THE INTERNATIONAL MONETARY FUND AND DEVELOPING COUNTRIES: RETROSPECT AND PROSPECT**

BY

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1 INTRODUCTION

The relatively poor economic performance of a significant number of non-oil developing countries (noldcs) in the period since 1973 has generated considerable interest in the mechanisms through which these countries receive international financial assistance. As part of this examination attention has focussed on the role played by the International Monetary Fund (IMF), with the nature of the relationship between the Fund and developing countries featuring prominently in the North-South dialogue.[1]

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A great deal of assistance has been provided by the IMF both in terms of discussing issues and in making data available. However without doubt the IMF would wish to dis-associate itself from many of the views expressed here. Similarly none of the afore-mentioned people share any responsibility for these views.

1 For the purpose of simplicity this paper treats the IMF as if it were an institution with but one view. In fact given the structure of the Fund there are a range of often conflicting views to be found within 'the' Fund. Particularly significant is the distinction between the Fund's own staff and its Executive Directors but also important is the distinction between the Fund's different departments. Similarly this paper cannot over-stress the heterogeneity of developing countries. Different developing countries may possess very different attitudes towards the Fund, and to treat ldcs as a group is there-fore a gross simplification. As a result many of the general statements made in this

This relationship finds expression in a number of ways. First, the Fund provides a direct source of international finance for developing countries through the allocation of Special Drawing Rights (SDRs) as well as through drawings under the reserve and credit tranches and under a range of special facilities. Second, since a proportion of Fund finance is conditional upon the agreement and execution of specific economic programmes the Fund exerts a significant impact on domestic economic policy within borrowing countries. Third, through such programmes the Fund may have a 'catalyst effect' on the provision of finance from the private international banking sector, not least in the context of debt rescheduling exercises. Fourth, the Fund may exert some albeit rather minimal pressure on surplus countries to expand their economies. To the extent that this pressure is effective it serves to improve the trading performance of developing countries. Finally, the Fund endeavours to provide a code of conduct for international monetary relations and this may afford developing countries some protection against economically stronger countries using measures which they construe as being to their own advantage but which are to the disadvantage of developing countries.

Since its establishment in 1947 the Fund has shown a growing awareness of the international financial difficulties encountered by developing countries, and over the years a number of facilities have been introduced which have had the primary intention of benefitting such countries. These include the Compensatory Financing Facility, the Buffer Stock Financing Facility, the Extended Fund Facility, the Trust Fund, the Supplementary Financing Facility, the policy of 'enlarged access' and various subsidy schemes.[2] While arrangements of this kind have undoubtedly been of assistance to developing countries, the Fund has always represented itself as a monetary and balance of payments oriented, rather than as a development oriented institution.

Among outside commentators, however, there is considerable debate about how far the Fund should move in a developmental direction, with some observers feeling that it has already gone too far in relaxing the financial stringency of the programmes which it supports. Indeed one suspects that even the Fund's own perception of its role is currently more ambiguous than has been the case in the past.

This paper sets out to contribute to the debate by analysing data on

paper are subject to a number of exceptions. It is perhaps particularly useful to distinguish between middle and high income noldcs that have access to private capital markets and low income noldcs that do not.

2 For a fuller discussion of the evolution of these facilities see Bird (1978) (1981a).

certain aspects of the Fund's dealings with developing countries; by identifying the key issues involved; and by proposing certain modifications to existing arrangements. Section 2 investigates the significance of the Fund as a source of finance for ldcs. Section 3 examines the nature of Fund conditionality and assesses its appropriateness. Section 4 presents a number of proposals for reform, while Section 5 offers some general conclusions.

2 THE IMF AS A SOURCE OF INTERNATIONAL FINANCE

Developing countries may acquire finance from the Fund through both the General Account and the Special Drawing Account. This paper concentrates on the former. Because their allocation is based on IMF quotas, developing countries have received only about 20 per cent of the SDRs that have been created. Having said this, they have derived considerable benefit from SDRs, perhaps particularly through the unrequited real resource transfers which their net use permits, but also from the security afforded by holding extra reserves.[3]

2.1 *The Pattern and Trend of Drawings*

As Table 1 reveals developing countries as a group have made considerable use of the IMF as a source of international finance, although there has been a marked range of experience amongst them. While some ldcs have made frequent and large drawings others have had little if any recourse to the Fund. 1976, 1980 and 1981 stand out as years when developing countries drew relatively large amounts from the Fund. These years contrast sharply with 1977 and 1978 when drawings were very low; indeed in both these years developing countries actually made a net repayment to the Fund. Table 1 also shows that in 1979, 1980 and 1981 developing countries accounted for 100 per cent of drawings on the Fund. By the end of 1979, of the 101 developing countries

3 For an analysis of the benefits of SDRs for developing countries see Bird (1979a). For an estimation of the real resource flows associated with SDR net use see Helleiner (1974) and Bird (1976a). Although this paper focusses on the relationship between the IMF and developing countries through the General Account it should be noted that there is considerable scope for using SDRs to provide assistance for developing countries not only through the conventional link mechanism but also through financing commodity stabilization (Bird (1976b) (1978) and through a substitution account (Bird (1981b)). With such modifications IMF pressure to move towards a SDR based system could be of major importance to developing countries, and could be of relatively more importance than many of the reforms discussed in this paper.

TABLE 1 – FUND ASSISTANCE TO MEMBERS – DISBURSEMENTS AND REPURCHASES (billion SDR's)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
1. Purchases under all Fund facilities (excluding reserve tranche purchases), plus Trust Fund loan disbursements	0.3	3.1	4.0	6.0	3.5	1.9	2.2	4.6	7.1
Industrial countries	–	1.5	1.8	2.4	2.3	0.1	–	–	–
Developing countries	0.3	1.6	2.2	3.6	1.2	1.8	2.2	4.6	7.1
Trus Fund loan disbursements	–	–	–	–	0.2	0.7	0.5	1.3	0.4
2. Repurchases[1]	0.6	0.6	0.4	1.3	2.9	4.8	4.2	3.3	2.1
Industrial countries	–	0.1	–	0.4	1.6	2.8	2.6	1.4	0.5
Developing countries	0.6	0.5	0.4	0.9	1.4	2.0	1.6	1.9	1.6
3. Net purchases (+) and net repurchases (–) (all members)	–0.3	2.5	3.6	4.7	0.6	–2.9	–2.0	1.3	5.0
Repaid to lenders	–	–	–	0.2	0.3	2.6	2.8	0.9	1.1
Industrial countries	–	1.4	1.8	2.0	0.8	–2.7	–2.4	–1.4	–0.5
Developing countries	–0.3	1.2	1.8	2.8	–0.2	–0.3	0.5	2.7	5.5

[1] The first Trust Fund loan repayments are not due until July 1982.

Note: Components may not add to totals because of rounding.

Source: IMF Survey 25, January 1982.

then belonging to the Fund, 87 had drawn on it. Historically, drawings have been heavily concentrated in a much narrower group of countries with the largest five users in absolute terms (to end 1979), India, Argentina, the Philippines, Chile and Pakistan, accounting for 29% of total drawings by developing countries, the largest ten accounting for 45% and the largest twenty for 62%. However, over more recent years the Fund has begun to do much more business with the relatively low income countries of Africa and Asia and proportionately much less with its more traditional Western Hemisphere and non-oil Middle East clients. Thus outstanding IMF credits to Western Hemisphere countries as a percentage of total credits fell from just under 24% at end 1977 to 10% at end 1981 while the share of credits to African countries (excluding South Africa) rose from 15% to 26% and to Asian countries from 27% to 36%. On a *per capita* income basis it emerges that following rapid growth as of end 1981 some 56% of outstanding IMF credits were with countries where 1978 *per capita* income was less than $700 while only 5% of credits were with countries with 1978 *per capita* income of more than $3000. Evidence for 1982 suggests that as much as two thirds of total IMF commitments are now with countries where 1978 *per capita* income was less than $700 and more than 80 per cent of these commitments are in turn with countries with *per capita* income of less than $300 (see Table 2).

