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# IS THE ERA OF CONDITIONALITY PAST? THE EVOLVING ROLE OF THE WORLD BANK IN THE 1990S

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## Introduction: Is the era of conditionality past?

For fifteen years, since the early 1980s, the international financial institutions -- above all the International Monetary Fund and the World Bank-- have played assertive roles, seeking to mold and often radically transform policies and practices in poorer countries throughout the world. Since 1990, they have also been deeply engaged in the post-Communist world. Their approach and tactics, particularly the extensive use of conditionality--policy reform requirements attached to loans--have provoked both scathing criticism and ardent defense. Some of their policy reform objectives also remain controversial, despite near-global acceptance by 1995 of their broad strategy of prudent macro-economic management, limited state economic intervention, and more open economies. In some circles, particularly among many of the non-governmental organizations that have come to play a significant role in international affairs, the World Bank is anathema. Bank and Fund annual meetings -- most recently in Madrid in autumn 1994 -- now regularly see large unruly demonstrations protesting their very existence.

It was not always so. In the 1960s and 1970s, the IMF and the World Bank played much lower-key roles. The World Bank concentrated on funding basic capital projects in poor nations-- roads, power stations, harbors, irrigation systems. Conditions attached to its loans focussed on the honest and efficient implementation of the loan itself, only sometimes extending to specific policy requirements such as the pricing formula for sale of electricity. The IMF assisted governments facing acute balance of payments crises. Loans beyond initial sums were routinely linked to requirements for corrective measures: those requirements occasionally sparked protests. But in general neither agency was in the news, nor even known much beyond the circles of international finance and development specialists. Neither was viewed as a major force shaping nations' policies and strategies.

The debt crisis thrust the IMF into a leadership role and engaged it in more countries, and for longer periods, than ever before. For its part, even before the debt crisis broke in mid-1982, the World Bank had become increasingly concerned with stagnation or backsliding in many of its client countries, and with costly patterns of inflation in some. In 1979 it introduced a new kind of loan intended to promote broad policy reforms while providing fast-disbursing, non- project support for governments facing crises. Initially a minor part of the Bank's operations, by the end of the 1980s adjustment loans accounted for more than a quarter of its commitments and probably a considerably larger share of its analytic and higher-level management attention. Forty-two countries had received one or more adjustment loans. This article argues that in the mid-1990s, the role of the World Bank (and to a more limited degree that of the IMF) is undergoing as profound a shift as that which occurred in the early 1980s. In the 1990s, without abandoning older

**concerns with investment projects and economic liberalization, the World Bank is broadening its substantive focus. Except in the poorest nations, it will find that it must make complementary changes in its instruments and its relations with client nations. Both from conviction and from necessity, the Bank will rely less on conditionality and more on persuasion and dialogue. It will interact with a much wider range of groups and organizations. Its influence will not necessarily decrease--indeed, it could be enhanced. But it will exercise influence through quite different approaches. To a limited extent, the IMF will also move in similar directions.**

**Two sets of factors drive this evolution. The international context--including capital flows, political trends, and ideological currents--has changed dramatically between the early l980s and the mid l990s. These changes powerfully affect the roles of the international financial institutions. Second, the agendas of many borrower nations are also rapidly changing. As initial reform challenges are more or less effectively addressed, different issues take top billing. The roles of the international financial institutions must shift as their clients' agendas change. The next two sections examine each of these sets of factors in turn. The final section sketches the implications for the relationship between the Bretton Woods institutions, especially the World Bank, and their clients.**

## I.THE CHANGING INTERNATIONAL CONTEXT AND THE ROLE OF THE INTERNATIONAL FINANCIAL INSTITUTIONS

**Five major international changes in the late l980s and early l990s are fundamentally remolding aid relationships and goals: shifts in the volume and composition of private capital flows; evolving intellectual and ideological currents regarding development strategies and the very concept of development; the end of the Cold War and the efforts of post-Communist nations to transform their economies; dwindling support in rich nations for foreign aid; and the global wave of democratization.**

### Private capital flows

**The debt crisis of the l980s triggered massive net outflows of private capital from much of the developing world, and left many countries largely dependent on international or bilateral aid. In l990, loans and grants from international financial institutions and bilateral aid programs accounted for more than half of all capital flowing to developing nations. However, private capital had begun to return to selected developing countries in the late l980s, and surged in the early l990s. By l994, private capital flows provided three-quarters of all inflows to poor and newly industrializing countries. Moreover, while private flows had been dominated by commercial bank credits in the l970s, the renewed flows in the early l990s were largely portfolio and direct investment. In l994 foreign direct investment accounted for $78 billion of the**

