The Conditions Attached to Adjustment Financing; Evolution of the IMF Practice

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Introduction

For more than three decades the conditionality attached to the use of the IMF resources in some of its operations has been one of the most controversial issues in the academic and political circles of Latin America and other parts of the world. It has equally been the subject of learned academic articles, political campaign speeches, or graffiti.

The term "conditionality" does not refer to the many obligations and conditions that a member country has to comply with in order to continue being a member of the Fund in good standing (as, for example, the obligation to furnish economic information, or to make punctual repurchases or other conditions in the SDR Department). Rather, as Sir Joseph Gold has defined it, "conditionality in the IMF refers to the policies the Fund expects a member to follow in order to be able to use the Fund's general resources."[1] That is, it encompasses the economic policies and other measures and decisions the institution expects a member country to adopt, maintain, or avoid, when making such use, under certain circumstances. More specifically it refers to conditions attached to such use when the resources are those of the General Department (as opposed to the SDR Department) and, in particular, when such use causes the Fund's holdings of the member currency to increase above its quota, to the so-called "upper credit tranches."

The basic reasons for this conditionality are to ensure that the IMF resources are used in accordance with the purposes of the Fund and to maintain the revolving character of those resources. For these reasons the Fund, in turn, is required by member countries to make its general resources "temporarily available to them under adequate safeguards."[2]

The conditonality attached to the use of Fund resources has been an evolving concept which grew and developed through the practice of the IMF, rather than by explicit definition, agreement, or description in the Articles of Agreement. In fact, the word has not appeared in any of the three versions of the successively amended Articles and, until the first amendment (1969), when the Fund was legally required to have policies on the use of its resources (without defining them), voices questioned its legal capacity to impose conditionality. Or as Sir Joseph Gold has said:

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[1]Joseph Gold (1979) p.1.

[2]IMF, "Articles of Agreement," Article I (v).

> The desirability of a concept of conditionality is usually accepted, and the legal necessity for it cannot be questioned at all since the date of the First Amendment...[3]

implying that those voices have been probably misled by the lack of precision of the original Articles.

Prehistory[4]

At the Bretton Woods Monetary and Financial Conference in 1944, there was little discussion of the issue of conditionality.

The revised version of the American proposal issued by the U.S. Treasury department and entitled "Preliminary Draft Outline of a Proposal for an International Stabilization Fund of the United and Associated Nations" (revised July 10, 1943, i.e., one year before the Conference) contained certain provisions implying specific policy conditionality.

Its Preamble stated that

> The resources of the Fund would not be used to prolong a basically unbalanced international position. On the contrary, the Fund would be influential in inducing countries to pursue policies making for an orderly return to equilibrium.[5]

Section V.2 of the outline stated that the Fund could sell to any member the currency of any other member provided that there was a balance of payments need ("predominantly on current account") and Fund holdings of the member's currency were below 150 percent of quota during the first year or below 200 percent of quota thereafter. These two limits called the "permissible quota" could, however, be exceeded but only if at least one of the following two conditions was met:

> (i) In the judgment of the Fund satisfactory measures are being or will be taken by the country whose currency is acquired by the Fund, to correct the disequilibrium in the country's balance of payments; or
>
> (ii) It is believed that the balance of payments of the country whose currency is acquired by the Fund will be such as to warrant the expectation that the excess currency holdings of the Fund can be disposed of within a reasonable time.

Furthermore, when in the judgment of the Fund a member (whose currency holdings by the Fund exceeds its quota) "is exhausting its permissible quota more rapidly than is warranted" or is using the Fund resources to prevent or delay a sound balance in its international accounts, "the Fund may place such conditions upon additional sales of foreign exchange to that country as it deems to be in the general interest of the Fund."[6]

[3]Joseph Gold (1979) p. 14.

[4]It seems appropriate for a paper presented at Bretton Woods, N.H., 40 years after the now historical Monetary and Financial Conference of July 1-22, 1944, to give some emphasis to the prehistory of the Fund.

[5]*Proceedings,* Vol. II, page 1601.

[6]Ibid., p.1606.

So in this second version of the American proposal, unless there was a strong belief on the part of the Fund directors that the imbalance will reverse itself within a "reasonable time," specific conditionality in terms of "satisfactory measures" to be taken applied essentially to purchases that would cause the Fund holdings of the member's currency to go beyond its "permissible quota," that is, purchases increasing those holdings beyond the 200 percent of the member's quota (the "permissible quota" of 150 percent of quota would only apply temporarily during the first year of operation of the Fund). But there was also the possibility of specific policy conditions being asked beyond the 100 percent of quota in case of accelerated use of "permissible quotas" or misuse of resources to prevent or delay external adjustment.[7]

Almost at the same time of publication of the original American version, the British government published its proposal for an International Clearing Union through the BIS (the British Information Service). This proposal was basically nonconditional. Its preface stated:

> There should be the least possible interferences with internal national policies and the plan should not wander from the international terrain. Since such policies may have important repercussions on international relations they cannot be left out of account. Nevertheless, in the realm of internal policy, the authority of the governing board of the proposed institution should be limited to recommendations, or, at most, to imposing conditions for more extended enjoyment of the facilities which the institution offers.[8]

An interesting feature of the Plan was that conditionality and adjustment were to be as symmetrical as possible.

> In recognizing that the creditor as well as the debtor may be responsible for a want of balance, the proposed institution would be breaking new ground.
>
> We need a system possessed of an internal stabilizing mechanism, by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium in either direction, so as to prevent movements which must create for its neighbours an equal but opposite want of balance.[9]

The principle of symmetry was also emphasized by the special charge of 1 or 2 percent per annum that members should pay on the amount of their annual average debtor or creditor balances if they were larger than 25 or 50

[7]The revised version of the American proposal was prepared at the U.S. Treasury after consulting on the first version with experts from nearly 30 countries. However, the basic ideas and most of the language remained as it was in the original American version, which appeared three months before the revised version. The only significant differences on this matter are that the Board's decision to exceed the 200 percent of quota in the original version required a four-fifths majority, instead of a simple majority, and that the country making the purchase "agrees to adopt and carry out measures recommended by the Fund designed to correct the disequilibrium in the country's balance of payments" (Ibid., p. 1538). Thus, the original version implied a stronger language and a more active exercise of conditionality on the part of the Fund.

[8]Ibid., p. 1549.

[9]Ibid., pp. 1550 and 1551.

percent of their quotas, respectively.

The way in which this symmetry operated was as follows. As a condition to allowing members, having debit balances equivalent to half their quotas, to increase their negative balances, the Board could require all or any of the following measures: a devaluation, the control of outward capital transactions, or the surrender of gold or other liquid reserves.

> Furthermore, the Governing Board may recommend to the Government of the member State any internal measures affecting its domestic economy which may appear to be appropriate to restore the equilibrium of its international balance.[10]

Beyond three-quarters of quota the member could be asked to take measures and if the debit balance was not reduced within two years the Board could declare that it was in default and unable to draw.

A creditor country with balances beyond half its quota "shall discuss with the Governing Board (but shall retain the ultimate decision in its own hands) what measures would be appropriate to restore the equilibrium of its international balances,"[11] including expansion of domestic credit and domestic demand, appreciation of its currency, increase in money rates of earnings, reduction of tariffs and other discouragements to imports, and international development loans.

Thus there is an attempt at symmetry but complete symmetry is not achieved. On deficit countries there is a limit which does not exist in the case of the creditor countries and the wording of the provisions is stronger in the former than in the latter case, including the parenthetical reference to the "ultimate decision."

