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IMF and World Bank Structural Adjustment Policies: Cooperation or Conflict?

by Karl Wohlmuth, Bremen*

The adjustment crisis of the oil-importing developing countries has raised the question as to the specific roles of the IMF and the World Bank in the process of structural adjustment and the actual relationship between their different concepts and programmes. What are the areas of cooperation and conflict between these two institutions and what must alternative concepts for structural adjustment and conditionality take into consideration?

In the early 1970s it became evident that the dramatic world economic changes required drastic modification to IMF adjustment policies in the oil-importing developing countries and that new policies and instruments had to be invented. The "large increases and marked shifts in external payments imbalances called for a blend of adjustment and financing different from that formerly incorporated in stand-by arrangements".¹ Consequently, the IMF established temporary financing arrangements, such as the oil facility, to provide low conditionality resources to its members.

The IMF's Extended Fund Facility

The IMF also established the Extended Fund Facility (EFF) in 1974, designed to help countries with (i) severe payments imbalances owing to structural maladjustments in production and trade, and (ii) imbalances owing to a combination of slow growth and an inherently weak balance of payments position constraining the country's pursuit of active development policies.² After the second oil price shock, the IMF increasingly emphasized adjustment programmes compatible with and furthering structural changes. Longer periods of adjustment and larger amounts of assistance were considered to be necessary. The IMF concentrated more and more on high conditionality programmes within a medium-term framework at the expense of low conditionality facilities.

The years 1979 to 1981 showed a great expansion in the volume of EFFs (see Table 1) and of one-year and multi-year stand-bys under a medium-term framework. There was a clear understanding in the IMF at this time that "adjustment" meant an improvement of the balance of payments situation via fundamental economic policy changes so that a "viable" balance of payments position could be restored. The "viable" balance of payments position was defined as a deficit on the current account which can be financed by capital imports consistent with longer-run development perspectives, so that the debt-servicing capacity of the country is taken care of. It was the view of the IMF that a viable balance of payments position should be realized without endangering the growth prospects and development perspectives of the developing countries pursuing adjustment policies. The IMF considered it more and more important to complement demand management policies by supply-side policies³ and also by measures to ensure better cooperation with the World Bank at all operational levels.⁴

In 1981 the Indian EFF loan implied a decisive turnaround. This EFF had strong elements of supply-

* University of Bremen. This article is based on a lecture given at a Working Group Meeting on Structural Adjustment Policies of the IMF and the IBRD, Friedrich-Ebert-Stiftung, Bonn, May 1984.

¹ M. Guittian: Fund Conditionality. Evolution of Principles and Practices, Pamphlet Series No. 38, International Monetary Fund, Washington D.C. 1981, p. 17.

² Ibid., p. 19.

³ Ibid., p. 26f.

⁴ On the collaboration between the IMF and the World Bank see M. Guittian, op. cit., p. 27; and on the evolution of collaboration, Joseph Gold: The Relationship Between the International Monetary Fund and the World Bank, in: Creighton Law Review, Vol. 15, 1981-1982, No. 2, pp. 499-521.

