The International Monetary Fund 50 Years after Bretton Woods

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In July 1944 at Bretton Woods, New Hampshire, delegates from 44 nations concluded an agreement outlining an international monetary system to be established following World War II. At the heart of that system was a proposed international organization, the International Monetary Fund, which was to monitor the system. The IMF, or Fund, began operations in Washington, D.C., in May 1946 with 39 members.

At this writing the IMF has 178 members and a record extending over nearly half a century. The purpose of this article is to survey the functioning of the institution, focusing on recent experience. Although evaluation is not the primary purpose, any seeming opportunities for substantial improvement will be considered. The article discusses the purposes of the IMF, the means and methods employed to achieve those purposes, the degree of success, and then some changes that might be desirable.

I. The Purposes of the IMF

The purposes of the IMF are set forth in the *Articles of Agreement of the International Monetary Fund*, adopted in July 1944 and amended in 1969, 1978, and 1992. They are ambitious:

> (i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
>
> (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
>
> (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

These were the original purposes of the Fund, and they remain its purposes today. Their formulation was strongly influenced by the experience of the prewar depression years, when countries raised barriers against imports and devalued their currencies in an effort to improve their balances of international payments and raise their national incomes and employment. Since one country's payments balance could be improved only at the expense of other countries, the end result was simply more instability and restrictions and less world trade and income.

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Drawing on this experience, the Bretton Woods delegates incorporated in the *Articles of Agreement* a cooperative approach toward enhancing world trade, income, and employment—an approach that eschews exchange restrictions and competitive exchange depreciation and offers loans to countries with payments difficulties so that they can refrain from these and other measures inimical to prosperity.

Nearly all of the purposes to be served by the IMF are means to a greater goal, essentially the goal of fostering economic well-being, as expressed in clause (ii) above. While it would hardly be feasible to quantify the Fund's overall contribution to economic well-being, or even to the growth of world trade, one can take encouragement from the growth in trade, which clause (ii) calls upon the Fund to facilitate. For example, between 1967 and 1993 the volume of world trade expanded at a compound annual rate of 5.3 percent, which was 1.8 percentage points faster than the growth rate of world output.[1]

The other purposes that the IMF is to pursue can be succinctly stated as international monetary cooperation, orderly exchange arrangements, restriction-free multilateral payments, and efficient balance-of-payments adjustment. The following sections discuss the means and methods employed by the Fund, and its success, in attaining these particular goals in pursuit of the greater goal of enhancing economic well-being.

II. Promoting International Monetary Cooperation

To promote international monetary cooperation, the IMF was endowed with the status of a permanent institution, and charged to provide the "machinery" for consultation and collaboration on international monetary problems. In view of this charge, it is not surprising that the highest authority of the IMF, its Board of Governors, consists for the most part of ministers of finance or central bank governors of the member countries. Each member appoints one Governor.

The rule of one Governor for each member does not mean that all members have equal authority. On joining the IMF, each member contributes a sum of money known as a quota, which can be drawn upon by the IMF to lend to members with payments problems. The bigger and wealthier is the contributor's economy, the greater is its quota, and voting power is allocated largely in proportion to the quotas. Thus, the United States now has about one-fifth of the total votes, more than any other country.

The Fund's machinery extends well beyond the Board of Governors. A so-called "Interim Committee," established some 20 years ago, provides continuing advice to the Board of Governors on the functioning of the international monetary system; and a Development Committee, established jointly by the IMF and the World Bank, provides advice on

[1] International Monetary Fund, *World Economic Outlook* (Washington, D.C.: IMF), various issues.

the special needs of poorer countries. The Board of Governors normally meets only once a year, having delegated many of its powers to the Fund's Executive Board, which conducts the organization's daily business at its headquarters in Washington, D.C. The Executive Board appoints a Managing Director, who serves as its chairperson and also heads the IMF staff of some 2,000 international civil servants.

Just what machinery does this substantial institution offer to promote consultation and collaboration on international monetary problems? To begin with, within its own walls the Executive Directors have the opportunity for face-to-face dialogue on a daily basis. And the IMF's Managing Director recently characterized the Fund's Interim Committee as "the only forum where finance ministers representing virtually the whole world meet on a regular basis" (IMF 1994b, p. 179).

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Moreover, upon joining the Fund, member countries obligate themselves to supply such information as the Fund deems necessary for its activities, including data on national income, prices, balance of payments, foreign exchange rates, and so forth, and the Fund is authorized to act as a center for the collection and exchange of information on monetary and financial problems. In addition, the Fund is directed to cooperate with other international organizations having responsibilities related to those of the Fund. More generally, many activities of the Fund either require, or afford the opportunity for, consultation and collaboration among the members.