For that reason it seems fair to describe the mechanism of the British proposal as the Paper does

> The object is that the creditor should not be allowed to remain entirely passive. For if he is, an intolerable heavy task may be laid on the debtor country, which is already for that very reason in the weaker position.[12]

The "tentative Draft Proposals of Canadian Experts for an International Exchange Union" appeared in June 1943 and contained provisions which were more similar to those of the American proposal than those of the British proposal. An interesting remark with respect to these proposals is the following:

> . . . both plans provide that foreign credits are to be available under certain conditions to countries having need of them, and that they shall be made available through an international monetary organization rather than through bilateral arrangements between pairs of countries.[13]

Once those different proposals were discussed by experts of more than 30 countries, a "Joint Statement" was issued in April 1944, almost one year

[10]Ibid., p. 1555.
[11]Ibid., p. 1556.
[12]Ibid., p. 1562.
[13]Ibid., p. 1577.

later. In this proposal for the establishment of an International Monetary Fund (apparently the first published document to name the institution as we know it today) the question of making the Fund resources available under "adequate safeguards" and the requirement of balance of payments need remained as before but there were no specific references to measures to be taken or to policies to be adopted when using the Fund's resources. Rather a maximum limit was established to the use of Fund's resources per year (25 percent of quota) with a maximum of 200 percent of quota at all times. In addition, the wording was reversed in the sense that a member may be

> suspended from making further use of the Fund's resources on the ground that it is using them in a manner contrary to the purposes and policies of the Fund.[14]

At the Bretton Woods Monetary and Financial Conference delegations were presented with the "Joint Statement" plus alternative and supplementary texts for almost every article and section submitted by the attending delegations to the Secretariat. In this particular area of "Transactions with the Fund," alternative texts were presented jointly by the U.S. and the British delegations and individually by the delegations of Australia, Czechoslovakia, France, and Belgium. Most of them, however, were proposals to increase the limits on the possible yearly use of the Fund's resources (Australia, France, and Belgium), which became a subject of intensive and extensive discussions during the conference. Only the joint U.S.-British proposal offered an alternative text on the questions of "using the resources of the Fund in a manner contrary to the purposes and policies of the Fund" stating and clarifying the procedure to follow in those cases.[15] Essentially it was the Fund that should take the initiative in those cases by presenting a report to the member and prescribing a time for reply. After that the Fund could limit the use of its resources by the member and if no reply was received within the stated time, or if the reply was not satisfactory, the Fund might continue to limit the member's use of the Fund resources and after reasonable notice, declare it ineligible to use the Fund resources. This proposal was the basis for what at the end of the Conference became section 5 or Article V entitled "Ineligibility to Use the Fund's Resources" of the original Articles of Agreement. The only significant difference with the original joint U.S.-British proposal was deleting the words "and policies" so that reference was only made to the "purposes of the Fund." This deletion has some importance because the "policies of the Fund on the use of its resources" returned to the Articles with the first amendment in 1969, and became the undisputed legal basis for the exercise of conditionality.

At the end of the Conference the Secretariat issued a press release entitled "IMF (Purposes, Method, Consequences)."[16] It was a four-page explanatory document in which the sole reference to this subject was the following:

[14]Ibid., p. 1632.
[15]Ibid., p. 28.
[16]No similar explanation was given for the parallel World Bank proposal.

> No safeguard provided for the Fund is more important than the provision that the countries' request for foreign currencies must indicate that the uses to which these currencies will be put are consistent with the purposes of the Fund. This means that countries which conduct their affairs in good faith in accordance with the undertaking to act in conformity with the purposes of the Fund will not in any circumstances divert the resources of the Fund to inappropriate uses.[17]

The preceding description seems to allow several observations.

First, that the idea of economic policy conditionality attached to the use of Fund resources existed with varying degrees in the different proposals discussed during the prehistory of the Fund. It was, as the British proposal stated (albeit in a different context) one of those "general ideas belonging to the contemporary climate of economic opinion...which are born of the spirit of the age."[18]

Second, that some of the proposals were rather specific and mentioned things like appropriate or adequate measures to be adopted, additional conditions in certain circumstances, internal measures to be recommended, etc.

Third, that in the "Joint Statement" there was a reduction, a limitation, of the maximum yearly usable amounts of Fund resources and an apparent loss of specificity in the conditions for such use, which were written in a broader language than originally was the case. This is most interesting. The maximum possible yearly use of Fund resources amounting to 25 percent of quota substitutes in the "Joint Statement," the preexisting policy conditionality. Thirty-four years later, with the second amendment to the Articles (1978), this 25 percent limit is deleted precisely because "the Fund's policies on the use of its resources" (i.e., policy conditionality) "have been more adequate safeguards of the Fund's resources than the deterrence implied in the necessity for waivers"[19] to exceed the limit of 25 percent of quota, that had become a commonplace.

Fourth, that the different delegations seem to have arrived at the Bretton Woods Conference with a fairly large consensus on this question as it was a subject on which there seems to have been little discussion. No alternatives suggesting substantial changes were presented, and no final reservations were recorded on these issues (contrary to what happened with other issues).

Finally, it appears as if during all this period there was a sufficiently strong trend away from the original specific policy conditionality so as to even change its nature. Or, as Sir Joseph Gold has said:

> It is still true, therefore, that conditionality cannot be defined by reference to the "conditions" of Article V, Section 3 (b).[20]

[17] *Proceedings*, p. 1213.

[18] Ibid., p. 1551.

[19] IMF—"Proposed Second Amendment to the Articles of Agreement of the IMF.' Washington, D.C. 1976, p. 22.

[20] Joseph Gold (1979) p. 1. Section 3 (b) of the current Articles which he mentions corre sponds to the former Section 3 (a) which included the balance of payments need, the annua limit, and the reference to section 5 of Article V, mentioned above.

History

The history of the Fund policies on the use of its resources (1946-84), can probably best be divided according to the four periods separating the adoption of the three main Executive Board decisions on the subject of 1952, 1968, and 1979.[21] The reason for this is that an important characteristic of these decisions is that they showed the practice that had developed in the day-to-day business of the Fund up to the moment of their adoption and thus allowed one to know the state of this practice as it has evolved through time.

1. *The period 1946-1952*

In the first (1952) decision there was a statement by the Managing Director with a reference to "a period of relative inactivity of the Fund" and a sentence that describes most graphically the state of the art of conditionality at that early stage on the use of Fund resources: "We shall have to feel our way."

In the early years of the Fund there were totally unconditional transactions, within the limits established by the Articles. In fact many drawings of relatively small amounts in terms of the member's quota (5 percent of quota per month) were decided directly by the Management without prior intervention of the Executive Board. This practice, however, increasingly came to be criticized because, in the view of some important members, it did not provide sufficient assurances to the Fund that its resources were being utilized in a temporary manner.

Thus, the concern that such use should be temporary, as a way of assuring the revolving character of the Fund's resources, was the main consideration that led to policy-conditionality.

During the first year of operation of the Fund, at the request of the Governor for the United States, its Executive Board decided that the correct interpretation of the Articles implied giving members "temporary assistance in financing balance of payments deficits on current account for monetary stabilization operations."[22]

This, in turn, implied that the Fund would be assisting members that might be in trouble and a consensus has developed around the idea that access to the Fund should not be denied because a member was having those problems. Precisely this was the time to help, when commercial banks and other lenders might feel reluctant to do the same, and the Fund might reestablish confidence that the country would overcome its difficulties. But the question remained, however. How could the Fund make sure that the member's problems were temporary, that they could be solved within a reasonable time like three to five years? By analyzing the policies pursued by the member. On this question the Managing Director's statement was very forceful: "The policies, above all, should determine the Fund's attitude."

[21]Decision No. 102-(52/11), February 13, 1952; Decision No. 2603-(68/132), September 20, 1968; and Decision No. 6056-(79/38), March 2, 1979.

[22]Board of Governors, Resolution No. IM-6, March 18, 1946 and Executive Board. Decision No. 71-2, September 26, 1946.

Moreover, the Fund would pay attention to the member's record with the Fund (prudence in drawings, willingness to offer voluntary repayment, promptness in reporting monetary reserve data and discharging repurchase obligations).

This decision (1952) is also important because among the different options envisaged by the Managing Director for members approaching the Fund there is one that constitutes the earliest description of what later became known as stand-by arrangements:

> At other times discussion between the member and the Fund may cover its general position, not with a view to any immediate drawing, but in order to ensure that it would be able to draw if, within a period of say six or twelve months, the need presented itself.

One other aspect of the use of Fund resources was clarified at this point by assuring memebers the virtually unconditional use of the gold tranche, that is, of purchases which would raise the Fund's holdings of a currency to not more than the quota of a member.

Thus during the first six years of the Fund there was relatively little use of the Fund's resources and virtually no policy conditionality. But the seed for the future stand-by arrangements was planted.

2. *The period 1952-1968*

The second period goes from 1952 to 1968, when the second main Executive Board decision on the use of Fund resources and stand-by arrangements was approved.

This Decision of September 1968 was adopted shortly after the Board of Governors had approved the first Amendment to the Articles of Agreement, but before they were effectively amended. This Amendment introduced three important elements in the area under consideration. The first one is that it required the Fund "to adopt policies in the use of its resources," although without specifying them. Thus, after 24 years, the words "policies of the Fund," deleted from the joint U.S.-British alternative text at Bretton Woods, reentered the Articles of Agreement. Here again the modification was largely declaratory of practice because by then the Fund had already built up a system of fairly well-defined policies. But one can still say that, in a sense, the 1968 decision was a direct by-product of the first Amendment. Second, it made the use of Fund resources policy conditional by requiring the Fund to challenge a member's representation[23] if it thought that a proposed purchase would not be consistent with the Fund's purposes and policies. Thirdly, by expecting gold tranche purchases from this challenge it gave legal unconditionality to the use of the gold tranche, confirming the trend adopted by the 1952 Decision.[24]

This period of the 1950s and the 1960s was the period in which the concept of conditionality became fully developed, the use of the stand-by agreement was refined and its diverse and complex techniques were frequently ap-

[23]The word "represents" in the Articles means "declares."

