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TOWARD A CONCEPT
OF DEVELOPMENT AGREEMENTS

by

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RÉSUMÉ

Les problèmes liés à la stagnation structurelle, à la crise de la dette et à une mauvaise politique de gestion ont persisté malgré les mesures de stabilisation de la balance des paiements et les ajustements structurels mis en place par le Fonds monétaire international et par la Banque mondiale. Ce document examine les défis soulevés par la fusion des politiques concernant à la fois l'ajustement et le développement et s'adresse aux pays où l'ajustement n'a pas été un succès et pour lesquels une nouvelle aide s'avère indispensable. Nous considérons ici certains principes directeurs et évaluons les chances de quelques alternatives politiques et, face au poids considérable des problèmes structurels, nous proposons une approche différente de la question. Elle suggère que pour les pays bénéficiaires de l'aide, les accords de développement impliqueraient des mesures basées sur "une stratégie du développement" et, pour les pays donateurs, des garanties financières à long terme. Il est entendu que de tels accords devraient être élaborés et contrôlés conjointement par des Commissions pour le développement composées de représentants des pays donateurs, des pays receveurs et des autres parties concernées.

SUMMARY

The problems associated with structural stagnation, the debt crisis, and policy mismanagement have proved resistant to the procedures of balance-of-payments stabilization and structural adjustment of the International Monetary Fund and the World Bank. This paper considers the challenges encountered in merging policies of adjustment and development planning. We consider some guiding principles and weigh some alternative policies. The paper suggests that a new approach may be useful for the countries that have been least successful at making adjustments, face massive structural problems, and need additional donor aid. Development Agreements would call, on the part of the recipient countries, for policies based on a "development strategy" and, on the part of the donor countries, for assurances of long-term financial assistance. It is suggested that such agreements be organised and overseen by joint Development Commissions made up of representatives of the donors, the recipient countries, and third parties.

PREFACE

On the occasion of the OECD Development Centre's 25th Anniversary Conference in early 1989, Thorvald Stoltenberg then, as now, Minister of Foreign Affairs of Norway, presented the concept of Development Contracts (see "Towards a World Development Strategy" in Louis Emmerij (ed.), *One World or Several?*, OECD, Paris, 1989, pp. 233-245).

The major characteristics of Development Contracts are comprehensiveness, longer-term in nature, based on a contract and hence on *reciprocal* conditionality. The advantages of such Development Contracts over present international procedures are firstly that they are based on a *development strategy* which fully embodies the priorities of the developing countries and the lessons from experience; secondly their *longer-term perspective*, which recognises that development is a matter of decades; thirdly their emphasis on *development* which requires not only stabilisation and adjustment, but also an explicit strategy in which private and public institutions can participate; and fourthly, their *reciprocity* in the sense of a guarantee in terms of international trade, access to markets, international investment, credits and aid over an extended period.

Professor Gerard Adams, of the University of Pennsylvania, who was a Visiting Fellow at the OECD Development Centre in early 1991, has explored the idea of Development Contracts further. He finds that the concept is most suitable for low-income countries where institutional and other constraints stand in the way of development. He furthermore elaborates on the characteristics of Development Contracts, as mentioned earlier.

Louis Emmerij
President, OECD Development Centre
August 1991

I. INTRODUCTION

The need to deal with the process of balance-of-payments stabilization and structural adjustment over a longer time horizon and from a more growth-oriented perspective has become widely accepted¹. While IMF financing and policy guidance has helped many developing countries to deal successfully with temporary balance-of-payments disequilibria, the problems associated with the debt crisis, with structural stagnation, and with sectoral and economy-wide policy mismanagement have proved resistant to current approaches.

Even when the policy prescriptions of the international financial organisations have been largely followed, they have produced recession, unemployment and increased poverty, often without renewal of sustainable growth. A few cases have been termed "success stories" from the perspective of macroeconomic performance and standing in financial markets, but distributional impacts have been adverse and the readjustment period has been very long and has required complex balance between internal policies and external assistance².

It is appropriate, therefore, to ask whether current mechanisms, the stabilization *cum* adjustment procedures of the IMF and the World Bank, are adequate to deal with the problem. Is the demand pressure, balance-of-payments equilibrium model followed by the international financial bodies appropriate for broadbased structural adjustment or development policy? Would an alternate or supplementary approach offer greater chance of success, at least in some cases? Would new institutional structures be helpful?

Since our focus is on development, we will consider the activities of the IMF and the World Bank together. In practice, while their work is closely co-ordinated, there is a division of labour with the IMF more concerned with macroeconomic issues and the World Bank more focused on structural questions and, of course, projects. As a result, the World Bank tends to have a somewhat longer-time perspective.

The World Bank and the IMF have sought to adapt their procedures by broadening the scope of policy and by extending its time perspective, the Structural Adjustment Loans (SALs) of the World Bank and the Structural Adjustment Facility (SAF) and Extended Structural Adjustment Facility (ESAF)³ of the IMF. In recent years, their financial support has overlapped on occasion, particularly in the World Bank's Structural Adjustment Loans (Guitian, 1987; Michalopoulos, 1987; and Polak, 1991).

Long-term support, though with very different orientation, has also been available for some countries through other organisations, for example, the Lomé Convention⁴, and the project-oriented lending policies of the regional development banks.

There have been numerous critiques of the IMF and World Bank's approach to stabilization, what has become known as "conditionality". Much work has also been addressed to adjustment policies and the problems associated with their implementation. But there has only been limited discussion of how the IMF/World Bank procedures could be usefully modified or supplemented⁵.

