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No. 144, October 1981

ON BEING GRANDMOTHERLY: THE EVOLUTION OF IMF CONDITIONALITY

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INTERNATIONAL FINANCE SECTION
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Princeton, New Jersey

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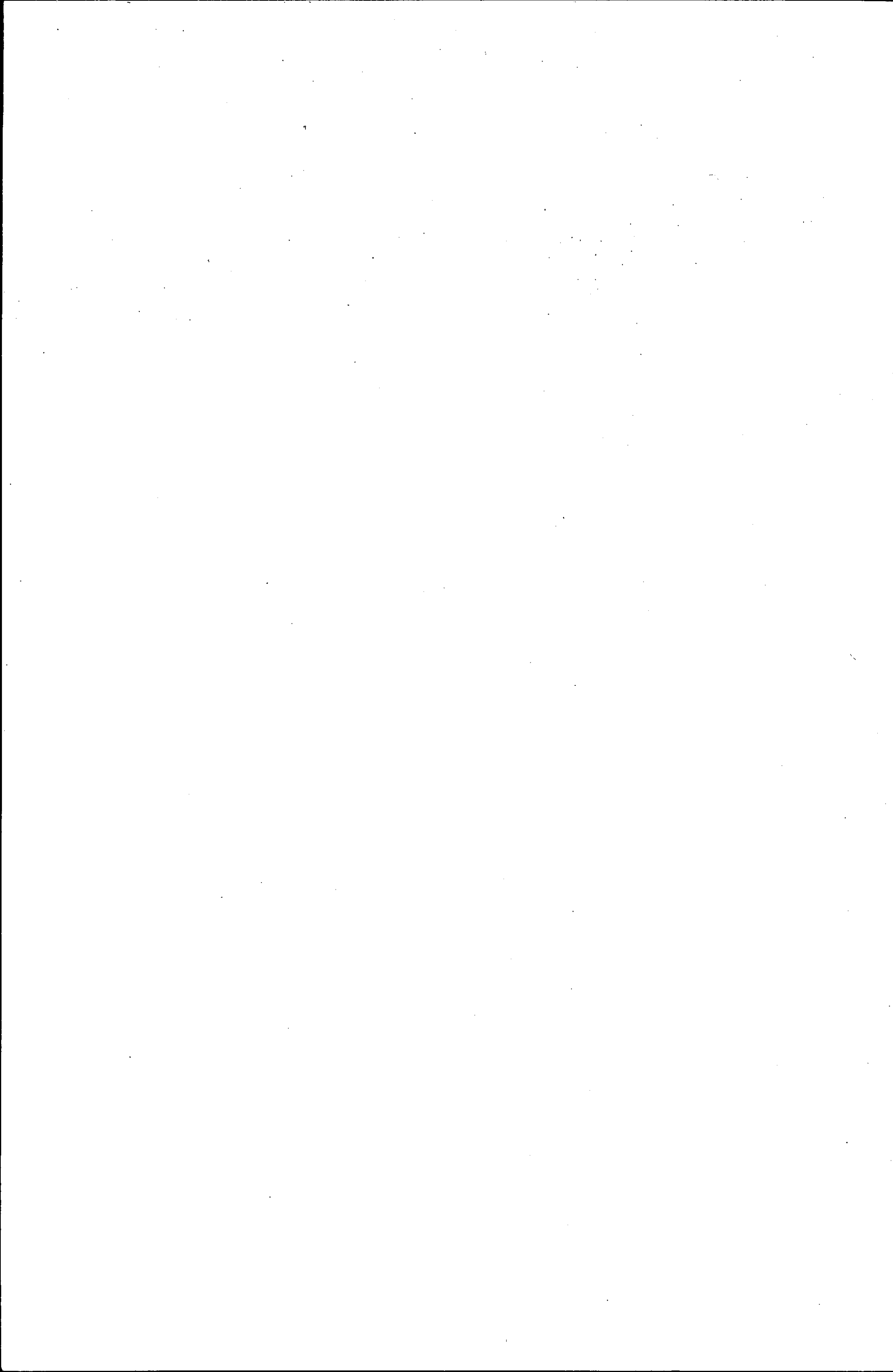

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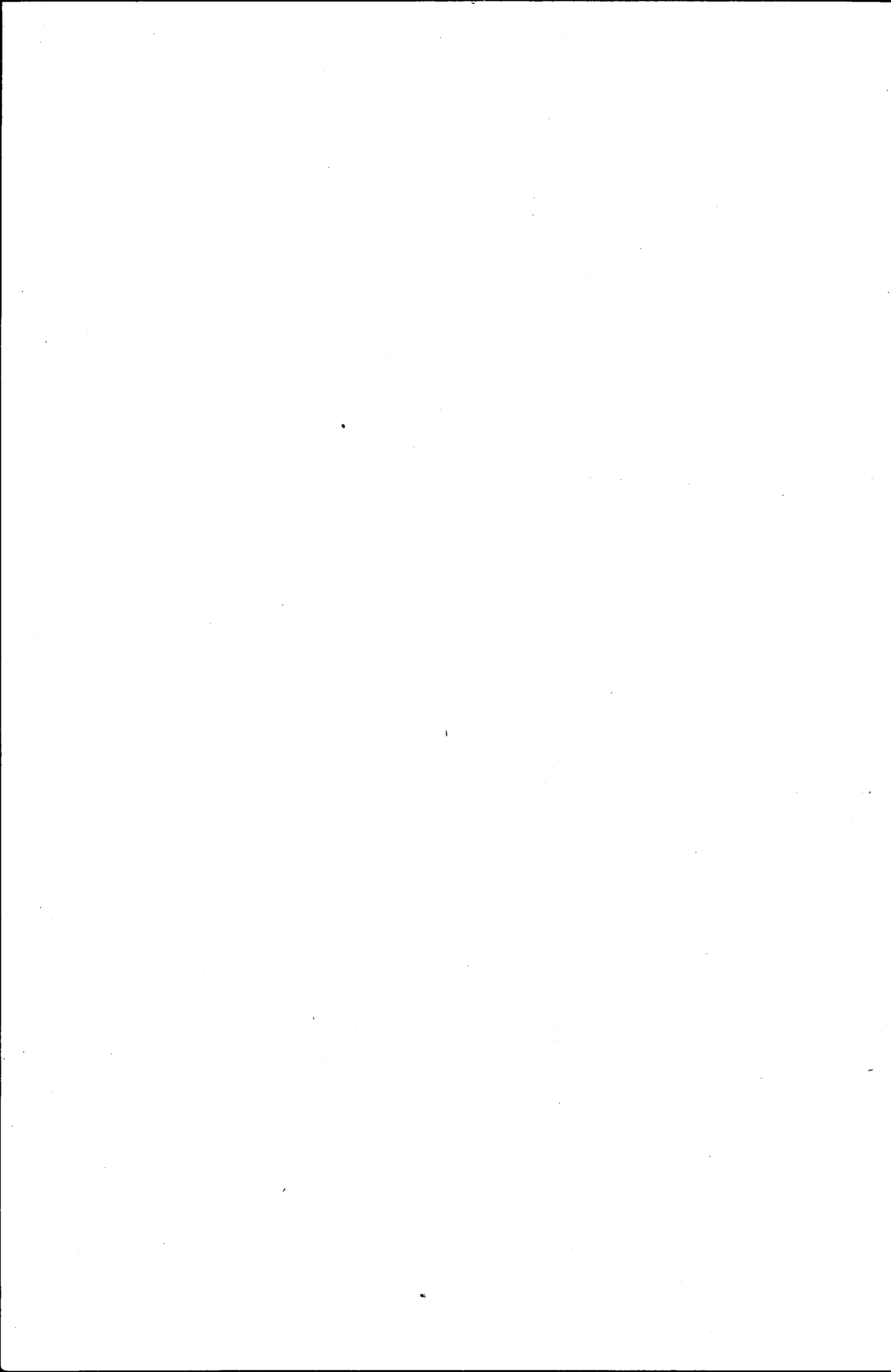

On Being Grandmotherly: The Evolution of IMF Conditionality

Introduction

On March 2, 1979, the International Monetary Fund adopted a set of guidelines regarding the conditions to be accepted by member countries wishing to draw on the resources of the Fund. The guidelines were intended as a positive response to previous expressions of concern by the developing countries on this matter, but they were only the first step in a process of change. As Sir Joseph Gold, former General Counsel of the Fund, put it in his 1979 Fund pamphlet on conditionality: "There is no reason to believe . . . that debate on this subject is at an end."

The present Essay is intended as a contribution to that debate. It deals with the history of conditionality, emphasizing particularly those aspects that seem to have a special bearing on current concerns. It then proceeds to an analysis of the contemporary issues and makes a tentative evaluation of the recent evolution of Fund policies.

1 The History

The Prelude to Bretton Woods

Writing in January 1944, before the Bretton Woods Conference, Lord Keynes described the views of the U.S. government on the future character of the International Monetary Fund as follows: "In their eyes it should have wide discretionary and policing powers and should exercise something of the same measure of grandmotherly influence and control over the central banks of the member countries, that these central banks in turn are accustomed to exercise over the other banks within their own countries" (Moggridge, 1980, Vol. 25, p. 404).

Keynes believed, however, that as a result of the Anglo-American discussions on this and related matters, "the American representatives were persuaded of the inacceptability of such a scheme of things, of the undesirability of starting off by giving so much authority to an untried institution, and of the importance of giving the member countries as much certainty as possible about what they had to expect from the new institution and about the amount of facilities which would be at their full disposal" (Moggridge, 1980, Vol. 25, pp. 404-405). Keynes thought he had gained acceptance for the view that the Fund's "initiative and discretion" should be limited "to cases where the rules and purposes of the institution are in risk of infringe-

ment" and that the Fund should be "entirely passive in all normal circumstances, the right of initiative being reserved to the central banks of the member countries" (Moggridge, 1980, Vol. 25, p. 404).[1]

It is particularly interesting, in the light of present-day controversy about the policies of the IMF, that in the Anglo-American discussions preceding Bretton Woods, the U.K. negotiators were under explicit instructions from Churchill's War Cabinet that a deficit country should not be required to introduce "a deflationary policy, enforced by dear money and similar measures, having the effect of causing unemployment; for this would amount to restoring, subject to insufficient safeguards, the evils of the old automatic gold standard" (Moggridge, 1980, Vol. 25, p. 143).

