Overseas Development Institute

Briefing Paper

April 1993

DOES THE IMF REALLY HELP DEVELOPING COUNTRIES?

The original Bretton Woods conference gave the International Monetary Fund wide responsibilities: to regulate the volume of international liquidity; to ensure the stability of exchange rates; to promote freedom of trade and capital transactions; to co-ordinate the economic policies of member-states; to assist members with balance of payments (BoP) difficulties. With the break-down of the Bretton Woods system in the early-1970s, some of these objectives became obsolete or unattainable, leaving the Fund with the principal task of providing BoP assistance. Until the recent emergence of former Comecon countries as borrowers, virtually all such assistance since the mid-1970s has been to developing countries (see Table 1). This situation was not envisaged in 1944 at Bretton Woods; then the Fund was expected chiefly to service industrial countries. So is the Fund ill-designed for providing effective help to developing countries? Is it even a net lender to them? How effective has its assistance been and how well has it adapted itself to dealing with these countries?[1]

Past Complaints

Past criticisms of the Fund's activities in developing countries can be grouped under four headings:

(1) *That Fund programmes are inappropriate:* Its approach to policy is preoccupied with the control of demand, too little concerned with BoP weaknesses stemming from the productive system; and it imposes large costs on borrowing countries through losses of output and employment, by further impoverishing the poor, and through the politically destabilising effects of its policy stipulations.

(2) That the Fund's *modes of operation and inflexibility in negotiations* infringe the sovereignty of states and alienate governments from the measures they are supposed to implement; that there is an increasing overlap with the World Bank; and between them that they are apt to swamp governments with policy conditions.

(3) *That its credits and programmes are too small, expensive and short-term.* The programmes are criticised as too short-term for economies whose BoP problems are rooted in structural weaknesses and who often face secular declines in their terms of trade. The credits are also criticised for their short maturity periods and the near-commercial rates of interest which they often bear; and as being too small relative to financing needs.

(4) *That the Fund is dominated by a few major industrial countries* who pay little heed to developing country views. The industrial countries, it is alleged, use their control to promote their own interests - for example, in using the Fund to impose a post-1982 approach to the debt problem which shifted a disproportionate burden onto debtor countries - and to reward 'favourites'.

The Fund's Response

The core of the IMF approach to programme design is its 'financial programming' model. This takes a broadly monetarist view, with a BoP deficit seen as caused by a surplus in the supply of money over the demand for it, emanating from excessive domestic credit expansion. Hence, the essential task of an IMF team is to analyze the money supply and demand situation and to restrict credit so as to restore BoP viability. In consequence, programmes almost always try to reduce budget deficits, to reduce governments' credit needs.

The Fund team does not confine itself to this task, however. For one thing, it regards the exchange rate as an important influence on the BoP, so that (except in currency union countries like the African member-states of the Franc Zone[2]) almost all its programmes involve devaluation. In recent years the Fund has reduced its reliance on quantified indicators of demand control, such as ceilings on credit to the public and private sectors, observance of which determine continued access to the negotiated line of credit. While such 'performance criteria' remain central to the Fund's modalities, it now makes greater use of (usually half-yearly) Review Missions, to take an overall view of programme execution and adjust programme details in light of the most recent economic data.

The Fund is also moving away from concentration on simple budgetary aggregates, such as total spending or the budget balance, in favour of paying more attention to the 'quality' of fiscal adjustment. Since the economic impact of its fiscal provisions will be much affected by which expenditures are trimmed and what is done with taxes, the Fund is becoming more insistent on knowing how a government proposes to implement promised reductions in the budget deficit, increasingly urging governments to install social safety-nets and asking awkward questions about military spending.

In other respects too it is paying more attention to achieving a better balance between demand-management and supply-side measures, even in its short-term (typically 18-month) Stand-by programmes, which now place greater weight on the goal of economic growth. In many cases, the privatisation or reform of public enterprises is stipulated - to reduce budgetary pressures but also to raise productive efficiency. Price and subsidy reforms are also common ingredients, e.g. raising petroleum prices or cutting food subsidies. And while Stand-bys remain short-term there is now a greater willingness to countenance a succession of such programmes, so that some countries (Cote d'Ivoire, Jamaica, Morocco...) have enjoyed the mixed pleasures of near-continuous support for a decade or more.

