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Jörn Altmann\*

## IMF Conditionality: The Wrong Party Pays the Bill

*Countries in acute payments difficulties generally seek the support of the International Monetary Fund. IMF credits are granted subject to compliance with economic conditions that have repeatedly given cause for criticism. The two articles that follow, by Jörn Altmann and Joachim Betz, examine the Fund's policy of conditionality.*

The international debt crisis has now vanished almost completely from the newspaper headlines. Superficially, it appears to have been settled. It is undoubtedly under control in banking terms, but it has certainly not been resolved. The latent international financial crisis was revealed in the early eighties when Poland, Mexico and other Eastern European and developing countries acknowledged their inability to service their debts; recently Poland concluded a loan agreement with the International Monetary Fund under which the first disbursements were made at the beginning of this year.

Countries in acute payments difficulties generally seek the support of the IMF in order to gain access to IMF credits that will help relieve their liquidity problems not only directly but also indirectly by acting as a catalyst for borrowing from other sources. However, IMF credits are granted subject to compliance with economic policy conditions, which generally include a drastic devaluation of the national currency, the removal of state subsidies on everyday requisites and the lifting of price controls, which usually also leads to sharp price increases.

The approach to the fundamental problem of the IMF's credit conditions is partially mistaken, and partially correct. It is true, as Jacques de Larosière once remarked when he was Managing Director of the IMF, that it is not the doctor's fault that the patient is ill. It is also true that there is no alternative to prescribing certain remedies – i.e. credit conditions – if one does not want to give free rein to the creation of debt by giving

unconditional access to sources of credit. It is also right to rebut the accusation that the IMF acts deliberately and maliciously as an inhumane and unsocial instrument of neo-colonialist exploitation.

It is debatable, however, to contend that the IMF may occasionally err in the dosage of its measures but is correct in the basic direction of the conditions it imposes. This is undoubtedly true in some cases, but not in general; in macro-economic terms IMF conditions are not always adequate to deal with the causes of the problems and in micro-economic terms they are aimed at the wrong targets.

### Historical Legacy

The IMF, which was founded as a fire brigade, so to speak, to deal with balance-of-payments problems after the second world war, still has the structural hallmarks of an institution geared to the problems of industrialised countries and steered by industrialised countries. The amendments to the Statutes and the facilities created specifically for developing countries have done nothing to change this legacy of the past. The fact that the fundamental structure of the Fund no longer accords with the nature of present-day problems is often ignored; under the Fund's Articles of Agreement, IMF stand-by credits granted subject to compliance with certain conditions – often described innocuously by the term “conditionality” – are intended to eliminate *short-term* external disequilibria, so that the necessary adjustment measures and their consequences must by their very nature be geared towards the short term and (a very important point) the *causes* of the problems must be capable of being solved by the measures demanded.

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This applies just as much to home-grown inflation, for example, as to an unrealistic exchange rate policy.

This is not true, however, of many of the economic problems of countries seeking credit. It cannot be denied that in many cases, and perhaps in most, a country's domestic and external difficulties have been caused by serious internal mistakes that can be rectified by taking appropriate action. Similarly, the effects of certain short-term exogenous disturbances, such as bad harvests, can be mitigated by IMF credits.

Matters are different where difficulties stem from fundamental problems in world markets that an individual country is unable to influence, however much it may wish to: rising import prices, falling commodity prices, stagnating or declining export receipts owing to a downturn in the world economy and the price and income inelasticity of demand in consuming countries (as in the case of demand for many raw materials and agricultural products), high interest rates in international credit markets, the appreciation of important trading currencies, worldwide trade protectionism, and so forth.

Difficulties also arise if fundamental structural problems prevent a country from integrating into the world market to the extent both desired and required, as now in the case of Poland. IMF conditionality can do little to improve the situation, either in the short term or in the medium term. Efforts to adjust the internal economic structure of a country to conditions in the world market must be a long-term undertaking and as a matter of principle do not fall within the domain of the IMF, however necessary they may be.

Criticism of IMF conditionality is therefore justified whenever it doctors the national symptoms of exogenous causes or tackles structural problems with short-term measures without having a medium or even long-term adjustment programme. It is precisely this that appears to have happened in the case of Poland, and Poland is no exception.

### Off Target

The action demanded by the IMF must also be scrutinised very carefully where internal causes are involved that appear to be a suitable case for borrowing subject to appropriate conditions.

