THE REFORM OF THE INTERNATIONAL MONETARY FUND, WITH SPECIAL REFERENCE TO CONDITIONALITY

Tony Killick*
Overseas Development Institute
London

Given a need to be brief, it is impossible for this paper to give adequate coverage to all possible reforms of the IMF. For example, no more than the briefest treatment is given here to questions of global exchange rate determination, the future role of the SDR, and specifics of increasing the usable resources of the IMF. What follows falls into three parts: (i) a statement of the case for reform; (ii) a discussion of the longer-term, 'systemic' directions of reform; and (iii) detailed consideration of desirable changes in the IMF's conditionality.

I. The Case for Reform

The general case for international monetary reform in contemporary conditions can be argued along the following lines. First, there has in recent years been an apparent ossification in international monetary arrangements even though the economic realities with which they have been striving to deal have been changing very rapidly. Not only has world trade grown much faster than total world output in the post-war period, but the last decade has seen an enormous expansion in international bank lending, with a well-known set of associated problems, not the least of which being the difficulties of ensuring adequate official supervision of some of this activity. An impression that arrangements and policies have become ossified is conveyed vividly by a re-reading of the 1974 report on International Monetary Reform of the Committee of 20, which identifies and seeks to deal with problems that remain unresolved today, and which contains many suggestions for change which have not been acted upon. In consequence of such neglect, we have today an apparent increase in the fragmentation and 'nationalisation' of policies impinging upon the international system, even though the underlying reality has been of increasing economic interdependence.

---

*Much of this paper draws heavily upon the results of a research project recently concluded at ODI, with the participation of the present writer, Graham Bird, Jennifer Sharpley and Mary Sutton. This is recorded in the bibliography under Killick et al, forthcoming. Hereafter, this is referred to as 'the ODI study'.

It is thus not surprising that existing arrangements lack cohesion and consistency. For example, on the one hand deficit developing countries are advised to adjust their economies so as to eliminate unviable payments deficits while, on the other hand, the domestic and trading policies of the industrial countries, and the official financing they are willing to make available to support adjustment, are apparently inconsistent with the successful achievement of the very adjustment they advocate. A similar criticism could be made of recent pressures put upon commercial banks to maintain credit exposure in certain developing countries, without matching actions on the part of industrial-country governments to achieve the increase in world economic activity that would be necessary for a restoration of debt-country creditworthiness. A related incoherence lies in the reluctance of G10 governments to provide the IMF with the financial resources it would need if it were to be able to carry out the tasks the G10 insists is ought to undertake.

Related to this is an apparently diminished recognition in surplus countries of the symmetrical nature of payments imbalances - the logical impossibility that the deficit group of countries can reduce its deficits without a corresponding willingness by the rest of the world to see their surpluses scaled down.[1] As is shown later, the necessity for greater symmetry of adjustment was the principal theme of the C-20 report but there are few echoes of this in present-day discussions. This is perhaps partly because the greater flexibility in exchange rates should diminish, even eliminate, the asymmetry problem but in practice it has remained a large difficulty - with some surplus countries being reluctant to allow the necessary appreciation of their currencies. The asymmetrical nature of post-war arrangements is, of course, reflected in a distribution of voting power within the IMF which allows surplus countries (plus those who can run persistent deficits by virtue of being reserve-currency countries) a dominant voice in the councils of the Fund. They can with justification point out that they are dominant too in world trade and that it is their currencies which are on-lent by the Fund (it could hardly be otherwise), but the fact is that such a distribution of power can hardly fail to perpetuate the very asymmetry which remains one of the system's weaknesses.[2]

Another weakness - too widely accepted to need elaboration here - concerns the uncertain and unsatisfactory nature of global arrangements for exchange rate determination since the break-down of the adjustable peg system in the early 1970s. Even with 'dirty' floating, wide fluctuations around trend values in the exchange rates of

key currencies, unrelated to any but the most transient economic circumstances, have added to the costs and uncertainities of world trade and payments, although it must be added that available evidence does not point to large negative effects (see paper by V. Cable)*. That the asset-structure of global reserve assets is similarly unsatisfactory is another long-established and widely recognised criticism. It is now over 20 years since Robert Triffin's (1961) critique of the deficiencies of national currencies and of gold as reserve assets, and over a decade since the first allocation of SDRs as a potentially superior form of reserve asset. Notwithstanding the lip service which continues to be paid to the objective set out in the 1976 Jamaica agreement of "making the SDR the principal reserve asset in the international monetary system" the reality is that the SDR remains of little significance in total world reserves and the idea of the substitution account has apparently been shelved.

The ambivalence of the G10 towards the role of the SDR reflects a deeper ambiguity about the desirable role of the IMF itself. For while governments continue to affirm the importance of its objectives and while large global payments disequilibria certainly point to an important role for the Fund, member governments have been unwilling to prevent a major erosion in the size of Fund resources relative to the value of world international transactions. This is indicated by the following figures (taken from Killick _et al_, forthcoming, p.132) on the value of total IMF quotas relative to world trade:

1945	16.2%	1971	8.2%
1950	14.2%	1981	3.8%
1960	11.5%		

Even the recently-agreed $47\frac{1}{2}\%$ quota increase in 1983-84 will probably only bring the ratio to around 5%. While it would admittedly be desirable to develop a more sophisticated measure, which would take account of changes in exchange rate practices, the existence of non-Fund forms of balance of payments support, the actual and potential degree of instability in international banking arrangements, the size of payments disequilibria and so forth, further reasons are given below for believing that the Fund's present and prospective resources are inadequate.

