Public Disclosure Authorized

Public Disclosure Authorized

WORLD BANK HISTORY PROJECT

Brookings Institution

Transcript of interview with

LAWRENCE E. HINKLE

January 5, 1993
Washington, D.C.

Interview by: John Lewis, Richard Webb, Devesh Kapur

FOREWORD

The following is a transcript of an oral interview conducted by the authors of the World Bank's fiftieth anniversary history: John P. Lewis, Richard Webb and Devesh Kapur, *The World Bank: Its First Half Century,* Washington, DC: Brookings Institution Press, 1997. It is not a formal oral history, and it is not a systematic overview of the work of the person interviewed. At times the authors discussed the planned publication itself and the sources that should be consulted; at other times they talked about persons and publications extraneous to the Bank. Some interview tapes and transcripts begin and end abruptly. Nevertheless, the World Bank Group Archives believes that this transcript may be of interest to researchers and makes it available for public use.

[Begin Tape 1, Side A][1]

[The quality of this recording begins to deteriorate about two-thirds of the way through the first side.]

WEBB: . . a large structural adjustment loan, structural adjustment lending, that I find it hard to understand, and I just don't know how the Bank sees these things. One is the question of fungibility, how the Bank senses that its dollars are affecting the foreign exchange markets, tax efforts. That's at the macro level.

The other question, the other area that I'd like to ask you to comment on is the question of the fixed exchange rate in the CFA *[Communaute Financiere Africaine]* Franc Zone, just how the Bank—reading, talking to Michael *[Gillette]* and one other person we talked to, one gets the sense that the Bank is almost unanimous in its opinion that this is perhaps the single most important impediment to economic recovery in the countries and the single most important foreign policy issue. And I say "almost unanimous" because one or two people we've talked to didn't share that view. One person in OED *[Operations Evaluation Department]*, for instance, was looking at some *[inaudible]*

But then the IMF *[International Monetary Fund]*, I'm not--I don't really know. Do they really believe that it doesn't work that way? Or are they completely--they just don't think about it and they are just obeying instructions?

And the French themselves, are they—is it--how so many people have such a definite idea that this is not the right policy? Or is it entirely explained by things that aren't French national objectives or French bureaucratic objectives that are not the same as the interests of the country? I really find that hard to digest, how to react to this, such a large difference of opinion.

I've been in a central bank for eleven years in Peru, and we've gone through all different kinds of policy regimes and always struggling with inflation. And I've always been an outlier amongst my colleagues in my belief in the virtues of devaluation, of having a high exchange rate, if you call it high.

HINKLE: In local currency terms?

WEBB: Yeah. But I often wonder. I really wonder how you can--I wonder whether you could be that sure about the sequel to leaving this exchange rate. And it's a bit like original sin. But I've never seen these things discussed in the Bank, and it always comes across as something that's obvious.

LEWIS: Well, that's a long question, but let me just add one clause to it, which is to ask you to put a time dimension to it. You've been working in CFA countries for a long time now . .

---

[1] [1]Original transcript by Brookings Institution World Bank history project; original insertions are in [ ]. Insertions added by World Bank Group Archives are in *italics* in *[ ]*.

HINKLE: Yeah. A decade.

LEWIS: . . and I'd like to know how you perceived that regime when you first got into the region. Was it as bad then as it is now? Or has it sort of aged poorly or . . .

HINKLE: Okay. Let me start with the history [all speaking at once]

WEBB: Sorry for the messiness of that question.

LEWIS: No, no. It's a good question. [both speaking at once]

HINKLE: It's a good question. Let me start with the history, and start then with the Bank's view on the exchange rate issue and how that evolved, and then I'll talk about the IMF, and then I'll talk about the French. Okay?

On the history of the question, it wasn't a problem. I mean, if you look at the macroeconomic performance of the CFA zone, compared to other low-income countries or compared to other sub-Saharan African countries, it's quite good up to the mid-1980s, including in the first half of the 1980s when they're adjusting to the external debt crisis and the terms of trade fall in the early 1980s. And during that period it was not an issue, basically, because partly--the dollar, if you recall (again, this is before the Plaza Accords) in this period the dollar was getting very strong and the French franc was getting very weak. So you had a fall in terms of trade, but you also had a fall in nominal exchange rate, a depreciation in foreign currencies, local currency decline in foreign currency terms, so that the exchange rate being pegged to the French franc was in fact moving in the right direction. And you had the dollar getting up to--there were ten francs to the dollar at one point, and this helped quite considerably for the CFA zone. And up till '86 it was not a big problem, okay?

Then what happened in the mid-'80s, though, you had another massive terms of trade decline in the coffee prices, cocoa prices, oil prices in the second half of the decade. So you had--take Cote d'Ivoire's terms of trade dropped by a half between '85-'86 and today. You had a massive drop in the terms of trade, and you had an appreciation in the real exchange rate index, driven by two things. One was the fact that you had the Plaza Accords and all of a sudden the franc changed directions against the dollar, and we went back--from ten francs to a dollar we went to five francs to a dollar, the franc being pegged to the mark.

The other thing that was happening in this period, too, was that French exchange rate policy was getting a lot tougher. During the first 15 years, up until about '85, you know, the franc had been a weak currency. They were devaluing against the mark. Nobody thought of—you know, they hadn't sort of--they weren't importing German monetary policy. They really, in the mid-'80s, they tied up very strongly with the Germans and became a much harder currency. So this reinforced the problem.

The other thing that was happening during this period was you had low-income developing countries depreciating their real exchange rates, usually through massive nominal devaluations because they also tended to have a lot of inflation. So you had competitor countries getting a lot better off. This resulted, the movement of the nominal exchange rate and the movement in competitors' real exchange rates, resulted in appreciation of the real exchange rate index between ‘85 and today of, in foreign currency terms, of between 30 to 40 percent, depending upon whether you use foreign wholesale prices or foreign consumer prices in the index, a fairly massive appreciation against a fairly massive drop in the terms of trade.

And they were starting to—and then we had a number of adjustment programs that just didn't pan out, okay? The Cote d'Ivoire had an adjustment program in the early ‘80s when the terms of trade recovered a bit; in the mid-‘80s they dropped it again. And they got hit by this second massive shock, and they started again, and it wasn't working. And along about ‘88, ‘89, ‘90 people started to say, “Hey, there's a problem here.”

And then we in fact had a--Mike might have mentioned something called Project Z. This was a confidential study that Stanley Fischer was the god father of—we were working--it started out—I was, in fact, I didn't even know about it. I was working in AF5 *[Country Department V]* as a division chief, and AF1 *[Country Department I]*, which was Ismail Serageldin, Pierre Landell-Mills, Dick *[Richard M.]* Westebbe, were working on this project with Stanley Fischer. And when I came over to AF1 as lead economist in the summer of 1990 I inherited Project Z. And it was called Z because it was the last option. There weren't any other choices.

And one of the methodological questions we faced in this thing is: What does it mean to say the exchange rate is overvalued when there’s no black market rate? When the thing is fully convertible at the official exchange rate, how can you claim it's overvalued? And the answer to claiming it's overvalued is that the austerity policies it takes to restore budgetary and debt sustainability with the overvalued fixed exchange rate have repressed growth and investment excessively. They have inflicted a massive deflation on the CFA Zone, but because prices and wages have been rigid downwards in the formal sector, you’ve had massive unemployment of resources. You had per capita GDP drop by a third in Cote d'Ivoire in the period between 1985 and today, and you've had investment rates drop by two-thirds. You had investment rates that were in the 20 to 25 percent range of GDP, and now you're talking 8 to 9 percent of GDP.

For these countries, this is the great depression. I mean, that's how serious. It's not just the growth. It's the poverty thing. It's killed—I mean, it’s set poverty alleviation efforts back at least a decade, if not two decades because, (a), there’s—you’ve had--within agriculture you've had return to subsistence agriculture. You've had no employment creation for the whole, so the whole sort of income side of it isn't there. And on the public services side of it, because you had a fiscal crisis, what's been maintained is the wage bill for the civil servants and what has been cut is everything else. So you don't have public investment. And you don't have health services. You don't have education services. You don't have

agricultural extension. I mean, it's sort of a disaster from a poverty alleviation point of view, too.

So that--in that sense, that's what we mean is that the exchange rate has been defended by what we would say are sub-optimal policies, to say the least. I mean, it's in equilibrium if you can go out and exchange money, you know, and you get it back, but the price of maintaining that equilibrium has been a massive recession.

