On the ownership of reform proposals. How social policies found their way into IMF adjustment programs

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Resumo – Há muito tempo, tanto o FMI quanto o Banco Mundial se vêem frustrados pelo grau relativamente baixo de sucesso dos programas de ajuste que ambas as instituições impõem aos países que buscam seu apoio financeiro. No caso do Fundo, os governos locais relutam em implementar suas políticas, abandonando os programas negociados assim que as crises que os levaram a pedir seu apoio se amenizam. A principal razão para que isso ocorra é a percepção por parte dos governos de que as políticas não são escolhidas tendo em mente o interesse dos países em crise, mas o interesse de terceiros, ora identificados com investidores internacionais, ora com governos dos países mais ricos. Por esta razão, o FMI desenvolveu o conceito de apropriação (ownership) de políticas, para descrever a situação em que um país adota como suas as políticas que lhes são impostas. Uma dificuldade, contudo, para que esta apropriação se desse sempre foram os elevados custos sociais que acompanham os programas de ajuste do Fundo – conjunturais e estruturais – em termos de desemprego, de agravamento da concentração de renda e de piora da pobreza. O desastre causado pelas políticas do Fundo na Ásia em 1997/8 e as conseqüências de suas políticas nos países mais pobres levaram-no a incluir políticas sociais em seus programas, como forma de obter a adesão dos governos locais e aumentar o grau de sucesso da imposição de suas políticas.

Palavras-chave – Programas de ajuste macroeconômico; FMI; políticas sociais.

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Abstract – For quite a long time both the IMF and the World Bank have complained about the low degree of success of the adjustment programs they impose on countries that seek their support. As to the IMF, local governments try to avoid implementing adjustment policies, abandoning them as soon as crises are alleviated. The main reason explaining this attitude is the perception that policies are not chosen by the IMF having their interests at heart. It is believed that the Fund pursues third parties’ interests, sometimes identified with international investors, sometimes with rich countries’ governments. To change this view, the Fund developed the concept of ownership, to describe the situation in which the crisis country accepts adjustment policies as being in its own interest. However, the acceptance of IMF-inspired policies has always been made difficult by the social costs they impose on the borrowing countries. The disaster caused by the Fund’s programs on the Asian crisis economies in 1997/8 and the consequences of their structural programs in the poorer countries led the IMF to include social policies in their adjustment packages to induce ownership and to increase their probability of success.

Key words – Adjustment programs; IMF; ownership; social policies.
I. Introduction

At the closing of their September 1999 meeting, the IMF and the World Bank announced that, from that date on, the fight against poverty would become an integral part of the adjustment programs sponsored by the two institutions. This was not a surprising announcement as far as the World Bank was concerned, although it could be construed as an admission of failure, to some degree, since fighting poverty had been a goal of the Bank for a long time. As to the IMF, on the other hand, the newly discovered social concern was hailed by many as a very significant act of contrition. Many read in the announcement the acknowledgment by the Fund that the policies it had sponsored to that date were actually causing poverty to increase. It was expected that the Fund would thus be willing to reform its ways and to accept and support new strategies aimed at privileging the interests of the poor, even if it meant to sacrifice some of the benefits enjoyed by banks and financial institutions, widely seen as the usual beneficiaries of its policies.

It was soon realized that there was a large amount of wishful thinking in these evaluations. The Fund itself contributed to dispel the first impression by insisting that there was really nothing new in its position since it had always been concerned with poverty. The announcement was a matter of emphases, not of new content. Fighting poverty, said the Fund’s authorities, was actually implicit in the first of its Articles of Agreement, since it was an element of the overall stability it was supposed to defend1.