[24]Articles of Agreement, Article V, Section 3 (c) and (d).

plied, initially in the Latin American countries and later on in other parts of the world.

As early as December 1953, an IMF Decision[25] defined the stand-by arrangements and set forth the general framework for them. Those original arrangements were limited to periods of not more than six months, but the Fund would give "sympathetic consideration" to a request for a longer arrangement, subject to understandings additional to those needed for the six-month arrangements. This decision followed the first two stand-by agreements concluded by the Fund during the financial year 1953.

In the statement introducing the 1957 Annual Report of the executive Directors to the Board of Governors, the Managing Director states "once again" the Fund policies that have been recorded in the Annual Report of 1955, only three years after the 1952 Decision:

> ...access to the gold tranche is almost automatic; and requests for drawings within the next 25 percent (the so-called "first credit tranche") are also treated liberally but, even so, such requests will be approved only if the country asking for assistance can show that it is making reasonable efforts to solve its own problems. For drawings beyond that tranche (i.e., beyond the first 50 percent of the quota), substantial justification is required, and among the justifications foreseen are transactions in support of the establishment or maintenance or convertibility. [These latter requests]...are likely to be favorably received where they are intended to support well-balanced and adequate programs which are aimed at establishing or maintaining the enduring stability of the currencies concerned at realistic rates of exchange, and may therefore reasonably be regarded as establishing the conditions for substantial progress toward convertibility.[26]

This means that during the financial year 1954 the Fund had already defined its tranche policies differentiating the conditions required for drawings in the gold tranche, the first credit tranche, and the upper credit tranches.

The frequent use of the stand-by agreements showed that they provided the intended assurances to both the member country and the Fund. To the member the stand-by agreement provided the assurance that it could draw resources from the Fund during a certain period of time (usually one year, but sometimes six months) provided the economic policies implemented produced the intended results. And to the Fund, the assurance that its resources were being used in accordance with its purposes and policies. Further, the agreements also began to give assurance to third parties—the "seal of approval" effect—that were thus more inclined to help the member financially—what used to be called the "parallel arrangements"—or in other cases, less inclined to be a part of a capital outflow. In many cases member countries renewed their one-year stand-by arrangements during several consecutive years for precautionary reasons and to prolong the benefits and side effects of the operation. But this practice was not generally encouraged.

As to the techniques that were developed during this period the Decision itself is an interesting source of information. By 1968 the agreements had

[25]Decision No. 270-(53/95), December 23, 1953.

[26]Per Jacobsson, "International Monetary Fund Monograph Series," No. 3, p. 20.

"consultations," "phasing," "performance clauses," "performance criteria," arrangements that went or not "beyond the first credit tranche," "evaluation of the program," etc.

Two of these techniques played a crucial role in the development of the practice of conditionality: the concept of an economic program and the technique of consultation.

The idea of a program helped to organize the economic decision-making—particularly in those early years, in many developing countries—and, by focusing on the interactions of different variables in the overall performance, helped to better understand the relative strength and importance of different decisions. By insisting on "comprehensive economic programs" the Fund, in many instances, introduced what could be characterised as the simultaneous equation approach to situations that could otherwise have adopted the isolated, barren policy measure. Additionally, the fact that these programs usually aimed at, and were evaluated by different statistical measures, gave a great impetus to the development of economic statistics in many countries and the use of objective standards of performance. The development of monetary and fiscal statistical information in many developing countries during this period owes much to the application of these techniques.

One important but sometimes negative aspect of these economic programs was the length of time involved in these arrangements. Time was needed to implement the program; time was needed for decisions to produce their intended effects; time was needed by the authorities to react to new information and new economic signals; time might show that the situation would get worse before improving, etc. The "shock vs. gradual treatment" controversy of the fifties and early sixties in Latin America was an exercise in economic policy timing—and sometimes, political impatience—which owed much to the length of these Fund supported economic programs. The one-year (and sometimes six-month) mold in which all stand-by arrangements of that period were exclusively cast created many unnecessary problems. Manuel Guitian has probably presented the best explanation for the one-year limit:

> The policy programs did not normally extend beyond a year, a period short enough to permit an economic forecast to be made but long enough to permit results of the policy measures to be assessed and judgement to be made as to whether additional measures or modifications of existing measures were warranted. Of course, this did not mean that adjustment was expected to be completed within such a limited time, regardless of the particular country circumstances. In fact, members often enter into consecutive stand-by arrangements with the Fund—a strategy that provided them with continued financial support until the imbalances were redressed.[27]

However, the fact that now the Fund has extended the time of these arrangements tends to show that probably the Procrustean one-year limit was not, after all, the most convenient one to operate with.

[27]Manuel Guitian (1981) p. 14.

The techniques of consultation usually through the Fund missions sent to the various member countries—which on some occasions seemed to reach the heights of missionary zeal—were a most important instrument. The innumerable personal acquaintances and contacts and the extended discussions the Fund staff had during that period, significantly contributed to providing the staff members a broader perspective, a better understanding of the problems faced by the authorities, of how diverse institutions functioned in different countries, and of the difficult political environment and climate in which sometimes hard decisions had to be taken. It also gave the authorities a better understanding of the working of the Fund and of the nature of its economic diagnosis and conditionality.

Performance criteria evolved, with the availability of new and better statistical information, economic research both at the Fund and elsewhere, and a clearer view of the problems at hand. During the 1960s the number of criteria also increased but this added complexity—and implicit assurance to the Fund—was not generally reflected in arrangements implying a larger access to the Fund resources which, on average, continued to represent roughly 50 percent of quota. Also, the number of performance criteria in the Latin American and Asian stand-by arrangements were much larger than in the European arrangements.

The 1968 Decision emphasized "the need for flexibility while ensuring uniform and equitable treatment of all members..." This equalitarian emphasis was due to the fact that the discussion of the request by the United Kingdom for a stand-by arrangement at the end of 1967, triggered—together with the first Amendment of the Articles—a general review of the Fund's policies on the use of its resources under stand-by arrangements whose final result was, precisely, this decision.[28]

The guiding "conclusions" of the 1968 Decision were very simple. All stand-by arrangements would carry consultation clauses, appropriate phasing, and performance clauses, except that the last two would only apply to purchases beyond the first credit tranche, to make this consistent with the fact that they also were to be omitted from arrangements that did not go beyond this limit. A major exception was introduced "when the Fund considers it essential that the full amount of the stand-by arrangement be promptly available" (as it had been in the U.K. case). Since in those cases there is no possibility of phasing the purchases, the consultation clauses should be drafted as performance clauses requiring the member to consult the Fund to reach understandings, if needed, on new or amended performance criteria. The number and content of performance criteria necessary to evaluate implementation of the program were not defined, given the diversity of problems and institutional arrangements of members.

[28]The United Kingdom stand-by was an arrangement for an amount equivalent to more than half the U.K. quota and took the Fund's holdings of pounds sterling to almost 200 percent of quota. The agreement had no phasing, no performance clauses, and only a few ceilings on certain economic variables. Instead of these provisions that were already standard clauses in all stand-by arrangements at the time, the agreement envisaged quarterly consultations on the economy and the balance of payments. It is only fair to add that despite the discussion on the particular techniques chosen for this important stand-by arrangement, the Executive Directors supported the request unanimously.

Toward the end of this subperiod the stand-by technique was well established. Between 1952 and 1968 the Fund approved 207 stand-by arrangements with member countries for a total amount of SDR 12,941 million. Starting with the first two arrangements during financial year 1953 the Fund approved an average of 12 arrangements per year up to a maximum of 25 during financial year 1967. During 1964 and 1965 commitments reached SDR 2160 million each year, the highest for the whole subperiod.

The economic content of policy conditionality as it developed during these years was basically geared to stabilize situations of external deficit and chronic inflation particularly, but not exclusively, in the Latin American countries. Obviously not all the variables chosen were the same, because the situations themselves differed, but there were certain similarities in the basic policy framework. Fiscal performance clauses included increased revenues through new taxes or increased rates on existing taxes, reduced government expenditures and reduced central government or public sector deficits. In certain cases the prices of government goods and services were included as a way of keeping revenues in line. The discussion of government expenditures, however, was not very detailed. Different expenditure compositions respond to alternative, and sometimes complex, political decisions and it was a subject difficult to deal with. Rather, in many cases, there was a preference for establishing ceilings on the financing of potential public sector deficits, leaving the authorities room to decide by themselves on the level and composition of revenues and expenditures within the financing ceiling. The insistence on limits to government deficit financing was thus the most natural procedure to follow but tended to give these arrangements an added monetarist flavor whose raison d'être was not properly understood.

