
Structural Adjustment and Policy Dialogue

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Introduction

Formal exchanges between donor and recipient about the domestic policy framework influencing the outcome of an aid transfer, are termed 'policy dialogue'. Donors' fondness for it has grown alongside (a) their perceptions of generalised economic *malaise* in many LDCs, and (b) recipients' demand for balance-of-payments support rather than project aid. A few observers have even claimed that the unique function of aid is to induce policy reforms engendering efficient resource allocation and economic growth, rather than to relieve scarcities of domestic savings or foreign exchange;¹ such a view greatly enhances the importance of policy dialogue.

Accordingly, this review emphasises macroeconomic, resource allocation and institutional questions, rather than the project-specific exchanges that typify aid relationships. Both balance-of-payments support and sector aid are now increasingly popular vehicles for wider policy dialogue; this article covers both.

Past donor reticence about seeking negotiations with recipient governments over matters not directly concerned with a particular project has receded. Recipients have acquiesced in procedures that might once have been considered infringements of national sovereignty. Now that it has become a prominent facet of international economic relations, what does (and what could) explicit policy dialogue add to aid-effectiveness? And what are the necessary conditions for the success of policy dialogue?

Some Definitions and Distinctions

Donors tend to argue that 'dialogue' is not 'conditionality' or 'leverage'. USAID's discussion of

¹ A view succinctly expressed by Krueger (1981): the core of her argument is not that aid flows in themselves assist capital accumulation or efficiency in resource allocation but that 'economic growth is largely the outcome of domestic policies and incentive structures which encourage the accumulation of additional resources and their efficient utilisation' [Krueger 1981:280].

policy dialogue [USAID 1982] points out that the use of aid to foster policy improvements presupposes some initial disagreement on the direction, scope, degree or timing of policy change.

'Leverage' refers to the capacity to enforce one viewpoint over another, while 'dialogue' implies that either viewpoint, or both, can change to bridge the initial difference. By means of 'dialogue' the recipient comes to view policy changes as advancing its own economic progress; with 'leverage' the recipient agrees to enact certain policies in response to incentives by the donor. Leverage, in this sense, is neither a necessary nor a sufficient condition for the success of policy dialogue.

The World Bank operates a similar distinction between 'policy dialogue' and 'policy conditionality'. The latter results from the view that, in success or failure at structural adjustment, vested interests count as much as the rationality of policy-making; the donor agency must therefore find a way to exert leverage.

It is doubtful whether such a sharp distinction between 'dialogue' and 'conditionality' can be sustained. There is, of course, a distinction of form between aid flows governed by agreements incorporating explicit policy conditions which a recipient must meet before funds are released, and those which are not. Explicit conditionality, however, is not the only route to leverage. Even in the most formal use of conditionality to exert leverage, the programmes of the IMF, the importance attached to a particular policy change in negotiations need not be reflected in the explicit conditions eventually incorporated in an agreement.²

A more workable set of distinctions concerns the arena of dialogue: short-run economic policy, development strategy as a whole, or sector policies?

² Therefore, one cannot gauge the relative importance of different policy instruments in IMF or World Bank adjustment programmes by establishing the frequency of their appearance in formal agreements.

The IMF traditionally confined the scope of its policy conditionality to those items it deemed necessary to ensure the repayment of its short-term loans, and those items falling within its mandate to supervise exchange regimes. Fund conditionality became identified largely with instruments of short-run demand management, and the Fund explicitly disclaimed any role in the determination of income distribution or the formulation of long-run development strategy. Macroconditionality of the kind incorporated in World Bank Structural Adjustment Loans (SALs) represents an extension of explicit leverage to cover a much wider range of instruments. In parallel, the focus of donors upon the conditions of operation of individual projects has broadened into a concern with the institutional framework and individual policies which govern the sectors in which projects and programmes are to take effect. The examples briefly outlined here will indicate that dialogue or leverage which can succeed at one level in one country or period will not necessarily be sustainable or appropriate elsewhere.

Is there a Universal Prescription?

Dialogue presupposes disagreement on the part of the donor with the recipient's policies, and hence some source for the alternative view. The USAID paper cautions that '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' [USAID 1982]. Nevertheless, concern that some excessively uniform policy prescription will be imposed on different countries, as a result of decisions taken by governing bodies knowing little of the individual circumstances, remains at the heart of doubts about conditionality and policy dialogue.

Until recently, the IMF was virtually the only international agency subject to that criticism. The Fund has been identified with the 'three Ds' (devaluation, deflation, decontrol), and with a short-term, demand-reducing approach to balance-of-payments adjustment. Whatever the merits of that criticism (see below), the Fund can claim that its articles require it to emphasise short-term stabilisation, to protect the revolving nature of its resources by ensuring rapid repayment, and to stress liberalisation in its approach to trade and payments practices. For other donors, such a justification for uniformity of prescription is not available.

The rise of policy dialogue, and of the participation of agencies other than the IMF in balance-of-payments aid to support structural adjustment programmes, has exposed multilateral (and to some extent bilateral) donors to similar criticisms. In part this is a

consequence of a natural learning process: while policy dialogue and conditionality remain novel, donor agency personnel are bound to rely on prescriptions from experience internationally, rather than from the policy problems of the country concerned.³ But there are also genuinely distinct views: that the general thrust of 'good policy' for development is now well understood [eg Krueger 1981]; or that it is not [eg Bird 1981].