Be it as it may, some changes were introduced both in the Fund’s rhetoric, and in its adjustment programs. In terms of its rhetoric, as former managing director Michel Camdessus often repeated, poverty was to be seen as “the biggest systemic risk”. As to actual policies,

1 E.g.: “… social policies are central elements of government budgets, of donors’ aid programs, and of international communiqués. Nor are these issues new to the Fund; for many years IMF-supported programs have explicitly incorporated social policies.” (CAMDESSUS, 1999c, p. 5)
two sets of initiatives in particular come to mind. First, the Fund began to make clear the need for countries benefiting from its financial help during balance of payments crises to consider the creation of social security nets to mitigate the social cost of crises themselves and of their resolution. Secondly, measures were to be taken to relieve the burden of the external debt of the poorest countries, the HIPC initiative, and to finance poverty relief strategies, the PRGF.

Of course, one could ask, if the Fund had always been concerned with poverty, why the rhetoric of September 1999? What, if anything, had actually changed in that meeting? On the other hand, if one judges that there was something actually new, what was it? How effective these new policies could be in the fight against poverty? Most importantly, how far was the Fund prepared to go to support these new goals?

II. The Roots of Change

The IMF has been well known for the self-assuredness its authorities and staff share as to the need for, and fundamental adequacy of, the policies and strategies they impose on the countries that appeal to the Fund for help. When something that could be construed as a self-criticism came out of the 1999 meeting, it was received, understandably, with a shock.

2 This paper is concerned primarily with the IMF rather than with the two Bretton Woods institutions. While, traditionally, the World Bank has financed sectoral programs, the Fund imposes macroeconomic strategies including, beginning in the 1990s, long-term structural reforms and macropolicies. Moreover, the IMF is usually accessed in times of crises, when the bargaining position of borrowing countries is particularly weak to resist the Fund’s attempts to impose policy and reform conditionalities. Finally, while the WB has been noted recently for exhibiting some diversity of views, the IMF is monolithic. For all these reasons, the strategic strength of the Fund has been much greater than the WB’s, at least for middle-income developing countries. The WB has been advised recently to change its focus from sectoral projects to general support of reform-minded governments (cf. DOLLAR AND SVENSSON, 1998). Even if the Bank changes its policies, though, its influence will remain largely confined to the poorest countries, beneficiaries of its loans, while the IMF, on account of its role in balance of payments crises can also impose its views on emerging market economies.
There is no doubt that, if nothing else, the Fund’s rhetoric has changed. One can compare, for instance, the following two statements made by Director Camdessus at two different opportunities explaining the foundations of the Fund’s strategies against balance of payments crises. The first was made in September of 1998, when the full impact of the Asian crisis was not yet completely known. The second was taken from a speech given in December of 1999, in Korea. Both are practically identical except for the inclusion of social “concerns” in the second speech:

Within these programs, we can discern three tiers of recovery. The first tier is to restore stability. As usual, immediate action is needed for countries faced with sudden acute pressure on their balance of payments; The second tier is to improve soundness. Lost confidence, especially in domestic financial and corporate systems has to be restored through fundamental institutional changes; The third tier is to boost efficiency. The approach of ‘managed development’ underlying economic policy, characterized by mechanisms that interfered with market allocation of resources, has become increasingly out of tune with the rigorous demands of our globalized economy. Basic changes in the approach to policymaking, allowing market forces to operate more freely, will be essential. (CAMDESSUS, 1998)

One could say that with certainty, in fact, only in the case of the former highest authority in the Fund, Director Camdessus, and of a few of the other directors, that fully incorporated the new rhetoric. It is noticeable, on the other hand, that Deputy Director Stanley Fischer, later Acting Managing Director, kept his speeches and interventions focused on the traditional targets of the Fund, seldom, if at any time, expressing social concerns. See, for instance, Fischer (2000), where the IMF approach to crisis resolution is expounded without any reference to poverty alleviation. New Managing Director Horst Kohler, in his first press conference at the IMF, seemed to follow Camdessus’ footsteps. Questioned about social tensions in Argentina caused by adherence to IMF’s programs, Mr Kohler replied that “[he] made clear that the market economy needs to be based also on social consent – on a consensus about the social dimension of development. There cannot be blindness to poverty and social problems.” He also emphasized, however, the fact that it is not an IMF program for Argentina, but Argentina’s own reform program, that is being implemented. He hinted that Argentina’s good will in taking the program as its own could make (continued)
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What challenges lie ahead for the Asian countries, including Korea, as they emerge from crisis and enter the unchartered waters of the new century? Well prudence suggests that each country, not least Korea, should be prepared for the unexpected. What does it require? Many things indeed, and you are better qualified than I to define. But at least the following – maintaining stability, strengthening institutions, raising efficiency and promoting equity. (CAMDESSUS, 1999f, pp. 4/5, emphases added)