But the IMF is not the only international forum for consultation and collaboration on international monetary issues. Several other organizations with smaller memberships play notable roles. Among the industrial countries, for example, the Organisation for Economic Cooperation and Development (OECD), as well as the Bank for International Settlements (BIS), have well-established functions. The OECD, with 25 member countries, was established in 1960 to promote policies favoring high economic growth and employment, financial stability, and nondiscriminatory international trade. The BIS acts as a central bankers' bank. In addition, the Group of 7—the United States, Japan, Germany, France, Italy, the United Kingdom, and Canada—hold periodic meetings of their chief officials at which their respective economic policies are considered and debated. And the member countries of the European Union are striving for the ultimate in collaboration: full monetary union.

While all of these organizations seek to promote international monetary cooperation, their other purposes are not fully identical, and their constituencies differ. With its vast membership, the IMF has by far the largest purview. Moreover, in compliance with its mandate, the Fund does cooperate with the other organizations. A noteworthy example is the assistance it provides to the G-7 deliberations, for which it constructs indicators of economic performance, projects future performance, and represents the interests of non-participating countries.

The bulk of the technical assistance provided by the IMF, however, goes not to the relatively advanced economies such as the G-7, but to the less developed and to those struggling to convert from centrally planned to market economies. This assistance is supplied through several different mechanisms, most prominently the IMF Institute and IMF advisory missions. The Institute offers training for officials from member countries both at its Washington headquarters and abroad, including a facility recently established in Vienna as a cooperative venture between the Fund and other international organizations. Technical assistance missions to participating countries provide instruction in subjects such as fiscal, monetary, and foreign-exchange management, and in related legal and statistical matters.

Largely because of requests from countries in the former Soviet bloc that are introducing freer markets, a virtual explosion has occurred in IMF technical assistance in recent years. In fiscal year 1993 the Fund dispatched 606 technical assistance missions, 336 more than in fiscal 1989 (IMF 1994b, p. 170). This surge in demand suggests that the organization is doing at least one thing reasonably well, although the fact that recipients pay nothing means that the technical advice does not have to meet the test of the marketplace.

More broadly, how successful has the IMF been

in promoting international monetary cooperation? At a minimum, the organization must be credited with providing the machinery. One dramatic illustration of this machinery at work is afforded by the international debt crisis that erupted in 1982 when many developing countries verged on defaulting on huge debts owed to foreign creditors. The IMF played a pivotal role in helping to arrange financing, as well as adjustment programs, to enable the debtor countries to avert defaults that could have bankrupted major creditor banks, whose collapse might have precipitated severe recessions.

More light will be shed on the Fund's role in promoting monetary cooperation in following sections that deal with the organization's other purposes, since progress in attaining those purposes also fosters monetary cooperation. In the final analysis, whether the Fund's members utilize its machinery for cooperation is largely up to them, not the Fund, which has no power to coerce them to do so.

III. Maintaining Orderly Exchange Arrangements

The goal of exchange stability, orderly exchange arrangements, and avoidance of competitive depreciation has posed a major challenge to the IMF and its membership. Over the years the exchange rate system has changed dramatically, and with it the role of the Fund.

The Bretton Woods Par Value System

Largely because of the exchange instability and competitive depreciations experienced during the Great Depression, the original *Articles of Agreement* establishing the IMF called for essentially fixed rates of exchange between national currencies, on the assumption that fixed exchange rates would foster international commerce and cooperation. In order to maintain fixed exchange rates, most governments specified "par values" for their currencies in terms of the U.S. dollar; they then bought or sold their currencies in exchange for dollars whenever necessary to prevent the dollar values of their currencies from deviating from the par values by more than 1 percent. With the values of other currencies thereby fixed in terms of the dollar, it was unnecessary for the United States to fix the value of the dollar in terms of other currencies. Instead, the obligation assumed by the United States was to fix the value of the dollar in terms of gold for purposes of transactions with foreign monetary authorities. The United States was to supply gold in exchange for dollars presented by these authorities—or to supply dollars in exchange for gold—at the official price of gold, originally set at $35 per ounce.

To make the par value system work, each government held a stock of international reserves—usually gold or dollars. A government could draw upon these reserves (or upon loans from the International Monetary Fund) to purchase its currency whenever necessary to stop a decline in the foreign-exchange value of its currency. If the currency subsequently tended to rise in value, the government would then reacquire reserves that it had previously paid out. (Of course, such reserve transactions would not have occurred, and reserves would not have been necessary, if governments had not chosen to fix the value of their currencies in the foreign-exchange markets. Instead, foreign-exchange rates would have fluctuated freely.)

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Countries experiencing relatively sizable reserve losses or gains were expected to undertake corrective macroeconomic policies. For example, a country with reserve losses (balance-of-payments deficits) might institute more restrictive monetary and fiscal policies, both to restrain demand for imports and to reduce domestic inflation so as to enhance the price competitiveness of its goods in world markets. However, no country was expected to suffer severe unemployment in order to right its balance of payments. Instead, it was allowed to alter its exchange-rate parity to help improve its international competitiveness if its balance of payments was in "fundamental disequilibrium."