And then we--in the study I sent to you, right? (Mr. Kapur had asked for a copy because Mike had referred to this)--we ended up doing four different methodologies to try to estimate the overvaluation, which are basically looking at what's happened to the real exchange rate index. There's a methodology that involves elasticities, trade elasticity and a target for the balance of payments. You can calculate how big a devaluation you need to achieve the target balance of payments given what you want to do with growth, investment, and *[inaudible]*. We had a very simple, computable, general equilibrium model that Shanta Devarajan worked with us on. And we did an econometric estimate that involves trying to estimate what determines the actual real exchange rate and then plugging in sustainable values to replace the--for the future to see what would be a sustainable real exchange rate. The fifth common methodology is to look at what happens to unit labor costs in foreign exchange terms, and that one we couldn't do anything with because we didn't have good wage data from the CFA countries. But all of this led us to a consistent conclusion that the thing is overvalued by 50 percent, 50 to 60 percent in local currency terms, 35 percent, say, in foreign currency terms.

LEWIS: The Project Z, this paper, is that is what it is?

HINKLE: [all speaking at once] Yup, yup, yup.

Project Z was ultimately split into two phases after Larry *[Lawrence H.]* Summers arrived on the scene. We split it into a phase that addressed the analysis of the problem and addressed concerns that people had about whether or not real exchange rate changes would lead to a supply response, whether nominal devaluation would lead to a change in the real exchange rate or it would all be eaten up by inflation, and that group of questions. And that's all contained in that volume. We've done some further work on that, but mostly we've moved on to questions of implementation, which is what we're working on right now.

Now, this debate has been held reasonably closely within the Bank because you had a very hostile French government saying, you know, we shouldn't even be talking about the thing. So not a lot of people know all the details of what's going on.

I think we have unanimous opinion within the group that's been part of the debate, including, you know, both chief economists of the Bank, Larry Summers and Stan Fischer, including the chief economists and all the economists involved in the Africa Region. You will find peripheral players outside who may have a different opinion, but I

think if they, you know, addressed the bulk of the evidence, they would find it compelling, too, although you might still find somebody . . .

LEWIS: Is it true the, up to the vice president, I take it, *[Edward V.K.]* Jaycox is also on board on this?

HINKLE: Jaycox, yeah. He's very much on board on this. Took a--there's been some to-ing and fro-ing within the Bank management, you know, with changes of president and so on, over how important the issue was and how much we should stake on it, but I think it, certainly the question and the analysis of the problem--it's a necessary but not sufficient condition. None of us will maintain that just doing this alone is going to solve any problem. You can inflate it away overnight, and that's certainly a danger to worry about. On the other hand, the only way we can see getting there through what is called internal adjustment in the CFA zone is to continue recession for another ten years until your cost structure gets into line with your competitors and you start to get an expansion of real output, then, covering investment.

Let me--why don't we now go on and talk a little bit more about these, and then we can talk about the French and the IMF?

WEBB: Right. Well, actually I was going to ask you whether, on this point, have you had anything that you would consider pretty honest questions of individuals in the IMF dealing with one country or another on this issue?

HINKLE: Okay. The IMF's position has evolved over time. At first [both speaking at once]

WEBB: You know, over drinks in the hotel [both speaking at once]

HINKLE: No, we've had candid discussions, okay, and more so recently. Initially their position was, you know, "It's not a problem, and if it is a problem, we'll take care of it, and you guys don't need to worry about it." As they got--even at that point, you know, there were some of the junior people who were very uncomfortable with having to defend a party line they didn't believe in, so you could always have candid discussions with some people about that. As it's become increasingly apparent that the policy is indefensible, you find more and more senior people who will have those same candid discussions with you. And the last, the most candid document, the first I think truly, reasonably candid document to come out, is the report of the Article IV consultations on Cote d'Ivoire which is being discussed at the IMF board tomorrow, and that is a pretty--within IMF jargon--it's a pretty candid statement that there's a major problem here.

LEWIS: Article IV is what? [all speaking at once]

HINKLE: Article IV consultations. This is the annual consultations, and that represents quite an evolution in . .

WEBB: Have you seen it?

HINKLE: Yeah, I've seen it. These are regularly available to the Bank. They exchange *[inaudible]* a bit. So the IMF is--and then their position also, they became increasingly convinced and--Mike must have mentioned they tried to do something about it last summertime. Did Mike go into this part of the story or not?

KAPUR: He briefly mentioned it, that there was a joint mission, the Bank and Fund staff.

HINKLE: Well, this was really mostly just Fund. I mean, *[Michel]* Camdessus was out there personally last July lobbying the African heads of state to devalue the CFA franc.

LEWIS: Oh, and this is when *[Abdou]* Diouf was [both speaking at once] up for election, so they deferred to his political calendar.

HINKLE: Yeah, they blamed it on Diouf, but I think it's unfair. I think in fact a whole bunch of them didn't want to do it, and it was convenient to blame it on the electoral calendar in Senegal. But I don't think the Ivoirians wanted it. *[Felix]* Houphouet-Boigny wouldn't do it. I think the technicians in the Cote d'Ivoire probably wanted to do it, but Houphouet-Boigny didn't. Some of the—*[Paul]* Biya from Cameroon might have wanted to do it, but he wasn't there because his wife died and he had to go back. I think the others were against it.

WEBB: To understand the mechanics of the alternative program, if one could just put it in, would be a higher exchange rate, but then how, what then? What else would be involved to get reflation? Does this mean you'd have to then increase government spending or what? There would have to be more spending by someone to reflate. How would that happen?

HINKLE: That's the least of the problems, in fact. I mean, this is atypical in the sense that, you know, most of your countries get into devaluation problems by inflating excessively, and you get a cost price spiral, and your exchange rate is fixed, and eventually your exchange rate gets out of line. So on the one hand you have to realign your exchange rate, but you have to get control of your cost-price spiral at the same time so that your new exchange rate just doesn't inflate and inflate it away. Here you have much more a situation like in the Great Depression, and in fact a lot of the historical examples we looked at were Europe in the 1930s where countries are trying to adjust their exchange rates in the context of depression or recessions.

Now, you have one group of things you have to do to keep the real devaluation, to make sure that the nominal devaluation isn't converted entirely into inflation. You have to keep wages in the formal sector under control. I mean, that is part of the problem because they've been rigid downward. Particularly you have to keep the civil services wages under control. A lot of these countries are very highly—"unionized" isn't quite the word--they have very interventionist wage policies. In effect what both Cote d'Ivoire and

Senegal have is you have an arrangement whereby the unions in the organized, formal sector get together with the monopolies with which they deal and negotiate a wage agreement, and this doesn't even cover the whole formal sector. But then the government comes in and says, "Okay, everybody else has to pay these same wages." So in effect you get the unionized, monopolized part of the economy which can pass the wage increases along, dictating the general level of wages in the formal sector. You then get a division in wages because this doesn't apply in the informal sector, where it's supply and demand in the labor market that balances things, that ends up setting the wages. So you get excessively high wage levels.

I mean you can't--it's hard to believe how inflated the cost structure is in these countries. When we were doing Project Z, we took a look at the list of the most expensive cities in the world. Five of them are in the franc zone. They're more expensive than Paris in some cases. I mean it's really very inflated costs and prices.

LEWIS: Housing, food, everything?

HINKLE: Everything. Because . . .

KAPUR: Just the CPIs *[consumer price index]*.

HINKLE: Yeah, well, the price of non-tradables was certainly very high and wages were very low.

So, anyway, you have to control that, but you also need to make a fiscal adjustment because what has happened during the process is that, as they tried to do this internal adjustment exercise, they cut expenditures for everything except the wage bill which was sacrosanct for political reasons. So you've got no public investment, and you've got no materials and supplies, and you're not paying your debt. They kept trying to raise revenues, but you were raising revenues in a declining economy. So you raise the tax--you get the *[Arthur B.]* Laffer curve with a vengeance, and you've got revenues going down as a share of GDP in spite of having increases in tax rates. So you're getting—so you've got to sort of restore. You've got to restore public investment rates. You've got to restore non-salary recurrent expenditures, and you've got to clean up the tax system because now you've got a very distorted, regressive tax system that's aimed at basically milking the economy to support the civil service wage level. So you've got a whole bunch of things you've got to do on the fiscal side, both to remove the distortions on private sector activity through the tax system, to provide expenditures to support development, and to raise public savings. Because one thing that you had is you had this collapse in investment and you also had this collapse in savings rates. You've got to get investment rates up from, you know, seven or eight percent of GDP to 20 or 25 percent of GDP. You have to get savings rates up by the same amount, and like four or five percentage points of that is going to have to come out of public savings.

Now, in fact, when you do devalue, it has an enormous--because tradables are a lot more heavily taxed than non-tradables--it has a big impact on revenues, on the one hand, and if

you can freeze or tightly control nominal wages, it substantially cuts the real wage bill. So there is a lot of scope in that kind of context for restructuring public finances to support the development of country instead of to feed the civil service.