Long-term views of development assistance have, of course, been current for many years. The World Bank's classic two-gap computations are in the spirit of long-term development projection and planning (Chenery and Strout, 1966). A concept of long-term development arrangements was central to the *Pearson Report* (1969). Concepts of long-term development relationships also lie behind the Lomé Convention and motivate the development partnerships between some smaller countries. Bacha (1987) has suggested broadening IMF calculations to compute capital assistance requirements and to assure such funding through a notion of "reciprocal performance criteria". Are there other new development-oriented mechanisms and/or institutions which would facilitate the stabilization-adjustment-growth process, to increase its time perspective, ease its social costs, and assure its continued support?

One recent thought along institutional lines was a proposal to put structural adjustment in a "development contracts" framework (Stoltenberg, 1989). The idea is to replace present stabilization and structural adjustment procedures with "development contracts" that would be "a comprehensive instrument for financing a medium and long-term development plan ..."⁶. Stoltenberg suggests the need for longer-term perspectives backed by a greater degree of balance and reciprocity of commitment between the developing countries and the donor organisations. One need not agree fully with the rationale for Stoltenberg's proposal nor with its details — all too limited — to recognise that alternative or supplementary approaches along such lines are worth considering⁷.

This paper is an effort to appraise the reasons for alternative approaches to stabilization and structural adjustment practices and, particularly, to suggest an alternative approach.

II. THE CHALLENGE OF STABILIZATION WITH ADJUSTMENT

The problem faced by the developing countries in disequilibrium and by their foreign advisers is how to combine a return to balance-of-payments equilibrium and price stability with the structural transformations leading to sustained economic growth. In this section we consider how this challenge interacts with the stabilization/adjustment mechanism.

It is important to note at the outset that the issues differ greatly in different parts of the world. They depend on a country's stage of development, its resource and cultural endowments, its fiscal and monetary policy tradition, its political stability and will, and its debt problem. The following are some examples:

- In sub-Saharan Africa, almost all the poorest countries have shown a continuous pattern of stagnation. High indebtedness, low levels of human and physical capital, high birthrates, and dependence on drought-sensitive and inefficient agriculture are only a few of the factors which impede economic development. In many countries, per capita incomes have declined. In Tanzania, for example, Ndulu (1987, p. 2) reports that "Expansion of education, health and water facilities stopped, despite increasing needs, as development expenditure was drastically cut", though in that country readjustment ultimately resulted in the beginning of growth in the late 1980s. With respect to the relatively successful case of Ghana, Green (1987) argues for better articulated agricultural sector policies and greater concern for the local government's priorities on income distribution and development planning. The Côte d'Ivoire, long a leader in Africa, has suffered greatly as a result of the fact that the constraints advised by the IMF are of little help in the face of high dependence on the declining prices of a small number of primary commodities (Hiey, 1987). Policy changes reducing overvalued exchange rates and providing incentives for agricultural production and entrepreneurship can help. But, fundamentally, the problem is one of insufficient capital. The issue in Africa is not so much one of damaging adjustment policies as of needs for long-run concessionary financial support combined with fundamental development initiatives aimed at basic infrastructure, human resources, and human welfare.
- In Latin America, the problems are closely related to the legacy of two decades of policy mismanagement and debt accumulation. Here adjustment policies have had some good results and, paradoxically, they may also have done the most damage. In the 1960s, Latin America showed considerable growth dynamism only to lose that in the effort to deal with inflation, excessive debt, and public enterprise and policy mismanagement in the 1970s and 1980s. Stabilization policies, whether the result of domestic initiatives or of external pressures, have caused recession, unemployment, and reduced human welfare. While the specifics vary, most of the countries of Latin America suffered from the same problems. Brazil has confronted the adjustment problem in the face of very large debt burdens. Cardoso and Fishlow (1989, p. 301) argue that "... Brazil epitomized the limits of the IMF approach. Despite favourable management of the trade account, internal stabilization and a sound basis for renewed economic growth did not follow". The dynamics of inflation

and the heavy burden of high interest rates and the heavy international transfers reduced rather than increased investment. Repeated policy shifts in a politically insecure environment during transition to democratic government, as also in Argentina, also account for some of the difficulties⁸. Chile, which is considered one of the successes, is "... a vivid example of how prolonged disequilibria build up into a new situation with lasting consequences" (Arellano *et al.*, 1987, p. 3). During more than fifteen years of economic transition, guided by conservative adjustment policies, Chile's recovery has been held back by low levels of investment and negative international transfers, so that per capita income in 1990 has only barely recovered to its pre-1980 level. The impact on income distribution has, until recently, been increasingly adverse. Variations in copper prices have significantly affected (favourably in recent years) Chile's ability to deal with its foreign exchange constraint (Ffrench-Davis, 1991 and Ffrench-Davis and Vial, 1991). Mexico, after suffering significant damage to its productive capacity as a result of "negative structural adjustment" (Ros and Lustig, 1987) has made progress to take advantage of debt relief under the Brady Plan, a systematic turn toward a liberalised domestic economy and liberalisation of imports, and the prospects of a free trade agreement with the United States. Inflationary pressures have been reduced and economic prospects have improved. At long last, a few of these countries appear to be disentangling themselves. Williamson (1990) notes that fundamental changes in attitudes and policies have been more widespread in Latin America than economic performance in these countries, so far, would suggest.

In this part of the world, the issues are inflation, debt and public policy mismanagement. The social and economic cost of readjustment has been high. Resumption of long-run growth has occurred only when the economy has been stabilized, public policy mismanagement reduced, and the economy opened to competitive enterprise. Viable development strategies require foreign capital assistance or debt relief as well as an appropriate mixture of trade, exchange rate policies and internal development initiatives. These appear to take many years to become effective (Ffrench-Davis and Vial, 1991).

