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CONDITIONALITY AND THE ADJUSTMENT-DEVELOPMENT CONNECTION*

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All economies continuously need to adapt to changing circumstances and opportunities, and countries which have adapted along lines promoted by the Bretton Woods institutions (BWIs) have achieved strongly improved economic performance. However, the results achieved by structural adjustment programmes (SAPs) in developing countries is patchy, at best. The paper seeks to explain this paradox, emphasising the adverse effects of the BWIs' narrow perception of the development-adjustment relationship, and of their over reliance on a conditionality of limited revealed effectiveness. The BWIs need to re-think how they can best contribute to adaptation in developing economies.

The Imperative of Adjustment

Since this paper is critical of some aspects of BWI policies and will inevitably be read in the context of Pakistan's present-day attempts at 'structural adjustment', let me avoid possible misunderstanding by describing the large extent to which I support what these institutions are seeking to achieve with their adjustment programmes.

The starting point has to be the inevitability of adjustment and the high costs of deferred adjustment. Since the beginning of modern economic relations, all economies have had to adapt to changing circumstances.[1] One of the ways in which this adaptation has manifested itself is in the basic structural changes that occur during

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[1] I am here summarising an argument developed in chapters 1 and 12 of Killick, forthcoming[b].

the process of long-term development, as studied by such writers as Kuznets and Chenery. Economies that have adapted most readily have achieved the fastest development; those which have resisted change have both recorded less economic progress and imposed unnecessarily large 'adjustment costs' on their peoples, for in the end adjustment is inevitable.

In the late-twentieth century the need for economic flexibility is particularly acute. Recent decades have brought much turbulence in the world economy, imposing terms of trade, financial and other externally-generated *shocks* on the vulnerable economies of developing countries — shocks to which, in the absence of international solutions, they have had to respond. In addition, various *trends* have accelerated which also necessitate responses: changes in the composition of world trade and the associated decline in the trend value of world real primary product prices, and the growing pace of technological change are two obvious examples. No economy can afford to stand aside from these developments. What came in the 1980s to be known as 'structural adjustment' is best understood as a particular type of response to them, as a manifestation of an ever-present need to adapt.

Moreover, it seems to me that the thrust of the adjustment strategy favoured by the BWIs has had demonstrably beneficial effects on the economic progress of many countries. In broad terms, the BWIs' approach to policy improvement in developing countries can be boiled down to three fundamentals:

- The avoidance of large macroeconomic imbalances.
- Working in co-operation with, and in support of, the private sector, and through market signals rather than in opposition to them.
- Taking maximum advantage of opportunities in foreign trade and for the attraction of foreign investment.

There is substantial cross-country evidence that this type of policy strategy produces economic results superior to what has gone before and to available alternatives. In addition to the results of academic investigations, an appeal to the recent histories of major countries and regions appears to demonstrate the strategy's efficacy. The remarkable response of the Chinese people to the rolling back of central planning, the encouragement of private enterprise, the gradual liberalisation and opening-up of the economy is a case in point. Of longer standing are the extraordinary results achieved by the East Asian 'miracle' countries – countries which departed in important ways from the standard BWI model but which nonetheless observed the three fundamentals spelled out above. Less dramatically and with the help of large but undependable capital inflows, Latin American countries which a few years ago appeared hopelessly mired in the debt morass have also achieved an economic turnaround on the basis of similar policy changes. India, too, shows signs of shrugging off its economic lethargy in response to a like package of policy changes.

In each of the cases cited above the positive connection between adjustment and development is palpable. Even in troubled sub-Saharan Africa there is supporting evidence, for the World Bank's recent study of *Adjustment in Africa* (1994) assembles fairly persuasive evidence linking improvements in policies and performance.

The Paradox of Good Policies and Weak Results

But this brings me to a paradox, because the evidence on the economic consequences of SAPs, which incorporate the same broad strategy, does not point to strong results. Assessment of the impact of SAPs is fraught with difficulty, particularly because we can only guess at what would have happened in the absence of a programme. However, enough expertise has developed, and enough evidence accumulated , to provide some firm indicators. The following generalisations are among the principal results of the empirical literature on the consequences of BWI adjustment programmes.[2]

(A) *Programmes have limited revealed ability to achieve their own objectives.* While there is consistent evidence for both BWIs that programmes are associated with improvements in export performance and other balance of payments indicators, programmes do not make much difference to economic growth or inflation. In the case of the IMF, most tests indicate no significant correlation between programmes and changes in GDP growth. Evidence on Bank programmes is more mixed: some tests show a similar absence of significant association; others indicate more positive results. The recent Bank report on Africa shows as many adjusting countries slipping back as those accelerating their growth. One reason for the poor growth results is that SAPs are associated with reduced investment levels, a joint result of reduced public investment levels and sluggish private sector responses to programme measures. Evidence on inflation is similarly indeterminate, with price-reducing and price-raising influences tending to offset each other.