From amongst the Fund's range of facilities the credit tranches have historically represented the single largest source of finance to ldcs. About half as important as these has been the CFF followed by the oil facility. The extended facility has been of growing significance while the buffer stock facility has been of only very limited quantitative importance. The overall picture is, however, not representative of all developing countries. Some have relied more heavily on the compensatory and/or oil facilities than on credit tranches.

The pattern of drawings under the various Fund facilities has also varied significantly over time. Ordinary tranche drawings represented easily the largest source of finance until 1972. In only five of the years between 1963 and 1976 did CFF drawings account for more than 10% of total ldc drawings. In 1976, however, there was a major change in the relative use of the various IMF facilities and for almost all developing countries drawings under the OF and CFF became larger than those under the credit tranches. Since 1976 the OF has been discontinued and ordinary tranche drawings have again been the single largest source of Fund finance for noldcs. A summary of Fund transactions is provided in Table 3. Until recently low conditionality drawings dominated the total. In the period following the first rise in oil prices in 1973

TABLE 2 – IMF COMMITMENTS UNDER CONDITIONAL PROGRAMMES
(in millions of dollars, as of December 31, 1981)

To countries with a 1978 GNP per capita of:

less than $300	*$300–$699*	*$700–$2,999*	*$3,000–$6,999*	*$7,000 and over*
Bangladesh, $931	Dominica, $10	Costa Rica, $322	Gabon, $40	
Burma, 31	Grenada, 4	Guatemala, 22		
Ethiopia, 79	Guyana, 175	Ivory Coast, 564		
India, 5,820	Honduras, 55	Jamaica, 556		
Madagascar, 127	Kenya, 281	Korea, 670		
Malawi, 58	Liberia 64	Mauritius, 35		
Mauritania, 30	Morocco, 951	Romania, 1,283		
Pakistan, 1,070	Senegal, 73	Turkey, 1,455		
Sierra Leone, 216	Sudan, 497	Uruguay, 37		
Somalia, 50	Thailand, 948	Yugoslavia, 1,935		
Tanzania, 209	Togo, 55			
Uganda, 131	Zambia, 931			
Zaire, 1,062	Zimbabwe, 44			
Subtotal:				
$9,814	$4,088	$6,879	$40	0
% of total:				
47.1%	19.6%	33.0%	0.2%	0.0%

Source: Morgan Guaranty Trust

about two-thirds of Fund lending was on a low conditionality basis. Even as late as May 1979 it has been estimated that drawings under the Fund's low conditionality facilities accounted for some 90 per cent of total Fund lending.[4] By 1980/1981, however, about 75 per cent of new lending by the Fund involved high conditionality.

While there is no obvious trend in terms of developing countries' aggregate drawings on the Fund, by examining the years 1965–81 a number of sub-periods do emerge. In 1965–69 drawings were relatively high, they were low between 1970 and 1973, higher during 1974–76, low again during 1977–79 and high again in 1980–81. Given the diversity of ldc experiences it is difficult to provide a satisfactory explanation of these variations, but world economic developments, as well as institutional changes are consistent with the pattern of drawings.

Thus the marked increase in drawings in 1975 and 1976 reflected the introduction of the OF, the liberalization of the CFF and an increase in the number of developing countries recording deficits. It has been estimated that had the rules governing the CFF remained unchanged drawings under this facility in 1976 would have been only 20% of their actual level (Goreux (1977)). As the relative importance of the OF and CFF increased so the share of drawings under the ordinary tranches diminished. Furthermore, there was a significant and apparently growing reluctance to make drawings which extended into the upper tranches. Prior to 1974 58% of total net purchases in the credit tranches went into the upper tranches, against only 19% in 1974–76. Over 1976–78 only 8 credit tranche drawings by developing countries went beyond the first tranche. This was no doubt partly due to the greater use that was made of other Fund facilities and the growing importance of commercial sources of finance. It is certainly not the case that noldcs' balance of payments were sufficiently strong so as not to require assistance.

The problem for 1977–79 is to explain the generally slight usage made of almost all sources of Fund finance, (see Bird and Orme (1981)). Ldcs showed considerable reluctance to draw on any of the Fund's facilities, which resulted in the Fund possessing considerable excess lending capacity.

During 1980 and 1981 drawings on the Fund by noldcs increased quite dramatically. This no doubt reflected the deterioration in the balance of payments of these countries associated with the second major increase in the price of oil at the end of the 1970's and their declining export performance. It probably also reflected the apparent softening of IMF conditionality which followed the Review of Conditionality Guidelines in 1979 as well as the

4 See Williamson (1979).

TABLE 3 – SUMMARY OF FUND TRANSACTIONS, 1978–81 (in millions of SDRs)

	Calendar year			January 1 to September 30
	1978	1979	1980	1981
TOTAL PURCHASES	3,744.3	1,842.8	3,752.7	5,236.3
Reserve tranche	2,535.5	147.1	359.2	279.7
Credit tranche	421.0	853.1	1,798.6	2,699.0
Of which, supplementary financing facility	(–)	(205.4)	(943.1)	(1,096.7)
Of which, enlarged access	(–)	(–)	(–)	(158.9)
Compensatory financing	577.7	572.0	980.4	1,044.7
Extended facility	174.0	233.0	614.5	1,212.9
Of which, supplementary financing facility	(–)	(101.5)	(275.2)	(410.0)
Of which, enlarged access	(–)	(–)	(–)	(190.4)
Buffer stock	36.1	37.7	–	–
TOTAL REPURCHASES	4,845.2	4,215.3	3,344.8	1,637.2
TRUST FUND LOANS	688.1	526.6	1,256.0	367.7

– signifies zero

Source: Finance and Development, December 1981 further liberalization of certain Fund facilities, the lengthening of the period over which assistance was made available, the increase in quotas, and the policy of enlarged access.

2.2 *The Significance of Fund Finance to Developing Countries*

So far we have looked only at the absolute size of drawings from the Fund. It is more instructive to examine such drawings in relation to the needs of noldcs for finance and in relation to other sources of financial inflow. The need for finance is reflected by the current account balance of payments. During the period 1974–79 net Fund credit financed less than 5 per cent of the noldc current account deficit. Again during 1980 and 1981 commercial banks provided noldcs with about fifteen times as much finance as did the IMF ($85b as compared with $5.6b). Even assuming that they were to have drawn to their full potential the quantitative significance of Fund finance to non-oil developing countries as a group would have remained limited as compared with other financial inflows.

Although the above evidence seems to suggest that the direct importance of the Fund as a source of finance is small, three riders to this statement are appropriate. First, the IMF may provide a directly significant quantity of assistance in particular years and in particular cases. Thus, while drawings on the Fund covered only 3.2% of the combined balance of trade deficit of all noldcs in 1978, drawings covered more than 40 per cent of the deficits of Peru, Jamaica, Burma and Sri Lanka. Similarly drawings covered 14 per cent of the combined noldc payments deficit in 1976, and 7.3 per cent in 1981. This is likely to become much more the case if the recent trend in Fund lending continues towards concentration in low income countries which do not have access to private capital markets. In this case the IMF and the banks would be involved in different noldcs and the overall figures would therefore mean very little.

Second, even where only a small proportion of the deficit has been covered by Fund finance, the availability of Fund resources has often been such that a much larger proportion could, in principle, have been covered.

Third, even though the absolute amounts of finance provided by the IMF are relatively small, through its conditionality the Fund may have a catalyst effect on flows from other sources, in particular the Eurocurrency market. Some proportion of Eurocurrency flows should perhaps therefore be indirectly attributed to the IMF inasmuch as they would not have taken place had it not been for the Fund's 'seal of approval.' However this effect is likely to be limited to the more credit-worthy middle and high income countries. It is unlikely that even the negotiation of a Fund programme would entice banks to lend to low income countries which they view as uncredit-worthy. Thus while in certain instances the catalyst effect may well be significant it is clear that drawings from the Fund and the acceptance of the related conditionality is, in itself, neither a necessary nor sufficient condition for access to commercial loans.

