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CEPAL REVIEW
April 1982

On being grandmotherly: the evolution of IMF conditionality

Sidney Dell ***

The principle of conditionality has always been at the centre of the controversy over the influence the International Monetary Fund should wield over national policies in connexion with its loans, to such a point that there were animated arguments on the matter during the negotiations to establish the IMF, not only between the European countries and the United States, but also between various institutions within the latter country.

After briefly describing the controversies of those times —in which Keynes played a leading part— the author shows how this principle gradually took shape through various agreements, until in 1968 a global decision was taken on drawing rights, establishing a procedure which has guided IMF policy since then. His main concern, however, is not to give a history of the principle of conditionality, but rather to analyse this principle in order to bring out its limitations and defects and thus contribute to the review to which it is currently being subjected both inside and outside the Fund.

Among the limitations and defects of the principle of conditionality, the author emphasizes those connected with the evaluation of country performance —such as the questionable concept of 'mismanagement', and the stress laid on monetary criteria—, the tendency to shift the whole responsibility for solving disequilibria onto the deficit countries, the scant concern shown to establish whether deficits are of external or internal origin, and the imposition of stereotyped stabilization programmes in widely varying actual situations.

The present crisis calls for structural adjustments which, in turn, call for a change in the policy of international financial agencies, and such a change demands not only larger resources and better conditions of access to loans, but also new criteria for appraising performance. In other words, it calls for the reformulation of the prevailing principle of conditionality.

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**The definitive English edition from which this shorter version has been prepared is entitled *On Being Grandmotherly: The Evolution of IMF Conditionality*, Essays in International Finance No. 144, Princeton, N.J., Princeton University, International Finance Section, October 1981. A Spanish version of the present article appeared in *Cepal Review* No. 13 (April 1981). The views expressed in these articles are of course those of the author and do not necessarily coincide with those of the United Nations Secretariat.

1. *The history*

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).

This view was not accepted by most of the other countries participating in the negotiations to establish the IMF. At a meeting of seventeen countries held in Atlantic City at the end of June 1944 the U.S. delegation proposed that the draft Article of Agreement dealing with the use of Fund resources should entitle the Fund to determine, as a pre-condition for authorizing a drawing on its resources, that such resources were to be used by the country concerned for purposes and policies consistent with the Agreement.

Keynes contested this view and said that countries must have an unqualified right to purchase foreign exchange within the prescribed quantitative limits, subject to the provisions of the Fund Agreement. He therefore favoured a wording of the Article which would make it clear that the decision on a drawing would be that of the member country, not 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 as required. J.W. Beyen of the Netherlands considered that there should be no question of having to convince the Fund on such matters and that the wording proposed by the United States was "impossible".

In the event, the wording proposed by the United States was not included in the final text of the Bretton Woods Agreement, and most countries therefore probably ratified the Agreement in the belief that British views on conditionality had prevailed and that the Fund would have no right to challenge a drawing by a member country that gave an undertaking that

the resources drawn would be used to effect payments consistent with the Agreement.

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 misbehaviour is flagrant", as White, the leader of the U.S. delegation, had 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 a 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.

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 "semiautomatic 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.[1]

Speaking for Canada, Louis Rasminsky, later Governor of the Central 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 behaviour 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 29 August 1946, that Managing Director Camille Gutt, said that the Fund could be con-

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

sidered 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. 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 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).[2]

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 undertaking by members to adopt 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).

Thus, it was a desire to enlist the co-operation 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 13 February 1952 [adopting the principle of conditionality] was intended to reinvigorate the Fund by encouraging members to believe

[2]It is ironic that in 1974-1979 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. 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".

that they would be able to use its resources" (Horsefield, ed., 1969, Vol. 2, p. 524).

The substance of conditionality

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.

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 programmes. 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 committed itself to 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).

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 programme were being achieved.

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, 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 de-

veloping 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.

Particularly noteworthy was the view of deficit countries then, as now, that the proportion of resources to be provided by the Fund unconditionally or at low conditionality ought to bear a direct relationship to the size of total Fund resources available to members. The British (Keynes) plan for a Clearing Union had envisaged total quotas of the order of US$ 30 billion or more, equivalent to one half or more of world imports. The United States proposal adopted at Bretton Woods, on the other hand, was for aggregate quotas of US$ 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 United States, 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 that, in case of necessity they would have access to a sufficient volume of balance-of-payments support to give them a minimal degree of freedom of action in their economic policies.

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 also 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 presure.

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, and 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-neighbour" 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. In recent times, strong international pressure has frequently been brought to bear upon deficit countries, while surplus countries have been under little or no pressure to adjust.

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 rigours 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 it is suggested that in terms of adjustment 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.

This 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.[3] 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 programmes 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.

Fund programmes often include measures to liberalize trade and payments and the devaluation of exchange rates. Yet there are many cases in which the wisdom of such measures 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

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

> domestic objectives, such as investment promotion and income distribution, may be a more potent factor on the negative side. (Crocket and Nsouli, 1977.)

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 defence 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 non-traditional 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 when dealing with the private sector.

It is true that programme 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 14 April 1981 by the Group of 30. This non-official 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 goverment. 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 programmes even in cases of self-generated imbalance, the validity of such programmes 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 US$ 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 1979-1981 is reminiscent of that in 1974-1975. 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 its communiqué of 13 June 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 co-operation 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 1974-1975. Any Fund member drawing on the oil facility was required "to co-operate 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 1981-1982. 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 1974-1975, it is important that deficit countries not adopt policies that merely aggravate the problems of other countries. But while in 1974-1975 it was recognized that countries incurring balance-of-payments deficits due to oil price increases should not be forced into immediate adjustment, in 1981-1982 the resources provided by the Fund bring with them all the rigours of upper-credit-tranche conditionality. Yet it is as true in 1981-1982 as it was in 1974-1975 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.

Objectives of the developing countries

Since 1978, the Fund has come under strong pressure from the developing countries to liberalize its conditions for lending. There was a widespread feeling among developing countries that the 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.

The Fund has responded to the representations made by the developing countries, notably through the Group of 24, by modification of its lending programmes. 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-programmes agreed with members reached SDR 7.2 billion, more than double the average level of the three preceding years. (*IMF Survey*, 9 Feb. 1981, p. 35.)[4]

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 programmes. "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*, 9 Feb. 1981, p. 35.)

Despite the foregoing, there is no doubt that the conditions now required by the Fund in connexion 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" programmes, that is to say, they require rigorous adjustment policies. (*IMF Survey*, 9 Feb. 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 programmes 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 programmes. 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 programme 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

[4]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.

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 pinpoin 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 manoeuvre 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 meant 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 programmes 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 centre 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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