(B) *Programmes have high mortality or interruption rates.* Over half (53 per cent) of all IMF stand-by, EFF and SAF programmes were discontinued before the end of their intended life in 1980-93; 61 per cent in 1991-93. As at April 1993, only 5 of a total of 26 ESAF programmes had been completed within their

[2] There is an extensive empirical literature on the effects of Bank and Fund programmes. Khan (1990) offers a valuable discussion of the methodological problems and surveys the literature on the effects of IMF programmes. Killick et al., (1992a and b) offer a more recent survey and additional evidence of their own. The IMF (Schadler et al.,1993) review of experiences with ESAF programmes should also be consulted, although see Killick forthcoming[a], for a critique. The best independent source on the effects of World Bank SAPs is Mosley et al., (1991); See also Corbo and Rojas (1991). Substantial in-house Bank evaluations are provided in World Bank (1992a and b). Results in Africa are presented in World Bank (1994) and Elbadawi et al., (1992). I am also drawing upon as yet unpublished results from on-going research.

planned period and 8 had apparently broken down altogether. Three-quarters of World Bank adjustment loans had instalment tranche releases delayed because of non-implementation of policy conditions in 1980-88, the latest period for which data are publicly available. By no means all of these departures from plan represent "failures" but enough of them do for the two institutions to be concerned.

(C) *There is little evidence of a strong connection between SAPs and implementation of policy reforms.* In the case of the IMF, even balance of payments improvements are not strongly connected with programme implementation;[3] the Bank's *Adjustment in Africa* (1994: 216) similarly reports an absence of correlation between macroeconomic policy improvements and adjustment lending.

(D) SAPs seek to achieve improved economic performance by raising the quality of domestic policies and strengthening institutions. However, the evidence reveals that *programmes have only modest impact on key policy variables* and even less on institutions. There is little evidence that programmes exert restraint on the core IMF programme component of domestic credit,[4] or of strong BWI influence on budget deficits, with much slippage in the implementation of fiscal conditionality. BWI conditionality does, however, exert a decisive and sustained influence on the exchange rate. There is also quite a strong association with reform of other price variables, such as interest rates, agricultural producer prices and the deregulation of consumer prices. However, they have far greater difficulty in influencing institutional change, e.g. in financial sector reforms and privatisation programmes. The Bank's *Adjustment in Africa* (1994) judges that only six out of 29 *adjusting* countries had achieved decisive improvements in macroeconomic policies (the most important of which, Nigeria, has since jumped off this pedestal), and that about a third of 'adjusting' African countries still combine poor macroeconomic policies with extensive interventionism.

(E) Even the above limited claims probably over-state the degree of programme influence because some of the changes would have been introduced in any

[3] See Killick et al., 1992a, Table4 and p.596. They compare outcomes as between completed and uncompleted programmes. The results for the BoP current account were of equal significance for both groups, although quantitatively larger for countries with completed programmes. They suggest, however, that this was due to the more adverse terms of trade experiences of non-completers and show that overall BoP changes were both larger and more significant for this group when compared with completers.

[4] Killick et al., 1992a Table 4, show that, while there is some tendency for the growth of domestic credit to decline, absolutely and relative to GDP, the relative decline is non-significant and there is no significant difference between the results obtained between countries which did and did not complete their programmes. They also show there is no significant reduction in the share of credit going to the central governments relative to the private sector. Schadler et al., 1993 Table 2, do show substantial reductions in the increase in domestic credit by comparison with the pre-programme situation but unfortunately these data are not related to programme implementation, nor is any statistical testing attempted.

case. Moreover, a good many of the reforms are not sustained and some governments regress, reverting to old practices or introducing equivalent interventions through the back door.

In the light of this evidence, it seems justified to describe SAP effectiveness as patchy, at best. Given the strongly positive results achieved by others who have followed the three-pronged policy strategy described earlier, the puzzle is to understand why SAPs have such limited revealed potency. The remainder of this paper is taken up with trying to explain this paradox.

We should note here that the explanation is unlikely to lie with the influence of exogenous shocks, for the success story countries identified earlier also experienced shocks, but overcame them.

Various other possible explanations suggest themselves. The problem might lie with weaknesses in the detailed design and sequencing of SAPs (as distinct from their broad thrust). The BWIs themselves are apt to point to frequent and major deficiencies in what they call governments' 'political will', or with what might more fruitfully be thought of as the internal political conditions bearing upon programme execution.

I shall return to these explanations later but in what follows will concentrate on two additional clusters of explanations, to argue (a) that SAPs would be strengthened if they were based on a more satisfactory appreciation of the linkage between medium-term adjustment and long-run development; and (b) that SAPs are far too reliant on a mode for trying to achieve change (conditionality) of very limited proven effectiveness.