There is a strong case, too, for a fresh approach to the policy conditions built into the stabilisation programmes supported by the Fund's stand-by and extended facility credits.[3] For one thing, there is an increasing mis-match between the policy prescriptions and the problems to which

* See this volume pp. 57-84. _Ed._

they are addressed. The time has long since passed when the presence of a balance-of-payments (BoP) problem was prima facie evidence of excessively expansionary demand policies at home. A large part of the deterioration in the BoP of oil-importing LDCS has in recent years been attributable to deteriorating commodity terms of trade and rising real interest rates. These have sometimes been aggravated by weaknesses in the domestic productive structure, eg. poor lagging food production. Of course, demand expansion has continued to play a role too but it no longer characterises the problem. Yet, despite attempts in the late 1970s and early 1980s to adapt its programmes to the changed nature of the problem, since the second half of 1981 the Fund's conditionality has in most respects been very close to its conditionality, say, in the late-1960s, with primary emphasis on demand restraint.

This mis-match between the nature of the problem and the measures employed to deal with it results in a potentially high-cost approach to BoP adjustment, with the risk of large losses of output and employment. It is an approach which appears to conflict strongly with the identification in the Fund's Articles of "the promotion and maintenance of high levels of employment and real income and ... the development of the productive resources of all members as primary objectives of economic policy" (Article I (ii)). It carries with it the danger not only of large economic costs but of political destabilisation too. Indeed, senior officials of the Fund privately admit that it is fully aware of the risk of political destabilisation resulting from its conditionality but does not know how to avoid it given the constraints with which it is faced. One of the well-known adverse consequences of this is that member-governments are often extremely reluctant to seek the Fund's higher-conditionality assistance, fearing that the cure may be more hazardous than the disease. As has recently been observed, "The premier institution for adjustment cannot remain a place to be shunned by those who need it most".[4]

It is ironic to recall that the proposals which led to the creation of the Bretton Woods institutions were presented as ways of avoiding, through international co-operation, a repetition of the recession of the 1930s, since the current thrust of the Fund's conditionality (as well as its praise for the anti-inflationary policies of industrial countries) tends to aggravate a world recession through further reductions in aggregate demand. The timing of the 'tightening up' which occurred in conditionality during the second half of 1981 was singularly inappropriate in this respect.[5]

A further strand in the argument for a re-examination of conditionality relates to the changing nature of the countries which come to the IMF for payments assistance. From 1947 until about 1978 industrial countries accounted for about two-thirds of all drawings upon Fund resources; it is only in the most recent years that developing countries have come to dominate its lending activities, so that, as shown in Table 1, as at end-January 1983 all but three of current stand-by and extended facility credits were to developing countries and the value of these amounted to 84% of the total.[6] The significance of this shift is that the formative period for the design of the Fund's conditionality was a period when most of its lending was to industrial countries. While the Fund has sought to adapt the specifics of its programmes to country circumstances this has been a 'constrained flexibility' and programmes have throughout been designed within a rather narrow framework. Partly as a reflection of this, there are widespread doubts about the suitability of the Fund's approach to the circumstances of many developing countries. Indeed, senior members of the Fund's staff share these doubts and suggest that what many of these countries need is more development assistance rather than short-term payments support geared to programmes of demand restraint.

Perhaps the most persuasive case of all for change, however, is the accumulating evidence that fund programmes are not achieving their objectives. On the basis of the results of internal Fund reviews and of independent analyses the evidence suggests that, in the general case, Fund programmes have limited effectiveness.[7] There is a tendency for them to move payments indicators in desired directions, and to affect other variables in certain ways but these tendencies only occasionally pass standard tests of statistical significance. In terms of results which do pass such tests, the programmes appear to have a limited impact. More specifically, the evidence suggests that:

- programmes are associated with a modest short-term improvement in the current account but this is of low statistical significance;

- there appears to be a stronger tendency for the basic or overall balances to be improved, although the known statistical significance of the results is again low and the achievement often falls short of IMF programme targets, which are apt to be over-ambitious;

- there are indications that Fund programmes result in additional inflows of capital from other sources but the effect is not large and ambitious expectations are likely to be disappointed;

- there is no systematic association at all between Fund programmes and sustained liberalisation;

- programmes have not generally had strong deflationary effects but there are indications that negative growth effects were stronger in the most recent years;

- programmes probably result in a net short-run increase in the inflation rate, rather than the desired reduction, but significances are again low;

- both Stand-bys and EFF programmes are subject to fairly frequent breakdowns.

It is necessary to add that the evidence surveyed is far from uniform, depending upon the period, variables and methodologies chosen. It is also important to bear in mind the intrinsic difficulties of forming an assessment of the results of IMF programmes. On the other hand, the results summarised in no way depend upon some unique set of tests and the Fund's own assessments do not claim great success. To quote the most recent internal staff review (of Stand-bys in 1980 and Extended Facility credits in 1978-80):

> The Fund cannot be complacent about a situation in which almost half the cases have not shown any progress towards balance of payments viability. This may be no worse a record than in earlier years....