BRETTON WOODS INSTITUTIONS

Table 1
Extended Fund Facility Arrangements
1975 - January 1983

Country	Date of Agreement	Expiration Date	Amounts		
			Approved	Drawn ^a	As Percentage of Quota
1975					
Kenya	July 7	July 6, 1978	67.2	7.7	140.0
1976					
Philippines	April 1	March 31, 1979	217.0	217.0	140.0
1977					
Mexico	January 1	Dec. 31, 1980	518.0	100.0	140.0
1978					
Jamaica	June 9	June 8, 1981	200.0	70.0	270.0
Egypt	July 28	July 27, 1981	600.0	75.0	263.0
Haiti	October 25	Oct. 24, 1981	32.2	10.8	140.0
1979					
Sri Lanka	January 26	Dec. 31, 1981	260.3	260.3	219.0
Sudan	May 4	May 3, 1982	200.0	251.0	227.0
Guyana	June 25	June 24, 1982	62.75	10.0	251.0
Honduras	June 28	June 27, 1982	47.6	23.9	140.0
Jamaica	June 11	June 10, 1981	260.0	85.0	351.0
1980					
Gabon	June 27	Dec. 31, 1982	34.0	0.0	113.0
Guyana	July 25	July 24, 1983	150.0	51.7	600.0
Senegal	August 8	August 7, 1983	184.8	41.1	440.0
Morocco	October 8	Oct. 7, 1983	810.0	147.0	540.0
Pakistan	November 24	Nov. 23, 1983	1,268.0	349.0	445.0
Bangladesh	December 8	Dec. 7, 1983	800.0	220.0	351.0
1981					
Dominica	February 6	Feb. 5, 1984	8.55	5.7	295.0
Ivory Coast	February 27	Feb. 22, 1984	484.5	292.1	425.0
Morocco	March 9	Oct. 7, 1983	817.05	136.5	363.0
Sierra Leone	March 30	Feb. 22, 1984	186.0	33.5	400.0
Jamaica	April 13	April 12, 1984	477.7	290.6	430.4
Zambia	May 8	May 7, 1984	800.0	300.0	378.3
Zaire	June 22	June 21, 1984	912.0	175.0	400.0
Costa Rica	June 17	June 16, 1984	276.75	22.5	450.0
India	November 9	Nov. 8, 1984	5,000.0	1,800.0	291.0
Pakistan	December 2	Nov. 23, 1984	919.0	445.0	215.0
1982					
Peru	June 7	June 6, 1985	650.0	100.0	264.0
Mexico	December 23	Dec. 31, 1985	3,410.625	100.3	425.0
1983					
Dominican Republic	January 21	Jan. 20, 1986	371.25	45.0	450.0
Brazil	February 28	Feb. 28, 1986	4,239.38	0.0	425.0
Mexico	January 1	Dec. 31, 1985	3,410.63	100.3 ^b	

^a As of March 11, 1982.

^b As of June 13, 1983.

Source: International Monetary Fund.

side policies to improve the infrastructural bottlenecks of the country; the loan was not motivated by actual balance of payments problems but was intended, rather, to allow an expansionary programme based on supply-side measures. It was considered by industrial country members of the IMF (mainly the USA) as a precedent for a new role by the IMF.⁵

Low Drawings/Approval Ratio

EFFs are three-year adjustment programmes which allow the drawing country access to 140 % of the quota with repayment periods of, now, 4 to 10 years. Compared with other drawings by IMF members the EFF was not that important before 1981. Only in 1982 were the drawings under the EFF as important as those under stand-by arrangements⁶, although in 1982 only two new EFFs were agreed (see Table 1).

The EFF data show great discrepancies between countries concerning the drawings/approval ratio. Only the Philippines, Sri Lanka and the Sudan have drawn the approved amount or more. The low drawings/approval ratio is taken as an argument by the IMF to oppose further EFF arrangements because large, three-year commitments can lead to a blocking of funds which then may not be used for other countries. From an accounting point of view this argument is correct – if such large commitments as 5 billion dollars to India or 1,268 million dollars to Pakistan are considered – but the causes of the low drawings/approval ratio should be considered first of all.

The commitments of the country concerned under an EFF were the main source of problems because the government had to agree to precise quantitative prescriptions (for credit policies, public finance, exchange rates, etc.) for a period three years ahead, and this in a situation of increasing world-wide economic uncertainty. Many countries could not meet these conditions so that cancellations were the consequence. The basic problem however is the fact that the IMF relied on the same financial programming procedure as for one-year stand-bys. The IMF assumes that there is a strong case for a relation between the balance of payments situation and the rate of inflation on the one hand and the monetary changes in the country

(domestic credit and foreign assets) on the other, so that demand restraint via credit ceilings is considered to be the most important tool to promote financial stability.⁷ This instrument may even be used in situations in which there is no “excess demand” according to the IMF staff analyses, but when cost and price distortions or other structural problems are at the roots of the payments difficulties.⁸

Although the IMF has verbally argued more and more in favour of the objectives of increasing the efficiency of resource allocation and of mobilizing additional resources, in reality these supply-side measures did not enter the adjustment programmes as quantified prescriptions (“conditions”), but only as “policy understandings”, which did not have the same weight because there were no detailed action and monitoring programmes involved. The IMF expected a quick return to financial stability by emphasizing the traditional conditionality criteria. It remained an implicit target of the IMF to reduce as quickly as possible balance of payments imbalances, thereby ignoring the genuine advantages of a “real economy” programme⁹ which allows balance of payments adjustment to be combined with a strategy to sustain or accelerate growth and to promote structural changes.