The extension of the Fund's conditionality into measures bearing directly on the productive structure is taken a good deal further in its Extended Fund Facility (EFF) - first introduced in 1974, kept in limbo during most of the 1980s but now reactivated as a major lending vehicle - and furthest of all in the Structural Adjustment Facilities (SAF and ESAF) initiated in recent years. Table 1 shows that by the end of 1992 these three facilities accounted for nearly three-quarters of the total value of all lending (see Table 2 for comparison of the terms attached to these various facilities). The EFF, SAF and ESAF have taken the Fund in the direction of medium-term lending, with the EFF

1. This paper draws upon the results of an ODI research project undertaken by Graham Bird and Tony Killick, further details of which can be provided on request.

2. See ODI *Briefing Paper*, 'Crisis in the Franc Zone' July 1990.

Table 1: Structure of IMF commitments, 1989 and 1992 (percentages of total commitments, by value)

	1989[a]				1992[b]			
	Stand-bys	EFFs	SAFs/ ESAFs	Total	Stand-bys	EFFs	SAFs/ ESAFs	Total
Low-income countries	11	3	27	41	9	-	10	19
(*of which*, sub-Saharan Africa)	(8)	(3)	(10)	(29)	(-)	(-)	(6)	(6)
Other developing countries	38	11	4	53	11	49	2	62
Total developing countries	49	14	31	94	20	49	12	81
Former Comecon countries	6[c]	-	-	6	8	11	-	19
GRAND TOTAL	55	14	31	100	28	61	12	100

[a] End-April 1989
[b] End-December 1992
[c] Includes a credit to Yugoslavia
Source: IMF

providing 3-4 year support largely to middle-income and former Comecon countries, and SAF-ESAF offering 3-5 year programmes to low-income countries, chiefly in Africa.

Uniquely, SAF and ESAF programmes are based on a Policy Framework Paper (PFP) setting out a three-year adjustment programme, supposedly drafted jointly by borrowing governments, the IMF and World Bank. In the early days of this innovation the involvement of governments in the drafting process was often minimal but they have gradually acquired more influence.

Under the influence of pressures from UNICEF and others, the Fund's Managing Director, Michel Camdessus, who took office in 1987, has changed its stance on the social effects of its programmes. It formerly insisted that it was for national governments to decide whether to protect the poor from hardships resulting from programmes. Now, its missions commonly discuss distributional aspects with governments when preparing programmes. PFPs are required to include measures to protect the well-being of vulnerable groups and programmes increasingly contain safety-net provisions. However, the chief examples of safety nets are in eastern Europe, and there remain doubts about how much difference these changes have made in practice.

The PFP has also provided a useful mechanism for co-ordination between the Fund and the World Bank. There is plenty of scope for disagreement between them, e.g. about the desirable levels of government investment, bank credit, imports and the exchange rate, and these tensions were heightened when the Bank increased its structural adjustment lending during the 1980s. There were some fierce turf battles and some celebrated rows over such countries as Argentina, Nigeria and Zambia, but it appears that top-management agreements on the division of labour and staff co-operation have substantially resolved these difficulties. Borrowing governments are less likely to be bewildered by conflicting 'advice' from the two institutions. Instead, they are more likely to feel confronted by a Washington monolith.

New Critiques

The Fund, then, has sought to adapt but have its efforts been sufficient? Some think not.

First, critics can point out that the Fund's use of more supply side measures has been *additional to* its traditional demand-control policies, not in substitution. The Fund has thus widened the range of its conditionality without diluting its monetarist hard core. There has been particular criticism of the especially demanding conditionality attached to ESAF credits, which frightened off potential borrowers, causing a slow take-up rate.

The Fund's approach to the supply side is criticised as blinkered: largely addressed to the reduction of price distortions and privatisation, taking a negative view of the state and associated with sharp reductions in public sector investment. Moreover, while the EFF and SAF-ESAF facilities, and toleration of repeated stand-bys, have taken the Fund into medium-term lending, these are no substitute for programmes conceived as long term.