In an examination of possible sources of this disappointing outcome, one possibility that comes obviously to mind is that it was due to poor programme implementation. There is a good deal of evidence that implementation leaves much to be desired. The IMF has experienced large difficulties in securing governmental compliance with a number of its key performance criteria, especially since 1973, with fiscal difficulties being a major source of non-compliance. Presumably as a consequence of this, programmes appear to have a meagre effect on the key policy

TABLE 1

Stand-By and Extended Arrangements
In effects as of January 31,1983
(expressed in millions of SDRs)

Stand-By Arrangements	Date of Arrangement	Expiration Date	Total	Undrawn Balance
Argentina	Jan. 24, 1983	Apr. 23, 1984	1,500.00	1,199.26
Barbados	Oct. 1, 1982	May 31, 1984	31.88	19.51
Chile	Jan. 10, 1983	Jan. 9, 1985	500.00	378.00
Costa Rica	Dec. 20, 1982	Dec. 19, 1983	92.25	73.80
El Salvador	Jul. 16, 1982	Jul. 15, 1983	43.00	15.50
Gambia, The	Feb. 22, 1982	Feb. 21, 1983	16.90	-
Guinea	Dec. 1, 1982	Nov. 30, 1983	25.00	13.50
Haiti	Aug. 9, 1982	Sept.30, 1983	34.50	22.50
Honduras	Nov. 5, 1982	Dec. 31, 1983	76.50	61.20
Hungary	Dec. 8, 1982	Jan. 7, 1984	475.00	332.50
Liberia	Sept.29, 1982	Sept.28, 1983	55.00	50.00
Madagascar	Jul. 9, 1982	Jul. 8, 1983	51.00	20.40
Malawi	Aug. 6, 1982	Aug. 5, 1983	22.00	12.00
Mali	May 21, 1982	May 20, 1983	30.38	5.00
Morocco	Apr. 26, 1982	Apr. 25, 1983	281.25	84.37
Panama	Apr. 28, 1982	Apr. 27, 1983	29.70	29.70
Romania	Jun. 15, 1981	Jun. 14, 1984	1,102.50	652.50
Senegal	Nov. 24, 1982	Nov. 23, 1983	47.25	41.34
Somalia	Jul. 15, 1982	Jan. 14, 1984	60.00	35.00
South Africa	Nov. 3, 1982	Dec. 31, 1983	364.00	205.00
Sudan	Feb. 22, 1982	Feb. 21, 1983	198.00	128.00
Thailand	Nov. 17, 1982	Dec. 31, 1983	271.50	224.10
Togo	Feb. 13, 1981	Feb. 12, 1983	47.50	40.25
Turkey	Jun. 18, 1980	Jun. 17, 1983	1,250.00	190.00
Uganda	Aug. 11, 1982	Aug. 10, 1983	112.50	62.50
Yugoslavia	Jan. 30, 1981	Dec. 31, 1983	1,662.00	554.00
			8,379.61	4,449.93
Extended Fund Facility Arrangements				
Dominica	Feb. 6, 1981	Feb. 5, 1984	8.55	2.85
Dominican Rep.	Jan. 21, 1983	Jan. 20, 1986	371.25	326.25
India	Nov. 9, 1981	Nov. 8, 1984	5,000.00	3,200.00
Ivory Coast	Feb. 27, 1981	Feb. 22, 1984	484.50	153.90
Jamaica	Apr. 13, 1981	Apr. 12, 1984	477.70	149.70
Mexico	Jan. 1, 1983	Dec. 31, 1985	3,410.63	3,310.32
Pakistan	Dec. 2, 1981	Nov. 23, 1983	919.00	474.00
Peru	Jun. 7, 1982	Jun. 6, 1985	650.00	550.00
			11,321.63	8,167.02
		Totals	19,701.24	12,616.95

Source: IMF, Memorandum, 7 March 1983.

variables to which they are directed. In particular, while they do tend to bring about a deceleration in domestic credit, this has slight claims to statistical significance. If we accept the basically monetarist premise underlying the Fund emphasis on the control of domestic credit, it seems unlikely that they could expect to achieve strong BoP results from the limited deceleration they achieve in the expansion of domestic credit. What is even more damaging, however, is evidence indicating no more than a moderate connection between programme execution and the achievement of desired results. Thus the hypothesis that IMF programmes have little impact because of poor implementation receives only slight support from available evidence.

In the end and accepting the desirability of effective stabilisation programmes, the most persuasive argument for reform of conditionality, and of the global economic system within which it must operate, is simply that existing practices are not working well. There have, of course, been some recent changes, particularly in response to the dangers of commercial bank debt defaults by major Latin American borrowers.[8] But they have been *ad hoc*, fire-fighting reactions to immediate problems, featuring little basic change and thus providing little assurance that similar crises will not recur. Indeed, as mentioned already, recent shifts in conditionality have been perverse, aborting some of the Fund management's attempts to adapt to changing needs. However, recent events have served to raise governments' awareness of their common interest in strengthened international monetary arrangements and have demonstrated that when the will is there changes can be achieved quite quickly. The present task is thus one of maintaining that momentum and of nudging it in the direction of systemic reform.

II. Systemic Reform

To start with the big questions, does the world need an International Monetary Fund. And, if so, in what directions should it develop?

A positive answer must surely be given to the first of these. Consider Article I of the IMF:

> The purposes of the International Monetary Fund are:
>
> (i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

These remain objectives of the highest importance in the present-day circumstances of the world economy and an international institution is needed if they are to be realised. There are, moreover, strong practical reasons for promoting these objectives through reform of existing institutions rather than by starting _de novo_. The prospects for reform are dim enough without setting up the additional resistances that would be aroused by attempts to design a new institutional framework.