**$173 billion total. The surge slowed in l994 (and may be dampened in l995 by the Mexican crisis of late l994 and early l995 and its ripple effects), but current patterns are still much less volatile than those before the debt crisis of the l980s.**

**The recent capital flows, of course, are mainly concentrated in a small number of middle- income countries in Asia and Latin America. In these, concessional aid now plays a fairly minor role. However, the poorest countries, especially in sub-Saharan Africa, continue to depend substantially on official aid.**

**A radically altered intellectual and ideological climate.**

**Ideologies and prevailing ideas regarding development policy and strategy changed rapidly from the early l980s forward. In most of Latin America and much of the then-Communist world, the l980s were a period of agonized debate and argument regarding appropriate policies and strategies. By the early l990s, the parameters of debate had narrowed greatly. The broad principles of orthodox fiscal and monetary policy and exchange rate management were widely accepted as crucial--though far from sufficient--requirements for sustainable growth. Put slightly differently, not only among technical specialists but also among many politicians and much of the public in many countries, the risks and costs of inflation and overvalued currencies were much more clearly recognized than in the past. Inward-oriented growth strategies were increasingly under challenge or discarded; debates about broad principles were replaced by bitter struggles over how, and how fast to open economies. Similarly, the general prescription of greater reliance on market mechanisms (and reduction in direct state intervention) was widely accepted, opening the field to hot debate over precisely when, how, and how far to liberalize.**

**A great many events and forces contributed to this altered intellectual and ideological climate. Among the more obvious were the failure of attempts to stabilize economies through heterodox programs (as in Brazil, Argentina, and Peru in the mid-l980s) or (more commonly) through half-hearted and rapidly abandoned austerity programs; the trauma of hyperinflation in a number of countries (including Bolivia and Argentina, and more recently in some post-Communist nations); Chile's success and that of the East Asian "tigers" (Korea, Taiwan, Singapore and Hong-kong); and of course the collapse of Communism in Eastern Europe and the Soviet Union. A more moderate stance among those most ardently supporting market solutions also contributed to increased consensus. While much of the rhetoric from the World Bank and the U.S. government in the mid-l980s seemed to endorse the idea that "that government is best which governs least," by the mid-l990s Washington clearly recognized that a well-functioning society -- including well-functioning markets -- demands a wide range of effective public services**

and regulation.

It is easy to exaggerate the degree of consensus by the mid 1990s. The new views are highly controversial in many countries including much of the former Soviet Union and most of sub-Saharan Africa. Moreover, even where the broad principles are widely accepted, strong vested interests continue to oppose changes, and the difficulties of reform create doubts and disillusion. Closer analysis of East Asian experience has prompted a hard look at free marketeers' strictures against industrial policy. Yet without question, the intellectual climate had undergone a sea-change in fifteen years. That shift is altering the focus of dialogue and interaction between the World Bank (and the international development community more generally) and its borrowers.

While the parameters of debate regarding development strategy narrowed, the concept of development itself broadened. The early 1990s saw new emphasis not only on growth, but on those patterns of growth that reduce poverty most effectively. Environmental protection is now viewed as fundamental to sustainable development. Similarly, more explicit attention to the needs and roles of women--viewed by many as a "special interest" or a marginal concern in the 1970s-- by the early 1990s was widely accepted as both a goal of and a means to development. Better governance, protection for basic civil rights, political participation and empowerment of marginal groups also are seen as inextricably related to these other elements. The broadened concept of development draws growing support not only within industrialized democracies but also from many in the developing and post-Communist countries.

Again, some caveats are in order. Intense disagreements remain. Some cultures, for example, simply reject the goal of equal rights for women. Other disputes focus less on goals than on phasing and trade-offs. In much of East Asia, for instance, the view prevails that political democracy can take root and function properly only in a context of healthy economic growth. Since economic growth depends on political stability and efficient government, this perspective argues that political liberalization should be introduced only gradually.

Despite these caveats, the development agenda of the 1990s clearly incorporates a much wider range of goals and elements than had been true in the 1960s and 1970s. The broader agenda has powerfully affected the programs and staffing of aid agencies in general, very much including the World Bank. The more encompassing concept of development is also contributing to changes in the World Bank's pattern of interaction with borrowing governments, in ways discussed in the last section of this paper.