Those in the first camp assert that we now have sufficient experience of the development process to identify the kind of policy changes that are likely to pay off; in particular, donors should encourage a shift from a policy stance of 'control' over the domestic economy to one favouring a liberal trade regime and an outward-looking framework of incentives. Proponents of this view assert widespread agreement about the benefits of iniform incentives (as between production for the home market and for export) in domestic markets and trade regimes.

The opposition points to the examples of multiple and conflicting definitions of 'good development performance' found over the years in the literature and in the pronouncements of aid agencies. They stress that many of the countries now praised for trade liberalisation initially built up their industrial sectors with the help of substantial protection and state intervention. Above all, they argue that the 'incentives school' has overestimated the benefits for equity, efficiency or growth of 'getting prices right' in the absence of complementary changes, eg foreign aid flows; institutional change; and restructuring of investment towards, or assets within, agriculture; or research into suitable production techniques (stressing, for example, the inevitably low total price-elasticities of supply in the technologically stagnant agricultures of much of sub-Saharan Africa [Bond 1983; Lipton 1985].

In the past three or four years this debate has to some extent been superseded. A good example of the evolution of donor attitudes is afforded by the second [World Bank 1983] and third [World Bank 1984] reports on sub-Saharan Africa by the World Bank. Although no-one, and least of all the Bank, would advocate 'getting the prices wrong', there is now much greater emphasis on the length of time needed to achieve structural adjustment and on the organised support for price changes and liberalisation that must

³ Even in the World Bank, which has traditionally conducted the most comprehensive reviews of overall country performance and policy, country economic work was previously carried out in support of allocation decisions about project aid rather than for macroeconomic policy prescription. The advent of SALs has, according to Bank officials, significantly enhanced the importance of country and sector policy work in its own right (and of those responsible for it).

come from institutional reform, agricultural research, and continued investment in social services. There is evidence (see below) that these shifts of emphasis arise from the accumulation of experience with conditional lending and the design of policy reform programmes. The World Bank is itself now conducting major research projects to examine the design of structural adjustment programmes, covering issues such as the 'timing and sequencing' of trade liberalisation.

Any universal prescription tends to dissolve when exposed to a specific context. Donors seeking policy dialogue face quite different tasks, for example, in countries with massive institutional deficiencies (budgets not made or followed, public sector salaries unpaid, or widespread corruption) from those they face in countries where administrative infrastructure survives but prices are manifestly wrong. The tasks alter again in most LDCs which exhibit neither extreme.

While there can be few objections to a judicious transfer of the lessons of international experience, reform programmes are likely to perform better when they have evolved from a process that recognisably incorporates local experience, objectives and constraints. Donor agencies routinely deny that there is uniformity in policy prescription from country to country; as agencies develop greater institutional experience with dialogue in differing circumstances it should prove easier to demonstrate substance in this denial.

The International Monetary Fund⁴

The IMF is not an aid-giving institution, but provides the yardstick for the stance of other donors in dialogue. Moreover, a Fund programme is a prerequisite for debt-rescheduling and World Bank SALs. Nearly 60 developing countries were engaged in stabilisation programmes supported by the Fund's conditional resources during 1982-84. The links between the IMF and donor agencies are therefore vital to the stance which donors adopt in dialogue. Recently, breakdowns in relations with the IMF have tended also to mean failures to attract additional inflows of aid.

The arguments about Fund programmes are of long standing. Does the Fund impose excessive contraction on deficit countries, neglecting the need for counterpart action by surplus countries? Does it take adequate account of social and political realities? Does it ignore equity concerns? Does it, unknowingly, sacrifice long-term development prospects to short-

run stabilisation? Does it distinguish adequately between internal and external causes of disequilibrium? And does it evaluate the differing capacities of its client countries to withstand external shocks?

The IMF has a straightforward reply to its critics. When a country has a balance-of-payments deficit which is not self-correcting, it must take steps to achieve adjustment within available resources. The Fund assesses what resources are available; it then looks at the means by which a government might close the residual deficit through domestic action. It is the government's responsibility, not the Fund's, to calculate the political or social consequences of its actions.

Accepting that some degree of retrenchment has become inevitable in virtually all deficit countries, the problem is the availability of resources to the Fund. The Fund has been obliged to restrict access to upper credit tranche facilities, encouraging the view that conditionality has toughened. The Oil Facility, Trust Fund and Subsidy Accounts used to provide concessional support in the 1970s have not been replenished; the Fund has tackled the problems of the post-1979 recession without them. The Compensatory Financing Facility has been able to respond only to a fraction of the valid claims upon it. Despite quota enlargement, the overall volume of the Fund's resources has not kept pace with demand, and the multiple of quota that may be borrowed by countries with severe debt service problems now seems in practice to be falling. In order to safeguard the integrity of its revolving resources, the Fund is now in the position of forcing many low-income countries to sustain net exports of capital to repay its own and other loans for five or even 10 years. It is difficult to view this resource-constrained stance as anything but damaging to the development of poor countries and the stability of international trade and payments arrangements.⁵ As the focus of Fund activities (and controversy about its impact) shifts from the larger, middle-income economies of Latin America towards the chronically dislocated low-income economies of sub-Saharan Africa, the impact of the resource constraint, as accentuated by the absence of any substantial medium- or long-term facility for concessional balance-of-payments support, becomes still more obvious and damaging. Such a facility may not properly belong with the Fund [Dell 1984], but its absence exacerbates the harshness of the Fund programmes.

⁵ Indeed, in sub-Saharan Africa 'repurchases' due by debtors to the Fund are sustainable only on the assumption that other creditors are prepared to engage in repeated reschedulings. For an overall assessment of African debt and its structure, see Griffith-Jones and Green (1984).