WEBB: Very favorable for the fiscal balance . .

HINKLE: Yes, subject to controlling [all speaking at once] wage bill.

KAPUR: How do you ensure that a, given that the economy of a country is such that the same lack of fiscal discipline which has led to this hugely inflated civil service burden now, will, if you devalue, not lead to inflation which would . . .

HINKLE: That's clearly a worry. I mean, clearly it's not just doing it by itself. If you move the exchange rate one day by 25 percent and you've got to raise wages the next day by 25 percent, you might as well not have bothered because all you've got for the pain is inflation as well as all the other problems you have.

Let me answer the question about the French here which is--the reason nobody in Africa has done anything about this is that the African political systems are basically sort of the elite in these countries. They are the civil servants, the unionized formal sector, the monopolies, and that's really where the government sees its constituency. It's 15 percent of the population, but it's the population with all the political muscle. And this group of folks has more or less survived. You know, they're still paying the civil service wage bill. There have been some reductions in employment, public enterprises, some layoff, but compared to the rest of the economy, they haven't adjusted. I mean, these guys haven't adjusted yet, and this is what the regimes represent by and large. And they just plain don’t care. They just plain don't care about the others.

And this is where it ties in with the French because the French would like--they see the zone as sort of maintaining their political influence in the world. It makes them a lot more important than they would otherwise be. I think it's much more political than commercial, and it gives them a status as spokesmen for developing countries. You have the whole mechanism of the franc zone and the annual meeting of the finance ministers and so on. So they're very reluctant to do anything that would jeopardize that relationship, so that until they see something coming from the African side, they're not prepared to take many risks on this.

And so you just get--the Africans don't want to do it because it would basically lower real wages and hurt the urban elite, and the French don't want to upset their relations with the Africans. They see quite clearly, also, that if the Africans don't adopt the accompanying measures that you need, you'll just have inflation and perhaps the breakup of the zone.

LEWIS: Any difference between younger and older French bureaucrats on this count?

HINKLE: Well, it's not the bureaucrats that--it's politicians.

LEWIS: It is the politicians?

HINKLE: I mean--well, you have for a while—you know, again, I think the French almost did it in 1988. They backed off, which would have--they almost took the leadership and got—and then I think they got scared about how it was going to go, about problems of implementation, and backed off from doing it sometime in the fall of 1988. Again, I don't have the sort of first-hand information. You'd have to talk to somebody who knows that part of it better than me.

But I think then you had this long rationalization about internal adjustment and fixed exchange rates and how the process would work. And, you know, real world, I mean if you're talking about small overvaluation and relatively flexible wages and prices, it can work. I mean, you can do the internal adjustment, say, if you're talking a ten percent kind of overvaluation. When you get numbers up around 50 or 60 percent and monopolized, unionized labor markets and a lot of rigidity, then it just isn't going to work. So you have this whole sort of mythology. And you can look back and say--and part of it was to look back and say, "Oh, it worked great for the last 15 years." And it did work great for 15 years because the thing just didn't get out of line and people never really put their finger on what was the magnitude of the problem.

KAPUR: Have you done the sequencing? Is the line that one must first break the unionized monopolies and only then go for devaluation because otherwise one risks undermining it? Or "Look, let's get what we can?"

HINKLE: Well, there's two. I mean, the sequencing is two kinds. There's sequencing independent of where you're starting from, okay, you know, where you're independent of the past. And ideally you would first like to liberalize domestic markets first, okay? And then you want to liberalize the trade regime at the same time that you change the exchange rate. And you would also want to start the fiscal adjustment process ahead of when you change the exchange rate. That's in an ideal world, okay?

In a world in which you've been fiddling around for six years, the economy is going down, GNP per capita has dropped by a third, you've tried some things, and you can't persuade anybody to do anything unless there's some benefits, and there's no benefits unless you deal with the exchange rate, you know, it becomes a matter of a lot of it's just going to have to be done simultaneously now. I mean, clearly you have to do all that day one, but how are you going to persuade anybody to take the political pain when everyone, you know: "What's the benefit here? What is something beneficial? Where's the growth coming from?"

WEBB: To come back to the mechanics, I still have a little difficulty in understanding. How do you--do you think it's pretty clear why such a huge loss of GDP per capita occurred, because that sort of jumps out from the figures, sort of obvious? Is much of that a real--the terms of trade don't figure in that, presumably.

HINKLE: Yeah, they do. [all speaking at once]

WEBB: So part of it is terms of trade.

HINKLE: Five or six percent is loss of terms of trade, and part of it is also, you know, that population has been growing along at two to three percent a year, too. So if you don't have real GDP growing at least that rate, you're going backwards constantly. So the drop in GDP per capita is more in the range of ten to fifteen percent, of which a third would be accounted for by losses due to terms of trade.

WEBB: I see. So you're talking what, six percent, seven percent, fall in absolute GDP [both speaking at once] real GDP.

HINKLE: No, adjusted for terms of trade--you're talking about four or five percentage points loss in GDP due to the terms of trade change and another about ten percentage points loss due to the subsequent fall in production.

WEBB: You've got a lot of excess capacity?

HINKLE: Yeah.

WEBB: Yeah. And that part of the loss . .

HINKLE: Plus, you've lost all the potential growth over six years by the fact that, you know, your labor force has been growing by three percent a year and you haven't been investing so you haven't been creating jobs for them, so that your potential GDP is in fact, per capita, is in fact a third higher than it used to be. I mean, if you just maintain steady per capita GDP over the period.

WEBB: The thing is--go back to about 1980, ‘81, ’82, no one imagined anything like this could ever be possible, such a large loss in output per person or even fall . . .

HINKLE: You have to go back to the Great Depression. That's where you'd find historical parallels to it. That's the only case I know. It's really—it’s staggering.

WEBB: I was working in the government in Peru through the early ‘80s, and our GDP fell ten, eleven percent in 1983. We had a natural disaster that year, *[inaudible]* change climate, and a lot of it was that, but the projection for the year was that we would have one percent growth. That was part of the standby. Halfway through the year we were beginning to think that production actually would fall that year, some figures suggested maybe four or five percent loss *[inaudible]* When we discussed this with the Bank and the Fund people, they refused to believe us, particularly the Fund. And they said there is no way that could happen. And there was just no possibility of getting through to them on this issue. In the end it wasn't five percent, it was a ten percent fall. And even then Fund figures refused to accept the—that particular figure. They used a lower estimate of the fall.

HINKLE: We've had the same problem.

WEBB: You had the same problem?

HINKLE: I mean, we and the Fund have deluded ourselves. I mean, if you go back and look at the projections and PFPs *[policy framework papers]* and Bank SALs *[structural adjustment loans]* and Fund papers, I mean they've always got that somehow growth is turning around next year, it's starting out low and it's going up, and in fact it's always going like this. It's—people, it's just against the mindset. It takes a long time to turn people's minds around on this, that unless you do something, the best projection is it will continue to go downhill rather than it's going to reverse itself.

WEBB: It takes a while for the Bank to realize really what's--do you think that has affected the way the Bank has dealt with the . . .

HINKLE: Oh, yes. We should have gotten a lot harder a lot earlier. I mean, I think you were--we were three years behind events. I mean, I think we should have been taking the positions we're taking today in 1992 back in 1989.

KAPUR: 1988 [both speaking at once]

HINKLE: You know, in 1988 when we didn't do it, I mean that was when we should have been having a kind of big confrontation.

KAPUR: But that's when the Bank went in with this quite elaborate subsidy, export subsidy, tariff scheme which, as one looks back at it, seems quite amazing in terms of the sheer complexity of bureaucratic---and I'm wondering how much of the Bank's . .

HINKLE: Yeah. It was intellectually naïve, is how I would describe that. Yeah, it's one of these things--a second best thing will work if you're only ten percent overvalued. But when you're, you know, talking 50 percent, it doesn't work because you can't raise the tariffs because of fraud and smuggling, so you can't enforce tariffs anywhere near as you would need. And then because the fiscal situation deteriorates, you can't pay the export subsidies, you know. And then the investment doesn't turn around until the end of the process, so until investors start to see that the economy's growing--so you don't get any investment, and you've just got a downward spiral, which is, in fact, what happened.

KAPUR: How much, I mean, of . .

HINKLE: We know better now. At the time it seemed like a great idea.

KAPUR: I'm wondering how much--one sees through the files, at times implicitly, at times explicitly, a part of the course of the dialogue with Cote d'Ivoire, perhaps, and some of the other francophone, have to do with the Bank's own recovery of its arrears or potential arrears, this whole thing of defensive lending. How much of that do you see? I

mean, it’s—in fact it’s absolutely clear. I mean, it says so. How much of this defensive lending played a role, including the events of the past year?