3 CONDITIONALITY[5]

Although historically it has not always been the case, there is now little disagreement over the principle of Fund conditionality.[6] Even the most outspoken critics of the Fund see it as legitimate that creditors, such as the Fund, should require borrowers to fulfil certain conditions. The contentious issue relates instead to the objectives of conditionality. One alternative is simply to view it as a means of ensuring that loans are repaid and thereby of ensuring compliance with the requirement stipulated in the Fund's Articles of Agreement that there should be only a temporary and revolving use of Fund resources. More ambitiously, conditionality might be seen as a way by which the Fund can encourage its resources to be used in support of balance of payments adjustment rather than being 'squandered' in a way that may actually result in a deterioration in the underlying payments position. A third possible interpretation of the role of conditionality again emphasises the connection with private capital flows. In this context conditionality may be allocated the job of restoring the confidence in and credit-worthiness of borrowing countries. Before private banks are prepared to lend to noldcs they may need some assurance that these economies will be properly managed over the duration of loans and will generate the resources necessary to repay them. The negotiation of an IMF programme may be interpreted by banks as providing just such an assurance. This interpretation of the role of conditionality implies a complementarity between the activities of the Fund and the banks, with the Fund having the expertise and supposed multilateral ob-

5 Though some resources are available from the Fund unconditionally the majority of Fund finance is conditional. In the cases of the lower credit tranche, the CFF and the BSFF, the conditions are not very strict and involve little more than rather vague assurances by the borrowing countries. In the cases of the upper credit tranches and the EFF the conditions are strict and involve the negotiation of a detailed macroeconomic programme. The discussion of conditionality in this section relates to drawings involving high conditionality.

6 For an intriguing account of the history of conditionality and the key role played by the United States in getting the principle of conditionality accepted see Dell (1981).

jectivity with respect to policy formulation that the banks lack, and the banks having the finance to lend which the Fund lacks.

Finally at the below market rates charged on Fund borrowing it might be anticipated that there will be excess demand for Fund resources. Indeed the relatively low charges might entice countries to pursue policies which ultimately result in a need to use Fund finance. Conditionality might be seen as a way of rationing scarce resources and of avoiding the moral hazard associated with the *relatively* low Fund charges. Indeed recent trends in conditionality would appear, at a superficial level, to be quite consistent with this interpretation, with conditionality becoming more relaxed in the period immediately following 1977–78 and stricter in 1981–82.

Of course the various objectives listed above are not mutually incompatible either within or across countries. Indeed it is quite probable that at one moment in time the role of conditionality will be different in low income ldcs as compared with the middle and high income ldcs that have access to commercial credit.

But even if the general objectives of conditionality can be agreed upon, disagreement is likely to persist with respect to the means by which these objectives are realised and over the precise form which conditionality takes. In this context it is again useful to distinguish between low and high conditionality Fund finance. In the case of low conditionality finance, such as is available under the first credit tranche, CFF and BSFF, countries are merely requested to make reasonable efforts to solve their balance of payments difficulties and to consult with the Fund. In contrast drawings in the upper credit tranches, and EFF, require the negotiation of a detailed macroeconomic programme involving narrowly defined and quantitatively expressed policy targets. A borrowing country's government undertakes to realise these targets in a 'letter of intent' which it signs, and the finance, which is available only in installments, is conditional upon the realisation of such targets. A fundamental issue relates then to the sorts of policies which the Fund supports. Are these appropriate for noldcs and will they achieve the desired improvement in the balance of payments at minimum cost in terms of unemployment and lost potential output? Discussion of this issue has resulted in a number of claims being made by critics of Fund conditionality and counter-claims being made by the Fund's defenders.

3.1 *A Review of Issues in the Conditionality Debate*[7]

(i) Critics maintain that the Fund is a hard-line, doctrinaire institution

7 In this section we shall not attribute specific criticisms to specific critics; however

dominated by monetarist modes of thought which place exclusive reliance on the control of monetary aggregates and ignore the structural nature of noldcs' payments problems. Defenders argue that the Fund is eclectic both in terms of the theoretical framework within which it operates and in terms of practical policy formulation. They turn to the EFF as the prime example of the Fund's recognition of the importance of structural factors.

(ii) Critics complain that the Fund places too much emphasis on the short run correction of payments disequilibria *per se* and underestimates or ignores the adverse effects of its programmes on growth and development. The Fund identifies the Articles of Agreement as imposing a constraint on the nature of its activities and draws attention to the fact that there is nothing to prevent a series of stand-bys being negotiated, and that even so the time period over which finance is made available has been significantly lengthened in recent years.

(iii) With regard to the causation of payments difficulties a criticism made of the Fund is that it assumes that these are almost exclusively a reflection of internal economic mismanagement, whereas in fact in a growing number of cases the principal cause is exogenous to the country concerned, resulting, for example, from a decline in export demand. To counter this view the Fund argues that the cause of payments difficulties is only of secondary relevance. What is of prime importance is whether the difficulties are temporary or permanent. In the latter case adjustment is required irrespective of the causes of the problem. In any case they point to the CFF which exists specifically to help deal with exogenously generated payments problems.

(iv) Inflexibility and unadaptability are other criticisms often directed at the Fund. Evidence used in support of these claims includes the narrow range of 'performance criteria' used by the Fund in its programmes. Defenders argue that the range of facilities available in the Fund enable it to deal with various types of problem in a flexible way. Furthermore it is argued that there is considerable scope for variation within what is only apparently a narrow range of performance criteria. Besides it is the noldcs themselves that insist on the use of only a limited number of performance criteria in an attempt to maximise their own degree of policy discretion, although the Fund is also anxious to minimise its own overt political involvement.

examples of the critics' view of the Fund may be found in Scott (1967), Colloquium on the Interest of Developing Countries in International Monetary Reform (1970), Corea (1971), Payer (1974), Development Dialogue (1980). Defenders of the Fund show less inclination to take to print; however numerous Fund documents and statements by Fund personnel present the defenses fairly clearly. A good example of self-defence and indeed an attack on critics by the Fund is to be found in Nowzad (1981).

(v) Critics argue that conditionality is much stricter than needs be to ensure the repayment of loans, is out of all proportion to the quantity of finance made available, and shows little or no appreciation of the economic, political, social and institutional constraints within which policy has to be pursued in practice. The Fund counters that strict conditionality frequently reflects late referral by the borrowing country and the fact that economic performance has been allowed to deteriorate into crisis proportions before a claim on Fund resources is made. The balance of payments constraint on domestic economic policy cannot be avoided permanently and there are no easy or costless solutions to payments deficits. Furthermore the Fund again puts considerable emphasis on the positive effect that strict conditionality has on private capital flows. In any case the Fund denies the accusation of unresponsiveness to non-economic factors by pointing to the facts, first, that programmes are adapted to suit the institutional environment as found by missions and, second, that the 1979 Review of Conditionality Guidelines explicitly states that 'the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members.'

(vi) Asymmetry and the lack of uniformity in the treatment of borrowers are other criticisms often made of the Fund. The discipline of IMF conditionality applies only to nonreserve currency countries in deficit but without large reserves and without access to private finance. Given the distribution of deficits in the world economy this system discriminates against the majority of noldcs. Within the group of countries subject to conditionality critics argue that there is further discrimination with the Fund showing favouritism towards free market systems. The Fund has therefore been labelled by some critics as antisocialist. In countering this criticism defenders maintain that the Fund has clearly recognised the global nature of payments disequilibria and that it exerts pressure on surplus countries to carry a share of the adjustment burden. While pointing to the satisfactory working relationships it has maintained with a number of socialist regimes most defenses of the Fund do suggest that on balance the evidence supports the superiority of free market, outward looking development strategies.