### The end of the Cold War

In some respects the collapse of communism in Eastern Europe and the Soviet Union affected bilateral aid programs, and especially the U.S. aid effort, much more powerfully than the international financial institutions. U.S. economic aid had long been shaped and justified in large part by Cold War goals. In contrast, World Bank operations were only rarely influenced by direct Cold War pressures; IMF programs still less so.

However, the collapse of communism almost overnight created a staggering new set of demands on the aid community in general and the World Bank and the IMF in particular. During eighteen months in 1992 and 1993, fifteen new members were admitted to the Fund and Bank. All these, plus several in Eastern Europe that were members before 1989 but were now freed to pursue radically changed policies, urgently needed advice and financial support.

The challenges of post-communist transformation are historically unprecedented: there is no blueprint or model for how to convert centrally planned economies, in many cases stagnating or in decline, into more open, market-oriented systems. The IMF responded by establishing, in April 1993, a new and temporary Systemic Transformation Facility, to provide loans with less stringent policy requirements and somewhat easier repayment terms than conventional Fund programs, during the earliest and most chaotic period of transformation. Beyond these initial credits, the Fund has also been flexible in its regular standby operations, as demonstrated most dramatically in the SDR 4.3 billion credit to Russia in April 1995 -- a clear gamble on the capacity of the beleaguered government to live up to the terms of its stabilization agreement with the Fund. While the IMF concentrates on macro-economic stabilization, the World Bank is much more intimately involved in trying to create or re-orient a wide array of institutions, at provincial and local as well as national levels, so as to support more market-driven economies.

Not only must the Bank invent new answers to new questions, but it must also deal, in many cases, with governments and political systems in rapid and chaotic flux.

### The changing political context of foreign aid in wealthy nations

Ironically, at the same time that broader concepts of development and post-communist transformation are posing immense challenges to aid agencies, support in wealthy nations for aid in general and for the World Bank in particular is rapidly eroding. Two sets of factors feed this trend.

First, in the United States and to some extent in other industrial democracies, the end of the Cold War has removed the central principle guiding foreign policy for almost fifty years, and triggered great uncertainty and widespread indifference to foreign affairs in general. In some other, mainly smaller developed democracies, such as the Netherlands and the Scandinavian countries, interest in poorer nations was driven more by humanitarian than security concerns, and is less affected by the end of the Cold War. Virtually everywhere in the industrialized world, however, chronic fiscal problems and increasingly urgent domestic issues are claiming a growing share of attention. In the United States, the result is the virtual disappearance of support for foreign aid.

While interest in foreign affairs in general and foreign aid in particular has dwindled, since l980 non-governmental organizations deeply concerned about the environment, poverty, and human rights in poorer nations have multiplied. Since the mid l980s many of these organizations have directed much of their attention to the policies and projects of the World Bank. Environmental groups critical of dams, roads, and other projects sponsored by the Bank have been joined by more traditional church and other charitable organizations concerned by the suffering resulting from the debt crisis and economic re-structuring. These criticisms rose to a crescendo in l994, on the occasion of the Bank's fiftieth anniversary, when many of the NGOs joined together to support a focussed public relations campaign directed against the Bank.

Together, these two trends have radically altered the political climate within which the World Bank and the IMF operate. In the l970s, they were technocratic institutions operating with only occasional publicity, and interacting with selected officials in the governments of both borrowing and wealthy member nations. For the most part, both institutions were highly respected in the specialized circles aware of their existence. In l995, both agencies, especially the World Bank, are exposed to close scrutiny from NGOs, the media, and occasionally the legislatures of major member governments. They are under growing pressure to alter the *process* through which they plan and implement their programs, to make them more transparent and accessible; to increase the *scope* of their programs to address the broader concept of development, and to *tighten* their administration to reduce costs in a time of fiscal stringency for all members. Despite considerable changes by the Bank in these directions, deep skepticism remains about the World Bank, especially among the U.S. public and in the U.S. Congress. As of spring l995 there is serious question whether the United States will support the eleventh replenishment of the International Development Association (IDA: the soft loan window of the World Bank, which provides virtually interest-free, long-term loans to the poorest countries). Several other wealthy member governments have indicated that they will also cut support for IDA if the United States does so.