As it turned out later, the U.S. government had by no means abandoned the idea of a "grandmotherly" Fund; still less had it acquiesced in the concept of a "passive" Fund. It is also clear that Keynes was far from being alone in his views—and that the United Kingdom had the support of virtually all countries other than the United States in wishing to place strict limitations on the Fund's responsibilities vis-à-vis the economic policies of its members. From an American standpoint, of course, the United Kingdom and most of the countries supporting its views were potential deficit countries seeking to obtain assured access to postwar balance-of-payments support, which could be provided—in the early postwar years at any rate—only from the real resources of the United States.

The Atlantic City Debate

An important episode in the legislative history of Fund conditionality occurred in the course of meetings of the Pre–Bretton Woods Conference Agenda Committee, which were held in Atlantic City at the end of June 1944 and in which seventeen countries participated. The documentation for this meeting included a combined draft in which the Joint Statement by Experts on the Establishment of an International Monetary Fund (prepared jointly by U.S. and U.K. officials and published in April 1944) was reproduced in conjunction with various amendments that had been proposed (Horsefield, ed., 1969, Vol. 3, pp. 131-135).

There was considerable discussion at Atlantic City about the wording of

[1] Sir David Waley and Redvers Opie, who were also involved in the negotiations with the Americans, appear to have taken a more realistic view of the American position, recognizing that credit would be obtained only "so long as the Fund thinks we are behaving reasonably" (see Horsefield, 1969, Vol. 1, p. 73). Keynes may have been unduly impressed by the division of opinion among the U.S. negotiators regarding the imposition of conditions on drawing rights: negotiators both for the State Department and for the Federal Reserve System expressed the opinion, in the presence of British negotiators, that "no great country would submit" to the kind of scrutiny that the U.S. Treasury was envisaging (see Moggridge, 1980, Vol. 25, pp. 344-346).

what later became Article V of the original Fund Agreement.[2] Two phrases in that article had a crucial bearing on the conditions governing the use of Fund resources. The Joint Statement had provided that:

> A member *shall be entitled to buy* another member's currency from the Fund in exchange for its own currency on the following conditions:
> (a) The member *represents that the currency demanded is presently needed* for making payments in that currency which are consistent with the purposes of the Fund [emphasis supplied].

The United States proposed an Alternative A to replace the above text, in which the following changes were made in the emphasized words:

> A member country *may buy* the currency of another member country from the Fund in exchange for its own currency subject to the following conditions:
> (1) The member country initiating the purchase *needs the currency requested* for making payments in that currency which are consistent with the purposes and policies of the Fund [emphasis supplied]. (NARS, Box 1, File A-3.)

When the Agenda Committee discussed this matter, Lord Keynes said that the wording of Alternative A left it unclear whether it was the Fund or the member country that would decide whether the payments for which a country sought to purchase currency from the Fund were consistent with the purposes and policies of the Fund. Countries must, he said, have an unqualified right to purchase foreign exchange within the prescribed quantitative limits, subject to the provisions of the Fund Agreement. He therefore favored the wording of the Joint Statement, which made it clear that the decision on a drawing would be that of the member country, not of the Fund.

Edward M. Bernstein replied for the United States that the fact that a country informed the Fund that it needed foreign exchange for purposes and policies consistent with the Fund Agreement did not provide sufficient protection for the Fund against misuse of its resources. The Fund must be in a position to question a country's statement on this point. The U.S. proposal to change "represents" to "needs" had been made because, in the event that a member's use of Fund resources was for purposes inconsistent with the Agreement, the Fund must be able to invoke the subsection of the same Article under which a member could be suspended from making further use of the resources of the Fund.

The U.K. position on this matter was supported by other delegations. Leslie G. Melville, speaking for Australia, took the view that a central bank must be certain that the resources it had counted upon would be available

[2] U.S. National Archives and Records Service, Records relating to the Bretton Woods Conference, General Records of the Treasury Department, Record Group 56 (referred to subsequently as NARS), Box 1, File A-9.

as required. J. W. Beyen of the Netherlands considered that there could be no question of having to convince the Fund on such matters and that the wording of Alternative A was "impossible."

In the event, the two draft amendments proposed by the United States were dropped, and the key words "entitled" and "represents" were included in the final text of the Bretton Woods Agreement.[3]

Given the foregoing legislative history, most countries probably ratified the Bretton Woods Agreement in the belief that British views on conditionality had prevailed and that the Fund would have no right to challenge a member's "representation" that it needed to draw resources from the Fund in order to effect payments consistent with the Agreement. In the Fund history, Horsefield (1969, p. 72) argues that Keynes had recognized in October 1943 that the use of the word "represents" did not imply that the Fund would automatically accept such a representation. He bases his argument on a cable to London in which Keynes mentioned as being still unresolved the question whether the Fund would be able to discipline a country's use of Fund facilities within the relevant quantitative limits. This does not mean, however, that Keynes accepted the U.S. view on the interpretation to be given to the word "represents." In any case, the developments at Atlantic City and Bretton Woods had clearly altered the situation, and it was understandable that Keynes and others should have thought that the British view of the matter had won the day.

When the Executive Board of the Fund eventually came to consider the interpretation of the word "represents" in May 1947, it was decided, in spite of the legislative history, that a member's representation under Article V, Section 3(a)(i), could be challenged by the Fund "for good reasons." As Horsefield (1969, p. 189) points out, in reaching this decision the Board was effectively rejecting the concept of an automatic right to draw within the quantitative limitations specified in the Articles.[4] The decision was therefore a turning point in the campaign for conditionality.

Silence at Bretton Woods

At a meeting held on July 1, 1944, at which members of the American delegation to the Bretton Woods Conference were briefed by Harry White, Assistant to the Secretary of the U.S. Treasury, on the U.S. government's position on questions likely to arise, the continuing conflict of views on conditionality was made clear, as was the fact that the United States stood

[3] A quite different Alternative A was put before the Bretton Woods Conference, involving much less significant deviations from the text of the Joint Statement than those discussed at Atlantic City. The new Alternative A was presented jointly by the United States and the United Kingdom and included the key words "entitled" and "represents" (see U.S. Department of State, 1948, Vol. 1, pp. 28-30).

[4] The Executive Director from France, Jean de Largentaye, dissented from the Board's decision.

virtually alone on this matter. White informed the delegation that "the foreign countries always speak of [drawings on the Fund] as a matter of right." He also acknowledged that the text of the Agreement was not clear on this point: "It reads in a way that is not too easy to see if you read it quickly." He was confident that the U.S. position was fully safeguarded by a number of provisions, including those, for example, of Article V, Section 5. This Section would enable the Fund to limit a member's right to draw if the member were found to be "using the resources of the Fund in a manner contrary to the purposes of the Fund." "Our lawyers," said White, "have taken the position that beyond question that gives adequate powers." Other delegations, he said, had tried to make it difficult for any Fund management to challenge the right of a member country to draw. But the U.S. negotiators had never yielded on this point, although (as a colleague, Ansel Luxford, pointed out) "we have tried to avoid emphasizing [this] any more than you have to" (NARS, Box 28, File W-5).

In view of the failure in Atlantic City to reach a common position on conditionality, it might have been expected that the subject would generate some lively controversy at the conference proper. In fact, however, the question was scarcely even mentioned at the conference, and certainly not debated.

Since none of the records thus far declassified throws any light on the reason for this silence, any explanation that could be offered is at best conjectural. One possible version might run as follows. The U.S. delegation, having encountered strong opposition in Atlantic City, was anxious that the conflict on conditionality should not surface at Bretton Woods. The fact that other countries interpreted the draft Agreement as authorizing unconditional drawings within certain quantitative limits, would, it might well have been felt, be bound to endanger the prospects of ratification by Congress. Congress was well aware that the United States would, for some time to come, be the only possible source of substantial net credit to the system. Prospects for ratification were already uncertain because of strong opposition to the idea of a Fund by the American Bankers' Association.

On the other hand, the delegations opposed to Fund conditionality had every reason to believe, after Atlantic City, that they had won their point and that, as long as the key words of the Joint Statement were maintained, there was no need to engage in another confrontation with the Americans on the matter. Moreover, Keynes had decided that he would raise as few issues as possible that might be embarrassing to the United States, because he was aware of the Administration's difficulties with Congress and was unwilling to add to them.[5]

[5] Keynes wrote on July 21, 1944, "We and we alone of the other delegations have spent 90 per cent of our time [at Bretton Woods] trying to help [the Americans] and not make trouble for them" (Moggridge, 1980, Vol. 26, p. 106).

One indication that nearly all countries other than the United States assumed that the question of conditionality had been settled along the lines of the view that had prevailed in Atlantic City is given by the fact that, although reservations were filed by governments on many provisions of the Articles of Agreement, there was not a single reservation on conditionality.

Another point of some interest is that, strong as the position of the United States on the principle of conditionality undoubtedly was, its objectives were clearly limited at this time. Members of the U.S. delegation at Bretton Woods might have been surprised if they could have peered into the future and read the text of a typical IMF standby arrangement. In intergovernmental discussions, the U.S. negotiators repeatedly emphasized that "no restrictions should be imposed [by the Fund] unless misbehavior is flagrant," as White put it at a meeting in October 1943. For example:

> The Fund's facilities should not be used to finance either a flight of capital or the issue of foreign loans by a country which could not afford to undertake foreign lending. Again, the Fund would be justified in intervening where a country was using its quota for rearmament. On the other hand, *it would not be justified in the case of an unbalanced budget. In general the Fund would intervene only in extreme cases of violation of qualitative rules, and would bear the burden of proof* [emphasis supplied]. (Horsefield, 1969, p. 69.)