Retreat from the EFFs

The IMF now considers the instrument of the EFF a burden and replaces the EFFs by one-year and multi-year stand-bys, arguing that a medium-term perspective is still maintained. Various factors are cited by the IMF as reasons for the policy change and to interpret the failure of EFFs: mistakes by the IMF in misspecifying policy variables, setting unrealistic targets, disregarding the low adjustment and implementation capacity of some countries, failures due to external events which over the three-year period have made unrealistic some of the basic agreements of the countries with the IMF; and also failures on the side of governments because of the lack of political commitment to a sound adjustment programme, so that especially the public sector commitments (e.g. the public saving targets) could not be met. Not mentioned is the main cause for the failure of EFFs: the fact that they were not transformed to an instrument which supported “real economy” changes.

⁵ See S. Dell: Conceptions and Misconceptions of Adjustment, New York, February 1984, pp. 11-16; and S. Dell: Statement to the Santiago Roundtable on World Monetary, Financial and Human Resource Development Issues, February 1984.

⁶ See K. Wohlmuth: Konditionierte externe Entwicklungsfinanzierung und interne Strukturanpassung in den Entwicklungsländern, in: U. E. Simonis (ed.): Entwicklungsländer in der Finanzkrise, Berlin 1983, p. 182.

⁷ This approach has also been referred to as the Polak model. A critical evaluation is given in: K. Wohlmuth, op. cit., pp. 203-208.

⁸ A reference to this IMF staff attitude is given in S. Dell: Stabilization: The Political Economy of Overkill, in: World Development, Vol. 10, No. 8, 1982, p. 608, quoting an earlier analysis by T. Killick.

⁹ See T. Killick et al.: The IMF: Case for a Change in Emphasis, in: R. E. Feinberg, V. Kallab (eds.): Adjustment Crisis in the Third World, Overseas Development Council, Washington, D.C., 1984. Killick argues in favour of a “real-economy” strategy of adjustment. This term should be considered as an alternative to the (monetary economy) financial programming approach of the IMF.

The IMF argues that the retreat from the EFFs does not imply that it is interpreting the payments imbalances as short-term in nature. In fact, this retreat from the EFFs poses enormous problems for the affected developing countries because, as the evaluations of one-year stand-bys show, the adjustment capacity of the countries most in need of IMF drawings is too limited to pursue policies to restore financial stability without endangering growth and development.¹⁰ Many countries have limited economic flexibility, a limited short-term responsiveness to price incentives, a limited capacity to further reduce real wages and incomes, and also a limited technical and administrative proficiency within governmental economic policy making institutions. Even the IMF staff have shown that in such countries the best way to achieve short-term improvements in the balance of payments is to provide adequate transport, credit, and supplies of real inputs, and to ensure adequate prices, mainly to agricultural producers.¹¹ The uncertainty surrounding the one-year and multi-year stand-bys strengthens the bias of the adjustment programme towards demand restraint, leading to programmes with high adjustment costs in terms of output and employment, thereby often violating the basic requirement for successful programmes – their political sustainability.¹² Such short-term programmes leave no adequate room for a constructive policy dialogue.

The World Bank's Structural Adjustment Loans

The dramatic proportions of the adjustment crisis at the end of the 1970s led the World Bank to change its lending policy towards a more explicit recognition of the importance of a genuine macroeconomic policy dialogue besides the traditional project and sector lending. New instruments of lending, such as the Structural Adjustment Loans (SALs) were introduced, with which the World Bank has been experimenting since 1980 when the first SAL was approved for Kenya.¹³ The approach of the World Bank on structural adjustment is quite different from that of the IMF, and

more constructive on various points. According to the World Bank's own operational definition, SALs are defined as non-project lending to support programmes of policy and institutional change necessary to modify the structure of the economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium term.