### The global wave of democratization

The fifth major trend in the international context reshaping aid relationships is widespread democratization, particularly in Latin America and Eastern

**Europe. Democratization brings three major changes to relations between aid donors and their clients. First, all aid channeled through governments (rather than non-governmental organizations), but above all aid that is linked to policy reforms, must take into account not only the preferences and capacities of the executive branch, but also those of legislatures, parties and pressure groups. The dialogue and persuasion leading to policy reforms must reach out to a far broader array of groups and organizations, both within and beyond official circles.**

**Second, in many cases democratization spurs decentralization. In Poland, for instance, a wide range of functions have been assigned to the newly autonomous and representative municipal governments. Argentina, Brazil, Peru, Venezuela, and other Latin American countries have also shifted substantial responsibilities (sometimes, but not always, accompanied by increased claims on revenues) to state and local governments. Aid agencies seeking to support decentralized programs find themselves dealing with several layers of government, including many state or local units--each layer and each unit with its own unique combinations of commitment and capacity or lack thereof.**

**Democratization (and political liberalization in countries not yet democratic) affects aid in a third way: it encourages the growth of a wide array of local and national voluntary and civic organizations. In many poorer countries, such organizations have spread rapidly in the past fifteen or twenty years; in much of the post-Communist world they have mushroomed since l989. Local NGOs are important potential channels for certain kinds of aid. For instance, in many Latin American countries Social Investment Funds have been established, often funded by a consortium of donors, to channel small sums quickly and with a minimum of red tape to local organizations for projects that will provide employment, infrastructure, and social services. At the same time, many local (as well as northern) NGOs are sharp critics of aspects of foreign aid, often particularly of the World Bank.**

## THE CHANGING REFORM AGENDA

**While the international context has been changing, the reform agenda itself has also evolved in many developing and post-Communist nations. By the mid-l990s, many countries had moved beyond the initial stage of economic reform to later, more complex and diffuse phases. The international financial institutions (and external aid agencies more generally) have different roles to play in these later stages of reform.**

### Components and phases of economic reform

**In countries seeking to move from substantial or total government control of the economy to more open, market-oriented systems, reform usually includes**

three broad components. Often high inflation (or, in post-Communist countries, repressed inflation in the form of widespread shortages) accompanies balance of payments crises. In these cases *stabilization* is crucial, and is normally tackled in the initial phase of reforms. In most cases effective stabilization requires sharply cutting producer and consumer subsidies. The difficulty of curtailing subsidies to large state enterprises has been the major stumbling block to stabilization in Russia and several other successor states of the former Soviet Union.

The second broad component of reform is *liberalization*: dismantling or radically trimming government controls on prices (including interest and foreign exchange rates), internal and external trade, and investment. The third component is *institutional and structural reform*. This covers a wide panoply of measures needed to encourage a vigorous and efficient private sector, including privatization, radical restructuring, or dismantling of most state-run enterprises; restructuring of the financial sector; reorganization of labor relations; creation or strengthening of bankruptcy laws and enforcement capacity; and a basic overhaul of social security and transfer systems. Included in this third component -- or, if one prefers, a crucial complementary fourth component -- is the *reform and re- invigoration of essential national and local public sector functions*, often grievously eroded by years or decades of fiscal difficulties and demoralization.

These broad components of reform -- stabilization, liberalization, market-oriented institutional reform and rehabilitation of (considerably pruned) governmental functions -- operate on different timetables and pose different challenges.

As noted, stabilization normally comes first, because so many other measures are ineffective in its absence. Well-managed stabilization can have dramatically rapid results, as in Bolivia in 1985, Poland in 1990-91, or Argentina in April 1991 (after two short-lived earlier efforts under President Menem). However, the need for tight budget constraint extends far longer -- until growth and rising revenues provide relief.

Some major liberalization measures often accompany stabilization, especially in Eastern Europe. But other aspects of liberalization, including labor market reforms, are likely to be delayed considerably. Institutional and structural reforms are far more complex and varied, and extend over many years. Institutional reforms are crucial not only to deepen and broaden economic transformation, but also to lock in gains from stabilization and liberalization. For example, improved tax administration and changes in the tax structure, and privatization or radical restructuring of public enterprises, are imperative to consolidate hard-won fiscal balance.

