SIDA EVALUATION REPORT 1993/2

# AID AND MACROECONOMICS:

*An Evaluation of Swedish Import Support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam*


BY STEFAN DE VYLDER

This report is based on four macroeconomic evaluations by Jennifer Sharpley, Gabriel Palma, Mike Faber and Matthew Martin.

Author: Stefan de Vylder

The views and interpretations expressed in this report are those of the author and should not be attributed to the Swedish International Development Authority (SIDA).

General Editor: Stefan Dahlgren
Editing: Helene Thornblad, Press Art

Printed by: Västergötlands Tryckeri, Skara 1993
Cover photo by: Ron Gilling

ISBN: 91-586-7150-1
ISSN: 0283-0736

SWEDISH INTERNATIONAL DEVELOPMENT AUTHORITY
S-105 25 STOCKHOLM, TELEX 144 50 sida sthlm

# *Aid and Macroeconomics:*

**An Evaluation of Swedish Import Support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam**

*December 1992*

*Stefan de Vylder*

**Key issues and a summary of four macroeconomic evaluations:**

**Jennifer Sharpley,** *Macro-economic Evaluation of Swedish Import Support to Mozambique,* **November 1991**

**Gabriel Palma,** *Macro-economic Evaluation of Sweden's Import Support to Nicaragua,* **April 1992**

**Mike Faber,** *Macro-economic Evaluation of Sweden's Import Support to Vietnam,* **May 1992**

**Matthew Martin,** *Macro-economic Evaluation of SIDA Import Support to Guinea-Bissau,* **August 1992 (draft)**

# Contents

# INTRODUCTION

The present report, commissioned by the Planning Secretariat of the Swedish International Development Authority (SIDA), is an attempt to summarise the major findings of four macroeconomic evaluations of Swedish import support carried out in late 1991 and 1992.

The report begins with a brief overview of Swedish aid objectives, and of the changing role of import support in Swedish aid policies.

In a second chapter, some key issues related to the macroeconomic impact of foreign aid in general, and of import support in particular, are discussed. This overview is intended as a theoretical background, and is largely carried out independently of the four evaluation reports.

The third chapter is a presentation of differences and similarities between the four countries under review: Guinea-Bissau, Mozambique, Nicaragua and Vietnam.

The last part of the report is a presentation of major results from the four case studies.

It should be stressed that although the first three chapters have benefitted greatly from the analyses made in the four case studies, the authors of the country reports bear no responsibility for the presentation made in these introductory chapters.

They have, on the other hand, to assume almost all responsibility for the statements made in the last part, where my aim is to present, as faithfully as possible, the findings of the four country reports, while keeping my own comments to a bare minimum. This also means that I do not necessarily share all the opinions and conclusions presented.

*Stockholm, December 1992*

*Stefan de Vylder*

# Executive Summary

Sweden's bilateral balance of payments support, including debt relief and import support, amounts to approximately 1.5 billion SEK per year. It constitutes over ten per cent of Sweden's total aid, and around twenty per cent of the bilateral programme. In addition, Sweden also participates in international programmes for balance of payments support, including debt relief.

The four countries discussed in the present report, which is based on evaluations of the macroeconomic impact of Swedish import support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam, account for almost fifty per cent of Sweden's total balance of payments support.

Swedish import support, or, as it was called in the past, commodity support, has generally aimed at reaching the growth objective. In many countries – including Mozambique, Nicaragua and Vietnam – this form of assistance has also been justified with reference to the objective of supporting national independence.

During the 1970s and early 1980s, import support was often regarded as a residual, a somewhat inferior form of aid which complemented traditional project and programme aid when lack of administrative capacity at SIDA and/or the recipient country made it difficult to disburse the entire country allocation on "high-quality" development assistance. The major advantage with commodity aid was that it was easy to handle and quickly disbursed.

Most of the countries with a low absorptive capacity of project aid were, however, also characterised by weak administrations and poor macroeconomic policies.

The result of the earlier tendency to regard import support as a residual when ordinary development assistance appeared too difficult was, somewhat paradoxically, that the "messier" a particular country was, the more likely was it that Sweden disbursed a high percentage of the country allocation on import support.

In the 1980s, macroeconomics came back to the forefront in the international debate about development assistance. Largely as a result of the protracted debt crisis, and the huge macroeconomic imbalances that surfaced in a majority of Third World countries, the role of a sound macroeconomic environment as a precondition for successful development assistance was increasingly emphasised by the international donor community.

As part of this international trend, Sweden started to pay more attention to macroeconomic matters, and developed more elaborate guidelines for import support. Shortage of foreign exchange in the recipient country remained an important criterion, but the shortage should mainly be due to external factors – i. e. a sudden deterioration of the country's terms of trade – rather than being the result of inappropriate domestic policies. The recipient country should also have a satisfactory capacity to utilise the foreign exchange provided. Mainly for administrative reasons, preference should be given to relatively large purchases of bulky commodities. The destructive role of a grossly overvalued rate of exchange was observed, and caution with import support was recommended in such cases.

The application of the above criteria – which was considered as recommendations rather than as binding rules – was "soft", however. As will be apparent in this report, where the macroeconomic policies of Guinea-Bissau, Mozambique, Nicaragua and Vietnam in the 1980s are briefly assessed, even the rather vague guidelines described above would have ruled out import support to these countries during most of the 1980s if they had been applied.

Today, import support has been further upgraded, and is now recognized as a perfectly legitimate, even essential, component in Swedish development assistance. The old emphasis on the foreign exchange bottleneck remains intact; preference should be given to countries with balance of payments problems. Import support has, however, also become more explicitly policy-oriented, and more emphasis has been put on sound macroeconomic policies on the part of the recipient country as a prerequisite for import support.

According the SIDA's recently adopted "Guidelines for Swedish Import Support", the major objective of import support is to "support an economic reform programme in the recipient country... Import support is normally given only to countries which implement a reform programme which has been approved by the IMF and/or the World Bank." It is furthermore stressed that import support should preferably be directed to countries with market-based foreign exchange regimes.

The "Guidelines" also emphasise that all recipients of Swedish import support must pay full countervalue for their imports according to the official rate of exchange. Import support should be support to the country, not to individual importers. In the past, countervalue payments have not always been made, however.

While support to the economic reform process has become increasingly stressed as a key objective for Sweden's import support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam in the last few years, the alleviation of a shortage of foreign exchange was normally presented by SIDA as the main economic rationale for providing import support to these countries in the past.

The conclusion in all four reports is that the foreign exchange constraint has been severe in all countries. During the entire period under review – which differs somewhat between the four country studies – the authors of the evaluations strongly support the major objective of Swedish import support.

The relatively small size of Sweden's import support in relation to overall imports makes it difficult or impossible to assess how this particular contribution to the donor community's bridging of the foreign exchange gaps has affected economic growth.

The authors of the evaluation reports are therefore very cautious when it comes to measuring the general effects. However, a conclusion that emerges from all four reports is that although Swedish import support has played a marginal role, the impact on economic growth has been marginally positive.

To judge from the case studies, Sweden has kept a rather low profile in the macroeconomic policy dialogue, in particular in the three countries (Guinea-Bissau, Mozambique and Nicaragua) where the International Monetary Fund (IMF) and the World Bank have entered the scene in connection with structural adjustment programmes.

In Vietnam, the situation is different. After Vietnam's invasion of Cambodia in the late 1970s and until quite recently, Sweden was virtually the only Western bilateral donor working in Vietnam, and Sweden played a far more active role in the policy dialogue than in the other three countries under the review.

As for the overall assessment of the structural adjustment programmes implemented in all four countries in recent years, the answers differ considerably between the different countries. Thus, while the structural adjustment programmes in Mozambique and Vietnam are given rather high grades, that of Guinea-Bissau is surrounded by a large number of question-marks. Nicaragua, in this sense, occupies an intermediate position.

In view of the fact that Sweden's – and most other donors' – programme support is closely linked to the success and credibility of a particular country's structural adjustment programme, one might perhaps expect that the recommendations from the four authors as to continued Swedish import support should follow their assessments of the respective programmes. This is not the case, however, as witnessed by the extreme cases: for Vietnam, where economic policies appear to have been most successful, the recommendation is to reduce Swedish import support, at least in a medium-term perspective, while the opposite recommendation is made for the least successful country, Guinea-Bissau.

A summary of some major findings and recommendations from the four country studies is presented below.

ordinary development assistance appeared too difficult was, somewhat paradoxically, that the "messier" a particular country was, the more likely was it that Sweden disbursed a high percentage of the country allocation on import support.

The guidelines used by SIDA for the handling of import support during this period took shortage of foreign exchange more or less for granted, and put the main emphasis on discussions about appropriate procurement and banking procedures related to import support. The macroeconomic policies pursued by the recipient country were occasionally mentioned, but seldom used as criteria in the actual allocation of commodity support/import support.

In the 1980s, macroeconomics came back to the forefront in the international debate about development assistance. Largely as a result of the protracted debt crisis, and the huge macroeconomic imbalances that surfaced in a majority of Third World countries, the role of a sound macroeconomic environment as a precondition for successful development assistance was increasingly emphasised by the international donor community, under the macroeconomic leadership of the International Monetary Fund and the World Bank.

As part of this international trend, SIDA started to pay more attention to macroeconomic matters, and developed more elaborate guidelines for import support[1]. Shortage of foreign exchange in the recipient country remained an important criterion, but the shortage should mainly be due to external factors – i.e. a sudden deterioration of the country's terms of trade – rather than being the result of inappropriate domestic policies. The recipient country should also have a satisfactory capacity to utilise the foreign exchange provided. Mainly for administrative reasons, preference should be given to relatively large purchases of bulky commodities. The destructive role of a grossly overvalued rate of exchange was observed, and caution with import support was recommended in such cases.

The application of the above criteria – which were considered as recommendations rather than as binding rules – was "soft", however. As will be apparent in later chapters, when the macroeconomic policies of Guinea-Bissau, Mozambique, Nicaragua and Vietnam in the 1980s are briefly assessed, even the rather vague guidelines described above would have ruled out import support to these countries during most of the 1980s if they had been applied.

## 1.3 SIDA's New Guidelines for Imports Support

Today, import support has been further upgraded, and is now recognised as a perfectly legitimate, even essential, component in Swedish development assistance. The old emphasis on the foreign exchange bottleneck – the legacy of past "gap theories", which will be briefly discussed in Chapter II below – remains intact; preference should be given to countries with balance of payments problems. Import support has, however,

1. The first SIDA memo putting emphasis on macroeconomic issues in relation to import support was written in 1984 (Joakim Stymne: *Importstöd. Principer och problem*. SIDA Planning Secretariat, June 1984).

also become more explicitly policy-oriented, and more emphasis has been put on sound macroeconomic policies on the part of the recipient country as a prerequisite for import support.

According the SIDA's recently adopted "Guidelines for Swedish Import Support"[2], the major objective of import support is to "support an economic reform programme in the recipient country... Import support is normally[3] only given to countries which implement a reform programme which has been approved by the IMF and/or the World Bank." (hopefully, the new guidelines will not rule out import support to countries which have already completed a reform programme, and find themselves in the midst of a transition from stabilisation and adjustment to growth).

It is furthermore stressed that import support should preferably be directed to countries with market-based foreign exchange regimes characterised by, among other things,

- "a realistic and market-related rate of exchange (as shown, for example, by the fact that the gap between the official and parallel rates of exchange is small)";
- "equal access to foreign exchange by all importers";
- the existence of a flexible and competitive financial system which guarantees that profitable enterprises can compete for credit on equal terms";
- "a predominantly non-administrative allocation of foreign exchange";

The "Guidelines" also emphasise that all recipients of Swedish import support must pay full countervalue for their imports according to the official rate of exchange. Import support is support to the *country*, not to individual importers.

The differences between debt relief, balance of payments support and import support are far from clearcut; indeed, all these forms of aid can be regarded as policy-related support, or "programme assistance", to countries with balance of payments problems. From the point of view of Swedish aid objectives, there is no reason to make a sharp distinction between them. Thus, while this particular review concentrates on import support in the limited sense, it should be observed that all countries that are discussed have also received policy-related assistance in the form of debt relief and/or balance of payments support. The macroeconomic implications are somewhat different, however, and in the following chapter, as in the four country cases that will be presented in Chapter IV of this report, the main emphasis is put on the macroeconomic impact of import support.

## 1.4 The Role of Import Support in Sweden's Bilateral Aid Programmes

Today, Sweden's bilateral balance of payments support, including debt relief and import support, amounts to approximately 1.5 billion Swedish kronor (SEK) per year.

2. "Riktlinjer för svenskt importstöd", August 1992. It should be observed that the new guidelines were not in force when the country evaluations discussed in the present report were carried out.
3. An exception is Vietnam, where opposition from the United States has impeded a formal agreement between Vietnam and the IMF and the World Bank.

It constitues over ten per cent of Sweden's total aid, and around twenty per cent of the bilateral programme. In addition, Sweden also participates in international programmes for balance of payments support, including debt relief[4].

During the past few years, total disbursements of Swedish bilateral balance of payments support are shown in Table 1 below.

**Table 1. Disbursements of Swedish Balance of Payments Support Under the Bilateral Aid Programme (million Swedish kronor).**

| Country | 1988/89 | 1989/90 | 1990/91 |
|---|---|---|---|
| Angola | 110 | 41 | 32 |
| Bangladesh | 32 | 2 | 18 |
| Botswana | 0 | 0 | 0 |
| India | 96 | 2 | 0 |
| Kap Verde | 64 | 29 | 36 |
| Kenya | 31 | 41 | 0 |
| Laos | 9 | 1 | 0 |
| Lesotho | 0 | 0 | 0 |
| Sri Lanka | 0 | 0 | 5 |
| Tanzania | 299 | 368 | 256 |
| Uganda | 5 | 95 | 119 |
| Zambia | 45 | 20 | 354 |
| Zimbabwe | 37 | 38 | 13 |
| Guinea-Bissau | 3 | 6 | 28 |
| Mozambique | 224 | 219 | 418 |
| Nicaragua | 79 | 169 | 99 |
| Vietnam | 77 | 11 | 254 |
| Total | 1.111 | 1.041 | 1.630 |
| Guinea-Bissau, Mozambique, Nicaragua and Vietnam as a percentage of total Swedish balance of payments support | 34 % | 39 % | 49 % |

Source: Based on Karl-Anders Larsson, SIDA, mimeo 1992

As seen in the above table, the four countries which will be discussed in this report account for a rather large, and increasing, share of Sweden's total balance of payments support.

