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Community support for structural adjustment in the ACP countries: towards the consolidation and strengthening of a realistic and concerted approach.

CONTENTS

COMMUNITY SUPPORT FOR STRUCTURAL ADJUSTMENT IN THE ACP COUNTRIES: TOWARDS THE CONSOLIDATION AND STRENGTHENING OF A REALISTIC AND CONCERTED APPROACH.

INTRODUCTION

The Community is a major technical and financial partner of the ACP countries and it was natural, therefore, that those implementing economic adjustment programmes should have approached the Community for assistance.

There were various specific reasons for this. The countries were facing unprecedented economic and financial difficulties, which required the commitment of appropriate financial resources; or else they were still not reaping the benefits, in the form of desired economic growth rates, from the reforms that they were implementing at high social cost; or, further, they were experiencing difficulties in their negotiations with those unavoidable financial partners in the sphere of adjustment, the Bretton Woods institutions. All these factors explain the ACPs' wish to involve the Community, both in the assessment of their programmes and in the financial support which it could bring to them.

The Community met these expectations and by the end of negotiations with the ACP countries support for structural adjustment was formally provided for in the fourth Lomé Convention.

This decision constituted a major political act. It was the first time that, in such a sensitive, perhaps even controversial, matter, specific provisions laying down objectives, guidelines and implementation methods for adjustment support had been freely negotiated between the developing countries and their external partners.

The first interim report setting out guidelines and practical arrangements for involving the Community in structural adjustment in the ACP countries resulted in a Council resolution adopted in May 1992. In it the Council reaffirmed the need for the Community to help restore the major macroeconomic balances in the countries concerned, against the background of the wider aim of creating conditions for the resumption of growth and an improvement in the welfare of the people.

The joint reports presented by the ACP-EEC Development Finance Cooperation Committee to the ACP-EEC Council of Ministers in March 1992 and April 1993, and the ACP-EEC Council resolutions resulting from them, endorsed the measures adopted since the signing of the Convention and the main guidelines for future action in implementing structural adjustment support.

There can of course be only one reform programme in any given country. Advancing beyond the specifically financial aspect of making funding available for adjustment support, and rather than leaving it to the Bretton Woods institutions to determine the reform programme and then insert the Community support component, the Commission followed the prompting of the Convention and opted for a more ambitious approach consisting in providing an input into the design of the programme itself.

The intention was not to open up parallel lines of action but rather to ensure that Community concerns as expressed in the text of the Convention were taken fully into account when reform programmes were drawn up.

With its role as a major player in the economic adjustment process acknowledged, the Commission concentrated on developing its expertise by focusing its efforts on the factors regarded as essential in the light of the Convention, namely: finding a balance between adjustment and long-term development, adjusting the pace of reform to each country's specific capacities and constraints (including social and political resources and constraints), making allowance for the regional dimension and safeguarding the social sectors, this last being the key to the sustainability of the process by combining growth objectives with considerations of equity.

In order to establish its credibility the Commission acted quickly to formulate a short-term core of priority actions:

(i) first, by ensuring stricter coherence between all Community instruments (Stabex, food aid, etc) in order to comprise not only a "critical mass" in the financial sense but also to provide a significant package of effective economic and sectoral reforms;

(ii) in addition, by taking an increasingly active interest in public finance in the countries concerned, in order to help them improve their budget procedures in terms of transparency, integrity, efficiency and equity, and to identify means of checking compliance by the ACP States with their budget undertakings, thereby providing security for the financial assistance provided by the Community;

(iii) lastly, by strengthening coordination with other donors - including the Member States, the IMF and the World Bank - both at the programme design stage and at the operational level, in order to exert a moderating influence on the process by arguing wherever possible for a strict but also realistic approach to adjustment, differentiated where appropriate, and above all humane.

At the same time the Community implemented a series of support programmes to help some thirty ACP countries meet their financing requirements in 1991-92 and again in 1993-94.

Meanwhile, major international discussions were taking place on structural adjustment and its effects and implementation, the question of renewing the IMF's Enhanced Structural Adjustment Facility (ESAF) and the prospects for the third phase of the SPA[1] to cover

[1] Special Programme of Assistance for Africa.

the years 1994-96. These discussions were based, in general, on the initial conclusions of the studies carried out by those variously involved in the adjustment process.

The Community has also embarked upon important negotiations for the renewal of the Financial Protocol under the fourth Lomé Convention, in which structural adjustment will retain a significant place.

Now is therefore a particularly good time to take stock of the quantitative and qualitative aspects of the Community's involvement in support for economic reform, to summarise current thinking and to spell out all the lessons to be drawn from the first round of Community involvement, in terms both of resources mobilized and the general approach adopted.

The gravity of the situation of the ACP States in general - and of Africa in particular - together with the reservations forming part of the conclusions to be drawn from a decade of adjustment in the region call for concerted action by the donor community, in which the European Union has a major role to play.