- The East Asian countries — the NIEs and the next generation of Asian growth economies — represent a success story. Some of these countries are further along the development path than others, but all share their export orientation and conservative fiscal and monetary and debt policies⁹. South-east Asian countries vary considerably with regard to economic structure, industrial policy, and the role of government. The sharp contrast between Taiwan and Korea is notable (Lau, ed., 1986). The Philippines is the exception that proves the rule. A very strict IMF stand-by agreement in the mid-1980s was successful, according to Dohner and Intal (1989), insofar as it related to stabilization and domestic inflation, but its cost in reduced investment, unemployment and industrial output was severe. While it set the stage for recovery later, the growth momentum has not been maintained: "If the Philippines is to achieve rates of economic growth that would allow it to rejoin the income ranks of its neighbours, it will require fundamental reorientation of domestic economic policy toward a more pragmatic instrumental and growth-oriented stance" (Dohner and Intal, 1989, p. 592).

In South-east Asia, except in the Philippines, the role of the international financial institutions is likely to be the traditional one: dealing with balance-of-payments readjustment. Growth and longer-term adjustment policies will be treated largely as matters of internal policy.

- The Soviet Union and Eastern Europe represent a new challenge, still another facet of the adjustment problem. These countries face a foreign exchange, balance-of-payments constraint that is becoming ever more severe as their markets in the Soviet bloc decline. Adjustment for these countries comes simultaneously with transition from controlled to free market economies. External assistance must be combined with policy prescription of an institutional nature to develop the organisational structures and incentives of a market economy.

There is a common thread to the appropriate short-run policy for countries in balance-of-payments disequilibrium. Some degree of stabilization may be necessary in all cases. But it is not clear that disequilibria can always be eased and growth restored simply by reducing demand pressures¹⁰.

The conclusion that during the 1980s, there has been a loss in welfare and growth impetus, is broadly based. The point is not that the IMF/World Bank are the sole, or even primary cause of the problem. At worst, IMF/World Bank policies may have aggravated the social burdens and may sometimes have delayed growth. More important is the fact that headway against overcoming the growth problems of many developing countries has been disappointing.

The considerable differences between countries are also apparent. In some, problems have been largely avoided or overcome. In others, stagnation and/or inflation continue. Since countries differ greatly in terms of adjustment needs, political will, economic structure, and other specificities, adjustment and growth policies retain a "made to measure" characteristic¹¹.

III. DIMENSIONS OF ADJUSTMENT AND DEVELOPMENT POLICY PLANNING

We begin by reviewing the problems related to extending policy from a short-term stabilization objective toward a longer-run growth-oriented target. In practice, a joint strategy is required. Short and long-run policies must be reconciled and aimed consistently at the same objectives.

The theoretical considerations involved in elaborating the development strategy can be described by the typical approach to investment evaluation. The policymaker seeks to maximise the present value of a future income stream, given external capital availabilities, i.e.

$$\max_{t=0, \infty} PDV = \sum_{t=0, \infty} GDP_t / (1+r)^t \quad (1)$$

where PDV represents the present value of the anticipated income stream, r is the appropriate discount rate and GDP_t represents a measure of economic performance attained in year t ¹². In view of the discounting, the exact time profile obtained may not appear to be important. If policies depress GDP in the short run, that loss could be offset by the discounted value of future higher values of GDP. But that is precisely the problem. To the extent that short-term stabilization measures impede capital accumulation or stand in the way of needed structural changes, they may reduce rather than augment future income flows.

The changing quality of capital requirements during the development process are a further complication. Early investment in infrastructure and education may be a necessary basis for subsequent development of manufacturing and exports. If stabilization impedes the basic expenditure, it may stand in the way of the "takeoff" to a longer-term growth process. There is also a question of credibility. The ability to carry through a development programme depends on the reliability of the future investment flow. If investment in later years is not assured, the initial investments may not be validated. Indeed, in the absence of credible assurances about later investments, the initial ones may never be made.

A number of other questions must be taken into account in the development planning process.

Perceptions of a nation's economic performance cannot be related in a unidimensional way to GDP. The gross domestic product is only one of a set of welfare criteria which include, along with GDP, the rate of inflation, employment, terms of trade, meeting basic needs, environment, etc. We introduce these underlying elements, shown here as Y_s , into relation (1) to write:

It goes almost without saying that policy practice must be based on theory, and that theory represents a simplification of reality. There can be legitimate differences on the relevant theoretical framework. In recent years the tendency has been to return to a macroeconomic structure with underlying equilibrium assumptions, and that appears to be the view of the IMF and the World Bank. While structuralist and disequilibrium ideas have gone out of fashion, they are often still seen as important, particularly in some developing countries.

In recent years, the IMF/World Bank perception of the underlying theoretical framework has undoubtedly extended beyond the simplified financial calculations embodied in Polak (1957) and succinctly summarised in Bacha (1987)¹⁶. But the framework remains one focused on macroeconomic considerations and relationships. That may be inescapable in view of the primary objectives of the IMF, its need to deal systematically with many lenders, and its understandable unwillingness to be involved with internal country politics. Yet, such a focus encounters real and perceived obstacles. Real, in the sense that some important considerations are not taken into account and that development policy calls for much more than macro policy management. Perceived, in the sense that it is often assumed that such considerations are not taken into account, even though they figure actively in staff analysis and in discussions between the IMF and the borrowers.

It is not clear whether the institutional framework of the international financial institutions permits them to adapt their procedures to be consistent with a broader perception of the development process. It may be difficult to modify procedures designed originally to deal with short-term disequilibrium, for taking a long-term view of structural development issues, for monitoring their progress, and for encouraging countries to stick to their development programmes.