As suggested earlier, the link between good macroeconomic policies and Swedish

4. Among these international programmes can be mentioned support to the Special Programme for Africa (SPA), co-financing of international debt buy-back schemes, grants to the International Monetary Fund (IMF) to finance concessional interest rates on ESAF (Extended Structural Adjustment Facility) loans, and contributions to the so-called Fifth Dimension, i. e. grants to low-income countries to enable them to clear their arrears with the World Bank. A discussion of these international initiatives falls beyond the scope of the present report, however.

balance of payments support was, during many years, weak. The role of such aid as "gap filler" in countries with a low absorptive capacity of project aid appears to have been more pronounced than suggested by SIDAs guidelines, as witessed by the fact that several countries characterised by gross macroeconomic mismanagement in the early 1980s – such as Tanzania, Nicaragua, Vietnam, and Mozambique – were large recipients of import support.

In the latter half of the 1980s, several of the major recipients of Swedish balance of payments support began to implement structural adjustment programmes. These countries were also "rewarded" with increased allocations of programme support; one obvious case is Zambia after the new agreement with the International Monetary Fund (IMF) in 1990/91. Guinea-Bissau, Mozambique, Nicaragua and Vietnam can also be said to belong to this category.

Countries which pursued relatively sound macroeconomic policies all through the 1980s received less balance of payments support. In the group of Swedish programme countries, Botswana, Kenya, India and Sri Lanka would, for example, probably classify as above average as regards macroeconomic management, but as seen in Table 1 above, they recieved rather little balance of payments support.

# 2.

# The Macroeconomics of Foreign Aid, with Particular Emphasis on Import Support: Some Key Issues

Evaluation techniques at the micro level have been elaborated and applied extensively since the early history of development aid. Virtually all donors use, at least occasionally, some kind of cost benefit analysis in their feasibility studies and project evaluations, and from a methodological point of view, there exists a rather broad consensus among professional economists and aid officials as regards the issues involved, and the techniques to apply.

At the macro level, this is not the case. Although the analyses of the impact of development aid were originally developed in a macroeconomic framework, it was not until the 1980s that macroeconomic analysis – and macroeconomic conditionality – came back to the forefront both in the theory and practice of development aid. But despite all the attention paid to macroeconomics among aid donors during the past ten years, it must be recognised that our knowledge is still very limited, and that modesty is required in any attempt to assess the macroeconomic impact of foreign aid[5].

The purpose of the present chapter is therefore not to present "the truth" – only to make an overview of certain key aspects which should be considered as a background to the case studies of Guinea-Bissau, Mozambique, Nicaragua and Vietnam which will be presented in subsequent chapters.

The case studies are evaluations of Swedish import support, not of foreign aid in general. The scope of this chapter is somewhat broader, however. It is often difficult to distinguish the macroeconomic effects of import support from the impact of the overall level and composition of aid to a particular country, and the presentation that follows therefore attempts to provide a general background to the issues involved. It may be added that the four evaluations, to varying degrees, also touch upon the broader issues of macreoconomics and foreign aid in general.

Before proceeding to the discussion, another reservation should be made. The analysis below is largely confined to the macroeconomic impact of *aid*, rather than the impact of the *conditions* to which the aid is linked. The distinction is important, since a large part of today's debate about the effects of aid in actual practice deals with the

5. A useful and well-researched overview of the evolution of macroeconomic thinking about foreign aid, and of available empirical evidence on the macroeconomic impact of aid, is found in White (1992).

latter issue, i e how programme aid can serve to change domestic economic policies in a desired direction.

As indicated earlier, the practice of linking development assistance to policy changes in the recipient countries has intensified during the last ten years. Most of today's policy-related assistance is directed by the IMF and the World Bank in connection with structural adjustment programmes, and bilateral donors, including Sweden, are to an increasing extent coordinating their non-project aid with such programmes[6]. Indeed, as mentioned earlier, an explicit objective of Swedish balance of payments support – including debt relief and import support – is today to support structural adjustment in the recipient countries. Any serious analysis of the impact of Sweden's policy-related assistance should therefore have to consider the impact of such aid on the recipient countries' *policies*, rather than the direct impact on a number of economic variables. The line of causation would, then, not be simply:

aid leads to investment, growth, inflation, balance of payments, income distribution, etc.

but rather

aid plus conditionality leads to changes in domestic economic policies, which in turn lead to investment, growth, inflation, balance of payments, income distribution, etc.

or

aid plus conditionality leads to structural adjustment, which in turn leads to investment, growth, inflation, balance of payments, income distribution, etc.

To some extent, this will be done in Part IV of this report, where the four case studies are presented. The question to be answered, or at least raised, is: Has Sweden used import support to increase Sweden's leverage in the policy dialogue, thereby contributing to making the recipient countries modify their domestic policies?

In this section we will, however, disregard the effects of donor behaviour and conditionality on economic policies in the recipient countries, and confine the discussion to the more traditional way of assessing the direct economic impact of foreign aid.

## II.1 Gap theories

The early discussions about development aid concentrated on the effects on growth. They were generally based on more or less sophisticated "gap theories", largely developed on growth models of the Harrod-Domar kind, which mushroomed in the 1950s and early 1960s.

In its simplest version, the rate of economic growth in such a model is determined by a fixed incremental capital-output ratio (ICOR) and a fixed domestic savings ratio, which together determine the rate of growth. Foreign aid then enters as a simple addition to domestic savings. With a given ICOR, the effects of aid are identical to an increase in the domestic savings ratio, enabling higher investment and growth.

6. A coherent overview – and defense – of policy-related assistance and IMF conditionality in a Swedish context is given by Hans Lundström (1990).

The "dual gap" theories, developed by Chenery and others in the early 1960s, concentrated on the existence of both a "savings gap" and a "foreign exchange gap". Domestic savings could be supplemented with foreign aid, as in the Harrod/Domar models, and by directing aid to new investment, the recipient country's investment ratio, and hence rate of economic growth, could be increased. If, however, the foreign exchange restriction was binding, the provision of foreign exchange through development aid would be expected to have an even larger positive impact in the recipient country, since aid in this case would allow domestic capital to be used more efficiently (the assumption being that some domestic capital would be redundant in the absence of imports of essential machinery, equipment, spare parts, etc).

Ideally, foreign aid could both raise the nominator in the Harrod/Domar growth equations – the investment ratio – and lower the denominator, i.e. the capital-output ratio.

Dual gap theories of the kind briefly indicated above still play an important role in current views on the effects of foreign aid, in particular of balance of payments related aid such as import support, where it is more or less taken for granted that the foreign exchange constraint is more binding than the domestic savings constraint.

In debt renegotiations in the Paris Club, or in conncetion with IMF-supported structural adjustment programmes, the dominant technique to assess how much external assistance and/or debt relief a particular country "needs" is still largely based on the financial gap analysis developed in the 1950s.

In Swedish aid policies, the foreign exchange gap has always received most attention. In general, commodity support has been justified with reference to shortage of foreign exchange rather than lack of domestic savings.

The apparent absence of any firm empirical support for the hypotheses behind the link between aid, investment and growth has puzzled many observers. White (1992), for example, discusses what he labels the "micro-macro paradox": while a large number of studies, evaluations etc. do indicate that aid performs reasonably well at the micro level, it is far more difficult to assess its macroeconomic impact[7].

Causality is, of course, difficult in any attempt to measure the effects of aid. For example, a negative correlation between aid and growth need not imply that aid is bad for growth – the explanation could simply be that countries which are facing protracted economic difficulties receive more aid than countries that are doing fine, and that the situation in the former countries would be even worse in the absence of aid.

Another complication in an analysis of the macroeconomic impact of aid is that aid in most cases constitutes such a marginal proportion of savings and investment that its effects on the recipient country's economy are lost in the general macroeconomic turmoil. For example, to make an econometric study of the impact of aid during the turbulent 1980s – characterised by, among other things, external shocks in the form of

7. White's own conclusion is quite agnostic: "The answer (to the "micro-macro paradox") is we are not in postition to say what aid does at the macro level, so there is no basis for saying that there is a paradox... We simply do not know how aid is affecting aconomies at the macro level." The reader who believes White is right can stop reading here.

declining terms of trade, rising interest rates, loss of access to private lending, rampant inflation, etc. – by using time series data would probably, in most countries, capture the effects of a large number of external factors other than aid, as well as the effects of domestic policy reforms. The methodological polemics surrounding all recent attempts to assess the effects of structural adjustment programmes in Sub-saharan Africa may indicate some of the difficulties involved.

In the countries covered by the present report, it should however be stressed that the role of foreign aid has been more than marginal during the 1980s. The extreme case is Mozambique, where aid, in the past few years, has accounted for some eighty-ninety per cent of total imports, which, in turn, constitute two-thirds of gross domestic product (GDP). Nicaragua also developed a strong aid dependency in the 1980s, as did Guinea-Bissau, (for data, see Part III below), and in Vietnam, the least aid-dependent country of the four, aid represented some ten per cent of GDP during most of the 1980s. Clearly, foreign aid has, in these countries, been of such magnitude that its macroeconomic impact must have been substantial.

As for the theoretical foundation of dual gap theories, it falls beyond the scope of this report to attempt a review of all the different issues involved. Still, a few critical aspects should be mentioned in this context.

One common form of criticism is the fact that gap theories tend to overestimate the role of capital formation in the development process. Apart from problems of definition – what is "consumption", and what is "investment"? – the link between investment and growth is far from mechanical, and the effects on economic growth of an increase by a few percentage points in the gross investment ratio should not be exaggerated. Today, the role of physical capital in the development process has been downgraded, and there is a pronounced tendency among development economists to put more emphasis on "soft-ware" – human capital, institutions, accountability, "good governance", policy environment, legal framework, property rights, transaction costs, incentive structure, etc. – at the expense of "hard-ware" more easily captured in investment ratios.

If we return to the Harrod/Domar growth models, we could, somewhat simplistically, argue that modern development theory puts more emphasis on the factors affecting the efficiency of investment, i.e. the determinants of the ICOR, than on the size of the investment ratio. As witnessed by, for example, Mozambique and Guinea-Bissau in the 1980s, a high investment ratio is certainly not a sufficient condition for a high rate of economic growth. Since there are, on the other hand, few countries which have managed to combine a low rate of investment with a high rate of growth over a longer period of time, we may tentatively conclude that a high rate of investment is a necessary, albeit far from sufficient, condition for rapid economic growth.

The impact of aid on economic efficiency then becomes the focal point of attention – unfortunately, there is, despite ambitious efforts by Cassen and others[8], no easy answer

8. See, for example, the comprehensive overview "Does Aid Work?" by Robert Cassen and Associates (1986).

to that question, although policy-related aid does attempt to address these issues by linking aid to policy improvements in the recipient countries.

Another critique, going back to an influential article by Griffin and Enos[9] from 1970, is that gap theories tend to regard foreign aid as fully additional to domestic savings and investment. This, however, need not be the case. Foreign aid is highly fungible at the macro level, and can be used to increase consumption as well as investment in the recipient country. An inflow of aid may, for example, enable the government to lower taxes or reduce domestic borrowing, or increase non-developmental expenditures. Following Enos and Griffin, one could argue that aid should simply be regarded as an addition to domestic *expenditure* rather than investment. Whether the aid is actually used to raise consumption or investment is basically an empirical question that cannot be settled on *a priori* grounds[10].

The implication of this line of reasoning is that although aid is likely to increase domestic investment, it is likely to do so by a smaller amount than the aid recieved.

One corollary to this observation is that aid may replace, rather than supplement, some domestic savings, and weaken the country's own resource mobilisation efforts.

In an extreme case such as Mozambique, it is quite obvious that aid increases domestic consumption (which is also the explicit purpose of a large part of the aid). In Mozambique, aid is substantially larger than gross investment, which implies that the domestic savings ratio is strongly negative. It is, then, a simple mathematical fact that aid has substituted for at least some domestic savings (which could not possibly be negative in the absence of external resources).

Another weakness of dual gap theories is that they are based on an implicit notion of the developing countries as being unable to increase the production of tradables sufficiently enough to overcome the external constraint. To say that the foreign exchange restriction is binding is tantamount to saying that structural rigidities in the domestic economic make it impossible to substitute domestic for imported inputs into the production of investment goods[11]. While there is much truth in this statement at a micro level – there are, for example, many capital goods that simply cannot be produced domestically in Guinea-Bissau – it is also true that gap theories do imply a too pessimistic view about substitution mechanisms in developing countries. A foreign exchange gap can be said to simply reflect insufficient domestic production of tradable goods, and from the proposition that a poor country is unable to produce, say, certain sophisticated machinery does not follow that it cannot expand the production of *tradables* in general in order to ease the foreign exchange constraint.

With perfect substitution between tradables and non-tradables, the foreign exchange gap disappears. Or, rather: it is reduced to a trivial gap between domestic savings and investment or – which is the same thing – between domestic production and expenditure.

9. See Griffin and Enos (1970) and Griffin (1970).
10. For a more comprehensive review of the polemics stimulated by the Griffin/Enos article, see White (1992).
11. For an early exposition of this critique against dual gap models, see Findlay (1973, Ch.10).

The effects of aid on private investment have also been discussed in recent years, without leading to any firm conclusions. Most aid has traditionally been directed to public sector activities – as we will see below, this has also been the case with Swedish import support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam in the past – and it has often been argued that aid may therefore displace, or "crowd out", private investment. On the other hand, a number of public undertakings, such as investment in physical infrastructure, education, etc., should stimulate private investment by increasing its profitability; the "crowding in" effect.

Again, it is difficult or impossible to generalise. Certain kinds of aid-financed public investments do indeed "crowd out" private investment, but whether this effect dominates over "crowding in" cannot easily be assessed without a concrete analysis of individual cases. It may also be observed that the dispute about "crowding out" or "crowding in" has generally concerned project aid rather than import support, although the discussion is relevant in the latter case as well, as there exists an obvious link between import support and public revenue and expenditure.

## II.2 Aid and International Competitiveness

Aid can, as discussed above, displace domestic savings. It can also displace foreign exchange earnings.

This may, in fact, be one of the most important dangers with foreign aid. A number of theoretical and empirical observations seem to confirm the following blunt statements by Sweder van Wijnbergen: "From the export promotion point of view, aid has been a failure." (1985, p. 1) and "Aid, even when temporary, permanently worsens export performance, unless proper policy measures are taken." (1985, p. 10).

There are a number of mechanisms to consider in this context. To begin with, there is a "policy effect": an inflow of foreign capital may allow a government to continue with erroneous policies, for example in the form of discrimination of exports. Since aid lessens the need for foreign exchange from other sources, it may reduce the government's export promotion incentives, and encourage a more inward-looking – and, presumably, less efficient – development strategy than would have been pursued in the absence of aid.

From a policy point of view, aid may introduce a "soft budget constraint" on the recipient country's external account; a country which mismanages its affairs can often be bailed out by the donor community in order to avoid a threating balance of payments crisis[12].