Similarly, at the private meeting held to brief the U.S. delegation on July 1, 1944, there was no suggestion by any of the participants that the Fund's conditions for drawings would be onerous. A striking remark by White was, "I don't think the Fund should butt into every country's business and say 'We don't like this or that.' "

On the latter point, the wording of Article IV, Section 5(f) of the original IMF Agreement is of particular interest. This subparagraph stated that, so long as the Fund was satisfied that a change in the par value of a particular member's currency was necessary to correct a fundamental disequilibrium, "it shall not object to a proposed change because of the domestic social or political policies of the member proposing the change." This wording (as pointed out to the author by E. M. Bernstein) makes it clear that the intention of the Agreement as a whole was to preclude Fund interference with domestic policies having social objectives such as the subsidization of food or other essential consumption goods for the protection of low-income groups.

At a later stage, when the Bretton Woods Agreement came up for ratification by Congress, Professor Raymond Mikesell drafted the response to be made to the expected Congressional criticism that the Fund would give member countries a virtually automatic right to borrow. Mikesell's brief, used by White, was categorical in asserting the right of the Fund, under the Articles, to refuse a drawing. But it also provided an answer to the

question why the Articles did not explicitly authorize the Fund to pass on each request for a drawing or to require guarantees of good performance from members seeking drawings:

> The reason is that if a member agrees not to impose exchange restrictions on current transactions, and not to depreciate its currency, it must be given assurance of assistance in periods of adversity. . . . If countries are asked to come to the Fund "hat-in-hand" each time they find themselves in need of reasonable amounts of foreign exchange, they are not going to be willing to forego those exchange practices which in the past they have been forced to employ for the protection of their economies. (NARS, Box 8, File E-204. Draft dated June 29, 1945.)

An explanatory document issued to the press on July 21, 1944, at Bretton Woods included the following passage:

> There are many safeguards provided in the Fund to protect its resources from uses that are excessive in amount or in duration. . . . No safeguard provided for the Fund is more important than the provision that the countries' request for foreign currencies must indicate that the uses to which these currencies will be put are consistent with the purposes of the Fund. This means that countries which conduct their affairs in good faith in accordance with the undertaking to act in conformity with the purposes of the Fund will not in any circumstances divert the resources of the Fund to inappropriate uses. *In international agreements between sovereign States no method of enforcement can be as important as reliance on the good faith of the participants* [emphasis supplied]. (U.S. Dept. of State, 1948, Vol. 2, Appendix I, Doc. 508, pp. 1212-1213.)

The Early Years of the Fund

The United States was fully aware that the battle for a "grandmotherly" Fund had not been won at Bretton Woods. Once the Fund was a going concern, however, its Executive Board might be persuaded to introduce the implementing regulations or interpretations necessary to give the institution supervisory functions. Without such safeguards, the United States would not agree to the release of Fund resources. At a meeting of the Board in May 1946, the U.K. Executive Director, George Bolton, put forward his view of the "semi-automatic character of Fund facilities." The U.S. Executive Director, Harry White, on the other hand, while conceding that the text of the Articles of Agreement did not specifically authorize the Fund to exercise supervision, considered that there would have to be some check on the right of a Fund member to draw. He suggested that all applications in excess of a ceiling figure, to be determined later, should come before the Board for comment and decision.[6]

Speaking for Canada, Louis Rasminsky, later Governor of the Central

[6] Telegram from Balfour to Foreign Office, May 28, 1946, U.K. Public Record Office (subsequently referred to as PRO), Treasury File 236/1162.

Bank of Canada from 1961 to 1973, argued that the Fund could not operate if every transaction were to be regarded as an application to the Board. If a member gave the necessary guarantees and carried out its undertakings in good faith, it must be able to use its quota with assurance. Quantitative limitations on drawings had already been set out clearly in the Articles of Agreement, and if a member was fulfilling its undertakings by not purchasing foreign exchange for purposes inconsistent with the Articles, it should not be questioned. The Fund should be aware of the behavior of members and should be prepared to be courageous in its criticisms. But large-scale drawings should be regarded as no more than danger signals (PRO Treasury File 236/1162).

In a statement to the Executive Board on August 29, 1946, the Managing Director, Camille Gutt, said that the Fund could be considered as "a sort of automatic machine selling foreign exchange to members within certain limits and on certain terms, and repurchasing this foreign exchange within certain limits and on certain terms." The Fund could, however, issue warnings to members and, in certain circumstances, declare a member ineligible to draw. In Gutt's view, an Executive Board composed of high-level officials was required not so much for the discharge of such functions as to constitute "a most important monetary policy-making body, consulted by and advising its members during the critical periods they may pass through" (PRO Treasury File 236/1162).

In November 1946, a report to the Bank of England by the U.K. Executive Director stated, "For the time being there is no reason to fear a policy of persistent and irresponsible interference in the domestic affairs of members" (PRO Foreign Office File 371/62340). As late as September 1947, the Treasury brief for the U.K. delegation attending the second Annual Meeting of the Board of Governors of the IMF suggested that the "battle for 'automaticity' may be largely regarded as won" and pointed out the failure of the United States to have the French economic situation discussed by the Executive Board before allowing additional French drawings (PRO Treasury File 236/1174).

But the situation was in reality quite different.[7] The Europeans had the best of the argument, perhaps, but it was the United States that had the resources, and it was resources that counted, especially in the immediate

[7] It is remarkable that for nearly four years—from January 1944 to at least September 1947—the U.K. Government seems to have believed that it was winning a battle that it was, in fact, in the process of losing. It is even more remarkable how deep a misunderstanding can persist in international discussions even as between countries speaking the same language. By October 1948, however, George Bolton was drawing the IMF Board's attention to the "increasing number of interpretations reading into the Fund Agreement limitations which were not in the text. Because of such limitations the Fund was now of no use to its European members; it carried obligations but no benefits" (see Horsefield, 1969, p. 243).

aftermath of World War II. By 1950, the Fund had come to a complete standstill, there being no drawings at all in that year. As the Fund history points out, "Many people, both inside the Fund and in member countries, were disturbed at the small extent to which drawings were being made available to assist member countries in the kind of difficulties which the Articles had envisaged" (Horsefield, 1969, p. 276).[8]

The decline in Fund operations was partly due to the so-called "ERP Decision," adopted over European opposition, whereby countries receiving assistance under the European Recovery Program were only exceptionally to request the purchase of U.S. dollars from the Fund. But an additional factor was the continuing insistence of the U.S. Executive Director that the use of the resources of the Fund must be subjected to close scrutiny. This contention was used to challenge requests for drawings not only by the Netherlands, which had withdrawn its informal undertaking not to draw on the Fund, but by a number of other countries such as Nicaragua and South Africa (Horsefield, ed., 1969, Vol. 2, p. 398).[9]

Deploring "the current tendency to write off the Fund as moribund," Gutt made a proposal in November 1950 to break the deadlock by linking drawings to an engagement by members to take specific steps to overcome balance-of-payments difficulties. The legality of this proposal was immediately challenged by European and other members of the Executive Board. In the end, however, only France and the United Kingdom withheld their approval, the remaining countries considering, as the Fund history puts it, that the Managing Director's plan "offered a useful technique for enabling members to resume drawing from the Fund" (Horsefield, 1969, p. 281).

Similarly, an earlier proposal by the United States to establish a maximum period of five years for the repayment of drawings was adopted despite initial opposition, on legal as well as policy grounds, by most members of the Executive Board (Horsefield, ed., 1969, Vol. 2, pp. 399-400). The view of the Fund staff on this matter was that the Board had no legal authority to set a term for repayment of drawings unless it distinguished between members. If at the time of drawing it seemed to the Board inherently likely that repayment could be made reasonably soon, the Board had no power to impose conditions. If such repayment could not be foreseen, the proper course was to refuse to allow the member to draw at all (Horsefield, 1969, p. 278).

[8] It is ironic that in 1974-79 the Fund again reached a position in which it was often unable to "assist member countries in the kind of difficulties which the Articles had envisaged"—this time because of *too much* conditionality rather than too little.

[9] In a letter to the author, Sir George Bolton, U.K. Executive Director from 1946 to 1952, writes that after the collapse of sterling convertibility in 1947, the activities of the Fund appeared to be a "stonewalling operation designed to protect the American reserves from being too heavily drawn upon as a result of Fund operations."

The Principle of Conditionality Conceded

Thus, it was a desire to enlist the cooperation of the United States as the principal source of credit that prompted other Fund members to give way to American views on the question of conditionality, rather than any conviction on their part that adoption of the U.S. concept of conditionality was indispensable for a successfully functioning IMF. As the former General Counsel of the Fund, Sir Joseph Gold, wryly put it: "The [Executive Board's] decision of February 13, 1952 [adopting the principle of conditionality] was intended to reinvigorate the Fund by encouraging members to believe that they would be able to use its resources" (Horsefield, ed., 1969, Vol. 2, p. 524).

Among the main points of this decision were the following:

a. The Fund's attitude toward the request of a member for assistance would turn on "whether the problem to be met is of a temporary nature and whether the policies the member will pursue will be adequate to overcome the problem within such a period."
b. Drawings should be for periods "within an outside range of three to five years."
c. "A member can count on receiving the overwhelming benefit of any doubt" respecting drawings in the gold tranche.
d. Standby arrangements might be envisaged, whereby a member would enter into discussions with the Fund not for an immediate drawing "but in order to ensure that it would be able to draw if, within a period of say 6 to 12 months, the need presented itself." (Horsefield, ed., 1969, Vol. 3, pp. 228-230.)