(vii) Clearly important in assessing the relationship between the IMF and noldcs is the effect that Fund programmes have on key macroeconomic variables such as the balance of payments, inflation and growth. Critics argue that the Fund has shown little success when judged on this criterion. Indeed they go further and argue that while bringing about little improvement in economic performance Fund programmes exert an adverse effect on income distribution in the sense of widening income inequalities. On the other hand, the Fund maintains that its policies do work in the desired direction and do exert a significant beneficial impact on the viability of the balance of payments. Failures it sees as being primarily due to a lack of political commitment to adjustment. It presents its policies as being distributionally unbiased and maintains that it is incumbent upon critics to suggest alternative programmes which would bring about a more marked economic improvement. Up to now, so the Fund argues, this is something that critics have been unable to do.

Before moving on to assess the validity of the above claims and counterclaims it should be noted that some of the individual criticisms of the Fund have a tendency towards inconsistency. Thus the uniform treatment of all borrowers would tend to imply a low degree of flexibility. Furthermore it is unlikely that complete agreement as to appropriate policy will ever be reached between borrowing countries and an international financial institution providing credit, since the policy objectives, or at least the priorities in which they are held, are likely to differ. Having said this, much of the disagreement may be more apparent than real with governments blaming the Fund for policies which they know to be necessary yet also know to be politically unpopular. Also it should not be imagined that all areas of the Fund's relations with developing countries are contentious. Thus there is a broad measure of consensus between the Fund (excepting certain Executive Directors) and noldcs that the size of Fund resources is small in relation to the size of the disequilibria which noldcs are experiencing. Similarly many Fund staff accept that conditionality as currently conducted may be inappropriate for low income countries which have little prospect of making their balance of payments viable during the time horizon under which the Fund is operating.

3.2 *Assessing the Issues*

In order to assess the validity of some of the various issues raised in the debate over Fund conditionality let us move on to examine them against the available evidence. In fact only relatively little and somewhat scattered evidence is available since for reasons of confidentiality the Fund, and sometimes countries themselves, are unwilling to disclose details of negotiations and agreements. This makes any evaluation of the Fund rather judgemental and likely to reflect the information that is available, and, of course, this may not be representative.[8] Subject to these limitations the following analysis concentrates on three issues:

8 It needs to be remembered that the Fund's relationship with developing countries would deteriorate markedly if it were to break confidences. The Fund may therefore find itself in a 'Catch 22' situation since faced with what it regards as unfair criticism its only means of defense is to make available confidential information, the act of which, though possibly vindicating the Fund's policy, would open it to further criticism.

(i) the causes of payments deficits in noldcs
(ii) the nature of Fund programmes and
(iii) the effects of Fund programmes

3.2.1 The Causes of Payments Deficits

Illustrative of the Fund's view of causation, and on the basis of a study of stand-by arrangements in the higher tranches between 1963 and 1972, Reichmann and Stillson (1978) argued that 'the most common cause of disequilibria has been overly expansionary demand policies.' More recent Fund data is contained in Table 4 which provides a summary of Fund missions' own assessments of the principal causes of payments deficits in a representative sample of noldcs.[9] As may be seen, in the vast majority of cases expansionary demand policies remain an important causative factor in the opinion of the Fund though there has perhaps been some slight decline in their perceived significance in the period since 1974. Certainly this period has witnessed an increase in the significance attached by the Fund to exogenous factors such as deteriorating terms of trade.

TABLE 4 – IMF MISSION IDENTIFICATION OF 'PRINCIPAL' CAUSES OF BALANCE OF PAYMENTS PROBLEMS[a,b]

	(Number of observations)		
	1964–69	1970–73	1974–79
1. Expansionary demand policies	7	7	6
2. Cost and price distortions:			
(A) Related to exchange rate	4	2	5
(B) Related to other prices and wages	2	3	9
3. Exogenous aspects:			
(A) Decline in export volumes	2	–	2
(B) Deterioration in terms of trade	3	1	5
(C) Noneconomic	3	3	5
4. External debt servicing problem	2	4	5

Source: IMF
Note: (a) For each entry the maximum number of observations is 10.
(b) See Killick (1981b) for further analysis of this Table.

9 Information in this section of the paper is based on questionnaires kindly completed by the Fund. The questionnaires were designed to protect confidentiality. The IMF was requested to select a representative sample of noldcs in receipt of upper tranche stand-bys. No country is included more than once in each subperiod identified and there is a reasonable geographical spread. The sample excludes cases where the credit was cancelled or suspended.

Still greater emphasis has been put on such exogenous factors by research conducted under the auspices of UNCTAD. Dell and Lawrence (1980) found that an increase in import quantities was the primary factor in explaining the deterioration in the trade position of selected noldcs over 1973–76 in only 12 per cent of cases; whereas it was the primary factor in 32 per cent of cases between 1962–72. They argue that this reflects the declining relative significance of expansionary domestic policies as the cause of payments problems. By comparison in 68 per cent of cases the principal cause of the deterioration was increasing import prices, or decreasing export prices, or decreasing export volume, all factors which according to Dell and Lawrence reflect external rather than internal causation. Yet, as noted earlier, the Fund consistently maintains that the important issue is not whether problems have been internally or externally caused but whether they are temporary or permanent. The issue of the importance of causation is one to which we shall return later.

3.2.2 The Nature of Fund Programmes[10]

Fund programmes comprise three components: preconditions, performance criteria, and various, frequently numerous, other policy elements. Whilst undoubtedly the performance criteria form the centrepiece of an IMF programme, and of IMF conditionality, a few words on the other components will not be misplaced.

Preconditions relate to policy actions which must be undertaken before an agreement is put up for approval by the Executive Board. However, it is difficult to get information about them since they are not normally mentioned in 'letters of *intent.*' Preconditions are commonly assumed to relate to measures such as devaluation and interest rate policy. It is further assumed that preconditions are made in the vast majority of Fund programmes. However evidence to be presented later casts some doubt on whether devaluation is as frequently advocated by the Fund as is often supposed.

Letters of intent do, however, often mention a wide range of nonquantified, but fairly specific microeconomic policy objectives relating to various aspects of fiscal and monetary policy, pricing policy, wages policy, trade policy and economic efficiency. While failure to comply with such policy objectives may damage a borrower's credibility with the Fund, it does not interrupt the flow of credit agreed under the stand-by which is not conditional upon such policies being adopted. For this reason this component of

10 The material contained in this subsection has been much more fully discussed by Killick (1981b).

a Fund programme is considerably less significant than the performance criteria; though the two components are related in the sense that the policy commitments undertaken should be consistent with and reflect the means by which performance criteria are to be achieved. It is to these that we now turn. Performance criteria are policy targets included in the letter of intent in quantitative or objective terms. Features of the variables chosen to act as performance criteria are that information on them should be available with only a short lag; they should give an accurate picture of economic performance; and should be within the control of the domestic authorities.

Table 5 summarises the performance criteria used in a representative sample of thirty upper tranche IMF stand-bys over 1964–79. Standard clauses relating to avoiding new multiple currency practices and payments restrictions are not mentioned in the table but are also usually appended to IMF agreements. It clearly emerges that credit ceilings are by far the most common performance criterion used by the Fund; a finding confirmed by the Fund's own research.[11] However the ceilings are usually on the rate of credit

TABLE 5 – PERFORMANCE CRITERIA IN UPPER-TRANCHE STAND-BY ARRANGEMENTS[a]

	(Number of observations)[b]		
	1964–69	1970–73	1974–79
1. Credit ceilings:			
(A) Total domestic credit	3	10	9
(B) Credit to government public sector	7	5	7
(C) Credit to private sector	5	–	1
2. Devaluation	3	–	–
3. Reduction in current payments arrears	–	1	2
4. Minimum levels for foreign exchange reserves	1	1	4
5. Restrictions on new external debt	3	7	5

Source: IMF

Notes: (a) In addition to the criteria listed there are standard provisions that borrowing countries will not introduce new multiple-currency practices; bilateral payments agreements with Fund members; restrictions on current payments and on imports. There were a number of other significant items which are not set out in the table because there were no occasions on which they were used as performance criteria. These included interest rate, pricing and wages policies.

(b) For each entry the maximum number of observations is 10.

(c) See Killick (1981b) for further analysis of this table.