IV. CONDITIONALITY

The term "conditionality" has become a euphemism, an imperfect one to be sure, for IMF and World Bank adjustment procedures. Based on extensive discussions between IMF and World Bank experts and representatives of the borrower, a Letter of Intent summarises the policy steps which the client country will undertake. In recent years, SAF and ESAF agreements have also required a Policy Framework Paper (PFP) which examines the situation in some depth and outlines the macroeconomic and structural policies which will be undertaken over a three-year time horizon¹⁷. A line of credit is made available to be disbursed when the lending institutions determine that the conditions of the agreement, as listed in the Letter of Intent, have been met, hence the term **conditionality**.

The IMF/World Bank approach, once quite narrowly focused on balance-of-payments adjustment, has undergone substantial change. There has been an increasing stress on a longer-term view: the analysis and computations extend more widely than the old monetary variable approach. Growth is **said** to be an important objective and other aims such as inflation, poverty, and environment are also increasingly being taken into account though, according to Polak (1991), they do not affect conditionality. Yet, the short-term stabilization objective, most closely related to the mandate of the IMF to assist its members to deal with balance-of-payments difficulties appears still to dominate.

Typically, the recommended adjustment policy seeks to alleviate domestic demand pressures and inflation. The prescription has generally been to limit monetary and domestic credit expansion, to reduce the public deficit by raising taxes and/or cutting expenditures and subsidies. An important objective is to divert production into tradable export products so that depreciation of the exchange rate is combined with other measures to increase the competitiveness of exports. Income and wage policies have also often been part of a stabilization package. The recommendations of the international lenders also include liberalisation of import restrictions and, often, moves to privatise public sector enterprises. In the short term, these may be seen as ways to assure that the economy is guided by realistic world market prices but, clearly, these policies also have longer-term implications that have been subject to some debate (Sachs, 1987).

Structural change and social considerations appear to stand second to balance-of-payments readjustment and stability objectives. This emphasis has often threatened the continuity and credibility of the policy. The difficulties encountered in reconciling socio-political objectives such as income distribution with macroeconomic and balance-of-payments aims have often meant that policy commitments are not fulfilled and have caused some governments to seek alternative, sometimes conflicting, avenues for dealing with their social and growth problems.

The IMF has sought to assemble financial packages and has asked for "financial assurances" as a basis for its own financing commitment. But the commercial banks in turn have waited for the IMF's "seal of approval" before deciding on their contribution. This has forced the IMF sometimes to act in advance of completion of a final financial package. In any case, the important role of the commercial banks makes it difficult to provide guarantees of continued funding over an extended programme period.

The conditionality aspect means that there is little perceived balance between the borrowers and the lenders. The lenders provide the funds subject to fulfilment of the conditions outlined in the Letter of Intent. The lenders set the terms and make the ultimate judgment on whether performance meets the prescribed criteria.

Critical difficulties are connected with the nature of "performance" under the IMF/World Bank agreements. An important distinction is between what we will refer to as **action-based** and **results-based** performance criteria.

In most cases performance must be judged on whether the agreed-upon steps have been taken. It is an action-based evaluation of performance. Only to a limited and specific extent can performance be judged from the results of policy. It is possible, for example, to determine whether monetary policy or the budget have changed in accord with the Letter of Intent, even whether domestic credit or money supply growth has been held to its planned objective. It is not feasible, however, to hold a country to the achievement of a specific inflation, balance-of-payments or growth target. This leads to a one-sided, retrospective approach to performance. A country is judged to have met its performance criteria if it has adjusted its policies in accord with its commitments. Deviations from policy commitments are possible only if they are required by the circumstances and approved by the lending institutions.

Numerical performance criteria have, of necessity, been defined in nominal terms and have not generally been adjusted to changes in other internal or external economic parameters¹⁸. Moreover, it is not always certain that meeting the criteria will assure that other economic targets are attained nor that desired stabilization objectives are realised.

In practice, there has been substantial variation in how these procedures have been applied and how they have worked. There are indications that the World Bank has been somewhat more growth- and structurally oriented than the IMF (Taylor, 1988).

Statistical summaries across numerous countries lend some support to the notion that IMF programmes have improved the current account and reduced inflation but at the cost of some negative effect, perhaps a temporary one, on growth (Khan, 1990).

One can find numerous cases where the procedures have effected a turnaround. Temporary funding tied to a degree of foreign pressure has enabled smaller countries in temporary balance-of-payments difficulties to put in place conservative monetary and fiscal policy measures. In cases where external developments have not been unfavourable and where economic and policy stability has prevailed, readjustment has often worked out successfully.

On the other hand, the problems of the 1980s seem to be somewhat different. Many cases of debt overhang and stagnation are still with us and many countries have suffered through recessions at high social cost without resumption of significant growth. Looking closely at a number of WIDER country studies, Taylor (1988, p. 3) concludes "that past policies could have been designed to better effect, and that programmes of the Fund/Bank type are optimal for neither stabilization nor growth and income distribution in the Third World".

How valid this charge is cannot be judged with certainty since recession and stagnation would have been the outcome of excessive debt and inflation in many countries regardless of adjustment policies. It seems to reflect to some degree the disagreement between structuralist and more orthodox macro thinking. But it is clear that externally based policies have not so far been able to redirect many countries toward a renewed growth path. Whether this reflects the nature of the adjustment policy, insufficient financial inflows, adverse circumstances, wrong domestic policies or whether a return to renewed growth is simply beyond the grasp of many countries and their foreign lenders is not known.

V. PRINCIPLES TO GUIDE ADJUSTMENT WITH GROWTH

It is not surprising that there should be pressure to modify IMF/World Bank adjustment procedures. A number of principles may be helpful to guide a new approach to structural adjustment and development assistance as distinct from balance-of-payments and macroeconomic stabilization.

1. Broad range of economic and social objectives

While the evidence on the success or failure of IMF/World Bank programmes is mixed, even those programmes that can be considered successful from macroeconomic and balance-of-payments perspectives have incurred what many would term "excessive" costs on other dimensions of social and economic performance, like unemployment and poverty.