The introduction of SALs has shaped the whole spectrum of the World Bank's activities because of the concentration of conditionality on central policy issues (e.g. trade regime, price and incentives policy, public investment and public sector policies, institutional reform).¹⁴

As Table 2 shows, up to now only relatively few countries have SAL arrangements with the World Bank. This means that only a few countries were able to design a programme or to convince the World Bank that the programme has political support so that a fundamental policy change can be expected. The main precondition for an SAL arrangement is that the governments must be able to sustain a process of policy reform and institutional change over (normally) 5 to 7 years. The structural adjustments made possible within this period should in turn make the World Bank sectoral and project lending activities more efficient. The SALs were considered as necessary primarily to achieve a viable balance of payments position "at a higher level of real income and with greater attention to the needs of development policy".¹⁵

To understand the role and the perspectives of the SALs, the roots of this instrument, namely programme loans and sector and project loans, have to be considered first. When the World Bank started with the SALs in 1980, it did so after many years of experimenting with programme lending. In some respects, programme loans can be considered as forerunners of the SALs. The same is true for the type of conditionality which had been developed for programme loans. The approach was to develop unambiguous, detailed and consistent action programmes or to set quantitative targets. Policy packages agreed contained measures and actions aimed at macroeconomic, institutional and administrative reform in the country concerned.

Another source of the SALs are the sector and the project loans involving more and more macroconditionality beyond sector or project-specific conditionality. If a project on road maintenance is

¹⁰ See S. Dell, R. Lawrence: *The Balance of Payments Adjustment Process in Developing Countries*, New York 1980; K. Wohlmuth, *op. cit.*, pp. 196-199.

¹¹ K. Nashashibi: *A Supply Framework for Exchange Reform in Developing Countries: The Experience of Sudan*, pp. 24-79, in: IMF Staff Papers, Vol. 27, No. 1, March 1980.

¹² This factor has been analysed by Joan M. Nelson: *The Politics of Stabilization*, pp. 99-118, in: R. E. Feinberg, V. Kallab (eds.), *op. cit.*

¹³ The basic literature on the Structural Adjustment Loans is: E. Stern: *World Bank Financing of Structural Adjustment*, in: John Williamson (ed.): *IMF Conditionality*, Washington D.C., Institute for International Economics, 1983, pp. 87-107; a more recent article is by Stanley Please: *The World Bank: Lending for Structural Adjustment*, in: R. E. Feinberg, V. Kallab (eds.), *op. cit.*

¹⁴ See S. Please, *op. cit.*, p. 88.

¹⁵ *Ibid.*, p. 84.

Table 2
Structural Adjustment Loans Approved
to June 30, 1983
(\$ million)

	Date of Approval	Amount	Disbursements
Kenya I	March 1980	55.0	Fully
Kenya II	July 1982	60.9	Partially
Bolivia	June 1980	50.0	Fully
Philippines I	Sept. 1980	200.0	Fully
Philippines II	April 1983	302.3	Partially
Senegal	Dec. 1980	30.0	Partially
Guyana	Feb. 1981	14.0	Partially
Mauritius I	May 1981	15.0	Fully
Mauritius II	Dec. 1983	40.0	Partially
Malawi I	June 1981	45.0	Fully
Malawi II	Dec. 1983	55.0	Partially
Ivory Coast I	Nov. 1981	150.0	Fully
Ivory Coast II	July 1983	250.7	Partially
Korea, Rep. of I	Dec. 1981	250.0	Fully
Korea, Rep. of II	Nov. 1983	300.0	Partially
Thailand I	March 1982	150.0	Fully
Thailand II	March 1983	175.5	Fully
Jamaica I	March 1982	76.2	Fully
Jamaica II	June 1983	60.2	Partially
Jamaica III	July 1984	30.1	Not begun
Turkey I	March 1980	275.0	Fully
& Supplement	Nov. 1980		
Turkey II	May 1981	300.0	Fully
Turkey III	May 1982	304.5	Not begun
Turkey IV	June 1983	300.8	Partially
Pakistan	June 1982	60.0	Fully
Togo	May 1983	40.0	Partially
Yugoslavia	June 1983	275.0	Partially
Panama	Nov. 1983	60.2	Partially

Source: International Bank for Reconstruction and Development.

conditional on a revision of the whole energy price system of a country, or if a loan for a great irrigation project, like the Gezira Rehabilitation Project in the Sudan, is conditional on a complete agricultural sector reform package, or if a sector programme for industry or agriculture is conditional on a macroeconomic reform package, then this can have a profound impact on structural adjustment. In reality however, the far-reaching conditionality in relation to projects and sector programmes did not show the expected results because the narrower project and sector conditions were met first and the far-reaching targets were often considered at the operational level as being of secondary importance only. It is a main purpose of the SALs to change

precisely this attitude by rearranging the priorities, so that the project and the sectoral lending activities are based on sound macroeconomic policy priorities.