Doubts persist about the appropriateness of the financial programming model. Its strength is that it confronts governments with the BoP and inflationary consequences of their budget deficits but the model remains open to a range of criticisms. First, it is seen as resting upon assumptions that may often not be valid for developing-country conditions. In particular, it assumes the demand for money is known and stable - so that non-expansionary levels of money supply and domestic credit can be estimated - a condition that does not always hold. Second, it requires that governments are able to hold credit within agreed ceilings, whereas their control is often highly imperfect because of unreliable data, the difficulties of forecasting and regulating budgetary outcomes, vulnerability to 'shocks', and unpredictable responses by banks and other financial institutions to governments' policy signals.

The model is criticised as too static, not well designed to cope with time lags and uncertainties, or to trace the effects of the private sector's reactions to stabilisation measures. The static nature of the model has caused the Fund particular difficulties since it was pushed in the later-1980s towards more 'growth-oriented' programmes. The incorporation of a growth objective alongside BoP viability generates a host of complications and increases the difficulties of using the model for policy purposes.

Finally, the model is criticised for focusing on only a few economic aggregates, diverting attention from important qualitative aspects of policy. Programme negotiations are often preoccupied with fruitless disputes about the merits of rival statistics and the exact numbers that should be included as performance criteria.

Yet while the specifics of IMF financial programming remain contentious, there is less controversy than formerly about the main thrust of the Fund's advice, about the importance of macroeconomic stability and of fiscal-monetary discipline to that end. Further criticisms have however arisen regarding the cost of IMF credit and its overall direction of flow.

How Effective are Fund Programmes?

Another approach to assessing the policies of the Fund in developing countries is to examine how programmes work in practice and what impact they have. There are major methodological problems here: the difficulties of disentangling programme effects from other influences on economic performance; of choosing adequate performance indicators and the best period for analysis. Above all, skill is required to construct a plausible assessment of what would have happened in the absence of a programme.

Empirical research nevertheless makes it possible to offer some apparently firm generalisations about programme effects:[3]

- Fund programmes usually strengthen the BoP. Moreover, these results are not typically achieved by means of swingeing import cuts; export performance is usually improved. It takes time for these improvements to show up but they are then usually sustained into the medium-term.
- About half of programmes break down before completion (two-thirds in recent years). This does not seem to make much difference to outcomes, however, which suggests that the BoP improvements are less attributable to the programmes than to a greater concern with macroeconomic management among governments which sign Fund agreements.
- Overall, programmes do not make much difference to the inflation rate. While demand-control measures may reduce inflationary pressures, this tends to be offset by the price-raising effects of devaluations and interest-rate liberalisations.
- Programmes have a muted impact on economic growth: neither the crippling deflation which the Fund's critics complain of nor the revived expansion which the Fund seeks to achieve. Programmes often result in substantially reduced investment levels and sometimes in shortages of imported inputs.
- There is little evidence that programmes typically impose large social costs, although the urban labour force commonly suffers reduced real earnings, and cuts in budget subsidies can have serious effects. Programme effects on the distribution of income can be large but are usually complex, with the overall effect on poverty depending on country circumstances and policies. There is no systematic evidence of political destabilisation, although there have been specific instances of this.
- Many of the programmes that break down do so because of adverse external developments. In the absence of adequate contingency financing, countries get into difficulties because world prices turn against them, and quite often because of natural disasters, such as droughts and hurricanes.
- Programmes often fail to trigger additional inflows of capital from the rest of the world, despite claims that the Fund's 'seal of approval' has a catalytic effect on capital inflows. While some countries have benefitted, research shows that the BoP capital account does is not typically improve, even though debt relief and development assistance are included. Indeed, a shortage of supporting finance is a common reason for programme breakdown.
- Programmes often do not have a strong influence on fiscal and monetary policies. This helps explain the Fund's imperfect ability to achieve programme targets. However, the exchange rate is strongly influenced; programmes are associated with substantial currency depreciations, and these are sustained in real terms.
- There has been a good deal of political interference in Fund lending decisions. Successive American administrations have in particular used their weight to favour (or oppose) friendly (or hostile) developing countries. In some countries, this forced the Fund into providing effectively unconditional finance to governments with proven records of economic mismanagement (e.g. in the Philippines under Marcos, Sudan under Nimeiri and Zaire under Mobutu) swelling the number of ineffective programmes. The end of the Cold War may diminish such geo-politicking.