It is undeniable that internal aberrations such as excessively high government expenditure, explosive money supply growth, corruption, imports of luxury goods and capital flight have caused serious problems

in all too many cases. In principle, the Fund's credit conditions are then adequate in macro-economic terms, but in micro-economic terms they hit the wrong subjects, in other words not the instigators but victims who are innocent in every respect. The arguments put forward in defence of IMF conditionality are barely tenable from this point of view.

It is argued first that the necessary price increases and the usually drastic devaluation of the national currency (50% in Poland!) do not always affect the poorest sections of the population. In most cases they do, however: for one thing, devaluation immediately increases the price of all imports in national currency terms. Quite independently of this, prices that were previously controlled often also rise rapidly: in Poland, for example, electricity charges increased fivefold overnight. The same applies to petrol, basic foodstuffs, social services, etc. The poorest in society are worst hit.

The second argument is that devaluation improves the country's export prospects. It is true that export prices expressed in foreign currency can fall as a result of devaluation, but it can hardly be assumed that this brings an improvement in international competitiveness that will benefit the poorest sections of the population. For one thing, as in the case of Poland, the range of export goods as a whole is often not very attractive, so that a reduction in export prices does not generate a corresponding increase in export demand. For another, the main benefit of any improvement in export earnings accrues not to the poorest strata but, especially where agricultural products are concerned, to large landowners (not only in Latin America) and middlemen. Most of the producers from the poor sections of society are not even directly integrated into the export trade and benefit correspondingly little from increases in exports.

Thirdly, the attempt to restore balance-of-payments equilibrium generally results in a drastic reduction in imports of goods; it is by no means primarily luxury goods that are affected but often everyday items such as replacement parts, sewing needles or food. Undoubtedly many imports are non-essential, but in many instances the range of imports cannot be compressed without calling on the poor sections of the population in particular to bear a further reduction in their already low standard of living.

Fourthly, it is argued that the distribution of the social costs of adjustment measures among the various sections of a society is a matter solely for the government concerned and that the IMF does not interfere in this regard. It does interfere however by

imposing its conditions and requirements, so why is it coy here? Leaving aside the effects of devaluation of the national currency, the poor sections of the population will yet again be hit particularly badly by any savings that have to be made. Budget cuts that make sense in macro-economic terms almost always include, in accordance with the urgent recommendations of the IMF, the abolition of consumer subsidies, subsidies granted on social grounds because of the target groups' needs, especially with regard to basic foodstuffs, rents, public transport and other social services. And who will be hardest hit by the resulting price increases and cutbacks in public services?

In addition, the reduction in government contracts, the cancellation of subsidies for business and the closure of unviable public enterprises generally leads to an increase in unemployment, which is usually already high and for which there exists no safety net that would be recognised as such in industrialised countries.

One can argue about whether IMF adjustment measures make the rich richer. The proposition is rarely stated seriously in these terms, but the fact that the consequences of the prescribed adjustment measures primarily make the poor poorer must give food for thought if the realities of the situation in the countries involved are not to be overlooked.

In general one can search in vain for signs of recognition on the part of the defenders of IMF policy that, no matter how appropriate the *macro-economic* approach of the Fund's requirements may be, their implementation is likely to distil existing economic, social and political tensions into a highly explosive cocktail. Advocates of IMF policy tend to dismiss criticism of this functional connection as groundless and ideologically biased.

This is incomprehensible, for an igniting spark (IMF conditions) is just as responsible for an explosion (in some cases popular reactions verging on civil war) as

the explosive itself (blatant internal inequalities and tensions), especially if it is known that the situation is inflammable. There is no lack of examples in this regard.

Since by the nature of its requirements (or rather "recommendations") the IMF interferes *de facto* in the affairs of a country, it is difficult to see why its demands cannot be differentiated so that they do not hit primarily the poor sections of the population. Budgetary balance could be sought perfectly well by increasing taxation on property, real estate and higher incomes, reducing expenditure on armaments and desisting from national prestige projects rather than cutting subsidies on basic goods. The IMF remains extremely reticent on this issue.

Of course, the IMF should not act as an economic pseudo-legislator infringing the sovereignty of member states. However, in its role as a balance-of-payments fire brigade it must make it difficult for actual and potential fire-raisers to play around with inflammable substances and not demand that a population that in most cases neither elected the economic pyromaniacs nor can dismiss them from office should help extinguish the fire by making sacrifices beyond their ability. Certainly an economy cannot permanently live beyond its means, no more than an individual can, but one can tighten the proverbial belt only if one has scope for economic adjustments. Sections of the population at or below the poverty line do not have that possibility.