The Adjustment-Development Link

Adjustment as Catharsis:

At some risk of over-simplification, the BWI position on this can be characterised as viewing adjustment as a preliminary to the resumption of sustainable growth and development. The Fund, for example, often describes its programmes as 'laying the foundations' for resumed economic growth. The Bank has similarly tended to view its 1980s shift into adjustment lending as transitional, a response to the particularly severe disruptions caused by the second oil shock, the associated world economic down-turn and then the breaking of the debt crisis. It initially thought adjustment could be completed quite quickly and, although it now accepts that adjustment often takes a long time, it still appears to regard the task as a preliminary to a resumption of development (and a return of the Bank to its traditional project- and sector-lending focus).

Two further considerations reinforce this view of adjustment-as-catharsis. The BWIs (and the wider creditor community) have tended to define the solution of the debt problems of middle-income developing countries in terms of the restoration of creditworthiness: the language of transition again. Second, as the structural adjustment movement developed increased emphasis was placed on the need to rectify past interventionist policy mistakes, the implication being that once the policy framework had been put right the adjustment task was essentially accomplished. On this view, then, structural adjustment is a phenomenon of the late-twentieth century.

Of course, no-one believes there is any stark dichotomy between adjustment and development, and the BWIs have never, to my knowledge, articulated any definitive view of how they see the connection. That may be part of the problem. I nevertheless think it is fair to characterise the BWI view in terms of adjustment-as-catharsis.

Adjustment as Continuous Adaptation:[5]

An alternative view sees a permanent need for economies to adapt to changing circumstances, and this adaptation as intrinsic to development. All economies are constantly in a state of flux, buffeted by developments in the rest of the world, by shifts in the composition of demand, and by technological change. There is thus an ever-present need to respond to – and take advantage of – such changes in the economic environment. The imperative to do so has been intensified in recent decades as economic interdependence has increased, with the rise of trade and international capital movements relative to domestic economic activity, and as the pace of technological change has accelerated. There are rich rewards for those who find ways of leading this expansion; increasingly, none can afford to be left out.

Economies' responses to these stimuli will result in long-term changes in their productive and institutional structures, of the type studied by such writers as Kuznets, Chenery and Syrquin. Inflexible economies can expect retarded development, with disjunctures between demand and supply creating bottlenecks, foreign exchange shortages, inflationary pressures and other dislocations.

Various contemporary examples can be cited of the evident importance of flexibility for economic development:

- The well-known success of the newly industrialising countries of East and South-east Asia in taking advantage of opportunities in world markets for manufactured goods. This region has been characterised by the speed with which it has been able to accommodate rapid adjustment and structural change, and the apparently low social costs incurred in the process.
- The starkly contrasting failures of the former Soviet Union and other ex-Communist countries of Eastern Europe to keep abreast of modern industrial

[5] The next few paragraphs are based on Chapter 12 of Killick (forthcoming[b]). See also Killick (1993), Chapters 2 and 3.

technologies, trading opportunities and changing consumer preferences, attributable in part to the rigidities of central planning.

- The great difficulties created for many of the economies of Africa by their failure to diversify their export bases in response to trend declines in world real prices for their traditional commodity exports.
- Concerns about the long-term growth-retarding effects of 'eurosclerosis', seen as eroding Northern Europe's ability to remain internationally competitive; and about a perceived general loss of flexibility among mature industrial economies, e.g., as articulated in Mancur Olson's *Rise and Decline of Nations* (1982).

Adjustment can, on the adjustment-as-continuous-adaptation view, be thought of as *induced or planned adaptation*, with adjustment policies as the instruments deployed to achieve the desired adaptations and to enhance the economy's flexibility. *Structural* adjustment can then be viewed as measures targeted at structural variables, particularly the productive system and the human, physical and institutional infrastructure.

There is a good deal of congruence in the policy implications of these two views of adjustment. There is agreement that adjustment *can* be consciously promoted and that the policy environment makes a crucial difference to the responsiveness of an economy. There is also agreement about the potentially heavy costs of deferred adjustment. If governments decline to act, or seek to avert change, the economy will still be forced to respond to outside pressures, but it will be able to do so only by imposing heavy avoidable costs on its citizens. There is also much in the characteristic policy content of BWI programmes that is congruent with the needs of long-term adaptation: the importance of prudent, well-designed macroeconomic management; of measures to raise the efficiency of markets; and of improving incentives for structural adaptation, of which the exchange rate is a price signal of exceptional importance.

In these ways and others, SAPs typically seek to move the institutional and policy environment in directions which enhance economy-wide flexibility. However, there are also important ways in which the policy implications of the two views of the adjustment-development connection diverge.

The adjustment-as-continuous-adaptation view focuses attention on the factors impacting on the long-term flexibility of an economy and these tend to go well beyond the main thrust of BWI SAPs. In all developing countries this focus draws special attention to the importance of institutional development, which is crucial to economic adaptation and for reducing transactions costs in the face of increasing structural complexity (North, 1990). In low-income countries, the improvement of education and other investments in human skills is also crucial, together with other measures which can increase economies' technological capabilities. So too is industrialisation, which in various ways adds to economies' capacity to adjust.