11 See Reichmann and Stillson (1978) and Reichmann (1978).

expansion and rarely call for zero growth or a reduction in the total quantity of credit. Furthermore there are many variants under the general heading of credit ceiling; control may relate to total domestic credit, credit to the private sector or credit to the government. Similarly controls may relate to the holdings of specific assets by tha banking sector and/or the central bank.

The apparent preoccupation with credit ceilings suggested by Table 5 might at first glance be interpreted as reflecting a fixed belief in the monetary approach to the balance of payments. However, this argument does not bear close inspection. Although the Fund's Research Department has indeed made a significant contribution to the development of the monetary approach the Fund's version of this general approach lays considerable emphasis on short run adjustment paths which are ignored in the general equilibrium versions associated with the principal academic contributions. More recent Fund research recognises the complex but potentially adverse effects that credit control may have on output and employment, something which is inconsistent with the strict monetary approach.[12] Furthermore the Fund is clearly aware of the restrictive and quite probably unrealistic assumptions upon which the monetary approach is based and seems prepared to accept many of the criticisms that have been made of the monetarist model. In addition the Fund's advocacy of policies to alter relative prices, in particular devaluation, is clearly at odds with the strict monetarist model, as is the Fund's interest in the composition of the balance of payments and the performance of the current account.[13]

If then the ubiquitous use of credit ceilings does not reflect a single-minded acceptance of the stricter versions of the monetary approach to the balance of payments it may reflect the view that credit variables possess the features required of a good performance criterion. However, again this is an argument of dubious validity. Although data on credit creation is relatively easily and quickly available there is little point in concentrating on credit for this reason alone. Data shortage is an argument for collecting more data not for using only the variables on which data is currently available. Furthermore there must be considerable doubt whether one financial variable can accurately and fully summarise what is happening in the real economy. Where structural deficiencies are identified as the underlying cause of balance of payments deficits credit control represents too indirect a way of acting on these. Even if this were not the case there must be some doubt concerning the scope for

12 See, in particular, Khan and Knight (1981).

13 For a fuller discussion of the Fund's position in the debate over the monetary approach to the balance of payments, see Bird (1981d).

monetary authorities precisely to control the rate of credit creation given the various endogenous and exogenous pressures which exert an impact on this variable.

As Table 5 shows, other performance criteria used in Fund programmes include devaluation, reductions in payments arrears, minimum levels of foreign exchange and restrictions on new external debt. Given the amount of publicity which it has received, it is perhaps surprising that devaluation appears only infrequently; even the response that this is because it is made a precondition for Fund support has little general foundation. Devaluation seems to be associated with only between 33 per cent and 50 per cent of Fund programmes and towards the end of the 1970's the Fund, in particular the Managing Director, showed a growing reluctance to stipulate devaluation largely because of its supposed unpopularity with developing countries and because of concern over the reluctance of these countries to draw from the Fund.

Setting a minimum level of foreign exchange imposes a limit on exchange market intervention and thereby on the domestic authorities' ability to prevent depreciation of the exchange rate; while the other two performance criteria serve to highlight the Fund's view of its relationship with the private capital market. Though reducing payments arrears is clearly aimed at improving a country's credit-worthiness, restricting new external debt seems, at first sight, somewhat inconsistent with the objective of encouraging private financial inflows. Although an overcommitment to foreign borrowing in terms of what the current account can service may, of course, adversely affect such inflows over the longer run the Fund's main concern here would seem to be that of preventing capital inflows from disrupting domestic monetary policy and from frustrating an improvement in the current account.

Given the wide range of policies in which the Fund expresses an interest, the number of performance criteria is indeed rather narrow. An important question then relates to the flexibility and adaptability that may be incorporated *within* a Fund programme.

In principle there is considerable scope for flexibility. Credit ceilings may take on various forms and may involve various quantitative targets, tight or less tight, and these variations may be used to reflect the characteristics of individual countries. Similarly the possibility of negotiating a waiver or a modification to the programme if initial targets are not realised provides further scope for flexibility. In addition the existence of a range of facilities in the Fund provides the possibility of tailoring the type of finance to the needs of individual countries. Furthermore, in practice, the negotiating ability of the borrower may well influence the precise details of the final programme. However, having said all this, evidence does seem to suggest that there is a reasonably conventional type of Fund programme which, in terms of its performance criteria, places almost exclusive reliance on demand side targets. Even in the instances where the Fund does not identify over-expansionary demand policies as a principal cause of the deficit or in the rarer ones where such policies are not even given a secondary importance there remains an apparent reluctance to break away from the conventional demand side performance criteria.[14] This is true even in the case of the EFF which is supposed to deal specifically with longer term, structural problems.[15] As a result there is a strange inconsistency between certain aspects of the Fund's activities – in published statements for instance, the Fund has shown clear recognition of the exogenous nature of the payments difficulties facing many noldcs and the global context in which they occur, and has taken a number of actions designed to alleviate these problems by introducing new facilities, subsidy schemes, and by liberalising existing facilities – and the details of the programmes which it supports.

3.2.3 The Effects of Fund Programmes: How Successful are They?

The success of Fund programmes may be assessed in a number of ways. One method involves comparing economic performance before and after the implementation of a Fund programme. A second involves comparing actual performance with the performance targets set in the programme. While a third involves comparing actual performance with what would have been the situation in the absence of the Fund programme.[16]

There are fundamental problems associated with each of these methodolo-

14 Out of the sample of thirty IMF programmes examined there were ten cases where overexpansionary demand was not mentioned as a principal cause of payments problems, and in six of these cases it was not even regarded as a secondary cause. However, there did not appear to be any reduced tendency to set credit ceilings in these cases; the ceilings may of course have been less tight but the evidence did not permit a test of this hypothesis. Looking more closely at the three programmes in 1974–79 where excess demand was not seen as either a principal or secondary cause of payments deficits, in only one case did the programme deviate from the conventional demand side type. This illustrates that while it is unusual for the Fund to support a supply side programme it is not unheard of. For further details see Killick (1981b).

15 The view that the EFF has failed to provide a genuine switch over to a supply side approach finds considerable support amongst Fund staff and is backed up by case study evidence drawn from Kenya, (see Killick (1981a)). Recent EFF programmes for Pakistan and Inda also put considerable emphasis on financial management, *IMF Survey*, 6 April 1981 and 23 November 1981.

16 See Guitian (1981) and Williamson (1982).

gies. In the first case there is the question of whether an economic improvement or indeed the failure to improve can legitimately be attributed to the Fund programme. In many cases there are likely to be other factors at work which will exert a dominant effect on economic performance. In the second case there is the question of whether the initial targets were realistic. In the third there is the problem of assessing what the situation would have been in the absence of a Fund programme. Two options are available here. The first assumes that without the Fund there would have been no change in economic policy, while the second assumes that policies alternative to those supported by the Fund would have been adopted. It is quite possible that a Fund programme could be judged successful when compared with the first option but simultaneously unsuccessful when judged against the second. For all three methodologies there is the additional problem of determining the time period over which a comparison is to be made; how quickly can Fund programmes be expected to generate results? While the Fund claims that its programmes have shown a broad measure of success, empirical evidence offers far from unambiguous support for this claim. Indeed the Fund's own research reveals very mixed results; considerable variation exists between individual stand-bys, time periods and specific targets. According to this research the greatest degree of success has been achieved in improving the balance of payments; other variables such as economic growth and inflation seem to be generally little affected by Fund programmes.[17] Clearly the balance of payments is a fairly narrow criterion for evaluating success. Indeed it would perhaps be surprising if Fund programmes primarily directed towards establishing a viable balance of payments did not demonstrate some degree of success in these terms.

Research conducted outside the Fund[18] seems to confirm that Fund programmes have relatively little apparent impact one way or the other on growth, inflation or liberalization, though surprisingly Fund programmes if anything seem to be positively correlated to growth.[19] Again the principal impact would seem to be on improving the current account of the balance of payments or more so the basic balance. However even this improvement is not usually found to be significant statistically and there is no guarantee

17 See Reichmann and Stillson (1978), Reichmann (1978) and Guitian (1981).

18 Examples are Connors (1979) and some as yet unpublished research designed to update, modify and extend Connors' work carried out at the Overseas Development Institute; see Killick and Chapman (1982).