The presumption was clearly against such exchange-rate changes, however. A country was permitted to change its original par value by a total of no

more than 10 percent at its own discretion, and for changes beyond that 10 percent it was obliged to seek the approval of the IMF. The Fund was to acquiesce only if it found that the proposed change was necessary and of the proper magnitude, and it could impose certain economic sanctions against countries that defied its decisions.

The par value system worked reasonably well for more than two decades. By the early 1970s, however, its time had clearly come. The United States had incurred large balance-of-payments deficits, and foreign central banks had accumulated dollar balances well in excess of U.S. gold holdings. Confidence dwindled in the ability of the United States to redeem these dollar holdings for gold, and on August 15, 1971, the threat of a run on U.S. gold reserves led the Nixon Administration to suspend its willingness to make such redemptions. More generally, in response to powerful market forces, governments became obliged to allow their exchange rates to change much more, and more often, than contemplated under the par value system. By the spring of 1973, exchange-rate variation had clearly become a primary means of balance-of-payments adjustment, and for all practical purposes the par value system had been abandoned.

Should the IMF, which was to monitor the system, be held responsible for its collapse? Did the organization fail to fulfill its purpose of promoting exchange stability, maintaining orderly exchange arrangements, and avoiding competitive depreciations?

Both at the time and with the perspective of history, the Fund has generally been held relatively blameless. The par value system contained the seeds of its own destruction, fundamental flaws of design that doomed it regardless of the performance of the IMF. One major flaw was the failure to provide an appropriate supply of an acceptable form of international reserves. Another was *too much* emphasis on exchange stability, that is, a failure to accept exchange-rate change as one of the standard remedies for imbalances in international payments. As time passed, it became clear that governments were unwilling to rely solely on monetary and fiscal policy to correct such imbalances, and that the par value system lacked an effective balance-of-payments adjustment mechanism.

A Composite System

Even though the demise of the par value system had become obvious by 1973, it was not until 1976 that a successor was formally acknowledged by the international community. In January of that year, a committee representing the member countries of the IMF gave its blessing to proposals that would amend the IMF *Articles of Agreement*, both to legitimize the new exchange-rate flexibility and to make other fundamental changes. On April 1, 1978, these amendments entered into force, with significant consequences for the role of the Fund.

While the current international monetary system differs from the par value system in several respects, by far the most important is the greater degree of exchange-rate flexibility. On the other hand, no government has gone to the extreme of allowing its currency's foreign-exchange value to float completely freely in the market; all governments continue to intervene by buying or selling their currencies, some more vigorously than others, in order to influence the exchange rates for their currencies. In fact, on or about December 31, 1992, the governments of 88 countries belonging to the IMF were pegging the exchange rates for their currencies to some other currency or composite of currencies, while 12 others were pursuing a policy of limited flexibility. A smaller number, 78 in all, were allowing their exchange rates to vary more freely (IMF 1993b, pp. 590–96). Therefore, while exchange rates are much more flexible than under the par value system, substantial official intervention still occurs in the foreign-exchange markets, and many governments still fix the rates of exchange for their currencies over fairly extended periods of time. In brief, the current system is not at all "pure," but is a hybrid, or composite—combining the characteristics of both fixed and flexible exchange rates.

Exchange rates now are much more flexible than under the par value system, but substantial official intervention still occurs in the foreign-exchange markets, and many governments still fix rates of exchange over fairly extended periods of time.

The 1978 amendments to the *Articles of Agreement* sanction these diverse exchange-rate practices, but they also include some general principles of good behavior that IMF members are expected to observe with respect to exchange rates. Specifically, each member agrees to cooperate to assure "orderly" exchange arrangements, especially by promoting orderly underlying economic and financial conditions and by refraining from exchange-rate manipulation designed either to prevent balance-of-payments adjustment or to gain unfair competitive advantage in international trade. Moreover, the IMF is charged with overseeing the adherence of its members to this code of good behavior and with spelling out the code in more detail. Accordingly, the Fund has added to the code of behavior the following principles (as quoted by Crockett and Goldstein 1987, p. 80):

> A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.
>
> A member should intervene in the exchange market if necessary to counter disorderly conditions which may be characterized inter alia by disruptive short-term movements in the exchange value of its currency.
>
> Members should take into account in their intervention policies the interests of other members including those of the countries in whose currencies they intervene.

The IMF has also adopted some guidelines to assist it in judging whether its members are adhering to the foregoing code. These "principles of surveillance over exchange rate policies" call for the IMF to be wary of the following developments (Crockett and Goldstein 1987, pp. 80–81):

> (i) protracted large-scale intervention in one direction in the exchange market;
> (ii) an unsustainable level of official or quasi-official borrowing, or excessive and prolonged short-term official or quasi-official lending, for balance of payments purposes;
> (iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or
> (b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;
> (iv) the pursuit, for balance of payments purposes, of monetary and other domestic financial policies that provide abnormal encouragement or discouragement to capital flows; and
> (v) behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long-term capital movements.

If the Fund suspects a member country of violating the code of exchange-rate behavior, consultations are held with that member. In principle, a serious offender could be denied the right to borrow from the Fund and could eventually be expelled from the organization.

