recognized that regular tranching may not be feasible in some instances, especially for some kinds of project assistance, such as establishing an agricultural research system or other forms of institutional development. Even in these cases, however, a tranche might be linked to the beginning of a new phase of a project or to an in-depth mid-term evaluation. Where a pre-determined tranche is not feasible, the mid-term evaluation or some other natural phase in project life should be a time for review of performance, including relevant country policies, with a mutual understanding that depending on the outcome of the review, the project might be modified and scaled upward or downward.

The nature and number of conditions, the tranching, the formulation of performance criteria — all facets of the conditionality addressed at promoting sound LDC economic policies — are a *means* to stimulate the host government in that direction and to arrive at the best informed possible assessment of its efforts and successes. In the final analysis, however, an inherently qualitative *judgment* by the donor is inevitably called for — a judgment of the seriousness, good faith, and competence of the host government in pursuit of the agreed economic goals identified through the policy dialogue.

F. Limits to the Effectiveness of the Policy Dialogue

Several important limitations are implicit in the previous remarks. Indeed, virtually any statement of "desirable" features of the policy dialogue contains within it a corresponding expression of a limit to its effectiveness. It may be useful, however, to recapitulate here the principal limits, keeping in mind that they do not necessarily rule out the possibility of a useful policy dialogue — but only imply the need for realistic expectations and for carrying out the dialogue in specially careful ways.

The presence of *overriding U.S. foreign policy objectives* other than the economic stability and development of the recipient country has already been noted as a constraint on the economic policy dialogue. Even then, a constructive exchange with the recipient country can take place regarding the maximum developmental impact of the resources provided — and hence regarding the overall policy context. The same is true of the possible limit posed by project-orientation of the assistance.

The existence of *large programs of other bilateral donors and of multilateral institutions*, as well as the activities of the IMF and the potential availability of funds from private international lenders — naturally also affect the capacity of the U.S. bilateral economic assistance program to promote improvements in a recipient country's economic policies. The important coordination issues involved are examined in the next section.

A third limit is set by *internal political and social conditions in the recipient country*. Insecurity, instability, administrative incapacity — all serve to lessen the chance of successfully inducing policy improvements. Paradoxically, external efforts to encourage improved policy may be least effective just when the need for improved economic policies and administration is most urgent. A variation on this theme is the possible extreme sensitivity of a recipient country to the slightest suspicion of interference with its sovereignty — sensitivity which is sometimes alleged to rule out a policy dialogue. But, that a host government may be particularly sensitive implies that the dialogue on its economic policies should be conducted in a particularly careful fashion — not that it should not be attempted in the first place.

One approach would be to ask as a condition of assistance that the recipient government formulate and present its own specific program of measures to deal with current economic problems. While much more palatable to the host government than U.S. insistence on certain policies, this approach still has the merit of leading the host government to recognize economic realities, and in all probability leading it to identify a set of measures similar to those which the U.S. would have specified in the first place. Even if this does not happen, discussion of the recipient government's own program would constitute a useful entry for a dialogue on concrete policy measures.

Finally, one often hears that the fundamental limit on the ability of donors to foster improved LDC economic policies is the incompleteness of our *understanding of the economic development process*. The incompleteness is real, but the limit is imaginary. It is, of course, salutary to keep in mind that the market for truth is a competitive one — where no monopoly survives for long — and that arrogance should be avoided.[19] The benefits expected from proposed major policy reforms should be substantial enough to allow for the inevitable large margin of error.[20] But to stretch this point too far leads to paralysis. It leads to the unscientific dead end of not ever counselling anybody about anything, for fear of not being entirely correct.

The fact is that if a donor government possesses a great deal of accumulated experience in economic development problems, information and insights about a particular developing country's economic difficulties and possibilities, and is in sympathy with the country's aspirations and long-term goals — it has a *responsibility* to its own people and to the recipient country to offer the best policy advice it can formulate, to urge effective economic policies, and to use its bilateral assistance program as a vehicle for promoting them. In addition, it is frequently a case of supporting LDC governments in doing what they recognize is needed and often want to do, and not at all a case of forcing them along a policy path which they do not find desirable for their country's economic development. Similarly, participation by donors in policy dialogue adds weight to economic development considerations in the recipient country policy formulation process, a process which — as in most countries — involves various and sometimes conflicting objectives.

[19] As the summary record of the *20th High-level Meeting* of the DAC notes, there was widespread agreement at that meeting that "past failure on the part of donors as well as recipients, should be sufficient to call for a certain humility with respect to the offering of policy advice" (DAC/M(81)11(Prov.), of 3 December 1981, p. 15).

[20] Nelson, *Aid, Influence, and Foreign Policy*, p. 83.

That said, there appears to be no disagreement among aid practitioners, development scholars, and policymakers, of the importance of a careful handling of the policy dialogue process:

External donors . . . assume a heavy burden of responsibility when they intervene vigorously and on a continuing basis in a developing country's policy formulation. This is not to argue against such intervention . . . external influence may be extremely useful as a counterweight to internal resistance to needed change, as a supplement to analytic capacity in countries lacking their own trained analysts, and as a stimulant to fresh perspectives in more sophisticated countries. But effective use of influence also demands recognition of the limits of our understanding of development problems, the patience to work toward a consensus on goals and means, and the willingness to stand by the implicit obligations of the game.[21]

[21]Nelson, *Aid, Influence and Foreign Policy*, pp. 89-90.