The first three elements are precisely the same in both speeches. What is new in the 1999 version is the discovery that “promoting equity” was a condition for the sustainable recovery of the Asian economies. As Mr Camdessus added: “promoting equity suggests an ambitious social agenda that is associated with sensitivity to national culture, with poverty reduction as a core consideration.” (CAMDESSUS, 1999f, p. 5) A little over a year before, the need to take into consideration “sensitivity to national culture” and “poverty reduction” was completely ignored.

What is the explanation for this change?

The timing of the change leaves no doubt that it was the unexpected (at least by the IMF) depth of the economic and social crisis in Indonesia, Korea and Thailand, especially the first of the three, that seemed to have scared the IMF. Social unrest in Indonesia led to the downfall of the Suharto Dictatorship. In Korea, unions took on the streets to protest against sharply rising unemployment resulting from high interest rates and fiscal contraction. Most of all, the recessive policies sponsored by the Fund seemed to fatally threaten the successes accumulated during years of economic growth and social improvement in the region.

IMF staff economists, Lane et al (1999), in a review of the Fund’s performance in Asia, admitted that the Fund was taken aback by the unexpectedly destructive impact of the policies adopted to stop capital

the Fund more flexible about compliance to specific targets: “that there is ownership is more important than a short-term effect of maybe a number, a specific number in a program of the IMF.” Kohler (2000).
flight and currency devaluation in the three crisis economies⁴. For many, the IMF transformed “slowdowns into recessions and recessions into depressions” (STIGLITZ, 2000). Those countries did not have adequate social safety nets in terms of unemployment relief, income and in kind transfers, emergency job creation mechanisms, etc. Laid off workers had to bear the impact of job losses. Besides, many of dislocated workers came from the middle classes, like bank workers, managers, technicians, etc. These groups had higher income expectations and were very often in debt, issued to buy houses, appliances, etc, as it is natural in growing economies. The sudden loss of income sources forced a large fraction of them to join the ranks of the unemployed, and to have their assets repossessed, without even the relief offered by access to the programs targeting the very poor.

Facing a situation like this, the Fund changed its policy stance, allowing the governments of the crisis countries to run fiscal deficits in order to mitigate the recession and to finance the enlargement of social safety nets. At the same time, the Fund tried to capitalize this retreat by dressing it as a conscious strategy to fight poverty⁵.

⁴ Lane et al. (1999) admitted that “[e]conomic events during the crisis have been dramatic and have defied expectations. … In several respects these outturns were much worse than expected: in particular, in all three countries there were sharp revisions to projections for growth and exchange rates which necessitated changes in program targets.” (pp. 5/6) One should notice a “structural” flaw in the IMF’s method of economic forecasting: “The IMF, like most observers, misread the extent of the recession. This was largely a reflection of the fact that, as in all Fund-supported programs, macroeconomic projections were predicated on the success of the programs, including the restoration of confidence. Moreover, the Fund and the authorities appear to have erred on the side of optimism in part because of concerns that realistically pessimistic forecasts would have exacerbated the situation further – but the resulting large revisions in projections were detrimental to credibility.” (idem, p. 45) On the underestimation of the impacts of IMF’s policies in the Asian crisis see also IMF (1999, p. 15) and Sugisaki (1999, p. 2).

