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THE IMF AND ITS CRITICS

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DEPARTMENT OF ECONOMICS

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CONTENTS

The IMF and Its Critics

1 Introduction

The role of the International Monetary Fund in developing countries has not enjoyed a good press. Public comment has frequently been hostile and at times abusive. Criticism of the Fund's role in developing countries has come mostly from those countries themselves, but there has been no shortage of detractors in developed countries.[1] It would be accurate to say that the most persistent and vocal critic of the Fund has been the "development community" or "development lobby," including its adherents in the developed countries and in certain international institutions.

The Fund's detractors comprise a diverse group: journalists, academics, social scientists, government officials, politicians, and even heads of governments. They have employed a variety of channels, including the print and broadcast media, political rallies, international gatherings, and books and periodicals. Commentary on the Fund has ranged from analysis and questioning of Fund policies and activities to impugning of Fund intentions and even attribution of dire motives to the Fund. The tenor of the unfavorable comment has ranged from relatively mild criticism to fairly strong accusations and occasionally even vituperative denunciations.

An attempt to collate, classify, and analyze systematically the vast amount of commentary on the Fund from this heterogeneous collection of sources would be a major undertaking of dubious value. This Essay attempts a more manageable task, and one that will perhaps be more useful: to study the broad lines of criticism that occur most frequently in appraisals of the Fund. Some of these appraisals are made by individuals, and some appear in studies and reports that are devoted wholly or mostly to the Fund. The studies and reports have the advantage of containing views and commentary on the international monetary system and the Fund that have been distilled from a large variety of sources.[2]

[1] Some of the criticism from developed countries is different from the criticism examined in this Essay, the principal charges being that the Fund is tending to behave like a development finance agency, that it is being lax in its lending policies, and that consequently it is failing to fulfill its proper role as the center of the world monetary system. These criticisms are not addressed in this paper. It should also be noted that criticisms of the Fund are related to its lending and policy-advice activities and do not refer to the substantial amount of technical assistance provided by the Fund.

[2] Among many recent or ongoing studies and reports, mention may be made of the work under way in the Overseas Development Institute (London) on *The IMF and Economic Management in LDCs*, a project sponsored by Queen Elizabeth House (Oxford) on the *Framework for International Financial Cooperation*, and the report of the Brandt Commission issued in March 1980. The *Outline for a Program of Action on International Monetary Reform* prepared

An examination of the way the role, purposes, and performance of the Fund are viewed, together with some of the changes and reforms suggested, should allow a better understanding of the reasons why the Fund has had—and continues to have—a largely hostile press. Although an attempt has been made to focus on observations and criticisms that relate specifically to the Fund, much of the commentary concerning the Fund is intermingled and interchangeable with observations relating to the international monetary system and, in this sense, criticism of the one indicts the other by association. Indeed, this tendency somewhat obscures two essentially different criticisms: first, that the international monetary system itself is unsatisfactory (or even nonexistent) and that a "better" Fund must await the creation of an appropriate system based on a different philosophy and new foundations, or, alternatively, that the Fund's activities and approach could be improved within the framework of the existing international monetary system and Fund.

A further distinction could be drawn in principle between criticism that is *a priori* in character and inspired by a particular ideology, and criticism that reaches its conclusions *a posteriori*, after an examination of the facts as perceived by the critic. Since, this distinction is frequently blurred in practice, no attempt is made here to classify critics solely along these lines.

Finally, while this Essay does not purport to provide a point-by-point evaluation of all the various criticisms of the Fund, rejoinders are made in many instances to clarify and put in sharper focus the judgments or criticisms under discussion.

2 Perceived General Defects

Faulty Beginnings

For many observers, the problems of the Fund began at birth: Bretton Woods produced a deformed infant, and little has been done through the years to overcome the deformities. The assertion is often made that the Fund was created by and for industrial countries; that those responsible for drawing up the "blueprint" for the postwar international monetary system were almost exclusively preoccupied with the interests of developed countries; and that, consequently, economic development was not a prime consideration in the designing of the Fund.

Such statements are somewhat surprising. Unlike disagreements on matters that are genuinely susceptible to differing judgments and perceptions,

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by the Group of Twenty-Four in September 1979 also contains a section highly critical of the present international monetary system. Reference to these reports is not intended to imply that their authors would endorse all the criticisms discussed in this Essay.

the list of participants in the establishment of the Fund as well as their views—in particular their views on development—are matters of record. The notion that the Fund was created by and for industrial countries does not do justice to the outstanding and substantial contributions made by the founding fathers of the Fund to raising the status and promoting the economic well-being of the countries that later came to be called "developing countries." Moreover, of the 45 countries that participated at Bretton Woods, 28 were developing, while only 9 of the countries now regarded as industrial were present. The absentees included Austria, Germany, Italy, Japan, and Sweden, all of them now classified as "major industrial countries." At the same time, officials from India and the Philippines were invited and took a very active part in the deliberations at Bretton Woods even though their countries were not constitutionally independent at the time. Furthermore, the considerable influence exerted by Latin American representatives is reflected in their right to two seats on the Fund's Executive Board. All this is not to imply that justice was fully done to the aspirations of developing countries when the Fund was founded but rather to dispel the notion that these countries were excluded or were passive and ineffective.