In much of Latin America and Eastern Europe, by 1995 stabilization was a

**fact, though somewhat precarious in many cases. In Latin America, inflation rates were far lower in l994 than in l990--below 15% a year in many cases. In Eastern Europe, the Czech Republic, the Slovak Republic, Poland, Hungary and even Albania had effectively stabilized their economies according to l994 projections, though price levels were expected to rise roughly 20% in Hungary and 27% in Poland. Bulgaria and Romania had made some progress, though inflation still was running at 70 and 90% respectively. Many Asian countries had long pursued comparatively cautious fiscal and monetary policies. In contrast, several of the successor states of the former Soviet Union still had not successfully stabilized.Many Latin American and East European countries had also made considerable progress in dismantling extensive controls and opening their economies. In Latin America, many countries had sharply reduced or eliminated quantitative trade restrictions and were gradually reducing tariffs. Most East European countries had dismantled all but a few price controls, removed most trade quotas, eliminated almost all direct government involvement in foreign trade, and established virtually full current account convertibility at a unified exchange.**

**In Latin America and Eastern Europe, as well as some other countries elsewhere, by l995 the agenda had largely shifted from stabilization and liberalization to a formidable array of institutional reforms. Labor market deregulation lagged behind other aspects of liberalization: only Chile and Colombia had seriously addressed the issue in Latin America, while none of the East European countries had made more than minor changes (and indeed most retained partial controls on wages, to help limit inflation). Privatization and financial sector reforms are more squarely in the structural and institutional reform categories: Latin American countries varied widely in the extent to which they had made progress on these issues. In Eastern Europe, all countries had carried out comprehensive privatization of small enterprises, but privatization of large state enterprises and resolution of corporate governance issues was painfully slow in most countries. Financial sector reforms were making substantial progress in the Central European countries, but were slower in the Balkans. Throughout the developing and post-Communist worlds, the intensely controversial challenge of re-designing social programs remained virtually untouched.**

### The changing politics of later-phase reforms

**The political and administrative characteristics of initial reforms differ in crucial respects from those of later measures. Stabilization programs are generally planned by a small circle within the executive branch of government. These officials work in considerable secrecy, since advance knowledge of the timing and precise design of the measures encourages speculation and can even defeat the purpose of the effort. With the approval of top-level political authorities, the same small circle of high-level economic**

officials can put into effect most of the key measures. Where legislative approval is required, the measures are often pushed through with little debate, in a crisis atmosphere. Some major steps toward liberalization, including removal of many price controls and some trade barriers, can also be determined and enacted quickly by a rather small circle.

In contrast, the design and especially the implementation of major institutional reforms require the active engagement of a great many people, at many levels in multiple agencies. Legislative approval is usually needed; political parties and strong interest groups are likely to enter the fray; the details are usually aired in the media for months, perhaps years. Moreover, while most stabilization packages are presented as one-time efforts (though in reality they may be followed by repeat packages), many institutional reforms proceed in stages, and the results of early steps affect the timing and design of later stages. Relatedly, stabilization packages are generally presented as temporary measures, while institutional reforms are billed as permanent. Vested interests therefore have particularly strong incentives to resist institutional changes, and they have opportunities to do so at many stages in the process of reform.

Not only the characteristics of the reforms themselves, but also the national political context is likely to change in later stages of reform. Stabilization programs are almost by definition launched in a crisis atmosphere, when much of the population is eager for firm government action to rescue a rapidly deteriorating economy. Legislatures are likely to be compliant. In Eastern Europe in the early l990s, initial reforms were undertaken shortly after the collapse of the old regimes, when formerly powerful vested interests opposing change were disorganized and demoralized. Some of the more dramatic Latin American stabilization stories (Bolivia, Argentina) also featured new governments able to shut out or defuse interests traditionally opposed to stabilization, above all the labor unions.

Once stabilization is largely accomplished and institutional and structural reforms come to dominate the agenda, however, the sense of crisis will have abated. In much of Eastern Europe, the initial chaotic dissolution of organizations affiliated with the old system and the bewildering sprouting of new groups evolved fairly rapidly into a smaller number of better organized pressure groups and parties. Legislatures and the media became more assertive and (with a lag) more coherent. The (re)emergence of "politics as usual" meant that key economic decisions were no longer insulated. In several Latin American countries, a similar pattern of reemerging politics as usual can be traced, though the widespread fear of returning to hyperinflation continues to be a powerful theme in Bolivia and Argentina.

In many countries, initial costs of stabilization and adjustment have also fed increased criticism and resistance in later stages of reform. While much of the population benefitted from reduced inflation or shortages, many were also harmed by falling real wages, rising unemployment, and the continued deterioration of basic services. Both in Latin America and in Eastern Europe, those who gained most from initial reforms often had been privileged under the old system (nomenklatura in Eastern Europe, wealthy financial and business people in Latin America). Their gains were widely assumed to be a result of insider deals or outright corruption.