⁵ The criticisms raised against the IMF and its response to them were listed and examined in Carvalho (2000b). Two mains criticisms were leveled at the Fund: its short term policies, raising interest rates and curtailing fiscal expenditures led to a wave of bankruptcies and growing unemployment when the correct medicine should be an injection of liquidity; its long-term policies consisted in imposing structural reforms that, even if necessary, should not be implemented during a crisis.
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In parallel to these developments, another debate had been taking place for some time on the need to relieve poorer countries of the burden of servicing increasing amounts of foreign debt. Practically all of this debt was owed to industrial countries’ governments and to multilateral sources, like the IMF and the World Bank, since these countries had limited or no access to private capital markets. In fact, even these debts to official creditors were considered to be unsustainable anyway since their service absorbed too large a share of fiscal and export revenues, leaving too little to reach the growth rates that would be necessary to reduce the debt burden to acceptable proportions.

From these two roots, two strategies were devised to deal explicitly with social problems. On the one hand, adjustment programs designed to deal with balance of payments crises in emerging economies would include provisions to guarantee the creation of sufficient social safety nets to mitigate the impact of recessive measures in the short term\textsuperscript{6}. These provisions were particularly forceful in the letters of intent signed by Asian countries with the Fund\textsuperscript{7}. The other strategy was directed at the poorer countries for which the HIPC (Highly Indebted Poor Countries) Initiative was created. The initiative consisted in establishing a series of conditions to allow the cancellation of a substantial share of these countries’ foreign debt. Among these conditions, two are particularly noticeable and will be discussed later.

\textsuperscript{6} In the long term, as we will see, the Fund considered that these measures would be superfluous because the policies it recommended should be able to allow sustained economic growth to be resumed. As Camdessus has repeatedly put it, “economic growth is a sine qua non and the most significant single factor that contributes to poverty reduction.” (CAMDESSUS, 1999e, p. 5).

\textsuperscript{7} The Fund did not show the same determination in its dealings with Latin American countries. As some observers have noticed it, the letter of intent signed by Brazil in November 1998 with the Fund vaguely refers to a promise by the Brazilian government to try to spare social expenditures from cuts, as much as possible. See Brazil’s Letter of Intent, November 13, 1998, paragraph 22, available in the IMF website. In fact, there is some hesitation as to whether middle income client countries should be bothered by the Fund into accepting conditionalities in terms of social policies. See Camdessus (1999d, p. 7).
in more detail. Firstly, countries had to accept and have implemented IMF structural policies for some time in order to qualify for the Initiative. Secondly, debt cancellation would depend upon the preparation of a Policy Reduction Strategy Paper, in which the client country would present the strategy it would follow to reduce poverty with the resources freed by the reduction in foreign debt. The preparation of PRSPs would in fact not only qualify the country for the benefits of the HIPC Initiative but also give it access to the Poverty Reduction and Growth Facility (PRGF).

A companion to the HIPC Initiative, the PRGF was designed to help focus additional financial help on instruments that could allow a more efficient combat against poverty. The facility is a successor to ESAF (Enhanced Structural Adjustment Facility), the most important novelty of which is precisely the requirement that the country in need itself defines itself its own anti-poverty strategies. Countries that succeed in preparing PRSPs will, thus, qualify for both debt cancellation under HIPC and for additional financial help under PRGF.

Both lines of attack on social problems had one crucial point in common: they were both conceived primarily as a means of making structural reforms politically acceptable to the countries under the IMF influence. They are proposed not to replace strategies implemented in the past, but to complement them. The key word for the IMF is “ownership”: policies aimed at relieving poverty will be part of the same package that includes the liberalizing reforms the IMF wants to see applied. As elements of a joint overall strategy, the Fund expects that the client countries will consider market liberalizing reforms as their own, as much as the anti-poverty strategies. Making policy packages palatable to local populations and, thus, politically more popular was an explicit aim of the Fund with its new emphasis on social problems, something which, in itself, would not be a problem if they did contribute to improve the situation.