Credit ceilings were very important. At times the emphasis was on central bank credit to the public sector or net domestic credit of the central bank. At other times the ceiling included the secondary expansion through the banking system and increased reserve requirements or higher than average marginal reserve requirements. This latter mechanism, in particular, caused some difficulties in certain cases in the early years. As fiscal discipline was only slowly regained, the base expansion triggered increasing average reserve requirements which affected secondary expansion and the flow of credit to the private sector, adding to the government crowding out effect and affecting growth.

The usual balance of payments performance test was the variation of the net international reserves for which minimum targets were usually established as a way of strengthening the reserve position and making sure that a realistic exchange rate was maintained. The avoidance of new or intensified restrictions and the possible elimination of existing restrictions on the making of payments for current international transactions were usually included.

Generally few, if any, commitments by the authorities on wages, prices, or interest rates were included, and if they were, they were not subject to performance clauses.

The question of foreign indebtedness and new borrowing entered these agreements only toward the end of the period and was one of latest variables to be considered.

In addition, up to the end of the 1950s, noncompliance with most of these ceilings and targets did not trigger the suspension of the right to make further purchases from the Fund; but this has changed completely since the early 1960s.

3. *The period 1968-1979*

The third period goes from 1968 to 1979, when the third major decision on conditionality was adopted, almost one year after the second Amendment of the Articles of Agreement became effective.

In this Amendment the provisions of the Articles dealing with the use of Fund's general resources were revised largely in order to give expression to the practices that have evolved in the course of the years since the first Amendment, as explained in the Proposed Second Amendment[29] of the Executive Board, but no substantial changes were introduced in the area of conditionality. Three points, however, merit a brief comment. First, the limit on purchases expressed in terms of an increase in the Fund's holdings of a member's currency of no more than 25 percent or its quota during the 12 months ending on the date of the purchase, was deleted. Waivers to this limit had become almost automatic practice and it was felt that "the Fund's policies on the use of its resources have been more adequate safeguards of the Fund's resources than the deterrence implied in the necessity for waivers."[30] Second, the word "stand-by" entered the Articles for the first time, its meaning was one of those concepts carefully defined in the "explanation of terms" (Article XXX), and other "similar arrangements" were also contemplated as additional facilities that could become the subject of policies to be adopted by the Fund. This expression was meant, for instance, to include agreements like the extended arrangements under the Extended Fund Facility. Third, the capacity of the Fund to develop and adopt "special policies for special balance of payments problems" was explicitly recognized. This expression was meant to include ad-hoc policies on the use of conditional resources like those of the compensatory financing or the buffer stock financing facilities, as different from those applying to the use of resources under the basic or regular credit tranche policies of the Fund.

The third period was also a period of transformation and adaptation of the Fund to the very difficult world economic circumstances. This period includes very significant events for the international monetary system and the international trade and payments system. In the early years of the 1970s increasing tensions and uncertainty disturbed the functioning of the foreign exchange markets. Recurrent crises in these markets led to the abandonment of the fixed exchange rate arrangements, established 30 years before at Bretton Woods, and to the adoption of new flexible exchange rate arrangements deemed more efficient to sustain the strains and pressures of the foreign exchange markets.

[29]IMF, "Proposed Second Amendment to the Articles of Agreement of the IMF," Washington, 1976, 19.

[30]Ibid., p. 22.

During 1973-74 the world economy was shocked by a very high increase in the price of oil which created or increased external payments disequilibria in many countries, changed surplus to large deficit in others, and shifted positive and negative imbalances across regions in an unprecedented manner in terms of size and duration. Prices began to accelerate, inflation reached intolerable levels in usually stable economies, and as the different authorities reacted to these significant disequilibria combating inflation, conserving energy and, in general, reallocating resources, the industrial countries entered a severe recession with very negative repercussions in the developing countries.

In those circumstances the demand for Fund resources increased very significantly and the Fund had to react to a new, critical situation. During the seventies the number and variety of Fund's policies and facilities increased considerably. Some of them were created on a temporary basis and have by now been discontinued but others will most probably become a permanent and positive feature of the institution. The degree of conditionality was changed in both directions. It was somehow lowered around the mid-70s and then it was increased, as more and more member countries used the Fund resources in the upper credit tranches. The size of the Fund resources was enlarged through quota increases and especially through new forms of borrowing. The length or duration of the use of the Fund's resources was increased in order to accommodate members subject to prolonged situations of disequilibrium.

From the sixties to the seventies the amount of drawings by members from the Fund for balance of payments assistance and reserve tranche drawings[31] increased from an annual average of U.S. $1,632 million to an annual average of SDR 3,049 million. During the seventies these figures ranged from a minimum amount of SDR 732 million registered in 1973 to a maximum amount of SDR 7,010 million in 1976; an increase of almost 10 times in only three years.[32] The decline after 1976 was due to the phasing out of the unconditional oil facilities of 1974 and 1975.

The format of the Fund's reaction to the economic turbulence of the seventies can briefly be described in terms of three dimensions or directions: somewhat lower conditionality through certain new, temporary facilities; continued degree of conditionality with longer-term use of resources than up to that time; and additional resources through still other facilities.

a) The first type of reaction was implemented through the now discontinued oil facilities of 1974 and 1975. The first one was a virtually unconditional facility in response to the problems created by the 1973-74 oil price increases. The 1975 facility, however, was characterized by a higher degree of conditionality than the initial one, although without performance criteria or phasing, like the one applying to drawings in the first credit tranche. The reason was that the Executive Board felt at the time that the effects of the oil price increases were not temporary, "that the rise in energy prices would be largely nonreversible and that financing should therefore be accompanied by

[31]The old "gold tranche drawings" changed their name to "reserve tranche drawings" after the Second Amendment, in order to harmonize language with the ongoing reduction in the role of gold in the Fund.

[32]A.W. Hooke, *The IMF. Its Evolution, Organization and Activities* (1981) p.42.

positive efforts of adjustment."[33] Another example was the Trust Fund, established temporarily in 1976, financed by the profits of the Fund's gold sales with a low conditionality similar to the one attached to the use of Fund's resources in the first credit tranche, for the benefit of the low-income developing countries.

b) The second type of reaction, the lengthening of the period of use, can be exemplified by the adoption of the Extended Fund Facility[34] in 1974, still in operation. The facility was intended for (i) an economy with "serious payments imbalance relating to structural maladjustments in production and trade," or (ii) situations in which "slow growth and an inherently weak balance of payments" prevents an active development policy. Given the middle-term nature of possible solutions to these problems the facility envisaged arrangements for larger amounts in relation to quota and longer periods than was the case under regular tranche policies. The arrangements' periods could extend up to three years and a longer repurchase period was also established. Conditionality under extended arrangements is similar to that of the stand-by arrangements. A three years' arrangement implies an extended basic program setting forth the objectives and policies for the whole period and a detailed statement of policies and measures for the first year. This latter procedure is repeated before the start of the second and third years. The arrangement carries with it performance criteria, performance clauses, and phasing.

The extended arrangements are a most welcome addition to the IMF-related facilities and financing techniques and they should become a permanent feature of the Institution. In this connection four ideas are worth emphasizing. First, as the Decision itself points out, "the facility, in its formulation and administration, is likely to be beneficial for developing countries in particular." The kind of situations amenable to be supported by this type of arrangement would obviously be encountered more frequently in developing than in developed countries. Second, the explicit recognition that these types of situations require longer than one-year programs to show results and the implicit notion that the one-year arrangements have probably been impeding the necessary ease that would allow these types of adjustments to take place. The number of such situations has probably increased during the seventies as a consequence of the sharp rise of energy prices, combined with recession in the industrial countries, but surely in the fifties and sixties many countries could have substantially benefited from the advantages of more extended facilities than those available at the time. Third, the idea of combining medium-term objectives and policies with a more detailed short-term set of specific policies and measures, sequentially designed within the medium-term framework, will probably have a highly positive effect on the task of the persons responsible for economic management in developing countries. It is, as if it were, the natural continuation of the earlier notion of a "comprehensive economic program" now expanded in its time dimension. This, together with the implicit continuity of purpose and sustainability of ef-

[33]Ibid., p. 57.
[34]Executive Board Decision 4377—(74/114).

fort of a medium-term framework, so indispensable for sound economic management, will probably enhance economic policymaking in many developing countries. Fourth, the notion that resource allocation is pertinent and should be more efficient even to help solve medium-term balance of payments problems is important. In other words, the extended arrangements recognized the continued importance of financial stabilization without overlooking the real side of the economy. Thus the extended arrangements will probably contribute to the attainment of medium-term policy conditional arrangements incorporating stabilizing aggregate demand management with supply side policy concern.

c) The third type of reaction may be exemplified by the creation of the Supplementary Financing facility[35] of 1977, operational in 1979, to provide supplementary financing in conjunction with the use of the ordinary resources of the Fund to members with serious payments imbalances that were large in relation to their quotas. The facility was financed by resources borrowed from members in a sufficiently strong balance of payments and reserve positions. This temporary facility also provided for stand-by agreements that could exceed the one-year limit and could extend up to three years in appropriate cases. Use under this facility carried with it the same degree of conditionality as a stand-by or an extended arrangement in the upper credit tranches.