In other words, SAPs can be seen as too narrow, neglecting important aspects of the task of raising economies' flexibility. Sometimes, indeed, SAP policies may get in the way. For example, BWI adjustment programmes rarely contain much by way of an industrial policy apart from the liberalisation of trade and investment regimes, but in low-income countries industrial firms often do not have the managerial and technical capacity to be able to stand up to, let alone take advantage of, heightened competition from imports and greater openness.

In other respects too the concentration in most SAPs on moving away from interventionist policy stances and on 'getting prices right' is too narrow. It is important to attend to a wider range of factors, bearing upon technological capabilities, institutional development, information flows, skill creation, the adequacy of the infrastructure, and the provision of other public goods. Indeed, to the extent that BWI programmes are associated – as they are – with reductions in public sector services and investments, they may make it harder for economies to adapt.

There is also the matter of time perspectives. Under adjustment-as-catharsis the idea that the Bank (but not the Fund, whose *permanent* responsibility is to offer support for countries needing to strengthen their balances of payments) should revert to its traditional project-lending focus after a transitional period of structural adjustment lending has some plausibility. It has none if we see the need for economies to adapt, and for international assistance with that task, as an indefinite requirement, intrinsic to the long-run development which is the Bank's remit, not merely a phenomenon of the late twentieth century.

A further respect in which the approaches of the BWIs may get in the way of long-term adaptation brings us to the second line of explanation of the relative ineffectiveness of SAPs, which relates to the processes through which change can be effected.

Conditionality and the Processes of Reform

The perspective of adjustment-as-continuous-adaptation views the adjustment movement of the last fifteen years as simply the latest episode in a history of economic adaptation at least as old as the invention of money and trade, although the circumstances of the early-1980s meant that it was an unusually intense episode. What was truly unique about it, however, was the extent to which the intellectual and policy impulse for change came from outside the affected countries. In many countries the BWIs played a lead role, a tendency greatly enhanced by the move of the Bank into structural adjustment lending and the initiation by the IMF of its SAF/ESAF facilities. The last decade-and-a-half have seen a veritable explosion of conditionality-related policy changes in developing countries.

Table 1 shows the rapid growth in adjustment lending by the Bank since the early-1980s with the number of new loans increasing five-fold over the period. The trend is less clear in the case of the Fund but by the last period shown it was making

TABLE 1

BWI Adjustment Lending, 1980-93
(average new credits and commitments p.a.)

	IMF				WORLD BANK	
	All credit		Structural adjustment [a]			
	No.	Value[b]	No.	Value[b]	No.	Value[c]
1980-82	28	8.24	7	4.64	7	0.81
1983-85	27	7.24	2	2.92	17	2.18
1986-88	27	3.51	9	0.86	28	4.48
1989-93[d]	24	6.79	10	3.48	35	5.77

Notes: [a] Includes EFF, SAF and ESAF credits. [b] In SDR billions. [c] In US$ billions.
[d] IMF latest: to 30 April 1993; Word Bank latest: to 30 June 1993.
Sources: World Bank (1992b), Annex 1, and *Annual Report, 1993*, p.13;
IMF *Annual Report, 1993*, Table II.1.

an unprecedentedly large number of *high-conditionality* (i.e., excluding SAF) structural adjustment loans.

In addition to the growing number of governments entering into structural adjustment arrangements with the BWIs, the number of policy stipulations per credit has also been increasing. Bank SAP conditionality has always been wide-ranging, and its staff's tendency to be over-ambitious in programme designs has been a recurring source of concern in internal Bank evaluations of its adjustment lending. This self-criticism has not, however, prevented further proliferation of policy conditions. A 1992 Bank evaluation [(1992b), Table A2.3], gives the following information concerning the average number of conditions per adjustment loan:

	1980-88	**1989-91**
Preconditions (prior actions)	9	18
Legal requirements [6]	12	17
Other policy commitments	18	21
Total	**39**	**56**

[6] Legal in the sense that their observance is required if a loan tranche is to be released, i.e. similar in status to IMF performance criteria.

A specific but not unusual illustration is provided by an unpublished Bank report on Uganda, a country still trying to rebuild its public administration after the ravages of prolonged civil war. This sets out a total of *eighty-six* specific policy commitments for 1991-92 to 1993-94, of which *seventy-nine* should have been undertaken or initiated in FY 1991-92 alone.

In the IMF, the tendency towards proliferation is most obvious with its ESAF programmes. The range of policy conditions in these is considerably wider than in traditional stand-bys. There has been extensive use of preconditions but the starkest evidence on proliferation is provided by the following averages for the number of performance criteria per programme (Polak, 1991: 14):

1968-77	below six
1974-84	seven
1984-87	nine-and-a-half

A principal reason for this is that Fund conditionality now goes beyond its traditional demand-management concentration to stipulate supply-side measures, e.g., as regards trade liberalisation, pricing policies or privatisation, but these extensions are *additional to* its traditional demand-management stipulations. Under pressure from some members of its Board, the Fund has also begun to take a more active interest in the impact of its programmes on vulnerable groups, including spending on social welfare programmes.