A prime need in present conditions is a reduction in the risks and uncertainties resulting from the scale and instability of global payments imbalances. What is needed, it seems, is for the Fund to take a view of a viable world pattern of current deficits and surpluses, given reasonable assessments of probable capital movements, and then to so co-ordinate the policies of both deficit and surplus countries as to achieve that viability. That such an aspiration may today sound unrealistic is a measure of the ossification referred to earlier, for it was precisely in this direction that the Committee of 20 _agreed_ that the

system should develop. They advocated greater international surveillance and a system in which all countries would aim to keep their reserves within the limits of agreed 'reserve indicators', and they envisaged the IMF playing a more active role in determining the consistency and appropriateness of member-country policies. No doubt, the precise nature of the various suggestions included in their report would need modification to take account of subsequent changes (for example, reserve norms may not be satisfactory BoP indicators given floating or frequently adjusted exchange rates), but their desire to push the system in the direction of improved international co-ordination is now even more valid than in 1974. So too is the desirability of reduced dependence on national currencies and gold as reserve assets, and of regulating the expansion of global liquidity in contra-cyclical directions. On this, there is perhaps not much more to be done than to return to the thrust of the Jamaica agreement. It would, however, be desirable to regularise decisions about new SDR allocations by establishing an agreed set of guidelines to determine desirable levels and allowing the Fund management greater autonomy in making decisions about this.

Some emphasis is placed above on the asymmetrical nature of BOP adjustment as a deficiency of the present system. On this too the agreed recommendations of the Committee of 20 are illuminating and refreshing. It urged "more effective and symmetrical adjustment procedures"; that surplus countries, as well as those in deficit, needed to justify their policies to the Fund's governing bodies; and that "graduated pressures ... be applied to countries in large and persistent imbalance, whether surplus or deficit".[9] The noted, though, that special provisions would be required for such cases as the Gulf oil states with very large export earnings and low import absorptive capacity. The Committee did not agree on the forms of "pressures" that might be adopted but for surplus countries the following were among the possibilities considered:

> (i) A country could be subjected to a charge on reserve accumulations above a reserve norm or other specified level. The rate of charge could be graduated with respect to the size of the reserve accumulation and the duration of the imbalance.
>
> (ii) Countries could be required to deposit reserves above a specified level with an Excess Reserves Account to be established in the Fund at zero interest. This pressure combined with the preceding one would amount to the payment

of negative interest on excess reserve accumulations.

(iii) All or part of future SDR allocations of a country in surplus could be withheld for a specified or an indefinite period.

(iv) A report could be published on the external position and policies of a country in surplus.

(v) Countries could be authorised to apply discriminatory trade and other current account restrictions against currencies in persistent large surplus, subject to any necessary modification in the rules or practice of the GATT. This would be the most extreme form of pressure on countries in surplus.

Of these, (iii) has the merits of combining a genuine economic incentive to avoid excess surpluses and of not being contingent upon the setting of reserve targets.

It was suggested earlier that the structure of voting power within the IMF's membership was itself a reflection of the asymmetrical nature of the adjustment process (see the paper by V. Cable on the failure of the provisions relating to the 'surveillance' of surplus-country policies as an effective means of bringing pressure to bear upon them*). Were adjustment to fall more evenly upon surplus and deficit countries there would be much to be said for a similarly more even-handed distribution of power. Of course, the interests of the major trading and financing countries must be adequately represented for the Fund to be viable at all. 'One country, one vote' is not an appropriate model - but neither is dominance.

In whatever way the voting is spread, there is also a question about the degree of political control over the day-to-day working of the Fund. At present the Executive Board meets on an almost daily basis and is highly intrusive, leaving a minimum degree of discretion with the management. In exercising such detailed control the member governments are no doubt paying the Fund the tribute of treating it as important but the effect has often been negative. It has, for instance, acted as a brake on the ability of the management to adapt Fund policies to changing conditions. It has also helped to politicise lending decisions in ways which have prevented the management and

*Op cit. Ed.

staff from applying the principle of uniformity of treatment across all member countries. As a result of politicking by Executive Directors some countries have received particularly favourable treatment (eg. Zaire, Pakistan, perhaps most recently Mexico and Brazil); others have been discriminated against (most obviously in the case of Vietnam, denied access to credits because of a de facto veto, notwithstanding its highly prudent fiscal and monetary policies). And while great care must be applied in likening the Fund to a central bank, it is noteworthy that the extremely short-leash political control of the Fund is in marked contrast with traditions in some countries which give their central banks a measure of freedom from political control. In any restructuring of the Fund it would be desirable to lengthen the leash, widen the discretionary powers of the management and de-politicise some of its decisions.

One type of decision that could be altered in such a direction relates to the size of Fund quotas and subscriptions. A simple alternative would be to make these automatically subject to annual adjustments, based on a system of index-linking to trends in world trade prices or to some more elaborate formula.

The last comment to be made under the heading of 'systemic reform' relates to the reference in its Articles that its resources may be made "temporarily" available for BoP support (I (v) on p. 9 above). No doubt "temporarily" is an elastic term but, as it has been interpreted, it has confined most Fund credits to disbursement over a single year, with a maximum of three years in the case of the extended facility. Without doubt, this is a major obstacle in the way of adapting the Fund to meet the BoP needs of many developing country members. If the Fund is forced to largely confine itself to short-term programmes in the context of a liberalised system of trade and payments, it must perforce concentrate on the contraction of demand, for that is the surest way of achieving quick results. Programmes which attend more to structural adjustment involve longer gestation lags and require longer-term support (as was recognised in the extended facility and, even more so, in the World Bank's structural adjustment lending programme). A simple deletion of "temporarily" from the clause in question might meet the point but the principle that needs to be positively affirmed is that the Fund's constitution and policies should be so designed that it can provide equally effective assistance to all members. That condition is not satisfied at present, which has led some to advocate creation of a new agency to fill the gap through which some ldcs currently fall. The preference here, however, is instead for a more versatile Fund.