COUNTRIES WITH A 1981 CAPITA INCOME LOWER THAN $2,000 RECEIVING MORE THAN $20 MILLION IN TOTAL U.S. BILATERAL ECONOMIC ASSISTANCE[a]

	Country	(1) FY 81 Actual Programs (million of dollars)	(2) FY 81 Imports (millions of dollars)	(3) 1 ÷ 2 (percent)
AFRICA:	Ghana	12.2[b]	1,010.1	1.20
	Kenya	49.9	1,990.8	2.50
	Lesotho	10.4[b]	224.1	4.26
	Liberia	57.8	471.8	12.25
	Senegal	35.6[b]	754.8	.13
	Somalia	57.0	177.9	32.04
	Sudan	109.4	1,640.9	6.66
	Tanzania	36.3	1,199.7	3.02
	Upper Volta	30.7	329.9	9.30
	Zaire	29.6	676.4	4.37
	Zambia	38.5[b]	727.2	5.29
	Zimbabwe	22.9[c]	1,198.0	1.91
ASIA:	Bangladesh	151.6	2,475.2	6.12
	India	275.1	13,675.6	2.01
	Indonesia	135.0	14,747.0[c]	.91[c]
	Korea	29.0	25,300.0	.11
	Pakistan	79.3	5,407.3	1.46
	Philippines	97.5	8,464.4	1.15
	Sri Lanka	71.7	1,921.7	3.73
	Thailand	30.8	9,950.1	.31
LAC:	Dominican Republic	38.6	1,627.1	2.37
	El Salvador	104.0	931.9	11.16
	Haiti	27.5[b]	218.6	12.60
	Honduras	38.5	965.6	4.00
	Jamaica	70.8	1,334.1	5.30
	Nicaragua	18.5	1,008.1[c]	1.84[c]
	Peru	81.0	3,283.4	2.46
NEAR EAST:	Egypt	1,133.0	7,748.2	14.62
	Morocco	55.7	4,336.3	1.28
	Tunisia	40.6	3,752.0	1.08
	Turkey	201.0	8,859.4	2.26
	Yemen Arab Republic	7.7[b]	1,283.8	.60

Sources: *A.I.D. Congressional Presentation, FY 83* Main Volume
International Financial Statistics, IMF, Various Issues
U.S. Overseas Loans and Grants, July 1, 1945 - September 30, 1982

[a]In addition to these, Israel received $764 million in FY 81, and Poland $47.6 million.
[b]FY 78 data. For Ghana, Lesotho and Yemen, the FY 1981 actuals were higher than $20 million.
[c]Estimate.

III. The Conduct of the Policy Dialogue Through Bilateral Economic Assistance

As mentioned at the beginning of the previous section, the conduct of the dialogue cannot be divorced from its effectiveness, of which it is a major determinant. It is discussed separately here because it is much more eclectic than the other determinants of the dialogue's effectiveness — as it includes practical (though important) considerations as well as systemic and organizational issues.

A. The General Tone and the "Emily Post Factor"

The introductory section outlined a "cooperative approach" as an alternative to the adversarial, confrontational, approach to negotiations, and concluded it to be particularly appropriate to negotiations where — at least in principle — donor and recipient share the common objective of the economic stability and progress of the latter.[22]

A correct *tone* of the dialogue with the host government officials is uniformly agreed to be essential to the chances of its success. Among other things, the tone of the approach ought to be generally consistent with the prior realistic assessment of the potential for U.S. influence in the concrete situation and avoid conveying an adversarial and confrontational flavor — for, once again, there need be no conflict of goals between donor and recipient in a genuine dialogue on the latter's economic policies.

A number of common sense maxims emerge from an examination of the practice of the policy dialogue. The following may be listed:

— as already mentioned, the obvious precondition to the dialogue is that the donor must *understand the country situation* well enough to identify the key policy measures at issue. This is much easier said than done. An essential prerequisite is an overall economic analysis of the country's major development problems and prospects. (Such analysis need not necessarily be carried out by the donor agency from scratch or independently of the analyses by other institutions. The *assessment*, as opposed to the research, must be independent, however.) This assessment needs to be based, moreover, on a thorough, balanced and sensitive understanding not only of the economic situation, but also of the political and cultural setting, including the historical evolution. This argues for country expertise by donors; ideally, in-country resident expertise.

— The donor and its representatives must pay attention not only to the *clarity of the policy message* as it is "broadcasted", but also to the clarity of it as it is "received", keeping in mind that governments do not discuss issues; people discuss issues. Needless disputes may result from a simple misunderstanding of each other's actual position. It is, for example, perfectly clear to say "private sector promotion". Nevertheless, if there is any chance that this might be misunderstood by the interlocutor to be limited to "private *foreign* sector promotion", it is far better to spell out "local and foreign private sector promotion", however repetitious it might become. This point leads, among other things, to the desirability of asking the host country representatives to articulate *their* understanding of the policy "message" being delivered.

— The dialogue must be conducted on a basis of *mutual respect*. For example, any chance of a successful dialogue on economic policies is — in most countries — badly compromised if the host government gets the impression that its sovereignty is considered to be "for sale". On the other hand, naturally, a recipient country must accept the donor's right to advance and promote its own position on the country's economic policies.

— *Open mindedness* is quite important too. It makes for better listening. Better listening makes for better quality advice, and advice which is more legitimate — hence more acceptable — from the recipient's viewpoint. It consequently allows the possibility of a stronger and more robust insistence on following the policy course and performance according to the agreement. That is, open mindedness in the formulation of policy advice leads to more forceful implementation of the outcome of the policy dialogue. And, since the parties' open mindedness is likely to improve the quality of the initial advice in the first place, the result is better policy, more forcefully implemented.

— A variant of the above maxim is that it is important that the *recipient government reach its own conclusions*, and not feel that it is being manipulated.

— *Policy concerns should be introduced early* in the aid negotiating process. Sometimes the policy concerns are not broached with the recipient government until the process is well underway. Occasionally, these concerns are allowed to remain dormant until just before

[22] A similar point was emphasized from the very beginning of A.I.D., with the 1961 Report of the President's Task Force on Foreign Assistance counselling reliance on "persuasion" as the primary means of influencing recipient countries' economic policies.

the agreement is to be concluded. Clearly, this results either in not having them taken seriously or in generating justifiable resentment by the host government. In addition, it is probable that the very design of the project is improved by early consideration of the policy issues relevant to the purposes of the assistance.

— The dialogue must be mindful of the *"Emily Post Factor"*, that is — as mundane as it sounds — the need for behaving in manners that do not clash with common politeness or with the host country's social conventions.

B. **Major Stages of the Dialogue and Some Administrative Issues**

A fundamental administrative problem is the assignment of appropriate weights to the necessarily partial views of the different components of an institution in such a way as to lead to an outcome which conforms to the objectives of the institution. *The dialogue with a recipient country cannot be productive unless the prior dialogue within the U.S. Government successfully takes place.*

The economic policy dialogue must be consistent, of course, with U.S. foreign policy overall and with respect to specific countries. Thus, the interaction between AID, State, Treasury, USDA, USTR and other U.S. agencies is a very important component of the eventual effectiveness of the policy dialogue with the recipient country, both in Washington and in the field. In Washington, a formal interagency coordination mechanism is provided by the Development Coordination Committee (DCC), which is chaired by the AID administrator, and its subcommittees on multilateral assistance, food aid, and so on. This formal mechanism needs to be supplemented by informal contacts between appropriate AID staff and that of other agencies. Such informal contacts, which already do take place frequently and constructively, should be extended to the area of the policy dialogue, its effectiveness and conduct. Coordination in Washington, whether formal or informal, is of course incomplete without parallel efforts in the field, to assure that all components of the U.S. presence in a country — including the Embassy, the USIA mission, and others — are at least aware and at best strongly supportive of the objectives of the economic policy dialogue being conducted by AID.