The importance placed on various economic performance objectives by the different parties involved may be different, even inconsistent. From an international perspective, the lending institutions place a premium on creditworthiness, balance-of-payments equilibrium and price stability. But domestically, the borrowers are likely to place greater value on output targets, employment and the alleviation of poverty. Within the country itself, a consensus on priorities is an important support for policy. There is no objective way to reconcile different aims. Yet the development process calls for some common thought on priorities. Diversities in development objectives between the developing country and its lenders, and within the country itself, must be recognised and, if possible, reconciled.

2. Focus on structural change

Development programmes must be focused on ways to overcome structural impediments to growth. While macroeconomic stabilization is often a necessary precondition for renewed growth, it is not a sufficient condition to get the growth process started. There is often need for policies that are more focused on development. A critical concern is to effect institutional change. The changes required may be quite specific and may differ considerably between countries. Some may call for improved entrepreneurial incentives and changes in wages and prices, others may need critical infrastructure investments. Some may need improvements in agriculture, others in manufacturing, etc.

Structural and development strategies call for very different policy from the traditional stabilization approach. Greater flexibility with respect to the specifics of the development approach may be required to recognise the structural and political characteristics of each beneficiary country (Taylor, 1988; Haggard and Kaufman, 1989). This may mean that a mix of policies, some general and some sector-specific — infant industry protection, industrial policy, human resource development, entrepreneurial

incentives, agricultural stabilization, education and social development, income distribution policies — may have a place in a structural adjustment programme along with more orthodox macro policy and devaluation approaches.

Co-ordination of more varied and specific development policies with the international lenders is likely to pose some difficult challenges.

3. Long time perspective

Development calls for a long time perspective. The experience of countries with some success at adjustment indicates that it takes many years to return to previous income levels and to establish a sustained growth process (Ffrench-Davis and Vial, 1990). When programmes seek institutional change, and educational and social development, the time perspective may be as long as ten or fifteen years, considerably longer than IMF/World Bank adjustment programmes.

4. Assured financial commitment

It follows from a longer-term perspective of development, that it requires assurance of long-term funding. Long-term financing is necessary also to assure policy credibility and stability since commitments for policy follow-through, for return of flight capital, and for foreign investment are based in part on assurances of future financial flows (Dornbusch, 1990a and 1990b and Persson and Tabellini, 1991).

5. Flexibility with respect to unforeseen developments

Some of the problems encountered by the countries in disequilibrium result from external events which were unanticipated and over which they had no control. The debtor countries have frequently argued, for example, that it was the rise of interest rates and the collapse of commodity prices in the early 1980s that led to the debt crisis. Similarly, there can be important deviations from the planning assumptions with respect to the internal environment, for example, if the adjustment programmes do not succeed in easing inflationary pressures and incur greater unemployment than had originally been anticipated. As the period of time over which the development commitment lengthens, the probability of such deviations increases.

An important consideration is that the programme be designed to recognise external and internal deviations from anticipated development and that it be able to respond with flexibility.

6. Balance

Enduring programmes are based on consensus among the stakeholders, in this case various interest groups in the beneficiary country, the international financial institutions, and the commercial banks. It has been argued that the institutions who "hold

the purse strings" must seek a degree of control. Polak (1991, p. 104) notes that "... there is no point to constructing symmetrical relationships where the basic positions of the partners are not symmetrical ...". But the difficulty with this argument is that the development process often requires co-operative actions by all the parties involved, a political consensus in the country undergoing the adjustment process (Haggard and Kaufman, 1989) and a degree of voluntary co-operation between the borrowing country and its lenders. This is particularly important in view of the "principal-agent" problems encountered between the parties in this relationship¹⁹. A degree of participatory balance is essential, in fact as well as in appearance.

7. Monitoring performance and conflict resolution

The relationship between the beneficiary country and its lenders is fraught with the possibility of conflict. There is need to monitor and evaluate the "performance" of the beneficiary country usually in the narrow sense of fulfilling its commitments rather than in a broader sense of achieving economic objectives. The concept of conditionality implies that the lender may withhold further credits if the borrower has not performed in accord with commitments. In turn, the borrower may suspend debt service or, even, repudiate the debt. That this does not happen more often is the result of the strong incentives for the borrower to maintain payments so that the lender will extend additional credits.

The mechanism for monitoring and conflict resolution is now largely in the form of direct negotiation between the IMF/World Bank and borrowers. Extensive consultations are held between Bank staff and senior officials of the borrowing country. Inevitably, there are disagreements and "brinkmanship".

It is not clear what kind of alternative mechanisms might be appropriate. But it appears that participation by a third party, one that can take an independent objective perspective, might reduce some of the tensions and politics that are a frequent part of the negotiations.

8. Donor or concessionary financing

Support aimed at long-term development objectives is often better provided as donor aid. The IMF and the World Bank have provided loans on concessionary terms. But their resources for this kind of support are limited and they have found it difficult to reconcile their stabilization and structural adjustment tasks with maintaining a degree of financial control and assuring the solvency of their investments.

For many of the more seriously impacted countries, repayment may be difficult and it may be appropriate to think in terms of larger quotas of donor aid in place of concessionary loans²⁰.

VI. ALTERNATIVES TO CONDITIONALITY

The discussion above has been suggestive of the gaps between present practice and what may be required to blend structural adjustment and development planning with stabilization. In this section we consider some alternative frameworks and evaluate them in light of the comments above.

Since there are numerous ways to organise stabilization and adjustment processes a taxonomic distinction is useful. We distinguish between a broad concept of **Development Agreements** and more narrowly defined approaches which we will term **Development Contracts** on one extreme, and **Development Partnerships**, on the other.