Mixed Experiences

The ultimate aim of the SALs is to achieve a maximum feasible level of economic growth during and after the period of adjustment by increasing the efficiency of resource use. The scope of measures is similar to the supply-side measures which the IMF had considered important: reform of the trade regime, sectoral adjustment policies, revision of public sector enterprises, mobilization of the resources of the economy by adequate interest rate policies and fiscal policies, improving debt management and institutional reform. The relative importance of these measures depends on the diagnosis of the country's structural adjustment problems. An SAL agreement not only requires that there is agreement on objectives and measures; agreement on the timetable for explicit action programmes is also necessary. This is a major innovation because the government has to stick to the agreed actions or implement alternatives which have a similar weight.

The experiences with SALs up to now are mixed, as far as the implementation of agreed actions is concerned. Interestingly enough, the Kenyan SAL I from March 1980 is considered by the World Bank to be a case of successful implementation, whereas the IMF programmes in this country show a bad record. On the other hand, the Malawian SAL and the supporting IMF programme both are considered failures. The SAL to the Philippines is considered a success in terms of implementation of the action programmes but the current state of the economy does not qualify this country for a success story in terms of structural adjustment. Judgements on the role of the SALs in affecting real economy variables are therefore premature.¹⁶ It is also premature to say how the policy dialogue can be improved by organizing the World Bank's total activities in a country around the SAL model.

Limited Applicability

The SAL approach depends on the existence of two real partners in such a policy dialogue, partners that can bring in their own judgements and objectives. This may not always be the case. The SAL approach also depends on the time horizon for the necessary structural adjustments. Follow-up SALs, allowing a time horizon of 5 to 7 years, are granted only in cases where a full disbursement of the first SAL was possible. In cases where an SAL agreement has failed because tranching

¹⁶ Ibid., pp. 93-96.

review has led to cancellations, it may be difficult to resume SAL negotiations. Thus only a few countries fulfil the necessary requirements. The validity of this approach to promote structural adjustment, however, depends on a critical number of countries with successful operations so that on the whole a decisive impact on the structural adjustment process in the Third World is achieved. The number of countries with follow-up SALs is too limited for this; this also raises questions concerning the limits of the World Bank's resources.

Also important is the question of the basic appropriateness of the measures undertaken under an SAL agreement. Are the measures agreed upon to improve the incentives system in the agricultural sector based on sound empirical judgements about the price responsiveness of the farmers? Are the institutional measures to improve the marketing system based on realistic assumptions about socioeconomic processes in the country? Are the sources of public sector deficits and of losses of public enterprises correctly evaluated? And so on. The SAL approach relies so much on institutional reform and on institution-building that such questions have to be answered first before proceeding with an SAL programme. The lack of such studies is evident.

All these factors have led to a concentration of SALs on semi-industrialized and middle-income countries. These countries already have better developed institutions and a somewhat higher adjustment and implementation capacity for all types of programmes. Those countries which are most in need of structural adjustment programmes, because they are low income countries heavily dependent on one or two export products, only have access to project and sector lending. The Sudan is a good example. The bad record of IMF programmes in this country shows that real economy programmes are necessary and that IMF measures to restore the financial stability in the short term may be in conflict with World Bank rehabilitation programmes for sectors and projects.¹⁷ According to the World Bank's policies this country has to make progress in institution-building and has to improve its adjustment capacity first before SALs are negotiated. This may be a disadvantage for the country because the great variety of conditionality applied by the World Bank in its various activities in the country may not be focused sufficiently on macroeconomic policy priorities.

IMF and World Bank: Cooperation and Conflict

A superficial review of the supply-side considerations of the IMF and of the structural adjustment policies of the World Bank may lead to the conclusion that there is no source of conflict between these two institutions. One obtains a picture of complementary and mutually reinforcing programmes. There are clear-cut and well-defined procedures for cooperation during all phases of programme design and implementation.¹⁸ There is an explicit division of responsibilities. The IMF has advisory functions and responsibilities concerning macro-economic policies and exchange rate policies, and an agreement with the IMF is necessary to proceed with an SAL operation, whereas for an EFF to come into effect a review of the country's investment programme by the World Bank is necessary.