Prevailing procedures in debt renegotiations – which should perhaps be analysed in a bargaining or game theoretical rather than purely macroeconomic framework[13] – may actually encourage macroeconomic mismanagement. Debt relief and other forms of balance of payments support are often granted on the basis of calculations of

12. For a discussion of the "soft budget constraint", see Part III below.
13. For an interesting attempt in this direction, see Mosley/Harrigan/Toyle (1991).

financial gaps. The larger the expected deficits, the more debt relief and additional aid may come forth. A country which prudently manages its external sector cannot expect the donor community to be very generous, however; the creditors normally insist on their share of any improvement on the external account. Many well-performing countries have realised that the marginal tax on "good behaviour" can be very high, while their neighbours, who continue with irresponsible policies, are constantly being bailed out by benevolent bilateral donors (who, incidentally, also bail out the International Financial Institutions nowadays; neither the poorly performing countries, nor the international financial institutions, usually have to pay the full price for their mistakes).

The attempts to link balance of payments support to policy reform can partly be interpreted as a recognition, on the part of the donors, of this dilemma. A country in crisis should attempt to put its house in order before receiving debt relief and additional support; the problems arise *ex post*, when countries have learnt that those that succeed are punished with reduced concessional aid flows and a tougher stand from their creditors as the financial gaps diminish.

As for possible disincentive effects of aid on export performance, there is also a price effect, which works through the impact of aid on the recipient country's real rate of exchange. *Ceteris paribus*, it can be expected that an inflow of foreign aid will put upward pressure on the real exchange rate, and this hypothesis seems to be verified empirically[14].

At root is the famous "Dutch disease" problem, originally used to describe the impact on the Dutch economy of the drastic increase in export revenues that followed upon the exploitation of natural gas in the North Sea and the resulting squeeze put on other sectors producing tradables in the Dutch economy. With strong export revenues from gas, the Dutch *guilden* appreciated against other currencies, exposing Dutch industries and agriculture to more intense competition from abroad.

In developing countries, similar effects have been observed as a result of a sudden increase in the availability of foreign exchange due to, for example, a boom in export prices, or increased foreign borrowing. The inflow of "coca-dollars" in a country like Bolivia has given rise to an overvaluation of the currency to a level which has eroded the competitiveness of tradables other than coca.

In extreme cases, such as a number of oil-exporting countries in the late 1970s and early 1980s, favorable terms of trade coincided with easy access to foreign loans, causing a real appreciation of the domestic currencies, and loss of international competitiveness in other traded goods sectors. Naturally, it can always be argued that wrong policies, rather than high export earnings or easy access to foreign borrowing, should be blamed; the point to be made, however, is that "good times" may greatly facilitate the implementation of very bad policies.

14. VZ<an Wijnbergen concludes, on the basis of an econometric test of aid and real exchange rates in a number of African countries, that "the results strongly support the teoretical prediction that increases in the real volume of aid cause real appreciation" (1985, p.15). For a further discussion of empirical findings, see White (1992).

Foreign aid in general, and import support in particular, can have similar effects. In addition to the usual "commodity cycles", developing countries may easily suffer from "credit cycles" or "aid cycles". As a result of the increased supply of foreign exchange thanks to aid, the domestic currency can either appreciate in nominal terms or, if there is inflation, make the currency depreciate less, in nominal terms, than is warranted by the difference between the domestic and international rate of inflation.

Aid can also, through its indirect effects, put an upward pressure on domestic costs, thereby making the real rate of exchange appreciate.

Project aid, which competes for scarce human and other resources, often contributes to the creation of inflationary bottlenecks. In particular, aid donors' fierce competition for skilled labour has, in many developing countries, pushed up real wages for certain categories of professionals to such an extent that activities which lack foreign financing find it impossible to compete for skilled labour. In this way, aid creates its own "booming sectors" along basically the same lines as natural gas in Holland, with serious consequences for the international competitivenesss of tradables.

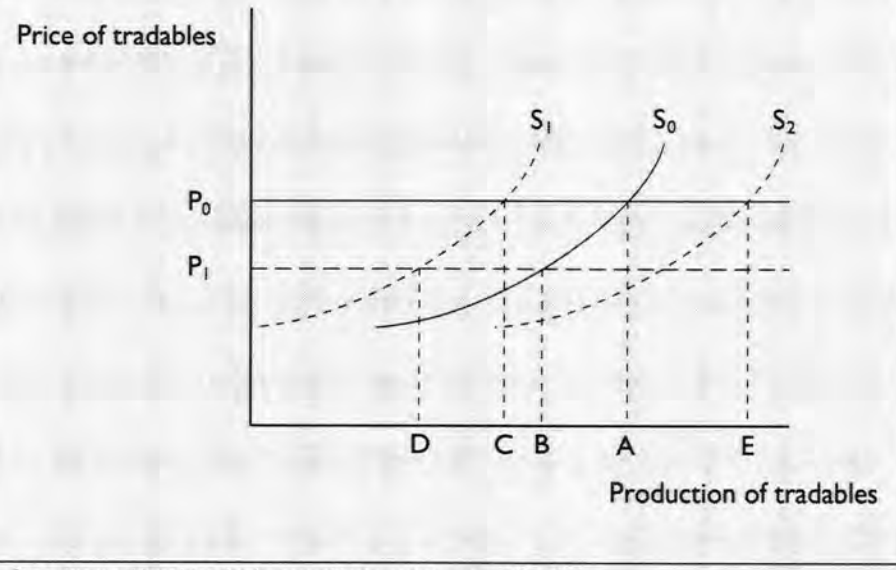
Following the Dutch disease literature, we can distinguish two different effects on domestic costs: one "resource movement effect", which arises when the "booming sector" attempts to attract real resources by bidding up their prices, and a "spending effect", which describes the potentially inflationary impact of the spending of "extra" money as a consequence of the boom in one sector. Clearly, these two effects may come from foreign aid as well as from a booming export sector.

However, the inflationary effects of foreign may be mitigated by the inflow of foreign commodities purchased by foreign aid. Food aid, for example, and aid that increases the supply of commodities in general and/or eases supply bottlenecks in the economy, can be assumed to have a deflationary impact which may, or may not, exceed the upward pressure on the real rate of exhange as a result of the aid.

Aid which increases overall productivity in the traded goods sectors – for example, investments in physical infrastructure which lower costs for producers of tradables, or technical assistance to key institutions which reduces transaction costs in the economy – serves to improve the international competitiveness, i.e. to increase the supply of traded goods at any given price (determined by world market prices, if the country is a price taker). Aid which raises the overall productivity can therefore be understood both in terms of a lowering of the ICOR in a Harrod/Domar growth model and in terms of a depreciation of the real rate of exchange, adjusted for productivity growth.

Figure 1 below is an attempt to capture these different effects of aid on the recipient country's international competitiveness.

**Figure 1. The effect of foreign aid.**




P = a given world market price (expressed in domestic currency) of tradables.
S = aggregate supply curves for tradables.

If an inflow of aid leads to a nominal appreciation, domestic prices of tradables are shown by P 1, and production of tradables declines from A to B. If the impact of aid is to raise costs of production of tradables, production declines from A to C. If both effects are present, the combined effect of foreign aid is to lower the production of tradables from A to D.

If, on the other hand, aid raises productivity in the traded goods sector – for example, by lowering transport costs, raising the educational level, improving the banking or postal system, providing extension services to small farmers, etc. – the result will be a shift to the right of the supply curve, and production of tradables will increase from A to E.

The net effects of foreign aid on a recipient country's international competitiveness and production of tradables cannot be assessed without empirical studies, of which there are very few. Figure 1 above cannot be used to draw unequivocal conclusions – only to indicate some of the different, and often contradictory, mechanisms involved. Still, both common sense and the wealth of theoretical and empirical studies on Dutch disease problems in other contexts do suggest that there is good reason to be aware of the dangers of an aid-induced real appreciation of the rate of exchange in countries where foreign aid plays an important role to cover external deficits.

## II.3 Structural Effects of Foreign Aid

Given the heterogenity of foreign aid, it is next to impossible to generalise about the structural impact of foreign aid. A couple of observations may, however, be justified.

If foreign aid is primarily given to the public sector, as has often been the case, a reasonable hypothesis would be that aid has strengthened the public rather than the private sector. Casual observation of the size of the public sector in a number of highly aid-dependent countries suggests that this has indeed been the case, despite recent attempts to roll back the state in connection with structural adjustment programme. There are, however, also a large number of developing countries which have created a strong public administration without major contributions from foreign donors.

Another potential structural effect is the aid-induced discrimination of tradables indicated earlier. In countries where foreign aid gives rise to "Dutch disease" effects, the non-traded sectors – often dominated by the public administration – will increase their share of production at the expense of tradables.

## II.4 Aid and Inflation

As suggested by the earlier discussion, aid can contribute to cost-push inflation through the "resource movement" effect as well as to a demand-led inflation via the "spending effect". The increase in the supply of goods made possible with external resources may, however, also lower inflationary pressures in the economy. This is also the case when aid helps to ease supply constraints and bottlenecks of various kinds.

On balance, which effect will dominate cannot be assessed on purely theoretical grounds. A reasonable hypothesis would, however, be that the inflationary effects tend to be strongest for project assistance, while commodity aid can be assumed to increase the supply of tradables while putting less pressure on scarce resources in the recipient country. Highly fungible balance of payments support, including import support, is, however, likely to have a large impact on the *nominal* rate of exchange.

In addition to the above effects, there are also fiscal and monetary effects of aid that need to be taken into account. In the theoretical discussions about import support and inflation, it is, in fact, these apects that have received most attention, and a few comments should therefore be made.

## II.5 Counterpart Funds and Inflation: A Comment

The discussion has to a large extent been centered around the monetary and inflationary effects of counterpart funds, i.e. the funds generated when aid-financed commodities are sold to the recipients and the proceeds in local currency are deposited in accounts that are normally controlled by the recipient country's government[15]. According to one line a reasoning, the subsequent expenditure of counterpart funds

15. A standard reference in this context, which the present paragraphs have drawn heavily upon, is Roemer, (1989). *IDB Bulletin*, Vol 23, no 2, April 1992, contains a number of highly useful articles about the issue of counterpart funds.

in relative prices by raising prices of non-tradables versus tradables, producers of tradables will lose. For example, exporters may find it difficult to compete for scarce resources with an aid-financed "booming sector", where real wages rise. As increasing costs spread to the rest of the economy, profitability, employment and real wages in the sector producing tradables, which is supposed to be a price taker, will tend to go down.

When the domestic currency is overvalued, the purchase of aid-financed commodities can be regarded as a subsidy, even when counterfund payments are made. The situation gives rise to classic forms of rent-seeking behaviour, with arbitrary gains for some, loss of competitiveness for others, and tendencies to corruption. The negative allocative effects not only of import support, but of imports in general, should also be considered in this context.

In recent years, the issue of the impact of programme aid and macroeconomic conditionality on vulnerable groups has been widely discussed. The question in this context is not the impact of aid *per se*, but rather the effects of the structural adjustment programmes to which the granting of additional aid, often in the form of balance of payments support of various kinds, is linked.

The complexity of the issues involved, of which income distribution is only one, minor part, makes it difficult to give the topic a comprehensive treatment in a brief overview of the present kind. I also believe that concrete analyses of individual cases are necessary in order to draw any conclusions (and even then it is difficult). As indicated in the introduction to this chapter, I will therefore not attempt a review of available theoretical and empiricial evidence on the effects of structural adjustment programmes in developing countries in general, but the cases of Guinea-Bissau, Mozambique, Nicaragua and Vietnam will, of course, be briefly presented in part IV of this report.

# 3.

# Guinea-Bissau, Mozambique, Nicaragua and Vietnam: Some Similarities and Differences

Superficially, the four countries under review may appear to have rather little in common. They are situated in three different continents, and in terms of history, culture, geography, etc., there are certainly more differences than similarities. The size of the countries also differs considerably: while Vietnam, with close to 70 million inhabitants, is a large and densely populated country, Nicargua is a small Central American republic with less than four million people, and Guinea-Bissau is even smaller. Guinea-Bissau, Mozambique and Vietnam belong to the very poorest countries in the world in terms of per capita income, while Nicaragua – though very poor by Latin American standards – has an average income appreciably higher than the other three countries.

Table 2 below gives some basic demographic and economic statistics about the four countries.

**Table 2. Guinea-Bissau, Mozambique, Nicaragua and Vietnam. Population, Population Density, Per Capita Income and Selected Social Indicators.**

| | GUB | MOZ | NIC | VIE |
|---|---|---|---|---|
| GNP/capita (USD), 1989 (very approximate figures) | 150-200 | 80-100 | 450 | 150-200 |
| Population, millions, 1989) | 0.9 | 15.3 | 3.7 | 66.0 |
| Area (1,000 square kilometers) | 36 | 802 | 130 | 332 |
| Infant Mortality Rate (per 1,000 live births), 1989 | 148 | 173 | 59 | 61 |
| Life expectancy at Birth (years), 1990 | 43 | 48 | 65 | 64 |
| Adult Literacy Rate (%), 1985 | 30 | 28 | 78 | 84 |
| Mean years of schooling, 1980 | 0.3 | 1.6 | 3.5 | 3.2 |

Sources: Social indicators are taken from United Nations Development Program (UNDP), *Human Development Report*, 1991. Gross national product (GNP) figures based on various offical estimates.

Apart from being recipients of Swedish commodity assistance, the countries also exhibit some other striking similarities, however.

One such similarity is the fact that they all share a recent history of successful armed struggle against foreign aggression and/or a brutal dictatorship. In all countries, the struggle was carried out under the leadership of national liberation movements (*Partido Africano da Independencia de Guiné e Cabo Verde, Frente de Liberacao de Mocambique, Front National de Libération, Frente Sandinista de Liberación Nacional*). In the cases of Guinea-Bissau, Mozambique and Vietnam, the major enemy was foreign (Portugal, Portugal/South Africa and the United States, respectively). In Nicaragua, the struggle was against a domestic oppressor, the Somoza dictatorship, but it had, from the very beginning, a pronounced anti-US character. A major conflict with the United States was virtually inevitable.

All movements declared themselves socialist, with a strong Marxist influence. For FNL, PAIGC and FRELIMO, Marxism was the very cornerstone of the ideology, and the political and economic systems created after national independence were explicitly based on Marxism.

With the possible exception for Guinea-Bissau, the countries also share – for very good reasons – a "victim image": they have all been subject to foreign armed aggression and, to varying degrees, political isolation from the West. This fact is of some importance for an understanding of Sweden's policy of making them major recipients of Swedish development aid.

Foreign *economic* aggression has also been part of the post-liberation history. During most of the 1980s, Nicaragua was subject to a trade embargo from the United States, which was lifted only after the defeat of FSNL in the general elections of 1990. The US trade embargo against Vietnam is still in force. In Mozambique, relations between the FRELIMO government and the West were never completely broken, but remained strained until the abandonment of Marxism and the implementation of a structural adjustment programme on the part of FRELIMO. Only Guinea-Bissau can be said to have been left in peace; more because of its marginal size, and unimportant strategic location, than because of ideological closeness to the West.