III. The Reform of Conditionality

The Content of Conditionality

Although this is not a concept which lends itself to precise definition, the chief components of conditionality attached to a Fund stabilisation programme can be broken down into: (a) preconditions; (b) performance criteria; and (c) other measures written into the letter of intent. However, a number of additional components can be identified as aspects of conditionality - and as variables that can be made 'easier' or 'harder' according to how the Fund wishes its conditionality stance to vary over time. These include: (d) the degree of Fund flexibility over performance criteria and other programme components, ie. willingness to grant waivers or modifications (discussed shortly); (e) the proportion of the credit which is made available in the initial instalment, ie. the amount of 'front-end loading'; (f) the frequency with which performance tests must be met before the next instalment becomes available, ie. short-leash versus long-leash programmes; and (g) its willingness to provide medium-term EFF credits rather than one-year stand-bys. Of these components, preconditions are, on past practice, most likely to include exchange rate depreciations and interest rate reforms, perhaps also changes in the pricing policies of government and parastatal agencies and, less likely, to changes in taxation. As regards the performance criteria, these include standard obligations not to introduce or intensify exchange controls and, frequently, ceilings on the acceptance of new external debt obligations of specified maturities. However, ceilings on total domestic credit and on credit to the government (or public sector) are invariably the hard core of the programme.

Reference was made earlier to a tightening in conditionality in the latter half of 1981 and it is interesting to relate this to the various dimensions of conditionality. It appears that this took the forms of (1) greater insistence on preconditions; (2) reduced willingness to grant waivers and modifications; (3) reduced front-end loading, with a substantially larger proportion of credits being retained for the last instalments of the credits so as to maintain maximum leverage over programme implementation; and (4) shorter-leash programmes.[10] It is not known whether there was any move to lower credit ceilings and in other ways make the performance criteria and 'other measures' more onerous, although it would be consistent with the direction of change if such did indeed happen. There was also an associated move away from use of the EFF and back to conventional one-year stand-by programmes (which, however, could be set within the context of a medium-term succession of such credits). The extent of withdrawal from the EFF can be judged from the fact that

while there were five EFF agreements in 1979, six in 1980 and eight in the first half of 1981, there were only two in the second half of that year and one in the whole of 1982.[11]

The Case of the Extended Facility

The history of the EFF in some ways encapsulates the problems with Fund conditionality. The EFF was, in fact, one of the few recommendations of the Committee of 20 to be acted upon. It was set up in 1974 to meet the needs of countries in 'special circumstances of BoP difficulty' requiring support over a longer period than normally covered by stand-bys. The Fund staff presentations in support of the EFF provided a cogent statement of the need for the Fund to move towards medium-term programmes and towards measures that would act upon the structure of production and demand, as well as upon the level of aggregate demand. But while it was presented as a significant shift to more supply-oriented programmes, the conditionality associated with EFF credits in practice continued to centre around the Fund's traditional concern with demand management, with credit ceilings remaining the key performance criteria. Indeed, the evidence is that credit ceilings under EFFs tended to be somewhat more restrictive than under stand-bys.[12] Any policy conditions that related to supply-oriented measures were additional to the conventional provisions.

It has become the received wisdom that EFF programmes, at least during the period of expansion of 1979 to mid-1981, were particularly problematical, which, of course, is the justification that can be offered for the subsequent, withdrawal from this facility in 1981-82. However, careful review of internal IMF studies reveals a more complex picture. Briefly, it found that EFF programmes were somewhat more likely to break down than stand-bys; that they probably brought smaller benefits to the BoP than stand-bys when comparison was made with the pre-programme situation but that there was little in it when comparison was made with programme targets; and that they appeared to have a better record in maintaining economic growth and restraining inflation. Overall, the evidence did not provide much support for the view that results with the EFF had been markedly weaker than for stand-bys. However, it should be added that the EFF represented an unsatisfactory test of the validity of supply-oriented approaches to adjustment, being a half-way house between the Fund's traditions and a more thorough-going re-design of adjustment.

Suggested Changes in Conditionality

It is the cost of adjustment which turn an unviable BoP into a problem. The task, therefore, is to minimise these costs, relative to the size of the needed adjustment. Implicit in many of the criticisms of past Fund policies is the view that it has paid insufficient attention to the cost-minimisation task. The chief determinant of such costs is the extent to which adjustment is achieved through reductions in demand (and the associated losses of output and employment), as contrasted with an increased production of tradeable goods and services. Linked to this factor is the amount of financing that is available to support the adjustment programme and, therefore, the time available to achieve the necessary changes in output and demand.

Our most general recommendation, therefore, is for Fund-supported stabilisation programmes to be consciously set within a cost-minimising framework.[13/] This would carry a number of important implications. First, it would involve placing greater weight on the 'primary' objectives of growth, employment and development specified in the Articles, and accepting them as constraining the design of stabilisation programmes. The Fund already does this to some extent with respect to economic growth (and also price stability). On the other hand, it has always declined to take explicit account of distributional consequences when designing its programmes. While we accept that this is both a sensitive area and one on which it is often difficult to obtain firm evidence, sensitivity of subject-matter has not deterred the Fund from other policy areas. Moreover, its programmes frequently include measures which directly affect the distribution of income: changes in the pricing policies of parastatals, in the structure of taxation and subsidisation, in incomes policies. No doubt it is often necessary for programmes to be addressed to such measures but surely no rounded view of their desirability can be formed without explicitly assessing their likely distributional consequences? This is particulary true of the poorest members of society who must be protected from the potentially adverse effects on their precarious hold on life of the general need to restrain consumption. Quite apart from this, the distributional factor has a crucial bearing upon the likelihood that an agreed programme will be executed and sustained, as repeated difficulties over the reduction of food subsidies and devaluation have demonstrated.