HINKLE: As to Cote d’Ivoire, that's been a concern all along. It wasn't up until just recently--in fact, really just this fall--that the management has decided, “Okay, if we have to write off the whole 2.2 billion dollars in IBRD *[International Bank for Reconstruction and Development]* loans to Cote d'Ivoire, we have to write off all 2.2 billion dollars.” I mean, that's really has been a concern, as has the relationship with the French.

KAPUR: And that fact that France . . .

HINKLE: Now, the other thing was, is the IDA X *[International Development Association]* negotiations would go down the drain. And that was, I think, in fact, it was concerns about IDA IX that kept us from taking as hard a stand [both speaking at once] as we should have back then, and it was very close the discussions of IDA X, you know, whether or not we were going to change our minds about . . .

KAPUR: Now, you said, I remember, on the phone that something happened the past few weeks which you were going to . . .

HINKLE: Yes. How long would you guys like to go on for? I just need to decide what I’m . . .

WEBB: We're completely in your hands because we could . . .

HINKLE: Okay. I didn't know when we talked on the telephone how long. Would you just like to . . .

WEBB: However much time you can give us.

HINKLE: Because I can--I'm supposed to be someplace else at three o'clock, but I can call them and tell them I'm not coming.

KAPUR: *[inaudible]* to have her call.

LEWIS: Well, I'd love to pursue this. I'll peel off about four, a little after four to go get a train.

HINKLE: Okay, just let me call my office, then, okay?

[Interruption for telephone call]

WEBB: If the Bank cut off these loans, then it would force the country, the Bank is making it possible, to some extent, for countries not to devalue . . .

HINKLE: Absolutely.

WEBB: But in this case maybe it doesn't quite work that way because they would simply have dropped, gone into arrears because they wouldn't have--the net effect on their balance of payments might not have been very large.

HINKLE: Yes, in the case of Cote d'Ivoire, in fact, they have had a natural resource surplus. The balance on exports of goods and non-factor services exceeded imports of goods and non-factor services by a couple of percentage points of GDP, by about three percent of GDP, so that if in fact they stopped paying all their debt, in balance of payments terms they would be okay. But the real thing is vis-a-vis the French government because they can always go and borrow money from the operations account of the French government on the balance of payments side, or what will happen is instead of coming to us to help them with their public finances, they'll go to the French government.

Let me just go back here a bit in the story. This thing came--Mike might have mentioned—there was a--it came to a head about the time of IDA IX in 1989 in which the Bank tried to force the issue. And there was some kind of alleged--I don't know what implicit understandings there were or weren't at this point--but we did make three sector adjustment loans, and they got bombed in the Board *[of Executive Directors]*. And the Board said, you know, “Don't come back to us until you have a credible medium-term framework that will restore growth, competitiveness, and creditworthiness in the country.” At the expense of some political capital, the Bank management got through that series of three adjustment loans in 1989 or early 1990.

When I came on the scene in 1990 we were in the process of disbursing--that was a done deal--and we were in the process of disbursing the second tranches of those operations. There were still Fund programs in place that were making progress towards getting to some kind of fiscal balance. And we all saw it quite clearly, you know, that the way to make the French, in this case, to get the--you want to put pressure on the Africans; you want to put the pressure on the French--is not to lend. And our first best scenario would have been not to do the last round of three adjustment loans. However, not enough groundwork had been laid politically on that ahead of time, and they should have started--we should have, when we did the round of loans in the ‘89 period, I think, made it very clear to everybody else there had to be prior action before there would be any further lending, but we never really came down and specified what we wanted.

And so we ended up with a compromise. And this was the *[Barber B.]* Conable-*[Moeen A.]* Qureshi compromise of the fall, of August or September of ‘91, where we in fact said, “Okay, we'll do the first tranches of the next series, but the second tranche of these series will depend on a restoring of competitiveness and a credible macroeconomic program.”

And that was then a huge to and fro because the Ivoirians--at this point you've got Alassane Ouattara as prime minister of Cote d'Ivoire, former director of the Africa Department of the IMF. He's got an IMF staff member working for him as his economic advisor, a quite competent minister of finance. They very quickly realized that there is no

way that, unless they cut wages, which they're not prepared to do, they're not going to meet the competitiveness condition. They start lobbying for delinking, delinking the adjustment operations from the competitiveness condition.

And that's been a debate that went on. It started last springtime when Ouattara came here--in April, I think it was--and I think was just finally resolved in early December in the context of the IDA X negotiations, where a week before the IDA X negotiations, the Managing Directors were calling me up to their offices to discuss what we're going to do about this problem and what has been our position on it because the French are going to raise it vis-à-vis the IDA X replenishment.

LEWIS: How's it been resolved?

HINKLE: It has been resolved as we're not, you know--as I understand it, the official resolution was we don't have any, we cannot delink these loans, that would be unfortunate if it affects your position vis-a-vis IDA X. Because at this point the Board is really polarized on the thing; I mean, everybody else, the U.S., the U.K., Germany, Japan, say that this whole thing is a nonsense. You only really get--the only people who are in favor of continued adjustment lending under the current circumstances are the, is the French African chair, *[Jean-Pierre]* Le Bouder, representing francophone Africa, and the French executive director.

So I think it was finally decided that we have gone over the letters of the loan agreements to see whether or not there was any wiggle room. There wasn't any wiggle room. In essence we had done what we were supposed to do, and we had wrapped it up so tight there wasn't any--you couldn't delink the thing without going back to the Board for a waiver of the conditions. And then you have to get Board approval of the tranche release, and all hell was going to break loose if that was done.

KAPUR: The fact that Cote d'Ivoire became IDA eligible, six months, maybe, from last year, August '91? [both speaking at once]

HINKLE: Yeah, it was in June '91.

KAPUR: Right. That seems to have provided sort of IBRD or the Bank some flexibility to use IDA on front load things and get IBRD . . .

HINKLE: Yeah, it meant the Bank was taking less risk because the Bank money, most of the Bank money, would be dispersed only after competitiveness was restored.

KAPUR: The first tranche was the essentially IDA.

HINKLE: Mostly IDA. I think there may have been a little bit of IBRD in one of the three operations.

LEWIS: Was competitiveness defined?

HINKLE: Okay, that--this was a, you know, because--it was a very sensitive issue, okay, how it would be defined. And we had in the--we had this requirement from the Board to have some kind of credible macro framework. And at the point they were becoming an IDA country, *[inaudible]* what we refer to here as a PFP, and that ran into two problems. One was that PFPs had only been insisted on for IDA only countries not for blended countries, and Cote d'Ivoire was still technically a blended country. Secondly, IMF--we were way out in front of the IMF on this one, and they weren't so keen to take the issue on right at this point, and they would have to be a party to a PFP. So we said, "Okay, we'll have a PFP and we'll call it a different name." And that's what the MTF *[medium term framework]* is.

And that, in the way it deals with that issue is it says, in the preamble it says competitiveness has been reduced by going down to something like 30 percent since 1985, and then paragraph 32 farther down says it's going to restored to the 1985 levels. And we've told them that, you know, we would use the RER *[real exchange rate]* index as a measure of that and then the Ivoirians--separately we told them that.

And then the, both the MTF and the loan agreements for the three adjustment operations say they will not request release of the tranches until competitiveness is restored.

WEBB: The actual mechanics of that condition is not put into the agreements. How is it communicated? Is there [both speaking at once] sign a piece of paper?

HINKLE: Okay. It's actually--you have this document called a medium-term framework (it looks just like a PFP) which is included in the documents that you submitted to the Board. It's transmitted by letter from the minister of finance, I believe, to the Bank, saying that this is the government's medium-term policy program. That is then cross-referenced in the legal agreements, so it in effect becomes part of the legal agreement, and the preamble . .

WEBB: A letter of intent, like the Fund . . .

HINKLE: Yeah, it's like the Fund letter of intent, it's the same—it's like the Bank *[inaudible]* and the matrix attached to it. And it says . .

[End Tape 1, Side A]
[Begin Tape 1, Side B]

HINKLE: . . whereas the government has adopted a medium term macro economic adjustment program which is spelled out in a letter from the minister of finance to the Bank dated blah-blah-blah. And then the letter from the minister of finance it says they will not request release of those tranches until competitiveness is restored.

WEBB: But that letter won't spell out an exchange rate, a new exchange rate, won't talk about it a new exchange rate. So how is that agreed on formally?

HINKLE: Which?

WEBB: The new exchange rate.