In the specific AID context, one must first of all acknowledge that Mission perspectives differ — and properly so — from the AID/W perspective, and hence assign a significant weight to both sets of views, *in order that the policies decided by AID/W be vigorously implemented.* Many of the principles outlined for a successful policy dialogue with recipient countries apply also to the successful exercise of AID/W influence and guidance for USAID mission activities and the vigor with which they are carried out. While the "leverage" possessed by AID/W vis-a-vis USAID Missions is clear to all participants, it is nevertheless true that *willing* cooperation by the Missions is indispensable for the achievement of a successful policy dialogue.

A meaningful and lasting response by Missions requires, among other things, clear and manageable instructions. So far, the Missions' response to AID/W emphasis on the policy dialogue have been supportive. The requirements for a further strengthening of Missions' interest and capability to engage in a robust policy dialogue with their counterparts in the recipient country are discussed in the next section. Here it is sufficient to note that one of the findings of a review of the AID experience of the 1960s in this area is "a strong tendency to 'package' existing activities in a particular field . . . in order to comply with Washington's directive . . . superficial packaging adds nothing to their effectiveness."[23] Thus, *asking for policy changes should never be allowed to become just another item on a statutory checklist.* To do so would tend to create the tendency to repackage exactly the same activities with a new cover fulfilling the formal conditions, but with no effective change.

The nature of the interaction with the recipient government will depend among other things on the country's level of development, its analytical capabilities, and its relationship with the United States. Except for the very few instances where strict and formal conditionality of assistance is a realistic option, such interaction may encompass one or another of the following approaches, or a suitable combination of all three. A *low-profile informal* approach entails discussions over an extended period of time, with an array of host government representatives, academics, etc. in whatever fora and occasions may be suited for raising policy issue. A *long-term planning relationship* entails the provision of a contract team to work for an extended period with the host country Ministry of Finance, Planning Office, etc., with the delicate dual responsibility of helping to implement host country policies at the same time as it attempts to promote their improvement.

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[23]Nelson, *Aid, Influence and Foreign Policy,* p. 63.

Finally, we may *concentrate aid resources* in those countries (or sectors) where the probability of successful policy improvement is greatest. All of these approaches lead to the same set of practical implications, discussed below.

C. **Sensitivity, Selectivity, Stamina, Staff: Four Essential Ingredients**

There is an unbroken consensus of experienced opinion that sensitivity, selectivity, stamina, and staff are essential to a successful policy dialogue in the circumstances of the 1980s. "Sensitivity" has already been discussed earlier under the heading of the tone of the dialogue. As for the latter three elements, while many aid practitioners and policy-makers might differ on other aspects of the strategy of the policy dialogue, or on the desirable policies themselves, there is no disagreement that the dialogue must:

—build on the Agency's strengths and concentrate on a few key policy changes;
—be conceived and carried out on a sustained, long term basis;
—be implemented by a knowledgeable and competent staff, on both sides.

1. **Selectivity**

The policy dialogue needs to be concentrated in areas where it can make a difference, rather than scattered across the entire economic policy landscape. The important question is the identification of the specific policy areas selected as fit subjects for the dialogue. Officials in the recipient countries inevitably help define the policy issues that are discussed. But it is also necessary that AID choose to discuss those key issues and policies about which we are best informed and which we feel are most important. These would normally lie in the areas of special AID expertise and/or interest, such as agricultural policy, parastatal enterprises, health and population, taxation and government expenditures, and trade and tariff policy.

The enormous economic, social, and political diversity among developing countries points to the need for defining those key issues and policies on a country-specific basis — albeit, of course, from among a "basket" of policy areas on which constructive discussions might be possible. Agency precedent as well as common sense thus combine to suggest that there is no substitute for allowing — indeed, requiring — the USAID/Missions to determine their own key area priorities for policy intervention or dialogue, on the basis of their familiarity with the country situation and with the strengths of the AID program in that country. (This is in fact the approach that has been followed so far.)

There is, of course, a need for "stimulation" by AID/W and for follow-up of Mission responses. The key policy areas to be identified ought to meet the following three criteria:

— They must be areas of importance to the economic development of the country. If they are unimportant, efforts at a policy dialogue are not a cost-effective use of mission staff. For example, the economic efficiency costs of subsidizing consumers by means of controls on agricultural producers' prices are a topic of great general importance. It would be, however, wasteful for a Mission to discuss this point in a country where such intervention on prices is minimal and thus not an important issue.
— They must evidence a significant and identifiable difference between the U.S. views of desirable economic policy and the host country practice. If there isn't a significant difference, the dialogue is moot.
— They must belong in the host government's discretionary sphere. If the economic policy measure is dictated by an overriding national imperative — domestic or external — the host government cannot be at all receptive to the dialogue. Thus, it would not be reasonable to harp on the economic inefficiency of a certain regional allocation of public spending when the expenditure "quotas" — as in several African countries — are dictated by the need for preserving minimal national cohesion in a multi-ethnic plural society.

2. **Stamina**

Any attempt at promoting policy changes must recognize the axiom that any economic policy measure, no matter how desirable or sensible, by itself always harms somebody somewhere.[24] Under special country circumstances, a sudden and large policy reform might be the only way to overcome successfully the predictable opposition by the vested interests of prospective losers. When a government, however, does not possess the requisite strength and authority for such a quick, broad stroke, its implementation of economic reforms requires gradual overcoming, pacifying, or compensating the groups that stand to lose from the reform — and this is delicate and time-consuming political

[24] A recent analysis concluded that the extent of liberalization in various policy areas has depended largely on the interaction between the government and those groups that stood to lose from the liberalization. Morrison and Arreaga, *Economic Liberalization in Developing Countries*, p. 6.

business. Correspondingly lengthy and gradual is an aid donor's build up of its capability to demonstrate to the recipient government how the latter can lessen, escape, or weather the political opposition to economic policy changes.