The greater attention to costs advocated here should be further extended to a more systematic and explicit consideration of the political consequences of stabilisation programmes; indeed, one of the chief reasons for programme

breakdowns is that governments often perceive the political costs of carrying through a programme to be greater than the payments crisis to which it is addressed. While the Fund does form political judgements, it is weak in this area. There are both ethical and efficiency grounds for urging the Fund to strengthen its capacity in this area. At the moral level, and to quote Foxley (1981, p. 225), if one prefers an open, democratic society then policies 'that require a good deal of political repression to have a reasonable chance of success are certainly not a satisfactory solution'. At the efficiency level, programmes designed with sensitivity to the probable political consequences simply stand a better chance of being implemented.

Not the least of the advantages of the changes suggested above is that it would tend to narrow the differences between the objectives of the Fund and member governments. It opens up the possibility that a higher proportion of programmes could be arrived at by consensus, thus increasing the probability of successful implementation. More extensive employment of resident Fund representatives would also facilitate the achievement of consensus, as would a cessation of the practice by which the Fund mission brings with it a draft of the letter of intent (admittedly open to negotiation) setting out what is represented as being the government's programme.

Another general recommendation concerns the degree of variety in programme design. Although the Fund does seek to adapt programmes to specific country situations, it does so within narrow confines and there is a rather well-defined 'conventional' IMF approach, based largely on demand management and exchange rate depreciations. We urge the use of a richer mix of policies and acceptance of the principle that programmes must be designed to address the causes of the problem in question. Demand-control programmes addressed to 'structural' problems are apt to be high-cost solutions; just as 'supply-oriented' programmes are in the face of deficits resulting from excess money creation. In our view, country circumstances vary too much for any standard approach to be appropriate.

Next we urge that the Fund should move away from its emphasis on quantified performance criteria and concentrate instead on achieving a consensus with member governments about the policy measures necessary to achieve the desired stabilisation. A shift towards achieving a consensus on policy changes would carry a number of implications. It would require substantial give and take among both parties, including more flexibility on the part of the Fund than it has sometimes shown in the past. It would also require more

time, or a more continuous interaction between the Fund and the government, than has typified past stand-bys. For this and other reasons, we favour more extensive use of resident Fund representatives.

The case for dispensing with quantified performance criteria in a wide range of circumstances relates to the attention biases they create; the large margins of error to which they are subject; the sometimes rather tenuous connection between them and the economic variables it is desired to influence; the barrier they may set up against a rounded judgement of the overall extent of programme execution. Instead, continuing access to Fund credit should depend upon an overall judgement about the extent of programme execution - what are known in Fund parlance as 'review clauses' - rather than upon observance of conventional performance criteria.

There would, however, remain a role for quantified indicators of programme execution so long as the uncertainties are small enough for them to be meaningful as indicators. Subject to this qualification, there is, however, a case for utilising a wider range of economic indicators than has been in the past. It is not typically the case any more that monetary indicators are the only tolerably reliable statistics which are quickly available. Monitoring these, probably in relation to a targetted range of values, could provide valuable evidence on progress with the programme and an early warning system when things are going wrong. When a red light is flashed, this could serve as a triggering device for a review mission from Washington to determine whether overall execution of the programme is sufficiently poor for the government to be declared ineligible for continued access to the credit until policy performance is improved.

A final general recommendation is to reverse the trend towards a relative reduction in the resources available within the low-conditionality facilities and specifically to increase the size and coverage of the compensatory facility (CFF). It is basic to any cost-minimising approach to BoP management that temporary deficits should be financed; only non-reversing deficits should bring into play corrective policy actions. This is, in fact, a widely accepted principle and one which is incorporated in the CFF.

The relative size of this facility has, however, declined over recent years and there is a good case for making more resources available under it by raising the quota limits on drawings and the percentage of shortfall

that may be covered. Furthermore, the logic of the CFF argues in favour of extending its coverage to include all aspects of externally generated short-term adverse movements in the income terms of trade. This implies compensation for import excesses arising from increases in import prices as well as against export shortfalls. While such modifications would assist countries in dealing with temporary payments problems, they would also ensure that where a deficit is persistent, ineligibility for CFF finance would drive the country towards the stricter conditionality facilities, even if the deficit results from external factors. Expansion of low conditionality lending through a modified CFF rather than through the first credit tranche has the advantage that it avoids the 'moral hazard' associated with the sub-market interest charges on some Fund finance. Without the external causation element contained in the CFF, countries might be encouraged to pursue over-expansionary domestic policies which result in access to relatively cheap, and in effect subsidised, resources from the Fund.

For expositional purposes, it is convenient to identify two polar cases of countries facing a (non-temporary) BoP problem. First, there is what might be called a 'classical IMF' problem, of a persistent deficit attributable largely to excessively expansionary fiscal and monetary policies. At the other extreme we may take the 'structural' case of a country confronted with an enormous increase in the unit cost of imports, a depressed foreign demand for its traditional exports and persistent, serious deterioration in the terms of trade, pursuing responsible fiscal and monetary policies at home. These factors may be aggravated by structural weaknesses of a more domestic origin, or such weaknesses may themselves be the principal source of difficulty - lagging agriculture; high-cost industry; an inefficient marketing system.