In all countries except Guinea-Bissau, the Soviet bloc became the dominant donor of development aid during the 1980s. And, which is of particular interest in the present context: in all four countries, Sweden became the largest single Western donor during the 1980s. In contrast with virtually all other recipients of Swedish development aid, Swedish aid to these countries has not been marginal, but quite substantial, both in relation to contributions from other donors and as a share of the respective countries' access to hard currency in general.

The situation in this respect has changed in recent years. After the electoral victory of Violeta Chamorro's centre-right coalition, the United States has become Nicaragua's major donor, and in both Mozambique and Vietnam, a large number of Western donors have increased their assistance in recent years. Still, it should be emphasised that all four countries developed a rather special relationship with Sweden during the 1980s, and that Swedish commodity support became a relatively significant source of hard currency during the past decade.

In all four countries, drastic structural adjustment programmes, which will be disccused in chapter IV.2 below, have been implemented in recent years. For all practical purposes, the old, socialist development strategy has been abandoned, and market-oriented policies have replaced past attempts to central planning. In Guinea-Bissau, Mozambique and Nicaragua, the programmes are supported by the the IMF and the World Bank institutions and by a large number of bilateral donors, while Vietnam, to date, has carried out far-reaching economic reforms without financial support from the IMF or the World Bank, and with only limited support from bilateral Western donors.

## III.1 Salient Features of the Old Development Model

There are, of course, striking differences between the development strategies adopted in Guinea-Bissau, Mozambique, Nicaragua and Vietnam in the 1980s. In particular, it should be stressed that Vietnam, after reunification in 1976, adopted an orthodox, Soviet-inspired economic model based on central planning and administrative, physical allocation of resources, while Nicaragua always maintained a mixed economy, albeit with state control over the "commanding heights" of the economy (the banking system, the foreign exchange market, the formerly Somoza-owned key agroindustrial enterprises which were nationalised after the Sandinista revolution in 1979, etc.).

In Guinea-Bissau and Mozambique, attempts at central planning were strong during the first decade after Independence. In the latter country, plans to "socialise the countryside" were elaborated. For a variety of reasons – such as the civil war, resistence from small-scale farmers, changing development concepts within the FRELIMO leadership, the fiscal crisis that soon developed, and others – these plans never really materialised, however, and central planning and collectivisation of the peasantry remained ideological concepts rather than actual development policies.

With due respect for all differences that existed in past development strategies, it may, however, be appropriate to indicate some of the similarities that came to characterise economic policies in the early period, which basically means 1979-89 in Nicaragua, 1976-86 in Vietnam, 1975-87 in Guinea-Bissau and Mozambique, i.e. before coherent attempts at systemic reform and structural adjustment were being implemented (partial reforms were introduced at various stages earlier in all four countries).

I will list some of these salient features under six different headings[18].

### *Exaggerated Optimism*

For many years, development policies of many countries in the Third World, especially those with socialist regimes with high ambitions, were characterised by an over-optimistic, and voluntaristic, bias: illiteracy would be eradicated within 10 years, health care was to be expanded to cover "everyone", agriculture would be developed and the

18. The presentation below follows rather closely some comparisons made by the present author of various socialist experiments in the Third World, including Guinea-Bissau, Mozambique, Nicaragua and Vietnam. See, for example, de Vylder (1988) or de Vylder and Fforde (1988).

country industrialised, etc. This exaggerated belief in the possibilities of developing the country was particularly strong within the leaderships of the four countries discussed here.

In Vietnam, the contrasts between the planned and actual results of the Second Five Year Plan (1976-80) could be used to illustrate this point. See Table 3.

**Table 3. Planned and Actual Results of Vietnam's Second Five Year Plan 1976-1980**

| Annual Increase in % | Planned | Actual |
|---|---|---|
| National Income | 13-14 | 0.4 |
| Agricultural production | 8-10 | 1.9 |
| Industrial production | 16-18 | 0.6 |

Source: Fforde & de Vylder (1988).

In Mozambique, a so-called "Perspective Plan" for the coming ten years was presented in 1979, and it included such vastly exaggerated targets as an eliminaton of illiteracy in ten years, and an expected annual rate of economic growth of ten per cent during the 1980s.

In Nicaragua, the following statement by a prominent Sandinista leader in 1986 may also serve to indicate this point:

"Perhaps our greatest error, if it can be called an error, is that we believed we could do more than was possible in this period, and tried to do so. When a country has been looted and virtually destroyed, you cannot reconstruct or overcome what was there before in a short period. The greatest task of the revolution – to reorganise – is not a simple one. We thought we could build more hospitals and schools than we have built, and produce more than we have produced. There was a little romanticism about the amount of things that we could do. Later we realised that things take time, and that in a country which has been squeezed for decades like Nicaragua, you cannot fix everything in seven years[19]."

In all countries under review, the combination of vastly exaggerated targets and war-torn economies was devastating: widespread bottle-necks, budget deficits, a repressed inflation which was fought with yet more strict and yet more unrealistic price controls, and so on.

At company level, the over-ambitious targets together with production goals expressed in physical rather than economic terms gave rise to a pronounced "investment hunger", characteristic of many other economies based on state planning. In order to reach the quantitative production goals that were established, industrial

19. Dora Maria Tellez, Minister of Health, interview in NACLA, *Report on the Americas*, Sptember/October 1986, p.26).

companies and (in Vietnam) agricultural co-operatives attempted to maximise their allocations of (subsidised) capital and material inputs. The resultant hoarding of machines, raw materials and labour which has been so common also in more developed socialist economies amplified the imbalances caused by the over-ambitious goals at the macro level (for a discussion about similar problems in other centrally planned economies, see Kornai, 1980, 1986).

### *Exaggerated Belief in Modern, Large-scale Technology*

In Karl Marx' writings, the faith in the potential of modern technology is a **Leitmotif**. Marx, more than any other nineteenth century economist, realised the enormous potential of science and technical progress. In the Stalinist version of Marxism, the "development of the productive forces" came to be almost synonomous with investment in modern, large-scale technology.

This belief in the powers of technology was very pronounced in Mozambique, Nicaragua, Vietnam and – although always on a smaller scale – in Guinea-Bissau. Within the industrial sector, fertiliser factories, steelmills and hydroelectric power plants were seen as symbols of progress in Vietnam. In Mozambique, the early development strategy was symbolised by the huge Mozambique-Nordic agricultural programme MONAP, with its heavy emphasis on a capital-intensive rehabilitation of the abandoned Portuguese commercial farms, which after 1975 were converted into state farms. In Nicaragua, similar tendencies were also very pronounced; only towards the end of the 1980s did *gigantismo* become a bad word in Nicaragua – as it had become in Mozambique just a few years earlier.

Donors, whether from the East or West, were, at least initially, keen on modern large-scale technology, and they appear to have shared the recipient countries' unrealistic views on modernisation and development. The donors thereby contributed to the polishing of the slippery slope during the early years by financing large-scale investment, primarily in agriculture and industry.

This was more than the human and physical resources of the four poor and devastated economies could cope with. Most of the projects failed, and by and large, the donors left behind them vulnerability, import-dependency, low capital utilisation and high unit costs.

Present policies in all four countries include severe criticisms of the exaggerated belief in the large-scale drive for modernisation which characterised the early years. Perhaps small is not yet beautiful in Guinea-Bissau, Mozambique, Nicaragua and Vietnam – but it is distinctly less ugly than ten years ago.

### *Lack of Monetary Discipline*

In the planning system developed in Vietnam, and to a large extent also in Guinea-Bissau, Mozambique and Nicaragua, money and prices played – and should play – a subordinate role for the allocation of resources. Official prices were low, and largely irrelevant for production decisions. However, someone – that is, the respective

governments, and foreign donors – had to foot the bill for those gigantic subsidies. Primarily Soviet assistance played an important role in supplying the Vietnamese and Nicaraguan economies with cheap machinery and inputs, but some aid also came from the West (in Vietnam also from China up until the overthrow of the Pol Pot regime in Cambodia in 1979).

The generalised subsidy system, and the lack of monetary and financial discipline, resulted in huge fiscal deficits. In Nicaragua in 1987, the overall fiscal deficit, (including subsidies to loss-making state companies, and before foreign grants) reached a staggering 41 per cent of GDP; in Mozambique and Vietnam, corresponding figures for 1987 were 21 and 7 per cent of GDP, respectively.

The nationalised banking system played a subordinate, and in relation to the physical planning system purely accommodating, role. The banks' main function was simple: to supply the economy with the required means of payment.

The real interest rate was low – under the prevailing inflationary conditions, it was strongly negative in all four countries during most of the 1980s – and substantial subsidies were directed to the state and co-operative systems via the banks. Private individuals could not borrow money, and private savings were normally made in foreign exchange (and, in Vietnam, gold). The quasi-banking system was, as a matter of fact, characterised by a virtual absence of deposits; no citizen in our countries would normally open a savings account in the state banking system before the economic reforms, and no responsible state manager would voluntarily choose to keep the company's excess liquidity in a bank.

A reluctance to close down state companies was another characteristic of all four economies, with Vietnam being the extreme case where the concept of bankruptcy did not even exist in the legislation. This led to effects well-known from other socialist economies, such as the locking-in of capital in unprofitable sectors and enterprises, thereby making the transfer of capital and other factors of production from stagnant and inefficient activities to more productive areas difficult or impossible.

### *The Soft Budget Constraint*

The "rules of the game" also differed in other respects from the ones we are used to in market economies. As a direct consequence of, among other things, the refusal to close down uneconomic enterprises, state companies were, albeit to varying degrees, confronted with a very "soft" budget constraint (a concept first introduced by the Hungarian economist Janos Kornai[20]). If the budget constraint is soft enough,

20. Kornai's concept of the soft budget constraint has given rise to a voluminous literature, and virtually no modern analysis of socialist economies fails to make reference to Kornai. See Kornai (1986), and, for recent contributions, Nagaoka/Atiyas (1990), Hare (1990), van Brabant (1990), Scott (1990). The following comments by van Brabant are directly relevant to our countries, and in particular to Vietnam before the economic reforms: "Because of sellers' markets, inventory policies of firms are geared toward ensuring inputs rather than output to satisfy demand. Though investment policies could in principle help to restore balance, firm behaviour is strongly influenced by the 'quantity drive' or the urge to raise output regardless of cost and the saleability of output. This drive leads to 'insatiable demand' for inputs, including 'investment hunger', made possible by the so-called soft budget constraint – essentially the ability of firms to survive and expand regardless of profitability as the planning bureaucracy is expected in the end to bail out unprofitable firms through subsidies, higher prices, lower taxes, or bank loans on easy terms." (p.164)

inefficiency and unprofitability are not punished as long as the physical planning targets are fulfilled (and, very often, even when they are not fulfilled); inefficient companies could normally rely on being bailed out either by the banks or directly by the government. It may also be added that with the large distortions that characterised relative costs and prices in all four contries, financial viability was an admittedly poor criterion of economic efficiency before the economic reforms were implemented.

The soft budget constraint has several important implications. The link between "macro" and "micro" is, to begin with, weakened; for example, a restrictive financial or monetary policy will not necessarily lead to a change in behaviour at enterprise level as long as the budget restriction is not binding, and physical production goals are accorded higher priority than economic criteria. Further, attempts to correct a distorted price and cost structure may easily become meaningless if relative prices play a marginal role. It is not just a question of, to use a phrase currently in vogue, "getting the prices right", it is also – and to begin with – a question of *making prices matter.*

## *An Inward-oriented Development Strategy*

Import substitution strategies in socialist economies have often resulted in the countries behaving as if they were "large" economies, attempting to produce a wide variety of commodities domestically. Socialist economies have therefore tended to develop a production structure which is largely independent of the countries' comparative advantages. They have become unspecialised economies in an era when the rest of the world is moving towards higher and higher degrees of specialisation.

Naturally, in an extremely poor and small country like Guinea-Bissau, these tendencies never became as procounced as in Vietnam. However, neclect of exports was a consistent feature in all four economies.

In Guinea-Bissau, Mozambique and Nicaragua – traditionally heavily dependent upon exports of raw materials from the agricultural sector – the export volume actually declined drastically during the 1980s.

In Vietnam, exports remained exceedingly low. As late as in 1987 – before the export success of 1989 and subsequent years – Vietnam had a total export of little more than one billion American dollars (USD), of which almost 60 per cent went to the the Council for Mutual Economic Assistance (Comecon) countries. Exports to the convertible currency area amounted to less than seven USD per capita per annum – which, to make a comparison, was appreciably less than Singapore's per capita exports *per day.*

To illustrate these observations, some data on the foreign trade situation in 1987 are presented in table 4 below.

**Table 4. Exports and Imports in Guinea-Bissau, Mozambique, Nicaragua and Vietnam. 1987, millions of USD.**

| | GUB | MOZ | NIC | VIE |
|---|---|---|---|---|
| Exports | 15 | 89 | 299 | 430 |
| Imports | 45 | 486 | 838 | 465 |
| Balance of Merchandise Trade | -30 | -397 | -539 | -35 |
| Exports per capita, USD | 16 | 6 | 81 | 7 |

Note: Only trade with the convertible area is included in the above table.

Source: World Bank, *World Development Report*, 1989, and various official sources.

The stagnation of exports was not only due to the consciously chosen "inward-looking" development strategy, however. The chronic "sellers' market" which characterised these economies signified – again a recogniseable pattern from other planned economies with constant excess demand – that the quality of the goods produced suffered. With the exception of simple bulk goods, it became almost impossible to export to the demanding markets of the West. The only alternative was to export to other countries where a sellers' market also prevailed, that is primarily to the Soviet Union and other Comecon members (a trade that has virtually collapsed today). It may also be added that the United States and several of her allies maintained a strict trade embargo against Nicaragua during most of the 1980s. The trade embargo against Vietnam is, as mentioned earlier, still in force.

In all countries, the extremely overvalued currencies formed a powerful obstacle to export; as a rule it was both simpler and more profitable to sell on the domestic market. The ratio between official and parallell rates of exchange was around 1:10 in Guinea-Bissau, Mozambique and Vietnam in the mid 1980s; in Nicaragua, the difference was even larger.

The countries under review exhibit, to summarize, a number of striking similarities as to choice of development strategy. The crisis symptoms in the mid-1980s were also strikingly similar, and can be summarised as

- huge macroimbalances;
- large distortions in relative costs and prices, and pervasive shortages;
- a low or (Mozambique, Nicaragua) negative rate of economic growth;
- a disastrous export performance;
- a low rate of domestic savings;
- tendencies towards demonetization, i.e. towards barter trade and/or a dollarisation of the economy:
- high aid dependency;
- structural distortions, in particular a neglect of agriculture.