HINKLE: Well, what we had, I mean [all speaking at once] in a technical thing there was no discussion. I mean, it was just left--again, you're getting in this waltz with the IMF over turf here because exchange rates belong to the IMF. So we--the whole thing was formulated in terms of competitiveness and the real exchange rate and leaving open the theoretical possibility if you could do it through internal adjustment by lowering wages and prices, you could do it that way.

WEBB: Oh, so there would actually be a number for a real exchange in the letter [both speaking at once] in the government's letter.

HINKLE: There's a [both speaking at once] competitiveness [all speaking at once]

LEWIS: *[inaudible]* dropped by 30 percent. That means that you had much of a . . .

HINKLE: Appreciation.

LEWIS: Appreciation, yeah, and you're going to bring it back to that same level of competitiveness.

HINKLE: Right.

LEWIS: That implies an exchange rate adjustment, but you just don't say the words.

HINKLE: Yeah. Or I mean technically you can do it by lowering wages and prices if you can figure out some way of doing it. Right. But this was all very—because, you know, it's an environment in which you have a hostile French government, you have an IMF which is reluctant to take on the issue but wants to defend their turf anyway, and a lot of nervousness--so people are very cautious about the wording of the thing.

LEWIS: The Fund is in a turf battle from their point of view, but they also have been substantively less aggressive than the Bank. Is that right?

HINKLE: Yeah. They finally, in the last round, they got quite aggressive in 1992 when they really made an effort to get the problem solved. And then Camdessus really went out on a limb to see if he could resolve the problem.

LEWIS: Is the posture, is it attributed to the fact there's a French Managing Director?

HINKLE: Partly that, I mean, and partly that the people who worked in the zone for a long time, nobody really--until people started putting numbers on how big the problem was you could persuade yourself, well, maybe you might do it through internal

adjustment, until you started to see that that didn't work for a number of years, until you started to see the magnitude of what was required. Then people started to realize, “Hey, this isn't going to work.” And some people saw it a lot, you know, a lot quicker than other folks.

KAPUR: How, generalize the . .

HINKLE: I mean, even with us being out in front, we're three years behind events. I think we should have been doing in '89 what we did in '92.

KAPUR: I was wondering if you—since you’ve worked in the Sahelian countries before, which I guess mainly in Mali, how generalizable is this Cote d’Ivoire *[inaudible]* to some place like Cameroon and the others? Is it less . . .

HINKLE: The pattern is that you have a group of countries. The most seriously over-valued ones are Cote d'Ivoire, Cameroon, and then Congo, since they doubled their wages, okay? And then you have another group that’s fairly close, not far behind them, which would be Senegal, Niger, and Gabon, where you're talking, in local currency terms, if you're talking 55, 60 percent in the most over-valued countries, these countries you're talking 40 to 45 percent.

Then you have some other countries that it’s, where it's not too bad. In local currency terms it's down around 20 percent. That's Togo, Benin, Burkina, Mali, in which countries actually have been able to grow a little bit under internal adjustment, where you really haven't had—you’ve had stagnation of GNP, very gradual declines in per capita GNP, sub-optimal growth, but not the disaster that you've had, you know, in the more over-valued countries. And it's, you know, it’s a--in terms of doing one exchange rate change, you've got to adjust an awful lot of other policies to compensate for the fact that the exchange rate change would be the same in every country if you maintain a single exchange rate for the entire CFA Zone. But that’s a technically soluble problem; practically it’s another question *[inaudible]*

KAPUR: Somehow operating in these countries, other than the exchange rate issue, how do you sort of see the role of France, I mean, and how has the Bank's own operations being helped, stymied . . .

HINKLE: Well, by and large, you know, the French have a very large aid program. They provide the countries a lot of support and we, you know, co-finance a lot of projects with them, have a lot of common ground on other aspects of the adjustment program, I mean, in terms of things that have to be done on controlling expenditure, on fiscal policy, on the state enterprise sector. The only other sort of constant bone of contention is over agriculture prices, with them having a preference for administered agriculture prices of one kind or another and the Bank being much more inclined towards market-determined prices, almost in key sectors trying to replicate the Common Agricultural Policy on cotton, coffee, cocoa, rice, sugar.

I mean, you still have pretty good relations at the technical level. This whole thing got very politicized, both politicized and personalized.

WEBB: What they're proposing when you say administered prices, did that involved marketing boards?

HINKLE: Yeah.

WEBB: Yeah. So they would have the funds, and they'd use that to smooth out . .

HINKLE: Yeah, within--both within the year, seasonally, and across years, to a certain extent, to stabilize prices.

WEBB: And is the Bank really of one mind now on, against that . . .

HINKLE: It's--again, that's not--there's, there's mixed opinion on that. I mean, not all administered price systems have necessarily worked badly. It's a hard to make them--I mean, they've been subject to an awful lot of abuse, and the problem with retaining them is you then have to run them well. And if you could guarantee that you would run them well, then there would—the issue of the administered price versus, you know, a market price plus some kind of variable, either export tax or import tax, depending on whether it's an importable commodity, but, I mean, the advantage of those kinds of schemes is that they work automatically. And in a system where you have very limited administrative talent, where you have a lot of political pressure on the making of administrative decisions, a quasi-automatic, you know, variable import or variable export tax has a lot to recommend it. You put the system in place once, and if no one makes a conscious decision to change it, you know, it, keeps functioning, whereas with an administered price, every time something changes in the world, you have to change the administered price and you have to have technicians who understand what they're doing and politicians who are capable of making and implementing often difficult decisions.

WEBB: Have you personally seen an evolution in the Bank's attitude to this, thinking about this . .

HINKLE: Well, you have to do [both speaking at once]

WEBB: . . because in the '70s the Bank didn't seem to worry too much about market policies. It wasn't pressing, at least.

HINKLE: No. Well, the Bank, and certainly vis-a-vis Africa at the time of what was the Elliot Berg report in 1982 . .

LEWIS: In '81.

HINKLE: I'm sorry, yes, in '81--came out, and at that point started to take a much firmer position on administered prices than it had before and on the role of marketing

boards. But the Bank was never completely homogenous on this. What you'd also had through the '70s and into the early '80s was you had a lot—I mean, the Francophone departments were very--they had a lot of French influence, and so you had a lot of people who were much more used to thinking in terms of administered prices. So you had a whole different culture in some—you know, from one department to the next you could have a different culture on these kinds of issues. It wasn't a sort of a homogeneous and monolithic people.

LEWIS: Getting back to the foreign exchange, I mean to the exchange rate and the monetary mechanics, I'm--my question, I guess, is where the West African central bank figures into this. That's--is that involved with Cote d'Ivoire?

HINKLE: Yes.

LEWIS: I--the only time I ever messed around with this at all was in regard to Senegal. I'm not sure I even understood at the time and I certainly don't remember, but I thought I remembered that in order to keep the CFA arrangement from giving everybody just a running access to the French currency, they had to retain control of the internal budget. Is that right?

HINKLE: Yeah. What you have is you have two monetary unions, one in West Africa and one in Central Africa. The West Africa one is based in Dakar, and it's run by--it has a board of governors and its overall governing body is the council of heads of state of the member countries. There's a national agency in each and a national director in each country.

Now, there are certain rules that govern the behavior of the union as a whole. They're set out in two places. One, there's the treaty that creates the West African Monetary Union, and secondly there is an agreement between the West African Monetary Union and France which sets up the operations account which fixes the parity and guarantees the parity. In those treaties there's a requirement on the central bank that when the site commitments of the—that's when the reserves of the central bank drop below 20 percent of their sight commitments—that's essentially sight deposits in any other--they have to consult with the French about tightening the monetary policy. And that is sort of the mechanism that drives the monetary at the zone level.

There is also a very important rule at the country level. So the countries don't have—you then have monetary policy and then it's—you have monetary programming exercises and monetary targets for individual countries. And the fiscal deficit part of this exercise is managed by a rule that limits the borrowings, the monetary borrowings, the borrowings essentially from the central bank, to 20 percent of the preceding year's fiscal revenues. So the total stock of borrowings can only—and that's what keeps the fiscal deficit from busting.

And so what happens, the governments are much, in fact, concerned, not too much about the overall monetary expansion target, much more about the amount of fiscal financing.

And the 20 percent rule has worked more or less well. I mean, there's various kind of loopholes and this thing has been tightened up over time, but that's in essence how it works.

And that's a useful feature, in fact. I mean, these countries would not have had as much discipline as they've had if you didn't have this 20 percent rule. I mean, if you take—I think half, at least half of the finance ministers in the CFA zone think if they got out of the CFA zone, their fiscal problem would be solved because they could print as much money as they wanted to. [both speaking at once]

LEWIS: But you were saying earlier . .