Director Camdessus was in fact very candid about the true goals of the Fund. As he admitted: “But the converse is also true: popular support for stabilization and reform will not be there unless the productive potential of the population, (continued)
III. The IMF’s Strategies for Middle Income Countries

With the collapse of the international monetary system created in Bretton Woods, based on fixed exchange rates between the currencies of the most important developed countries, the IMF temporarily lost its function. The Fund had been created at that conference to help solve eventual liquidity crises that usually arise in fixed exchange rate systems. When exchange rates were allowed to float in the 1970s, the Fund lost its *raison d’être*. During the 1980s, and especially in the 1990s, however, the Fund changed its clientelle from industrial countries to developing countries going through balance of payments crises. These countries, however, in contrast to developed countries, were diagnosed as suffering from deeper illnesses than the industrial economies. Balance of payments problems were believed to result from structural maladjustments, rather than mere imbalances between aggregate demand and supply. To attack the crises it was, then, necessary to change the economic “structures” of these countries. The general idea was that these economies suffered from too many “rigidities” that prevented the efficient operation of markets. These markets had to be freed, especially from the shackles created by including the poorest, is unlocked through better health, education and nutrition …” (CAMDESSUS, 2000a, p. 5). Also: “the experience has reinforced that the ultimate objective of all economic policy is human development, and that sound social policies, centered on poverty reduction, must be an integral part of policy formulation. The programs in Asia have demonstrated clearly the circular linkages among strong monetary and macroeconomic management, high quality growth, and poverty reduction. Without the first two, there is little chance of reducing poverty. Without the latter, then the essential broad-based support for policy implementation will be absent.” (CAMDESSUS, 1999f, pp. 3/4 ). Another example: “popular support for stabilization and reform cannot be counted upon, unless the poorest … is able to participate in the formulation of the policies and, of course, in the benefits from those policies.” (CAMDESSUS, 2000b, p. 4) In a more somber tone, Camdessus adds, in the latter speech: “If the poor are left hopeless, poverty will undermine the fabric of our societies through confrontation, violence and civil disorder.” (idem, p. 5)

The evolution of the IMF’s views and strategies as it moved from the focus on developed to developing economies was discussed in Carvalho (2000a).
government intervention in all its forms. Governments intervened too much in the economy by creating enterprises, orienting credit policies, distorting risk calculations, picking up winners and, of course, by corruption, cronyism, etc. As a result, economic structures were weak, dependent on protectionist measures, distributing favors rather than rewarding efficiency, and so on\textsuperscript{10}.

Because of this diagnosis, adjustment programs to help solve balance of payments problems began to include conditionalities in terms of structural reforms aimed at liberalizing goods, labor and financial markets. Reform programs most of the time target for elimination protective measures that surround domestic firms, be them regulations of market access, special financial lines, fiscal privileges, etc. An inevitable result is the increased competition from foreign suppliers in domestic markets, leading many producers to close their doors. Jobs may be lost in large numbers. In addition, financial restructuring may also imply closing down corporations and financial institutions. Rising interest rates and fiscal austerity add still more strain to the picture. Domestic firms may not resist the increase in financial costs because of rising interest rates and the loss of demand resulting from the cuts in government expenditures. All this implies job losses. Finally, the downsizing of the state apparatus itself leads to additional lay-offs\textsuperscript{11}.

Even in its earlier years, the Fund was associated with recessive policies and growing unemployment. The Fund’s influence, however, was temporary, limited by the duration of the period for which finance was needed to cover balance of payments disequilibria. When structural reforms come to the scene, the impact of the IMF’s policies may persist for a much longer period of time, causing long-lasting pain. Unemployment may become permanent because sources of

\textsuperscript{10} That countries could miraculously grow at very high rates for extended periods of time, competing successfully with industrial economies in many markets and improving living conditions of its population, as it was the case of Korea, is now generally overlooked.

\textsuperscript{11} As it happened in Argentina in the early 1990s.
employment are now destroyed, existing labor skills may become suddenly obsolete for a large fraction of the labor force, all of this taking place in a period in which the state sees its capacity to intervene reduced by compulsory fiscal austerity. In fact, fiscal adjustment programs themselves add another deleterious element to this picture, since the Fund’s strategy is to preserve the expenditures related to the service of public (foreign and domestic) debt, at the expense of everything else, including social spending.