The preceding pages show how the Fund reacted to the challenges of the seventies in the way circumstances required. Two slightly negative aspects of this reaction, however, need to be mentioned. Both originate in the declining relative size of the Fund in terms of imbalances, as quotas were not sufficiently increased. The first one is that, despite the consensus in the Executive Board that Fund's resources should be strengthened by quota increases, the Fund had to borrow heavily to face the increased demand for its resources and this, in turn, increased the cost of borrowing by member countries. In 1978, it was said:

> . . . the Executive Board is of the view that, in general, increased access to the Fund's resources should, over the longer run, normally result from an increase in Fund quotas.[36]

The second one is that, as more and more countries began to use resources in the upper credit tranches because of the Fund's limited size, average conditionality increased not as a consequence of a conscious political decision to change the degree of the Fund's conditionality but rather as an inevitable and negative (because not intended) by-product of an insufficient own-resource base.

In March of 1979 an important decision entitled "Guidelines on Conditionality" presented a synthesis or a codification of the practice the Fund developed during the seventies, together with a ratification of some earlier decisions on conditionality.[37] A comment on some of these guidelines follows.

[35]Decision No. 5508—(77/127), August 29, 1977.
[36]Board of Governors Decision 34-2, December 11, 1978.
[37]Executive Board Decision No. 6056—(79/38), March 2, 1979.

The first guideline constitutes an encouragement to member countries to take corrective measures and to approach the Fund for financial support at an early stage of their external difficulties or even as a precautionary measure. It is interesting that 27 years after the stand-by embryo was implanted in the 1952 decision as a precautionary procedure, the Fund felt that it has to insist on this aspect of the use of its resources by members. What the Fund was saying is that if an economy has to adjust sooner or later, it is preferable that it does so sooner than later. Delay breeds danger and most probably leads later on to more difficult adjustment, stronger corrective measures, bitter medicine, a more traumatic experience, more unwanted political repercussions, and a sense of harsher conditionality than would otherwise have been the case. Probably a large part of the political criticism directed towards the Fund's conditionality has its true origin in these delays. In many cases corrective action taken earlier than actually was the case would probably have not allowed those situations to deteriorate as they did, and would probably have not required the amount of resources and the degree of conditionality they finally required. The question then moves to a different point: Why are some authorities so reluctant to approach the Fund for early support? One of the answers might have been that if the size of the Fund would not allow a member to use its resources in an ample, reasonable way, it might not be worthwhile to approach the Fund, at least in the first instance, particularly at times when commercial bank financing was readily available. Another cause sometimes mentioned, particularly during the sixties, was that the famous expression "to correct a fundamental disequilibrium" (now, by the way, softened in Schedule C by "or prevent the emergence of")[38] was too much for a minister to admit openly, unless it was absolutely unavoidable. Richard Cooper, in a celebrated essay analyzing a number of devaluations, and with all the necessary caveats, has given empirical content to this possibility:

> The fourth apprehension concerns the political fate of those responsible for the decision to devalue, and here experience is not nearly so encouraging. A naive test is whether the government fell within a year of the devaluation. In nearly 30 percent of the cases examined it did.

And also,

> Ministers of finance fared much worse. Nearly 60 percent of them lost their jobs in the year following devaluation—half of them of course when their governments fell—compared with a turnover in a control group of only 18 percent.[39]

Another guideline insists on the one-year stand-by but opens up the possibility of extending arrangements up to three years. The practice initiated with the extended agreements and continued with the supplementary financing policy was now definitely extended to normal stand-by arrangements.

Still another guideline states that "a member may be expected to adopt some corrective measure before a stand-by arrangement is approved by the

[38]IMF Articles of Agreement, Schedule C, Par Values.

[39]Richard N. Cooper, "Currency Devaluation in Developing Countries," Essay in International Finance, No. 86, Princeton University, June 1971, p. 28.

Fund." These "preconditions," in part, were due to the short (one year) stand-by arrangements where the initial purchase was a substantial portion of the total amount involved in the whole arrangement. In other cases these are necessary assurances that the Management of the Fund needs, in order to recommend the agreement to the Executive Board for approval. If Congress or Parliament has not yet enacted the pertinent yearly budget, what value can be attached to the letter of intent's fiscal targets that so crucially depend on the final shape of the budget? In the more extended arrangements or when the member cannot responsibly establish in advance some of the performance criteria, provisions will be made for a review, for later understandings, for the remainder of the agreement.

The last two guidelines reflect an internal practice of the Fund that can be generalized. With the first one the Fund will analyze and assess the economic performance of individual programs supported by the use of the Fund's resources in the credit tranches, once the arrangement expires. The Fund will do this in connection with the Article IV consultations (the regular surveillance consultations) or, as appropriate, in connection with further requests by the member for the Fund's assistance. According to the last guideline, the staff of the Fund will prepare studies of stand-by supported programs to evaluate and compare the appropriateness, effectiveness, observance, and results of different programs.

It would be extremely useful if the Fund were to publish regularly these two types of evaluations, with a reasonable lag, and with the consent of the members involved in each study. As was said before, policy-conditionality in the Fund has been a difficult and controversial issue and probably nothing will contribute more in throwing light and removing heat from these academic and political discussions than adequate knowledge about the facts as they evolved, the analytical basis for the authorities' original programs, and the Fund's evaluation and assessment.

Although there are interesting approaches to this question[40], there is still room for improvement and need to develop the analysis fully. The regular publication of these studies would allow a variety of other approaches to the assessment of economic programs besides the Fund's staff approach. It will enlighten and enrich the discussion with an empirical basis not now available (although in existence) and will help economic research centers everywhere (starting with those of the country concerned) to develop more fully the analysis of economic policy's difficulties, intricacies, and implicit value judgments. We still could learn much, and benefit accordingly, from a thorough analysis of some of the 239 or 332 stand-by arrangements agreed upon up to 15 or 10 years ago, respectively, and yet be chronologically far enough removed to avoid undesirable political repercussions because of their publication.

[40]John Williamson, "On Judging the Success of IMF Policy Advice," article in Williamson, ed., *IMF Conditionality*, Washington, D.C.: Institute of International Economy, 1983, p. 129.

4. *The period 1979-1984*

The last period includes the years from the 1979 decision to the present. The Fund has continued to gain experience with its practice of conditionality in the midst of a phenomenal increase in the use of its resources. From 1979 to 1983 commitments to members under stand-by and extended arrangements increased from SDR 1.6 billion to SDR 25.0 billion; gross purchases increased from SDR 1.2 billion to SDR 10.3 billion; and net purchases from SDR 3.2 billion to SDR 8.7 billion.[41] Further, as the 1983 Annual Report explains:

> The bulk of the financial assistance made available by the Fund to its members since 1977 has been through purchases in amounts and under facilities that require high degrees of conditionality in accordance with the Fund's policy of combining adjustment and financing.[42]

During this period there was little innovation in the practice of the Fund on the use of its resources except for the policy on enlarged access, approved during 1981.[43] This was a temporary policy that was to be in effect until the Eighth General Review of Quotas became effective, subject to the possibility that the Fund might extend this period. The decision became operational once the resources available under the supplementary financing facility were fully committed and adequate borrowing arrangements had been concluded. Thus this policy allowed the Fund to continue helping members with payments imbalances that were large in terms of their quotas and prolonged in time. As the enlarged access was provided to members with stand-by or extended arrangements in the upper credit tranches, the use of these resources carried with it the same degree of conditionality as these other arrangements.

In the summer of 1982 the slowdown of bank lending to developing countries, particularly in Latin America, created a critical situation and even serious concern about the proper functioning of the international monetary and financial mechanisms.

Once again the circumstance of the eighties presented new and difficult challenges to the IMF. Countries heavily indebted came to the institution for significant support and found new and imaginative responses in ways that have not been implemented before. In particular, the management of the Fund, in close contact with representatives of the commercial bank consortia, central banks, the creditor and debtor governments, and the BIS (the Bank for International Settlements), worked out ways and means to ensure that whatever Fund resources could be put at the disposal of the member concerned, sufficient additional resources would be forthcoming from commercial and official sources in the creditor countries to alleviate and support the adjustment efforts of the debtor countries. In a recent article Otmar Emminger has said

[41]IMF, Annual Report 1983, Washington, D.C; 1983, Table 20, p. 85.