Many commentators have also complained about the way voting power was allocated at the Fund's inception. They say that the structure of voting has confined developing-country representatives in various bodies of the Fund to the role of silent, passive partners. The fact is that the structure of voting in the Fund reflects the realities of economic and financial power in the world: the countries with the largest economies make the greatest contribution to the financial resources of the Fund and also have the most votes. While alternative voting structures can be envisaged, the fundamental point is that a weakening of the link between financial contribution and voting power would risk inciting the stronger countries to bypass the Fund and create new organizations, an outcome that would be contrary to the interests of developing countries. Furthermore, the fact that industrial countries have a majority of voting power in the Fund does not mean that developing countries form a helpless minority. On the contrary, throughout the Fund's history, developing-country representatives have played an important part in shaping its policies, formulating its operating guidelines, and determining its general direction. Some of the Fund's facilities—the compensatory-financing facility and the extended Fund facility—were established in large part as a result of the pressure and influence of developing countries. The voting power of developing countries has increased over the years and, on those matters that require special majorities, the developing countries as a group have, at least in principle, enjoyed a power of veto for some time. Most significant, perhaps, there have always been eight or nine Directors from developing countries on the Executive Board (at present eleven, counting Saudi Arabia and China). In a body that reaches most of its decisions by consensus, the importance of this must not be underestimated.

The assertion that because economic development was not one of the prime considerations in the establishment of the Fund, the Fund's main emphasis has consequently been on matters like control of inflation, to the neglect of development and social issues, gives inadequate credit to the full achievements at Bretton Woods.

First, the accusation does not take into account the fact that the World Bank was also a creation of Bretton Woods. The Bank's official title, International Bank for Reconstruction and Development, clearly implies that it was established as a development-finance institution specifically to accommodate the interests of participants from developing countries. The creation of the Bank was a response to the objections of these participants that the Fund's resources were intended for temporary use and designed to revolve, and were not to be used for development purposes. The Fund and the Bank have collaborated closely over the years, a cooperation that has recently been enhanced with the explicit aim of improving response to the longer-term structural needs of developing countries. Moreover, the distinction between the development role of the Bank and the adjustment role of the Fund has not prevented the Fund from adopting policies (both financial and regulatory) that were intended to be and have been of particular benefit to developing countries.

Second, while economic development was not a prime direct consideration in the creation of the Fund at Bretton Woods, it was (and continues to be) a prime indirect objective to be promoted by facilitating the expansion and balanced growth of international trade so as to "contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members ..." (Article I[ii]). In other words, it was very much in the minds of the founders of the Fund that the expansion of trade and investment would be the best way to promote economic prosperity for all countries, including developing countries. The expansion was to be achieved by removing the extensive controls and restrictions then imposed on trade and payments, establishing convertibility among currencies, and maintaining stability in exchange rates. This prescription turned out to be correct, as is readily admitted even by the critics of the Fund. No one seriously questions that the postwar economic "order," based on the twin pillars of the Fund and the GATT, succeeded in fostering an unprecedented era of expanding trade and prosperity that lasted until the breakup of the Bretton Woods system and the onset of the oil crisis.

Deficient Reforms

Many observers charge that, in addition to the deficiencies of the Fund at its inception, it has not adapted sufficiently to the needs of the developing countries since then. Over the years, the Fund *has* gone a considerable way to meet some of the concerns specific to developing countries. The Fund introduced, then broadened and deepened, its compensatory-financing facility; it introduced the buffer-stock facility and the extended Fund facility; and it recently established a "food facility" to be integrated into the compensatory facility. It gives greater emphasis to structural adjustment problems and to policies designed to enhance supply responses. As a result of all these actions, the Fund has assumed a role that is much broader than that of an international monetary authority narrowly defined, and—far from remaining aloof from development concerns—it has gone a considerable way to meet them within the confines of its Articles. Nevertheless, many observers regard these changes in the Fund as inadequate from the point of view of developing countries.