In this picture, it should not be surprising that: 1. the population of these countries identify the implementation of these programs with the Fund itself, since they were “agreed” to by client governments negotiating under obvious duress; 2. reaction against such a program takes the political shape of criticism of, and opposition to, the Fund itself, rather than the domestic government, since the appeal to the IMF is widely seen as equivalent to letting go of national autonomy. Resistance to the “structural reforms” supported by the Fund takes the immediate form of opposition to foreign intervention.\(^\text{12}\)

It is in this context that the Fund began to worry about “ownership”. The first explicit attempt to sell the idea that IMF programs were actually proposed by the client economies themselves was on the occasion of the signature of Brazil’s Letter of Intent of November 1998. Although it is widely acknowledged that Letters of Intent\(^\text{13}\) are in fact produced at the prodding of the IMF, the Fund’s authorities insisted that the initiatives listed in the Brazilian letter were decided by the government and not by the Fund. Deputy Director Fischer, in the press conference called to present the letter emphasized

\(^{12}\) Even if, as it is the case of Latin American countries like Argentina, Brazil and México, the liberalizing reforms were already part of the political programs of the parties in power before they had to appeal to the Fund for rescue.

\(^{13}\) A Letter of Intent is the document signed by the client government committing itself to pursue certain adjustment goals in exchange for the financial support from the IMF. It is the document that the board of the Fund examines in order to decide whether to negotiate a rescue package. In theory, the letter is written by the government and sent to the Fund for examination. As it is well known, however, the terms of the letter are dictated in detail by the Fund itself. Details of how this process takes place are given in Mussa and Savastano (1999).
that the adjustment program being proposed was “owned” by the Brazilian government\textsuperscript{14}. The same concern with ownership was expressed in the case of Russia, this time to stress the need for the Russian government to “own” the adjustment program the Fund judged to be necessary.

As we saw, it all boils down to the question of political support for the adjustment programs. It is hardly surprising that programs that are widely seen to be prepared abroad, to benefit mainly international banks and financial investors at the expense of national interests, are likely to generate political opposition, the more so the more it is perceived as solely benefiting foreign and sectoral interests. The Fund realized that to gather political support, to commit governments to comply with the programs, and to guarantee that reforms would continue to be implemented even after the repayment of the debts with the IMF, they had to include explicit initiatives to defend local groups, particularly those bearing the most visible burden of the adjustment. As the Fund made clear repeatedly, it was not a change of strategy. The goal of liberalizing markets and downsizing governments was kept in its entirety. The point was to get support for it and the way to do it was to foster “ownership” by incorporating the defense of the social groups most immediately hit by the reforms themselves. The IMF did not retract from its main views. It still believes that a world of free goods, labor and financial markets is the one most conducive to prosperity, growth, etc. It is the short-term side of the strategy that changed. It is necessary to mitigate the short-term costs of implementing these programs to minimize opposition and to guarantee that they will be taken to completion\textsuperscript{15}.

\textsuperscript{14} In a press conference called to announce the signature of the agreement between Brazil and the Fund, Stanley Fischer remarked: “…as the Brazilians emphasize – and we are happy to agree with them – these are Brazilian policies…” Press conference held at the IMF, November 13, 1998, available at the IMF’s website.

\textsuperscript{15} As it was explained in an evaluation made by the Fund itself of its social policies: “In the short run, measures needed for macroeconomic stability can adversely affect some poor groups, while helping other such groups. … Mitigating the adverse effects of reform programs on poor groups should be an important aspect of the IMF’s policy advice and program design.” (IMF, 1999, p. 9)
IV. The HIPC Initiative and the PRGF

Similar reasons seem to justify the second line of attack by the Fund on the poverty problem. The starting point of the HIPC initiative and the PRGF\(^{16}\) seems to be the perception, enhanced by the continuous criticism of international NGOs such as the Jubilee 2000, that in the poorer countries growth alone may not be enough to solve the poverty problem\(^{17}\). The Fund maintains the belief that liberalizing reforms will succeed in fostering growth in these countries as much as in any other\(^{18}\). The extent of the poverty problem, however, in these cases would require specific steps to make sure that some of the fruits of expected growth will trickle down to the poorest groups in these societies. Again, the general motivation seems to be the same: it is necessary to include these groups to gather their political support for the reform programs themselves. It is, again, the question of “ownership” that is at stake.