A policy dialogue will need to be considered as a long term investment of talent and resources. When progress is achieved, it will most likely occur in small increments and when we are most successful, it will be from gradual progress over an extended period. We should not delude ourselves that we will be able to catalyze large or dramatic changes in the macroeconomic policy arena for a small investment of time and resources.

If the policy dialogue is properly viewed as continuing involvement on a long-term basis, one may add to the *direct* policy dialogue (such as may be exercised during program loan negotiations, for example) all the various *indirect* ways through which the U.S. viewpoint on desirable economic development policies is advanced — including help to build up the host government's policy analysis capacity, support for applied research in certain policy areas, professional exchanges among government agencies, seminars and conferences, and the provision of short-term technical assistance for the analysis of the political and economic implications of certain policy measures. Indeed, it can be argued that the bulk of the policy dialogue in many countries is and has been effected through these techniques rather than through U.S. officials' conversations with host government officials. However, it was not possible in this paper to do justice to the elusive topic of the possible long-term policy impact of these indirect measures.

The long-term nature of the policy dialogue leads to one final point. Experience suggests that one should "never give up on countries": today's basket case may be tomorrow's growth model. A case in point is Korea, which in the late 1950s was considered to have extremely poor economic prospects.

3. Staff

The AID staffing implications of three other ingredients of a successful policy dialogue — sensitivity, selectivity, and stamina — are predictable, yet valid. It is unrealistic, and ultimately counterproductive, to try and carry out a dialogue on economic policies of great import to the recipient country without knowledgeable, competent, and sympathetic people to conduct it. This is not the place for a discussion of numbers and credentials of AID staff that may be required.[25] One may, however, note that much can be accomplished by optimal use of a relatively small number of high-quality staff.

There are a number of ways in which the staffing requirements of the emphasis on the policy dialogue can be kept down to manageable proportions. First, adhering strictly to the criterion of selectivity of intervention entails a significant potential for targeting efforts on a few key policy areas even with a relatively small staff. Second, as noted earlier, independent AID assessment of the host country's economic policy context does not necessarily require original research. A lot can be done by intelligent critical scrutiny and synthesis of other institutions' analyses — notably those by the World Bank and by the IMF, along with relevant documents by regional MDBs and other sources — and by frequent exchanges of views with staff of these institutions and of other U.S. agencies. Superimposing the U.S. priorities and perspective onto another institution's work will normally result in certain significant differences in conclusions, or at least changes in emphasis, from the original assessment. An independent economic policy assessment need not, therefore, require a great deal of in-house analytical capacity. (Whether the conclusions of such an assessment should be pressed independently of other donor institutions is a separate major issue, taken up in the next section.)[26]

Even after all possibilities for limiting new staff are utilized, there remains the hard core reality that a constructive policy dialogue, however selective, *mandates* a minimum in-house analytical capability — consisting of a sufficient number of U.S. direct-hire economists on the staff of USAID Missions along with supporting local staff and analytical backup in the form of TDY

[25] A detailed plan concerning the use of economists in AID and requirements for new positions has been prepared by the Chief Economist, partly on the basis of the staffing implications of the economic policy dialogue.

[26] U.S. Embassy personnel often possess the needed economic skills and relevant experience, and judicious coordination with them at the country level can do much to limit direct AID staffing requirements. Much of the same point can be made with regard to coordinating with State and/or Treasury on the economic policies to be urged on the MDBs, or on the IMF. Certainly, better coordination and a greater AID role in the formulation of instructions to the U.S. Executive Directors of the MDBs and of the IMF, would do much to lessen the need for conducting the policy dialogue on a bilateral basis, and would consequently serve to keep down the number of AID staff required.

assistance from AID/W or on contract. At present, in a large number of Missions such analytical capability is notable for its absence.[27]

These considerations do not mean that the policy dialogue can be carried out by staff. Subject to the authority of the Ambassador, the AID Mission Director has the major role (though not an exclusive one) to play in the interaction with host government officials of the requisite level. However, it should be clear to both sides that there are limits on a Mission Director's autonomy. It is good for the effectiveness of negotiations to be able to disclaim authority and to have to refer major issues to AID/W. (The "policy staff" should, of course, enjoy easy access to the Mission Director — or, at AID/W, to policymakers in the regional bureaus.) A management/organizational corollary is that Mission Directors ought to be chosen partly on the basis of their ability to engage in substantive economic policy discussions, and of their understanding of the importance of sound domestic policies in the economic development process. Also, it is necessary that the policymakers in the regional bureaus at AID/W appreciate the importance of the policy dialogue, and evaluate Mission Directors in part on the basis of their performance on this score.

D. The Host Country Participants

The quality and attitude of the host country interlocutors is also very important. All too frequently outside experts quickly interpret non-optimal economic policies undertaken by LDCs as indication of ignorance rather than political constraints or contradictory objectives. Few mistakes can be more damaging to the chance of a constructive dialogue than to underestimate the technical competence and savvy of the host country counterparts. The story is told of the aid organization representative who gave a paternal lecture to a host government economic official concerning a particular conclusion of economic development research — only to find out after the interview that the official had co-authored the original research. Especially in countries with a large economic assistance program, AID will often be negotiating with the host country's most competent professionals, and must be represented by individuals capable of commanding respect and thus attention from their counterparts.

[27]It should also be kept in mind, as the experience of the 1960s shows, that the size and "deployment" of the policy dialogue staff depend on the nature and intensity of the dialogue, with more staff required by a formal conditioning approach than by an informal dialogue.

By contrast, in countries with a limited economic and administrative capability, the dialogue may be constrained by inability of the host country interlocutor to understand what the issue is about and why a certain policy course may be desirable. When this is the case, AID assistance to build up the host country capacity for policy analysis would be in line both with the requirements for a successful policy dialogue and with the institutional strengthening which is of general importance for the development.