No country has been subjected to such punishments for its exchange-rate policies. Although the IMF consults regularly with its members concerning, among other things, their exchange-rate practices, suspected violations of the exchange-rate code have been minor or nonexistent or have been fairly quickly resolved, because the public record reveals no significant confrontations. This quietude is reassuring, because serious, persistent offenses would almost surely have been publicized, if not by the IMF, then by countries that considered themselves injured or wrongly accused.

The Fund deserves recognition for promulgating a code regarding exchange-rate behavior and for holding regular discussions with members regarding their exchange-rate policies.

How much credit the IMF should receive for this apparently good behavior is an open question. At the least, the Fund deserves recognition for promulgating a behavioral code and for holding regular discussions with members regarding their exchange-rate policies. It is hard to see how these measures could have failed to exert a salutary impact.

IV. Facilitating Multilateral Payments

The mechanisms used to make payments across national boundaries comprise a key component of the international monetary system. Without an efficient means of making these payments, the international exchange of goods and services would be impeded, and world prosperity would be diminished. The

fourth stated purpose of the IMF stems from recognition of this fact.

Upon joining the IMF, countries obligate themselves to remove any restrictions they may have on payments for current international transactions as soon as their international balances of payments will permit. Failure to honor this agreement could precipitate suspension of their borrowing privileges and, eventually, expulsion from the Fund. Members that have no such restrictions are not to impose them without Fund approval. Similar bars apply to discriminatory currency practices.

A currency that can be used without restriction to make international payments for goods, services, and other current items (as distinct from capital items such as securities) is generally considered to be "convertible." For a currency to attain this status, its holders must be allowed to convert it without limit (again, for current transactions) into other countries' currencies at the going market exchange rates. At the time the *Articles of Agreement* were drafted, restrictions limiting such conversion were widespread, and achieving general convertibility has been the prominent means through which the IMF has sought to facilitate multilateral payments.

Convertibility not only promotes international trade, but also yields other related benefits that may not be so obvious. Once a country's currency can be used freely to acquire foreign currencies (and foreign goods and services), competition will bring the prices of the country's own goods and services into line with prices in world markets, other things equal. Thus, the country's consumers will be able to buy tradable goods at the lowest world cost, while the country's producers will concentrate on supplying the goods that they can produce at those costs. In addition, the removal of government restrictions on the use of a currency eliminates the administrative costs and incentives to corruption associated with such restrictions.

How successful has the IMF been in propagating currency convertibility? By the end of 1946, the organization's first year of operation, only four member countries had officially established such convertibility. Not until the early 1960s did the bulk of the industrial countries embrace convertibility, and thereafter countries did so at a rate of about three per year. In 1993, however, eight countries joined in, bringing the cumulative total to 82 (Nsouli 1993).

The number of countries that have adopted convertibility is not so informative as the percentage of the world's commerce they transact. As can be seen

Figure 1

Percent of World Imports Accounted for by IMF Member Countries Accepting Article VIII Convertibility Obligations and Having No Restrictions on Payments for Current Transactions

Five-Year Intervals, 1957 to 1992

Source: *International Financial Statistics*, taken from Board of Governors of the Federal Reserve System, FAME data base.

in Figure 1, that percentage has risen, albeit irregularly, from only 23 percent in 1957 to nearly 85 percent in 1992. Not all of the Fund's members have embraced convertibility; but those that had done so by 1992 accounted for 88 percent of the total trade of all members.

It is unlikely that the same progress would have occurred without the obligations imposed by the IMF upon its membership. But even though the Fund may have had considerable long-term success in fostering convertibility as conventionally defined, much remains to be done. The conventional definition of convertibility applies only to current transactions, but essentially the same argument that justifies the freeing of payments for current items also justifies the freeing of payments for capital transactions. Yet IMF members that have adopted capital-account convertibility account for a much smaller share of the world's commerce than do the members that have adopted current-account convertibility (Figure 2).

Figure 2

Percent of World Imports Accounted for by IMF Member Countries with No Restrictions on Payments for Capital Transactions

Five-Year Intervals, 1967 to 1992

Source: See Figure 1.

To be sure, facilitating multilateral payments for capital transactions is not among the IMF's chief purposes, so the relative lack of progress in this area does not imply that the organization is failing to fulfill its primary mandate. That mandate should now be expanded with a view to promoting a more efficient allocation of the world's capital resources. Specifically, the *Articles of Agreement* should be amended to establish a strong presumption in favor of unrestricted capital, as well as current, transactions, with sanctions applicable against member countries that cling to such restrictions. Fortunately, precedent exists for amending the *Articles*; it is recognized that they are not carved in stone.

V. Eliminating Balance-of-Payments Disequilibria, and Easing Balance-of-Payments Adjustment through Lending

Of all its purposes, the one for which the IMF is best known is the elimination of balance-of-payments disequilibria, with the process to be eased by Fund lending that enables deficit countries to avoid taking measures destructive of prosperity. Although this purpose is listed as two separate purposes in the *Articles of Agreement*, the two are so intimately coupled that they are treated here as one. Like the other purposes of the IMF, this one is designed to serve the higher goal of enhancing economic well-being, in this case by facilitating the process of balance-of-payments adjustment.