As regards the 'structural' problems, the type of programme required is one that places primary emphasis on improved capacity utilisation and on shifting the distribution of productive resources in favour of tradeable goods and services, plus supporting demand management policies. Essentially, what is being urged is a redesign and reactivation of the EFF - something which, therefore, it should be possible to accommodate within the Fund's existing framework of activities. The precise nature of this type of programme is specified in some detail in the concluding chapter of the ODI study (see Killick *et al*, forthcoming). Since it is possible fully to specify such programmes only in a country context, the Annex includes a specific illustration applied to the situation in Kenya as at mid-1982. The chief features of this are:

(a) It is set in a cost-minimising, growth oriented framework and is also designed to be consonant with the government objectives of poverty alleviation.

(b) It is a medium-term programme, designed to be executed over five years.

(c) The emphasis is upon a programme arrived at as a consensus, reflecting a genuine government commitment. We place some importance on the role of an IMF resident representative in this context, as also in monitoring the programme.

(d) A substantial number of measures to stimulate the production of exportable and import-substituting goods and services relative to non-tradeables are included, with at least the same status as other provisions of the programme.

(e) The inclusion, however, of supporting demand-management measures, including fiscal and monetary restraint, in recognition that the absence of such restraint could subvert the success of the measures directed at the productive system by preventing the necessary reduction in absorption (especially consumption) relative to output.

(f) Quantified performance criteria are replaced by a broader set of 'review indicators'. Performance under these indicators would not govern eligibility for continued access to the credit, as in the case of existing performance criteria, but - like these criteria - they would trigger a review mission whose job it would be to form a rounded judgement of overall progress with the programme and to make recommendations about continued access on that basis. A review mission could be despatched at the initiative of either the government or the IMF.

(g) There would be an agreed timetable of execution of all, or a large proportion, of the programme elements and explicit provision for the ways in which progress would be monitored.

(h) In addition to lending its own resources, the Fund would initiate actions to attract additional supporting finance from other multilateral, bilateral and, perhaps, commercial sources.

It is worth repeating that the type of programme just outlined is not presented as a new standard approach. The important principle is that programmes should be designed according to specific country circumstances. In practice these are likely to include some combination of excess-demand and structural weaknesses, and these will call for a blend of the Fund's traditional approach (subject to the various recommendations presented earlier) and of the type of measure just outlined.

Questions Arising

Inevitably, many questions are begged in the foregoing because of the difficulties of doing justice to the complexity within a brief paper. Most of these questions are, however, discussed in the concluding chapter of the ODI study; the procedure is adopted below is to give only brief reference to the discussion in the ODI study. Particular attention is drawn to the following:

(a) Consideration is given to the possibility that the Fund's conditionality should incorporate 'positive discrimination' in favour of the less developed countries. It is argued that the Fund should rather adhere to its present principle of uniformity of treatment but that in applying this it should pay more attention to countries' differing capacities to transform their economies.

(b) For the above recommendations to be feasible the Fund would require large increases in its usable resources (in addition to the pending increase in quotas). There is a variety of possible sources and we favour further quota increases, a new SDR allocation designed to provide extra resources for programmes financed out of the General Account, and further utilisation of the Fund's gold resources. Such increases in resources would be linked with interest-subsidy arrangements for the poorer (or least creditworthy) borrowing ldcs.

(c) The above proposals could be regarded as an attempt to transform the IMF into a long-term aid agency, and as obscuring the traditional division of labour with the World Bank. This is rebutted and it is argued that in order to carry out its primary task of providing BoP support the Fund must perforce move in the direction of longer-term programmes which pay more attention to supply-oriented measures.

(d) It can also be objected that the proposals would give the IMF too much power over borrowing-country policy, extending its influence from macroeconomic demand variables to microeconomic supply variables. The reply is that the macro/micro distinction is unhelpful; that supply measures would not be additional conditionality, as they are with the present EFF; that they are offered in a context which would be structured so as to arrive at programmes by consensus; and that this type of difficulty does not appear to have been insurmountable in the case of the World Bank's structural adjustment programme.

(e) Put crudely, the suggestions are open to the objection that 'there's nothing in it for the industrial countries' - that it would require an additional transfer of resources to LDCS which would involve real and unacceptable costs to DCS It is replied that there is a common interest in a strengthening of the payments adjustment mechanism (and the international monetary system) and that, when there is much underutilised capacity in industrial countries, it is not apparent that there would be significant real economic costs.

One point not dealt with in the Annex on which some comment should be offered is the suggestion (by Cooper, reported in Williamson,1982) that Fund conditionality should be varied over time so as to have a contra-cyclical effect on the world economy. While sharing his criticism of the 1981-82 tightening at a time of acute world depression, the suggestion carries certain difficulties. It implies that some countries facing payments problems may be refused credits even though they are agreed with the Fund about what

needs to be done, on the grounds that there is a global excess of liquidity (as well as the contrary position in which a country receives a credit even though it has no adequate BoP programme, because of a global shortage of liquidity). A preferable principle would be that credit decisions should be made on the merits of the country case and that like circumstances require like solutions, both across countries and over time. A better way for the Fund to smooth out fluctuations in the world economy would be through the discriminating creation and withdrawal of SDRs according to global liquidity needs, although it is true that were it in a position to give large-scale support to many countries the Fund could not ignore the effect of its decisions on global liquidity.