HINKLE: These are fairly underdeveloped countries, okay, and I would bet you that if you got half of the finance ministers *[inaudible]*

LEWIS: But you were saying earlier that the way that they maintain market, I mean, a balanced market for foreign, for exchange, is by real deficits in activity, I mean, you know, unemployment, underproduction, and so on.

HINKLE: So what's happened, okay, is as the zones swung, as the monetary unions went below the required reserve level and the unions started to swing into deficits, you had very restrictive credit policies at the monetary union level, and you had essentially no growth in domestic credit from 1985 until today. In fact, it has gone down, okay? So you had nominal domestic credit. And within that, because you've had a decline in revenues, you've also had the permissible level of monetary borrowings declining. So you've had a very, very restrictive monetary policy on top of this. I mean, the terms of trade shock in its own right has had a recessionary effect.

WEBB: Devaluation would allow a looser monetary policy? Or more expansionary?

HINKLE: If you stay with a fixed exchange rate regime, certainly, you know, it depends what your policy--I mean, if your policy target is to get to a new, a lower depreciated real exchange rate, you're going to have to control the price level if you want to do that because you won't change the nominal and if the domestic price level starts to—if the price of non-tradables start to rise, you're going to go into real depreciation. So they're going to have to maintain a tight enough monetary policy, but because of the slack in the economy, when you actually do the calculations, you can program two or three years of fairly rapid expansion in GDP just to get back up to your potential growth path, okay?

So I would think, you know--when we looked at the timing of the thing, you in fact have—what I guess would happen, you could have fairly substantial expansion of exports and public investment in the early years, and then the government has to have more savings as private investment starts to pick up. But you can have a fairly rapid expansion for the first few years of this thing. You've got to go back down, back on your train of growth path.

WEBB: The reflation that's seen as becoming possible after devaluation would be driven principally by exports in this scheme?

HINKLE: Right. The big stimulus would be on the export side.

WEBB: Exports. Because the higher public investment would be largely financed by lower current expenses. At least, that's what I thought you were suggesting.

HINKLE: Your expenses would be lower in real terms, okay? You'd have a shift within the total, so you would have a higher public investment but lower public consumption.

WEBB: Right. So total public spending wouldn't be higher, but what would be higher is external, now. That's really the one thing that would drive . . .

HINKLE: No, the exports would be much higher.

WEBB: That's the way this is seen. That's the model the Bank has in mind.

HINKLE: You would also have a big expansion in import substitutes, too. I mean, we've done work, we've done a lot of work on it. You've just got the summary study, and if you look at the supply response side of this, in fact it's the import substituting side that does better for you in the early years. You know, everybody thinks it's export, but in fact it's the imports. And you get quite impressive performance out of import substitutes.

LEWIS: What kind of stuff?

HINKLE: Agriculture, a lot of agricultural stuff, a lot of simple manufactures replacing fancier ones that have become very expensive. [both speaking at once]

WEBB: *[inaudible]* quickly?

HINKLE: Yeah, faster than on the export side. Now, it's tricky because, you know, the literature on this one--they estimate elasticities, they go back and they find that a lot of times, at the time you devalue you also liberalize your trade regime. So you have the effect--you realize--the statistics show you on the one hand devalue and on the other the value of your imports go up. What's going on here is the price elasticity is positive instead of negative and in fact it's because everything isn't equal, you also take off all your quantitative restrictions, abolish your exchange rate, and all that kind of stuff. But once you sort all of that out, the people in the research complex who looked at it came to the final conclusion that in the first couple of years you did a little bit better, it was likely to do a little bit better on the import substituting side than the export side, particularly because you have a lot of tree crops here, where you get an initial surge because they start to maintain the tree crop where it required new plantings, took a number of years to come on line.

KAPUR: I was wondering, off on a slightly different subject, but also a country which you are involved with, just looking at a country like Equatorial Guinea and the Central African Republic, and sort of, just sort of going through some of these files, it sort of like *[inaudible]* the Bank, well, in the one case it failed, in one case it failed talks of structural adjustment lending to these countries where really if you look at the actual structures within these countries, one wonders what really exists. I mean, Equatorial Guinea is--and even Central African Republic for a long time; it's been better, but now--how do you sort see that, I mean the Bank's sort of philosophy of structural adjustment lending in these sorts of countries where there's virtually no civil society, almost nonexistent institutions at any level?

HINKLE: It's clear, you know, the Central African Republic's a pretty primitive country but you have, you know, you still market cotton, you still market coffee, cocoa exports, and you have market—and you still have a public budget. I mean, it's a lot—it's not nearly as developed and the structures aren't nearly as flexible, but you can still have, you know, have fiscal disequilibrium. You can have misguided price policies. In the case of Central African Republic, you have very inflated wages, also, in the public sector. But, you know, they don't have very sophisticated economies.

WEBB: In which of these, in all the countries you've dealt with during the '80s, have you seen the Bank having a pretty clear or favorable contribution to broad policies?

HINKLE: I've seen—a number of countries have made steady progress. I mean, if you take Mali, over a decade has made sort of—it's the one, I mean, it's the best case where you could say that you've have had a non-reversed, steady and improving policy performance over a long period of time.

WEBB: And the Bank played a role in getting that?

HINKLE: Yeah. Ever since the start of the original technical assistance operation back in the early '80s. And I--you know, I think we try to play a constructive role, I mean, and I think overall the Bank has, but it's, you know, the combination of the exchange rate issue and an external environment that's moved against you and things have gotten--as people have been working to try to improve the policy performance the world, you know, the world's been getting more and more difficult as time passes. And that's--that hasn't made it any easier.

They had good performance in Togo over a long period of time, up until you had the latest round of political disturbances which has brought it to a halt. Now whether, when they get by the political disturbances, the current ones, the process will be continued or not, I think it's too early to tell.

You've had a number of countries that have recently turned around, starting to move in sensible directions: Benin and Burkina. The others are more questionable; there's a lot of stop and go. And there's been a—there's been a whole group of stop and go people, like that would be Senegal, Cote d'Ivoire, Cameroon, and some I don't, you know--starting

to, started and went backwards, too, like Gabon and Congo *[inaudible]* You have countries where you've had one adjustment operation and the thing went off the track and hasn't been resurrected: that's Congo and Gabon.

WEBB: In the cases of Mali and Togo . . .

HNKLE: I'd come up with a typology if I thought about it in three or four different categories, just thinking out loud.

WEBB: In the better cases, Mali and Togo, is—do you see this as being associated very much with individuals, the Bank's good relationships, developed, steady relationships. What was it that made the Bank more effective?

HINKLE: I don't—I mean, clearly that's a part of it, okay? I think it's more the conditions—I would say it's more the conditions in the country so that the same level of effort that is going into it. You know, Senegal and Cote d'Ivoire and Cameroon have gotten massive levels of staff effort. If you look at the sort of experienced qualifications of the people who've put to work on those countries as opposed to the guys that were working on Togo and Mali, you would have said, well, in terms of the—that the effort that was being made is much greater in the other cases. But it's been a—it's (a) the starting position wasn't as bad, the cost price structure wasn't as over-inflated, the external environment wasn't as hostile, the terms of trade (they had a different mix of commodities) the terms of trade that didn't go as badly against them. And the governments, for one reason or another, were able to stay the course for a long time on a slow policy reform platform without reversing it which I think is a fair—I mean, that's got to be the exception in the rule.

I mean, I think, you know, reform programs work—they work and somebody comes in and you do a hell of a lot in one year, you know, just changes the whole structure. And things get going and then you set off on a new track. And people tinker with it at the margin. Where you start with a colossal mess and you take ten years to fix it, I mean, it's--I think it's hard to find those kind of processes working out.

LEWIS: I think I'm coming at the same kind of issue in a little different way, but going back to things you said earlier about this being a depression in West Africa. Richard was talking about fluctuations. It struck me sometimes that in the old-fashioned development game we are talking all in terms of growth. And actually in the old days we used to talk about planning, which, you know, was waiting longer, weeks at a time. I came at it as somebody who had messed around a lot with domestic macroeconomics. In the U.S. we were all concerned about fluctuations and stability.

And it—and so in India I discovered that almost nobody, in the '60s when I was there, did any short term forecasting. They didn't—nobody was thinking about the short term. Everybody was trying to push that growth engine out there.

Now, it seems to me that, you know, again, the Bank I would say cast itself as being a growth promoter and very much on a sort of a piece-by-piece basis, projects and technical assistance and so on, but sort of getting the things, those rhythms going in an uphill direction, right, not worrying too much about the slashing around in the short run, and the Fund, as a matter of fact, was, in terms of macro programs, in the short run.