First, many have noted that Fund resources, compared with relevant magnitudes such as world trade, have declined sharply over the years. This cannot be contested: by almost any calculation, the relative size of the Fund has declined. Whether or not, seen in the context of other financial facilities, the decline in resources is warranted is a broader question that is not addressed here.

Most commentary about reforms focuses on the second amendment, since, in a sense, it legitimized the post–Bretton Woods system. When seen against the perceived need for major, comprehensive monetary reform and, in particular, against the perceived requirements of developing countries, the second amendment is frequently regarded as wholly inadequate. Its drafters are accused not only of having failed to provide a comprehensive and coherent program for dealing with the general problems facing the international monetary system, or the basis for dealing with them, but more seriously of having failed to cope with those aspects of the international monetary system of particular interest to developing countries. These perceived shortcomings of the second amendment relate to many important issues: effective control of the international reserve system and of international liquidity, convertibility of official balances and provisions for asset settlement, a symmetrical system of balance-of-payments adjustment, arrangements to promote the transfer of real resources to developing countries, and the achievement of stable exchange rates.

The most visible, and perhaps the most important, difference between the Bretton Woods and the post-Bretton Woods systems concerns the exchange-rate regimes sanctioned by them. The variability of exchange rates under the post–Bretton Woods system is seen as a source of particular difficulty for developing countries and has elicited much comment critical of the Fund and the present international monetary system. In sharp contrast, prior to 1971 the Fund was routinely castigated for promoting a regime of exchange rates that was not flexible enough.

Many observers concerned with the problems of developing countries view the establishment of an orderly and stable system of exchange rates as the first task of the international monetary system. They argue that predictable exchange rates encourage investment and trade and promote confidence, whereas fluctuations or erratic changes in rates discourage them. Developing countries, they assert, are particularly vulnerable to uncertainty in exchange-rate movements and to fluctuations in the exchange rates of major currencies. These critics claim that the buffeting developing countries have received from violent swings in major currencies has created problems for them in regard not only to the management of their own exchange rates but also to the management of exchange reserves and external debt. In short, they see flexibility of exchange rates as having complicated the task of economic management for developing countries.

The impact of the present exchange-rate regime on developing countries is an important issue that cannot be adequately dealt with here, but a few observations are in order. Empirical studies have shown that exchange-rate instability has increased significantly for the overwhelming majority of developing countries since 1973, when floating rates became widespread. At times, exchange rates have fluctuated more than was justified by underlying market forces. This has created difficulties for developing countries, particularly as they lack adequate forward-exchange facilities and do not have easy access to the forward markets of developed countries. But it is important to consider exchange rates in a global context and not only on the basis of how they affect a group of countries. Given the differential rates of inflation that have been characteristic of the post-1973 era and the divergent policies followed in the major countries, a worldwide regime of flexible rates has been the only realistic option. Unfortunately, there seems to be no viable and generally acceptable alternative in present circumstances. And whatever the relative merits of fixed and floating rates, exchange-rate developments reflect world economic and political conditions—in particular the degree of stability in the economies of major countries—and the Fund has little influence over them.

Indeed, the Fund shares some of the concerns regarding exchange-rate developments, particularly when variations seem excessive and not related to fundamental underlying conditions, but its power to bring about greater stability is limited. The Fund is, of course, required to exercise "firm surveillance" over the exchange-rate policies of its members and seeks to carry out this task, but its effectiveness depends on the cooperation of members, and some of them may resist when pressure is applied. The promotion of greater exchange-rate stability requires changes in domestic economic and financial policies to bring about greater domestic economic stability, and such changes meet resistance. Thus, the fact that the Fund makes its views known on these matters does not ensure that it will be heeded. Although the Fund is an entity legally separate from its members, the members control it. While this control strengthens the Fund, it also makes it impossible for the Fund to act against the political will of the membership.

Philosophy and Approach

The Fund's general "philosophy," or what is seen to constitute an identifiable philosophy, has been the subject of much disapproval. An institution's philosophy is bound to affect its approach to issues, and that too has been found wanting. A summary critical view of the Fund's philosophy and approach, based on comments and observations from many sources, would be as follows:

Philosophy: The Fund (as is evident from its Articles) has a market-oriented, pro–free enterprise, pro-capitalist, anti-socialist philosophy, with a pronounced bias in favor of free trade, private investment, and the price mechanism. This reflects a "vision of the world" inspired and imposed by industrial countries, in particular the United States, on debtor [implicitly, developing] countries. Many economists and politicians genuinely believe that the policies implied by this philosophy are in the best interests of developing countries. It must be recalled, however, that these officials are Western-trained and believe in the efficiency of the market. The imposition of this philosophy is facilitated by the dominant voting power of the industrial countries; in this way, the Fund serves the interests of creditor countries and helps to preserve their resources from claims by developing countries to larger resource transfers. In brief [as one head of state has put it], the Fund is "a device by which the rich countries increase their power over the poor."