In 1955 the policy of differentiating between drawings in the successive credit tranches was embodied in the further principle that "the larger the drawing in relation to a member's quota the stronger is the justification required of the member," but it was noted that in practice the Fund's attitude toward drawings in the first credit tranche would be "liberal" (Horsefield, ed., 1969, Vol. 2, p. 404).

The Substance of Conditionality

It follows from the above that the conditions a member must satisfy in order to be eligible for a drawing on the Fund's ordinary resources, or for a standby arrangement, vary according to the size of the drawing in relation to the quota. The main concern of the Fund has been to protect the revolving character of its resources, and it was this consideration that prompted the adoption of the three- to five-year limit for repayment of drawings. Linked to the capacity to repay, of course, is the need for the country concerned to adopt policies and measures that will help to restore and maintain balance-of-payments equilibrium.

Such policies and measures have in the past focused on the restoration

of a balance between the aggregate demand for and aggregate supply of resources, making use of monetary and fiscal policies to this end. Where the balance-of-payments problem was thought to be due in part to distortions in the price structure, the measures required for re-establishing equilibrium might be held to include changes in exchange rates, interest rates, and other prices and incomes. Limitations on the accumulation of new foreign debt might also have to be considered.

It is obviously not possible, within the scope of this Essay, to undertake a thoroughgoing review of the manner in which the Fund's policy requirements have been worked out and applied, although certain aspects will be touched on subsequently in connection with the examination of some of the main issues that have arisen in relation to conditionality. One point, however, may be noted even at this stage. As Gold (1979b) has pointed out, the Fund maintains a deliberate relationship between the resources it makes available unconditionally, or on the basis of mild conditionality, and the resources for which it applies stronger conditionality. At times the Fund has leaned in the direction of milder conditionality (as in the mid-1970s, when it established oil facilities at low conditionality), while at others (as at the present time) it has emphasized more exacting conditions. "The relationship," says Sir Joseph, "is not fixed, and a prevailing balance may be modified in favor of milder conditionality if circumstances make this change advisable."

Particularly striking from this point of view were the Fund's decisions whereby the conditions relating to gold subscriptions arising out of quota increases were relaxed in the case of members encountering "undue payments difficulties." On the occasion of the fourth review of quotas in 1965, the Fund declared that "the representation of a member with respect to undue payments difficulties . . . would not be challenged by the Fund except where it was clearly evident that the representation was without basis." Sir Joseph draws the conclusion from this experience that the Fund evidently considered that it had the authority to adopt policies on the unconditional use of its resources quite apart from its gold-tranche policy.

The Proliferation of Limitations and Targets

From 1952 onward, the standby arrangement was developed as the main instrument for conditionality applicable to drawings beyond the first credit tranche. Two stages in the evolution of standby arrangements may be noted. In 1956, phasing was introduced; in other words, drawings were authorized in installments over a period of time, each installment being approved in the light of satisfactory performance by the drawing country. Binding performance conditions evolved gradually, beginning in 1958. In that year, a drawing by Paraguay was made conditional on observance of a

credit ceiling and of maximum commitment levels for budget expenditure and public works programs. When this matter was reviewed in the Executive Board, the Executive Director for the United Kingdom asked that it be recorded that the performance conditions required of Paraguay on this occasion should not be regarded as a precedent for general application (Horsefield, ed., 1969, Vol. 2, p. 485). In 1959, Haiti undertook a broader range of policy conditions, and this time several Executive Directors expressed reservations.

These developments were followed by further elaboration of performance conditions. As the Fund history puts it, "There has been a tendency toward the proliferation of specific limitations and targets" (Horsefield, ed., 1969, Vol. 2, p. 486). There is some difference of opinion as to the significance of this "proliferation."

On the one hand, Gold argued that the progressive "refinement" of standby arrangements "should not be understood to mean that the provisions of stand-by arrangements have become stricter with each development in the Fund's policies" (Horsefield, ed., 1969, Vol. 2, p. 534). It was essential, on this view, that the assurance of access to Fund resources given to a member country entering into a standby arrangement be balanced by equally firm assurance by the member country of consistency with Fund policies.

A quite different view was taken by the developing countries and, in the earlier years, by some of the developed countries as well. It was felt that, in the nature of the case, a "proliferation" of limitations and targets would be bound to have the effect of increasing the stringency of the conditions imposed, because the freedom of action of the monetary authorities of member countries would thereby be reduced still further. It was for this reason that in September 1968 the Executive Board decided that the number of performance criteria to be applied in cases of drawings beyond the first credit tranche should be limited to those considered truly necessary for determining whether the objectives of a member's stabilization program were being achieved.

The steps that led up to this decision are of considerable interest. A relatively large standby arrangement for the United Kingdom was approved in November 1967 with a minimum of conditions, causing particular concern among developing countries represented on the Executive Board as to equality of treatment of member countries.[10] The Executive Director from Brazil, Alexandre Kafka, while supporting the proposed arrangement, drew attention to the fact that it contained no provisions for phasing, no perform-

[10] The following account of developments in 1967-68 is based on de Vries, 1976, pp. 338-347.

ance clauses, and relatively few monetary or credit ceilings. In other words, although this standby arrangement was in the highest credit tranches and should therefore have involved stringent performance conditions, it lacked both a quantitatively defined program and other clauses customarily included in standby arrangements. Instead, it contained unusually far-reaching provisions for consultations, the significance of which in terms of performance conditions was far from clear. Kafka went on to say that many countries might wish that any standby arrangement approved for them should be modeled on the same lines as that for the United Kingdom. His position was supported by nearly all the Executive Directors from developing countries.

This episode touched off a general review of the Fund's policy on the use of its resources under standby arrangements, which took place in August and September 1968. In the course of this discussion, the U.K. Alternate Executive Director, Guy Huntrods, defended the absence of specific safeguards in the U.K. standby arrangement on the grounds that the U.K. economy was the subject of close examination by the Fund and the terms of the arrangement were therefore, in his view, no less stringent than arrangements for other members. Moreover, performance criteria had been expressed largely in qualitative rather than quantitative terms because the difficulties of accurate forecasting were particularly marked in the case of the United Kingdom.

Developing-country members, on the other hand, no doubt considered that, however great the difficulties of accurate forecasting might be in the United Kingdom, they were considerably greater in developing countries. Yet the information placed before the Executive Board by the IMF staff showed that the number of performance criteria in standby arrangements for members in Latin America and Asia had on average been much greater than for members in Europe. Executive Directors for developing countries noted the view expressed by the Fund staff that one of the reasons for not setting fiscal targets as performance criteria was that fiscal data were not sufficiently reliable. But since monetary ceilings and targets could also not be forecast accurately, how, they asked, could it be supposed that these would be any more useful in performance clauses than fiscal targets?

On September 20, 1968, a comprehensive decision was adopted that has, with minor modifications, provided the basis for Fund policy since that time. These were the main elements of the decision:

a. Clauses requiring the member to remain in consultation with the Fund were to be included in all standby arrangements. Periodic consultations were also to be required in all cases of drawings beyond the first credit tranche, whether under a standby arrangement or otherwise.
b. In standby arrangements limited to the first credit tranche, no provision would

be made for phasing of amounts drawn or for the achievement of performance criteria as a condition of each additional drawing. Such provision would, however, "normally be included" in all other standby arrangements but would be applicable only to purchases beyond the first credit tranche.

c. Performance clauses would be limited to stipulating criteria necessary to evaluate the implementation of a member's stabilization program. (de Vries, 1976, p. 347.)

Notwithstanding this development and codification of Fund practice, it was not until 1969 that the principle of conditionality was given explicit legal sanction through amendment of the Articles of Agreement. Among other things, it was made explicit in Article V that:

> A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies adopted under them, with the exception that proposed gold tranche purchases shall not be subject to challenge. [*Articles of Agreement of the International Monetary Fund*, as amended effective July 28, 1969, Art. V, Sec. 3(d).]

2 The Issues

Conditionality and the Access to Resources

An obvious question is whether any useful purpose is served by reviving the old debates about automaticity and conditionality. There is now no disagreement among governments, whether from developed or developing countries, on the broad principle of conditionality in the Fund. Moreover, as noted above, an amendment to the Fund's Articles of Agreement adopted in 1969 explicitly recognizes the principle of conditionality.

It is nevertheless useful, at a time when the application of the principle of conditionality is being re-examined inside as well as outside the IMF, to bear in mind that there is a role for both conditional and unconditional resources within the Fund, and that there are compelling reasons for a major increase in the proportion of resources made available unconditionally or at low conditionality. These reasons will be set out in the course of the following discussion.

Another reason for going back over the historical record is the startling similarity between the views held today by developing-country members of the Fund and the views that were being vigorously advocated by the Europeans at a time when they, too, had to face major balance-of-payments pressures of a structural character. If the monetary authorities of countries such as France, the Netherlands, and the United Kingdom would like to gain a better understanding of the current insistence by developing countries on the need for access to a larger volume of unconditional resources, they have only to look back at their own files and position papers of the

early postwar period. What was sauce for the goose in the late 1940s and early 1950s should, perhaps, be sauce for the gander in the 1980s.

Even the United States, concerned as it was at the end of World War II not to expose itself to excessive external demands on its resources, and unyielding as it therefore was on the basic principle of conditionality, had quite limited objectives at the time of Bretton Woods on the policing of Fund lending, as has been shown above.

The fact that Keynes was opposed to the idea of a "grandmotherly" Fund does not mean that he thought all drawings on the Fund should be automatic. On the contrary, it is worth looking at Keynes's own proposal for an International Clearing Union. Not only did it limit the rate of drawing on the Union and provide in certain circumstances for the deposit of collateral, but it empowered the Governing Board, as a condition of allowing a member to increase its debit balance to a figure in excess of half its quota, to require the member to devalue, to control the outflow of capital, and to surrender gold or foreign exchange in appropriate reduction of its debit balance. The Governing Board could also recommend "internal measures affecting [the member's] domestic economy" (Horsefield, ed., 1969, Vol. 3, p. 23). Where a member's debit balance had exceeded three-quarters of its quota on the average for at least a year, the member could be "asked by the Governing Board to take measures to improve its position," and if appropriate improvement had not occurred within two years, the member could be declared in default and lose its entitlement to draw further (*ibid.*, section II.8.c).