There have also been important changes in the Fund's thinking on fiscal conditionality (Tanzi, 1989) which have further increased the intrusiveness of Fund conditionality. Internal staff papers now write disparagingly of the past tendency of programmes to go for 'quick fixes' and to over-concentrate on aggregate spending ceilings. Detailed attention is now paid to improving the content of government expenditures, as well as to tax reforms and other revenue-raising measures, to raise the 'quality' of fiscal adjustment.

Where the BWIs have led the way bilateral donors have, in varying degrees, followed (Hewitt and Killick, forthcoming). It is increasingly common for the granting or disbursement of bilateral aid to be made conditional on continued compliance with BWI conditionality, but several donors have not stopped there. There have been a number of well-known cases where donors have stipulated *political* reforms in the directions of improved observance of human rights, reduced military spending, accountability and democratisation. A number of donors have also widened the net of policy conditionality, going beyond the BWIs to insist on measures for environmental protection, poverty reduction, enhancement of the role of women and private enterprise development. Some have further attached conditions to the ways in which governments use counterpart funds generated by programme support.

This proliferation tends to undermine the development of indigenous policy-making capacity.Relatedly, conditionality can give the impression that programmes are being imposed upon a reluctant government even when that is not the case. Such public perceptions may undermine the legitimacy of a programme and hence the likelihood that it will be implemented and sustained. Even where that does not occur, external determination of programme content will weaken what the Bank calls the government's sense of 'ownership' of the programme, which may well be the most important determinant of its success.

Surprisingly little attention has been paid to the findings of a Bank (1992a) report which provided substantial, statistically highly significant, evidence on the importance of this factor.This assessed programme 'ownership' by the extent to which the initiative for the programme's policies was local or external, the level of intellectual conviction in the appropriateness of its measures, the extent of support from the top political leadership, and efforts towards consensus-building among the wider public, and tested for correlation between this variable and its assessment of the satisfactoriness of programme outcomes. The result was that the extent of government ownership predicted the satisfactoriness of adjustment programme outcomes in three quarters (73 per cent) of all cases, with most outliers explained by exogenous shocks. Ownership was high in most programmes achieving good outcomes and low in most unsatisfactory programmes. In the absence of ownership, governments evade commitments and regress when opportunities arise.

Unfortunately, conditionality, being essentially coercive,[7] undermines ownership. Its imposed nature can result in resentments by the ministers and officials who must implement the measures – and live with their consequences. In the more extreme cases, public perceptions of imposition can undermine the legitimacy of programmes and strengthen opposition to reform. (For this reason the BWI complaints of 'weakness of political will' on the part of governments mentioned earlier are often unhelpful.) Berg [(1991): 217, 219] has put the point trenchantly:

> Explicit conditionality coexists uneasily and indeed may be incompatible with the notion of local 'ownership' of adjustment programs . . . [It] gives the impression of being imposed from outside, even when it is not. It causes liberalization ideas and policies to be identified with outsiders. Local critics attack the 'World Bank's austerity program' or the 'World Bank's liberalization scheme'; foreign reporters write about it in the same way . . . The overall effect is to discourage the growth of local 'ownership', discredit the policy idea at issue, and delay the growth of political responsibility.

[7] I anticipate objections to a description of conditionality as coercive. But conditionality requires governments to take measures they otherwise would not choose (if not, it is redundant) against the threat of the withholding of financial help. This is *not* the same as saying that BWI-government relationships are coercive, which is the exception rather than the rule.

The BWIs deny that conditionality is coercive or programmes imposed but the degree of imposition is more common than they are willing to admit. This is strongly confirmed by evidence in the Bank report just cited showing that government ownership was regarded *by Bank staff* as 'low' or 'very low' in half of programmes (40/81), and "very high' in only a fifth (16/81).

There is no equivalent information of the Fund but there is a strong presumption that similar considerations apply with at least equal force, not least because many of the Bank SAPs analyzed were accompanied by Fund programmes. That the Fund has been unforthcoming on this subject is not, I suspect, because it thinks ownership is unimportant but because it has particular difficulties in dealing with this subject. Many of these arise from the crisis conditions in which governments often turn to it, the intense pressures of work under which its country staff commonly operate, the speed with which its programmes are prepared and their relatively short-term nature. In such circumstances, with negotiating missions commonly lasting two or three weeks, its staff do not have time to ensure that the government is fully 'on board', just as the government often will not have time (even when it has the inclination) to undertake the consultations and public information necessary for consensus-building.

However, its modalities of operation compound these intrinsic difficulties. The key document for the Fund is the 'Letter of Intent' in which the borrowing government formally presents the policies it will undertake to promote programme objectives. Herein, it might be said, lies programme 'ownership'. However, these letters, although ostensibly from the government, are still almost invariably drafted in Washington, with the government left trying to negotiate variations in a draft presented to them. It is difficult to imagine a procedure more subversive of ownership. The practices of the Fund flatly contradict the obvious good sense of the Bank report [(1992a):15] that, 'one good indicator of ownership is the borrower's willingness and capacity to prepare the letter of [intent]'.