I. THE CONTEXT OF COMMUNITY ACTION

1. An international climate still working against the ACP

External factors have continued to be unfavourable and have helped produce particularly difficult economic conditions for the countries under adjustment, thus dampening the positive effects expected from supply side reforms and aggravating the adverse impact of financial reform policies.

The deterioration in the terms of trade and the downward trend of prices for the main commodities (coffee, cocoa, phosphates, oilseeds, etc.) to levels lower than at any time since the Second World War, together with price and exchange rate instability, had a proportionately greater impact on countries with economies largely dependent on commodities, notably agricultural commodities.

Commodity agreements, negotiations on which have become seriously bogged down, failed to provide a means of offsetting certain adverse effects of market trends.

The high interest rates of recent times and the dwindling or even disappearance of external private capital flows have in many cases worsened external balances, already affected in most of the countries concerned by structural trade deficits. The combined effect of the overall unfavourable world trade situation, from the standpoint of the ACP countries, stemming from pressure exerted by newcomers on world markets (countries in south and south-east Asia, for example) in a climate of fierce trade rivalry between Europe, the United States and Japan, and also the absence of the ACP countries from the major international negotiations, resulted in a continual shrinking of markets, in the face of which the measures adopted by the countries concerned (not always convincingly, it is true) with regard to productivity, competitiveness or exchange rates were of no avail.

On top of this external debt has continued to increase during the adjustment period, with a steep increase in the portion of the debt that cannot be rescheduled, despite the fact that in recent years appreciable progress has been made in the treatment of debt. The burden of this debt and the need for adjustment measures geared to dealing with it have become an unavoidable aspect of adjustment programmes.

2. A particularly unstable social and political background

War and serious political disturbances have continued in some countries - especially in Africa - bringing instability even as they search for new and more democratic systems. Political instability and the uncertainties dogging the initial moves towards democracy have in many instances upset the delicate balance between the social and political background and the economic policies from which the people, after decades of quiescence, are now entitled to expect positive results in terms of living standards and social progress.

At the same time those newly responsible for government are themselves having to come to terms with democracy, with its train of agreements to be reached and social and political balances to be struck, and realizing that while the favourable effects of their economic policies may be slow in coming, their adverse consequences accrue immediately.

3. Disappearance of traditional economic development growth centres

The countries which in the past provided (or might have provided) the driving force for development in their region, pulling their neighbours' economies along with them to some extent, have lost a great deal of their influence, either because of the particularly serious nature of the economic and financial situation they themselves are facing, or because they are having to deal with social and political disturbances degenerating substantially into virtual civil war, or else because, failing to find the necessary degree of consensus, they end by drifting inevitably towards a compounding of both kinds of crisis.

The situation in Africa is particularly striking from this point of view since the former economic heavyweights are today in the most serious difficulties. It is to be hoped that the recent devaluation of the CFA franc will enable some of these countries to shake off the crisis and thereby return to the path of growth.

4. Strong international competition for available financial resources

Although the international community has endeavoured on many occasions to reassure the developing countries, a number of developments in recent months indicate that they are tending to receive relatively less attention, at least in terms of financial resources that are available or can be made available.

The renewal of the ESAF, the IMF's most concessional instrument for supporting structural adjustment policies - and one targeted on the poorest countries - has run into problems stemming from lack of financial resources following the withdrawal of some bilateral donors.

The last SPA meeting revealed a difficulty - not previously encountered in that forum - in finding all the funds required for phase 3, which was planned to meet the financing needs of the countries concerned for the years 1994-96. So far, less than 70% of requirements is covered and there is a danger that adjustment in the countries concerned will be underfinanced - and hence ineffective - unless corrective measures are taken. Failing a significant additional financial effort on the part of donors, the source of such measures can lie only in more radical treatment of the countries' external debt.

In this connection it is vital to understand that in spite of all the undertakings given there is still no long-term solution to the debt problem, since the amount owed has increased steadily and the overall effect of successive reschedulings has merely been to shift the heaviest part of the burden into the future.

5. Yet economic adjustment had become inevitable for most ACP countries

Adjustment aims to restore various kinds of economic balance where these have been upset and to adapt economies to the facts of a changed international economic situation. It became an unavoidable necessity for the countries concerned because of their critical economic, financial and, consequently, social difficulties and the tottering structure of their economies.

Some developing countries were able to postpone this adjustment process through massive borrowing, but it is now clear that they could put it off no longer; as a logical consequence, the adjustment issue now dominates relations between developing countries and their external partners and has become the required basis of dialogue between them and the donors.

In these circumstances, a growing proportion of the funds channelled to developing countries is allocated by reference to adjustment programmes, and no debt processing operation can be carried out unless the debtor country has first concluded an agreement with the International Monetary Fund. This fact demonstrates to what extent adjustment has become an absolute necessity for the vast majority of ACP countries.