One of the most important points of contrast between the British (Keynes) plan and the American (White) plan was in the size of member-country quotas. The Clearing Union proposal appears to have envisaged total quotas on the order of $30 billion or more, equivalent to one-half or more of world imports.[11] The American proposal adopted at Bretton Woods, on the other hand, was for aggregate quotas of $10 billion. In particular cases, of course, quota limitations could be set aside by a waiver procedure. But in global terms, at the lower level of quotas proposed by the Americans, it became much more important, in Keynes's view, to provide for a larger unconditional element in drawing rights on the Fund. Otherwise, countries would not have the assurance they needed of access to a sufficient volume of balance-of-payments support, in case of need, to give them a

[11] Quotas were to amount to "(say) 75 per cent" of the average annual sum of each country's exports and imports during the three pre-war years. According to a contemporary estimate by Joan Robinson (1943), quotas were to total $36 billion if all countries joined, and $26 billion if only "United and Associated Nations and their dependencies" became members. The latter figure was used by Sir Frederick Phillips, of the U.K. Treasury, at a meeting of nineteen country representatives held in the U.S. Treasury on June 15, 1943. World imports amounted to about $60 billion in 1948 and were no doubt smaller in previous years.

minimal degree of freedom of action in their economic policies. In October 1943, Keynes wrote to Professor Jacob Viner that, on second thought, he felt that the Clearing Union "policing" provisions may have been too strict, "though this was actually balanced under the Clearing Union by the much greater size of quotas" (Moggridge, 1980, Vol. 25, p. 333).

Similar considerations apply *a fortiori* to the present situation in the IMF. While IMF quotas averaged about 16 per cent of total imports in 1948, the proportion had fallen to less than 3 per cent in 1980. For non-oil developing countries the percentage was a little higher—between 4 and 5 per cent. The proportion of quota now available unconditionally, or at low conditionality, includes not only the reserve tranche and the first credit tranche but drawings under the combined compensatory financing and cereal import facility of up to 125 per cent of quota. (Drawings for the financing of buffer stocks are also available at low conditionality.) The combined facility, however, deals only with balance-of-payments difficulties due to export shortfalls or to excess import costs for cereals, and many other factors outside the control of these countries—such as increases in import prices for commodities other than cereals—can exert balance-of-payments pressure.

On the whole, therefore, the capacity of the Fund to provide balance-of-payments support to developing countries unconditionally, or at low conditionality, has declined substantially. At the same time, drawings in the upper credit tranches are subject to stringent conditions. Such expansion of Fund resources as has taken place recently, as noted below, has added to the lending capacity of the Fund only at high conditionality, while the low-conditionality resources previously available through the oil facility and from sales of gold have come to an end.

It is true that balance-of-payments financing is also provided by commercial banks. But this is available only to a limited number of developing countries, and generally not to the poorest or, by commercial-bank standards, least creditworthy among them. The commercial banks did play a useful role in meeting the need for balance-of-payments support in the 1970s, at a time when no alternative sources were available on the scale required. Now that such financing has been widely accepted, it is likely to continue, though not necessarily in the volume or on the terms that borrowing countries would consider desirable. But commercial-bank financing should not be regarded as a substitute for adequate resources in the Fund, especially in view of the inability of many Fund members to obtain access to private capital markets for balance-of-payments support.

Conditionality and the Burden of Adjustment

As is well known, the distribution of the burden of adjustment tends to be highly inequitable as between countries. During the Great Depression,

the term "beggar-my-neighbor" was used to describe the policies whereby countries sought to shift the burden of adjustment to one another, and it was generally the stronger countries that achieved the greatest success. Keynes summed up the historical experience of the functioning of the adjustment process as follows:

> It is characteristic of a freely convertible international standard that it throws the main burden of adjustment on the country which is in the *debtor* position on the international balance of payments. . . . Thus it has been an inherent characteristic of the automatic international metallic currency (apart from special circumstances) to force adjustments in the direction most disruptive of social order, and to throw the burden on the countries least able to support it, making the poor poorer. (Moggridge, 1980, Vol. 25, pp. 27, 29.)

As Keynes points out, the process of adjustment is compulsory for the debtor and voluntary for the creditor. Moreover, most of the means of adjustment open to the debtor country are apt to have adverse effects on its terms of trade, and in the case of the poorer countries—exporting mainly primary products—the adverse price effects may be large enough to offset, or more than offset, any favorable movement in trade volumes.[12]

Experience since Keynes's time amply confirms his assessment. Strong international pressure has frequently been brought to bear upon deficit countries, while surplus countries have been under little or no pressure to adjust. Developing countries that are in deficit are frequently accused of "mismanagement" of their affairs, but the same term is never used to describe the policies of surplus countries. Surplus countries may be faulted for unwillingness to share the burden of adjustment but never for mismanagement. On the contrary, recent years have seen a revival of mercantilist policies among the industrial countries aimed at the attainment of surplus positions all round.

It would be difficult in these days to point to a country, developed or developing, that is *not* vulnerable to the charge of economic mismanagement from some point of view or other, so that the common use of the term mainly to describe the conduct of developing countries is hardly objective, to say the least. But there is a more subtle abuse in the indiscriminate use of the term "mismanagement" to describe the alleged sins of developing countries. For once it can be shown that a country has made some error of economic management, there is a tendency to assume that this fact alone can be held responsible for the entire balance-of-payments deficit with which the country is confronted. This may be far from the case. A country

[12] Keynes also argued that the downward pressure on the economy of a debtor country resulting from a given loss of reserves is proportionally much greater than the corresponding expansionary impact on the rest of the world, simply because the debtor country is small compared with the world at large. But this line of argument seems to assume that deficits are necessarily more highly concentrated on particular countries than the counterpart surpluses. It is not clear why this should be so.

may have made errors of economic management, and yet the more important factors contributing to external imbalance may be a deterioration in terms of trade or the imposition by other countries of import restrictions affecting its exports. Under current practice, it is not a standard requirement that allowance be made in stabilization programs for factors outside the control of the deficit countries concerned, other than those arising in cases where shortfalls in export earnings are involved. Once there is a *prima facie* showing of mismanagement—and few if any countries are completely innocent of it—the conclusion is generally drawn that the elimination of the entire deficit is the exclusive responsibility of the deficit country.

In defense of this position, it has been suggested that, despite all the hopes for effective exchange-rate surveillance, the Fund still does not have any mechanism for compelling a surplus country to adjust. Given this fact, and given a situation where a country is faced with a balance-of-payments deficit of more than temporary duration, adjustment cannot be avoided. This reasoning is inescapable as far as it goes, but it does not go far enough. It certainly does not justify the application of standard upper-credit-tranche conditionality to a country finding itself in the situation described. As matters now stand, whether or not a country is compelled to accept exacting Fund conditions does not depend upon the character of its balance-of-payments problem or upon the degree of its responsibility for that problem. It depends simply on whether its cumulative drawings on the Fund have risen beyond the level of the first credit tranche.

As noted earlier, owing to the failure over the years to increase Fund quotas in line with world trade, the ratio of quotas to trade has fallen to an exceedingly low level. In most of the countries that have to rely mainly on the Fund for balance-of-payments support, it does not take a very large deficit to move the country from the first credit tranche, where conditionality is low, to the upper credit tranches.

Clearly, the situation of a country whose deficit is merely the mirror image of a structural surplus elsewhere in the system is vastly different from that of a country in which domestic expenditure is excessive. There are no rational grounds for compelling the former country to undergo all the rigors of standard upper-credit-tranche conditionality. On the contrary, precisely because of its inability to carry out the mandate of the Articles of Agreement in relation to surplus countries, the Fund might be expected to lean over backward to ease the difficulties of countries that are suffering the effects of that shortcoming. The Fund cannot, of course, supply more resources than are available to it. But, subject to that constraint, there is much that the Fund can do to lighten the burden of adjustment and avoid the application of severe measures, especially of a deflationary character.

The Fund, however, has rejected the idea that the origin of a deficit

should be taken into account in determining the degree of conditionality imposed. In justifying this position, it is pointed out that both internal and external factors may be present in many situations. Moreover, in terms of adjustment, it is suggested, a more important consideration is whether the imbalance is transitory, and therefore self-reversing, or is likely to persist. If it is likely to persist, the country will need to undertake adjustment regardless of the internal or exogenous character of the deficit.

Here again the reasoning is valid but incomplete. It is quite true that in real life a balance-of-payments deficit may have elements of both internal and external origin and that, where the deficit is persistent, adjustment is inescapable. But it is also true that, within the resources available to it, the Fund has sufficient degrees of freedom in the application of conditionality to be able to distinguish between a country whose deficit is mainly self-generated and a country whose deficit is mainly due to external factors. In particular, there is no reason why a country that has already sustained a decline in real income because of a deterioration in terms of trade for reasons beyond its control should be called upon to lower its income still further by means of devaluation or fiscal and monetary contraction unless there are specific indications of a genuine need for such measures. The Fund should seek rather to support the kind of solution that is consistent with an expansion of output and employment.

Conditionality and Self-generated Imbalance

There are reasons for questioning the Fund's methods of applying the principle of conditionality even in conventional cases where countries themselves are primarily responsible for their balance-of-payments difficulties—for example, where there is excess pressure of domestic demand.[13] So far as the diagnosis of problems of imbalance is concerned, the Fund history has itself pointed to the questions that arise regarding the validity and applicability of the monetarist approach to the balance-of-payments employed by the Fund (de Vries, 1976, p. 368). There are also dangers inherent in the characteristic effort of stabilization programs to sum up the economic performance of a country in terms of a few monetary aggregates. Moreover, the use of quantitative monetary targets as performance criteria tends to determine the character of the adjustment to be undertaken even though other forms of adjustment may be more appropriate.