[42]Ibid., p. 84.

[43]Executive Board Decision No. 6783—(81/40).

> The international action on the occasion of the debt crisis is, of course, the most spectacular example of monetary and financial cooperation.[44]

The worse phase of the crisis seems to be over now, as countries have initiated the adjustment of their economies and their accommodation to the new circumstances, with varying degrees of success.

As a consequence of all this a new period has probably dawned in the history of policy-conditionality in the IMF. The monitoring of debt management and debt servicing was one of the last performance criteria to be included in the stand-by arrangements of the sixties and a decision about them was already adopted by the Executive Board in 1979, codifying this practice.[45] But it seems clear now with the benefit of hindsight that the debt surveillance exercised by the Fund was not efficient enough, at least for the massive recycling of the seventies and that it could and should be improved to prevent countries from reaching acute debt crises in the future.

As it has been the case in the past the Fund, in collaboration with other institutions like the World Bank and the BIS, will have to develop its own early warning procedures by stages in a gradual and pragmatic way. Information gathering, external debt analysis, actual and prospective debt servicing analysis, new borrowing behavior, routine consultations and debt policy formulations would probably be some of the prerequisite logical steps to develop appropriate recommendations and performance criteria.

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[44]Otmar Emminger, "International Cooperation—a personal view" in M. Deane and R. Pringle, "Economic Cooperation from the Inside," Group of Thirty, N.Y., 1984.

[45]Executive Board Decision No. 6230—(79/140), August 3, 1979.

Appendix

A Geometrical Note on Conditionality

In this appendix the indifference map technique is used to illustrate certain characteristics of conditionality.

Let us assume economic authorities have a certain indifference map describing their preferences on the financing and adjustment mix they would like to apply to correct a particular situation of negative external disequilibrium.

Figure 1 depicts one such possible indifference map. The vertical axis (F) shows the potential amounts of financing as measured by the possible amounts to be included in the IMF-cum-banks stand-by operations. The horizontal axis (A) measures what could be described as abstract units of adjustment effort.

Let us also assume that the authorities prefer more financing to less financing, but not more adjustment to less, because the adjustment effort has a political and in the short- to medium-term perhaps also an economic cost in terms of growth or unemployment, and they are reluctant after a point to intensify adjustment. Under these circumstances the indifference curves will be positively sloped and from any point in the map a new point located in the upward or leftward directions, or any combination of the two will show a more comfortable (preferred) situation for the authorities—with more financing, less adjustment, or more time to adjust.

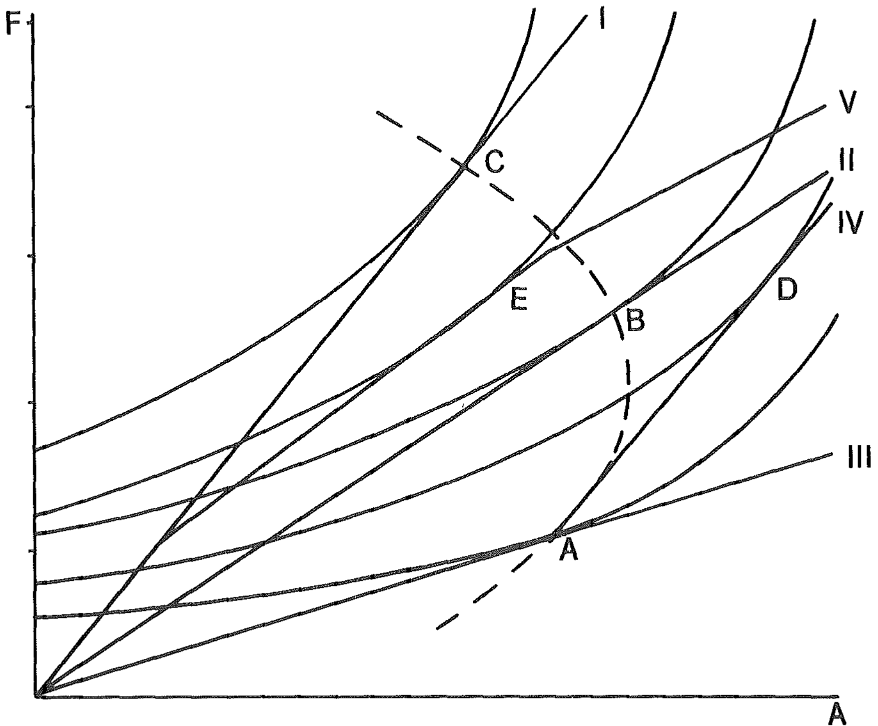
The indifference curves are also upward concave because the authorities would be ready to add successive units of adjustment effort to their policy only if they were able to marginally elicit increasing amounts of financing, or, alternatively, because marginally declining financing might increasingly discourage the will to adjust.

Obviously the positive slope of the curves might be different. Curves with a greater steepness would indicate, ceteris paribus, greater reluctance to adjust, or alternatively, that only larger amounts of financing would encourage a given adjustment effort. These variations in slopes can be peculiar to different political administrations in a given country, but also peculiar to different circumstances for a given administration (the early stages of an administration, approach of elections, etc.).

The counterpart of the budget line of indifference curve analysis—the boundary of attainable combinations of A and F—would be the conditionality applied by the IMF and the banks, at a given point in time, to this type of operation. In other words, how much financing could the authorities obtain with different degrees of adjustment effort? Different lines through or near the origin, also positively sloped, will show the maximum amount of financing they would obtain for different degrees of adjustment effort or alternatively, the minimum degree of adjustment effort they would be required to exert, for different volumes of financing.

In the figure lines I, II, and III show alternative situations with increasing conditionality (less financing per unit of adjustment effort). These lines should be seen as the boundary between the attainable (below) and the nonattainable (above) combinations of A and F.

Points A, B, and C show the most preferred attainable combination under these three alternative situations. For instance, if conditionality were to be the one described by line II, the authorities will maximize their potential economic "welfare" by choosing the F-A combination B. If the Fund and the banks were to loosen conditionality to situation I (something that probably happened, collectively, during the seventies) the authorities will move to the F-A combination C. The broken line shows that these decisions might imply moving along a backward-bending supply curve of adjustment effort.



The indifference map can also show two additional points. The first one is that if more individual country adjustment were to be desired from a collective (world) point of view, additional individual adjustment could be obtained, given the authorities' preference, by lowering conditionality marginally. For instance, in the conditions shown by line III (relatively high conditionality) the authorities will choose the A–F combination A. But if they were told that after making that effort they could obtain more financing moving along line IV (implying lower conditionality) they would most probably aim for the A–F combination D. This could be the quasi-symmetrical counterpart of the performance clause that suspends drawings for failing to attain a particular target. Here a prize (in terms of F) is given for exceeding the target agreed initially.

The second point is that the profile of conditionality in the Fund is the opposite of the conditions represented by line IV. Since as early as 1954 the IMF conditionality has been upward convex, rather than upward concave, like the situation depicted by line V. Here, as we move through the first credit tranche, conditionality is equal to the one shown by line I. Then, as we continue through the second and third credit tranches, conditionality increases to something similar to the conditionality of line II. Finally, through the fourth credit tranche conditionality increases to something similar to that of line III. If those are the conditions prevailing, the authorities will move to the A–F combination E, with as much adjustment as with the relatively low conditionality situation I, short of the results attained by uniform conditionality in situations II and III, and far shorter than the effort obtained with the marginally declining conditionality of situation IV.

Discussion

Eduardo Wiesner*

Introduction

During the last two days we have heard thoughtful presentations on the problems of the international monetary system four decades after Bretton Woods. Listening to what has been said, one cannot avoid reflecting on what has changed since then and what has not. This is an interesting analytical exercise which I suggest should be conducted at two interdependent levels: One, the changes that deal with institutional, legal and political developments. The other, the changes that have to do with basic principles and fundamental issues. Certainly, there have been profound changes at both levels. But there is one area where there has been basically no fundamental change. I am talking about the underlying principles behind the concept of conditionality. Here, little if any change has taken place in the last 40 years and this has been a good thing for the international monetary system as a whole and for the individual countries. I trust I will be able to substantiate my view in the pages that follow.

The most relevant question for us today is whether conditionality had changed or whether it should now change. These were, I believe, the issues Mr. Diz had in mind as he analyzed the antecedents of conditionality from the pre-Bretton Woods discussion to the last guidelines on conditionality that were adopted by the Fund's Board in March 1979.

I would propose, therefore to discuss Mr. Diz's paper not only on its unquestionable merits and solid content but also in the light of the central question of how much conditionality has really changed, and whether it should change now, in response to the tribulations of the countries currently facing adjustment.