The evolving political climate in turn influenced the economic reform agenda. Issues viewed as low priority or postponable in initial phases gained new urgency. Social sector reforms, in particular, became far more salient. In much of Eastern Europe, education and health systems which earlier had provided adequate (if inefficient) services to all had severely deteriorated. The problem was especially acute in smaller towns or cities where these services had been provided by one or a few large state enterprises. As subsidies were cut, these enterprises shed their service functions. In much of Latin America, education and health services had always been inadequate for the poor, but now were badly eroded also for the urban working and middle classes -- the same groups that had suffered the largest drops in real incomes in the course of depression and adjustment.

Economic considerations bolstered political concerns to increase the priority of social sector reforms. Particularly in Eastern Europe but in some Latin American countries as well, pensions and other social transfer programs were a growing and unsustainable fiscal burden threatening hard-won stabilization. Moreover, more far-sighted economists and businessmen began to realize that capacity to compete successfully in international markets required a flexible and energetic labor force: open economies placed a premium on human resource development.

Regulatory frameworks for private markets are another category of reforms that were initially neglected but grew more important in later phases. The early emphasis on liberalization removed many of the controls and regulations that prevented competition, stifled initiative, and allocated resources with no concern for efficiency. But market systems require more than an absence of political interference to function effectively. As with social services, both political and economic considerations led to growing recognition of the need for new kinds of regulation: to establish criteria and procedures for bankruptcy, prevent collusion from eroding competition, contain the ever-present risks of fraud and speculation in financial markets, and protect consumers and the environment. From both political and economic perspectives, curbing the excesses or deficiencies of "raw capitalism" is crucial to create a sustainable market-friendly environment.

## III.POLICY REFORM AND EXTERNAL INFLUENCE IN THE LATE 1990S

**Changes in the international economic and political context and the shifting agenda within many developing or post-communist nations point toward continued efforts to encourage reforms but a dwindling role for conditionality. Conditionality will become less important than other channels of influence for four overlapping sets of reasons. In all but the poorest countries, the leverage attached to concessional aid is shrinking. Second, fast-disbursing non-project aid--the main instrument to which broad policy conditions have been attached--is not well matched to the new reform agenda. Third, knowledge and models for late stage reforms are less clear-cut than for earlier steps. Fourth, commitment within client countries, always a crucial element of effective reform, is more important than ever. Conditionality is rarely an effective route to commitment.**

### Declining aid leverage

**The leverage of concessional aid is declining in many countries, and is likely to dwindle more in the remainder of the l990s. For many middle-income countries, leverage is reduced because their need or demand for aid is less. In the l980s, they faced heavy debt service burdens and a virtual cut-off of private capital. By the mid-l990s, they are receiving sizable private capital inflows, and have far more manageable debt profiles. Among low-income countries, India and China--together accounting for almost two-thirds of the population in all low-income countries (using World Bank classifications)--also are attracting considerable private capital.**

**However, as noted earlier, aid dependence remains undiminished in many poorer countries, particularly in sub-Saharan Africa. In these countries the pattern of leverage exercised during the l980s continues largely unchanged. If the United States decides to contribute little or nothing to the next replenishment of the World Bank's soft loan window, and the International Development Association (IDA) and other wealthy nations follow suit, then leverage in poor nations may be reduced not because of weaker demand but due to reduced supply of aid.**

**Ironically, the possibility of sharply reduced contributions to IDA may dilute the leverage of some World Bank IDA-funded loans even before the fate of the next replenishment is known. Commitments of IDA funds dropped somewhat in fiscal l994. Worried that further drops may weaken the case for replenishment, the Bank may be eager to maintain or slightly increase new commitments--a concern that undercuts staff willingness to attach firm and significant commitments to new loans.**

### The mismatch between traditional conditioned loans and the new reform agenda

**Both IMF Standby Agreements (and related kinds of credits carrying strong conditions) and World Bank Structural and Sectoral Adjustment loans provide foreign exchange to bolster reserves and ease balance of payments pressures. Such loans support the economy as a whole, rather than specific sectors or projects. They also can be released far more rapidly than project loans, which are expended only as a project is actually constructed. Both characteristics make such loans very attractive to governments facing economic crises. Therefore, it is both logical and feasible to attach requirements for policy reforms that affect the economy as a whole to such loans.**