All of them are ways of channelling additional financing for purposes of stabilization, adjustment, and development. The different categories are often intended to reflect philosophical as well as institutional differences. The categories are obviously not mutually exclusive. The alternatives blend into one another and overlap so that what some people will call a contract others may call simply an agreement. But there are differences and, for this reason, it is useful to elaborate on the conceptual distinction.

The term Development Agreement is clearly the broadest. It says nothing about the form of the agreement, its rigidity, nor about its duration.

In principle, present adjustment procedures can be fitted into the "agreement" category and so can contracts and partnerships. We emphasize the word "development" as a way to recognise the need to extend the process beyond its current emphasis on stabilization into the direction of development planning and programming.

The two sub-categories also imply some form of agreement and carry the same emphasis on development. They differ in the nature the agreement would take, the concept of a formal contractual relationship, in one case, and the notion of partnership, in the other. These are fine distinctions. Nevertheless they may be of considerable importance in the management and success of the development effort.

The term "contract" suggests a formal contract to guide the development process. Normally, a contract includes a defined action commitment, criteria for evaluating performance, and settlement procedures in case the contract is not fulfilled. It is better, here, not to stick too closely to the narrow formal meaning of the term "contract" and Stoltenberg (1989) probably does not intend to do so. The properties of contracts do not apply here in the same way that they do to contracts signed between private enterprises. The classic protection against moral hazard, the ability to claim damages and to enforce that claim by taking over the debtor's property, does not apply to dealings between financial institutions and sovereign powers. In a formal sense, development contracts are not enforceable. But even if they were, the longer the time period of the contract, the greater the need for escape clauses or negotiations to allow for changes in the economic environment or for other unforeseen developments. The promise of stability implied by a formal contract is illusory if the enforcement of its provisions becomes unlikely or impossible.

The concept of the Development Partnership is an attractive option. Partnerships represent a willing co-operation between advanced countries and LDCs. Partnership implies a joint commitment to common ends, in this case, structural adjustment and development in the beneficiary country though the objectives often include trade and cultural relations with the partner country, in addition.

How firmly the Partnership is governed by formal agreements, how long it will last, how credible it is, depends on the specific circumstances. It is a form of Development Agreement which is most appropriate for voluntary donations between two countries rather than repayable loans or financial aid channelled through international financial institutions. Yet Partnerships, too, must be governed by rules and incentives to avoid the moral hazard problem. Among Development Agreements, from the perspective of the formal conditions and enforcement, the partnership form lies on the opposite extreme from contracts.

From a terminological perspective it is probably best simply to use the broadest term, that of "Development Agreements". The choice of words is intentional, the word **development** to emphasize the target of development, in its various dimensions, and to recognise that a long-term perspective is required. The term **agreement** to signify that the mutual commitment of lender and borrower to a continuing development and financing strategy. The formal agreement can take many forms.

VII. WHAT KIND OF DEVELOPMENT AGREEMENT?

The specifics of a Development Agreement depend greatly on the purpose that it is intended to fulfil. Our thinking here focuses on those countries that have been least successful at making adjustment to renewed growth and who need additional donor aid. This means particularly countries of Africa and South Asia and the Caribbean. Similar arrangements may be of use in dealing with countries of Eastern Europe. The large debtor countries, particularly in Latin America and the Philippines, represent special problems and may require special arrangements. Some of them are successfully making a transition, Mexico, for example, on the basis of special US-supported Brady Plan assistance (a form of Development Agreement?). What can be done for the others depends in large part on their ability to master their domestic instability.

This means that the larger share of adjustment processes would continue to be managed, as they are at present, by the IMF and the World Bank. These are, after all, the organisations charged with the adjustment responsibility and who have the appropriate funding and years of experience. Their procedures can gain from greater adaptation to the development objective. It appears that some of this redirection is already taking place (Polak, 1991). The alternate approach proposed here is supplementary to the World Bank and IMF procedures and must be closely co-ordinated with their work.

The Development Agreement we visualise is an agreement between a country and its donor(s) **on a development strategy over a long period**. It is an agreement not so much on specific policy actions as on an **approach**, though clearly some policy provisions and performance targets are implied both by the stabilization/adjustment needs of the economy and by the commitment of financial support from the lender(s). The idea is that the borrower agrees to embark on a strategy, a plan of development. Within the limits of the specific strategy agreement, which will be based on extensive consultation with the lenders and on outside advice, the borrower has flexibility about the nature of policies to be invoked, their timing, the appropriate response to changes in the economic environment or to internal problems. In turn, the lender makes a long-term commitment to lend or provide development aid and promises to exercise a degree of flexibility about the amount, timing, and terms so long as the borrower sticks, insofar as warranted by circumstances, to the agreed-upon development strategy.

Even when the agreement is based on extensive mutual consultation and planning, such an approach calls for a substantial degree of trust on the part of both parties. The borrower must have incentives to continue on the development strategy, which often will involve painful stabilization and readjustment aspects. These incentives take the form of continued development assistance over an extended time period. The lender must be willing to make guarantees of continued aid, unless the borrower flagrantly violates the terms of the agreement. Supervision with balance may be provided by institutionalising the agreement under a joint Development Commission, with representation from the lenders, the borrowing country and mutually acceptable third parties.

What distinguishes this scheme from present IMF/World Bank procedures?

- A development strategy which fully embodies the priorities of the developing country with respect to the various objectives of development. The trade-off

between the short run and the long run, the acceptable changes in income distribution, the minimum satisfaction of basic needs, etc. must be based on a consensus internal to the adjusting country itself.