IV. Bilateral-Multilateral Cooperation in the Policy Dialogue

The etymology of "dialogue" does not reflect the complexity of the problem of assuring the developmental effectiveness of external assistance. More than "two voices" are involved and "the" policy dialogue in practice comprises a number of formal or informal exchanges, whether joint or several. The contact between a U.S. AID Mission Director and the host country counterpart is only the intersect of two complex decision-making planes. In turn, the U.S. economic assistance program is, in most countries, only one among a constellation of sources of external finance, including the MDBs, the IMF, other bilateral donors, and private international lenders. The need for coordination among these is an age-old issue, with the objective to assure — at best — maximum stimulation of economic policy improvements, and — at least — that one program or one donor not undercut valuable efforts through another program or by another donor.

A. The Role of the IMF and of the IBRD in the Policy Dialogue

The IMF and the World Bank are always potential actors in the dialogue, and very often play the leading role - in large measure owing to their substantial resources. The interaction between AID and these multilateral institutions thus ranks as the first item in any discussion of coordination by AID in the area of the policy dialogue. The burgeoning literature on IMF conditionality and on the World Bank's approach to influencing economic policy in developing countries is too vast to be examined here in detail.[28]

[28]On IMF conditionality, the most useful references are: Joseph Gold's *Conditionality*; Manuel Guitian's three articles in *Finance and Development* of 1980-81; IMF documents EBS/81/152 of July 14, 1981, and EBS/81/152 Supplement 1 of September 1, 1981. A number of papers were also presented at a conference on IMF conditionality, organized by the Institute for International Economics in Washington on March 24 - 26, 1982, and some of these are useful analyses. Another recent treat-

Even though the IMF practices have to an extent changed in response to international economic developments in the 1970s, and notwithstanding the views of some that IMF conditionality has "slipped", it remains true today that the IMF policy conditionality is still by far the strongest and clearest of any international institution, albeit, of course, limited to measures consistent with the Fund's purpose of helping the member country achieve a sustainable balance of payments position in a reasonable period of time. Three interrelated factors are probably responsible for this. *First,* the theory underlying international financial adjustment is reasonably complete, and better established than the theory of economic development, so that IMF conditions can be formulated with more assurance and thus implemented more vigorously. *Second,* the IMF can marshal significant amounts of quick-disbursing financial resources to back its economic policy advice. *Third,* member countries in balance of payments trouble usually yield to the natural temptation to postpone the recourse to unpleasant adjustment measures as long as possible — with the result that when they do go to the IMF for financial assistance their needs are acute, and lend a certain special weight to IMF adjustment policy conditions. It should be stressed that the Fund has often urged member countries to *anticipate* a need for drawing from the Fund, and not wait until their financial problems become severe. The "lender of last resort" terminology is not the Fund's own.

The World Bank's influence on macroeconomic policies of developing countries has generally been more diffuse. Historically, the Bank has been primarily a project lender, and within that vehicle there has always been a concern with the economic policy environment. The recent introduction of program lending with an explicit policy dialogue component (Structural Adjustment Lending — SAL), may, however, have given added robustness to the Bank's economic policy dialogue with recipient countries and increased their success in fostering improvements in host country policy.

ment is R.S. Eckaus' important conceptual piece "The Conditionality of International Financial Institutions and U.S. Policy", presented in draft form to the M.I.T. conference on U.S. International Financial Policy on February 25, 1982. On the World Bank, Edward Mason and Robert Asher discuss the earlier Bank experiences with the use of leverage in their 1973 study *The World Bank Since Bretton Woods.* For a description of the policy dialogue through structural adjustment lending programs, see Pierre Landell-Mills' "Structural Adjustment Lending: Early Experience", *Finance and Development,* December 1981. See also the Treasury Department's *U.S. Participation in the MDBs in the 1980s.* (Full references are shown in the Bibliography.)

B. Coordination Between the IMF and the IBRD

The introduction of SAL has been a major factor in the establishment of closer Bank/Fund links than had been the case previously — although the Bank and the Fund have cooperated with each other throughout their history.

The division of labor — and therefore the nature of cooperation — between the IMF and the IBRD is not as easily defined as it was in earlier days, when the distinction between "stabilization" and "development" was clearer — largely because the duration of "temporary" balance-of-payments disturbances was shorter. It was more acceptable then to think of the Fund as dealing with "short term" difficulties, and of the Bank's function as applicable to the "long run". The onset of oil crises, and the progressively longer duration of temporary balance of payments problems has changed all that. To neglect external financial problems can be fatal to long term development and, conversely, the lack of needed structural changes is eventually paid for in the form of financial crises.

The Fund has correspondingly lengthened the time horizon of some of its activity (with the introduction of the Extended Fund Facility — EFF), and broadened its institutional concern to include production issues; and the Bank has foreshortened its own time perspective to a degree and — within that — begun paying serious attention to requiring certain policy adjustments. Neither Fund nor Bank representatives find it fully acceptable any longer to define their boundary as short-term versus long-term, or stabilization versus development, or macroeconomic versus microeconomic — although it remains beyond argument that the Fund is in all three cases closer to the former of these two terms of comparison, and the Bank to the latter.

What is left as a fairly clearcut dividing line (in addition to the very different "personality" of the two institutions) is the respective institutional policy competence and experience. The Fund possesses primary competence/responsibility in the analysis of balance of payments adjustment problems and has therefore a comparative advantage in the dialogue on exchange rate, monetary, and incomes policies. The Bank possesses primary competence/responsibility concerning development programs and priorities and project evaluation, and has thus a comparative advantage in the dialogue on the size and composition of the investment program, on the efficiency of the use of resources, and on individual pricing policies.

Coordination and cooperation between the Bank and Fund has naturally been easier in regard to the areas of clearcut primary responsibility of one or the other institution, than in the remaining policy areas "in between" (especially fiscal matters and external debt problems). Still, with some limitations and difficulties arising partly from the different pace of activity in the two institutions and their different operational time horizon, cooperation has evolved in keeping with the substantive changes made by both Fund and Bank in response to the changed international economic environment. Outside observers are understandably skeptical that Bank-Fund cooperation has been characterized by as much unbroken smoothness and amity as the representatives of both institutions are typically careful to project. However, it is very probably true that, at least, coordination has not proven to pose any constraint to the operations and overall effectiveness of either the Bank or the Fund.