No matter how the general debate about development proceeds or how appropriate IMF conditions in developing and other countries are judged to be, this fact will have to be taken into consideration in taking any measures aimed to support restructuring efforts. The governments that have come to power recently in some developing countries, and especially those that have assumed office in the Eastern European economies, are not responsible for the present situation of their countries, but they must now cope with it. Far-reaching adjustment measures, however necessary

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they may be, easily exhaust the goodwill of the population that has to bear the consequences. This threatens the confidence the population has in their new governments, so that they are skating on very thin ice. The impossibility of reducing existing social and economic disparities quickly enough can very easily undo the initial success of these reform efforts.

It is therefore all the more important for Western industrialised countries to try to provide support without

imposing socially harmful economic requirements and conditions. A new and yet familiar problem will then arise, in that the already inadequate assistance being given to the South – the “traditional” developing countries – will tend to be eroded in favour of support for Eastern Europe, whose development prospects are more promising in many respects. In all probability these shifts will make the nineties the decade of West-East development, while the North-South conflict will erupt again with renewed vigour.

Joachim Betz\*

## The Social Effects of Adjustment Policy in LDCs

Since the onset of the debt crisis at the beginning of the eighties the Third World countries, and especially the most heavily indebted countries of Africa and Latin America, have displayed a marked and in some cases severe deterioration in social conditions, a rising level of absolute poverty, a partial collapse of the social and physical infrastructure, an increase in crime and internal unrest. The per capita income of the heavily indebted countries has fallen by one-seventh since 1980 and that of sub-Saharan African countries by one-quarter.<sup>1</sup> In Africa the investment ratio, which gives an indication of future growth prospects, has fallen to the level recorded in the mid-sixties and in some countries it is no longer sufficient to maintain the economy's capital stock. In the most heavily indebted countries real wages are now lower than in 1982 (38% lower in Mexico and 21% lower in Brazil) and unemployment has risen considerably owing to slow economic growth.<sup>2</sup> Public expenditure has fallen by 18% in the most heavily indebted countries and public investment has been cut by 35%, damaging the prospects for growth and leading to a deterioration in the social indicators. For example, most developing countries have cut their expenditure on health care and education and reduced the quality of public services in these areas. Per capita expenditure on education in Latin America is now lower than at the beginning of the eighties and spending on equipment for educational institutions is now no more than a fraction of what it was. The same applies to the health service, with the result that the decline in infant mortality in Third World countries has slowed down and overall mortality is again rising slightly. Nutrition has also deteriorated again in many countries, not least owing to the rise in agricultural producer prices.<sup>3</sup>

There is now a wider-spread tendency in socially critical literature on the Third World to blame the adjustment programmes prescribed by the IMF or the World Bank for these adverse developments, since they all require quite severe cuts in budget expenditure and other measures to curb demand and steer the less developed economies towards exports, resulting in a fall in real wages, a temporary increase in unemployment and the destruction of domestic production capacity. Implementation of the programmes is also held responsible for the rising level of internal conflict and repression in developing societies. On the other hand, one often reads that democratisation and adjustment are irreconcilable or that only authoritarian regimes are in a position to carry out typical IMF programmes.<sup>4</sup>

### Criticism of the IMF and World Bank

These critics see the poor and the working class as the main victims of the adjustment programmes laid down by the international financial institutions, in other words the very groups that benefited least from the earlier debt-financed growth. It is claimed that they are regularly the main losers from the IMF's demand for the

<sup>1</sup> With regard to adjustment during the debt crisis, see for example World Bank: World Development Report 1984, Washington, D. C., 1984; World Bank: World Debt Tables, 1988-89 Edition, Washington, D. C., 1988; Jeffrey D. Sachs: Introduction, in: Jeffrey D. Sachs (ed.): Developing Country Debt and the World Economy, Chicago and London 1989. Figures from World Bank: World Debt Tables, 1987-88 Edition, Washington, D. C., 1987.

<sup>2</sup> Figures from World Bank: World Development Report 1988, Washington, D. C., 1988.

<sup>3</sup> Ibid.

<sup>4</sup> Cf. World Food Council: Consultations on the Food-Security Impact of Structural Adjustment, WFC/1989/4, 11th April 1989; Klaus Didszun: The Debt Crisis and IMF Policy, in: INTERECONOMICS, July/August 1988; Jandhyala B. G. Tilak: Economic Slowdown and Education Recession in Latin America, in: IDS-Bulletin, Vol. 20, 1989, No. 1.

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