⁴ This section draws upon the chapter on 'The Policy Dialogue: the IMF' by Robert Cassen, included in the unpublished literature survey for the Aid-Effectiveness Study.

Substantial and rapid retrenchment inevitably reduces the effectiveness of traditional project aid. When governments cannot meet local and recurrent costs, foreign exchange for capital works is of limited use. Public expenditure reductions in a context of already weak administration tend to make delivery of services still less reliable — at least in the short run.

This is not to argue that 'Fund-type' stabilisation and adjustment programmes are wrong or unnecessary. But their usefulness, and that of aid flows, is strongly influenced by the availability of resources to the Fund. Moreover, the potential for recovery in many of the Fund's low-income borrowers, will depend on the availability of aid from other donors to support a process of adjustment in the production structure.

Each country's situation is different in respect not only of the causes of its difficulties; but also of its capacity to respond and adapt, given the will to implement stringent adjustment programmes. Some of the middle-income countries have adjusted well to the external shocks of the 1980s. They have shifted resources towards tradeables production, curbed excessive domestic expenditures, and — albeit at high cost in austerity — re-positioned themselves for expected future conditions. It is precisely this capacity to adjust that is lacking in the poorest countries.

The World Bank and Structural Adjustment Lending⁶

The World Bank's experience and mandate made it ideally placed to establish a facility providing balance-of-payments lending in support of long-term adjustment programmes for low-income countries. Structural Adjustment Loans (SALs), however, have developed not as an alternative to Fund programmes, but as a complement to them. They are still relatively modest operations, since there has been a limit of 10 per cent of annual commitments upon the Bank's non-project lending. Until recently, there was a concentration of SALs upon middle-income countries (and semi-industrial ones): Turkey, South Korea, Thailand, Philippines, Panama, for example. Even within Africa, middle-income and 'near-middle-income' countries figure prominently in the list of SAL recipients: Ivory Coast, Kenya, Mauritius, Togo, Senegal. Conspicuously absent are low-income South Asia (one SAL operation in Pakistan was suspended when the country's balance-of-payments improved), the Sahelian countries, or those populous countries in Africa suffering severe political and economic dislocation (eg Zaire, Sudan, Ethiopia).

⁶This section is based upon the chapter 'Structural Adjustment Lending' by Philip Daniel in the literature survey for the Aid-Effectiveness Study, and upon the accounts of SALs in the Kenya and Malawi country case studies.

Not all World Bank non-project lending is channelled through SALs. Nor is policy dialogue dependent upon non-project lending. In Ghana and Zambia, for example, much the same intensity of policy dialogue has been achieved through World Bank programme or project support for rehabilitation projects in key export sectors, whose operation is sufficiently affected by macroeconomic policy and overall public investment allocation decisions to make economy-wide dialogue and conditionality a feature of what is ostensibly sector support.

A senior official of the Bank [Stern 1983] has stated that SALs are designed to:

- support a programme of specific policy changes and institutional reforms designed to reduce the current account deficit to sustainable levels;
- assist a country in meeting the transitional costs of structural changes in industry and agriculture by augmenting the supply of freely usable foreign exchange;
- act as a catalyst for the inflow of other external capital to help ease the balance-of-payments situation.

SALs' sprang from the realisation that, in the post-1979 international economic environment, LDCs were likely to require extensive programmes of domestic policy reform in order to respond to changed international relative prices, terms of trade deterioration, and declining net inflows of foreign finance. The postponement of such reform had, it was claimed, created in many countries a syndrome of severe price distortions, administrative over-regulation, public-sector inefficiency, falling savings and low-yielding capital investment. The Bank recognised the political difficulty of remedial action and the likelihood of perverse short-term economic effects from the measures required for long-term structural change. Hence the need to provide additional resources to enable a government to implement the necessary programme of reform.

In principle, the distinction between Bank SALs and IMF programmes is one of time horizon and range of instruments. Whereas the Fund is primarily concerned with financing and correcting balance-of-payments deficits in the short-run, the Bank's SALs are intended to encourage a sustainable long-run balance-of-payments position that is compatible with growth. The Bank concerns itself, much more than the Fund, with resource mobilisation and allocation policies directed at increasing the supply of tradeable goods. In

⁷In what follows, we discuss World Bank policy dialogue in terms of SALs, but the points also refer to other forms of Bank conditional non-project lending.

practice, the distinction is less clear — especially where the Fund becomes involved in a series of programmes, or in an EFF.

The two institutions normally complement each other well. Differences of function, however, have led to differences between the Bank and the Fund, particularly in East Africa. Differences arise over the degree of retrenchment judged necessary: partly a matter of technical judgement, and partly of political or institutional feasibility.

The key question is the comprehensiveness and timing of appropriate measures. The Bank's appraisals of SAL operations so far suggest that much learning has taken place about the pre-requisites for successful policy reform: comprehensiveness appears to be yielding to selectivity, and 'short, sharp shock' to a more sensitive approach to the sequencing of critical measures such as trade liberalisation, the removal of subsidies, or introduction of user charges for public services. The Fund's resource constraints, and the nature of its facilities, make it less able to follow such an evolution. The continuing tensions thus need to be addressed urgently, if the normally effective cooperation between the Bank and the Fund is to be maintained.

At 1 July 1985, 31 SALs had been approved covering 17 countries and amounting to \$4.5 bn. Four programmes had been discontinued (Bolivia, Senegal, Guyana and Pakistan⁸), but one country (Turkey) had received four consecutive loans while eight countries had received two loans each.