C. **Coordination Between AID and Multilateral Institutions**

The dialogue on macroeconomic policies to a large extent does need to be carried out by multilateral institutions, not only for the standard reasons of their greater volume of assistance and their non-political nature, but also because — to be plain — from the U.S. viewpoint it is obviously much better that the IMF or the World Bank bear the onus for insisting on inconvenient or unpopular policy reforms. But U.S. bilateral economic assistance programs must themselves have the capability to serve as an independent vehicle for the dialogue on LDC economic policies. This capability is useful to support and reinforce the dialogue when it is led by the IMF or the Bank; and it is an indispensible check on the policy advice rendered through those sources. Lacking such capability, U.S. support for the policy dialogue conducted by the multilateral institutions would suffer form a knee-jerk automaticity which would be very hard to justify — from the U.S. standpoint, from that of the recipient country, or from that of the multilateral institutions themselves.

An opposing argument is often heard, however, to the effect that the dialogue on macroeconomic policy should be left to the multilateral financial institutions, or — which amounts to almost the same thing — that the U.S. effort to foster improved economic policy should "piggyback" entirely onto the IMF or IBRD conditionality. Supposedly, policy changes urged by multilateral institutions are more acceptable to the recipient countries because they are advanced on "technical" and not on "political" grounds.

As Edward Mason put it fourteen years ago:

> [The stigma of aid] becomes less embarrassing and loses much of its sting, we are told, if aid comes from a multilateral agency in which a recipient country and countries in a similar position of dependence have a voice.[29]

It is not sensible, however, to regard economic policy issues as merely "technical"; indeed, it is not good economics to do so. The historical pattern of reaction to the IMF's own conditionality makes this quite clear. Related to the "technical" character of multilateral policy advice is the alleged greater capability of multilateral institutions to undertake a more vigorous policy dialogue. The record of the IMF is invariably cited in this regard, and the argument indeed carries weight in this specific case.

A second argument put forward to support a policy of "100% piggybacking" by the U.S. on the conditionality of the Fund or the Bank is the greater analytical capability underpinning these institutions' assessments and policy dialogue. This is a valid, but not determining, argument. There are still three specific reasons why 100% piggybacking would be an undesirable policy. First, as competent and thorough as the staffs of the IMF and the IBRD are, there is always the possibility that their analysis may be faulty in some respect in any particular case. Second, while the analysis may be on mark, they may have a different perspective on the kinds of ecoomic policies that would lead to broad-based economic development. Third, and most important, the principle of appropriate conditionality should be recalled once again: it is to be expected that the policy dialogue will be carried out by different institutions in pursuit of the achievement of their own statutory objectives and functions. Since these are significantly different, the shape and direction of the policy dialogue carried out through one institution cannot be identical to that which another institution should in principle adopt, and the *possibility* of an independent stance must not automatically be ruled out.

This problem is especially relevant to the next

[29]"Notes on Bilateral and Multilateral Aid", p. 13.

section's discussion of the difficulties of coordinating the policy dialogue through U.S. bilateral economic assistance with other bilateral donors — whose objectives, and the time phasing of those objectives, have the greatest overall divergence from one another. This problem is, instead, least troublesome as regards coordination with the MDBs, with which the U.S. economic assistance program shares the major objective of promotion of long-term economic development.

Interaction with the IMF is somewhere in between, and requires separate consideration. There has been generally strong Agency support for IMF programs from the early days of AID and even before. The U.S. has occasionally conducted parallel (and sometimes even joint) negotiations with those of the Fund and of the Bank with recipient countries. Recently, the connection between U.S. assistance and the IMF imprimatur on recipient country policies has been underlined — consistently so at the level of public support, and often including clear linkages to the probability and amount of bilateral economic assistance.

To a large extent, such strengthening of support for IMF conditionality is grounded on the recognition that the danger to long-term development posed by short-term financial crises is greater than ever. However, lest this posture become purely automatic and hence, by definition, no longer defensible from the viewpoing of the U.S. interests and those of the international economy, it is well to be reminded of the difference between the objective of financial and economic stabilization and the objective of long-term broad-based economic growth. This difference, although blurred by recent events, is still very much an economic reality. While, in most cases, well conceived adjustment programs and sound long-term development plans are mutually reinforcing, the possibility that stagnation and stability might occasionally go hand-in-hand obviously exists.

Bilateral economic assistance, naturally, cannot afford to disregard considerations of economic stability in developing countries — both because stability is linked to longer term development and because it is an important component of U.S. foreign policy objectives in its own right. But neither should one forget that the *weight* assigned to various economic objectives will in most cases be quite different for U.S. bilateral economic assistance than it is for the IMF. Although the strong presumption should continue that the policies counselled by the IMF (or the Bank) are conducive to economic stability and to broad-based development, in light of these institutions' substantial analytical capacity and integrity of purpose — such presumption must not be absolute, and needs to allow the possibility of proving otherwise in any given specific case. Furthermore, the need for consistency of the bilateral economic policy dialogue with overall foreign policy goals also requires leaving open the possibility of an independent U.S. stance — in general, or with reference to specific countries.

This principle has an important implication for internal policymaking processes within the U.S. If indeed the policy dialogue to be carried out through U.S. bilateral economic assistance is to reflect largely (though never unquestioningly) the conditionality of IMF programs, it is plain that AID, which has a major role in formulating policy in regard to bilateral economic assistance:

— should participate in the making of U.S. policies vis-a-vis the IMF to a much greater extent than is currently the case; and
— should interact with the IMF in such a way as to allow for the possibility of changes in views or modification of policy prescriptions by *either* side. At a minimum, any unquestioning presumption that IMF prescriptions are invariably correct or complete should be avoided by the U.S. participants to that aspect of the dialogue.

This is not intended to suggest a need for significant variance from the present practice of Treasury-led coordination of the U.S. dialogue with the IMF. Nor should the arguments of this paper be read as counselling that AID should "duplicate" the multilateral policy dialogue, but, more modestly, that it is important that the bilateral economic assistance program in a specific developing country support and reinforce the multilateral policy dialogue, *in an informed and knowledgeable fashion and in keeping with the U.S. own foreign policy objectives* — including the sustained economic development of the country in question. Informed and knowledgeable support by AID naturally must be grounded on a capability for independent assessment, which can be accomplished by optimal use of a relatively small number of high-quality staff. At the same time, country-specific U.S. support for the IMF or MDB-led multilateral dialogue could be much stronger if the bases of such dialogue incorporated more fully the AID perspective on the importance of development considerations and sound macroeconomic policies to begin with.