Fund programmes have often been surrounded by much sound and fury, yet what do these findings show? Governments are better able to resist the rigours of Fund stipulations than is often assumed; and the Fund has only limited ability to achieve its objectives, except when governments are genuinely convinced of the need for fiscal and monetary discipline.

How might we explain such muted effects? It has long been suspected that the extent of programme implementation is strongly influenced by the extent to which the borrowing government regards the programme as its own. A recent investigation by the World Bank of its own adjustment programmes corroborated this, finding a strong correlation between programme success and indicators of such government 'ownership.' Government 'ownership' was high in most programmes obtaining strong results and low in ineffective programmes, and was strongly predictive of programme success in three-quarters of all cases, with most 'deviant' cases explained by the intervention of external shocks.

There has been no equivalent research on Fund programmes but there are good reasons for expecting similar considerations to apply, not the least because many of the Bank programmes analyzed were accompanied by Fund programmes. The Fund's own tendency to attribute non-implementation to 'lack of political will' points in the same direction.

Critics attribute weak government identification with programmes to a certain arrogance in the Fund's approach. Although there is evidence of some increase in IMF negotiating flexibility, including occasional willingness to settle for technically sub-optimal but politically more sustainable programmes, it seems that the change has been only marginal. Its negotiating modalities do not help. The key negotiating document is a 'Letter of Intent' in which the borrowing government presents the policies it will undertake to strengthen the BoP and to promote other programme objectives. Herein lies the 'ownership' of the programme. But these Letters, although formally from the government, are almost invariably drafted by Fund staff, with the government left trying to negotiate modifications to a document presented to them.

However, relationships between a government and the Fund are not typically adversarial. There are other factors impeding government identification with programme measures. Much difficulty arises from the crisis conditions in which governments often turn to the IMF, the speed with which IMF staff have to prepare programmes and their often short-term nature. In such circumstances, staff do not have time to ensure that the government is fully 'on board', just as the government will often have no time to build a pro-programme political consensus. It is perhaps an *intrinsic* limitation of conditionality that it undermines the legitimacy of the stipulated policies, and hence the prospects that they will be fully implemented. However, against this should be set the tendency of some governments to use the Fund as a scapegoat, blaming it for unpopular policies which they privately know to be inescapable.

The Size and Cost of Credits

What now of the complaint that IMF credits are inadequate in value, too short term and expensive? Table 2 provides summary indicators of the financial terms attached to credits in 1991/92. This shows repayment periods of up to ten years. The *average*

Table 2: The terms of IMF credits, 1991/92

	Repayment period (years)	Interest rate (%)
Stand-by credits	3¼-5	8.0[a]
Extended facility	4½-10	8.0[a]
SAF and ESAF	5½-10	0.5

[a] higher if from borrowed rather than 'ordinary resources'.
Source: IMF

3. For fuller substantiation see articles by Killick *et al* in *World Economy*, September 1992.

maturity period has increased in recent years due to the relative rise of EFF, SAF and ESAF lending and by 1992 was probably about eight years, against about five years in the mid-1980s, when stand-bys predominated. Table 2 also shows that, while SAF-ESAF credits bear only a nominal interest rate (subsidised by special grants and loans from industrial countries), stand-by and EFF credits are much more expensive. Indeed, the average rate of 8% in 1991/92 was little cheaper than commercial money - a considerable contrast with the position during most of the 1980s, when the Fund's rate was well below that offered by commercial banks.