Such modalities are apt to result in programmes which governments do not regard as their own and of which, therefore, they will implement only the inescapable minimum. Consequently, some governments have become adept at finding ways that do not formally contravene agreed policies but which effectively restore the *status quo ante*. One of the difficulties is that, by insisting on major policy changes, the BWIs *ipso facto* become important players on the domestic political stage but without the ability to assemble a coalition of interests sufficient to sustain the reforms, particularly if the economic crisis abates and felt pressures diminish.

There is here a classical principal-agent problem, with differences in goals and interests between the principals (BWIs) and agents (implementing governments); inadequate incentives for the agents to promote principals' objectives; asymmetrical information; and high enforcement costs.

There are hence large advantages to 'home grown' programmes, which avoid such dilemmas. This helps explain the examples cited earlier of favourable Asian and Latin American experiences that apparently owed little to direct BWI participation (as distinct from the positive indirect influence of their advice and technical assistance). The most successfully adjusting group of countries are the East Asian 'miracle' countries (note, for example, South Korea's successful response to its large debt problems of the mid-1980s) *but their efforts owe little or nothing to BWI adjustment programmes*. Indeed, in important and well-known ways most of them departed from BWI orthodoxies. The same local ownership appears to characterise the reform process in China and India. More tentatively, it is not clear that much of the restoration of credit-worthiness in heavily indebted Latin American countries owes much to SAP conditionality. Conversely, sub-Saharan Africa has undoubtedly been subjected to more conditionality *per capita* than any other region — and has achieved the least adjustment. Politically-motivated changes in domestic government attitudes to macroeconomic management appear the decisive factor.

Being a product of domestic political and policy-formation processes 'home-grown' programmes more faithfully reflect domestic goals and priorities, and are less likely to be sabotaged during implementation. In the ideal case, the programme will be consensual, based on wide consultation and public information. Even in the absence of that, the government must take into account how the resulting social costs and political opposition are to be managed – something the BWIs are not well placed to do. By definition, such programmes are tailor-made to suit local circumstances, and they tap superior local knowledge of the economy. The probability of sustained government commitment to the chosen path of reform is enhanced.

There is accumulating evidence that the nature of a country's polity – and the interventions that emanate from it – exerts a decisive influence on national economic flexibility, for good or ill. Political systems have hampered adaptation in sub-Saharan Africa, which has been marked by long-term government persistence with dysfunctional policies. Conversely, there is wide agreement that governments in East Asia have been highly successful in promoting adaptation, experimenting with different policies, quick to drop those that have not worked and to try alternative measures. The relative autonomy of the state in these countries, i.e. its relative freedom from the influence of special-interest pressure groups, has been the central influence on the state's responsiveness and (tacitly) the resulting flexibility of the economy. Thus, Wade (1990) identifies the following factors to explain the success of Japan, Korea and Taiwan: centralisation of a decision-making structure employing the best managers; insulation of decision-makers from all but the strongest pressure groups; a powerful executive not beholden to the legislature; the absence of a powerful labour movement; the absence of conflicts between the owners of natural resources and manufacturers; and decision-makers' perception that their legitimacy is grounded in economic success.

Thus, even though the thrust of the policy reforms promoted by the BWIs is desirable, their programmes can get in the way by undermining the building of local capacities and responsive political systems which alone will permit adjustment to be sustained over time. They can get in the way for a more prosaic reason too: that the proliferation of conditionality aggravates the already formidable pressures on the cadre of key administrators in often weak and poorly-manned public administrations, increasing the probability of slippage in programme execution. Overall, the conditionality explosion seriously affects the cost-effectiveness of SAPs. It increases the associated information and opportunity costs. The ever-growing influence of external agencies in socio-economic policies, to say nothing of political processes, also increases investor uncertainties about the future policy environment and the sustainability of the reform process.

I am not wanting to argue that conditionality is *never* effective, however. It – and the money which comes with it – probably works best when it tips the balance between evenly-poised domestic forces promoting and opposing policy reform, enabling vested interests to be bought off, or confronted. But in the general case I suggest that to be effective, measures to promote adaptation must emanate from an understanding by responsible ministers of the actions necessary, with policies emerging organically, as it were, through local decision and implementation processes, and tailor-made to domestic conditions in a way that is only feasible when designed locally. The success of home-grown programmes is far from guaranteed, of course, because the possibility of mis-design is still present and shocks can supervene. However, they stand a better chance of success than the opposite case of Washington-designed programmes which are in substantial degree wished on more-or-less reluctant governments desperate for money.

Other Constraints on the Effectiveness of Conditionality

Besides the 'ownership' problem, various other factors limit what it is realistic to expect to achieve through conditionality.

First, the BWIs suffer from *resource problems*. Arguably the most serious of these is *inadequate knowledge*. The circumstances of each country differ. Each economy has its special structural characteristics and problems. Policies and other economic variables interact with each other in complex ways. To be effective, adjustment programmes must be tailored to these local peculiarities. A great deal of in-depth country knowledge is hence necessary for well-founded programmes — more knowledge than it is often reasonable to expect of hard-pressed BWI staffs in Washington.