Prehistory of Conditionality

After a meticulous analysis of the legislative history of the conditions attached to the use of Fund resources in the period leading to the Bretton Woods Conference, Mr. Diz comes to several interesting observations:

> First, that the idea of economic policy conditionality. . . existed in the prehistory of the Fund in varying degrees. Second, that some of the proposals were rather specific and mentioned things like appropriate measures to be adopted. . . Third, that in the Joint Statement there was a reduction in the maximum useable amounts of Fund resources and an apparent loss of specificity in the conditions attached for such use. . .

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> Fourth, that the different delegations seem to have arrived at Bretton Woods with a fairly large consensus on this question as it was a subject on which there seems to have been little discussion.[1]

Mr. Diz's observations are well documented. Sidney Dell's[2] and J. K. Horsefield's[3] review of the Atlantic City discussions leave no doubt that there was a genuine controversy (particularly between the United Kingdom and the United States) on the conditions governing the use of Fund resources. And yet, in the event, the question of conditionality was scarcely even mentioned at Bretton Woods. Different explanations have been offered for this silence. Apparently, those in favor of conditionality, as well as those opposed to it, found it better to avoid an open confrontation and tacitly agreed to leave the matter to be resolved later.

But does this really mean that the principle of conditionality was not present at Bretton Woods? Of course not. Each party was fully aware of it. Those that saw themselves as creditors as well as those that saw themselves as debtors knew that conditionality was the key factor that would determine the extent to which their hopes could be fulfilled or their fears averted. Each party knew that without some kind of conditionality, additional resources would not be available in significant amounts.

Of course, no one had in mind at Atlantic City, at Bretton Woods, at Savannah,[4] or during the first years of operation of the Fund, the kind of instrumentation that conditionality nowadays implies. All these sophisticated and refined tools to design, implement and monitor conditionality would evolve gradually in the years to come. But what occurred was the in-house gradual development of the principle, not its genesis. Even in the early years through 1952, when countries allegedly only had to "represent that the currency demanded is presently needed for making payments in that currency which are consistent with the purposes of the Fund,"[5] there was no automatic unconditional access. On May 29, 1947, after a lengthy discussion the Board of the Fund departed "from the concept of an automatic right to draw on the Fund."[6] S. Dell calls this decision a turning point in the campaign for conditionality.[7] I would call it an expression of the underlying principle of conditionality that had been there all along.

I could put my argument in another way. The fact that no country was able to draw resources—apart from its own reserve tranche—before the principle of conditionality was unequivocally established in 1952, means that up to that moment no new or additional resources were available. That is, I equate the application of conditionality to net resource availability. If net ad-

[1]Adolfo Diz, "The Conditions Attached to Adjustment Finance," in this volume.

[2]Sidney Dell, "On Being Grandmotherly: The Evolution of IMF Conditionality," *Essays in International Finance,* Princeton University, No. 144, Oct. 1981, p. 5.

[3]J.K. Horsefield, *The International Monetary Fund,* 1945–1965, IMF, Washington, D.C. 1969, p. 85.

[4]The inaugural meeting of the Board of Governors of the International Monetary Fund and the International Bank for Reconstruction and Development convened at Savannah, Georgia March 8, 1946.

[5]Original text of Article V, Section 3(a) of the Fund Agreement.

[6]J.K. Horsefield, *The International Monetary Fund,* p. 189.

[7]S. Dell, "On Being Grandmotherly," p. 4.

ditional resources are sought, conditionality is the indispensable *quid pro quo.* Otherwise, "who is going to provide the resources?" In saying this, I am not being original or ingenuous, I am reinstating an old and stubborn principle of economics: resources are limited. Conditionality is thus the link between net resource availability and the adoption of corrective policies of adjustment by a given country.

Just as adjustment is inescapable in the sense that claims on resources will have to be limited to those available, so is conditionality unavoidable if net financing is to be obtained to smooth out the process of adjustment. The tradeoff of conditionality is the possibility of an organized and controlled process of adjustment; the absence of conditionality is equivalent to a sudden calamitous adjustment, as a consequence of the unavailability of resources. The choice is not between conditional resources and unconditional resources, because there are no unconditional resources. The choice is between a conditionality that evolves out of a planned process of adjustment—based on the resources that can be mobilized—and a conditionality that is instantly imposed by the absence of resources.

Even when the adjustment is done through the market peremptorily without any mitigating conditional financing, one cannot think that conditionality has been avoided. Surely, there has not been *ex ante* conditionality but this does not mean that after the adjustment has taken place it will not be realized that *ex post* conditionality turned out to be in fact more severe and traumatic.

History of Conditionality 1952–79

Mr. Diz develops his careful analysis of the Fund's policies on conditionality by following its evolution during the periods which separate the adoption of the three main Executive Board decisions on the subject in 1952, 1968, and 1979. Commenting on the problems inherent in an automatic access to Fund resources, Mr. Diz correctly identifies the key question of "how could the Fund make sure that the member's problems were temporary, that they could be solved within a reasonable time, like three to five years?" The answer he gives: "by analyzing the policies pursued," is a clear recognition that conditionality, meaning policy conditionality, was inescapable. To this same question the Managing Director at that time, Mr. Camille Gutt, replied analogously, "The policies above all should determine the Fund's attitude."[8] He then made a proposal, in November 1950, "to break the deadlock by linking drawings to an engagement by members to take specific steps to overcome balance of payments difficulties."[9]

Although Mr. Gutt's proposal met with resistance, principally from the United Kingdom and France, it prepared the way for the Executive Board's decision of February 13, 1952 in which the principle of policy of conditionality was formally adopted. According to J. Gold, this decision on conditionality, which was negotiated by Ivar Rooth, "is to this day one of the most

[8]IMF Decision No. 102, February 13, 1952.
[9]S. Dell, p. 9.

remarkable ever adopted by the Fund. [It] clarified the meaning of the temporary use of Fund resources by establishing the basic period for use, created the gold tranche, and adumbrated the idea of the stand-by arrangement."[10]

Within the context of my initial proposition that the principle of conditionality has not really changed since Bretton Woods, I should indicate that in my view the 1952 Board decision did not create conditionality at the Fund, it merely brought out the fact that without it there would be little, if any, additional resources. The decision simply revealed the validity of the principle which was finally conceded by all. Sidney Dell says on this matter that "it was a desire to enlist the cooperation of the United States, as the principal source of credit, that prompted other Fund members to give way to American views on the question of conditionality, rather than any conviction on their part that adoption of the U.S. concept of conditionality was indispensable for a successfully functioning IMF."[11] Here I do not agree with Mr. Dell. This apparent concession to the U.S. position was not really a betrayal of a conviction, but rather a realistic acknowledgement that resources are scarce and that normally no one gives them up without some reciprocity or assurance of being repaid. Had those allegedly opposed to conditionality been asked to be creditors—instead of debtors—their views on conditionality would have been different. Let me add that, of course, no hypocrisy is involved in all of this but merely the reflection of different legitimate immediate interests.

Referring to the decades of the fifties and sixties, Mr. Diz states that "this was the period in which the concept of conditionality became fully developed." I would word the statement somewhat differently saying that it was in this period when the instruments and tools of conditionality were developed to meet the requirements of the new circumstances. It was also during this period that the idea and practice of consultations and of comprehensive economic programs came into being. These important developments were the result, to a large extent, of the progress that was taking place in the understanding of the adjustment process.

We have come now to a very interesting aspect of conditionality that has not received all the attention it deserves. I am referring to the relationships between the "state of the art" understanding of internal and external disequilibria on the one hand, and the policies to bring about and to monitor adjustment processes on the other. If balance of payments problems were only structural or self-reversing within time, there would be little need for conditionality or, for that matter, for large amounts of financial assistance. The structural problem could be dealt with through a devaluation; the self-correcting disequilibrium could be handled through the provision of financing. If these were the typical situations, then one could make a good argument for minimum conditionality and certainly for minimum monitoring and surveillance. But, as Walter Robichek says, "what the founding fathers apparently had not foreseen is that the typical balance of payments deficit is neither structural nor self-correcting inasmuch as it is caused by faulty

[10] J. Gold, "Some Impressions of the Early Fund," *Finance and Development,* IMF, March 1984, p. 25.

[11] S. Dell, p. 10.

domestic and external policies."[12] The stand-by arrangement, with all its customary features, provided a solution for the prevalent intermediate case of internal and external disequilibria.