II. SOME FIGURES

1. Community contribution

Between the entry into force of Lomé IV and the end of September 1994, the Commission adopted 54 financing decisions allocating to 36 countries eligible for structural adjustment support a total of ECU 1 098 million, made up of ECU 856 million in special structural adjustment resources and ECU 242 million from national indicative programme resources.

By the end of 1994, the total will have risen to an estimated ECU 1 180 million, including ECU 920 million in special structural adjustment resources (out of a grand total of ECU 1 150 million provided for under the Convention).

In 1990 and 1991, the first allocation was assigned to 41 potentially eligible countries, of which 35 were notified of their first allocation, in line with Article 281 of the Convention.

By the end of 1992 only 21 of these countries had managed, with the financial support of the Community, to put their structural adjustment programmes into effect.

This means that half of the potentially eligible countries have been unable to exploit that eligibility, and that funds available to active countries have been frozen. There are several reasons for this. The most important of these have been the linkage between the automatic eligibility established in the Convention and the position of the Bretton Woods institutions in their reviews of programme performance (including their reaction to programmes going wrong), but also the relatively frequent infringements of democratic processes and human rights (a key element of the Convention) during the first few years of implementation.

2. Distribution of resources

In response to this situation, a new method of distributing resources was used for the second allocation, based on a more direct link between eligibility, allocation of funds and implementation, and on annual disbursement targets for active countries, revised at the end of each financial year.

These new procedures made it possible to give more support to countries successfully pursuing their reform programmes with the help of the main donors, and to achieve higher disbursement rates.

At the end of September 1994, from both allocations, of the ECU 1 098 million approved in financing decisions some ECU 725 million (66%) had been disbursed, of which ECU 600 million from specific structural adjustment resources.

3. Use of instruments

Community support has most frequently taken the form of general import-programmes, this being the instrument that is best suited to the requirements of across-the-board economic liberalization, and to the needs of convertible currency economies such as those of the franc zone, given that the current regulations preclude giving direct budgetary assistance to the countries concerned.

This aid, which is made available to the central banks of the countries concerned, has provided economic operators with the currency they require to pay for their imports.

The programmes have generated counterpart funds that have been gradually integrated into a macroeconomic approach linked with financial and monetary balances in the countries concerned, as opposed to past practice, which assigned them only a micro-economic role.

The funds have been used as part of a single, coordinated budget policy to cover public operating and capital expenditure, thus enabling the Community to act as the Convention directs in support of essential social services and the maintenance of economic and social infrastructure.

Nearly 70% of the counterpart funds generated by the financing decisions have been allocated to the social sector, with basic health care and primary education the main beneficiaries, and nearly 10% has gone to the maintenance of infrastructure, particularly roads. Employment has received around 4% of the total, while financial restructuring in the agriculture and parastatal sectors has accounted for the balance.

In addition to allocating resources to national budgets, the Commission has also promoted structural changes in the budgets to target spending on the priority health and education sectors, and to reflect real needs in terms of infrastructure maintenance. This has entailed an ever-closer involvement in public expenditure reviews, often in collaboration with the World Bank.

4. Implementing conditions

There has been no major problem in monitoring compliance with the conditions imposed with regard to the implementation of Community measures. The organization of these conditions into a three-level hierarchy has enabled a balance to be struck between the problem of subjectivity that can affect the assessment of a general programme and the importance attached to special, suspensive, often sector-specific, conditions, which together comprise the basic factors determining the effectiveness of Community support.

The first-level conditions are of a general nature, and allow the Community to remain independent in its assessment of the general framework of the adjustment process in question. It is often at this level that the detail, and the sheer number, of the conditions specified in the "contracts" concluded with the Bretton Woods institutions can generate one-off delays and ultimately create a "stop and go" policy situation.

The Community has managed to avoid such delays by focusing on a second level of conditionality consisting of a few powerful and effective conditions reflecting the specific macro-economic and/or sectoral objectives pursued, although this approach does entail the risk of a temporary breakdown in the necessary coordination of the measures conducted by the body of international donors as a whole. There is as yet no definitive solution to this problem.

While an adequate degree of non-negotiable detail is essential, common sense dictates the need for a certain amount of flexibility, which will obviously contain elements of subjectivity if the aim is to achieve something approaching a fair assessment of national constraints.

The third group of conditions are administrative and financial. Here the Commission has developed a range of monitoring and inspection techniques that facilitate the integration of Community support into the procedural framework of the country concerned, as regards both the provision of foreign exchange and the use of counterpart funds in line with strict budgetary procedure.

Experience has shown that internal procedures and modalities for decision-making and payment are ill-suited to the requirements of the adjustment support instrument, where the priority is to provide rapid disbursement without sacrificing any administrative rigour. A major drive to rationalize monitoring and decision-making procedures has recently been carried out.