# 4.

# Major Conclusions from the Case Studies

While the preceding chapters only occasionally made reference to the four evaluations of import support commissioned by SIDA, the purpose of the remainder of this report is to present the major conclusions from these case studies. Since they all cover a wealth of information and observations, any selection of major points to stress is necessarily subjective, and I apologise in advance for not making justice to the individual reports.

The conclusions that follow are divided into three parts. To begin with, an attempt is made to summarise the main conclusions as regards the macroeconomic impact of Swedish import support in the past. A second part is a summary of the assessments made in the reports of today's macroeconomic policies. Finally, the main recommendations to Sweden as for future import support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam are presented.

## IV.1 Macroeconomic Effects of Swedish Import Support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam

### *IV.1.1 The Overall Size of Foreign Aid and Sweden's Role as Major Donor*

Table 5 below provides some statistics in order to illustrate the overall role of foreign aid in general, and Swedish aid in particular, to Guinea-Bissau, Mozambique, Nicaragua and Vietnam. The data is of doubtful accuracy, and not easily comparable between the countries, but the figures may nevertheless serve to indicate something about aid dependency.

**Table 5. Official Development Assistance (ODA) to Guinea-Bissau, Mozambique, Nicaragua and Vietnam in 1989.**

| Country | GDP per capita (USD 1989) | Aid/GDP (%) | ODA/capita (USD) Total | Swedish | Sweden as % of Total ODA |
|---|---|---|---|---|---|
| GUB | 180 | 59 % | 105 | 13 | 12 % |
| MOZ | 80 | 67 % | 53 | 8 | 15 % |
| NIC | 360 | 18 % | 65 | 19 | 29 % |
| VIE | 120 | 2 % | 2,3 | 0.8 | 35 % |

Source: Proposition 1991/92:100, Bilaga 4, p. 298-385 and World Bank, **World Development Report**, various issues. Note: Aid from the Comecon countries is not included above.

> Swedish commodity assistance [to Mozambique] is widely appreciated by the Government of Mozambique because of its regularity and reliability, but also because of its untied nature. Sweden is the largest donor to Mozambique and all assistance is provided on grant terms [Sharpley].
>
> SIDA's import support [to Guinea-Bissau] has not been of sufficient size (until 1992-93) on its own to have a major effect on macroeconomic developments...However, on closer examination, SIDA has played a vital role in allowing imports of certain goods (particularly zinc roofs and batteries); and its countervalue funds served a crucial purpose in funding 25-30 % of the FND (National Development Fund) until 1990, and by paying teachers' salaries in 1991 [Martin].

### *IV.1.3 Impact on Economic Growth*

For reasons indicated above, the relatively small size of Sweden's import support in relation to overall imports makes it difficult or impossible to assess how this particular contribution to the donor community's bridging of the foreign exchange gaps has affected economic growth.

The authors of the evaluation reports are therefore very cautious when it comes to measuring the effects. However, a few points deserve to be made.

In Mozambique, Swedish import support funds have largely been channelled through an administrative agency, GCPI (*Gabinete de Coordenacao de Programas de Importacao*), which co-ordinates the allocation of import licenses and procurement of imports. A minor share of Swedish import support has, at times, been made available for a non-administrative, open general license system for foreign exchange allocation initiated by the World Bank.

According to one study (Rebelo, 1990), it appears as if Swedish funds have largely been used to import consumer goods, vehicles, spare parts and certain raw materials and inputs. This would, by and large, correspond to the overall pattern of Mozambican imports, which have been dominated by consumer goods and a wide varieties of inputs, spares, etc. However, the fact that Swedish import support has been channelled through the official system, without ear-marking of the funds[21], means that there is no meaningful way to assess how the *Swedish* funds have been used; since Mozambique has pooled most available funds in the GCPI system, the "fungibility" has been very high.

The author of the Mozambique report refrains from drawing any firm conclusions about the effects of the Swedish import support on economic growth. "The impact of incentive goods, raw materials and investment goods on the supply response of the economy cannot be quantified in any meaningful sense because of the lack of import and production data", is the conclusion. However, since the author strongly argues that the foreign exchange bottleneck has severely limited the recovery of the productive sectors of the economy, the general hypothesis is that import support has been useful in arresting the economic decline.

In Guinea-Bissau, Swedish import support has has been explicitly targeted at a

21. Only a small "negative list" of commodities such as military equipment and luxury goods has limited the free disposal of Swedish import support funds.

positive list of imports of agricultural inputs and incentive goods. According to the report, "the agricultural sector focus and the positive list have been successful mechanisms for providing key imports in the quantities and at the time desired by the market, thereby avoiding gluts and shortages".

According to the Guinea-Bissau report, it does appear as if the increased supply of incentive goods and inputs made available through import support from Sweden and other donors has had a positive impact on agricultural growth. "There is no doubt that food production rose sharply: in spite of the rising population, the food deficit has fallen from 30,000 tonnes in 1986 to 15,000 in 1991". The author indicates, however, that even better results should have been expected, as "the vast improvements in agricultural incentive policies since 1987 have borne limited fruit." The role of Swedish import support in this process has been marginal – but marginally positive.

In Vietnam, the concrete handling of Swedish import support has evolved over time – in part as a response to changing perceptions and aid policies in Sweden, but largely as a result of developments in Vietnam. Among the changes to be observed is, to begin with, a movement away from treating import support as an outright subsidy to the recipient production unit and towards treating it as a loan that should be repayable with interest to the Ministry of Finance and, second, an attempt to move away from having the recipients of import support determined administratively by different ministries and towards an allocation of imports determined through market forces via the intermediation of the banking system. Other significant reforms that took place during the period involved the complete untying of any obligation to purchase Swedish exports, and a requirement that at least 25 per cent of the imported commodities should be made available to firms in the private sector.

The concrete handling of import support in Vietnam has, as this brief overview has indicated, differed considerably from the mechanisms used in Guinea-Bissau, Mozambique and Nicaragua. It should also be stressed that virtually all Swedish import support to Vietnam has been directed towards a limited number of productive activities, almost exclusively in the manufacturing sector. The end-users of the commodities can thus be identified – the evaluation report contains a number of interesting observations about the actual use of the funds in individual cases – and the effects can more easily be identified than in cases where the impact gets lost in the general fungibility of foreign aid.

As for the impact on growth in Vietnam, the general conclusion is that "the scheme seemed to be working very usefully in the sense that the imported commodities were generally adding to domestic production and employment". And: "Swedish import support is a good way of promoting sustainable economic growth in Vietnam. It was always a quick way of expanding Vietnamese output. It has evolved into an instrument for promoting sustainable growth because its modalities and instruments have been changed in negotations with the Vietnamese authorities."

In Nicaragua, the extreme shortage of foreign exchange until quite recently made, as indicated earlier, Swedish import support useful in providing "easy" hard currency.

The author of the Guinea-Bissau report is alone is discussing the independence objective. The conclusion is that the structural adjustment programme as a whole has reduced the country's national independence (see section IV.2.1 below).

### *IV.1.5 Fiscal and Monetary Impact of Swedish Import Support and the Problem of Counterpart Funds*

Import support can, as discussed in Part II, be expected to influence not only real, but also monetary, variables in the recipient country. Issues to consider in this context are mainly related to the fiscal deficit, money creation and inflation, which are all considered, to varying degrees, in the evaluation reports.

The direct effect on the price level comes through the increased supply of commodities. In the Guinea-Bissau report, the conclusion is that Swedish import support has alleviated shortages of certain key commodities in rural areas, thereby reducing shortages. The import support scheme has also reduced prices by bulk purchasing, which has contributed to price stability.

In Vietnam, the quantities of raw materials and other inputs supplied to a limited number of manufacturing enterprises are clearly too small to be able to significantly effect the general price level. In individual cases, some shortages may have been avoided, thereby stabilising prices for individual commodities.

In Nicaragua, the evaluation report concludes that "during the Sandinista period, more imported inputs (due to import support) were likely to permit increased production, and this increase (that could not have taken place otherwise) would exert a deflationary influence on the economy (in the absence of other changes)." However, with a rate of inflation exceeding several thousand per cent during the latter half of the 1980s, the discussion about the impact of Swedish import support on the overall price level becomes rather academic; imports financed by Sweden may have helped to ease certain limited bottlenecks, but with a fiscal deficit averaging over thirty per cent of GDP towards the end of the decade, financed almost entirely by the printing press, any such effect was a drop in the ocean.

In Mozambique, however, the impact of import support from Sweden and a number of other donors has been far from marginal. Imports of consumer goods and key inputs financed by these schemes have been of paramount importance for the supply of commodities in the Mozambican economy. Well over 80 per cent of the total marketed supply of basic foodgrains has been supplied by foreign donors (under various food aid and emergency programmes), and for industrial consumer goods, the figure may be even higher. Clearly, import support in various forms has multiplied the supply of commodities in Mozambique (and, certainly, helped to boost demand as well).

As for the fiscal impact of import support the key question is whether counterpart payments are made or not. The situation in this respect differs considerably between the four countries.

In Mozambique, the impact of counterpart funds is exceedingly large. Total

revenues and grants from various forms of foreign aid – food aid, import support, etc. – amounted to between 37 and 49 per cent of total government revenue, or 18-25 per cent of GDP, between 1987 and 1991.

Potentially, counterpart funds generated by the sales of Swedish commodity support are rather large in Mozambique. Total Swedish aid amounts to almost ten per cent of GDP in Mozambique, of which balance of payments support, including import support, has accounted for over half in some years. Countervalue from this source alone thus represents several percentage points of GDP.

It should also be stressed that the use of Swedish counterpart funds in Mozambique (as in the other three countries) is very flexible. The revenues are available as general budget support for recurrent or capital expenditures, and are not tied to specific Swedish projects or used for off-budget items. They carry, in short, no obligations for additional state spending, but can be used entirely to finance the fiscal deficit, contrary to the principles applied by many other donors, which still insist on the tying of counterpart funds, often to the financing of their own development projects (or even, in some cases, to pay for the aid agencies' own staff expenses in local currency).

However, the Mozambican report concludes that "there is considerable evidence to suggest that a large percentage of counterpart funds supposed to be collected by the government from the importing entities is in fact collected late, collected only in part, or not collected at all...It is likely that on average much less than half of the countervalue is paid within one month of the goods clearing customs." In addition to the income distribution effects of the lax enforcement of countervalue payments – individual importers can reap handsome profits – the poor payment rate also reduces the anti-inflationary impact of commodity aid.

In the case of Swedish aid, where stricter control has been exercised, the report estimates that some 66-67 per cent of counterpart payments are, in fact, being made. In order to increase the anti-inflationary impact of Swedish import support, and to reduce the scope for rent-seeking behaviour and corruption, the author recommends that Sweden, together with other donors, assist the government of Mozambique in enforcing proper counterpart fund procedures.

In Nicaragua, the extreme overvaluation of the domestic currency – which, in the late 1980s, reached staggering proportions – made countervalue payments, even if they were made, rather illusory. In view of this situation, it is only natural that, as stated in the report, "very little thought has been given on both sides to the issue of counterpart funds".

The revolving funds schemes (FOPEX, FAIM) have, however, had their particular arrangements, using credits on (almost) commercial terms to the end-users rather than countervalue payments. As indicated earlier, the rate of repayment to the revolving funds has been disappointingly low, however.

In Guinea-Bissau, as in Mozambique, counterpart funds have come to represent a very important source of government revenue. As in the other three countries, the problem of counterpart funds was hardly an issue in the past (i.e., before structural

adjustment), when the grossly overvalued rate of exchange made payments of countervalue in local currency according to the official rate of exchange quite ridiculous, from a fiscal point of view. And it was the importer, rather than the Treasury, that reaped almost the entire benefit.

In Guinea-Bissau, again as in the other three countries, a more realistic rate of exchange has now been established. Great improvements in the collection of counterpart funds have also been made in recent years, and to make the system even better is regarded as a top priority by the government. Previously, a large proportion of countervalue was simply forgotten, or financed by unsustainable credit or fell into arrears. Credit financing ended in 1991, however, and in the first half of 1992, virtually all arrears were cleared. Future countervalue will be collected by the commercial banks.

In view of the small size of Swedish import support in the past, its effects on the fiscal deficit and on inflation have necessarily been marginal. Sweden has, however, regarded proper payment of countervalue as a matter of principle, and has once suspended the import support programme because of non-payment of countervalue (somewhat ironically: Guinea-Bissau has been the best performer of all countries in this respect in recent years, but it is the only country among the four that has been punished so drastically by SIDA because of non-payment).

In Vietnam, several of the recipients, in particular in the state sector, have been unable, or unwilling, to pay their countervalue. In the past, most of Sweden's import support was granted on easy terms – an overvalued rate of exchange, in combination with a negative real rate of interest and lax enforment of payment obligations, made the import support become a form of working capital subsidy to the end-user – but this has gradually been changed. Today, after a long series of reforms of the import support procedures, the payment of countervalue is done to the Ministry of Finance through credits from the banking system; the intention is that import support will be directed towards units which the banks consider creditworthy (i.e. profitable).

The report on Vietnam concludes that this mehanism has several advantages, and that it might be difficult to exert a similar influence if the Swedish funds were granted for generalised balance of payments support rather than import support. The marginal size of the Swedish import support program in comparison with the Vietnamese state budget makes the issue of countervalue payments a question of principles rather than a macroeconomic problem, however; as a support to the reform programme, the new mechanism should be seen as a means to strengthen the role of the banking system, to improve allocative efficiency (by abolishing arbitrary subsidies to individual enterprises) and to reduce the scope for rent-seeking behavior.

### *IV.1.6 Impact on the Real Rate of Exchange*

As discussed in Part II, the impact of foreign aid in general, and of balance of payments support in particular, on the rate of exchange in the recipient country may deserve more attention than it has received from aid donors.

A problem not addressed in the four evaluations is whether access to foreign aid in Guinea-Bissau, Mozambique, Nicaragua and Vietnam in the past actually delayed the process of economic reform by enabling the countries to continue with erroneous policies, such as discrimination of exports, including an overvalued rate of exchange. We will therefore not attempt any judgement – only indicate that this "policy effect" *may* have been present. In the absence of import support in the 1980s, the countries *might* have had to adjust the rate of exchange and other distortions earlier than they did. On the other hand, it may also be argued that the combined effect of an increased flow of foreign exchange and macroeconomic conditionality may have been to accelerate a long overdue reform of the exchange rate regime in Guinea-Bissau, Mozambique and Nicaragua.

As for the situation today, all reports observe the drastic devaluations, in real terms, that have taken place since the initiation of structural adjustment. The margins between official and parallel markets for foreign exchange are today, in all four countries, quite small (around ten per cent, on average).