The Rationale for Balance-of-Payments Lending

A country that is incurring balance-of-payments deficits which deplete its international reserves must take measures to stanch the deficits. One option for the country would be to abandon the practice of spending its reserves to support the value of its currency in the foreign-exchange markets, thus allowing its currency to depreciate and raise the domestic price of imported goods. Another option would be to pursue a more contractionary macroeconomic policy, such as a more restrictive monetary policy. Or controls might be imposed to restrict the purchase of foreign goods or securities.

Whatever course of action is taken, the end result typically must be slower growth, or reduction, in the country's aggregate demand for goods and services, thereby allowing a decrease in the country's imports and/or an increase in its exports. If this adjustment must be taken abruptly, it likely will impose higher costs and more social disruption than if taken more gradually. For example, a sharp tightening of monetary policy that generated a steep contraction in demand could reduce imports rapidly—but before workers and capital had time to shift appreciably into the production of goods to be exported or to replace imports, and out of the production of other goods and services. The ensuing unemployment would not only be a waste of productive resources, but could generate political opposition that would force a premature reversal of the government's balance-of-payments adjustment program.

Such harsh adjustment measures also tend to diminish economic welfare in any foreign nations that experience sharp decreases in their exports to the deficit country. These nations, too, would benefit from a more gradual correction. Even thornier international problems could arise if the deficit country were to introduce controls as part of its adjustment program. In particular, if the country were to erect higher barriers against its imports as part of its adjustment program, the nations whose exports were

impacted might well retaliate with barriers of their own, perhaps leaving all concerned even worse off.

It was to forestall such economic losses that the IMF was directed and enabled to undertake balance-of-payments adjustment lending. An IMF loan bolsters a deficit country's international reserves and thereby empowers it to prevent or moderate the decline of its currency in the foreign-exchange markets while the country's resources are shifting toward the production of goods to be exported and to replace imports. In providing for such loans, the founders of the IMF sought to relieve deficit countries from having to take measures that would eliminate their deficits abruptly at excessive cost to themselves and sometimes to other nations as well.

The Lending Programs of the IMF

As the years have passed, the facilities, or lending programs, offered by the IMF have increased in number, chiefly to accommodate the payments difficulties faced by developing countries or by countries shifting from centrally planned to freer market economies. Currently, members may apply for loans from their credit tranches (percentages of their quotas), from the extended Fund facility, the compensatory and contingency financing facility, the buffer stock financing facility, the systemic transformation facility, the structural adjustment facility, or the enhanced structural adjustment facility.[2]

The IMF is best known for its work in combating balance-of-payments disequilibria through conditional lending that helps deficit countries avoid taking measures destructive of prosperity.

To ease the balance-of-payments adjustment process is the underlying purpose of all these loan programs, but some, as their names suggest, are tailored to fit specific kinds of adjustment problems. The standard credit tranche loan is to be repaid within five years or less, while the extended Fund facility issues loans with durations as long as 10 years, for longer-term adjustment problems. The compensatory and contingency financing facility offers loans with terms of up to five years to offset shocks arising from events beyond the borrower's control, such as temporary shortfalls in export earnings and increases in import prices or world interest rates. (Natural disasters are dealt with through emergency assistance loans.) From the buffer stock financing facility, loans are made to help relieve the strain on a member's balance of payments from making contributions to approved buffer stocks of commodities, again with repayment due in five years or less.

The remaining facilities are designed more specifically for particular categories of countries. For countries undertaking the difficult transition from central planning to freer markets, the systemic transformation facility extends loans of up to 10 years to help offset payments deficits arising from the shift away from trading at nonmarket prices toward trading at world market prices. For low-income developing countries, both the structural adjustment facility and the enhanced structural adjustment facility offer loans at extraordinarily low interest rates, again with maturities as distant as 10 years.

The funds for these various loan programs come from the IMF's members, primarily from their quota subscriptions. Not only do the members pay such subscriptions upon joining, but they have agreed to increase them a number of times to finance a larger volume of loans in keeping with the growth of the world economy and other changes in economic conditions. In addition to tapping the quotas, the IMF borrows from its members to finance its lending activities, and has obtained voluntary contributions to fund the structural and enhanced structural adjustment facilities.

Although the Fund's loans are intended to provide a helping hand and are sometimes made on highly concessional terms, they are not to be converted into grants. The statement of the IMF's purposes specifies that the Fund's financial resources are to be made available to the members "temporarily . . . under adequate safeguards." In other words, the Fund is to make only those loans that can prudently be expected to be repaid. Consequently, before ex-

[2] See *IMF Survey: Supplement on the IMF*, Vol. 22 (October 1993); International Monetary Fund, Treasurer's Department, *Financial Organization and Operations of the IMF*, 3d ed. (Washington, D.C.: IMF, 1993); and *International Monetary Fund Annual Report 1993* (Washington, D.C.: IMF, 1993), esp. pp. 58–59.

tending a loan, the IMF requires the applicant country to describe how it intends to correct its payments problem so that it will be able to repay the loan punctually. This practice of conditioning loans upon corrective policy measures has become known as "conditionality."