In the face of inadequate knowledge, the danger is that they will fall back on institutional orthodoxies and more-or-less standard prescriptions. Moreover, the large number and ambitious scope of country programmes described earlier add to pressures for the adoption of standard recipes. Pressure of work and the inherent limitations on the freedom of action of the BWIs increases the difficulties of coping with the complexities and uncertainties of devising tailor-made adjustment packages. Martin [(1991): 35] has observed the consequences of these tendencies in Africa:

> IMF staff were overworked, especially because they had to reconcile positions with the World Bank and take account of creditor-government pressure. A larger number of African countries were applying for loans more often . . . And conditions were proliferating, demanding new expertise. . . . Time pressure, notably in functional departments, often meant that staff did not understand the country's economy or politics, or had not enough experience of African adjustment to be flexible. They tended to absorb the Fund's view of the country in the briefing paper.

The managements of both the BWIs deny any mechanistic application of standard formulae and insist that their staffs tailor programmes to country circumstances. But there is a frequently- complained-of gap between management aspirations and what happens in practice, to which there is no easy solution. It is an intrinsic difficulty with conditionality as a mode for achieving change. The danger, of course, is that some programmes turn out to be ill-fitting or unrealistic, and that they result in avoidable adjustment costs — another recurring developing-country complaint.

The knowledge constraint is compounded by problems with *staffing* — problems of numbers and of turnover, not of competence. The numbers aspect has particularly affected the IMF, which in recent years has seen a large increase in the number and labour-intensity of its programmes (particularly since the emergence of a major group of European 'economies in transition', the introduction of ESAF, the associated Policy Framework Paper mechanisms,and the Fund's welcome increased use of review missions) while shortsightedly being prevented by their boards from recruiting parallel increases in professional staff.

The turnover aspect of the problem refers not so much to movements out of the BWIs (although their terms and conditions have become somewhat eroded, also because of board pressures) but to movements within each institution. Developing-country officials complain often and strongly about the delays and other costs imposed by this. Thus, an official of an African government in private correspondence has written of the problems caused by lack of continuity in the 'away team':

> To give an example, a new Exchange and Trade Relations [now PDR] man was sent with the IMF mission earlier this year. It took at least two missions for him to get to grips with [this country's] case, and only on his last mission did he look comfortable. However, he has been transferred so the next mission will bring a new PDR man. This will significantly increase my workload as I will have to 'educate' him on [my country],

> answer endless questions and supply lots of information that has already been given in the past. This has also been the case in other areas of the 'away team'.

In addition to these extra costs, high turnover and the erosion of mission self-confidence that results aggravates the knowledge problem and can lead to an appearance of BWI inflexibility and arrogance in negotiations.

Finance is a third resource constraint. This, however, is too large a subject to go into here. Suffice it to say that there are still too many under-funded programmes and that it is easy to exaggerate the extent to which SAPs have a catalytic effect on net inflows of capital from other sources.

A further constraint can be called the *rigour problem*, referring to pressures from major shareholders or managements for programme measures to appear tough and far-reaching. This is associated with the trend towards the proliferation of conditionality and has various adverse consequences. It discourages governments from seeking assistance (a large problem for the ESAF take-up rate) or leads them to delay until all other options have been exhausted, so that programmes too often have to address crisis situations. They strain the limited policy implementation capabilities of borrowing governments, causing 'noncompliance' and suspicions of bad faith.

Alternatively, when combined with continuing pressures on staff to maintain the level of adjustment lending, they give rise to 'paper programmes' — the penning of ambitious-seeming commitments to reforms which it is tacitly understood by both parties cannot or will not be implemented. Thus, Berg[(1991): 219-20] argues that conditionality:

> . . . Tends to encourage a game in which differences are reconciled more on paper than in reality and agreements are framed so as to meet conflicting needs — the country's need for understated, flexible conditions that will not involve rigid, risky, or excessively difficult commitments, and the World Bank's desire for conditionality that is as firm and explicit as possible.

There is a good deal of pretence in conditionality: paper agreements which the BWI staffs know cannot stick but intended to impress managements and boards and to 'keep the money moving', or just to give the appearance that borrowing governments are being treated equally.

In either situation a consequence is to reduce the credibility of reforms, reducing programme capacity to influence expectations and investment decision-making, and prejudicing the prospects for good responses to future reforms. This helps explain the sluggishness of private investment response, reported earlier.

Finally, there is what can be called the *unequal treatment* constraint. This takes two forms. One occurs among borrowing governments, in breach of the BWIs' principle of uniformity of treatment, defined by the Fund to mean that 'for any given degree of need the effort of economic adjustment sought in programs be broadly equivalent among members'. Unequal treatment arises chiefly as a result of lobbying on behalf of favoured countries (ex-colonies, strategic allies) by major-shareholder governments. This has been particularly a problem for the IMF, of which there are several well-documented cases, but it has also seriously affected the Bank as it has moved into policy-related lending. It is perhaps now of diminishing concern, following the end of the cold war.