The appraisal of SALs involves four elements: the appropriateness of the policy reform package; the sequencing of programmes; the process of dialogue, including the capacity to sustain it within the recipient LDC; and, lastly, the accuracy of the estimates of terms of trade movements and foreign financial inflows, upon which the macroeconomic prescriptions of the programme depend.

The limited evidence so far does *not* convict the Bank of imposing uniform policies through SALs. On the other hand, there has been vigorous attention to regularly recurring areas of desirable policy reform. The Bank's task is to continue to act as a catalyst for difficult domestic decisions, while not so elevating disagreements that they are perceived as a political or

ideological challenge by the government concerned.⁹ The components of SAL reform programmes tend to comprise, not necessarily in order of priority, (1) restructuring of incentives (pricing, tariffs, taxation, subsidies, interest rates); (2) revision of public investment priorities; (3) better budget and debt management; (4) strengthening institutions, especially public enterprises. There is widespread awareness of the complementarity between these broad groups, particularly between measures to alter price incentives and the institutional reforms which might give real effect to incentive changes.

Now that sub-Saharan Africa has become a major focus of the structural adjustment effort, the recipient's capacity to sustain dialogue and policy reform is central to the success of SALs. With few exceptions (of which South Korea is the prime example) it seems that the initiative in SAL programme formulation tends to lie with the World Bank rather than with the recipient government. While neither surprising nor reprehensible, this does point to the need to strengthen recipient capacities for negotiation and policy analysis. Otherwise, the risks remain that the programme will be regarded as an outside imposition, will fail to take root or produce lasting change, and will contain inappropriate diagnosis.

The priority attached by the Bank to lending for reconstruction and recovery in sub-Saharan Africa carries a special risk that particular problems will be viewed as 'solved' once a programme has been drawn up that can win Bank staff and board approval. Agreement on a structural adjustment programme is only the beginning of a long and fragile process.

Poor estimation of trends in externally-determined influences on a country's balance-of-payments has been a prominent cause of difficulty in SAL programmes. Export prices and capital flows, for example, are vital determinants of a country's ability to sustain trade liberalisation (*vide* Kenya's first SAL). From 1979 to 1983, World Bank commodity price forecasts were persistently over-optimistic; the forecasts affected the design of programmes, and the collapse of justified expectations exacerbated programme failures (notably those in Guyana¹⁰). The possibility of forecasting errors does not detract from the value of SALs, but it makes a case for greater

⁸ Pakistan's SAL became unnecessary when the country's balance of payments improved; Bolivia's collapsed as a result of political upheavals; Guyana's fell victim to the severe economic dislocation in that country; only for Senegal can we conclude that a different approach to policy dialogue, and greater flexibility, might have allowed the programme to be sustained — the lessons of this case seem now to be well-understood. Consequently, the Bank can fairly claim a satisfactory 'success rate' for SALs.

⁹ This problem has clouded the relations of the international financial institutions with countries as diverse as Jamaica, Nigeria, Tanzania and India; the recurrent disputes of the IMF with Argentina, Brazil and Peru are better known.

¹⁰ The suspended SAL in Guyana fell victim to domestic mismanagement, but the domestic strains themselves were intensified by larger-than-expected deteriorations in the unit value of sugar and bauxite exports.

flexibility in policy reform programmes and in the volume of funds the Bank is permitted to devote to SALs. When an unexpected terms-of-trade deterioration makes a government unable to meet individual conditions of a programme there should be some alternative to complete abandonment or renegotiation of the whole programme; without the necessary flexibility, Bank (and IMF) adjustment programmes could become self-defeating.

The World Bank's conditional non-project lending has shown potential to evolve in fruitful directions. Balance-of-payments support is clearly needed in a large number of low-income countries, and the new Bank schemes offer one of the most effective methods of providing it. They also offer a focus for support from other donors in a framework within which recipients appear increasingly able to implement major measures of reform. Far from curtailing SALs and related Bank operations such as sector aid, there is still an urgent need to expand them — learning from recent experience, bolstering them with concessional support, and improving the consistency with them of Fund operations. As a means of delivering aid, non-project forms linked with policy dialogue deserve support, even if there are justifiable criticisms of reform programmes undertaken in particular contexts.

Other Donors and Policy Dialogue

Policy dialogue and leverage involving bilateral donors has rarely been conducted within explicit frameworks comparable to Fund programmes or Bank SALs. Such dialogue is inevitably an extension of bilateral political and economic relations in non-aid fields; it thus raises more sensitivities, and may involve more influences extraneous to development policy than the dialogue of multilateral agencies.¹¹ Some bilateral agencies are more enthusiastic than others about interventions in recipients' domestic policy discussions. In Bangladesh, for example, USAID maintains a large mission and engages in continuing bilateral policy dialogue with the government; the Japanese agencies, on the other hand, maintain no such representation and claim never to exert influence in bilateral discussions with the government; other donors occupy positions on the spectrum between.¹² There have been a few instances of direct use of leverage by a major bilateral donor to bring about

¹¹ The FEC is commonly considered a multilateral agency; for purposes of this discussion, however, the increasingly coordinated foreign policy stance of FEC member states, and the relation of aid and trade under the Lomé Convention, make its role in policy dialogue more 'bilateral'.

¹² USAID maintains a high profile, but it is not the only agency with an independent approach. The Scandinavian donors, the Dutch and the Canadians all maintain independent channels of dialogue — often because of their special interest in the distributional effects of aid.

macroeconomic policy change by a recipient government. The case of US pressure in India in the mid-1960s is outlined below, and casts doubt on the usefulness of the approach. The management of a long-term bilateral relationship where, for historical reasons, the recipient's reliance upon the donor's support is substantial, is a matter of great delicacy; by its nature, not much will be known about the record by non-participants.