To aid in monitoring the progress of the corrective process in the borrowing country, the Fund uses objective indicators, or performance criteria. Among the items commonly subjected to such criteria are the magnitude of domestic credit, the public sector deficit, international reserves, foreign debt, the foreign exchange rate, and interest rates. Thus, ceilings may be agreed with the borrower for the amount of domestic credit to be issued or for the size of the public sector deficit, and targets may be set for the level of international reserves and foreign debt. Loan disbursements to be made to a borrower over a period of time may be withheld until the criteria are met.

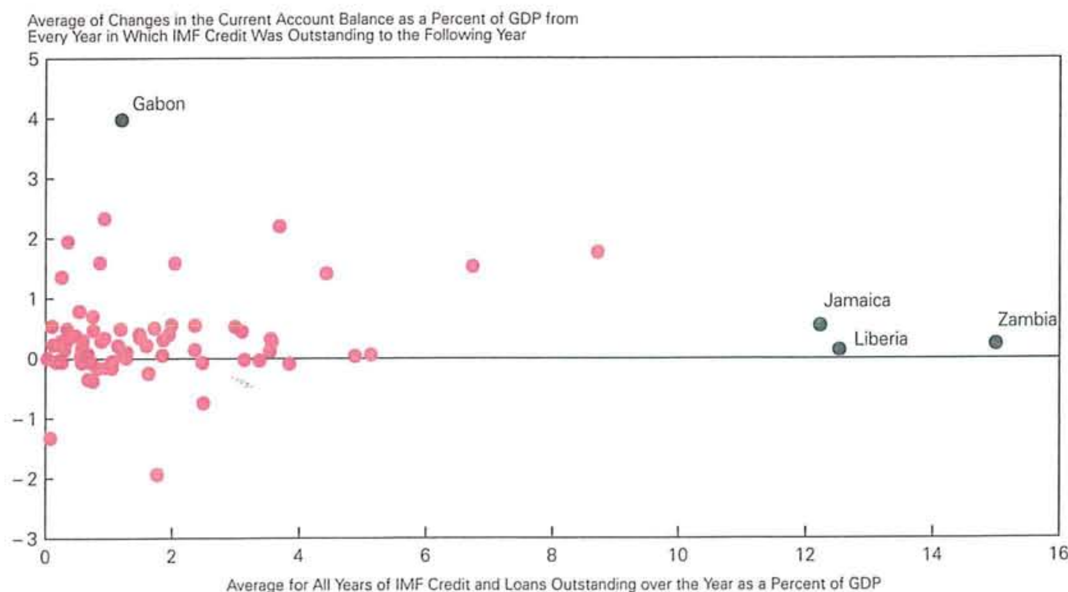
Success of the Lending Programs

How successful have the IMF's lending programs been in facilitating balance-of-payments adjustment? To answer this question, it is not enough to know how the balances of payments and economies of the borrowing countries have actually behaved, for that behavior might be attributable largely to influences other than the IMF's programs—influences that were hardly foreseeable at the time the loans were disbursed. To know what difference the Fund's lending programs have made, one must also know, among other things, how the balances of payments and economies of the borrowers would have behaved in the absence of the loans.

More precisely, what is needed in order to evaluate fully the effects of the IMF's lending programs is an accurate macroeconometric model of every borrowing country, including equations that specify the

Figure 3

Average for All Years of IMF Credit and Loans Outstanding over the Year (as a Percent of GDP) and Average of Changes in the Current Account Balance (as a Percent of GDP), for 73 Countries, 1982 to 1990



Note: GDP is expressed in terms of current U.S. dollar purchasing power parity.
Source: IMF credit and current account balance data are from *International Financial Statistics*, from FAME data base; GDP data are from Summers, Robert & Alan Heston, *Penn World Table*, June 15, 1993.

policies the country's officials would have pursued without receiving Fund loans. Not only must the model be conceptually correct, but the data used to operate it must be reliable. No such modeling effort has even been undertaken, let alone completed, given the difficulties of constructing accurate models, the number of countries involved, and the widely varying quality of the available data.

In view of the difficulties, it is not surprising that definitive evaluations of the IMF's lending programs have yet to be produced. The tentative evaluations that have been performed offer mixed and dubious verdicts. For example, two of the more sophisticated appraisals, by economists within the IMF itself, have reached contrasting conclusions. One found that Fund lending programs typically produced no significant effects on the borrower's balance of payments, rate of inflation, or economic growth (Goldstein and Montiel 1986). The other found an improvement in the balance of payments, no significant effect on the rate of inflation, and some decline in the rate of economic growth (Khan 1990, esp. p. 222).