Foremost among the basic assumptions underlying IMF stabilization strategy, as pointed out by John Williamson (forthcoming), is that "the least-cost way of satisfying a budget constraint is to let the market decide how it is to be done, except where there are specific reasons for believing

[13] For a fuller treatment of this subject, see Dell and Lawrence (1980, Chap. 3).

that there are divergences between private and social costs and benefits." It is on these grounds that the Fund seeks to promote the liberalization of trade and payments, and prefers exchange-rate changes to the intensification of controls when expenditure switching is called for. While sharing the general viewpoint on which the Fund's preferred strategy is based, Williamson sees difficulties in avoiding controls in cases where reliance on the market would lead to what he calls "peremptory (or, even worse, oscillating) adjustment."

A further consideration is that the magnitude of social costs and benefits is rarely quantifiable and there is therefore a tendency to ignore them. From the standpoint of a country committed, for political and social reasons, to planned development, any proposal for a stabilization program that would, in effect, take major decisions out of the hands of the planners and rely instead on determinations by the market inevitably appears to involve a political judgment outside the competence or responsibility of the IMF. (For a strong reaction to such proposals, see Nyerere, 1980.) The IMF's own Guidelines on conditionality imply that the Fund ought to be able to adapt its policy prescriptions to the social and political objectives of individual member countries.[14] Yet, while the Fund has made an effort to adapt stabilization programs to the goals of centrally planned economies, it has tended to assume that for all other countries market forces are likely to yield the best results.

Even on purely economic grounds, there are many cases in which the wisdom of exchange-rate changes or of the liberalization of trade and payments is open to serious doubt. As two members of the Fund staff have put the matter:

> Where trade flows are responsive to price factors (as, for example, for developing countries which have a substantial manufacturing sector) there is more likely to be a balance of advantage in rate flexibility. . . . In other cases, however, where trade flows are not very responsive to exchange rate changes (because export prices are determined in world markets and there are no close domestic substitutes for imports), the exchange rate changes needed to secure equilibrium in the balance of payments will be large. For these countries, the repercussions of exchange rate variability on domestic objectives, such as investment promotion and income distribution, may be a more potent factor on the negative side. (Crockett and Nsouli, 1977.)

[14] As noted below, however, the Guidelines require the Fund only to "pay due regard" to domestic social and political objectives, as well as to the economic priorities and circumstances of members, including the causes of their balance-of-payments problems. Gold (1979b, pp. 22-25) points out that the phrase "the Fund will pay due regard" does not have mandatory force. Under Article I of the Agreement the Fund is required to adopt "adequate safeguards" when making its general resources available, and this requirement is considered to take priority over anything stated in the Guidelines. One difficulty here, of course, is that the phrase "adequate safeguards" is far from precise, and it can only be a question of judgment as to when safeguards are "adequate" and when they are not.

For countries whose exports consist mainly of primary products, moreover, it cannot be assumed that an increased share of the market can invariably be obtained by cutting export prices in terms of foreign currency, with or without devaluation. Any such move is bound to put pressure on other producers to retaliate in defense of their own market shares. The result is a loss for all producers, and this loss is aggravated where a series of devaluations leads to a rise in the output of primary products and hence a further deterioration in the terms of trade. Devaluation is justified only where domestic costs have risen so high that it has become unprofitable to export traditional primary commodities, or where dropping the exchange rate can reasonably be expected to generate a major expansion in nontraditional exports, particularly manufactures.

The liberalization of trade restrictions is another policy approach that should not be insisted on indiscriminately. The case for maintaining and even reinforcing trade controls is particularly strong where a country would otherwise be forced into substantial deflation and unemployment as a means of reducing imports, when the same goal could be achieved with a lesser decline in real income and employment through the use of trade controls.

Even in the many situations where member countries themselves prefer to rely on decision-making by market forces, the use of pinpoint monetary targets raises serious difficulties. The setting of such targets is far from being as scientific a process as is usually implied in the literature on this subject, particularly in view of the historical evidence cited by the IMF staff itself. The evidence does not support the presumption that the velocity of circulation of money remains steady when domestic credit is manipulated for policy purposes (see Fleming and Boissonneault, 1977, and Park, 1970). There is also the practical difficulty that the evidence shows that huge errors in short-term forecasting are commonplace even in regard to monetary aggregates presumed to be under government control, let alone in relation to the private sector.

It is true that program ceilings can be, and often are, modified by the Fund to take account of unforeseen events or incorrect assumptions. But frequently this cannot be done until after the mistaken targets have been in operation for some time and significant damage has already occurred. Analysis of recent experience of monetary targets in industrially developed countries with advanced statistical underpinning has shown the extraordinary difficulties that arise even in selecting and quantifying the appropriate monetary target, let alone in exercising the control required to achieve that target. The Governor of the Bank of England is among those who have been sharply critical of procedures that require a particular numerical target to be reached by a particular date (Bank of England, 1978). An important statement dealing with this matter and entitled "Measures to Combat

Inflation" was issued on April 14, 1981, by the Group of 30. This nonofficial group of leading bankers, central bankers, economists, and businessmen meeting under the chairmanship of Johannes Witteveen, former Managing Director of the IMF, expressed the view that "It is perhaps time to review critically recent experience with the use of strict quantitative targets for growth in the money supply, whether it is broadly or narrowly defined."

In some cases, it is felt that the situation calls for shock treatment in the form of a drastic change in the exchange rate or a major cutback in real income. Where economic chaos appears imminent, such treatment may be almost unavoidable. Moreover, if internal political and social relationships are cohesive, such measures may be accepted without political upheaval. But there are at least as many cases in which such cohesion is lacking, so that shock treatment may be compatible only with authoritarian government. In such cases, international pressure for drastic measures may have consequences that are incompatible with other international objectives.

Conditionality and Externally Generated Imbalance

If there is a need for reconsideration of certain features of traditional stabilization programs even in cases of self-generated imbalance, the validity of such programs is still more questionable where balance-of-payments problems are of external origin or of a structural nature.

The Fund's *Annual Report* for 1979 (p. 23) noted that the entire increase in the balance-of-payments deficit of non-oil developing countries from 1977 to 1979, estimated at some $22 billion, was due to two factors: the deterioration in terms of trade and the rise in the cost of servicing external debt. Both of these developments were the result of forces outside the control of the developing countries concerned, including the mounting export prices of the industrial and oil-exporting countries and the increases in interest rates associated with efforts by the industrial countries to curb inflation by means of monetary restrictions.

The situation in 1979-81 is reminiscent of that in 1974-75. At that time, too, developing countries, as well as many developed countries, encountered very large deficits in their balances of payments, owing mainly to a deterioration in terms of trade. In a note presented to the Committee of 20 at its Rome meeting in January 1974, the Managing Director indicated that oil-importing countries would, in the short run, have to accept the deterioration of the current account of the balance of payments, since:

> Attempts to eliminate the additional current deficit caused by higher oil prices through deflationary demand policies, import restrictions, and general resort to exchange rate depreciation would serve only to shift the payments problem from one oil importing country to another and to damage world trade and economic activity. (IMF, 1974, pp. 25-26.)

Subsequently, in its communiqué of June 13, 1974, the Committee of 20 noted:

> As a result of inflation, the energy situation, and other unsettled conditions, many countries are experiencing large current account deficits that need to be financed. . . . Sustained cooperation would be needed to ensure appropriate financing without endangering the smooth functioning of private financial markets and *to avert the danger of adjustment action that merely shifts the problem to other countries* [emphasis supplied]. (Committee of 20, 1974, p. 221.)

These were the considerations underlying the decision to establish an oil facility to provide balance-of-payments support at low conditionality in 1974-75. Any Fund member drawing on the oil facility was required "to cooperate with the Fund to find appropriate solutions for its balance of payments problem." This was the same level of conditionality that was applicable to the compensatory financing facility.

Very similar considerations apply to the situation in 1981-82. Here again, the recent upsurge in oil prices, coupled with general inflation, has had a major effect on the balances of payments of a large number of countries. And once more, as in 1974-75, it is important that deficit countries not adopt policies that merely aggravate the problems of other countries. But while in 1974-75 it was recognized that countries incurring balance-of-payments deficits due to oil-price increases should not be forced into immediate adjustment, in 1981-82 the resources provided by the Fund bring with them all the rigors of upper-credit-tranche conditionality. Yet it is as true in 1981-82 as it was in 1974-75 that the inevitable outcome of forcing excessive retrenchment on deficit countries while the surpluses of oil-exporting countries are maintained is that deficits are simply shifted from country to country. The cumulative deflation brought about by the adjustment process is thereby superimposed on, and reinforces, the primary deflation resulting from business recession in the industrial countries.

Adjustment to the new increases in oil prices, in any real and lasting sense, cannot be achieved within a short period of time. The kind of shock treatment often considered advisable in cutting back excess demand is virtually useless in current circumstances, which call for the adaptation of the economy to a new level of the energy terms of trade.

In some respects, the situation in 1981-82 and the foreseeable future is even more difficult than in 1974-75. Countries that obtained ready access to private capital markets in 1974-75 cannot count on accommodation on the same scale[15] in the period ahead because of mounting concern among commercial banks about the risks involved and the tightening of credit in major industrial countries. And the lowest-income countries have to rely

[15] Net bank lending to non-oil developing countries in 1974-78 is believed to have exceeded $100 billion, equivalent to over $170 billion at 1980 (third quarter) prices.

on official sources of finance, which have been subject to curtailment as part of a process of budget cutting in donor countries. These considerations point to the need for a substantial increase in the flow of resources to developing countries from the multilateral institutions—the Fund, the World Bank, and the regional development banks—on terms and conditions that permit rates of growth to be maintained and programs of structural adjustment accelerated.