Only one of the reports, Nicaragua, expresses concern about the fact that today's large inflow of foreign exchange, mainly in the form of aid, constitutes a problem for the real rate of exchange. And while the other three reports conclude that the present rate of exchange is not overvalued, the Nicaraguan report suggests that the Nicaraguan economy today (but not necessarily tomorrow, when large debt payments have to be made) suffers from an aid-induced "Dutch disease" problem, making a recovery of the production of tradables difficult.

### *IV.1.7 The Role of Sweden and Swedish Import Support in the Policy Dialogue*

To judge from these four studies, Sweden has kept a rather low profile in the policy dialogue, in particular in the three countries (Guinea-Bissau, Mozambique and Nicaragua) where the international financial institutions have entered the scene in connection with structural adjustment programmes.

The Guinea-Bissau report regrets this low profile. "This report has found that SIDA has until now had little influence on economic policy – especially compared to its role as a major donor – though it has greater knowledge of the economy than most other donors. SIDAs laudable attitude has been that the the Government of Guinea-Bissau should be left to formulate its own priorities, and that insofar as it requests assistance, SIDA will help. There is little evidence that this has allowed import support to give SIDA leverage on macroeconomic policy. Rather the Guinean government regards SIDA as the 'soft' donor which can be relied upon to be friendly...However, this has never been the attitude of other bilateral donors. They have not hesitated to lobby (or in some cases set formal conditions) on macroeconomic policy, as a quid pro quo for import support."

Another quotation from the Guinea-Bissau report – which, together with the Vietnamese report, is the one which devotes most attention to this issue – may be relevant for other countries as well:

"Insofar as SIDA's (and other donors') import support has had positive effects on macroeconomic developments, particularly on internal trade and agricultural incentives, it has encouraged improvements in the Guinean government economic policy. This is especially obvious in relation to improving external trade and exchange liberalisation; internal trade liberalisation; the collection and utilisation of counterpart funds; and customs efficiency. In addition, since 1987, balance of payments and import support have enhanced SIDAs image and recognition as a major donor.

They could potentially give SIDA a key role in assisting in the design of macroeconomic policy. It has not yet used this because it believes the Guinean government should not have priorities dictated by donors. Both other donors and the the IMF and the World Bank institutions are not hesitating in meddling and sometimes dictating to the Guinean government, with different aims from SIDA, and sometimes to the detriment of long-term sustainable development."

The Mozambican report does not explicitly discuss Sweden's role in the policy dialogue as separate from the stance of the donor community and the international financial institutions as a whole.

Outside the programme assistance, Sweden plays a more active role in Mozambique. SIDA is, for example, the lead, or coordinating, agency for the educational sector in Mozambique. In connection with policy-based assistance, Sweden has, however, decided to support the overall direction of the reforms, rather than try to influence the programme by, for example, putting up its own, bilateral conditions. One reason could be that SIDA has comparatively less competence in macroeconomic management than in, say, health, telecommunications or primary education. Another reason could simply be that Sweden has been rather satisfied with the way the the IMF and the World Bank institutions and the government of Mozambique have designed and implemented the structural adjustment programme.

In Vietnam, the situation is again different. Since Vietnam's invasion of Cambodia in the late 1970s and until quite recently, Sweden was virtually the only Western bilateral donor working in Vietnam, and Sweden played a far more active role in the policy dialogue than in the other three countries under review.

The author of the report on Vietnam strongly emphasises the role played by Swedish import support in the process of "mutual learning provided by the negotiation of the modalities of the programme and the monitoring of its subsequent performance."

And: "By chance and by ingenuity, and with Vietnamese consent, Sweden's import support programme has evolved into an instrument for encouraging policy reform and, over a limited range, for exploring modalities that will make it more successful...Much the most interesting aspects of Sweden's import support in Vietnam are (i) how the programme has been shaped over time, and (ii) its use in the process of policy dialogue and reform. From the studies that the consultant has read of Tanzania, Zambia, Mozambique and Nicaragua the import support programme does not appear to have been used in anything like the same way in these other countries. Was the potential there for doing so? Possibly not to the same extent. For while it is true that Vietnam has

a very special position in Sweden's overseas aid programme as a whole, it is also true that Sweden has a very special position amongst donors for the Government of Vietnam. As a long-standing friend from the West, and more recently as Vietnam's single largest bilateral donor, Sweden is well placed to be accepted as a sympathetic guide to the perils and requirements of the market economy, and moreover has equipped its Hanoi office with a staff well-equipped, respected and willing to act in that capacity. The lesson is this: the beneficial (or even harmful) impact of import support depends greatly upon the design of the programme and the allocations made under it; the more work that is put into these aspects, the greater the potential benefit for the recipient."

In the report on Nicaragua, the role of Sweden in the policy dialogue is hardly mentioned. As in the case of Guinea-Bissau and Mozambique, SIDA emerges as a "soft" donor, with little intention to use the large aid programme for macroeconomic leverage. Certain modalities of the import support programme, such as the revolving funds, were, however, introduced with active assistance from Sweden.

One aspect, not mentioned in the report, that might be observed is the fact that SIDA did finance an appreciable input of technical assistance to key areas such as tax reform and macroeconomic advice. These activities, intended to strengthen the Government's admittedly poor macroeconomic capacity, was not tied to the import support programme, however.

After the change of Government in 1990, the international financial institutions and the United States have come to replace Sweden as the largest suppliers of hard currency. The size of the Swedish import support programme has been increased, but the already marginal role of Sweden in the policy dialogue has been further reduced as the the IMF and the World Bank institutions entered the scene.

## IV.2 The Present Situation: Structural Adjustment and Import Support

### *IV.2.1 Overall Assessment of the Structural Adjustment Programmes*

While the preceding chapter has attempted to summarise some of the conclusions about the effectiveness of Swedish import support in the past, the purpose of this section is to discuss how the programmes fit into today's macroeconomic situation in the four countries. In particular, given that programme aid should be regarded as support to a policy worthy of general support (or as a means to influence a certain set of policies in a desired direction against the will of a reluctant government), the key question to be asked in this context is whether the economic programmes presently being implemented are coherent and credible enough to deserve such support.

The answer to this question differs considerably between our four countries. Thus, while the structural adjustment programmes in Mozambique and Vietnam are given rather high grades, that of Guinea-Bissau is surrounded by a large number of question-marks. Nicaragua, in this sense, occupies an intermediate position.

To begin with it can, however, be concluded that all four countries have made great progress in eliminating the most glaring distortions of relative prices that characterised the economies before the economic reform process began to be implemented. By and large, prices have been liberalised, and the huge differences that existed earlier between prices on the official and parallel ("black" or "grey") markets have virtually disappeared; for example, in no country is the difference between the official and parellel rate of exchange larger than fifteen per cent. Deregulation of domestic and foreign trade has been rapid, and privatisation of state enterprises have taken place in all countries.

As for macrostabilisation, the picture is more mixed. Inflation has been drastically reduced in Nicaragua, but remains rather high – som 30-60 per cent – in Guinea-Bissau, Mozambique and Vietnam. In Guinea-Bissau, Mozambique and Nicaragua, massive increases in capital inflows – mainly aid and loans, in Nicaragua also some private capital – have helped to finance large fiscal and current account deficits. The sustainability of the programmes in the absence of huge flows of aid can therefore be questioned; only Vietnam has largely relied upon the country's own resources to reduce macroeconomic disequilibria.

Both Vietnam and Guinea-Bissau have managed to achieve a respectable rate of economic growth – around five per cent per year, on average – since the process of economic reform was started. In Nicaragua, stagnation has continued (albeit not "stagflation", as before). In Mozambique, a strong recovery after the crisis years preceding the reforms has taken place, but growth has been sluggish in recent years. In Mozambique and Guinea-Bissau, the rate of growth appears to be decelerating in 1991 and 1992.

Major achievements and problems areas in the four different countries are summarised in the following way in the four reports:

**Mozambique**

> Mozambique's achievements under the Economic Rehabilitation Programme (PRE) 1987-89 and the Economic and Social Rehabilitation Programme (PRES) 1990-92 have been substantial, especially when viewed against the country's economic background of acute poverty, extensive destruction of physical infrastructure caused by the war, and lack of skilled human resources to carry out the reform measures, programmes and projects.
>
> There has been a major improvement in the magnitude of macroeconomic imbalances since 1987. Macroeconomic adjustment has been especially impressive in the area of fiscal stabilization where domestic bank financing of the fiscal deficit recently has been eliminated. Comprehensive administrative controls over pricing and distribution have been largely dismantled, except in those areas of the economy still most seriously affected by the emergency. The reduction in state subsidies and increase in government revenues has been striking. The massive price and exchange rate distortions of the early 1980s have been drastically diminished, and substantive improvements have been implemented in the allocation of foreign exchange and the tariff system [Sharpley].

The author, however, also expresses concern about a number of problem areas – apart from obvious concerns about the war and the difficult security situation – such as inefficient use of public expenditures and declining investment.

The major concern regards the availability of foreign aid, and declining foreign exchange inflows from a number of donors. The author regards the Mozambican economy as basically foreign exchange constrained. "The economic growth prospects for 1991-92 are not encouraging...The overall reduction in donor assistance available to finance imports for rehabilitation, investment, and incentive goods is bound to curb the supply response of the economy and make it more difficult to attain the 4.5 - 5.0 per cent growth rate for 1991-93 projected in the Policy Framework Paper."

Lack of aid coordination is strongly stressed as a problem in relation to the structural adjustment programme.

**Vietnam**

The author of the report on Vietnam is impressed by recent achievements in terms of economic growth and policy reform:

> Despite its poverty and a number of exceptional difficulties, the growth of GDP in Vietnam over the past five years has averaged more than 5 per cent. Growth over the next few years is likely to be even more rapid, and the country is widely believed to be capable of becoming one of Asia's next Newly Industrialising Economies.
>
> Policitically, the country is still ruled by its communist party which clearly intends to retain its role as the 'leading power for state and society'. There is no talk of multi-party democracy. But policies and personnel are being changed. The role of the private sector (including foreign investment) is being encouraged and expanded while the public sector contracts. Output targets are being set for a small number of strategic commodities. Trade is rapidly being switched from Comecon partners to hard currency markets. State enterprises are being reestablished as share companies. Prices, including the prices of labour and of foreign exchange, are being increasingly set by market forces rather than by administrative fiat. Agriculture has been decollectivised.
>
> Perhaps the most remarkable of all the achievements of the Vietnamese economy in the past five years has been the ability to redirect the pattern of the country's trade following the disintegration of the Comecon and to survive the cessation of Soviet aid and technical assistance while still maintaining a positive growth rate in GDP [Faber].

There are many problem areas, however:

> There may be doubts as to how quickly the government will be able to get rid of the subsidies to inefficient state-owned enterprises which largely cause the excessive credit creation that fuels inflation; and doubts too as to how effectively a communist government will be able to shape the institutions and the policies needed to guide the development of a thrusting market economy. There must be questions too as to how the rehabilitation and extension of the country's crumbling and inadequate infra-structure is to be financed. But over the direction of change, and over the apparent determination to proceed with further changes, there can be no doubt.

If both policy reform and growth rates are taken into account, Vietnam undoubt-

edly stands out as the best performer of the four countries under review. It may also be observed that the Vietnamese – in sharp contrast with the Mozambican case – have accomplished this in the midst of *declining* volumes of foreign aid, and without an agreement with the international financial institutions.

**Nicaragua**

In Nicaragua – the only country of the four where a change in government has taken place during the period under review – the picture is mixed. The new government's first year in office, in economic policies symbolised by the so-called "Mayorga Plan", was a complete failure, with the rate of inflation actually accelerating sharply, and with a continued decline in overall production. However, the situation improved appreciably in early 1991:

> After the failure of the 'Mayorga Plan' there followed a period of uncertainty and indecision in matters of economic policy. However, the government succeeded in addressing several important issues. Firstly, it abandoned its previous confrontational style of government and started serious negotiations both with labour and with the Sandinista leadership, seeking a basic consensus on matters of economic policy; this led to the '*Concertación* Agreement' which established a political truce after a year of almost incessant conflict and crisis [Palma].

The major achievement of the new government was the Stabilisation Programme, launched in March 1991, whose cornerstone was a huge devaluation in combination with a currency reform. The government also used the programme to introduce cuts and changes in the allocation of public expenditure. In particular, defense expenditures were drastically reduced; in 1989, during the *contra* war, approximately 50 per cent of the state budget had been used on defense.

The March 1991 stabilisation programme succeeded, concludes the report, where many others had failed. Inflation came to a sudden halt. Also,

> By June, the government had succeeded in financing its spending for the previous four months from a combination of tax revenues, foreign aid and official foreign borrowing. This was a remarkable improvement on its 1990 record, when the fiscal deficit was estimated at 14 per cent...Finally, the government also sped up the process of import liberalisation. As a result, after ten years of very low levels of investment, technological backwardness, and high levels of protection, domestic industry suddenly had to compete on equal terms with foreign producers.

Crucial to the success of the 1991 plan was the solution of several important problems affecting the capital account of Nicaragua's balance of payments. It is estimated that in 1991 and 1992 there will be an inflow of some USD 700 million in different forms of capital inflows – foreign aid, grants, loans, private capital inflows, remittances from Nicaraguan workers living in the United States, etc. This amount is around three times the expected level of exports in 1991 and 1992.

From the point of view of arresting hyperinflation, the stabilisation programme has, since April 1991, been a success story. From having suffered from Latin America's worst hyperinflation ever, Nicaragua has, during the last year, achieved a one-digit rate of inflation.

This is the bright side of the picture. But:

> However, despite the initial success of the 1991 plan, there are some elements of concern in the present situation. Firstly, the nominal rate of exchange seems to be fixed at a still overvalued level from the point of view of the real side of the Nicaraguan economy...The March 1991 devaluation and the price stability since the middle of 1991 must have brought this real rate of exchange down considerably, but it still has a very long way to go down....An overvalued real rate of exchange...worsens the domestic relative prices of tradables against non-tradables. Although there is no information yet on the effect that this may be having on import competing activities, the negative effect on some export activities seems to be evident from the available statistics.....Although it is difficult to calculate the short-term effects of a relatively overvalued fixed exchange rate on Nicaragua's exports and import competing industries, there is evidence from other experiments of this kind that suggests that the long-term effects are negative, and sometimes very damaging...In respect of the sustainability of an anti-inflationary policy based on a still grossly overvalued fixed exchange rate, one has to remain on the side of the skeptics.
>
> Another cause for concern is the damage that the 1991 stabilisation programme is producing in the social sectors...There is clear evidence that the social sector has had to pay a disproportionate share of the cost of the stabilisation programme, and areas such as health and education are already suffering serious deterioration. At the same time, poverty and unemployment have increased at an alarming rate – by early 1991 unemployment stood at well over 40 per cent.