III. FIRST QUALITATIVE RESULTS

1. In-house

(a) In addition to the harmonization of internal control procedures and the introduction of tailor-made monitoring and inspection procedures in the Commission and decentralized procedures at national level, there has been a major reorganization which has produced greater coherence among the Community's aid instruments, based on their integration with sectoral policies and on a clearer perception and better analysis of the macroeconomic situation in each country.

(b) The Commission has developed its in-house expertise on the horizontal issues that are the subject of the Convention's main guidelines for structural adjustment support.

Assessment of the social aspects involved has led to new guidelines on food security and nutrition, health, education, training and employment.

One of the main components of the practical procedures for the financial implementation of adjustment support is the use of counterpart funds as part of a coherent national budget strategy. The Commission has developed a procedure based on the Council Resolution of May 1991 whereby a blanket approach is adopted to all counterpart funds, irrespective of the instrument by which they are generated.

It is through the restructuring of public expenditure that help for the priority social sectors will have a viable, sustainable impact. This explains the Commission's increasing involvement in public expenditure reviews, which has entailed coordination with the other donors.

The Commission's development of health, employment, education and training policies will facilitate involvement in the social sectors and the related public expenditure decisions.

(c) In line with one of the Convention's main guidelines, a special effort has been made to allow for the regional aspects of adjustment, particularly as regards the repercussions of national adjustment measures on regional integration policies, and the need to tailor national policies to the regional context. The Commission has assessed the convergence of national economic policies at regional level and the possibility of supporting the establishment of multilateral monitoring schemes in some regions.

(d) As its evaluation of the impact and content of adjustment policies and the practical aspects of implementing Community support has taken shape and improved, the Commission has launched a series of in-house studies on such issues as the sequence of reforms, the effectiveness of foreign exchange allocation systems, the pertinence of import programmes and the impact of the tax system on income distribution.

2. At Community level

The emphasis has been on strengthening coordination with the Member States along the following three lines:

(i) upgrading instruments and implementation procedures by bringing them into line with the requirements stipulated by the Member States and matching them to the macroeconomic framework within which they operate;

(ii) developing a Community approach and the makings of a strategy in priority areas of Community action, e.g. health and agricultural exports;

(iii) developing a framework of regular Community consultations prior to and during the course of the meetings of major international structural adjustment bodies; the structure mainly used for this purpose has so far been the SPA.

However, Community coordination remains limited and should be further developed.

3. At international level

It is probably at this level that the Commission's efforts to gain credibility for a specific Community voice have been most successful, particularly in the framework of the SPA.

(a) The Commission has actively participated and will continue to participate in ad hoc working groups on:

- restructuring public expenditure and improving the efficiency of national budget procedures through regular public expenditure reviews;

- general studies carried out by a number of bodies to assess the impact and results of structural adjustment;

- measures to combat poverty and the integration of this issue in structural adjustment programmes.

(b) Wherever possible, the Commission has urged the importance of various key issues, drawing them to the notice of other major donors.

For example, the link between democracy and adjustment has been the subject of in-depth assessment jointly led by the Commission and the United States. The aim is first of all to avoid the short-term negative impact of economic reform on democratization, e.g. by being more realistic as regards the timing of the introduction and intensification of measures, or in respect of the conditions imposed. It is also vital to exploit synergies between the two processes: if they can be made to support each other, the long-term viability of the reforms will be better assured. The dialogue that develops in a democracy is the very essence of what has become known as the "internalization" of reform programmes; however, the democratization process can often be fragile, and such dialogue is bound to lead to certain changes which may temporarily halt the reforms in a given country. It is hard to strike the correct balance between the social and political consequences of the changes ushered in by the imposition of economic discipline and the legitimate aspirations of the people, who are entitled to expect positive economic results from the reforms.

A second factor, already emphasized by the Convention and one which should become a major element in the adaptation of adjustment policies following the Commission's campaigning, is that of the pace of the reforms and the sequence in which they are introduced in line with the specific needs of the country concerned. Several studies are currently being carried out with the active participation of the Commission, with the aim of striking a balance between the sequence of economic and financial policies required by the gravity of the situation (e.g. foreign exchange shortages, non-financeable budget deficits or liquidity crises), the importance of not stifling investment and the supply side in the long term, and the need to make due allowance for the constraints imposed by the social and political liberalization process.

The third issue actively promoted by the Commission is that of the implications of national structural adjustment policies for regional integration prospects, and more generally the regional consequences of national policies. This initiative has produced work in collaboration with the IBRD, the IMF and other donors such as France and the African Development Bank, in West Africa (with the West African Economic and Monetary Union), in southern Africa, the Indian Ocean (with the Cross Border Initiative) and, nearing completion, in Central Africa. The prospects for regional integration or its promotion have never been so positive, or so favourable as a path to growth.