Despite important conceptual advances in policy statements by the Fund management, to which reference will be made below, there is a continuing reluctance within the Fund to accept the proposition that the origin of balance-of-payments disturbances is a highly relevant factor in determining the appropriate way of dealing with them. There is no dispute that permanent changes, such as in the energy terms of trade, call for adjustment by the deficit countries. But the crucial point is that the adjustment process required of them is not of the classical variety designed to curb excessive domestic demand. It is concerned much more with the need for structural changes in the economy—changes that will bring about savings in the use of imported fuels, for example, or that will redeploy domestic resources in a manner that can achieve external balance without undue disturbance to domestic growth and employment. The experience of the 1970s dramatized the adverse effects on long-term growth and development that can occur through compression of the balance-of-payments adjustment process into an unduly brief period of time. It is clear that the period of adjustment was much too short for many countries, and that a lack of adequate official resources for medium-term balance-of-payments support was severely felt.[16]

Objectives of the Developing Countries

Since 1978, the Fund has come under strong pressure from the developing countries to liberalize its conditions for lending. Such use of Fund credit as did occur during the middle and later 1970s was concentrated almost entirely on the facilities available on relatively easy conditions—the oil facility, the compensatory financing facility, and the reserve and first credit tranches. Even where countries were under the most intense pressure both in their external accounts and in their domestic economies, they hesitated to make use of the upper tranches of their quotas in the Fund and avoided such drawings if they could. There were only ten cases of drawings beyond the first credit tranche in 1974-76 among the entire Fund membership.

There was a widespread feeling among developing countries that the

[16] For details, see Dell and Lawrence (1980, Chaps. 1 and 2).

quota resources available in the Fund were too small to justify the considerable changes in economic plans and policies that might have to be made in order to be allowed to draw on them, except as a last resort in circumstances leaving no other option. A relationship therefore existed between the willingness of countries to accept Fund conditions and the amount of resources that the Fund was able to make available to them. By the same token, the larger the resources that could be provided and the longer the period over which they could be made available, the less abrupt did the adjustment process have to be and the less exacting the conditions imposed.

Beginning in September 1978, the Group of 24—representing developing-country members of the IMF—held a series of meetings at which issues were raised that were considered to be of key importance. At its meeting in September 1978, the Group expressed concern about the multiplicity of performance criteria and some other forms of conditionality that were inhibiting access to Fund resources by member countries. The Group urged the Executive Board of the IMF to set appropriate guidelines designed so as to limit the performance criteria only to relevant macroeconomic variables, paying due regard to the need for sustained growth in the developing countries (Group of 24, 1978, p. 306, par. 12).

A further meeting held on March 6, 1979, expressed agreement with the fundamental conclusion of a study that had been prepared for the Group, to the effect that "in determining the volume and conditionality governing balance of payment assistance, a clearer distinction needs to be made between the causal factors attributable to the domestic policies of the developing countries and the external elements beyond their control" (Group of 24, 1979a, p. 87, par. 9).

The following September, at a meeting in Belgrade, the Group of 77,[17] meeting for the first time at Finance Minister level, adopted a program of international monetary reform submitted to it by the Group of 24. The program included support for the establishment of a medium-term balance-of-payments facility to respond to the particular needs of developing countries. It was proposed that the new facility have sufficient resources at its disposal to permit a volume of support that would be significant in relation to current levels of deficits. It should, moreover, carry "minimum conditionality, since it is responding to an externally induced balance of payments deficit, and should provide support on longer-term maturity." Finally, an interest subsidy should be provided to low-income developing countries. It was proposed further that existing IMF facilities should be

[17] The Group of 77, the parent body of the Group of 24, is the political organ of the Third World. It has retained the name "Group of 77" for historical reasons, though its current membership exceeds 120.

adapted so as to lengthen repayment periods, provide for larger amounts, and set conditionality "with due regard to causes of deficits" (Group of 24, 1979b, p. 322, pars. 9-10).

The Response of the Fund

These meetings and proposals gave rise to a corresponding series of meetings of the Executive Board of the Fund at which the various issues were discussed and, in some instances, decisions made. Some of the issues were also examined at ministerial level by the Fund's Interim Committee, notably at its meeting in Washington on September 28, 1980, when there was a first discussion of the proposals for international monetary reform advanced by the developing countries.

In response to the representations made on conditionality, on March 2, 1979, the Executive Board adopted a set of guidelines providing, among other things, for the Fund to "pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems." Moreover, performance criteria were to be limited to those necessary to evaluate implementation of stabilization programs, and were normally to be confined to macroeconomic variables and those necessary to implement specific provisions of the Articles or policies adopted under them (Gold, 1979b, pp. 22, 30).

While useful in certain respects, there was relatively little that was new in the guidelines. Their significance was described as follows by Gold (1979b, p. 15): "Most of the decision is declaratory of the practice that has emerged since 1968, but the decision includes certain new or clarified elements, largely in deference to the views of developing members. There is no reason to believe, however, that debate on this subject is at an end."

Sir Joseph's implicit recognition that the new guidelines did not dispose of the fundamental issues is noteworthy. In particular, the guidelines did not deal with the question of the applicability of the Fund's standard performance criteria to the particular types of structural balance-of-payments problem experienced in recent years. It is true that the Fund had already, in 1974, begun to address problems of structural imbalance. It had established an extended facility to deal with two main types of balance-of-payments problem: those associated with structural maladjustments in production and trade due to persistent cost and price distortions, and those involving a combination of slow growth and an inherently weak external sector. The extended Fund facility (EFF) assured members of Fund assistance for up to three years in a maximum amount equivalent to 140 per cent of quota, as against the normal standby arrangement for up to twelve months and 100 per cent of quota. In consideration of EFF assistance, a

member country was required to present a one-year program of measures to correct structural imbalance, to be followed by corresponding programs for the second and third years. The three- to five-year repayment period of standby arrangements was extended to a period of four to eight years, which was in turn subsequently extended further to ten years. Repayments were, however, to be accelerated in case of improvement in the balance of payments, involving a potential source of uncertainty for the borrowing country. In the first few years after the introduction of the facility, there were relatively few EFF drawings because of difficulties in reaching agreement on the programs to be implemented by the governments concerned.

The need for special arrangements to deal with structural problems became still more pressing following the second round of increases in oil prices and the accompanying deterioration in terms of trade in oil-importing developing countries. Moreover, the volume of balance-of-payments support required was greatly increased. As a result, the Fund agreed to lend in substantially larger amounts than in the past. As the Managing Director pointed out:

> Traditionally, a member using the Fund's ordinary resources used to be able to borrow from us a maximum cumulative amount equal to 100 per cent of its quota in the Fund. As circumstances have changed, we have progressively adopted policies whereby a member may now draw on ordinary resources and on resources borrowed by the Fund up to a cumulative amount of 600 per cent of its quota. In 1980 alone the Fund's new lending commitments under adjustment programs agreed with members reached SDR 7.2 billion, more than double the average level of the three preceding years. (*IMF Survey*, Feb. 9, 1981, p. 35.)[18]

The Fund also recognized that pressures on the balance of payments of developing countries under current conditions called for structural changes in the economy, involving, for example, the need to economize on oil and develop additional sources of energy. The Managing Director acknowledged that structural changes of this type may take longer than the one to three years normally set as the length of Fund programs. "Thus, while we continue to stress the importance of appropriate demand management, we now systematically emphasize the development of the productive base of the economy and we contemplate that countries may, therefore, need our financing for longer periods" (*IMF Survey*, Feb. 9, 1981, p. 35).

[18] The 600 per cent limit does not take into account drawings under the compensatory and buffer-stock financing facilities, or outstanding drawings under the oil facilities. New guidelines on the scale of Fund assistance to member countries following the completion of quota increases under the Seventh General Review provided, generally, for members to have an annual access to Fund resources of up to 150 per cent of their new quotas, or up to 450 per cent over a three-year period. For a complete review of the financial facilities of the Fund, see *IMF Survey*, Supplement on the Fund (May 1981), pp. 6-10.

A New Departure?

It is not clear to what extent, if any, the new developments in Fund thinking involve an easing of conditionality. Recent cases can be cited in which certain countries appear to have been able to obtain large drawings on apparently easy terms, while in others, involving broadly similar circumstances, the performance requirements seem to be no different from those associated in the past with standard deflationary programs.

Whatever disposition there may be to increase the proportion of balance-of-payments assistance to developing countries that is provided at low conditionality encounters strong resistance from the major industrial countries—including those that fought hard for that self-same objective in the 1940s and early 1950s. In part, this resistance probably reflects a basic distrust of the ability of developing countries to manage their own affairs, as well as a suspicion of what the industrial countries regard as newfangled concepts of structural adjustment. These concepts do not fit easily into the traditional categories of fiscal and monetary balance.

The Minister of Finance of the Federal Republic of Germany, Hans Matthoefer, was undoubtedly speaking for other major industrial countries as well as for his own when he told the Annual Meeting of the IMF on September 30, 1980: "The IMF was created as the guardian of internal and external monetary stability.[19] It should resist all attempts that might call this mandate in question. The conditionality of its lending must be maintained."

It is well known that all governments, developed and developing, are now in agreement on the principle of conditionality and that there is no proposal before the IMF to change that principle. It is therefore important to try to identify the nature of the concerns that gave rise to Matthoefer's statement. There are two areas in which he may have seen difficulty. One is the suggestion by developing countries that the total financing available to them for balance-of-payments support includes too small a proportion of unconditional as against conditional resources. The second is the contention of developing countries that, so far as conditional resources are concerned, the conditions applied should be adjusted in the light of the character and origin of the balance-of-payments deficits involved, taking structural factors into account. This carries the implication that fiscal and monetary restraints should be applied only where, and to the extent that, the circumstances require them.