A closer look at the two institutions' policies is, however, necessary. A consideration of the differing time horizon, the divergent theoretical basis of these institutions' work and their differing procedures leads to the conclusion that there may be an inherent source of conflict between these two institutions, so that conflicting advice may be given. Sensitive issues arise in the case of exchange rate policies, because this instrument is important for the pursuing of the IMF's policy of restoring the balance of payments position as quickly as possible, but is important also for the World Bank's policy of improving the incentives for producers and exporters. There can therefore be conflicts on the timing and the extent of the exchange rate changes, but also conflicts if the World Bank designs export bonus schemes which have budgetary implications. The costs of such schemes may lead to large budgetary deficits, thereby counteracting the IMF's public savings targets.

The most important conflict which may arise between the two institutions is probably in the field of public finance, as this sector is of extremely great importance in many developing countries for any strategy of adjustment and expansion. In this context the subsidies are a main source of conflict. The IMF is interested in reducing subsidies first of all in order to reduce public sector deficits, whereas the World Bank is more concerned with the efficiency of resource allocation.

Structural adjustment not only requires demand restraint to restore financial stability in the country (thereby laying the foundations for a higher allocation efficiency), but also requires supply-side measures such as the provision of funds for transport, credit and

¹⁷ See K. Wohlmuth, D. Hansohm: Economic Policy Changes in the Democratic Republic of the Sudan, A Study for the World Bank, Bremen 1984, pp 55 ff

¹⁸ See S. P l e a s e , op. cit

the supply of real inputs. Although the IMF in principle has accepted this position¹⁹, in reality there may be conflicts with the World Bank's real economy approach if credit ceilings are not flexible enough. In this context new World Bank instruments have to be mentioned which take this into consideration: the Special Action Programmes and the Export Development Funds. The Special Action Programmes allow high priority lending operations supporting structural adjustment, policy changes, production for exports, fuller use of existing capacity and maintenance of crucial infrastructure, whereas the Export Development Funds are a component part of the World Bank's Programme of Special Assistance to member countries and emphasize quick-yielding and export-oriented projects focusing on international competitiveness. These programmes mean that the World Bank can now give support even in cases of shortage of local money (whether this shortage is IMF programme-induced or not). In some cases the World Bank has even modified the cost-sharing formulae for the local versus foreign exchange part of the total project financing and is now even ready to finance the working capital and the recurrent costs of projects in certain cases. These are major innovations in development finance which close a gap in cases where important projects cannot be implemented or cannot start with production because of shortage of foreign exchange or local money.

In order to bridge the gap between the two organisations the IMF will have to follow the main elements of the World Bank's SALs. The time horizon of IMF programmes must be adjusted so that a realistic timetable for structural adjustment policies can be outlined, the IMF's financial programming approach must be complemented by real economy measures and the IMF must also shift to action programmes agreed with governments instead of concentrating on quantitative prescriptions or policy understandings for macroeconomic targets. This would mean an extension of the EFF approach towards a real medium term IMF facility.

These are the fundamental reforms which are necessary, but at the operational level a better synchronization of IMF and World Bank programmes is also required. The coordination does not always function: if the World Bank works out an action programme and agrees on export incentives with the country, the IMF is required in time to negotiate exchange-rate policies for support. A case study for the Sudan reveals fundamental deficiencies in this respect.²⁰ If such a synchronization does not take place (in the case of the Sudan the government may be

responsible for the resistance), both programmes may fail. Synchronization also implies that important elements of the IMF and World Bank programmes are identified and that they are given priority in negotiations. A consistent and more acceptable exchange-rate policy recommendation by the two institutions may be the outcome.

Another priority area is in the field of public sector savings targets. A concentration on these targets by both organizations is necessary so that the IMF's credit ceilings are not in conflict with the World Bank's public investment and public expenditures policy for the country. The IMF must be sure that there was time enough for the World Bank to prepare a priority selection of expenditures and to arrange for political support. The search for solutions which are politically sustainable is therefore of importance for the IMF programmes too.²¹

Alternative Conditionality

The discussion on alternative conditionality concentrates on various aspects: on the definition of adjustment itself; on the asymmetry of adjustment measures imposed; on the appropriate ways to minimize the costs of adjustment by designing adequate programmes; on the capacity of individual countries for adjustment; on the political structure behind the adjustment process; and on the institutional set-up of international organizations supporting adjustment programmes and the mandate given to these institutions.