**But the same features that make fast-disbursing, non-project loans useful for encouraging and supporting macro-economic policy reforms make them less appropriate for encouraging more specific policy or institutional changes. Institutional reforms often have many stages and take a long time to complete. Worse, left half-done they may be useless or even harmful. Aid that can be released rapidly is not particularly helpful for such reforms, though in principle loans can be designed with multiple tranches, so that a slice of aid is released as each step in a series of reforms is taken. The questions of appropriate incentives for those who must carry out reforms is harder to address. Non-project aid generally goes into a government's general foreign exchange reserves. That provides a strong incentive for the Minister of Finance or Central Bank Governor, but offers little reward for a Minister of Health or the manager of a state enterprise who must take painful restructuring measures.**

**The World Bank's internal guidelines also complicate the use of fast-disbursing, non- project aid to pursue the kinds of reforms likely to come later in a country's adjustment efforts. The major economic rationale for such a loan is to bolster the borrower's balance of payments; the size of the loan is determined in part by considering the client's need. If the client has adequate reserves and no severe balance of payments problem, there is little justification for such a loan, and no economic rationale for determining its size.**

### Less clear blueprints for later-stage reforms

**The use of conditioned aid to promote reforms implies that the lender knows what measures will promote stabilization, economic efficiency, and growth -- goals presumed to be shared by the borrowing government, or at least in the interest of the people of the country. If the borrower agreed fully that the required measures were the right ones and was strongly committed to carrying them out, there would be little need for conditionality (though conditions might still serve to strengthen the government's hand against criticisms or protests from vested interests).**

This basic logic applies reasonably well to stabilization. While each stabilization program needs to be fine-tuned to the circumstances, the scope for basic differences in approach is limited--as the failed attempts at "heterodox" stabilization in the mid-l980s in Argentina, Brazil, and Peru demonstrated. Therefore a strong technical consensus and a well-tested "model" underlies the general nature of the conditions usually required by the IMF, and often backed by related requirements in World Bank Structural Adjustment Loans.

In contrast, there is often less technical agreement and no clear models to guide later institutional reforms. Many of these raise issues which the industrialized democracies are far from resolving. For instance, despite wide agreement that better "governance" -- more honest, efficient, transparent and accountable public sector institutions and services -- is a high priority, there is no clear formula for how to reach these goals. Similarly, there is not much consensus on how to reform inefficient and ineffective health and education systems, though some partial principles are clear. Where the lender itself is not certain what should be done, conditionality becomes a highly dubious technique.

### The growing importance of client commitment

Government commitment is essential for any significant reforms. Occasionally, commitment grows out of intellectual conviction and dedication to public welfare, even at a high political price. For example, in l992 the Russian government of Prime Minister Gaidar was convinced that sweeping reforms were imperative, although it fully expected to lose office in a year at most. Much more usually, commitment grows out of calculations comparing the costs and benefits, economic and political, of feasible options. Conditionality without commitment can bring about specific actions, but it cannot ensure that those actions are not reversed once aid is disbursed, or that the additional measures needed to maintain or deepen the reforms are taken. These facts have been well-recognized by thoughtful people in the international (and bilateral) financial institutions for many years, and have been an explicit and emphatic theme in World Bank evaluations and policy statements since the late l980s.

Perhaps less well recognized is the fact that commitment becomes ever more crucial as a country moves into later stages of a far-reaching reform agenda. In part, this reflects the changing nature of the reform measures themselves. Because institutional reforms are complex and slow, they can be diverted or derailed at many points, by many agents. Moreover, as noted earlier, while austerity packages are intended to be temporary, institutional reforms are permanent, and therefore prompt tenacious resistance from vested interests that will lose privileges or benefits. And in contrast to stabilization, institutional reforms are likely to be launched in a period of "politics as usual" rather than a crisis atmosphere that encourages willingness to endure sacrifice. For all these reasons, strong government commitment is essential to keep later-stage reforms on course.

Democratization and decentralization also heighten the importance of commitment. In democratic systems, many reforms cannot be carried through without some co-operation from the legislature, and often also from the judicial branch, an array of executive agencies (including some that may be quasi-autonomous, like public universities), and interest groups. Usually a committed government is crucial to explain and publicize the reasons for reform, construct alliances, and devise other tactics to cope with democratic cross-pressures. Decentralization similarly increases the importance of commitment, at national and sub-national levels. If later- stage reforms focus on sectors such as banking, education, health, or agriculture, and provincial and local governments have major responsibilities for those sectors, then systemic reforms require co-ordinated action by several levels of government. Even with commitment, it is difficult to organize co-ordinated reforms at several levels of government. Without substantial commitment at all levels, such co-ordination is almost impossible.