The Community remains a major partner of the ACP countries primarily because of the large sums of money made available for long-term investment, long-term social and economic development being the Convention's most important objective. The sheer scale of the economic and financial problems with which most of the countries concerned are confronted could have resulted at one stage in long-term development aims being sacrificed to the imperatives of structural adjustment, in the guise of restoring the major financial balances. The Commission has been campaigning precisely to make its partners aware of the need to reconcile the two sets of objectives and procedures.

The general conclusions of the SPA meeting of November 1993 show that the concerns the Commission has been expressing for several years are now on the agenda, at least in terms of general principles. Greater attention to the sequence of the reforms in forthcoming adjustment programmes and a more realistic approach to the conditions they impose, tailored to local perception and implementation capacities, will be a major feature of the third phase of the SPA. In the same way, regional integration and trade promotion programmes will be broadly integrated into adjustment programmes and supported by specific reforms.

This change of heart among our partner donors to countries undergoing adjustment demonstrates the extent to which participation in the relevant international forums can be used to wield influence. At the Commission's instigation a general consensus has been achieved on the basis of the main principles underpinning the Convention, although much work has still to be done to translate the guidelines into practical measures. Case by case, country by country, the tasks awaiting the development cooperation community are onerous, but thanks in large measure to the Community's input, a realistic, practical and humane approach to adjustment has begun to emerge.

(c) To give greater weight to its concerns, the Commission is chairing the working groups responsible for the most sensitive issues:

- the link between democracy and adjustment, the aim being to reconcile economic reform policies with the realities of democratization;

- public expenditure reviews designed to: improve national budget planning and implementation; restructure spending, giving priority to key social services and the maintenance of basic infrastructure; improve spending efficiency and safeguard donors' financial contributions.

4. In the recipient countries and regions

(a) Wherever possible, the Commission participates in the preparation of reform programmes, particularly through close involvement in sectoral policies.

(b) The Commission is increasingly working with the World Bank and other donors on public expenditure reviews, focusing its input on sectoral issues in the fields of health, education and infrastructure maintenance.

(c) The Commission is playing an active role in the following three regional programmes currently under way in Africa, all designed to promote - to varying degrees - economic integration, customs harmonization, and trade:

- a programme to facilitate intra-regional payments, trade and investment in East and southern Africa and the Indian Ocean;
- a reform programme to set up the West African Economic and Monetary Union;
- a regional reform programme for the Central African Customs and Economic Union;

IV. EFFECTS OF ADJUSTMENT: CONCLUSIONS FOR AND AGAINST

1. Adjustment: unavoidable, but with ambiguous results

Structural adjustment has for several years been the subject of debate, criticism and controversy and, more recently, there have been numerous evaluations carried out by such bodies as the World Bank, the IMF and UNCTAD. The Commission has contributed to this debate with its own study, carried out by a team of European researchers, evaluating the results of economic reforms introduced by ACP States.[2]

One common factor that emerges from all these evaluations is the undoubted difficulty, when assessing economic performance, of mechanistically identifying those effects which may be ascribed to policy reforms and those which are brought about by external factors. In the same way, it is hard to gauge objectively the relative impact of economic recession and that of adjustment.

The second constant is that the African countries have generally been less successful than other developing countries, or their economies have suffered more.

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[2] "Adjustment and development - the experience of the ACP States". This study was carried out at the request of the Commission by the *Centre d'Etudes et de Réflexion des Dirigeants* with UK, French and Italian researchers, under the direction of Patrick and Sylviane Guillaumont.

Some general positive observations can be made about the developing countries as a body:

- the countries that have adopted adjustment polices have, on average, achieved faster growth (4.2% in 1986-90) than those that have not (2.4%);

- adjustment policies have generally reduced budget deficits, from an average 8.5% of GNP in 1980 to 4.2% in 1990 in countries undergoing adjustment, whereas the figure has remained a constant 6.5% for the others (though it has to be remembered that such reduction was the central aim of the first generation of stabilization programmes);

- inflation has generally been better controlled in countries undergoing adjustment, particularly in middle-income countries, by means of extremely tight monetary and lending policies, a key feature of stabilization programmes;

- in countries undergoing adjustment, real exchange rates have been brought back to levels that are more commensurate with the economic fundamentals.

Evaluation has also revealed, however, some rather more worrying features:

- structural rigidities have promoted poor resource allocation, to the considerable detriment of the social sectors;

- the substantial reductions in public expenditure have been made at the expense of maintaining economic and social infrastructure, which has in many cases ceased to operate;

- investment has stagnated where it has not decreased;

- external imbalances deriving from trade and capital transfer trends have not been genuinely or durably corrected;

- the external debt situation has not improved, and has in some cases (e.g. Africa) deteriorated.

In other words, financial stabilization has frequently been more or less a success in the very short term, but the underlying economic trends have not been reversed and the positive effects of adjustment, particularly in terms of growth, have been slow to appear.

This is certainly the case in Africa, which was recently the subject of an additional World Bank study in the context of the SPA ("Adjustment in Africa", March 1994).