According to a minority point of view there are even alternatives to the whole concept of conditionality. This view is that neither the IMF nor the World Bank should impose strict conditions on domestic economic policies, but should lend unconditionally. The majority point of view is that conditionality on the use of IMF and World Bank resources is indispensable for many reasons. The IMF argues that because of various constraints which it has to consider there are no alternatives to conditionality practices although the content of conditionality may be adjusted according to circumstances.²² Even critical observers of IMF policies now argue in favour of strict conditionality, but a type of conditionality which is compatible with the country's

¹⁹ See K. Nashashibi, *op. cit.*

²⁰ K. Wohlmuth, D. Hansohm, *op. cit.*

²¹ Joan M. Nelson, *op. cit.*

²² On the current policies of the IMF see two insiders' views: A. F. M o h a m m e d : Fund Conditionality: An Insider View Paper, for the Santiago Roundtable on World Monetary, Financial and Human Resource Development Issues, February 1984; M. A l l a n : Recent Experience With Fund-Supported Adjustment Programmes, Washington D.C., 1983, mimeo.

own political and economic priorities and does not endanger progressive socioeconomic and political changes.²³

What are the main requirements of an alternative conditionality? What are the main elements of a conditionality which brings about "successful" adjustment? First of all, the term "adjustment" has to be clarified. It is used in differing meanings by the various international institutions. The basis for adjustment programmes is therefore ambiguous. Neither the position of the IMF (to restore a viable balance of payments position under conditions of liberal trade and capital policies), nor the position of the World Bank (to restore a viable balance of payments position which is compatible with maximum growth) is unambiguous, so that both need analytical clarification. The IMF only defines general criteria for "successful" programmes: political commitment and support for a programme, early action, flexibility in policy formulation and implementation in respect of emerging circumstances, and an adjustment effort sustained over years.²⁴ The requirement of structural change is not considered among the conditions of successful adjustment. Therefore, the question is raised whether the IMF programmes are more than mere programmes to reduce aggregate demand. Also, the World Bank SAL programmes are criticized as enforcing the IMF concept of conditionality more strictly than the IMF itself, so that the World Bank's own approach is superimposed.²⁵

An alternative conditionality also requires that a better distribution of the adjustment burden is aimed at. A certain symmetry of adjustment is necessary for successful adjustment programmes. At the moment, no more than lip service is given to this issue. This lack of symmetry has grave consequences for the poor and

poorest countries. They have to accept the high conditionality programmes of the IMF to get access to funds at all. On the other hand, they are not able to negotiate successfully with the World Bank on SALs. The adjustment costs due to demand restraint measures may be very high in these countries. But also those countries which have access to SALs may find the service of these programmes rather useless in the long run if no complementary adjustment effort is undertaken in developed countries and surplus countries. Without a certain degree of symmetry in adjustment, the adjusters in the Third World may have a more efficient export sector in the future, but may also have more and more limited export chances because of the protectionist tendencies and the depressed demand in the industrial countries. The IMF and the World Bank adjustment programmes have to be complemented by actions to support structural adjustments in the developed market economies, which requires cooperation with the OECD, GATT and the main governments on this issue.

Alternative conditionality requires the design of cost-minimizing programmes. Such programmes should reduce the total costs of adjustment in terms of output and employment by optimum combinations of demand and supply policies. The IMF (and also the World Bank) should examine "alternative courses of action on the balance of payments and select that which is most in harmony, or least in conflict, with other objects of government policy. This implies giving greater weight to

²³ See N. Girvan: Swallowing the IMF Medicine in the Seventies, in: *Development Dialogue*, No. 2, 1980, pp. 55-74.

²⁴ J. de Larosière: Adjustment Programs Supported by the Fund. Their Logic, Objectives, and Results in the Light of Recent Experience, International Monetary Fund, Washington D.C., 1984, pp. 11-12.

²⁵ S. Dell in a comment on the lecture version of this paper.