- The longer-term perspective, recognising that development may be a matter of decades and that many of the specifics of the policy required cannot be determined and/or predicted in advance.
- An emphasis on development. This requires not only stabilization and adjustment, but also an explicit strategy in which private and public institutions can participate. The structural characteristics, institutions, and traditions of the recipient country will play a significant role in determining the nature of the strategy and the mechanisms of planning which it will imply.
- Reciprocity in the sense of a guarantee of credits or aid from the donor country(ies) over an extended period, subject, as we note above, only to limited concepts of conditionality.
- A continued dialogue in the framework of a new institution, a Development Commission which will deal with the specifics of the policy, monitor performance and supervise the required revisions.

VIII. ELEMENTS OF A DEVELOPMENT AGREEMENT

What are the elements that might be a part of a Development Agreement? What is the institutional framework that might guide it?

We visualise a new framework, or an extension of existing institutional arrangements, if that proves possible. Development Agreements may take many forms, of course, but the essential idea, as is noted above, is a long-term commitment to a growth strategy and financing based on a balanced institutional mechanism for monitoring and control.

The World Bank's structural adjustment loans (SALs) represent sensible precedents. They have been an important step in the desired direction. They are aimed directly at structural changes, such issues as tariff reform, agricultural and industrial incentives, institutional development, etc. They reflect an adaptation of the World Bank's objectives towards support for broader structural reform²¹. But a Development Agreement calls for somewhat different institutional setting than that available in current agreements between the lending institutions and the national borrowers.

We begin here by outlining the major elements which must be a part of a Development Agreement:

1. Outline of a development strategy

The fundamental ingredient is to design a programme to overcome current disequilibria and to launch the country on a systematic development growth process. This calls, in most cases, for more than stabilization with some perspectives toward structural adjustment. Alternatively, it also calls for more than specific but limited structural adjustment initiatives.

The preferred strategy for development depends greatly on the country. Not all countries can usefully opt toward a strategy of export promotion because markets are limited or because that is not their comparative advantage. Not all countries will want or be able to opt for a strategy of entirely liberalised markets; in most cases some degree of mixed economy is likely to remain. The development strategy must be a realistic appraisal of the policy approach which will lead to development in a particular setting.

The development strategy must clearly embody compromises between the groups participating in decision making. Domestic elements will have a dominant voice — domestic coalitions must be broad enough to support the agreement — and foreign contributors will contribute useful advice. The agreement will usually be the result of elaborate dialogues between the officials involved and other interest groups.

2.Computation of growth or development policy exercises

Policy making requires some conception of where policy will lead, what costs it will incur, and what benefits it will provide. The development strategy must be supported by a computation of a growth or development policy exercise.

The exercise, which may be quantitative but which should always include qualitative considerations, will present an analysis of the impact on goal attainment of alternative policy strategies, subject to various assumptions about the external environment and financial aid streams. The study must evaluate results in terms of various economic and social aims as well as traditional macroeconomic variables. It is, in effect, a test of whether the development strategy is feasible given the resources available, or alternatively how much aid would be required to achieve a desired multi-dimensional development target. The IMF's Policy Framework Papers are a first step in the direction of such a development strategy study. Bacha (1987) suggests "growth" exercises in place of "financial" exercises, but what is needed is probably a good deal broader than Bacha's proposal.

3.Regular review and reappraisal

The development strategy must be reviewed regularly and reappraised. The notion of a rolling plan, one which modified annually or more often, in response to changing external and internal circumstances is a useful one. It must be based on consensus between the parties involved. This will turn out to be one of its principal challenges. Continued consultation and discussion between borrowers and lenders is required. The review process may call for new institutional structures, to be considered below.

4.Long-term development aid commitment

The Development Agreement envisions a long-term financial commitment by the donor countries. It is not clear whether a banker's calculation seeking the ultimate repayment of the funds borrowed is a good model for the financial commitment. Development assistance or concessionary lending may be more appropriate since repayment may not be consistent with aspirations for improved living standards in the poorer recipient countries. But the commitment need not be without strings. The donors can insist that the money be used wisely, in accord with the provisions of the agreement, and continued contributions by the donors can be made to depend on the continued co-operation of the borrower.

5.Institutional frameworks

Can the Development Agreement be managed within present institutional arrangements? The answer must be: "possibly yes, but probably no." It is possible to modify operations of the IMF or, more particularly in this case, the World Bank, to establish appropriate institutional organisms. The SALs are a step in that direction.

However, Development Agreements call for institutional backing which is different in financing and philosophy from that of the Bretton Woods organisations.

An important question is whether alternatively the required work could be carried out by existing international institutions, such as UNDP, for example. Since our proposal is for specific single country focus of each development effort, the international institutions which rely heavily on cross country political compromise may not be the ideal vehicle. The institutional setting in which the Development Commissions will operate requires further consideration²².

We propose a scheme built around the concept of joint Development Commissions. The idea is that the Development Agreement between the beneficiary country and its financial contributors would be managed by a jointly appointed Development Commission. Each Agreement would call for a specific commission, consisting of senior officials appointed by the beneficiary country government, staff from the financing organisations or governments, and jointly chosen third parties. Each Development Commission would be concerned with assisting **one** specific country, though there may well be overlap or common management between several Development Commissions. To function properly, the Development Commission must be given substantial responsibility by all the participants. It would serve not only to give advice, which should be given substantial standing by all parties involved, but also to evaluate performance under the Agreement. That is why the presence of third party members of the commission appears appropriate.

Development Commissions would co-ordinate their work closely with the IMF and the World Bank and with other international banking and development institutions. Present frameworks would continue to be used for international lending and adjustment in cases where they are appropriate. A suitable sourcing of financial support packages would be to distribute donor funding through the Development Commission and lending through the financial institutions²³.

Other aspects of the institutional arrangements: secretariats, advisory groups, consultants, etc. are left unexplored here.

CONCLUSIONS

Will Development Agreements replace current IMF/World Bank procedures?