The conclusions of that study are somewhat reserved. While a limited number of countries have indeed achieved growth in the agriculture and industry sectors by adopting the appropriate macroeconomic policies on agriculture and trade, these results are meagre when seen in the light of population growth and achievements elsewhere in the world.

Many countries, struggling increasingly to meet their reform commitments and the conditions attached to the support of their donors, have also been obliged more or less to abandon, or at least cut, their reform programmes.

This contrasts with the situation in south and south-east Asia, where the economies of the newly industrialized countries are now growing after a brief period of recession. While it is true that these countries had fewer macroeconomic problems to start with and already possessed a well-developed private sector that proved capable of adapting to structural reforms, the key point is that the specifics of their economic policies have been relatively varied, and they have been able to adapt to their own circumstances and strategies the theoretical models that have generally underpinned orthodox adjustment policy on trade liberalization, state intervention in production, and so on. In fact, the only constant discernible among these countries - and it is of tremendous significance - is the high concentration of qualified human resources compared to the average situation in the ACP countries, particularly in Africa.

The World Bank sought to explain Africa's plight in terms of this lack of qualified human resources, also citing its inadequate and dilapidated infrastructure, lack of economic diversity, fragile economic fabric, inefficient public institutions and economic distortions on a scale not known elsewhere. It concluded that adjustment would take longer than expected in the low-income African countries, and that, to attain the target of long-term development, considerable sums should be allocated to investment, which had unfortunately been neglected in favour of short-term financial programmes over the last ten years.

The Community would certainly endorse this conclusion, having for several years argued that adjustment should not be imposed at the expense of the long term, and that short-term requirements should not mask the need to finance basic infrastructure, develop human resources, ensure food security, etc.

However, besides purely economic rigidities, there are other factors involved that argue in favour of a more realistic approach not only to the results expected from adjustment, but also to the definition of its procedures and conditions.

2. Some critical comments

The Commission's commitment to a realistic approach, now shared in the SPA context as a whole, is based on a critical analysis covering the ACP countries as a body.

The paper on "Adjustment and development" (see footnote 2) stresses that adjustment has encouraged the development of the informal sector, has failed to allow for the long term, and has not been "internalized".

(a) Informal adjustment: there is no doubt that the informal sector has grown significantly over the last ten years. This comes as no surprise. Being subject to little official regulation, particularly as regards pay and working conditions, and requiring little in the way of capital, the informal sector is well placed to adapt spontaneously in line with market trends. In countries obliged to undergo structural adjustment to improve competitiveness, the informal sector has a natural advantage over the formal. The redundancies that are the inevitable consequence of restructuring the public sector have propelled part of the workforce into an informal sector already swollen by population growth.

Attempts to reduce budget deficits by raising taxes in the "modern" sector have also given an advantage to informal businesses that pay little or no tax.

Official GDP statistics undoubtedly make inadequate allowance for the growth of the informal sector. As a consequence current estimates lend undue weight to developments in the "modern" sector, which does not reflect the reality of the economic situation, particularly in Africa. This observation should go some way to tempering the excesses of official pessimism with regard to Africa and its underestimation of African capacity to adapt to market trends. However, it also underlines the acute difficulties faced by African countries whose "modern" sectors are shrinking in relative terms.

Yet it is this sector that provides governments with their main source of revenue. Essential public services and infrastructure that are vital to the development of the economy as a whole depend on the growth of this sector.

Informal adjustment has undoubtedly helped alleviate the social distress caused by the reforms, but it has also contributed to the crisis at national level. It can therefore never be more than an imperfect, interim phase.

(b) Short-sighted adjustment: the process has made inadequate provision for the requisite complementarities between financial restructuring and long-term strategies.

Adjustment policy is made up of three main complementary aspects: macroeconomic stabilization, correction of relative prices, and improvement of productivity. In fact, the decisions taken have tended to favour stabilization at the expense of correcting price distortions with structural and sectoral reforms even further in the rear; these have generally been minimal and without any noticeable effect on productivity or the incentives system. Budget allocation trends illustrate this clearly.

The adjustment of public finances has been achieved more by reducing expenditure, with no real restructuring, than by boosting revenue; the major tax reforms planned have been applied with great difficulty or not at all.

As a direct result of this tendency there has been a drastic reduction in public investment, which is now insufficient to guarantee the minimum infrastructure and maintenance required for the economy to develop. There has also been a major drop in health and education spending, which is threatening the very survival of these essential public services.

Between the beginning and end of the 1980s, health and education spending as a proportion of total public expenditure fell by an average of six percentage points, whereas over the same period in non-ACP countries their shares increased by six (education) and four (health) percentage points.

These cuts obviously have a negative impact on productivity and on long-term development in general.

There are several reasons why long-term interests have been passed over. The first is intellectual: while there is little disagreement as to how to control demand, there are doubts on how best to correct prices or gauge the response of economic agents and, even more, on how to boost productivity.