The IMF never admitted that their past programs, like the ESAF, predecessor to HIPC, implied especially high costs for the poor in these countries. In fact, an evaluation of its experience with poor countries made public by the Fund insists that not only these past programs were successful in fostering economic growth but also that the countries that had the support of ESAF actually increased social spending in health and education, mitigating poverty\(^{19}\). To take these arguments at their face value, the point of creating new initiatives seems to be mainly political. It is not only a question of better marketing for the Fund’s program, by changing labels and emphasizing the social

\(^{16}\) These are in fact two different but related programs, usually examined jointly since the client countries for one of them are also the candidates for the other.

\(^{17}\) As Michel Camdessus admitted in one of his farewell speeches, “growth alone is not enough” (CAMDESSUS, 2000b, p. 3).

\(^{18}\) See, e.g., Camdessus (1999b).

\(^{19}\) “On average, in the past decade, education and health care spending has increased (in real per capita terms, as well as in relation to GDP) in countries with IMF-supported programs.” (IMF, 1999, p. 4).
content of its strategies, but to involve the local population itself in the fight against poverty\(^\text{20}\).

The new initiatives involve two benefits for the poorer countries. On the one hand, there is the possibility of partial debt cancellation for the countries that define an appropriate strategy to fight poverty. Debt alleviation is expected to allow these societies to use fiscal revenues and foreign currency inflows to finance initiatives against poverty rather than using them to service foreign debts. On the other hand, it is expected that donors will offer additional resources to countries that prove their willingness to use them more effectively to benefit the poor. To do it, a requirement was included in the new initiative that client countries should prepare Poverty Reduction Strategy Papers describing how they intended to fight poverty, setting priorities, defining instruments, quantitative goals, etc. If these plans were approved by the Fund (and the World Bank), they would serve as the guiding document for implementing the HIPC initiative.

The fact that these Papers should be prepared by local governments, in ample consultation with civil society, would enhance “ownership” and, thus, gather the political support for the program the Funds seeks for.

We will evaluate the two strategies described in this and in the previous sections in the next section. One should note, however, that the HIPC initiative, if successful in attracting the interest of potential candidates, might in fact be very cost effective for the Fund. Although there is still debate as to how the costs of debt cancellation will be allocated among donors, one should not lose sight of the fact that the HIPC Initiative is being offered to help countries with “unsustainable” foreign debt, which means countries with debt with very low probability of repayment anyway. In this sense, donors and the IMF can score political points by forgiving a debt that they did not expect to be paid back anyway, that adds to a relatively low total value, and

\(^{20}\) As the IMF’s Fact Sheet on the PRGF puts it: “Nationally-owned poverty reduction strategies are at the heart of the new approach.” (p. 1) See The IMF’s Poverty Reduction and Growth Facility, available at the IMF’s website.
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that does not involve private donors and, thus, creates no risk of causing financial crises. In addition, as it will be argued in the next section, the Initiative strengthens the Fund’s power to continue to impose liberalizing reforms in these countries. Given its estimated cost\(^{21}\), one could say that the Initiative is a real bargain for the Fund.

V. A Critical Evaluation of the Two Strategies

The necessary starting point of an evaluation of the IMF position with respect to social policies and the fight against poverty is the realization that nothing remotely like a change of mind has taken place. The IMF is very explicit in maintaining that growth is the most important pre-condition for eliminating poverty, and that growth is best attained through market-friendly structural reforms of the kind it has included as conditionalities in the agreements it has signed with client economies\(^{22}\). Thus, the Fund still believes that there is only one way to maximize expected growth, that is liberalizing goods, labor and financial markets, and maximizing growth remains the overriding goal of the institution. Active governmental intervention can only hinder growth and therefore intervention powers have to be drastically reduced. Sound, market-friendly policies, and arm’s length relationships between governments, banks and firms are the foundations of long term prosperity and nothing should be done that could threaten these foundations. That was, and remains, the main thrust of the IMF’s doctrines.