It is unlikely that Development Agreements will widely replace present procedures. In many cases present procedures are appropriate and necessary. Where the disequilibrium lies clearly within the Bretton Woods mandate, it would be inappropriate for the international institutions to concern themselves with development policy. Where countries are able to redirect their own structural adjustment, such intervention may be unwise.

On the other hand, in many cases the reappraisals of the recent experience suggest that IMF/World Bank approaches have on occasion been insufficient, or counterproductive. In those situations a broadening or recourse to alternative policies and institutions may be appropriate.

Perhaps, the broadening may be carried out in the context of present institutions and policies. The SALs and ESAFs could be expanded in scope and extended in time, so long as the financial means are available. That may be difficult, however, in the context of the Bretton Woods organisations as presently set up.

For some of the most troublesome cases, however, a new Development Agreement approach may be more appropriate. Particularly for the countries at the earlier stages of development, where significant institutional and technological and other constraints stand in the way of development, the issues are more challenging than can be handled with present approaches. For these countries, the adjustment process must be a development strategy placing primary attention on the barriers to development, which frequently explain the disequilibrium problem itself as well as continued underdevelopment and stagnation.

Development Agreements may be an appropriate framework in which to provide development aid and in which to establish consistent long-term growth-oriented policies. Such an approach may, however, call for new international institutional arrangements, which contain a greater degree of concessionary aid and development assistance than is now available in the framework of the Bretton Woods institutions.

NOTES AND REFERENCES

1. See, for example, the various papers in Corbo *et al.*, (1987), *Growth-Oriented Adjustment Programs*. The very different views of the World Bank and the IMF are presented in the papers by Michalopoulos and Guitian, respectively. "It is thus clear that the *Articles of Agreement* call on the Fund, in a particularly direct fashion, to support members in balance of payments need that are willing to adopt corrective policies that conform to the agreed code of conduct and that give assurances that the specific objective of balance of payments recovery will be achieved over a foreseeable period" (Guitian, 1987, pp. 68-9). But Polak (1991) argues that in recent years the Fund has added growth as an equally important objective.
2. The experience of many countries has been surveyed systematically in the WIDER Stabilization and Adjustment Policies and Programmes country studies, in J. Sachs, ed. (1989). Khan (1990) summarises numerous statistical studies, note particularly Killick (1984) and Corbo (1990). That the statistical studies yield some conflicting results has not prevented observers of specific economies from speaking of "overkill", (Dell, 1983, Bacha, 1987).
3. Funds for the SAF and ESAF facilities which are available to "poor" countries at a concessionary interest rate (0.5 per cent) are limited unless the IMF is enabled to make additional allocations.
4. Unfortunately, the promise of the Lomé Convention, a long-term relationship providing the LDCs financial aid, open markets and dialogue concerning structural policies, has not been realised (Baragiola, 1989 and 1991).
5. The December special issue of *World Development* contains several useful papers, particularly Bacha (1987), Streeten (1987), Helleiner (1987) and Kenen (1987).
6. Stoltenberg (1989), p. 242.
7. The notion of a "development contract" has also been posed at a global level, the relations between industrial countries and the Third World. The question has been posed as follows: In asking the Third World to readjust, have the industrial countries fulfilled their part of the bargain to provide the economic setting, markets, and financial aid to make readjustment to renewed growth possible? Behind this idea lies the concept of a world scale bargain, even an implied contract. It would be difficult to translate such a grand concept to reality and we will not attempt to do so here.
8. The link between political stability and adjustment is discussed in Haggard and Kaufman, 1989.

9. A central factor in the contrast between rapid growth in East Asia and stagnation in South America has been the conservative fiscal and monetary policies of the Asian countries.
10. Bacha (1987) argues that the IMF's position that external disequilibria are a consequence of excess domestic demand is the "single most important issue which has always damaged the relationship of developing countries with the IMF".
11. On the basis of the WIDER survey of the experience of many countries, Taylor (1988) notes that the differences between the results of adjustment policy in different countries require explanation.
12. It is straightforward to link this approach to the typical growth exercise computation.
13. The typical approach is with a quadratic welfare function. But some recent work on a lexicographic approach, ordering the various objectives and seeking a minimum "satisficing" level of each sequentially, is probably a more realistic view of the real world process (Stork and Viaene, forthcoming).
14. The composition of capital flows and the related debt or equity service flows also influence the growth path.
15. Besides the uncertainties introduced by variation in the exogenous variables, each of the structural equations making up the underlying system carry an error term, and the coefficients of the structural equations are estimated subject to error.
16. Lal's (1989) analysis of the orthodox framework suggests that the timing of the results is likely to be highly uncertain and that problems are associated with the control of nominal variables.
17. Polak (1991) discusses the procedures and IMF objectives on an up-to-date basis.
18. To deal with unanticipated changes in the external economic environment, the IMF has been turning recently toward criteria contingent on outside events, the price of oil (Mexico) and the price of copper (Chile) for example (Polak, 1991).
19. The literature on debt considers various aspects of this principal-agent problem (Eaton *et al.*, 1986).
20. In this regard, we note that rescheduling or debt renunciation represent a form of *ex post* donor funding without the advantages that recognising the need for such funding might have had in the first place.
21. Yet Stern (1983, p. 99) notes that "there will be many countries for which structural change is necessary, but for which there will be no basis for structural adjustment lending because of the political constraints faced by the government or because of institutional weakness that would make the implementation of broad policy changes unduly uncertain".

22. We note that there have been numerous country-specific rescue efforts based on *ad hoc* groupings of countries; "clubs" so to speak. The most recent example is the funding being provided to Peru.
23. We note that any level of concessionary financing desired can be achieved by combining market rate loans and development aid in various combinations.

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