### The changing aid relationship

For all of these reasons, the aid relationship that was widespread in the l980s is changing, and will shift further in the late l990s and beyond. Conditionality will play a much more limited role in most countries. The basic mode of IMF assistance during crises will continue, and the World Bank still may play a major role in shaping policies in some of the poorer countries, especially those with very limited analytic capacities of their own. But in most countries, information and knowledge will increasingly provide the main channels of influence. Analyses are likely to be conducted increasingly in collaboration with analysts from the country concerned. Dialogue is likely to engage considerably broader circles, including media, universities and think-tanks, legislators, and representatives of interest groups.

Particularly for the newer areas of emphasis like improved governance and human resource development, the World Bank (and the international community more broadly) is likely to emphasize data collection and analysis, experimentation, and evaluation. More broadly, there must be a shift away from a tutorial relation to which the Bank brings the "right model," towards a joint search for useful ideas, a problem-solving approach to which the Bank brings information and experience rather than answers.

Evolution in this direction not only means less conditionality, but also slower and more selective aid. Greater reliance on data collection and analysis (especially done jointly), dialogue and persuasion inevitably means much slower preparation of projects and programs. That in turn means increased

**staff-time per dollar spent--a logical necessity that has yet to be recognized by the World Bank's wealthy member governments which review its internal management policies.**

**Moreover, decreased use of conditionality, in combination with an on-going desire to promote reforms (rather than simply build dams or schools) will mean considerably more selective commitments of aid. If the World Bank, or international financial institutions more generally, must rely more on commitment to reforms within borrowing countries, as I have argued, then they must wait until there is fairly clear evidence of such commitment. That is likely to mean concentrating aid on a smaller number of recipients which demonstrate an interest in reform, while hoping that their example will inspire stronger efforts elsewhere. That implication also must be recognized and accepted by the Bank's major member governments.**

**In retrospect, the l980s will surely be viewed as a highly unusual period in the history of aid relations. Never before had international organizations intervened so vigorously in the detailed internal affairs of so many countries. Moreover, the intervention was designed not only to correct immediate crises, but to promote far-reaching changes in internal structure and policies.**

**Such intervention was feasible and in considerable degree effective because of a unique combination of international circumstances. Many of these have now changed. Moreover, in many countries considerable reform is already accomplished. External pressure often played a useful role in early stages, but its role in later phases is more limited, because of the inherent character of the reforms now on the agenda.**

**The reform agenda for the later l990s and the early 21st century will continue to be pursued with a great deal of trans-national and international involvement and support. But in general, the era of high-profile conditionality is over. Nor can there be a return to the older era of aid for discrete projects, on the assumption that increasing physical and human capital alone will promote development. The challenge of the future is to strengthen old channels and devise new ones for influence based primarily on information and joint problem-solving, and secondarily on resource transfers, rather than on pressure attached to large resource transfers.**

**FOOTNOTES**

**1. *Financial Times*, January 23, l995, p. 4.**

**2. For a fuller discussion of the broadened concept of development, and some of the challenges to the concept, see Joan M. Nelson and Stephanie Eglinton, *Global Goals, Contentious Means: Issues of Multiple Aid Conditionality*, (Washington, D.C., Overseas Development Council Policy Essay No. 10, l993), pp. 12-22.**

**3. While the bulk of funds for World Bank operations come from borrowing on securities markets and repayments of earlier loans, and are loaned on terms consistent with maintaining the Bank's capitalization, the soft-loan IDA operations are funded by periodic contributions from the better-off member nations--that is, from taxes raised in those countries.**

**4. European Bank for Reconstruction and Development, *Transition Report* (London: EBRD, October l994), Appendix 10.1, p. 148.**

**5. l993 and estimated l994 data from ECLAC, *Economic Panorama of Latin America, l994* (Santiago, Chile: ECLAC, l994), pp.6-7 and Table 2, p. 11. For a concise summary of the status of major components of reform in many Latin American nations through l992, see World Bank, *Latin America and the Caribbean: A Decade After the Debt Crisis* (Washington, D.C.: The World Bank, September l993), Table 3.1, pp. 32-33.**

**6. European Bank for Reconstruction and Development, *Transition Report* (London: EBRD, October l994), Table 2.1, pp. 10-11. _**