IV. Conclusion

No attempt will be made here to summarise the foregoing. It must, however, be added that a paper confined to an examination of the reform of the IMF suffers from the disadvantage that what the Fund can and ought to do may only really be decided in a more general context which includes other aspects of payments financing, international trading policies, the roles of other monetary and financial institutions, and the economic policies of the major economies of the world. Just as the ability of deficit countries to achieve BoP adjustment is contingent upon the actions of the surplus countries, so suggestions concerning the policies and resources of the Fund can only finally be settled in the context of an overall view of the total flow of resources to deficit countries and the terms upon which these are made available. These matters are, however, outside the present terms of reference.

Footnotes

1/ This discussion admittedly glosses over the question of what definition of "deficit" is most relevant in this context. In loose terms, the objective must be to eliminate that part of current account deficits (surpluses) that cannot be matched by sustainable inflows (outflows) of capital.

2/ For an authoritative discussion of the dominance of the Group of Ten (G10) countries in the affairs of the IMF see Tew, 1982. Dell and Lawrence, 1980, discuss the asymmetrical nature of present-day arrangements.

3/ There are, of course, other Fund facilities which do not attract the same of conditionality, the most important of which being the Compensatory Financing Facility (although even with this there is apparently a greater tendency to associate access to the CFF with agreement to a higher-conditionality credit). Discussions of conditionality in this paper refers to the higher-conditionality stand-by and external facility credits, plus associated uses of the Enlarged Access Policy.

4/ From the second report of the Brand Commission (1983) p. 65.

5/ That such a 'tightening up' occurred is by now well documented - see chapter 6 of the ODI Study. See also Williamson's (1982) record of criticisms of the Fund for the pro-cyclical effect of this change.

6/ It is evident, however, that the economies of countries such as Mexico, Brazil and Argentina have many of the characteristics of industrial economies and continue to be classified as 'developing' largely as a matter of convention. This qualifies statements about the concentration of Fund lending in 'developing' countries.

7/ For published evidence see Beveridge and Kelly (1980); Connors (1979); Donovan (1982); Johnson and Reichmann (1978); Reichmann (1978); and Reichmann and Stillson (1978). Chapter 7 of the ODI Study also makes extensive use of unpublished Fund staff assessments, as well as drawing attention to the conceptual and practical difficulties of arriving at a definitive judgement.

8/ On this see ODI Briefing Paper No. 2, 1983, 'Developing Country Bank Debt: Crisis Management and Beyond'.

9/ These references are from pages 4-11 of their report.

10/ We suspect that there was also an associated tendency to increase the de facto conditionality for access to the Compensatory Facility by requiring prior agreement on a higher-conditionality programme but have been unable to confirm this.

11/ However, three new EFF credits were announced in the early months of 1983, including large ones for Mexico and Brazil. It is not clear at this stage whether this signals a more general rehabilitation of the EFF.

12/ Unpublished Fund statistics show the targetted deceleration of overall and public sector domestic credit to be both absolutely and relatively greater in 1978-80 EFF programmes than in 1980 stand-by programmes.

13/ The term 'cost minimisation' is admittedly being used loosely here, to describe a conceptual framework rather than any precise quantification. We do not intend to imply that all adjustment costs are capable of being measured in value terms.

REFERENCES

Beveridge, W.A. and Kelly, M.R., 'Fiscal content of financial programs supported by stand-by arrangements in the upper-credit tranches, 1969-78' IMF Staff Papers 27 (2), June 1980.

Brandt, Willy et al, Common Crisis; Second Report of the Brandt Commission, London, Pan Books, 1983.

Committee of Twenty, International Monetary Reform, Washington, IMF, 1974.

Connors, Thomas A., 'The apparent effects of recent IMF stabilisation programs', Washington, Federal Reserve International Finance Discussion Paper No. 135 (mimeo), April 1979.

Dell, Sidney and Lawrence, Roger, The Balance of Payments Adjustment Process in Developing Countries, New York, Pergamon Press, 1980.

Donovan, Donal J., 'Macroeconomic performance and adjustment under Fund-supported programmes: the experience of the seventies', IMF Staff Papers 29 (2), June 1982.

Foxley, Alejandro, 'Stabilisation policies and their effects on employment and income distribution: a Latin American perspective', in Cline, William R. and Weintraub, Sidney (eds), Economic Stabilisation in Development Countries, Washington, Brookings Institution, 1981.

Johnson, G.G. and Reichmann, T.M., 'Experience with stabilisation programs supported by stand-by arrangements in the upper credit transches, 1973-75', Washington, IMF, Unpublished paper, February 1978.

Killick, Tony (ed); Bird, Graham; Sharpley, Jennifer; and Sutton, Mary, (1) The Quest for Stabilisation: the IMF and the Third World: (2) The IMF and Stabilisation: Developing Country Experiences, London, ODI and Heinemann Educational Books, forthcoming.

Reichmann, T.M., 'The Fund's conditional assistance and the problems of adjustment', Finance and Development 15 (4), December 1978.

Reichmann, T.M. and Stillson, R., 'Experience with programs of balance of payments adjustment: stand-by arrangements in the higher credit tranches', IMF Staff Papers 25(2), June 1978.

Tew, Brian, 'The position and prospects of the international monetary system in historical contex', in Killick, Tony (ed), _Adjustment and Financing in the Developing World: the Role of the IMF_, Washington, IMF and ODI, 1982.

Triffin, Robert, _Gold and the Dollar Crisis_, New Haven, Yale UP, 1961.

Williamson, John, _The Lending Policies of the International Monetary Fund_, Washington, Institute for International Economics, August 1982.

Williamson, John (ed), _IMF Conditionality_, Washington, Institute of International Economics, 1983 (forthcoming).