**Guinea-Bissau**

As in the case of Mozambique, the author stresses the lack of aid coordination, and the different modalities and conditions imposed by different donors, as a serious problem in the implementation of the structural adjustment programme.

Among positive achievements, the report observes that "the Guinean adjustment programme has produced a surprisingly high growth rate during 1987-91, averaging 5,2 per cent." However, in view of the wide array of policies to boost rural incentives – such as large inflows of inputs and incentive goods, higher producer prices, etc – the results in the agricultural sector are regarded as "disappointing": "The vast improvements in agricultural incentive policies since 1987 have borne limited fruit."

> Only cashews and food crops have shown any consistent response. Other structural barriers to production and export increases are responsible – particularly the division of the sector into large farms (*pontas*) and smallholdings (*tabancas*) and the discrimination in favour of the *pontas* [Martin].

The author's assessment of the structural adjustment programme is appreciably more critical than is the case in the other three countries. The critique differs considerably from the one delivered by the the IMF and the World Bank institutions, however (which have temporarily suspended disbursements to Guinea-Bissau due to slippage in the implementation of the programme):

> Overall, the programme gives the impression of having been hastily and imperfectly constructed in order to ensure that multilateral debt service seemed able to be paid – even though new aid flows have collapsed, and regardless of the consequences

for the economy. Its targets were always unrealistic and should not be expected to be attained by the the Guinean government... Multilateral debt accounts for approximately half of the total stock, and payment of multilateral debt dervice has become the main driving force behind the design of the adjustment programme, as well as the main problem for the budget and the balance of payments.

As for the immediate future, the author is pessimistic:

> The short-term (1992) prospects for the economy are bleak...
>
> GDP growth is expected to slow dramatically, and may turn negative...
>
> The Government, Bank and donors now believe that it will be impossible to meet the fiscal revenue targets set in April...In spite of current savage expenditure cuts, the Guinean government will be unable to meet its primary surplus target, or to pay essential debt service to its multilateral creditors...
>
> ... the Guinean government thinks it is virtually impossible to keep inflation below 50 per cent for the year 1992...
>
> The balance of payments and foreign exchange availability are perhaps the bleakest prospects...
>
> The foreign exchange shortfall will have knock-on consequences for the rest of the economy: export and import tax receipts will be below target, as will counterpart funds for public investment. Shortages of imported consumer goods and rice will accelerate inflation: in turn this will oblige more rapid devaluation to maintain the real exchange rate, especially with the instability of a unified rate.

The Guinea-Bissau evaluation is the only report which explicitly relates the structural adjustment programme to all five Swedish development aid objectives. The conclusion is summarised as follows:

> The current adjustment programme provides evidence of incompatibility with SIDAs development cooperation aims. It is increasingly less growth-oriented, and could focus a great deal more on economic and social equality and environmental issues. Recessionary adjustment may well have a negative impact on democratisation – or democratisation may postpone adjustment during the election period. National political and economic independence has suffered under adjustment. Above all, budgetary and balance of payments dependence on aid and imports has grown: foreign exchange, import and budgetary constraints are crucial (though not the only) barriers to renewed growth and adjustment in Guinea-Bissau.
>
> National political and economic independence has suffered somewhat under adjustment. Economic indicators show that the budget and balance of payments are increasingly dependent on aid and debt relief; and that domestic savings and investment rates have fallen. Independent macroeconomic policymaking has been overridden by the irresistible influence of the IMF and World Bank, and political pressure from other donors.

## IV.3 Recommendations for the Future

In view of the fact that Sweden's – and most other donors' – programme support is closely linked to the success and credibility of a particular country's structural adjustment programme, one might perhaps expect that the recommendations from the four authors as to continued Swedish import support should follow their assess-

ments of the respective programmes. This is not the case, however, as witnessed by the extreme cases: for Vietnam, where economic policies appear to have been most successful, the recommendation is to reduce Swedish import support, at least in a medium-term perspective, while the opposite recommendation is made for the least successful country, Guinea-Bissau.

In all four reports, a number of concrete recommendations are made regarding, for example, improved aid coordination, counterpart fund procedures, improvements in the foreign exchange regime, suggestions for fiscal policies, etc. Although most of these recommendations are highly useful and valuable for SIDA and for the country in question, they will not be listed in this summary report, which mainly addresses the macroeconomic issues of import support. The interested reader is therefore recommended to consult the individual country reports if he or she wants more information on particular issues.

**Guinea-Bissau**

The overall conclusion is that import support, given the critical shortage of foreign exchange that can be expected in a short and medium term scenario, is a highly useful form of assistance to Guinea-Bissau. Therefore, "SIDA should have no doubts about continuing with substantial import support to Guinea-Bissau. Import support has fulfilled – or could potentially fulfil – all of the goals intended by SIDA."

In a longer run perspective, however, "SIDA should aim to ensure that a successful adjustment programme will imply a reduction of its import support towards the end of the 1990s." The author recommends that additional Swedish funds to Guinea-Bissau be made available for "direct contributions to economic growth by project investments, particularly in infrastructure (roads and water transport), and small agro-processing industries. It could also increase its provision of technical assistance to increase macroeconomic policymaking capacity, particularly in debt and aid management".

As to the overall composition of the Swedish import support, the author recommends that: "the focus of SIDA import support should remain on imports for the agricultural sector, which is the most effective engine of growth of the economy and the key sector in which adjustment needs to have positive result."

To allow for, for example, imports of industrial inputs, or let the market alone decide, would reduce the positive effects:

> In the light of the stagnation and uncreditworthiness of the industrial sector, the question is whether in order to achieve an agricultural focus, it is necessary to have a positive list, or whether the private sector can be relied upon to supply the goods farmers want. The consultant has concluded that market determination of the goods imported would make SIDA import support much less efficient in promoting value for money, an efficient private trading system, and agricultural incentives. While the private commercial system is still so under-developed, there remains a need for the Guinean government to programme agricultural imports, in order to:
>
> – continue coordinated bulk purchases of goods and quality control, to maximise value for money;

– assist efficient coordinated bids for goods by traders, to avoid gluts and shortages of goods; and

– ensure that the goods imported are needed by farmers, rather than simply profitable for the private traders [Martin].

As for the use of counterpart funds generated by the sales of Swedish import support, the author concludes that "there is no need for SIDA to consider imposing conditions on the utilisation of its counterpart funds. However, it needs to push for timely implementation of the measures currently being taken under the adjustment programme, to ensure that budget expenditure is most effectively planned and implemented, and that use of countervalue is transparent and publicly accountable."

The author strongly suggests a higher profile of Sweden in the policy dialogue with Guinea-Bissau, and to counteract the dominant influence by other donors in general, and by the IMF and the World Bank in particular:

> The IMF and (to a lesser extent) the World Bank have not hesitated to insist on misconcieved adjustment policies, or to judge the the Guinean government record of implementation too harshly, over the Guinean government and SIDA misgivings.
>
> In this light, it is vital for SIDA to play a more active role in influencing the formulation and execution of economic policy and future adjustment programmes, at both the international and local levels. SIDA could take several steps:
>
> i) assisting the the Guinean government, in this crucial period when adjustment is suspended, in formulating its own coherent programme, to reduce dependence on IMF and World Bank advice. It is uniquely placed to continue this technical role as a 'friend of Bissau' before and after the elections;
>
> ii) insisting on participating in IMF and World Bank macroeconomic missions, particularly providing members for areas of SIDA expertise such as rural development and the social sectors;
>
> iii) organising formal meetings with all IMF and World Bank missions, preferably both bilaterally and in a local meetings of all donor representatives;
>
> iv) expressing SIDA views more forcefully in day-to-day meetings and contacts with the World Bank resident mission and local representatives of other donors in Bissau;
>
> v) lobbying the IMF and World Bank for more flexible and appropriate conditions, through its senior management and the Nordic Executive Directors in the IMF and World Bank, and through regular contacts with Fund-Bank desk officers.

The author, finally, urges SIDA to become more involved in donor coordination activities:

> The tasks of coordinating other donors and assisting the policy dialogue outlined in this section are large, and may require additional manpower in SIDA's Development Cooperation Office in Bissau and technical assistance expenditure. However, given the current suspension of the adjustment programme and the dire macroeconomic prospects of stagflation, there is no more effective way for SIDA to increase the effectiveness of its import support, and to improve the prospects of sustainable development for Guinea-Bissau.

**Mozambique**

High levels of foreign aid are, according to the Mozambique report, absolutely essential. For the growth strategy to be effective in 1991-93, continued high levels of capital assistance will be critical. Otherwise, the existing per capita income levels of USD 80-100 will not be sustainable, and the modest growth that is anticipated will prove impossible. Further declines in living standards would seriously jeopardize the viability of the economic reform programme.

The author quotes, approvingly, a World Bank memorandum, stating that

> Given the automatic link between donor aid and import levels, the reduction in imports of raw materials and incentive goods will immediately impact adversely on growth, and reduced investment and rehabilitation will produce a lagged relative fall in growth. Both agricultural and industrial development would be hampered [Sharpley].

The role of Sweden is regarded as crucial:

> The economic growth prospects for 1991-93 are not encouraging. Following pledges at the Consultative Group Meeting in December 1990 there were reasons to believe the level of donor assistance would increase in real terms in 1991...However, only a few of the donors responded promptly and with higher levels of real disbursements...To a large extent the economic and political viability of the economic reform programme in 1991-93 will depend on the level of untied Swedish commodity assistance, and the reliability and promptness of these disbursements in support of the priority sectors. Additional and timely balance of payments support is needed in 1991-93 if Mozambique is to avoid a sharp contraction in domestic credit, and deflationary monetary policies that would undermine economic growth.

The author identifies shortage of foreign exchange as *the* crucial bottleneck in the Mozambican economy, and does not regard the high dependency on foreign aid as serious at present.

As for the modalities of the Swedish import support, the author recommends an administered allocative system for import licenses rather than an open general license system with a market rate of exchange (as has been suggested by the IMF and the World Bank, and is presently being introduced in Mozambique):

> It is preferable that over the next one to two years SIDA resources should be disbursed through an administered system for the allocation of foreign exchange, rather than a non-administered (open general license) system. The institutional capacity of GCPI and the Central Bank to process import licenses and collect countervalue payments requires strengthening. The allocation of import licenses needs to be more closely integrated and co-ordinated with the banking system and fiscal budget so to provide access to domestic credit for productive activities. The unification of the official and secondary markets based on demand and supply forces is likely to be highly volatile in such a thin foreign exchange market, and a managed floating exchange rate system would be more stable and therefore conducive to medium term economic growth.

Since the author's assessment of the structural adjustment programme is highly favourable, the best thing Sweden can do is to provide untied programme aid to increase the viability of the programme. She concludes:

> In summary, over the period of the economic reform programme, commodity assistance in the form of untied import support and balance of payments support has been the largest and fastest growing component of Swedish aid and currently accounts for about half of total assistance. Sectoral programmes and project aid account for one-quarter of Swedish assistance, while emergency aid has tended to decline as a share of Sweden's co-operation programme with Mozambique, and technical assistance has remained at around 5 per cent of official development assistance. *These broad trends should be continued. More specifically, the level of untied commodity assistance should be increased in real terms, and emergency assistance should be slowly phased out. Technical assistance through the Personnel and Consultancy Fund should be maintained in real terms* [emphasis in original].

**Nicaragua**

The overall conclusion as regards the appropriateness of balance of payments support to Nicaragua under present circumstances is summarised in the following way:

> Obviously, the new economic situation of Nicaragua has many direct consequences for Swedish aid. It is clear that for the time being at least the economy has been stabilised and (thanks to developments in the capital account) the balance of payments has ceased to be the main overall constraint on growth (if it is one at all). Thus, import support and other balance of payments support should not have today the same priority for Swedish aid as they had during the 1980s. At the same time, given the policy of import liberalisation, where traditional and static comparative advantages should play a crucial role, manufacturing industry also should not be accorded today the same priority as before. On the other hand, the extraordinary neglect of the social sector makes it an urgent target for international assistance, particularly through non-governmental organizations, municipalities, local organisations, etc. Finally, in a country with a basically stable but not very dynamic economy, project aid could possibly become again an issue for consideration [Palma].

In the present adjustment programme, very little attention is paid to long-term issues. "In Nicaragua today", writes the author, "there seems to be abundant short-term finance (for both productive and speculative purposes), and very little for more long-term productive objectives, like investment."

In Nicaragua, as emphasised earlier, it is not only a question of new economic policies, but also of a new government, with new development objectives and priorities. Apparently, the author does not regard these priorities as fully compatible with Sweden's development cooperation objectives. Indeed, "the time seems to be ripe for a comprehensive re-thinking of the whole of the structure of Swedish aid to Nicaragua".

Instead of arguing for policy-related programme aid, such as untied import support, the author suggests that "within the new economic and social realities of Nicaragua, import support should be well down the list of priorities".

Indeed, instead of simply assisting the implementation of present policies, Swedish aid could be used to *compensate* for the Nicaraguan government's relative neglect of certain areas. After advocating a reduction of import support in general, the author continues: "However, the same does not necessarily apply to import support to energy, transport and health, because even if there is availability of foreign exchange in the economy, it is very unlikely that the government will allocate sufficient amounts of it to

these essential activities. In fact, one of the few things that everybody we interviewed in Nicaragua agreed with, was that today some of the main bottlenecks for the Nicaraguan economy are located in its very poor infrastructure – energy, roads, ports, transportation, etc." Also, since "social conditions in Nicaragua today are appalling":

> There can be little doubt that in Nicaragua today, as opposed to the 1980s, the social sector is in far greater need of Swedish aid than the productive one (particularly as the latter is given in the form of import support to large firms with, in some cases, a short life expectancy).

The skepticism towards present development policies in Nicaragua is also reflected in the author's recommendations to exercise a stricter control of countervalue payments and the use counterpart funds:

> Given the characteristics of the government in Nicaragua at the moment, it seems clear that SIDA should help to solve the impasse between the Central Bank and the Ministry of Finance regarding both the 'property' and the amount of counterpart funds. SIDA should also take a more active role in determining the use of counterpart funds to make sure that the beneficiaries are those sectors and activities that SIDA wants to help. The principle of least interference should only be applied in circumstances which have provided minimum assurances regarding the progressivenss of economic and social policies. [Also:] SIDA should ask for complete reports from the Nicaraguan government regarding the use of its import support and counterpart funds.

Clearly, Nicaragua is a case where present economic and social policies are not regarded as reasonably well in accordance with Swedish development cooperation objectives; for this reason, SIDA's priorities as regards the allocation of imports and the use of counterpart funds are therefore assumed to be "better" than those of the recipient government.