The second reason is to do with the scale of the recession and the urgency of finding a response to it. Foreign exchange shortages and liquidity problems engendered measures designed to ease the situation rapidly: it is relatively easy to reduce spending or alter a customs tariff, but much more difficult and time-consuming to restructure businesses and liberalize and deregulate the economy.

The imposition of inflexible conditions, compliance with which can be measured, has reinforced the trend, favouring measures having immediate results at the expense of far-reaching reforms the outcome of which it is difficult to gauge.

(c) Borrowed adjustment: national reactions to policies seen as imposed from the outside have tended to be shaped by social and political pressures that work against the process, in some cases compounded by instinctive reticence in the face of economic policies that antagonize vested interest. Adjustment policies have frequently been accepted under financial duress, without any genuine conviction on the part of the governments concerned and without the willing support of the officials responsible for their implementation, not to mention the general public, which is still awaiting the economic and social benefits of their young democracies.

The lack of internal acceptance also applies to the conditions attached to adjustment, often agreed to simply as a means of securing urgently needed financing. Wary donors have reacted by adding new, ever more stringent conditions, making them increasingly complex, unrealistic and ultimately impractical.

The validity of the concept of conditionality is not open to discussion. What is debatable, however, is the excessive proliferation of conditions that lack fine tuning and fail to take account of the conditions and constraints specific to each individual country.

V. THE WAY FORWARD

Adjustment is not a fad, but an absolute necessity if financial and budget stability is to be restored. There is a consensus that the process is unavoidable, a necessary - though not sufficient - condition for growth. However, while the principle of adjustment is accepted almost unanimously, opinions are more divided as to the best way to proceed, given the conflicting, and indeed disappointing, results achieved by the policies applied thus far. Improvements are needed, and in some cases are already in the pipeline. The European Union has championed the need for change, and now has an important rôle to play in promoting and strengthening the changes. It can do this in three ways: by consolidating Community action, and by deepening and broadening it.

1. Consolidation

Recent analysis endorses the Union's main priorities as expressed in the Lomé Convention, namely: overall consistency with the objectives of adjustment; the long-term implications of programmes; their social repercussions; and their integration into a regional framework. The key policy considerations highlighted by the Convention - the social dimension, the regional dimension, the pace of reform, adapting reforms to the specific requirements of individual countries, acceptance within the country ("internalization"), realistic conditions - must remain central to the Union's contributions in this field.

The Commission will therefore continue to argue the case for the recent SPA recommendations on adapting the pace and sequence of reforms and structuring conditionality in line with the specific requirements of the individual countries, with a view to ensuring that these recommendations are duly implemented in practice.

The Commission will also help promote local acceptance of the adjustment process through detailed analysis of national planning, decision-making and implementation capacities. The nature of the EU-ACP dialogue, which is characterized by medium-term programming and confidence in the availability of resources, is conducive to this purpose.

2. Deepening

Structural adjustment must form part of a more general long-term approach aimed at developing human resources, rebuilding a healthy economic and social environment and revitalizing the supply side. In addition to striking the correct balance between spending to support financial restructuring and economic reform, and investment spending, long-term aims can be secured by improving the structure of public finance and integrating national programmes into the regional framework.

(a) Public finance

The Community should continue to attach special importance to the problem of public finance, which has become one of the key components of reform and of the dialogue with the countries concerned.

The Community will continue with its role of assisting priority social sectors by helping create a genuinely sectoral approach supported by the allocation of counterpart funds in coherent, transparent, equitable and well-implemented national budgets. The harmonious development of human resources can best be achieved through the restructuring of public expenditure. It is essential that the process of economic transition be accompanied in the interests of effectiveness by a consistently high level of investment in economic and social infrastructure.

The focal areas for the investment of Community resources must also be broadened, however, to stimulate production and supply, primarily by rationalizing and streamlining the state's relations with its suppliers with a view to restoring its credibility and the confidence of the business sector. To that end, the Commission will give priority to the assessment and monitoring of public expenditure, in collaboration with the countries concerned and the other donors.

(b) Integration into the regional framework

The integration of national programmes into a regional framework designed to promote trade or economic integration will undoubtedly continue to be one of the Commission's main priorities, the aim being to create a dynamic that transcends the economies of individual countries and thus promote the gradual integration of the ACP countries into a world economy that is itself in the throes of transition. There is a double incentive for the ACP States to incorporate regional integration into their national programmes.

The first is linked to the limitations of national markets. The second is based on the new regional integration theory, now held to be an institutional means of promoting the adoption of economic policies under partial protection from pressures that have a more powerful impact nationally than at regional level.

These arguments should persuade the ACP countries' international partners to support the regional aspects of national adjustment programmes on a systematic basis, i.e. automatically including regional integration criteria when formulating programmes. They should also persuade them to increase the amount of adjustment aid to these countries, as an incentive to integration and also to offset the transitional costs that integration can entail, such as loss of tax revenue.