Table 3: Net credit from IMF and balance of payment outturns, 1986-91[a]

	(US$ billion)	
	Net credit	BoP[b]
All developing countries	-2.2	-31.0
(*of which*):		
Asia	-1.2	+5.5
Sub-Saharan Africa	-0.3	-6.9
Western Hemisphere	-0.3	-12.4

[a] Annual averages [b] Balance on current account
Source: IMF

Turning to the adequacy of the credits, Table 3 shows that the annual average amount of credit to developing countries, net of return flows from them, was actually negative during 1986-91, i.e. service payments on past credits exceeded the value of new lending. This was so in each of the regions shown, even though Africa and Western Hemisphere had major current account deficits in these years. In consequence, the Fund has greatly reduced its proportional exposure in Africa (see Table 1). In this sense the Fund could be seen as adding to the financing problems of the developing world rather than reducing them.

However, the result is different if the test is confined to countries which actually borrowed from the Fund. Calculations for a sample of 17 developing countries showed that, even on a net basis, Fund credits covered nearly a third of their deficits. However, coverage was much smaller - less than a fifth - for countries whose programmes subsequently broke down, suggesting that under-funding contributed to the failure rate.

From these mixed results perhaps the safest conclusion is that Fund credits *can* be quite generous in size and cost for countries which qualify for favourable treatment, but for others credits may be quite inadequate, and that the short maturities of credits can easily leave a country having to make net transfers to the Fund despite continuing BoP deficits.

Partly for this reason, the new phenomenon emerged during the 1980s of countries falling into arrears in servicing their IMF debts. As at April 1992 ten countries owed a total of $4.8 billion - equivalent to over an eighth of the Fund's total outstanding credits. Although the Fund has devised a 'rights' scheme for helping countries work off their arrears and so become eligible for new credits, only Peru has so far successfully completed this process. The Fund's insistence that its credits cannot be rescheduled, let alone forgiven, prevents it from responding more adequately to the needs of the poorer countries in arrears.

Conclusions

So does the IMF really help developing countries? From the evidence on programme effects, it seems that the effects of Fund programmes, and the extent of their influence on macroeconomic policy, are over-rated. The Fund is able to secure sustained improvements in the BoP. But it is unable to achieve its secondary objectives on growth and inflation, or to exert decisive influence on fiscal outcomes and credit expansion. A high proportion of its programmes break down before the end of their intended life.

By the same token, exaggerated fears have been held of deflationary, poverty-aggravating and destabilising programme effects. While there are instances of each of these, programmes do not typically have the potency to impose such costs on a large scale. Developing-country governments have increasingly become persuaded of the importance of financial discipline, so that the broad thrust of what the Fund seeks to do has become less controversial. Managing Director Camdessus can justifiably speak of a 'silent revolution' in the attitudes of many member governments - a change most obvious in Latin America.

In various ways the Fund has in recent years sought to respond to past criticisms and to adapt to changing conditions. It has become somewhat more sensitive to the potential social harmfulness of its programmes. It has reduced its reliance on a small number of demand-management indicators. It has found ways of providing soft, medium-term finance to low-income members, and of addressing some structural economic weaknesses.

These policy changes are making a difference to programmes. But in many cases the difference is modest - a good deal smaller than the extensive reforms of economic policies of many of its developing-country members. High failure rates and a paucity of 'success stories' leave particular questions about the Fund's ability to operate successfully in African and other low-income countries. Political determination of country lending decisions remains a weakness. The Fund in recent years has been associated with a net return flow of finance from debtor developing countries and there is evidence of programme under-funding. The effects of the Fund on capital inflows from other sources varies greatly and its claims to exert a catalytic effect are exaggerated.

Shortages of supporting finance, and requirements upon countries to undertake adjustment measures even in response to natural disasters, are among the severest constraints on the ability of the IMF offer more effective help, although the Fund now believes there is little danger for the next few years that increased lending to former Comecon countries will be at the expense of developing countries. Renewal of the ESAF 'soft window,' which expires in November 1993, will be essential for a continued Fund presence in Africa and other low-income countries, but is not yet assured.

Ultimately, it is the governments of the OECD countries which decide the Fund's policies and which determine its stance towards developing countries. Since the USA exerts particularly strong influence, disproportionate to its importance in world trade, to say nothing of its record as persistent producer of the world's largest budget deficit, the policies of the Clinton administration will be crucial in this regard.

For further information please contact Tony Killick at ODI.