The author also emphasises – as in the cases of Guinea-Bissau and Mozambique – that "there is a clear need for greater coordination between different donors".

**Vietnam**

While useful at present, the author believes that Sweden's the role of import support in the Swedish aid programme should gradually be phased out in medium-term perspective:

> It follows from what has been said that the consultant believes that Sweden's commodity import support programme in Vietnam should continue, and that it should also continue to evolve. It is logical to seek to introduce the banks as a form of intermediary for determining which productive units are creditworthy, although the more successfully this is done, the more the present scheme will start to resemble general balance of payments support. Import support, for the present, is still useful in itself despite the very small (and declining) contribution which it makes to total import capacity...
>
> In the proximate future, however, say two to four years, a number of things are likely to happen that will render this form of aid less appropriate. Hard currency earnings will grow rapidly. The domestic banking system will become stronger and more sophisticated. Production units will become more used to operating in market

conditions, and those state owned enterprises that are unable to sustain themselves profitably will become fewer in number. With the lifting of the U.S. embargo, the World Bank and the Asian Development Bank will again start disbursing (assuming that arrears are cleared) and the Japanese may be expected to mount an aid programme. Direct private foreign investment, particularly from the Asian region, is likely to expand rapidly. Meanwhile, the state's own revenue raising powers may be expected to improve. If it so desires, the Vietnamese government will be able to have a structural adjustment programme – and some of the funding for it – from the IMF and the World Bank.

All of these events will progressively render Sweden's present form of commodity import support programme less relevant to Vietnam's needs...

At that point, in the consultant's judgement, it will become appropriate for Sweden to change its modality (and perhaps the scale) of its aid support for Vietnam. The commodity import support programme will have played its part and could be phased out in favour of project support, humanitarian aid, and – in particular – assistance through consultation technical assistance and training in the building of institutions appropriate for the successful running of a market economy [Faber].

As long as Sweden continues to give import support to Vietnam, the report recommends a further redirection of the support towards the private sector. The report also recommends a continued active role in the policy dialogue:

It follows from all that has been written in this report, that it is not the size of the import support programme that is of primary concern....What is important is that the programme should continue to be significant enough to justify Vietnam continuing its productive policy dialogue with the Swedish embassy and particularly with SIDA's Development Cooperation Office in Hanoi, which in turn entails the potential for Sweden to use some leverage in negotiating policy instruments, at least over those ranges of policies that are likely to effect the developmental efficiency of its own aid provisions.

# Concluding Remarks

Hopefully, the lengthy quotations in the preceding chapter from the country studies have served the purpose of presenting the different authors' main recommendations, as formulated in the reports. In order to provide a comprehensive overview of similarities and differences in the four cases, an attempt has been made in Table 7 below to summarise some of the main lessons and recommendations in a way that makes a direct comparison possible. I hope the authors of the four reports will accept my excuses for the somewhat rude way of summarising sophisticated and complex arguments into a "yes" or "no" or "plus" or "minus".

**Table 7. Summary of some major conclusions and recommendations from the four country studies.**

| | GUB | MOZ | NIC | VIE |
|---|---|---|---|---|
| Has Swedish import support played a positive role in the past? | yes | yes | yes | yes |
| Is today's structural adjustment programme successful and credible? | no | yes | well... | yes |
| Is the programme reasonably well in accordance with Sweden's overall objectives for development assistance? | no | yes | no | yes |
| Agreement with the IMF and the World Bank? | 1987 | 1987 | 1991 | no |
| Is the foreign exchange constraint critical at present? | yes | yes | no | no |
| Is the domestic currency overvalued? | no | no | yes | no |
| Was the domestic currency over-valued before structural adjustment? | yes! | yes! | yes! | yes! |
| Has aid dependency increased with structural adjustment? | yes | yes | yes | no |
| Would present policies be sustainable with lower levels of foreign aid? | no | no | no | yes |
| Should Sweden increase (+) or decrease (-) its import support in the near future, or maintain it as it is (0)? | 0 | + | - | 0 |
| In a longer-term perspective? | - | ? | - | - |
| Should Sweden attempt to control the use of counter-part funds? | no | no | yes | no |
| Has Sweden been active in the policy dialogue on macroeconomic issues? | no | no | a little | yes |

# BIBLIOGRAPHY

(a large number of country-specific official documents, SIDA memos, IMF and IBRD country reports, etc. are not included in this selected bibliography unless there is a reference to them in the text).


Aguilar, Renato & Zejan, Mario: ***Guinea-Bissau: Structural Adjustment and Beyond***, Department of Economics, University of Gothenburg & Department of International Economics, Stockholm School of Economics, August 1992

Van Brabant, Josef M: ***Socialist Economies: The Disequilibrium School and the Shortage Economy***, *Journal of Economic Perspectives*, Vol. 4, No 2, Spring 1990

Cassen, Robert, and Associates: ***Does Aid Work?***, Oxford University Press, Oxford 1986

Cassen, Robert, and Nissanke, Machiko, ***The Macroeconomics of Aid Dependence***, paper prepared for the World Bank Symposium on Africa's External Finance in the 1980's, Wash. D.C. September 1990

Corden, William L. and Neary, Peter: ***Booming Sector and De-industrialisation in a Small Open Economy***, *Economic Journal*, Vol. 92, 1982

Edwards, Sebastian: ***Real Exchange Rates, Devaluation and Adjustment: Exchange Rate Policy in Developing Countries***, MIT Press, London 1989

Faber, Mike: ***Macro-economic Evaluation of Sweden's Import Support to Vietnam***, SIDA Planning Secretariat, Stockholm, May 1992

Findlay, Ronald: ***International Trade and Development Theory***, Columbia University Press, New York 1973

Griffin, Keith: ***Foreign Capital, Domestic Savings and Economic Development***, *Bulletin of the Oxford University, Institute of Economics and Statistics*, Vol. 32, No. 2, May 1971

Griffin, Keith & Enos, John: ***Foreign Assistance: Objectives and Consequences***, *Economic Development and Cultural Change*, Vol. 18, 1970

Holmes, Sir Frank (ed): ***Economic Adjustment: Policies and Problems***, IMF, Wellington, New Zealand, 1987

Hughes, Helen: ***The Role of Aid and Private Capital Inflows in Economic Development***, in Holmes (ed), 1987

***Counterpart Funds and Development***, *IDS Bulletin*, Special Issue, Vol 23, no 2, April 1992

Kornai, Janos: ***The Soft Budget Constraint***, *Kyklos*, Vol. 39, No. 1, 1986

Lundström, Hans: ***Economic Adjustment and Swedish Assistance***, in Fruhling, Pierre (ed), ***Recovery in Africa. A Challenge for the Development Cooperation in the 90s***, Ministry for Foreign Affairs, Stockholm 1988

Martin, Matthew: ***Macroeconomic Evaluation of SIDA Import Support to Guinea-Bissau***, August 1992 (draft)

Mosley, Paul, Harrigan, Jane, & Toye, John: ***Aid and Power. The World Bank & Policy-based Lending***, Routledge, London 1991

Nagaoka, Sado and Atiyas, Izak: ***Tightening the Soft Budget Constraint in Reforming Socialist Economies***, The World Bank Industry and Energy Department, working paper No. 35, May 1990

Palma, Gabriel: ***Macro-economic Evaluation of Sweden's Import Support to Nicaragua***, SIDA Planning Secretariat, Stockholm, April 1992

Qureshi, Moeen Ahmed: ***Policy-based Lending by the World Bank***, *Journal of International Development*, Vol. 3, No. 2, 1992

Rebelo, Pamela: ***Swedish Assistance and the Current Context of Commodity Import Support Programmes in Mozambique***, report for SIDA, Maputo 1991

Roemer, Michael: ***The Macroeconomics of Counterpart Funds Revisited***, *World Development*, Vol 17, No 6, June 1989

Scott, Chris: ***Soft Budgets and Hard Rents: a Note on Kornai and Gomulka***, *Economics of Planning*, Vol. 23:2, 1990, pp.117-127

Sharpley, Jennifer: ***Macro-economic Evaluation of Swedish Import Support to Mozambique***, SIDA Planning Secretariat, Stockholm, November 1991

SIDA: ***"Principer för svenskt importstöd"***, mimeo, Stockholm August 1992

Stymne, Joakim: ***Importstöd. Principer och problem***, SIDA Planning Secretariat, June 1984

UNDP: ***Human Developmment Report***, various issue

White, Howard: ***The Macroeconomic Impact of Development Aid: A Critical Survey***, *The Journal of Development Studies*, Vol. 28, No. 2, January 1992

Van Wijnbergen, S: ***Aid, Export Promotion and the Real Exchange Rate: An African Dilemma?***, World Bank, ***CPD Discission Paper*** No. 1985-54, Washington 1985

De Vylder, Stefan: ***Biases and Distortions in Socialist Economic Policies: Some Lessons from the Third World***, in R. García (ed): ***Central America: Crisis and Possibilities***, The Institute of Latin American Studies, Stockholm 1988

De Vylder, Stefan, and Fforde, Adam: ***Vietnam. An Economy in Transition***, SIDA, Stockholm 1988

World Bank: ***World Development Report***, various issues

# SIDA EVALUATION REPORT SERIES

**1988/3**
**IMPROVE YOUR BUSINESS**
An Evaluation of an ILO/SIDA Regional small scale business promotion Project in Africa by Claes Lindahl and Rob Dainow

**1989/1**
**THE KOTMALE ENVIRONMENT**
A Study of the environmental impact of the Kotmale Hydropower Project in Sri Lanka by Dick Johansson

**1989/ 2**
**FISH FARMING FOR RURAL DEVELOPMENT**
An Evaluation of SIDA/FAO supported aquaculture in southern Africa by Karlis Goppers and Jim Miller

**1989/3NO SHORT CUTS TO HEALTH**
An Evaluation of SIDA health sector support to Zambia 1979-1988 by S. Dahlgren, V. Diwan, K. Eduards, A. Gunnarsson, L-K. J. Mwansa, R. S. Patel, O. S. Saasa, T. K. Sinyangwe

**1989/4**
**FROM COMPETITION TO CO-OPERATION?**
An Evaluation of MEIDA and its impact on the engineering industries in Tanzania by Jerker Carlsson, Kim Forss and Serve Malai

**1990/1**
**CONCERN AND RESPONSIBILITY**
An Evaluation of the Dodota Water Supply project by Eva Poluha, Göran Engstrand, Annika Idemalm, Johan Melchert and Judith Narrowe

**1990/2**
**CENTRAL AUTHORITY BLOCKS LOCAL AUTONOMY**
An Evaluation of SIDA support to Local Government in Zimbabwe 1983-1989 by Lennart Gustafsson, Anthony Redmond and Christopher Rambanapasi

1990/3
**NEW PATHS FROM POVERTY**
An Evaluation of SIDA Rural Employment Sector Support to Bangladesh 1986-1989 by Nigel Hawkesworth, Md Mainul Islam, Mahmuda Islam, Ton Jansen, Ole Lindberg, Sadrel Reza and Else Skjønsberg

1991/1
**AID UNDER FIRE**
An Evaluation of the Mozambique-Nordic Agricultural Programme (MONAP), by Yussuf Adam, Robin Goodyear, MartinGreeley, Mick Moore, Julio Munguambe,Miguel Neves, Penelope Roberts, Gulamo Taju and Sergio Vieira

1991/2
**A FLAWED SUCCESS**
An Evaluation of SIDA Support to the Kotmale Hydropower Projectby Bjørn Gildestad, Erland Kleivan and Tor Stavsholt

1991/3
**THE ART OF SURVIVAL**
A study on sustainability in health projects by Lillemor Andersson-Brolin, Birgitta Lorentzson, Ole-Memiri, Elisabeth Michanek and Daniel Ndagala

1991/4
**KEEPING THE GOALS IN SIGHT**
An Evaluation of Swedish support to public administration in Zimbabweby Lennart Gustafsson, Peter Blunt, Duduzile Chandiwana, Peter Gisle, Charles Katiza, Desire Sibanda, Stefan Sjölander and Robert Tendere

1991/5
**JOINING FORCES**
An Evaluation of the Cooperative Integration in Central America and the Caribbean through CCC-CA/SCC by Elisabeth Lewin and Guido A. Monge

1992/1
**BIRCHES DON'T GROW IN SERENGETI**
An Evaluation of Development Policy and Nordic Support to the Construction Sector in Tanzania 1975-1990by Sune Björklöf, Tage Klingberg, Boniface Muhegi and Abisai Temba

1992/2
**THOUGHTS FOR FOOD**
An Evaluation of the Tanzania Food and Nutrition Centre by Michael C. Latham, Lillemor Andersson-Brolin, Britta Antonsson-Ogle, Elisabeth Michanek, Winnie F. K. Mpanju and Jumanne W. Wagao

1992/3
**DOI MOI AND HEALTH**
An Evaluation of the Health Sector Programme between Viet Nam and Sweden by Jan Valdelin, Elisabeth Michanek, Hans Persson, Tran Thi Que och Bo Simonsson

1993/1
**HEALTH THROUGH SANITATION AND WATER**
An Evaluation of the SIDA supported HESAWA programme in the Lake Regions of Tanzania by Jo Smet, Phil Evans, Mary Boesveld, François Brikké, IRC – International Water and Sanitation Centre. Isaack Oenga and Daniel Makerere, African Medical and Research Foundation.

# *Aid and Macroeconomics:*

## An Evaluation of Swedish Import Support to Guinea-Bissau, Mozambique, Nicaragua and Vietnam

Import support is a form of foreign aid consisting of a grant of foreign currency to a developing country. SIDA gives such grants to certain countries, on the condition that the recipient governments sell the foreign currency to domestic firms and implement economic reforms. SIDA paid SEK one billion in import supports to eight program countries during fiscal year 1991-1992.

SIDA recently commissioned independent evaluations of import support to Guinea-Bissau, Mozambique, Nicaragua, and Vietnam. In this report, Stefan de Vylder summarizes these four studies as well as reviewing the macroeconomics of import support.

Twenty years ago, import support was considered a "residual" form of aid, easy to administer but not as good as project aid. Now it is considered an important way of supporting necessary economic reforms in developing countries.

Import support is largely motivated by theories showing how shortages of capital or foreign currency can hinder economic growth. De Vylder warns that aid can have adverse effects on a developing country's foreign currency earnings, by enabling a recipient government to pursue policies which hurt exports, by appreciating the recipient country's exchange rate, or by increasing inflation.

The evaluations conclude that import support has played a positive role in all four countries, but the structural adjustment programs in these countries have met with mixed success. In all countries the foreign exchange rates had been significantly overvalued, and in most countries they are no longer. Foreign currency will continue to be the key restraint on growth in Guinea-Bissau and Mozambique in the future.

Copies of this report can be ordered from SIDA, S-105 25 Stockholm, Sweden.

SIDA