And then you get to the adjustment era, and it turns out that there are important problems, that in order to promote growth, assuming that things have gotten really out of whack in the price system and the fiscal system and the monetary system, you've got to fix them to get back sort of on a growth track. Is that right? I mean, are these distinctions—how--do they make sense in terms of your West African experience?

HINKLE: Well, certainly, you know, the Bank started--in West Africa--started out the same way, basically was worried about projects and investments and you sort of assumed the macroeconomic context, that you have public, a fiscal environment in which, you know, the counterparts could be financed in which they'd service the debt and you wouldn't have to suspend disbursements on investment operations, and an incentive environment in the private sector, both in terms of prices, you know, marketing board and that kind of thing, that provided an economic incentive for expanding activities, some kind of reasonably stable macroeconomics so you wouldn't have a prolonged recession.

And that was certainly the way, you know, the way it stared out in Africa. And when I came to, in 1982, to work on Africa—and at that point I'd worked on the first structural adjustment loan, I worked on the first Philippines structural adjustment loan in 1980, '79 to '81. And at that point we were just getting into the business. And Africa was just like the rest. It was that people were waking up and realizing that you had massive fiscal problems that prevented all the things that needed to happen on the public finance side of making the investment operation work and you had all kinds of distortion in private sector incentives and either inflation or recession or both, depending on the country's macroeconomic mismanagement.

And you had the Fund—I mean, the Fund and the Bank have met in the middle, is what's happened, because the Fund was very sort of focused on the short—I mean, projections were one year ahead and they weren't really set in the context of—and policies were, you know, how do you get through the next year, not sort of where do we want to go in the long run so how should we deal with it in the short run to get there. And they've sort of extended their time horizon. You know, you've got now, you know, ESAF *[Enhanced Structural Adjustment Facility]* and SAF *[Structural Adjustment Facility]* and PFP. And the Bank has shortened its kind of horizon. So it's very much a concern about how you—what kind of policy environment do you need to make investment operations contribute to growth.

KAPUR: But isn't a part of the Bank's concern a little more of the short-term, a sort of recurrent concern for financing gaps, country after country *[inaudible]* six month flows, this year's financing gap?

HINKLE: Well, there's also—I mean, there's been a problem with both the Bank and the Fund being captured by short-term. I mean, and to--depending on the country, you can--the Bank has in some cases been captured by sort of the Fund perspective of the world that everything becomes a fiscal deficit target.

I mean, this is a major problem, too, in that, particularly in Africa, the Fund out-staffs us in a lot of these countries. So we'll have one junior economist and they'll have a very senior mission chief, three or four other economists who are more senior than the Bank guy, and you know—not all fiscal deficits are equal. I mean, I can accept a Fund target that 3 percent of GDP is a reasonable target for the fiscal deficit, and I'll buy it with a 6 percent public investment rate and I won't buy it if you get me there by a 3 percent public investment rate and that other 3 percent goes into the wage bill. And the Bank has not been very good—it hasn't really staffed itself to deal with these kind of issues on the ground, and it hasn't really provide the junior people with the support that they need in dealing with some of this stuff on a day to day basis. I think they ought to—we're becoming too Fundian in our approach to certain, some African countries.

Now, that was part of what happened in West Africa, too. I mean, the thing was working fine in the first half of the '80s, you know, a reasonable man—and even for couple years, okay, we'll say, "We can get by this one, too." But it wasn't--we had to make a major investment of resources to turn around the whole thinking on the issue.

LEWIS: Is there a reasonable division of labor between the two institutions in West Africa?

HINKLE: It depends on the—I mean, it's very much a question of the people you're working with. I mean, if you've got a team from each side where they see the world the same way and they want to work together, a lot of good things happen jointly. And it deteriorates from there in both directions, with either side being capable of being incompetent, obnoxious or both. You know, all kinds of unfortunate outcomes from the two institutions for the countries concerned.

KAPUR: You've sort of been mentioning throughout our conversation that part of the thing that has occurred with these countries in terms of trade and declining *[inaudible]* And that's particularly true because of the commodity investments, of course, especially cocoa and coffee. Yet the Bank's strategy seems to be precisely to help them with these exports in a lot of these countries. Now, you know, there used to be this earlier argument on the problem of composition, and some recent PRE *[Policy, Research, and External Affairs]* as well as some other people within the Bank sort of *[inaudible]* on this issue. They seem to again perhaps begin to question this.

HINKLE: Okay. First on the adding up problem. There's only one—in the franc zone there's only one commodity where it's a problem and it's cocoa. Where Cote d'Ivoire accounts for about 40 percent of the world production, exports of cocoa, there it's a problem if you take the *[inaudible]* Everywhere else it's a non-problem. And we have looked at the cocoa problem separately from the other aspects. And it's not—it's also not

correct to say that what we want to do is promote exports of coffee and cocoa. We want to promote exports.

And, you know, if you're real worried—the solution to the problem which really is to tax cocoa exports, which is the one that faces inelastic demand which you probably don't want to encourage any expansion of, but you need the exchange rate to promote all the other things—I mean, they can do, the Cote d'Ivoire can do rubber, it can do palm oil, it can do bananas, it can do pineapple, it can do flowers, it can do a whole host of things but you can't do it, you can't export them if the exchange rate isn't right. And equally on the import substituting side, it is the best instrument for import substituting because it's every single transaction. You can't avoid the exchange rate. You can avoid a tariff; you can even avoid a quantitative restriction.

And so I mean, yeah, there's a—you know, the whole debate about this thing is—the guys who were defending—I mean, the debate's gone--we've had a lot about there's no supply response. We've had some discussion about it, but we did a whole chapter in that paper that I gave you on supply response. There's another whole paper, follow-up on that, where we did even more work on it. There's a whole debate about inflation and is it going to get away from you and are you just going to get in a devaluation/inflation/ devaluation cycle and that's another whole debate. Within the supply response one is also the business about the adding up problem. That's a valid problem for cocoa; for cocoa it's a problem. For everything else it's not a problem. And the world is not just cocoa run.

WEBB: This supply response is a very self-fulfilling—the longer you're over-valued the more you kill price-sensitive tender shoots. They're not on the map anymore, and therefore all you have left are the less price sensitive . .

HINKLE: The ones where you have the very strongest competitive advantages.

WEBB: . . and when you look at it, it looks very inelastic.

HINKLE: The only way you can do it is to look at the problem the other way around. If prices don't work, why do these exports collapse when you lower the price? Then it's—the people who argue it have to argue prices only work in one way. In other words, if you lower the price, the supply collapses, but if you raise it, it doesn't affect supply.

I mean, when I first started to read this stuff, it was like reading all the ECLAC *[Economic Commission for Latin America and the Caribbean]* stuff that came out of Latin America in the 1950s. I mean, it was all taken—it was all the same authors and all the same models and they were all quoted and put in French and put in an African context. And it isn't any—I mean, it isn't any more valid.

There are constraints, okay? You can overdo it, you know, and the inelasticity, you know, you have to have a balance. So the idea that you don't change the exchange rate because you're not going to get a supply response and the fact somehow justifies inaction on that issue isn't supported by the evidence.

WEBB: Did the UN Commission on Africa have much of an intellectual impact, do you think?

HINKLE: Much less. It's not been like the—it's the Economic Commission for Africa and it's been much less influential than, say, ECLAC was in Latin America in the 1950s and the 1960s. And it has, you know—it has, though, tended to be an apologist for the same kind of regimes to, you know, you want to rationalize over-valued exchange rates, import controls, marketing boards, heavy government intervention to . .

LEWIS: Carrying on what much of the debate with what the Berg report was on.

HINKLE: Yeah, the Berg report was really the first effort of the Bank to deal with the intellectual arguments in Africa. There's been a whole series. There's now an African adjustment study in the works over in PRE right now that is the latest in this whole series, responding to a long-term perspective study which came out, I guess, about three or four years ago now. It's a continuation of the same trend and debate of the Berg report.

LEWIS: Do you see any sign—well, I guess we've really talked about this already—you don't see any particular sign of change in French political mentality about all this?

HINKLE: We have elections coming up in France, and it all depends. It could change if you get—because it's not—it's an issue that's within an administration's capacity to deal with. It's not a politicized issue within France. It's not something that, you know, that people stand on soapboxes and debate about. It's something that's entirely within the control of the government.

KAPUR: Especially *[inaudible]*

HINKLE: And if you get a different approach, it could change rapidly. On the other hand, you could also get—there are a lot of folks around who still have what we call the clientelist view of the Africans, you know, you focus on maintaining your relations with your clients and you sort of interpret their interests as they interpret their interests. And then you get involved in retaining and maintaining your elite in power. It's entirely possible that this whole thing will have a very depressing outcome.