19 Such a finding suggests that the critics' claim that Fund programmes exert an adverse effect on development may be without empirical foundation. For a theoretical analysis of the way in which Fund programmes may have an adverse effect on growth, see in particular Khan and Knight (1981).

that the improvement has been achieved in the most cost-effective manner.

The impact of Fund programmes on income distribution is difficult to pin down empirically. While it is unreasonable to assume that economic stabilization involving falling real wages, reduced government spending, increased taxation and price rises will have no effect on the distribution of income, the precise effects will depend on the economic characteristics of individual countries such as the degree of real wage resistance, the ownership of the factors of production, and intersectoral mobility. In principle there is no necessary reason why Fund programmes should raise income inequality and their relatively slight effect on other variables, particularly economic growth, suggests again that their effect on income distribution is probably small.

It is interesting to ponder as to why Fund programmes seem to exert so little impact on the economies which pursue them. Part of the answer may lie in the relatively low degree of implementation. Over recent years perhaps in as few as 20% of cases are performance criteria actually fulfilled. In turn this might reflect first a low degree of commitment by countries to IMF programmes, certainly there is plenty of case study evidence to suggest that many ldc governments put a low priority on stabilization and this is an explanation that the Fund itself stresses. A second explanation may be the incidence of exogenous shocks which push economies off the courses mapped out in IMF programmes. Finally, the programmes themselves as currently constructed may simply be incapable of generating the objectives set. Thus if the largely financial targets set as performance criteria in IMF programmes do not generate changes in the real economy it may not be surprising that they have little effect on output and trade. Lack of implementation cannot however be the whole of the answer to the low degree of success achieved by Fund programmes since economic performance does not appear to be significantly different as between those countries that do and do not observe performance criteria.[20]

3.3 *Conclusions on the Conditionality Debate*

The foregoing analysis enables us to reach certain, albeit guarded, conclusions on the issues raised in the debate over Fund conditionality and the role of the Fund in stabilization programmes in developing countries.

20 Before moving on to try to reach some conclusions on the conditionality debate, it should also be noted that the strict conditionality of Fund programmes may have an indirect and hidden, but still significant effect on *potential* but reluctant borrowers by encouraging them to pursue policies which minimise the risk of getting into a situation where they need Fund finance.

1. The Fund does possess too few resources to deal adequately and directly with the adjustment problems which noldcs are encountering. The Fund's indirect influence on private capital flows may be significant, though difficult to quantify precisely, in middle and high income ldcs but is less likely to be relevant for low income countries to which the Fund is currently lending relatively substantial amounts. Apart from its role in supervising the operation of the international financial system there is a role for the Fund to play in the provision of finance, arising from the deficiencies of the private capital markets particularly with respect to the distribution of finance.
2. The Fund is not a hard line doctrinaire 'monetarist' institution. However it does place very considerable emphasis on credit ceilings as performance criteria and does therefore tend to orientate its programmes towards the realisation of specific and quite narrow quantitative targets. There seem to be valid reasons for challenging what appears to be *undue* emphasis on credit control.
3. Although apparently fully cognizant of the importance of supply side factors, the Fund has concentrated on demand side variables as both the cause of and cure for payments deficits. Demand side variables even feature significantly in EFF programmes. The Fund has tended to focus its attention on correction *per se* rather than correction at minimum cost in terms of output and employment. The Fund is however right that evidence fails to reveal a simple alternative solution particularly when a relatively short time horizon is selected, and it is also right that the regulation of demand is a vital component of any stabilization package.
4. The Fund has demonstrated a considerable measure of adaptability and flexibility particularly in terms of increasing the range of facilities available. It has also shown a growing awareness of the global context in which noldc deficits are to be found. In terms of its own conditionality, however, flexibility is strictly constrained and has been insufficient to meet fully the demands of a changing world economic environment.
5. There is a lack of uniformity in the treatment of Fund members.[21] Amongst those deficit countries drawing from the Fund this reflects their differing geopolitical importance and their ability to influence the Executive Board

21 This claim is largely based on discussion with individuals inside the Fund, but there are a number of quite notorious examples of cases where the Fund has shown rather more leniency than in others. There is also a view that in the early 1980's the Fund became significantly more lenient in its credit granting policy to developing countries than it previously had been, though this additional leniency represented only a temporary interlude.

and the Managing Director. However it is inaccurate to argue that the Fund is simply antisocialist. At a wider level, particularly through the Executive Board, the Fund is subject to political influences. In turn the Fund itself plays a political as well as an economic role.

6. The economic effects of Fund programmes are difficult to evaluate. However programmes have not been clearly and unambiguously successful, suggesting that there may be room for improvement. While Fund programmes are highly unlikely to be neutral with respect to income distribution it is illegitimate to maintain that they have a clear unidirectional bias.

7. It is unrealistic to assume that all conflict between the Fund as a creditor and developing countries as borrowers may be eradicated, simply because they are likely to possess different policy priorities. Neither those that will hear no good of the Fund nor those that will accept no criticism emerge as having all the evidence on their side. The truth is vastly more complex and involved and lies somewhere between these two extremes.

However, given that some criticism is not without foundation, we now turn to examine what policies might be pursued in order to make the Fund's involvement with and assistance to developing countries both more efficient and more equitable.

4. PROPOSALS FOR REFORM AND RELATED ISSUES

4.1 *Modifying the Nature of Fund Conditionality*

The Fund is currently operating in a very different global economic environment from the one that existed in the 1960's. Adverse terms of trade movements – not exclusively resulting from changes in the price of oil – have had an important bearing on the payments position of developing countries and the traditional explanation of payments deficits in terms of the fiscal deficit has become a less valid generalisation. At the same time the clientele of the Fund has changed with a much larger proportion of Fund finance now going to low income countries than has historically been the case. There are strong *prima facie* reasons to believe that short term, essentially demand-oriented programmes based on the realisation of quite specific financial targets are inappropriate to such countries in current conditions.

This section examines ways in which Fund conditionality might be modified so as to make a greater contribution to solving the payments difficulties of developing countries. If the proposed modifications did indeed improve the success rate of Fund programmes by making them more appropriate and perhaps as a result more acceptable politically they would not only assist the borrowing countries but would also assist the Fund in complying with its own Articles of Agreement.

Before moving to look at the nature of high conditionality access a prior question relates to the balance between low and high conditionality access in the Fund. As noted earlier the proportion of low conditionality finance has fallen quite markedly over recent years. The conventional defence of the move towards greater conditionality is that where deficits are not self-correcting or reversible adjustment has to be undertaken; it is only through the strict conditions associated with Fund assistance that adjustment may be encouraged, without such conditions adjustment will simply be postponed, allowing the balance of payments to deteriorate further and implying more draconian corrective action some time in the future. The acceptability of this reasoning hinges on two factors: first that it is possible to distinguish *ex ante* between deficits that are temporary and reversible and those that are permanent; and second that where adjustment is undertaken it is appropriate in the sense that it is both effective and cost effective, improving the balance of payments whilst imposing minimum adverse effects on other economic objectives.