3. Broadening

The European Union's contribution to improving the adjustment process must undoubtedly involve more than consolidating and deepening its current input, though they are essential. It must also embrace the adaptation of existing instruments, the search for new types of cooperation and recasting of the approach to conditionality. All this will require greater coordination.

(a) Adapting instruments and procedures: the Union must adapt to changing and varied situations, with a view to:

- providing direct, targeted budget support for countries with liberalized foreign trade and a freely convertible and transferable currency;

- gradually moving towards channelling counterpart funds into a more general package, in step with progress in terms of the efficiency and internal acceptance of public expenditure reviews used as a tool to keep a check on programming and budget implementation. This will involve radical changes in the current thinking and methods of the Community's supervisory bodies;

- decentralizing implementation monitoring.

It should be possible to arrange a rapid and flexible reallocation of financial resources under a country's adjustment programme to meet exceptional financial needs that may arise in certain countries, provided that such reallocations do not prejudice development programmes already under way.

In order to secure greater consistency in its activities and to create adequate "critical mass" in terms of both conditionality and financial resources, the Union will seek to improve the operational integration of all Community instruments, including indicative programmes, adjustment resources, Stabex and food aid.

(b) Other types of cooperation: monetary matters comprise one area in which the Union could promote the reform process in the ACP States, as the Maastricht Treaty indeed provides. The disparate nature of the various monetary systems and the non-convertible status of most of the ACP currencies have been a major handicap to regional integration, while the dearth of foreign exchange has at the same time in many cases been an obstacle to economic activity. The international community, and especially the EU, can help countries with integration projects in the direction of stable exchange rates and greater convertibility. This does not mean the monetary integration of the ACP States, Africa or even large subregions. It means making Union expertise available to these countries by extending cooperation to an area that, while undoubtedly presenting a tough challenge, can make a significant contribution to growth and stability.

(c) New approach to conditionality: there is currently a "conditionality crisis" which has led many of those actively involved in the adjustment process to question at least the application of the concept, if not its validity. There is already a consensus at SPA level in favour of introducing a greater note of realism in the definition of conditionality. The Commission has played a significant part in bringing about this development, and could now contribute further to the debate by proposing a different approach to conditionality, more demanding in the long term and less rigid in the short term.

This would involve incorporating into the concept of conditionality general economic policy agreements based on a medium-term programme, of which specific measures would be but one component. It would also entail the introduction of "adjustable" factors that would allow economic policy to be steered in response to developments in the national or international environment. Finally, it would mean assessing the *real* effort made by countries to push through their reforms, in the light of material, social and political problems which affect economic policy-making, and which may be difficult to overcome.

Such an approach, by showing greater respect for the internal choices of the countries concerned, particularly as regards the sequence of reforms, would increase local involvement in reform planning and implementation, and would also allow for greater emphasis on factors promoting long-term development. It would tend to promote a long-term view, responding to overall progress on a realistic basis, rather than reacting to one-off results that can be rapidly overturned.

In other words, the Commission's proposal to its partner donors would be to consider replacing the current conditionality system based on specific instruments and results by one based on programmes.

(d) Strengthening coordination: in an area as politically charged and complex as macroeconomic reform, where no one can claim to know all the solutions, it is not right that the developing countries should be given the impression that they have no say, and that there is a monopoly on macroeconomic expertise. The leadership of the key traditional institutions, the World Bank and the IMF, is not in question, but the Commission has developed a degree of expertise and influence in its problem assessment and *modus operandi* which have made a significant contribution to the improvements already made to the adjustment process. This influence would be greatly enhanced by a concerted coordination effort involving not only Community structures but also the recipient countries, and the European members of the Boards of the Bretton Woods institutions themselves. For the Union, it is a question of credibility as much as efficiency.

CONCLUSION

The Community was not involved in the first generation of adjustment programmes, entering the debate in 1987 and carrying out its first operations in 1988 through its participation in the first phase of the SPA. It was really only with Lomé IV that the Community began to play a direct part in the process.

Since the Convention was signed, the Commission has adopted a wide range of measures to give full effect to that participation. The experience gleaned in the intervening years has given it the perspective and the know-how to assess more comprehensively the impact of adjustment policies and to draw conclusions as to their implications for the future.

The purpose of this communication is not only to provide factual information on the implementation of the Convention's structural adjustment provisions, but also to use that experience to contribute to the debate on an aspect of development that is not only crucial but also one of the most controversial.

The Commission remains convinced that adjustment is an essential prerequisite for relaunching the growth of the ACP countries' economies and, at a deeper level, for their real development. However, adjustment procedures have to be sufficiently realistic and innovative to ensure that well-balanced and equitable long-term development is not sacrificed in the interests of financial and budget stability, and in order to maximize the chances of success of a process that has so far had mixed results.

That is the essence of the Commission's approach and of the role it intends to play in this field.