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V E R L A G W E L T A R C H I V G M B H - H A M B U R G

the 'primary objectives' of policy, to the distribution of income and to the political implications of the proposed measures".²⁶ The basis for such a cost-minimizing strategy has been outlined in recent years by Killick et al.²⁷ The major innovation in comparison with the SAL approach is the emphasis on the selection of a cost-minimizing strategy and on a more careful review of the political feasibility and sustainability of the stabilization programme. Alternative combinations of demand restraint and supply-side measures have to be found for each country case. Because of the lack of information on the effects of various types of supply-side measures and because of the lack of country studies on their use and efficiency, the elaboration of a cost-minimizing alternative action programme may be a very time-consuming process. This is a further impetus for intensive cooperation between the World Bank and the IMF, as the World Bank has much more knowledge at hand on sectoral and microeconomic issues.

Alternative conditionality also requires that adequate consideration is given to the developing countries' varying capacities to adjust. Four determinants of adjustment capacity may be singled out: the structure of the foreign trade sector, the structure of the public sector and of the budget system, the structure of the financial system and the structure of the administrative system. The insufficient adjustment capacity of the low-income and the least developed countries requires a medium to long-term perspective in the design and implementation of adjustment programmes. The retreat from EFFs by the IMF and the restrictions by the World Bank on the use of SALs imply that at the moment the design of cost-minimizing adjustment programmes for countries with a low adjustment capacity is impossible. It is therefore no surprise that the "successful adjusters" according to the IMF are semi-industrialized countries rather than low-income and least developed countries.²⁸ The unfavourable performance of IMF programmes in Africa may be interpreted in this context.²⁹ The IMF gives a rather superficial explanation for the failures by arguing that the "slippages in implementation involved primarily the emergence of unforeseen developments, an insufficient political commitment to the adjustment measures, limitations in the administrative

infrastructure, overoptimistic targets, and delays or shortfalls in net inflows of development assistance".³⁰ In fact, the limited adjustment capacity and the lack of political commitment seem to be the crucial variables.

Alternative conditionality must therefore put much more emphasis on the factors determining political commitment and political sustainability of adjustment programmes. However, the World Bank gives access to SAL resources only if the political sustainability can be taken for granted – thus the small number of countries involved in SAL programmes. The IMF implicitly assumes that most of the governments cannot keep to their three-year commitments in EFF arrangements, so that one-year and multi-year stand-bys may be more suitable instruments. No attempt is made to consider the determinants of political sustainability in the process of programme design. It is therefore imperative that during the design of programmes the real basis of the government's commitment for stabilization is considered more explicitly, by reviewing the position of vested interest groups and by designing, if necessary, compensatory measures for groups affected by structural changes. These groups have to be treated as decisive factors for the success of stabilization.

Finally, alternative conditionality requires that the IMF and the World Bank are given the political support of their members for such constructive moves. The Indian loan affair shows that this is a crucial point. The negotiations on the resources of the IMF and the World Bank reveal this dependence of the institutions on their main members very clearly. A new role by these institutions in the process of structural adjustment has to be accepted by the members first, so that genuine medium-term adjustment programmes, better participation by the low-income and the least developed countries, an enlarged base for drawings and better cooperation between the two institutions can be realized. Such a new role would also imply that a minimum of symmetry in adjustment can be enforced. EFFs and SALs should then be brought to a certain degree of convergence in timing, objectives and measures proposed. In order to make possible a real policy dialogue with the countries, alternative arrangements for the review of the adjustment effort are necessary. Review criteria and review missions may be more suitable than the performance criteria of the IMF, giving the countries more opportunity to submit their own interpretations of the causes of deviations from agreed objectives, measures and action programmes. The innovative lending instruments developed in the 1970s could in this way be brought to have an important impact on the worldwide structural adjustment process.

²⁶ See T. Killick et al.: IMF policies in developing countries: the case for change, in: *The Banker*, April 1984.

²⁷ See T. Killick et al.: *The Quest for Economic Stabilisation: The IMF and the Third World*, Vol. 1, London, New York 1984, and other works by the same author.

²⁸ See J. de Larosi re, op. cit., pp. 6-11.

²⁹ See Justin B. Zulu, Saleh M. Nsouli: *Adjustment Programs in Africa: The Recent Experience, 1980-81*, International Monetary Fund, July 13, 1983.

³⁰ *Ibid*, p. 22.