The new task for bilateral donors has been to assess the implications of the rapid spread of Bank- or Fund-organised adjustment programmes, and the counterpart need for increased flows of non-project aid. With some exceptions, bilateral agencies have traditionally been organised and staffed to cope with project aid, not with programmes of economy-wide policy reform. The World Bank has invited bilateral donors to support SAL programmes,¹³ which, therefore, they must be able to appraise. But will policy dialogue and negotiation of policy conditionality by agencies other than the Bank and the Fund be confusing or counter-productive?

Avoidance of fragmentation and mis-diagnosis in the dialogue process requires, first, strengthening of the recipient's negotiating capacities, and role in donor coordination. Secondly, the obstacles to donor coordination are well-known (trade interests, political competition, agency self-preservation and so on); nevertheless, there could be better use of consultative groups for 'dialogue among donors', and for resolution (involving the recipient) of policy reform packages that will command wide donor support. Which, then, is to be the lead institution in the process — the Bank, the Fund, a multi-donor secretariat? The best approach will probably involve the gradual evolution of more formal procedures for consulting key bilateral donors in consultative groups, and during the process of framing Bank or Fund-supported adjustment programmes. The key objective, however, must be to raise the capacities and importance of the recipient in the dialogue.

Recipient Experience of Dialogue: the Indian Case¹⁴

India enjoyed good relationships with aid donors up to the mid-1960s. Donors accepted India's formal planning framework and selected from among the projects it yielded; they made few noticeable attempts at intervention in the conduct of economic policy. When war, drought and agricultural problems placed

¹³ Notably in its reports on sub-Saharan Africa. The FEC (European Development Fund) and the OPEC Fund both contributed in support of Kenya's first SAL reform programme.

¹⁴ This section is based on the chapter on policy dialogue by Michael Lipton in the case-study of India for the Aid-Effectiveness Study.

India's balance-of-payments under pressure from about 1965 onwards, donor attitudes quickly changed. Since then the Indian story of policy dialogue consists of three transitions: from explicit use of leverage to more relaxed dialogue; from heavy involvement of a single donor (the US) to the conduct of dialogue with a Bank-led donor consortium; and from macro-conditionality to a sectoral framework for dialogue.

The devaluation forced on India in 1966 was much needed, but ill-timed. It was forced as a condition of the resumption of US aid, against the wishes of the Indian Finance Minister, and it was the subject of major pressures and tensions between the donors and the Government of India. The Consortium's aid package, designed to support both devaluation and further trade liberalisation measures, collapsed when the US pulled out. Such a degree of bilateral leverage over macro-economic policy was achieved only in conditions of acute economic difficulty for India, and at a cost of chronic disruption to both aid relationships and Indian economic management. In the medium term the Indian response was to seek to diversify her sources of political and economic support; the donors who sought to promote internal changes by strong leverage in fact failed to secure the changes and, in the process, lost the capacity to influence future Indian policy.

An atmosphere of partnership in policy dialogue took considerable time to rebuild. In the past decade, major donors (excluding, of course, the IMF) have shifted to a sectoral framework for dialogue and now prefer the World Bank to mediate. Active coordination by a bilateral donor continues where the donor has special expertise (the Scandinavians in health, the UK in coal), but the general approach is multilateral.

The successful re-establishment of policy dialogue has depended greatly on India's own skills. At both sectoral and project levels, India fields a large range of capable people with accumulated skills and experience. The learning process is decidedly two-way. Moreover, Indian officials are prominent at many levels of the World Bank, so that Bank-coordinated dialogue seems far removed from bilateral leverage with its diplomatic and political overtones of an outside imposition. India's planning and budgeting systems are sophisticated, and tempered by long experience; the country has clear and project-specific priorities. Research results and capabilities are available from outside the Indian Government. These circumstances are absent for the vast majority of low-income countries.

The Indian experience suggests that dialogue is most effective where aid is in any case most effective, and where the donor can persuade the recipient to go

further along a path on which it already wants to go. A more radical approach — challenging prevailing vested interests or political convictions — can be implemented only when the recipient's need for aid is overwhelming. If aid constitutes more than 50 per cent of public investment then macro-leverage is tempting, if not often successful; if aid is 25 per cent or less of public investment, donors can exert influence only if they are realistic, and sectorally selective.

Recipient Experience of Dialogue: some Cases in sub-Saharan Africa

(i) Tanzania

The most pronounced failure of dialogue in Africa has probably been in Tanzania. Recent policy shifts (for example, over the exchange rate and agricultural pricing) have still to result in successful negotiation of conditional Fund and Bank programmes, despite the fact that few countries are in a worse economic condition than Tanzania. Indeed, several observers concur that Tanzanian negotiations with the Bank and the Fund 'have not simply failed to reach agreements that hold up, but have arguably had consequences for domestic policy debate which have delayed the pace of adjustment which would otherwise have taken place' [Green 1986]¹⁵.

Responsibility for this debacle of dialogue is shared among external circumstances, Tanzanian domestic mismanagement, and donor (plus IMF) failures and misperceptions; but the assignment of proportions is in the eye of the beholder. It is now difficult even to quantify Tanzanian performance, since local economic data-gathering has itself fallen victim to the traumas of 1978 onwards.