Where the conditions supported by the Fund are inappropriate then reducing the proportion of high conditionality finance offers a way of avoiding such adjustment but it may also mean that no adjustment is undertaken in circumstances where it should be. Provided that adjustment is needed and that appropriate adjustment policies may be identified there seems little reason not to provide an incentive to pursue these policies irrespective of the initial cause of the problem – though this will influence what form of adjustment is appropriate. The fundamental issue with regard to estimating the optimum amount of low conditionality support does not then relate to the exogeneity of causation but to isolating those deficits that will be self-correcting, since what is needed in these circumstances is not a change in policy but temporary finance. The Fund already possesses the CFF which provides finance to help cover deficits resulting both from *temporary* export shortfalls and from extra expenditure on certain food imports reflecting production shortfalls. A geometric moving average is used to estimate, albeit imperfectly, the size of the temporary shortfall and the finance provided is of a low conditionality type. There does seem to be a case for expanding the role of the CFF within the Fund to finance a larger proportion of export shortfalls and also to finance some proportion of those import excesses, more widely defined than at present, caused by increased import prices. These changes would assist countries in dealing with the balance of payments repercussions of temporarily adverse movements in their terms of trade without having to sacrifice domestic economic policy objectives. But at the same time they would ensure that where a dificit was permanent, even if resulting from external causes, for which the borrowing country was not directly 'responsible,' adjustment would be encouraged since in these circumstances the country would be ineligible for CFF assistance and would have to borrow under the high conditionality facilities. Unless the aim is to raise the amount of effective aid provided by the Fund there would seem to be no equivalent reason to raise the amount of low conditionality finance by increasing the relative size of the lower credit tranches; indeed the above analysis would suggest that there might be some case for contracting them – given the expansion in the CFF. The above changes in the CFF would also imply some relaxation in the constraint on access to the CFF as expressed in terms of the proportion of quota that may be drawn.

Turning to the appropriateness of high conditionality Fund programmes the basic proposal here is to raise the degree of flexibility exhibited by allowing programmes to reflect to a greater extent than in the past the varying causes of payments difficulties and to encourage the pursuit of the least cost adjustment strategy rather than the strategy that will simply bring about viability to the balance of payments most quickly. In a significant number of cases where it is overexpansionary demand policies through large fiscal deficits and excessive credit creation that have caused the deficit, programmes should clearly continue to emphasise and focus on demand side measures, and the policies conventionally supported by the Fund might be expected to be both effective and cost effective in these circumstances.

Even in cases where demand expansion has not been a principal or indeed secondary cause of the deficit some assurance may be required that overexpansion will not serve to frustrate any future programme. This having been said, where the principal cause of the deficit is an externally generated deterioration in the terms of trade, policies are needed that will induce the required structural changes in the real economy, *i.e.* the volume and pattern of production consumption and trade, and these policies will relate rather more to the supply side of the economy than to the demand side. This is certainly not to argue that conditionality should be less strict or rigorous but merely that strictness exclusively expressed in terms of financial targets may not always be appropriate or indeed effective, especially where the measure of control exerted by monetary authorities over financial variables is highly imprecise. Conditionality would continue to have the role of encouraging balance of payments correction but it might be expected to relate to a much wider range of instrument variables including those which have a more direct impact on the real economy than does credit creation. Programmes would still be objectively monitored and tested. Failure to comply with the policy conditions of a loan would however initially trigger off consultation between the borrowing country and the Fund and a review of the programme rather than immediately serve to cut off future access to credit. During this review the reasons for failure would be closely examined and it would be in the light of this examination that a decision would be made as to whether additional financial support would be provided. Where, for instance, exogenous and unforeseen factors were responsible for the failure to fulfil conditions then, while it might be appropriate to modify the programme, it might also be inappropriate for the Fund to withdraw its financial support. Whereas if the government had effectively abandoned the programme the withdrawal of future financial assistance would seem quite appropriate.

Other intermediate reforms that would move the Fund in the direction just outlined might involve: expressing financial targets in the form of ranges rather than precise points; using the failure to comply with performance criteria as a triggering mechanism for consultation, during which the reasons for failure would be examined – again the *extent* of overshooting could be used to determine whether consultation should precede or follow the discontinuation of financial provision – or adopting some formal type of contingency performance criteria under which the reasons for failure would be taken into account.

Although under the reformed conditionality guidelines outlined above programmes would be subject to quantitative appraisal, the objective would be to shift the emphasis away from negotiating precise quantitative financial targets and towards achieving agreement on the underlying policy approach to be adopted.

The wider range of conditionality to which these proposals would lead would bring with it a number of important implications. First, in many cases the IMF would be exerting a much more direct and binding influence over a larger number of (essentially microeconomic) variables than is at present the case. Developing countries that have themselves attempted to constrain the Fund to expressing conditionality in terms of a few macroeconomic variables would need to be persuaded that the new form of conditonality would enable the Fund to support adjustment programmes more appropriate to their own economies. Second, the greater use of supply side conditionality would have implications for the Fund's relationship with the World Bank. In circumstances where the causes and cures of payments disequilibria can only be viewed in a long term structural context, the distinction between the balance of payments and development becomes somewhat artificial and so therefore does the traditional distinction between the Fund and the Bank. What needs to be ensured through close cooperation between the two institutions is that their activities are mutually reinforcing rather than contradictory. There are various bureaucratic arrangements through which this cooperation could be achieved; but it should be noted that the activities of Fund and Bank will not overlap in all cases and in the case of middle and high income ldcs the Fund's relationship with the commercial banks may be more significant. It is clearly important that the potentially catalytic effect of Fund programmes on private financial flows should not be ignored. Confidence is likely to be enhanced, however, if Fund programmes can be modified in such a way that they generate a higher success rate. Again it should be stressed that in a significant number of cases and perhaps particularly in the situation often found in middle and high income developing countries the conventional Fund programme with its emphasis on strict financial control and rapid adjustment may not be inappropriate.

Third, in cases where a supply side approach is adopted finance will have to be made available by the Fund for a longer time period than it has been in the past; adjustment and the desired turn round in the balance of payments will not usually be achieved in a few years. While it is not to argue that so-called shock treatment will always be inferior to gradualism, a longer term perspective which spreads a given adjustment over a larger number of years will clearly serve to reduce the time unit costs in the early years of the programme. With longer term programmes it might be appropriate to monitor performance in terms of ultimate target variables such as the balance of payments somehow defined in addition to instrument or policy variables. The programme would need to be ongoing with regular reviews. Furthermore the policies themselves could be given a dynamic element. For instance instead of simply advocating a devaluation of x per cent the programme could encourage the adoption of a crawling peg to maintain the equilibrium real exchange rate once attained. Such modifications might go some way towards meeting the Fund's objection that longer term programmes are basically unworkable because of the problems associated with formulating and monitoring them.[22]

22 The Fund maintains that there is a serious problem in translating a supply side approach into performance criteria. However it is not impossible to identify variables which would influence the performance of the real economy. These include the exchange rate and other relative prices, fiscal policy including subsidies and taxes on trade, and investment incentives, measures which will raise output and switch production into those exports and import substitutes with relatively high price and income elasticities of

Finally there is the implication that greater flexibility with regard to conditionality and programmes may seem to imply that not all Fund members are being treated equally and uniformly. However another way of looking at this, given the differences between countries, is that variety amongst programmes is required to ensure that adjustment *effort* is approximately equivalent across countries.[23] There seems no point in advocating a standard programme if there are not standard problems.

The greater diversity advocated above would enable the Fund to make a greater contribution to solving the payments problems faced by low income countries. At the moment the Fund seems somewhat uncomfortable in dealing with this group of countries. There is some doubt within the Fund concerning its role in low income countries, with a not insignificant feeling that it should not become involved with such countries since what they need is concessional aid. There is certainly evidence to suggest that conventional Fund programmes have had little success in low income countries but the more appropriate solution might be to modify the programmes rather than cut off financial support. There is a strong 'market failure' argument for the Fund to assist low income countries in solving their payments difficulties since these countries have been virtually ignored by the private banks and the Fund could play an important role as a provider of finance.

Apart from the arguments mentioned above concerning the balance between low and high conditionality finance there seems to be no reason to reduce the *strictness* as opposed to the *nature* of conditionality associated with IMF finance to low income countries. More assistance to low income countries could however be channelled to such countries through the IMF by the expanded use of the subsidisation of Fund charges. The Fund would not in this case be supplying the aid itself since the subsidies would be financed as at present by contributions. The contribution of the Fund would be exclusively in terms of its conditionality, which might encourage aid to be

demand and supply. On rare occasions the Fund has made use of such performance criteria and certainly the World Bank, in the context of its structural adjustment loans, has emphasised such variables. For a discussion of structural loans see Balassa (1981) and Landell-Mills (1981).