Approach: The Fund's philosophy has a direct impact on its general approach to its members, it analytical approach to economic problems, its assumptions regarding causative factors, and its modus operandi. *As an institution that serves to impose the vision of the world held by its more influential members on its other (and numerically more important) members, the Fund's attitude is paternalistic or "grandmotherly." The Fund tends to assume that any country that needs to borrow must have been incompetent or careless and therefore would benefit from its guidance. It* *works on the assumption that all balance-of-payments problems have been caused domestically. Its rigid approach, together with its doctrinaire philosophical underpinnings, are a key element in helping to maintain an exploitative pattern of developing-country dependence on the industrial countries of the West.*

The above, not atypical, characterization of the Fund's philosophy and approach by its critics may contain a small grain of truth, but it is mostly based on a fundamental misunderstanding of the Fund and how it operates.

To begin with, it should be freely admitted that the Fund *does* have a point of view ("philosophy" is too formal). For reasons in part related to the circumstances in which the Fund was established, the Fund assumes that market forces, liberalized trade and payments, and general freedom in economic matters are usually more efficient and promote greater prosperity and a better allocation of resources than a system characterized by controls and restrictions. As a result, most Fund programs can perhaps be better understood in the context of a market economy. It is also true that the Fund has a bias against policies that overcommit a country's resources. A country must over time keep its spending within the limits of what it can produce plus what it can mobilize in external loans or grants. Countries tend to overcommit their resources for a variety of reasons, which may include ideological reasons. But ideology per se is not really the relevant issue. Sooner or later, all governments have to face reality: if resources are overcommitted, either supply must be increased or demand must be reduced. These points of view were not handed down on a tablet at Bretton Woods; they have evolved gradually, shaped in part by the tasks the Fund has had to perform and in part by experience.

Having a point of view, however, is an entirely different matter from maintaining, and rigidly applying to all countries in all circumstances, a philosophy whose objective is to exploit the majority of the Fund's membership for the benefit of the major industrial shareholders. Not only is this assertion grossly askew in principle, it ignores the proven and considerable flexibility of the Fund in dealing with member countries in the context of their economies (including economies that have become more centralized *after* joining the Fund) without any request or even suggestion that they modify their socioeconomic system to fit the analytical assumptions and meet the requirements of supposedly rigid Fund programs. In recent years, these countries have included such centrally planned economies as Burma, China, Laos, Romania, and Vietnam. The Fund has accommodated its programing techniques to the special features of each country and has been able to reach a considerable measure of agreement with the country's authorities as to the appropriate adjustment policies. In many instances, the

Fund has accepted conventions and practices, such as restrictions and subsidies, that would hardly have been reconcilable with an unbending, inflexible, market-oriented approach.

Because the Fund's largest members provide the bulk of its resources and thus have a majority of the voting power, there is no question that they exert considerable influence on the direction, policies, and practices of the Fund. But the assertion that these member countries seek to impose their "vision of the world" is not borne out by the nature of the agreements reached with many countries of differing economic systems and differing visions of the world. Some critics have averred that the new surplus countries may have a less market-oriented and more control- and plan-oriented vision of the world than the old ones. This is a possibility, though there is little evidence to support it to date. And, to the extent that they become providers of resources through the Fund, the new surplus countries are likely to become more concerned about the "proper" use of those resources.

Little can be said about the charge that the Fund is "paternalistic," since this concept is not always fully explained. Furthermore, it is not clear whether it is based merely on chance encounters between the critics and particular Fund officials or is perceived as a deeper failing affecting the Fund. Fund officials who conduct negotiations with member countries are of course subject to the same failings and mistakes as other humans.

3 Fund Programs and Conditionality

No aspect of the Fund's activities has been more controversial, more persistently criticized, or more routinely misunderstood than the conditionality attaching to the use of Fund resources in the context of Fund-supported programs. As a result, conditionality has been the single most important source of friction between the Fund and some of its members.

The Fund's programing and conditionality have been reproached on many levels and for a wide variety of reasons. The principal criticisms can be summarized as follows:

It must be conceded that some degree of conditionality in the use of Fund resources is both necessary and legitimate to ensure repayment of borrowings, since Fund resources are for temporary use and are meant to revolve. However, Fund conditionality, as it is practiced, goes beyond this requirement. Fund programs have many shortcomings in terms of their analytical formulation, their application and requirements, and their consequences.

First, the underlying analysis in Fund programs is based on the assumption that balance-of-payments difficulties result from excessive domestic de-