Since 1975 agreement has been reached with the IMF only once (in 1980), on an EFF which broke down after the first drawing. Until 1984, relations with the World Bank steadily deteriorated: there has been no SAL, although there has been programme lending for rehabilitation of export sectors. While in 1978 aid inflows effectively offset the current account deficit, the deficit subsequently widened at an alarming rate and the increase in aid flows slowed down. Even observers sympathetic to the Tanzanian position agree that short-run economic policy from 1977 to 1979 was 'fiscally reckless' [Green 1986:31], but later attempts to redress the position have floundered in a mire of seemingly unresolvable disputes.

The experience reinforces the Indian lesson: where leverage is not 'leaning on an open door', and where

¹⁵ The second tranche of the first SAL was delayed — apparently because Malawi was in difficulty with the IMF over domestic credit ceilings; see the Malawi Case Study for the Aid-Effectiveness Study, by Adrian Hewitt and Jonathan Kydd (p106). Similar views are expressed by Van Arkadie (1983) and Payer (1982).

resources are not adequate for the task, it will fail even in the severest economic circumstances. Fund and Bank policy advice was perceived as an external imposition, sometimes as an ideological challenge to the Tanzanian Government's chosen path, and was generally debated in a context of fierce battles over individual instruments (for example, the exchange rate) — usually out of all proportion to the role of the instrument in a wider policy package. This phase may now be drawing to a close, as a result of changes in attitudes on all sides in response to Tanzania's increasingly desperate plight; it leaves an unfortunate example of how not to conduct policy dialogue, whether as donor or recipient. The Tanzanian case is well-known, in part, because the Tanzanian Government has been unusually willing to make public its disagreements with the international financial institutions. Whereas, in other cases, agreement has been followed by failure to deliver, the Tanzanian case is distinguished by determined adherence on both sides to relatively fixed and explicit positions so that agreements have not been reached.

No other sub-Saharan examples (except, possibly, Nigeria 1983-85) exhibit this degree of explicit disagreement, but almost all demonstrate signs of the lack of experience of both sides in dialogue over macro-economic and broad development policy questions; limited recipient capacity for negotiation and policy analysis; and over-optimism about the extent of policy reform that can be achieved even in the most pressing circumstances. Above all, there is an air of unreality about the potential efficacy of incentive reforms in conditions where net foreign resource inflows are continuing to decline (they are negative for the more heavily indebted countries), and where the technological or institutional support for reforms is inevitably slow to develop. On the other hand, reform programmes are now taking hold in countries with long records of below-average performance: Tanzania has already been mentioned; Ghana, Zambia, Uganda, Mali and Guinea have set in train major restructuring efforts. The task now is to sustain these efforts with increased resources (and also the efforts of those countries historically more favoured by the West as 'successes': Kenya, Ivory Coast, Malawi), while incorporating the lessons of initial experience with macro-policy dialogue and reform.

(ii) Malawi

Malawi has received two Bank SALs to date, and is one of the very few low-income countries with a current Fund EFF. For some years Malawi has enjoyed 'most favoured nation' status with the international financial institutions as a result of its growth record in the 1970s, and its apparent willingness to rely more on the market and private

initiative than upon state intervention. In 1979, Malawi's external position deteriorated rapidly; a Bank SAL was put together during 1980 in some haste, involving limited conditionality, but with a wide range of studies with a five-year adjustment programme in view. There seems to have been a deliberate element of 'learning by doing'; in 1979 the Bank's country reviews of Malawi were still geared to support of project decisions; by 1983, when the second SAL was negotiated, the Bank felt confident enough to press a stronger dose of policy reform (the country's external position had further deteriorated in the meantime).

The Bank diagnosed six main structural difficulties in Malawi: the slow growth of exports from peasant agriculture; the narrow export base (dominated by tobacco); energy shortage, especially a declining fuelwood stock (also used for flue-cured tobacco); deterioration in the financial performance of parastatals; widening budget deficits, caused principally by rapid expenditure growth; rigidity in government price and wage control administration. Both SALs have been disbursed with few interruptions¹⁵ but the extent of policy reform achieved appears to have fallen short of the World Bank's wishes, and the record has exposed the points of stress and misinterpretation in the original diagnosis. The most progress has been made on improving the financial performance of parastatals, and of the large private corporation, Press Holdings, which effectively functions as a somewhat personalised parastatal.

Progress in the other areas has been slowed down either because the structural problem was initially mis-specified (the reversion of peasant producers to subsistence cultivation was as much a function of land scarcity as of price distortions — though the latter were important), or because government played no role in the market concerned (fuelwood pricing), or resisted the Bank's approach (social service user charges, price control) and concentrated on resistance rather than compromises. These shortfalls from expectations, however, are best regarded as part of the essential learning process, rather than failures of policy dialogue.

(iii) Mali

Bank and Fund programmes in Mali have involved more radical departures. Mali has no SAL, but other forms of Bank support; it reached its first IMF agreement in May 1982. Mali (following Guinea) had been one of the few former French territories to adopt an explicitly socialist path. Mali was seriously affected by Sahelian drought; it also accumulated over the years a vastly overgrown public sector (particularly in the civil service itself — the government guaranteed employment to secondary and higher education

graduates), severe domestic price distortions, controlled grain marketing, and an unstable exchange rate.

Since 1980, Mali has responded to large increases in non-project aid flows by adopting a five year programme of reform. In February 1983, the automatic recruitment of graduates to the public service was abandoned, strict limits were placed on new hiring, and redundancy schemes were introduced to encourage civil servants to move into private business. There were accompanying reforms in salary determination and administration. From 1976, grain prices were progressively increased, and more recently grain marketing has been substantially decontrolled. A Fund programme has supported debt rescheduling; it includes reforms in tax administration (evasion was running at high rates) and monetary and credit policy, including credit allocation to rural business, and the adoption of an apparently explicit target of the abolition of exchange controls on current transactions by 1985.