KAPUR: How do you see the role of the French ex-patriate community in Cote d'Ivoire: as a problem or as a variable in these *[inaudible]*? It's quite large and in quite sensitive positions, in fact, quite a few policy *[inaudible]* How do you—I mean, has that been a . .

HINKLE: I mean, it's been a part. I mean they still have a--there's also a whole sort of cultural imperialism aspect. I mean the French do a lot for the African countries. They provide a lot of assistance, a lot of technical assistance, you know, a very high share of GNP, too, if you look at their DAC *[Development Assistance Committee]* figures are a lot better than, say, the United States. But there is also a cultural imperialism aspect to it.

Look, I wanted to say something different. I just wanted to--speaking of structural adjustment in Africa, I just--in terms of having, what happened, okay, you have the debt crisis in 1982. And the people who really responded at the debt crisis were the IMF. It wasn't the Bank. And the IMF went out and they got adjustment programs going all over everywhere, but they didn't—but two things happened to them. One is they had a lot of short-term money, you know, and the programs--to have made the adjustments within the period of the programs you would have had to have very draconian measures. And they didn't have those, so the programs weren't going to deliver their results within the period. So then they got in a question of trying to refinance them themselves. That was one thing that was happening.

The second thing that was happening was the world got worse because, you know, the second round, in terms of trade shock in the '80s, instead of the environment, you know, going back, it got worse. But the Fund got out there and got all its money out there.

And the Bank eventually got itself geared up on the scene and got the SPA *[Special Program for Africa]* organized and, you know, basically went out and refinanced all the Fund programs. And we also deluded ourselves, I think, to a large extent about the seriousness of the problem and the quality of the effort it would take to undertake such. So now we're--there's very few success stories out there. And there's been a lot of money spent to support adjustment, but a combination of self-delusion, a more hostile external environment than we anticipated when we saw the big adjustment agenda. There's still a big adjustment agenda ahead, you know.

And the IMF had then got themselves—they got themselves in a problem because they got compromised by the fact all the countries owed them money. And we've had the same kind of problem, you know, that they then get in the process of, "Well, we've got to lower our lending program so we get paid so we'll tell everybody else that this program isn't so bad so that their new money is coming in and our money is going out." And we've had that same kind of problem, too. It's not—so there's a long way to go.

WEBB: You know, I look at these figures on percentage of ODA *[overseas development assistance]* to GDP, and I—it just boggles my mind. I tried--what on earth does this mean for the future of the country to be getting 10, 15, 20 percent GDP and only a 40 percent in some—how do you see that? It's one thing, I would think, it would swamp the foreign exchange market; it really raises questions about efforts for tax raising . .

KAPUR: But also *[inaudible]* Equatorial Guinea, the Bank *[inaudible]* sort of said, "Look, they're coming to grips with the fiscal deficit. It's declining from 60 percent or 90 percent last year." And then you see, on the other hand, that, look, ODA is 40 percent of GDP. What does the term of fiscal deficit of 2 or 3 percent mean when you have 40 percent of GDP as ODA? I mean, how does one . . .

HINKLE: First, I mean, you've to keep the problem in perspective. You've got to get the micro economies out of this thing. Equatorial Guinea's got 300,000 people. And you've got Cape Verde which has got, you know, a couple hundred thousand people,

okay? And you've get all of those guys, and those are where you get those really—but there are still some countries with some big numbers. I mean you take Malawi . .

KAPUR: Zambia?

HINKLE: . . take Senegal, okay? Senegal has per capita GDP of about 750 dollars, and they must have ODA flows of about 100 dollars per cap so it must be about 15 percent of GDP net. That's a more typical kind of African problem. And there you're not—first it's a question of sustainability. If you really think--if the aid flow—you know, if you're talking about a Sahelian country and the aid flow is both sustainable as to level and sustainable as to form, in other words it's, you know, investment or stuff that people are prepared to maintain over time, it's one thing. If it's unsustainable as to level—if, you know, it's 20 percent of GDP and it's got to come back to 10, okay, you have a 10 percent of GDP problem, you don't have a 20 percent of GDP problem, though. And equally you can have a composition problem. If everybody's providing short term adjustment support and they really don't want to do that and they want to provide *[inaudible]* then the country's got a composition problem, too. And there is a--there are a whole host of problems around this. And the, you know—on the one hand they're very poor countries; on the other hand, they get a lot of aid but they haven't done a hell of a—you know, the policy performance is very mixed. I mean, you get your Ghanas, which are doing--and you get this whole debate about the French saying, "Well, but, gee, if Cote d'Ivoire only had the per capita aid flows that Ghana had, it would solve its problems." But then you look over at Senegal, which does have those per capita aid flows and it didn't solve their problems.

No, but there are a lot of questions about the whole politics of the thing and who's running the country and who's getting . . .

WEBB: Are these questions that are kind of on the side of the mind of the Bank? Do they come into major thinking? Do you find in one country—does anyone ever suggest, "Well, maybe we should just cut, substantially cut the aid flows to X country. That's the only way they're ever going to grow up, as it were."

HINKLE: I think—it goes around with performance issue. Where a country is not performing, I mean you'll find a lot of folks who would say that if you look at how our aid flows are distributed, they've been too uniform. In other words, if I had to go back and repeat the--what we did in the 1980's, I would say our mistake was to give—not to concentrate on the good performers, not to really try to make a difference and give a lot to the people who are really serious and are really trying and hardly anything to those who aren't trying. And you've got—I think you've got a lot of folks around who think that too much has gone to people who aren't trying. But then you have also the constant, the political pressure is to always give something, to give more or less the same to everybody, and it has this leveling effect. So on the one hand you have, you know, an intellectual or strategic approach to the problem says, "Let's concentrate our resources on the countries that are performing, let's concentrate where it's going to make a difference." And you have the political approach which says, "We've got to maintain the

relations with this country, and we've got to maintain the, and this donor wants, you know." And you get into that, and so it all gets watered down.

WEBB: But even in the good performers, you don't think that the aid is helping growth, that it makes it even harder for them to help push through difficult reforms?

HINKLE: It could make it harder or could make it easier. It depends on the politics. I mean, in other words, if you—you can point to a lot of cases of inadequately financed adjustment programs where you're coming out and where some aspects of adjustment are going to be contractionary and you're going to have recession for a couple years because you have to shift resources from tradables to non-tradables, whereas if you had had more resources available during that period you could grow faster during that period. So there's a whole debate about how some of the major adjustment programs have, in fact, been underfinanced and they've been going off the track because they've been underfinanced.

KAPUR: Any examples?

HINKLE: I mean, people at various points have felt that way about one of the Zambia adjustment programs, is the one that's—again, I haven't worked on one of those countries. I suspect the, you know—maybe Nigeria was one, too, I don't know. But you do hear people say that, but it doesn't—and again it hasn't happened that much in francophone Africa, which is the only part I know well.

WEBB: I mean, the Bank always works on that premise, doesn't it, that aid can facilitate reforms? Reforms mean going through a tough period, and aid money makes it easier for a country to go through that. And this is the . .

HINKLE: Well, people actually see that aid can work the other way, too. I mean, adjustment . .

LEWIS: That's a view of mine, that you can do too much in these countries.

HINKLE: I mean, that's our view right now in the franc zone, again, that we're not helping anybody by financing the Cote d'Ivoire right now. Frankly, if they default to us and the whole thing starts to head towards a cataclysm, that's exactly what's needed. And I was not personally happy to see the French come in and pay Cameroon's debt service here because what that means is that they're just putting off the problem. If they decided not to pay and let them go into nonaccrual, I'd know we're heading towards a crisis and the issue was going to get resolved. And that would have been certainly in the interest of the country, the long-run interest of the country, I think, and I think also in the Bank's interest, too. Even if we're in nonaccrual for a while, ultimately we'd get this problem resolved.

WEBB: Do you think it would be better if they were democracies?

HINKLE: They are becoming more democratic—I mean, democracy is a value in its own right. The correlation with, you know, good economic policy-making can go either way. You can have—you can become more democratic and have better policies or you can become democratic and have worse policies. I don't—there's some aspects of it, you know, the transparency side of it, assuming you have transparency and accountability and that kind of stuff that erodes the corruption, is good in its own right and also necessarily improves economic management. But it's not—I think the jury is out on whether or not the relation between good economic performance and democracy--goes both ways.

WEBB: Were you quite involved in Mali and Togo?

HINKLE: Yeah, I was. I was involved in Togo for the last three years. I was involved in Mali from '82 to '90.

[End Tape 1, Side B]
[End of interview]