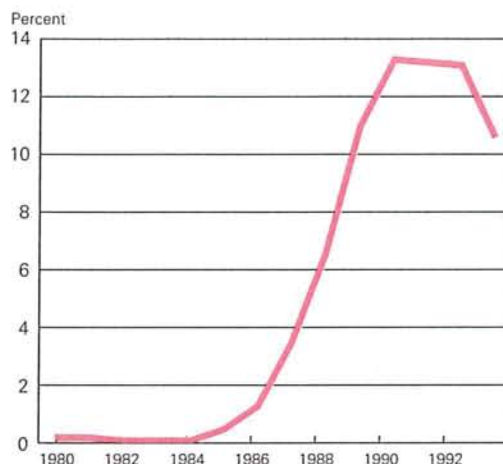
In such circumstances, when macroeconometric modeling is not feasible, less demanding analytical techniques can sometimes be fruitfully employed. Thus, Figure 3 depicts the relationship between the volume of Fund credit outstanding and the change in the international current account balance for each of 73 countries—a relationship that is key, since the primary goal of Fund lending programs is to facilitate reduction of balance-of-payments deficits. Both the credit outstanding to a country and the change in the country's current-account balance are expressed as percentages of the country's gross domestic product, and both percentages are averages of the yearly percentages for the entire period. This use of averages should smooth out random and cyclical variations and help to reveal the impact of the Fund's lending programs.

If Fund lending programs served to improve the current-account balances of the assisted countries, the points plotted in this chart would form an upward sloping pattern, other things equal. In fact, no connection seems to exist between the amount of Fund credit outstanding and the change in the typical country's current-account balance during the following year. Basically the same result is obtained if change in the current-account balance is measured for the same year as the credit outstanding rather than for the following year.[3] While hardly conclusive, this finding is somewhat disappointing. It reinforces the doubts raised by other studies, such as the ones already cited in this section, about the efficacy of Fund lending programs.

Figure 4

Arrears to the Fund of Members with Obligations Overdue by Six Months or More, as a Percentage of IMF Credit and Loans Outstanding

April 30, 1980 to 1993



Source: See Figure 1.

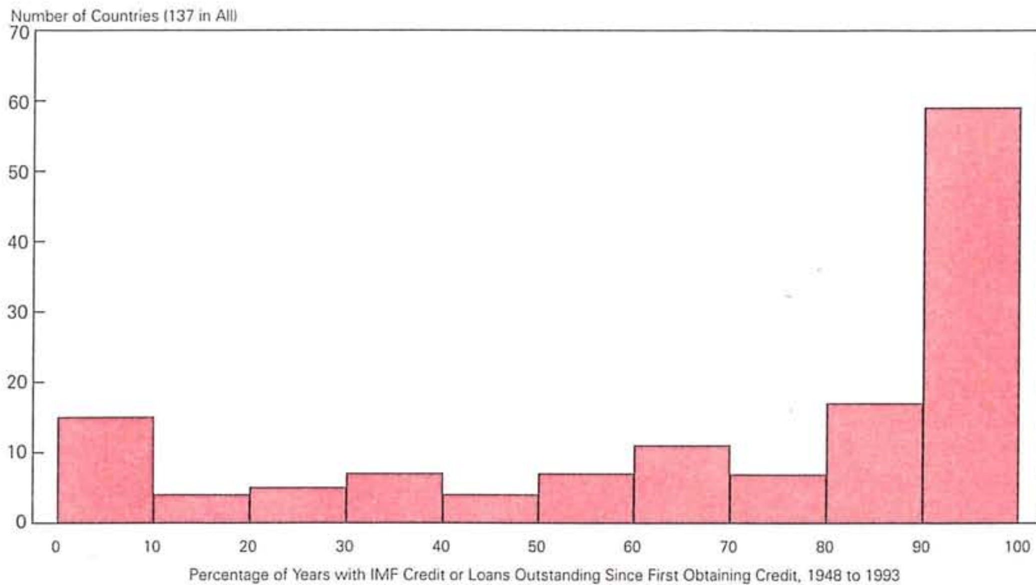
One very simple but important test of the IMF's lending programs is whether the loans have generally been repaid on schedule. Not only is the Fund charged with the responsibility of collecting its loans, but any failures to do so would establish a presumption that the loans in question had not achieved their purpose of facilitating correction of the borrowers' payments deficits. The longer overdue the loan, the stronger would be this presumption.

As can be seen in Figure 4, during the latter 1980s arrears to the Fund of six months or more rose sharply, mounting to more than 13 percent of total Fund credit and loans outstanding, and declining only to roughly 11 percent in 1993. The preponderance of this increase was owed by countries such as Liberia, Peru, Somalia, Sudan, and Zambia, which experienced extreme misfortune, including civil strife.

[3] The simple correlation coefficient is 0.10 in the first case and 0.04 in the second.

Figure 5

Countries Grouped by the Percentage of Years with IMF Credit Outstanding since First Obtaining Credit, 1948 to 1993



Source: See Figure 1.