The sustainability of these reforms in the exceedingly difficult conditions of a Sahelian country is clearly open to doubt. Nevertheless, this is a clear case where, after a long period of deterioration, policy dialogue associated with aid has helped to bring about wide-ranging reforms. Mali is apparently somewhat better placed to withstand environmental difficulties than some of its non-Sahelian neighbours.¹⁶

(iv) Zambia

The experience of Zambia is roughly intermediate between those of Malawi and Mali. Zambia has had a series of IMF programmes since 1978, and, instead of a SAL, the World Bank has lent large sums for rehabilitation of the mining sector — which still accounts for 95 per cent of foreign exchange earnings. Zambia's structural problems of excessive dependence on a single export, protected and import-intensive industry, slow agricultural growth, high relative wage costs and an expensive public sector have since 1979 been compounded by drought, sharp falls in the purchasing power of copper exports (for reasons of both volume and price), and one of the largest debt burdens in sub-Saharan Africa — much of it contracted over 1978 to 1982 when expectations of a copper price revival encouraged fiscal laxity.¹⁷

Vigorous attempts at reform began in December 1982, with formal decontrol of all but four regulated

¹⁶ G. Bourgoignie, 'L'aide dans un contexte sahelien: le Mali', case study prepared for the Aid-Effectiveness Study. By December 1984, a famine threat had arisen again.

¹⁷ Such expectations were supported by World Bank copper price projections and by those of the minority private shareholders in the Zambian mines.

consumer prices, followed by frequent devaluations of the local currency (and, in October 1985, a foreign exchange auction to determine the rate), prompt increases (in real terms) in agricultural producer prices, foreign exchange retention schemes for 'non-traditional' exporters, and reductions in the budget deficit. The government has so far succeeded in avoiding compensatory wage increases, despite strong urban unions and an accelerating rate of inflation. The constraints on the success of the programme are two-fold. First, the foreign exchange shortage continues to be so acute that most industries function at 30 per cent capacity or less — incentive changes alone cannot alter this position; debt-service payments exceed annual export earnings, and accumulated arrears amount to more than two-thirds of export earnings — debt rescheduling is thus a chronic preoccupation. Second, it has proved far simpler to adjust prices (including the exchange rate) than to overhaul agricultural marketing, introduce user charges for public services, reduce employment in the public sector, or improve agricultural research and extension. In a sense, the (successful) external pressure for price changes has deflected attention from the need to reform institutions or take difficult decisions on employment. Without these reforms, and some easing of the projected net capital outflows, the effects of the price changes may well be dissipated — reducing confidence in external advice and support in future.

These cases all indicate that dialogue- and leverage-induced reform is possible in sub-Saharan African conditions. But the experiment is still in its very early stages, and its success is still highly vulnerable. In order to sustain the momentum three things are necessary: additional net foreign inflows; steady improvement in domestic capacities to design and negotiate reform programmes; and some reduction in expectations that incentive reforms alone will produce a 'quick fix'. Now that so many African governments have shown willingness to de-politicise exchange rate management, raise producer prices, and decontrol consumer prices, it is perhaps time to shift the emphasis to the support of institutional changes and other policies that can make price changes effective.

Policy Dialogue: the Lessons so far

Policy dialogue is more successful where aid is in any case more productive. In the cases of India and South Korea, the policy dialogue has matured over long periods during which the returns to aid-supported investments have evidently been high. But even in these cases the relationships had their critical points, and on occasions the dialogue virtually ceased. Dialogue over macro-conditionality is usually the most difficult, and seems not to be sustainable when there is regular or prolonged use of leverage. A stable

framework for dialogue in the long term is suggested by the relationship of mutual respect which has emerged over sectoral policies in India [see Toyé's article in this *Bulletin*].

Yet that requires country experience, appropriate forms of aid, and confidence in the government's conduct of macroeconomic policy or development strategy. In sub-Saharan Africa, reliance upon project aid had brought donors and recipients to an *impasse* by the late 1970s: projects provided no framework for policy dialogue, yet were low-yielding (or complete failures) often because of broad failures in the policy and institutional environment. Once non-project aid forms were adopted by donors — in themselves, more suited to sub-Saharan countries' contemporary needs for input support, maintenance and rehabilitation — the way was open for the use of dialogue and leverage to engender broad macroeconomic policy changes.

African countries' recent willingness to implement major reforms is doubtless in large part a product of appalling economic and social deterioration; but the design of the reforms, and the path to implementation, is predominantly the outcome of policy dialogue, conditionality and support from non-project aid flows. The shift in the composition of aid has thus made for more effective aid, and explicit policy dialogue about macroeconomic and strategic questions has developed in tandem. If this phase is successful it will be impermanent: the long-run aim should be to shift the composition of aid, and the focus of dialogue, back to the sectoral and project allocation of public investment once economic recovery is in train, though probably still with a greater emphasis on non-project aid forms than was common in the 1960s and 1970s.

Donors' ability to exert leverage may be greatest *in extremis*, but so are the risks of their failure to deliver. In this respect, the experience of India in the mid-1960s is salutary for donor involvement in sub-Saharan Africa today. Reform programmes, whether willingly adopted or conceded under severe pressure, must be supported with adequate, suitable aid. Otherwise they may not have time to take effect before the regimes which adopted them are ejected from power, or disillusionment with donor failures sets in. In the short run, the degree of leverage is crudely related to the volume of aid on offer; in the long run, the credibility of policy dialogue in general depends on donors' ability to make and sustain long-term aid commitments.