The second form of unequal treatment is one of asymmetry between developing and developed countries, with the former required to endure a degree of BWI involvement in policy formation that would not be tolerated for a moment by OECD governments, who routinely discount the 'surveillance' advice of the IMF. Note that this is not strictly an asymmetry between deficit and surplus countries, as the position of the USA demonstrates.

Both these inequalities of treatment undermine the legitimacy of BWI conditionality, weakening the motivation of governments confronted with demands to implement their commitments, and further reducing the credibility of programme measures.

Reconsidering the Link between Adjustment Policies and Supporting Finance

Now to the hard part: to suggest alternatives to the approaches criticised above. If they are to diminish their reliance on conditionality as a mode for trying to achieve policy and institutional reform, while still offering financial support for adjustment efforts, how should they proceed?

First the BWIs should recognise what I believe is the case, that their main contribution to successful adjustment in developing countries has been through their influence on the contemporary intellectual climate in which policy issues are debated, and persuasion of governments and their advisers through the regular contacts that occur. If there has been a tendency to over-state what has been accomplished through SAPs, there has also (because it is hard to demonstrate) been under-acknowledgement of this intellectual influence on the 'silent revolution' that has occurred in many governments' attitudes towards economic policies. On this view, the turnaround in Latin America can still be viewed as a BWI success story, although not one achieved principally through the specifics of SAP conditionality.

An implication, then, is that the BWIs should seek ways of maximising this influence. One possibility that suggests itself – desirable for other reasons too – is that both the BWIs should decentralise their activities and bestow more genuine authority upon their in-country offices. Perhaps the Bank should institute a tradition of regular consultations analogous to the Fund's Article IV consultations. The research activities of the two institutions have a crucial role to play in this, subject to two cautions: (a) they should avoid any tendency to confuse the reportage of research with propaganda, as seriously erosive of intellectual credibility; and (b) they should ensure that their researchers do not become estranged from field operations, so that the latter do not reflect best professional practice. Of course, none of these actions could guarantee that all governments would be sweetly reasonable. However, there is an incentive mechanism at work here: governments that make a mess of their countries' economies are apt to become unpopular and to fall from office.

It also follows from the earlier comparisons of the policy implications of the adjustment-as-catharsis and adjust-as-continuous-adaptation views of the relationship between adjustment and development, that a broader view and a longer time horizon are needed, to comprehend the strategic importance for economic adaptation of such factors as the development of skills and institutions, and industrialisation, and to rely less heavily upon getting prices right (important though that is). Such a perspective might also encourage the BWIs to keep a better focus on the main thrust of what programmes are seeking to achieve over time, steering them away from the temptation of (an actually unattainable) 'fine tuning' of policies and economies and its associated proliferation of policy stipulations.

Above all, the BWIs should be willing to say 'no' more often to governments with weak commitment to reform, and should insist that all programmes be prepared by the borrowing governments. The willingness of governments to draft their own letters of intent or of development policy should be a *minimum* obligation; they should *never* be prepared by BWI staffs in Washington. The BWIs should refuse to play the paper conditionality game; their staffs should be assessed on the quality of the adjustment lending they undertake, not the volume – a recommendation at the macro level similar to that in the Wapenhans Report on improving the quality of Bank project lending [see also Wapenhans,(1994)] but applicable also to the IMF.

Implementation of these recommendations should result in a reallocation of financial resources away from reluctant adjusters and client states, releasing more for the committed adjusters. If it is correct that domestically-designed adjustment programmes are more effective, they should further induce larger additional inflows of foreign capital, private and public (as again apparently exemplified by Asian and Latin American cases).

It would, however, be important not to confuse unwillingness to adjust with the limited technical capabilities of some developing-country governments. Technical assistance to enhance such capabilities should be even more freely available *but* : it should be independent of the BWIs, so as to minimise conflict-of-interest problems; and this assistance should *never* be imposed. Imposed advisers are no more effective that imposed policy reforms, as forcefully conveyed by the World Bank Vice President responsible for Africa [Jaycox (1993)]:

> Donors also relied too heavily on foreign experts, even when qualified Africans were available. This did little to foster a receptive environment for the transfer of skills. In fact, it was often bitterly resented. Over-reliance on technical assistance also brought many difficulties. Expatriates were frequently chosen for their technical skills rather than their ability to pass on those skills. This, coupled with operational difficulties pulled foreign consultants into operational support at the expense of capacity building.

A further implication of my recommendation is that the required broadening of programmes and insistence that they be home-designed would require the BWIs to be more pragmatic and pluralistic in their assessments of programmes. Willingness on the part of the Bank to countenance measures of the type associated with Japan, Korea and Taiwan are an example. Moreover, the recommendation of greater country selectivity would necessitate greater restraint on the part of major-shareholder governments from lobbying on behalf of favoured applicant governments. Hopefully, the end of the Cold War would facilitate such restraint.

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