While it would be unreasonable to expect the IMF fully to foresee such calamities, the rapid escalation of arrears is nonetheless somewhat disquieting.

Still another approach to this issue is to determine the frequency with which a country typically borrows from the Fund. Do recipients of IMF loans free themselves from IMF support by correcting their balance-of-payments deficits, or do they become dependent on IMF credit, borrowing from the Fund year after year? More precisely, once countries secure their first credit from the IMF, in what percentage of the following years do they obtain credit?

Of the 137 countries represented in Figure 5, 60 borrowed from the IMF in 90 percent or more of all the years following the year when they first borrowed, and 52 of these 60 borrowed in every following year. For both sets of countries, the median number of years of borrowing was 17. Well over half of the 137 countries—77, to be exact—borrowed from the Fund in 80 percent or more of all the years following their first borrowing. These findings suggest a pattern of chronic balance-of-payments deficits and dependency on Fund loans, raising further question about the success of the IMF's lending programs.

Such appraisals of the lending programs are suggestive, but hardly conclusive. A far better approach would consist of case-by-case analyses. The body best situated to undertake such analyses is the Fund itself. This is not to say that the IMF fails to perform any detailed evaluations of its programs. Much more, however, could usefully be published.

In this area the IMF might well follow the example set by its sister institution, the World Bank, which was also established at Bretton Woods in 1944. Each year the Bank publishes a volume entitled *Evaluation Results*, which presents the Bank's overall assessment of performance on recently completed projects that it helped to finance in less developed countries. In addition, fairly detailed performance evaluations for various projects are issued throughout the year.[4]

[4] These are entitled *OED Précis*.

These self-examinations by the World Bank have a candid tone. For example, *Evaluation Results for 1991* includes the following conclusions (pp. xv and xvii):

> The overall downward trend in project performance . . . has continued. Sixty-three percent of the 1991 cohort projects were rated "satisfactory." This compares with 68 percent for all operations assessed between 1988 and 1990. . . .
>
> . . . assessment . . . confirms the persisting need both for borrowers to improve project preparation and implementation and for the Bank to improve project appraisal and supervision . . .
>
> . . . there is a need for the Bank to improve its analysis of project risks and strengthen its assessment of the role of institutional and political factors in project performance so as to avoid excessive optimism in project appraisal.

Similar published assessments by the IMF would help outsiders to frame better-informed judgments on how well the organization is using the funds contributed by their countries to fulfill its stated purposes. The chief goal of such assessments, however, would be not simply to evaluate performance, but to improve it.

VI. Conclusion

Fifty years ago, while World War II was still raging, 44 nations agreed upon a postwar international monetary system. A crucial component of that system was the newly established International Monetary Fund, which was to foster economic prosperity by promoting international monetary cooperation, orderly exchange-rate arrangements, restriction-free multilateral payments, and efficient balance-of-payments adjustment. While the means and methods used by the Fund to pursue these goals have changed with the times, the goals have remained the same.

To promote international monetary cooperation, the IMF carries on a number of endeavors. Among other things, it affords ample opportunity for discourse among its 178 members, cooperates with other international organizations having related responsibilities, and provides technical assistance both in monitoring and forecasting world economic developments and in managing fiscal, monetary, and foreign-exchange affairs. Thus, the Fund does provide impressive machinery for international monetary cooperation. How effectively its members use that machinery is essentially their responsibility, not that of the IMF, which is charged simply with promoting cooperation, not with the authority to coordinate.

The Fund's role in promoting orderly exchange-rate arrangements changed dramatically as the Bretton Woods par value system gave way to a composite system incorporating much greater exchange-rate flexibility. The Fund could hardly be held responsible for the collapse of the par value system, whose fragility stemmed chiefly from fundamental flaws of design. To foster orderly exchange arrangements under the composite system, the IMF has, among other things, promulgated a code of behavior for its members to observe, and has conducted regular discussions with them concerning their exchange-rate policies. It is encouraging that significant violations of the code seem to have been rare or nonexistent.

Fund members should now enlarge the purposes of the organization to embrace the abolition of restrictions on payments for capital, as well as current, transactions.

The chief means employed by the IMF to facilitate multilateral payments has been to secure the removal of restrictions imposed by its members on payments for current international transactions. In this endeavor the Fund has made great progress, although over a period of many years. Its members should now enlarge the purposes of the organization to embrace the abolition of restrictions on payments for capital, as well as current, transactions.

To foster orderly, efficient balance-of-payments adjustment, the IMF makes loans to many nations that need to correct their balance-of-payments deficits. Evaluating the efficacy of these loan programs is very difficult, but the relatively high level of arrears, the chronic nature of balance-of-payments deficits and borrowing on the part of many countries, and the results of statistical studies all suggest that the programs have had very limited success. A first step toward improving this performance would be for the Fund to issue fairly detailed evaluations of its lending programs, including case studies. Similar evaluations of the technical assistance programs would also be fruitful.

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