23 The IMF has already indicated some measure of acceptance of this approach to uniformity as the following quotation from Guitian (1982) shows: 'In general terms, uniformity of treatment requires that for any given degree of need, the effort of economic adjustment sought in programmes be broadly equivalent among members. Like all other aspects of the principle of conditionality the achievement of uniformity of treatment necessarily involves a measure of judgement based on a consideration of the particular features of each case.'

provided in this indirect fashion. It may, of course, be noted in passing that Fund conditionality has an important influence on more conventional aid flows. Additional finance for an expanded interest rate subsidization scheme could also come from further gold sales by the Fund.

The Fund could further assist low income countries by establishing a link between the creation of SDRs and the provision of development finance since, first, there is still a significant grant element associated with SDR net use even with the market related interest rate on SDRs; second, low income countries in practice face an availability constraint with regard to the provision of international finance and the link would help overcome this; and, third, SDRs may be used unconditionally and are not subject to a fixed repayment schedule.[24]

4.2 *Increasing Fund Resources*

The expanded role for the Fund envisaged in this paper will increase its need for resources. This could be met in a number of ways. The first, and in many ways simplest alternative is to raise IMF quotas. By raising these the lending capacity of the Fund in both low and high conditionality facilities would be increased. But of course an increase in quotas would also increase the demand for Fund resources since capacity to draw on the Fund is expressed as a percentage of quotas.

A second alternative would be to undertake *ad hoc* borrowing from individual members of the Fund. This is a course of action that has been adopted by the Fund both in the less and more recent past, when borrowing from Saudi Arabia and various industrial countries has been used to supplement Fund resources. Apart from the political pressures to which such borrowing may expose the Fund it hardly represents a satisfactory long term solution to the shortage of resources but it is more appropriate for dealing with short run liquidity crises. The scope for future borrowing from Saudi Arabia also hinges crucially on the future price of oil and the size of the Saudi surplus.

A third alternative is for the Fund to borrow directly from private capital markets. Borrowing from the private sector raises a number of questions. Would private banks lend to the Fund in circumstances where they are not prepared to lend to noldcs directly? Would the Fund lend on commercial terms similar to those under which it borrowed or would it attempt to trans-

24 For an attempt to quantify these benefits see Bird (1981e). Recent suggested versions of the link which have the effect of connecting the provision of SDRs with that of other IMF resources would clearly introduce conditionality in the SDR scheme (Bird (1982)).

form the maturity and terms of loans? If it were to lend on softer terms than those on which it was borrowing where would the finance for such subsidisation come from? Would all noldcs benefit from such arrangements or would there be distributional variations particularly between the more and less credit-worthy noldcs?

The incentive for private banks to lend to the Fund would have to arise from the rate of return offered to them by the Fund and their own assessment of the risk involved in lending to the Fund, which could be influenced by the ways in which the Fund used the extra resources. If the banks assessed the risks associated with lending to the IMF as being less than those involved with lending directly to developing countries, then they might be prepared to accept a relatively lower rate of return on such loans. In terms of widening their portfolio of assets, the prospect of lending to the Fund could be quite attractive to commercial banks since it would enable them to combine relatively high return high risk lending directly to developing countries with relatively low return low risk lending to the IMF. However, it might encourage them to pull out of direct balance of payments financing, an area in which the Fund has the traditional expertise. Furthermore, IMF lending which is itself financed by commercial borrowing might be expected to possess a somewhat skewed distribution unless some form of interest rate subsidisation for ultimate borrowers could be devised.[25]

A final alternative is for the Fund to provide itself with additional resources by selling its remaining stock of gold or by using the gold as security for raising loans, from the private capital market. A strong case may be made for using IMF gold to benefit noldcs by raising their access to Fund finance.[26] Gold sales could also be used to finance subsidies for poorer countries if the Fund were to borrow at commercial rates. However the quantitative relevance of such schemes clearly varies positively with the market price of gold.

25 Private banks' assessment of the credit-worthiness of the Fund would also depend on their estimation of the Fund's usable resources, its holdings of gold, SDRs and currencies, and the degree of international support for the activities of the Fund. Certain technical problems would be associated with direct borrowing by the Fund. For instance, the Fund's holding of particular currencies, which could be affected by borrowing, in turn affects countries' access to Fund finance: see Morgan Guaranty Trust, World Financial Markets, September 1980. For further analysis of the scope for cooperation between the IMF and the banks see Bird (1981). There it is concluded that the scope is strictly limited.

26 For a well and rigorously argued presentation of this case see Brodsky and Sampson (1980, 1981).

5 CONCLUDING REMARKS

World economic events during the 1970's and 1980's have exerted an ambiguous effect on the relevance of the IMF in international economic affairs. The increasing significance of foreign exchange and latterly gold (when valued at its market price) as reserve assets as well as the rapidly growing importance of the Eurocurrency market have reduced the Fund's influence over the quantity of international liquidity. At the same time the move towards generalised floating has reduced the need for additional liquidity and has downplayed the role which the Fund had previously played in the adjustable peg Bretton Woods system.

The massive payments disequilibria generated by the increase in the price of oil, terms of trade movements, and industrial recession have increased the need for finance in those countries experiencing deficits, primarily the non-oil developing countries. While a few of these countries have had access to private capital, for the majority the Fund is a potentially significant source of finance. Even for those noldcs able to attract private resources the Fund has played an important indirect role primarily through the generation of confidence.

However in the low income countries with which the Fund is now largely dealing where deficits are likely to reflect structural deficiencies rather than exclusively over expansionary demand policies, the cost-effectiveness of conventional Fund programmes is in doubt. The Fund needs to find some way of modifying its conditionality in order to be of more use to these countries. This paper suggests that a more flexible approach to conditionality especially in terms of the use of performance criteria could make a significant contribution in this direction, whilst maintaining the Fund's essential purpose as a balance of payments agency. The Fund should show a greater awareness of the possibly long term nature of payments correction, and a greater degree of concern that payments correction be achieved in the most efficient fashion, minimising the adverse effects on output, employment and on desired structural change. Unavoidably this involves lengthening the Fund's operative time horizon. Conditionality should have the role of encouraging cost-effective adjustment. In many cases this will involve adjustment in the real sectors of the economy influencing the productive and trading performance of borrowing countries. The effectiveness of the implied policies will depend on the economic characteristics of borrowing countries including the causes of payments problems, the extent of capacity utilization and the elasticity of supply once spare capacity has been used up.

During 1979 and 1980 there were some indications that the Fund was beginning to relax its approach to conditionality; there was the Review of Conditionality Guidelines, a move towards longer term lending and more discussion of the relevance of supply side variables. More recently, however, there has been a retrenchment from this position with fewer multi year programmes being made, fewer waivers being granted, less use of front end loading of credits and generally a stricter application of more conventional conditionality. The reason frequently given within the Fund for this reversal of policy is that alternative approaches were shown to be unsatisfactory and to have failed. However given the somewhat extreme global economic environment during 1979 and 1980 this may be seen as a rather harsh judgement.

A more important observation is that noldcs themselves have to demonstrate greater cognizance and greater political commitment to the need for adjustment, and of the fact that adjustment at zero cost rarely, if ever, exists. While earlier referral by them to the Fund, rather than referral in conditions of economic crisis, could make a contribution towards modifying the nature of conditionality, developing countries need to accept that many of the demands they put on the Fund are mutually inconsistent. Until developing countries become more flexible in their attitude towards the Fund the scope for the Fund to become more flexible in its attitude to developing countries will remain strictly constrained.

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Summary

THE INTERNATIONAL MONETARY FUND AND DEVELOPING COUNTRIES: RETROSPECT AND PROSPECT

The relationship between the IMF and its developing country members has been the subject of considerable debate over recent years. At the heart of this debate has been the issue of IMF conditionality and its appropriateness to developing countries. Having examined the importance of the IMF as a source of finance to developing countries this paper goes on to review IMF conditionality and to suggest certain ways in which it might be modified. It is concluded that the Fund is potentially of great significance to developing countries, particularly in the current world economic environment, and that its activities should be extended.