D. **Coordination Between AID and Other Bilateral Donors**

The need for policy reform is not limited to countries receiving aid. It extends to the aid practices of the different bilateral donors. There are severe limits, however, to the feasible extent of bilateral donors' coordination for the purpose of fostering sound macroeconomic policies in the recipient countries. As often noted earlier, the greater the difference in objectives, experience and outlook, the more difficult is the task of coordination; that bilateral donors differ greatly from each other in both general aims and economic perspective is a point that requires no elaboration. It is clear that, *at this time*, some other donors do not attach as much importance to LDC economic policies as the U.S. does; even when they do, some appear generally wary of bilateral involvement in sensitive macroeconomic policy issues. Greater bilateral coordination for a more effective policy dialogue should, of course, be attempted and is achievable. The reasons behind the initial reluctance of some other donors do, however, need to be considered in any concrete effort at achieving greater coordination.

The great diversity among bilateral aid programs is well known. There is no clear donor consensus on providing a major portion of bilateral aid for specific purposes or objectives (with the possible exception of aid for stimulating food production). There appears to be only partial donor agreement on aid priorities and development strategies in particular LDCs. In several development areas, e.g., basic human needs, physical infrastructure, industrialization, etc., donor involvement also varies a great deal. In actual historical practice, therefore, major donors have not sought actively or consistently to coordinate their positions on economic policy questions. Some donors have traditionally strongly disapproved of any attempt to link bilateral aid to policy changes, and prefer looking to the multilateral institutions to raise LDC policy issues. However, it would appear, based on U.S. experience in the OECD's Development Assistance Committee (DAC), that over the last year the interest of other bilateral donors in policy dialogue has increased.

For the most part inadvertently, donors at times work at cross purposes. One example of this is the uncoordinated provision of assistance from several sources for overambitious development efforts, beyond the means of the host country and with a plethora of recurrent cost problems. Another example is one donor's provision of general unconditional aid support which as a byproduct relieves the incentive of the host government to take needed policy measures urged by another donor.

One difficulty with formal inter-donor coordinating mechanisms is that most policy questions are politically and economically sensitive, and thus not a good subject for productive and frank discussions in open settings. Confidential, one-to-one relationships in all probability must complement — and preferably precede — whatever formal coordinating mechanisms exist. The pre-requisite for a better coordinated approach, naturally, is a greater degree of agreement by other bilateral donors concerning (a) the importance of LDC policies, and (b) the desirable policy direction toward which a recipient country ought to be urged. Once again, one is confronted with the necessity of a *prior* dialogue — this time, between donors — if the dialogue with the recipient country is to be successful. The U.S. must, therefore, persist in its efforts to present others with an ever more persuasive case in support of its development perspective. This is much more important than elaborating additional mechanisms of coordination — which may or may not be necessary or even desirable, in view of the probability of suspicion by aid recipients.

This policy dialogue among donors can be pursued in a number of already-existing ways including discussions:

— among donor representatives in the field,
— between senior aid officials in donor capitals,
— in MDBs and international organizations,
— in regional donor/LDC groups, e.g. Club du Sahel, the CBI.

Two fora in particular should be mentioned: the Development Assistance Committee (DAC) and the Consultative Groups (CGs).

DAC: As a central coordinating forum, DAC is most suited for broad scale discussions of the need for appropriate LDC policies, the relationship between aid and LDC policies, and the desirability for coherent collective donor positions. Individual LDC situations are not considered in DAC. It would be useful to aim for discussion in DAC on how development critically depends on appropriate LDC policies; on the desirability to provide aid in support of such policies; on the definition of policy areas within which some agreement is possible; on the desirability of coordinated donor positions on policies in respective LDCs; and on the ways and means for reaching agreed donor positions.

Consultative Groups: While there are limits to the utility of CGs for pursuing the policy dialogue, certainly this is a useful mechanism for reinforcing donor views on the importance of policies. As most CGs are managed by the IBRD it is necessary that bilateral donors and the Bank work closely together to ensure that the issues selected are appropriately highlighted, discussed in country economic reports, and prominently considered in CG meetings. Donors, individually and collectively, should be urged to be less hesitant to raise country-specific policy questions in the CGs. However, the positions of major donors must be similar or at least compatible.

When consortia or consultative groups do not exist for a particular developing country, it is in the interest of a constructive discussion of economic policies of developing countries for the U.S. to support formation of a consultative group — if circumstances permit. In addition, the possibility of country-specific mechanisms along the lines of the Club du Sahel may be worth exploring: a systematic mechanism of consultation, convened at intervals, and led on a rotating basis by that bilateral or multilateral donor institution that has special experience and/or interest in the particular issue to be discussed. It would be desirable, also, to examine the possibility of arrangements through which host government officials could participate in such consultations as well. Possible fora for such joint discussions include the UNDP in certain countries and the Development Center of the OECD.[30] The UNDP through its round tables represents another mechanism for coordination and dialogue which has been useful, particularly in the case of very small developing countries, where consultative groups do not currently exist and may not be practical.[31]

[30] LDC officials have in fact participated in their personal capacities in meetings at the Development Center and in informal workshops held under DAC auspices. The subjects of these meetings, such as rural development, have often dealt with recipient country as well as donor policy issues.

[31] As a follow-up to the UN Conference for the Least Developed Countries (LDCs) in September 1981, the UNDP has organized a series of roundtables at the request of individual LDCs.

Annex
AID EXPERIENCE AND CURRENT MISSION VIEWS

Several of the principal conclusions from and examples of the AID experience with the use of program lending to influence LDC economic policies have already been noted in the body of this paper. In most cases, contemporary comments and opinions echo those conclusions, although without the "can do" tone and the presumption of omnipotence of public policy pervading some of the 1960s attempts at shaping the course of economic change in the developing world. The main results of a comprehensive survey of AID experience with program lending in the 1960s are summarized here.

An important generalization emerges from this material, as well as from comments by individuals. By and large, the greater the distance from the recipient country, the less appears to be the concern with special local sensitivity — since the knowledge of those sensitivities is less keen and the perceived cost of adversely affecting them are much smaller. Thus, at Mission level, concern with host government sensitivity is greater and — other things being equal — willingness to urge policy changes is generally less. At central AID levels, the recognition of the delicate nature of the dialogue and of its practical limits may be less clear, but the perspective on the policy problem is also keener. The crucial administrative question is to assure that the decision-making process embodies that particular pair of weights assigned to Mission versus AID/W views on the policy dialogue that will lead to a realistic but not paralyzing strategy on the dialogue.