Mr. Diz then goes on to comment on the characteristics of the stand-by arrangement and commends the Fund for having accepted that, at times, the "Procrustean one-year limit was not after all the most convenient one." Referring to the conditionality implied in the different kinds of performance criteria, Mr. Diz observes that "the number of performance criteria in Latin American and Asian stand-by arrangements were much larger than in the European arrangements." This issue of equality of treatment of countries arose at the end of 1967 when a relatively large stand-by arrangement was approved for the United Kingdom which did not contain provisions for phasing or performance criteria and specified only a few monetary and credit aims. At that time Alexandre Kafka, the Executive Director for Brazil, Colombia, Dominican Republic, Haiti, Panama, and Peru argued that such asymmetry should be corrected and that all countries should be treated equally. According to S. Dell, this episode "touched off a general review of the Fund's policy on the use of its resources under stand-by arrangements."[13] Finally, on September 20, 1968, a comprehensive decision on conditionality was adopted. The new guidelines encompassed all aspects of conditionality and "stressed the importance of providing adequate safeguards to preserve the revolving nature of the Fund's resources, and the need to allow for flexible, and yet uniform, treatment of all members. It also recognized the usefulness of phasing and of performance criteria."[14]

As the par value system came under strong pressure in the beginning of the 1970s and as the turbulence from the oil shock disrupted the world economy, the Fund responded, according to Mr. Diz, with three types of answers. The first was to create the oil facilities of 1974 and 1975 in which conditionality was comparatively low. The second was a more fundamental one. In 1974, it created the Extended Fund Facility to provide medium-term assistance to countries experiencing severe balance of payments problems. The third was the creation in August 1977 of the Supplementary Financing Facility, which permitted countries to borrow additional resources to be used in conjunction with stand-by or extended arrangements. The Supplementary Financing Facility practically doubled the amount of financial assistance that member countries could obtain from the Fund. After 1981, this facility was converted into what is now called "enlarged access."

Conditionality and Resource Availability

Before concluding his paper with an analysis of the 1979 Guidelines on Conditionality, Mr. Diz makes two important observations on the way the Fund responded to the disturbances of the 1970s. First, he believes that the

[12]E.W. Robichek, "The IMF Conditionality Re-examined," IMF, Universidad Federico Santa Maria and Central Bank of Chile Seminar, Vina del Mar, April 1983, p. 3.

[13]S. Dell, p. 13.

[14]M. Guitian, "Fund Conditionality," IMF Pamphlet Series No. 38, Washington, D.C., 1981, p. 16.

Fund was and is hampered by the small size of its own resource base which in relative terms has decreased in comparison with the magnitude of the problems it is supposed to correct.

The second point that Mr. Diz makes is, in my view, a fundamental one:

> as more and more countries began to use resources in the upper credit tranches because of the Fund's limited size, average conditionality increased not as a consequence of a conscious political decision to change conditionality but rather as an inevitable and negative byproduct of an insufficient own resource base.

This statement by Mr. Diz includes the essence of the point I have wished to make throughout this paper: that conditionality has its origin in the scarcity of resources and nowhere else. It is its inevitable by-product, as Mr. Diz puts it. Conditionality is thus a positive and not a normative concept. I find it puzzling to hear so much criticism of conditionality and so little reference to resource availability. I can only understand this as the result of a confusion of what J. Polak calls "the positive, the normative and the possible."[15]

A last comment on the relationship between conditionality and resource availability may be called for. When critics press for lower conditionality, do they mean that the proposed policy path of adjustment is wrong? Do they mean that the conditions are not, in terms of policy, the right ones?[16] Or are they really asking for a different—slower—pace of adjustment?

And yet a special caveat is in order. A rapid and major loosening of the resource constraint may induce a false sense of security and could lead to the wrong policy in the country concerned. One only needs to look at the experience of 1975–81, in terms of the external and internal resource availability of many of the countries now facing serious debt problems, to be able to conclude that additional financing by itself is not the answer. If you will excuse me for making an apparently immodest reference to my personal experience in Colombia during 1978–82, I will say that our policies never assumed that greater availability of financing meant that the country should go into debt or that our fundamental problems would be resolved if we simply, and passively, accepted all the financing that was being offered to the country. We had the view that development was much more complicated than that.

Guidelines on Conditionality, 1979

The last part of Mr. Diz's paper deals with the guidelines on conditionality that were approved by the Board in March 1979. I think his most interesting point has to do with the question of why some authorities are "so reluctant to approach the Fund for early support?" The first guideline on conditionality encouraged member countries to come to the Fund at an early stage of difficulties or even as a precautionary measure. Mr. Diz mentions two possible explanations of the reluctance observed. One has to do with the

[15] J. Polak, "The Role of the Fund," in this volume.

[16] S.T. Beza, "Panel Discussion," in John Williamson, ed., *IMF Conditionality*, Washington, D.C.: Institute for International Economics, 1983, p. 589.

size of the resources that the country may expect to get from the Fund. If the amounts are not large, it may not seem worthwhile to accept the accompanying conditionality. The other explanation refers to the political costs for a Minister of Finance to admit that a mistake has been made or that a situation is deteriorating and is out of control. In brief, and as William Dale has aptly put it, whatever the reason may be "the publicity that is given to negotiations with the Fund and the widespread impression that is created that an approach to the Fund signals a desperate situation have clearly been a deterrent to many countries that might decide to negotiate with the Fund."[17]

I will complement Mr. Diz's answers with the following comment. Coming to the Fund at an early stage is the most difficult step for a government to take because, by definition, an early approach means that the policymakers still have options or alternatives on how to handle the situation. The existence of those options creates two kinds of problems. First, the authorities will find enormous resistance to all corrective measures from the different groups that will be affected by those measures. Just warning that further deterioration should be avoided is not a very powerful or effective argument when the different vested interests are desperately trying to shift to one another—and to the public sector, of course—the burden or the cost of the precautionary adjustment. Once the economy succumbs to that struggle and no room is left for the maneuver then, and only then—in most cases—does it become politically acceptable to come to the Fund, if only because it is inevitable as there is no other recourse.

The other major obstacle to an early approach to the Fund is the possibility that a technical impasse will develop between the government, the Fund management and staff on the policies that should be put in place to redress a given situation. The earlier the approach is contemplated, the more ample and varied[18] will be the options for corrective measures and the more room there will be for different judgments "about the behavioral responses of the economy in question to this or that particular action."[19]

Conditionality in the 1980s

Mr. Diz concludes his paper with a reference to the difficult challenges that the Fund had to deal with in the first three years of this decade. He thinks that the "worst phase of the crisis seems to be over" and sees that, as a consequence of all that has taken place, "a new period has probably dawned in the history of policy conditionality in the IMF."

I began my comments on Mr. Diz's paper by stressing the immutability of the principle of conditionality. I stated that this basic principle had a permanent validity that did not change over time. While I would agree with Mr. Diz that a new era in the history of conditionality in the Fund may already have begun, I would add that the changes that have taken place since the

[17]William Dale, "Financing and Adjustment of Payments Imbalances," ibid., p. 13.

[18]It may be worthwhile to point out that in the opposite case when countries come late to the Fund, few policy options are open to design an adjustment path. Obviously, in these cases, the room for disagreement is more restricted.

[19]Richard N. Cooper, "Panel Discussion," *IMF Conditionality,* p. 571.

beginning of this decade and those that will occur in the near future, will consist of innovations and modifications in the instruments and in the modalities of conditionality but not in its underlying principles.

This, of course, does not mean that new solutions to new problems will be adopted. Recent history proves that the Fund can respond and take the initiative to tackle successfully complex and unexpected problems. Several examples could be offered. It should suffice at this point to mention the formidable task of assembling in 1982 and 1983 complex financial packages involving, inter alia, commercial banks, central banks, the BIS, creditors and debtors. Surely, there are still difficult and unresolved problems like those stemming from upward changes in the rate of interest or from the need to examine the multiyear rescheduling of debts, but they do not seem insurmountable. On the basis of what has been accomplished in the past, one can look to the future with optimism.

General Discussion

Robert Solomon posed two questions. First, no distinction had yet been made in the conference between conditionality imposed when a country's request for Fund resources arises from previous domestic policy mistakes and that imposed when a request arises from the negative impact of a foreign shock. Should Fund conditionality vary between these two cases? Second, suppose several requests emanated from the same region of the world, such as Latin America. Would the Fund design each country's program individually, or would the Fund's approach be regional?

Adolpho Diz responded that the first question had arisen within the Fund as early as 1953. Indeed, certain IMF facilities, such as the Compensatory Financing Facility, were arranged specifically to finance adjustment to shocks from abroad.

Eduardo Wiesner added that recent economic programs have been designed to take into consideration the world's economic policies. Adjustment policies within developing countries should incorporate probable policy actions within, say, the OECD countries.

Robert Roosa asked what the prospect was for designing adjustment programs and conditionality to take greater account of the complex, structural problems that many countries face. Diz responded that a new era in Fund conditionality might be dawning; he felt that the Fund rose to a new height in response to the debt crisis. He suggested that the economics of external debt be further analyzed and incorporated into Fund conditionality.