[19] While, presumably, nobody would question the need for internal and external monetary stability, there is no explicit mandate to the IMF to act as "the guardian" in this matter. The purposes of the IMF are set out in six paragraphs of Article I of the Agreement, and while an argument could, perhaps, be sustained that monetary stability is a precondition for the attainment of some of these purposes, the term "monetary stability" is not even mentioned, let alone established as a primary objective of the IMF in its own right.

The first of these areas of difficulty involves a question of judgment but certainly not of principle. It is even more unusual today than it was in the past for developed countries to seek access to the conditional resources of the Fund, because they have a variety of other borrowing facilities at their disposal. But for those developing countries that are unable to obtain balance-of-payments support from the international private banking system, the resources available from the Fund are crucial. In fact, Fund upper-credit-tranche lending may in the future be virtually confined to developing countries simply because developed countries no longer have any need for it. In these circumstances, it is important for the Fund to be able to provide an array and distribution of resources—at zero-level, low-level, and high-level conditionality—that is not too dissimilar from the corresponding array and distribution available to developed countries. Since this is not the case, and since developed countries have access to a much higher proportion of unconditional or low-conditional resources than do the developing countries, there is serious inequity in the system. Moreover, the imbalance is accentuated by the huge unearned increment to the reserves of developed countries resulting from the rise in the price of gold. At a gold price of $400 per ounce, the unearned increment accounted for over half of the total developed-country reserves at the end of 1980, as against a proportion of less than a quarter for the non-oil developing countries (UNDP/UNCTAD, 1981).

Mention was made earlier of the IMF decision to allow members to draw on Fund resources up to a cumulative amount of 600 per cent of quota exclusive of drawings under the compensatory financing and buffer-stock facilities. This enlargement of access to Fund resources represented an important step forward, but the form of the increase had a major shortcoming. The very fact that it became necessary to establish drawing rights at so large a multiple of quotas highlights the severe lag in quotas in relation to world trade to which reference was made earlier. By providing for the expansion of access in this way, governments escaped the need, under the Articles of Agreement, to provide additional subscriptions to the Fund equivalent to 25 per cent of whatever increase in quotas would otherwise have been required. But the result is that of the 600 per cent of quota thus made available, only 25 per cent of quota is provided at low conditionality—the conditionality of the first credit tranche. In a sense, this is contrary to the spirit of the Articles of Agreement, since if quotas had been adjusted in line with world trade and had therefore been increased sixfold, first-credit-tranche conditionality would have applied to the equivalent of 150 per cent of current quotas instead of only 25 per cent. The method of expanding access that has been chosen has the effect of forcing member countries into upper-credit-tranche conditionality much sooner than would occur if quotas had been adjusted appropriately. This is one of the factors

responsible for the hardening of conditions on Fund drawings to which the Managing Director has referred, as noted below.

One way of offsetting this deterioration in the conditions for borrowing from the Fund would be to make substantial allocations of SDRs. The international liquidity explosion of the 1970s, in the form of reserve-currency creation and the rise in the price of gold, redounded mainly to the benefit of the developed countries. Yet, from 1973 to 1978, it was used as a basis for refusing new allocations of SDRs that would have benefited developing countries at least to the extent of their share in Fund quotas—the basis of SDR distribution. The failure to maintain allocations of SDRs led to a decline in the share of the SDR in world reserves, notwithstanding the injunction in the Articles of Agreement that the SDR was to become the principal international reserve asset. Thus a strong case can be made on several grounds for major new allocations of SDRs. (A more complete statement of the case is contained in UNDP/UNCTAD, 1981.)

As for the second major area in which the views of industrial countries may diverge from those of the developing countries, there is no question of abandoning conditionality but rather of adapting it to the circumstances. Diagnosis and treatment should bear some relationship to one another. If a balance-of-payments deficit is due to structural deficiencies in the energy sector, there is little point in applying a crash program of monetary and fiscal deflation. On the other hand, where demand is excessive, compression of demand is indispensable. And where both phenomena are present, both kinds of remedy can and should be invoked.

The conceptual lag is such, however, that few if any developed countries are prepared for the time being to envisage any change that could be regarded as departing from conventional ideas about standard upper-credit-tranche conditionality. Nevertheless, the availability of larger resources in the Fund, together with the decision to permit adjustment over longer periods than in the past, should, in principle, make for a less drastic adjustment process than would have been required if the restoration of equilibrium had been sought in a one- or two-year period with a minimum volume of resources. On the other hand, while it has been announced that the Fund envisages a borrowing program of SDR 6 to 7 billion in 1981, the Fund's total resources will remain small in relation to projected balance-of-payments deficits of developing countries, though substantial in past perspective.

For middle- and upper-income developing countries with access to international capital markets, additional borrowing facilities afforded by the Fund may do no more than compensate for any shortfall in borrowing from commercial banks resulting from the constraints referred to earlier. For the low-income developing countries, on the other hand, the interest rates on

borrowing from the Fund may be a serious deterrent even if they are lower than would apply to loans obtained elsewhere. An important new factor is the subsidy account established by the Fund in December 1980 in connection with drawings by low-income countries under the supplementary financing facility (*IMF Survey*, Jan. 12, 1981, p. 1). Unfortunately, such subsidies will apparently not be available in the near future on any resources that the Fund may obtain by other means. In view of the exceptional difficulties in maintaining the ability of the low-income countries to import at a time of severe externally generated pressures on their balances of payments, the policy of interest subsidization accepted by the Fund should clearly be given broader application.

Overall, there is no doubt that the conditions now required by the Fund in connection with the balance-of-payments support it is providing are, on average, much more stringent than they were at a similar period during the mid-1970s. In the words of the Managing Director:

> In the period following the first oil shock, approximately three quarters of the resources provided by the Fund to its members were made available on terms involving a low degree of conditionality. At present, by contrast, some three quarters of our new lending commitments involve "upper credit tranche" programs, that is to say, they require rigorous adjustment policies. (*IMF Survey*, Feb. 9, 1981, p. 35.)

Some Tentative Conclusions

The new concepts of the IMF management represent an important step forward, indicating a readiness to re-examine some of the basic assumptions underlying the Fund's treatment of stabilization programs in the past. At the same time, additional clarification will be needed before the new ideas can be translated into operational guidelines. One suspects that particular difficulty will be encountered in establishing performance criteria in line with the new concepts. For example, the most important single performance criterion in most, if not all, standby arrangements of the past was a ceiling on the net domestic assets of the central bank or the banking system, accompanied usually by a subceiling for credit supplied to the government by the central bank or the banking system.

The monitoring of country performance in terms of compliance with a set of quantitative targets is a traditional element in IMF supervision of stabilization programs. It cannot readily be adapted to a different kind of approach in which structural adjustment rather than the curtailment of effective demand is the basic objective. There may well be a tendency for the Fund to continue relying on indicators of demand management even in situations where the primary objective of a stabilization program is quite different. Even where the need for structural adjustment is recognized,

there appears to be a tendency to emphasize the importance of pricing policies, exchange rates, and tax regimes as against more direct measures such as the sectoral allocation of investment.

Certainly, structural adjustment does not lend itself to the kind of quantitative measurement and pinpoint targetry that the money supply does. To the extent that the Fund engages in a new type of balance-of-payments support, new methods of monitoring will be needed accordingly.

The idea advanced above that a reasonable balance should be struck between the low-conditional and high-conditional resources provided by the IMF is fully consistent with the credit-tranche policies of the Fund itself—policies that have been distorted by the failure of the Fund membership to raise quotas in line with world trade. Such a balance is also essential as a means of giving developing countries at least some of the freedom of maneuver in the management of their economies that developed countries have under similar conditions. It is not in the interests of the international community that developing countries should be continually hemmed in by the policy prescriptions of an international organization, however well motivated those prescriptions may be. Developing countries should have access to balance-of-payments support, especially in cases of externally generated imbalance, on conditions that are appropriate to their circumstances. This is not an argument for unconditional Fund programs but for forms of conditionality that are clearly adapted to the specific character of the imbalances encountered.

Finally, the distribution of the burden of adjustment among countries cannot be separated from the question of responsibility for the factors making adjustment necessary. This basic idea was written into the Fund's Articles of Agreement in the form of the scarce-currency clause. It was this fundamental concept, likewise, that animated the Committee of 20's attempt to find an objective means of determining the distribution of adjustment obligations as between surplus and deficit countries, as well as between the reserve center and the rest of the world.

A passive attitude to the distribution of the burden of adjustment is by no means the same as an impartial or objective attitude. To suggest that, regardless of whether a disturbance is of domestic or foreign origin, it is the deficit country that must accept the full burden of adjustment is to settle the question of responsibility as decisively as if the matter had been addressed directly instead of indirectly. Such an attitude is tantamount to saying that those countries that have the power to shift the burden are entitled to do so. And it is precisely this approach that in the 1970s resulted in the imposition of a burden of adjustment on the poorest and weakest countries out of all proportion to their responsibility for the disequilibrium that had arisen.

The step forward that the Fund management has taken in its latest thinking contains the potential for one of the most important and constructive changes in IMF policy since Bretton Woods. But the word "potential" should be stressed, because for the time being it is mainly concepts that have been developed, and those concepts have not yet been translated fully into practical action. The shift in approach is significant and the importance of structural adjustment in solving balance-of-payments problems has been acknowledged, but the new thinking does not yet fully accept the proposition that the difference between internally and externally generated disturbances is a crucial factor in assessing the form and content of conditionality required. While the Fund management has received the support of governments in its effort to provide larger volumes of balance-of-payments financing over longer periods, there is a reluctance to make any significant changes in conditionality. In fact, in global terms there has been a step backward: on average, resources are being provided at a much more exacting level of conditionality today than they were in the mid-1970s, even though the problems confronted in the two periods are very much alike.

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