AID Experience with Program Lending in the 1960s

Some of the earlier experiences with the use of aid to promote sound economic policies were not good, and well publicized blow-ups occurred. These were partly caused by style differences but partly also by substance. Less known are the quietly successful efforts to encourage improvements in economic policies the U.S. aid program undertook in other countries during that period. Nevertheless, one important lesson of those earlier experiences is that a bilateral aid program — however large — cannot be effective as the sole vehicle for a macroeconomic policy dialogue, nor even perhaps perform the leading role in this respect.

A comprehensive review of program lending in the 1960s found that program lending did indeed affect the economic policies pursued by recipient countries, more so than project loans, which were narrower in their scope and exerted only occasional and localized policy influence, or sector loans, which were relatively new during the 1960s and offered no substantiated results. (The conclusions concerning individual country cases were, however, sometimes rosier than the evidence available at the time — let alone the aftermath — indicates.)

Through observation and documentation of program loans as a means of promoting economic policy improvements, two characteristic methods were found to be typically used in their implementation. The first was the "Latin American Strategy", characterized by "tough" and "formal" conditioning and performance evaluation. The second was the "Near East-South Asia Strategy", which exemplified "informal" conditioning, with an emphasis on a continuing dialogue. Although no conscious effort was made to formulate two such divergent methods of promoting economic policy improvements, the AID experience generally proved that the approaches taken in countries in each of the respective regions tended to pattern themselves along the lines of their regional approach. The following table provides a visual summary of the pattern and modality of the AID approach to promoting improved economic policy.

The Brazilian country experience provides a good example of the Latin American or formal conditioning system. Brazilian economic performance was judged on the basis of its fulfillment of both quantitative and qualitative performance targets which were previously agreed to in formalized, written agreements. In turn, tranche releases of program loan funds were contingent on a judgment of whether these specific and explicit loan conditions were met. The Agency concluded that this approach did encourage host governments to pursue policies which would not have otherwise been followed in the areas of monetary and fiscal stability.

India is illustrative of the Near East-South Asia or informal approach to the dialogue. In this case, more emphasis was placed on maintaining a continuing dialogue through gradual persuasion in verbal program loan agreements. Often, agreement on a loan was finalized after the prescribed policies had already been adopted, such as India's devaluation of the rupee.

More generally, the AID experience during the 1960s leads to several useful recommendations and conclusions, many of which (but not all) are still applicable to the policy dialogue today. Regardless of which type of approach is used, a recipient country needs to understand that its cooperation and performance in self-help efforts are critical to its economic development. Therefore, the host government needs to cooperate with the AID Mission, by providing the Mission with an influential contact point in its government and encouraging relations with the Mission Director and his staff in order to establish a firm foundation for the dialogue.

AID should also concern itself with the human element in promoting development and foster diplomatic relations between the Mission Director, his staff and other local counterparts. The AID Mission should be cognizant of potential political, military and commercial considerations which could possibly reinforce or undermine the success of policy discussions.

Certain conclusions pertaining to the use of the program loan itself as a means of promoting policy improvements, and to the time factor, merit additional attention. Although a dialogue can take place in almost any policy area, with the exception of an area of ideological importance to a country, a time allowance should be made for the adjustment needed to accompany and accommodate changes in fiscal and monetary policies. Another important point is that a host government's receptivity to policy suggestions does not usually remain constant over time. The characteristics of the policy dialogue need therefore to be periodically reviewed.

Multilateralism, whether in conjunction with the IMF or the IBRD, including consortia and consultative groups, is useful in promoting improvements in economic policy. The Chilean country experience during the 1960s is indicative of how IMF fiscal and monetary stabilization policies were incorporated into AID program loan conditions. The 1970 PPC study also concluded that donor consortia can be useful in promoting sound economic policies consistent with the views of the United States, yet at a lesser political and diplomatic cost.

				Environmental Factors						
Country	Nature of Conditions	Implementation of Conditions X = Strict[a]	Areas in Which Conditions Were Specified	Diplomatic Relations	Domestic Politics	Unforeseen Economic Developments	Multilateral Presence Consortium	 IBRD	 IMF	Mission-Host Relations
Brazil	Specific	X	Stabilization Policy Federal Budget Coffee & Wage Policy Fiscal and Monetary Policy Inflation	Good	Unstable	Inflation		X	X	Good
Chile	Specific But Implicit	X	Stabilization Policy Balance of Payments Inflation	Good	Obstacle to Aid Relations military press. pol. system	Favorable Copper Prices		X	X	Conducive to Diplomatic Relations
Colombia	Specific and Explicit	X	Stabilization Policy Exchange Devaluation Coffee Policy Agriculture, Education Export Promotion	Fair	Political System Provided a more Secure Yet Less Powerful Government	Exchange Rate Crises		X	X	Strained Staff Capabilities Excessive Staff Demands
India	General and Implicit		Development Policy Agriculture Family Planning Import Liberalization Export Promotion Exchange Rate Devaluation Increased Foreign Private Investment.	Indian Neutrality Emphasized	Political System Sensitive to Outside Influence	Indo-Pakistani War 1965	X	X	X	Continuing Dialogue Emphasized
Pakistan	General But Explicit		Import Liberalization Population, Agriculture Fiscal Policy	Good	Good Stable	Indo-Pakistani War 1965	X	X		Continuing Dialogue Emphasized Persuasion
Turkey	Implicit		Balance of Payments Stabilization Policy Foreign Exchange Import Liberalization	Politico-Military Relations Interfered	Sensitive to Outside Influence	Perennial Balance of Payments Difficulties	X	X	X	Continuing Dialogue Emphasized
Tunisia	Explicit	X	Stabilization Policy Credit, Public Expenditure, Tax, and Private Investment Policies Agriculture Fiscal Policy Current Account Viability	Good	Good		X	X	X	U.S. Attempt to Find Another Principal Donor
Korea	Specific		Stabilization Policy Credit, Fiscal, and Foreign Exchange Policies	Good	Good		X	X	X	Good Working Relations

[a]Strict program loan condition implementation may be characterized as having more than 15 loan conditions in a given year accompanied by 2 or more tranche releases and/or penalties in the form of delays and deobligations of loan funds.

SOURCE: *The Use of Program Loans to Influence Policy*, AID Evaluation paper, March 1970.

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