There is no guarantee that the priority currently given to economic reform in many sub-Saharan countries can be sustained. Past policies of discrimination against agriculture, excessive protection of import-substituting industry and subsidisation of urban

consumption may have been economically irrational but they have been entrenched by a strong political logic. Governments' political support often consisted of influential urban groups which stood to bear much of the short-run cost of structural adjustment. Reform has now become possible because economic conditions have in any case forced powerful groups to accept reductions in consumption and the rationalisation of public spending, and leaderships have become aware of the costs of postponing reform. Sustaining these changes requires sufficient time (and thus external resources) to allow some of the benefits of adjustment to be realised and distributed, and to permit the groups which stand to gain substantially from reform (eg smallholders producing mainly for the market, or citizen businessmen) to consolidate their influence upon decision-making. It also requires institutional changes to ensure that economic considerations remain high on any regime's agenda.

Recipient Capacities

Beyond the confines of emergencies, effective dialogue or conditional programmes also require negotiating strength and analytical capacity on the recipient side; without these, the risk that reform programmes will be seen as outside impositions, and will lapse when aid flows cease, will remain high. The task of improving negotiating skills overlaps to a considerable extent with that of strengthening the decision-making capacities and economic policy-making institutions of LDCs — a task which the World Bank already stresses in SAL operations — but it is not identical. There is scope for improvement of the technical assistance facilities available to LDC governments for support in the process of negotiating external finance of all kinds.

There is an approximate analogy with the improvement, over the late 1960s and 1970s, of LDC governments' capacity to negotiate deals with foreign private companies — particularly in minerals industries. This improvement was aided by the establishment of independent international centres of advice, research and technical assistance to governments — not only for investment appraisals, or specific technical reports, but also for regular and long-term assistance in clarifying objectives, drawing up negotiating positions, and the conduct of negotiations.

In the field of assistance for negotiations on debt rescheduling, and on adjustment programmes, there is at present a vacuum — partly filled at times by costly private finance advice from merchant banks. Selected multilateral agencies, independent of the main lenders, should be supported in modest efforts to expand the provision of advisory services for adjustment programme negotiations.

Increasing emphasis on policy dialogue is likely to bring changes in technical assistance practices, but there are dangers in tying technical assistance too closely to conditionality. Some donors (eg the World Bank) now show signs of wishing to link technical assistance more explicitly to the implementation of policy reforms agreed in SAL-type programmes: technical assistance in support of reform programmes, with flexibility for experts to respond to changing circumstances is clearly desirable but assignment of new personnel to carry out a negotiated programme, with the threat of their withdrawal if the government deviates, is less evidently useful. Moreover, such initiatives may over-estimate the strength of a donor's leverage, and fail to recognise that any negotiated programme is a compromise.

In sub-Saharan Africa the present phase of dialogue involves a heavy concentration on the recipients' own macro-policies. The traffic predominantly flows one way. The Indian case suggests that dialogue becomes fully constructive and durable when there is a genuine two-way exchange. This requires recognition of past donor errors, and discussion of them in the course of dialogue. It is clear that, in Africa, many donors have a long record of preference for large infrastructural projects, capital-intensive production plant, complex administrative structures and so on — the very things for which African development patterns have recently come under heavy criticism. These errors are recognised in general terms (eg in World Bank reports on sub-Saharan Africa); it would be of greater value if the lessons of individual experiences were to be examined in country-level discussions. There is also scope for inclusion of discussion about rich country policies which affect the performance of LDCs: trade policy and the rise of protectionism, interest rates, aid policy itself.¹⁸

Donor coordination for policy dialogue — in seeking to avoid conflicting or confused policy advice — may risk the appearance of 'ganging up' on the individual recipient, forcing it to adopt a defensive and perhaps hostile stance. The solution probably lies in the sensitive use of consultative group arrangements, with coordination by both the recipient and a multilateral agency, and with a strong analytical input from the recipient.

Finally, the context of dialogue about recipient policies should include explicit appraisal of the terms of trade outlook, and of prospects for debt-rescheduling, or for new capital inflows. The donor involved in dialogue, and *a fortiori* in the imposition of conditions, should be prepared to make clear and

monitorable commitments about the aid flows that will be forthcoming if reforms are made. Moreover, an apparent donor interest in 'good domestic policy' that is in fact tempered by the commercial interest of suppliers in the donor country will breed disillusionment, and may cause serious damage.¹⁹

Policy dialogue is now an integral part of international aid relations. Macro-conditionality, too, is the necessary counterpart of the volume of non-project aid that is needed in low income countries. The record suggests that improvements in aid-effectiveness have already been achieved by these means. The tasks now are to appreciate that relationships in policy dialogue must evolve if they are to endure, that the successful exercise of leverage over macro-policies is possible only in exceptional circumstances, and that the prerequisite for consolidation of the gains already made and for the future success of dialogue is the strengthening of recipient capacities to make it a genuine two-way process.

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¹⁹ For example, the UK in 1969-73 could well have conducted 'policy dialogue' with Sri Lanka on how to reduce tractor imports given: the surplus of tractors used in roadwork; rural unemployment; and lack of spare cultivable land. Instead, due in part to commercial pressures, the UK sought to *increase* tractor aid to Sri Lanka. [Burch 1979].

¹⁸ As in bilateral discussions between Papua New Guinea and Australia, see the case review of Papua New Guinea (by Philip Daniel) in the literature survey.

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