The IMF was created to help solving balance-of-payment crises that were expected to take place in the framework of the fixed

\(^{21}\) One has also to remember that not all potential clients of the HIPC Initiative will be contemplated with the benefits of the program at once. In fact, the program is beginning to assist a very small number of countries among the potential beneficiaries.

\(^{22}\) According to IMF (1999), the Fund promotes sound macroeconomic policies. Macroadjustment policies benefit the poor (p. 8). As Michel Camdessus often insisted, fiscal austerity and structural reforms promote growth and, thus, help the poor. See, among innumerable speeches, Camdessus (1999a).
exchange-rate system decided in the Bretton Woods conference. Its role should be limited to financing short-term current account deficits in the context of the adoption of a certain set of macropolicies designed to reestablish current account equilibrium. Crises caused by capital flows disturbances should be dealt with through capital controls (cf. article 6 of the Fund’s Articles of Agreement).

In the BW conference, Keynes, head of the British delegation, proposed that balance of payments adjustment should be pursued by expanding aggregate demand in surplus countries, which increases output and employment, rather than by contracting demand in deficit countries, that is, reducing their incomes (and employment) to the point in which the demand for imports is low enough to zero trade and services accounts deficits. According to Keynes, balance of payments adjustments under the gold standard was characterized precisely by the imposition of deflation and unemployment on the deficit countries. Keynes argued, in contrast, that, as a matter of arithmetic, a country can only be in deficit if at least one other country is in surplus. If the latter can be persuaded to spend its surplus revenues in imports from deficit countries, both will be able to experience growth and increasing employment.

Keynes’s proposals were defeated in the conference. No mechanism to defend global employment was created. In fact, the IMF staff never even shared Keynes’s concern with unemployment. As the IMF historian M. de Vries shows, inflation has always been the Fund’s primary concern, not employment (DE VRIES, 1987). Inflation cannot be fought by sustaining high levels of aggregate demand and employment. Only by cooling off deficit economies one can successfully pursue price stabilization, according to the Fund.

23 The World Bank, on the other hand was created to finance the reconstruction of the European economies damaged by World War II. Neither of the two institutions was conceived to fight poverty or to support development of the underdeveloped economies. In fact, a third institution was to be created to deal with the latter problem, but it never came to light. See Kregel (2000).
The theoretical approach developed by the IMF was developed gradually. According to de Vries (1987) it is the combination of three strands: the elasticities approach to trade imbalances; the absorption approach; and the monetary approach to balance of payments adjustments. The elasticities approach embodies the traditional Marshall/Lerner conditions to determine if changes in exchange rates can balance exports and imports. The absorption approach is based on the idea that imbalances between exports and imports reflect imbalances between aggregate demand and domestic aggregate supply. To solve current account imbalances one has, thus, to bring aggregate demand and domestic supply into balance. Finally, the monetary approach to the balance of payments establishes a relation between money supply and aggregate demand.

One can see that when the Fund identified as its overriding concern fighting inflation rather than unemployment, adjustment policies designed in the theoretical framework just referred could only have perverse impacts on poverty. While the Fund primarily dealt with developed countries, the deleterious impacts of its policies on income and employment were relatively limited in both depth and duration.

In the 1990s, a series of factors increased the poverty-enhancing impact of the Fund’s actions. Firstly, in fact since the late 1970s, the Fund changed its clientele, from developed to developing countries. Industrialized economies, nor maintaining floating exchange rates, no longer needed the Fund’s help. Secondly, and as a result, the Fund concluded that balance of payments problems in developing countries could not be addressed by its traditional strategy alone. The latter had to be supplemented by a host of structural reforms to remove distortions deeply ingrained in their economic structures. The Fund, however, never developed a theory of development. It limited itself to vague statements that liberalization of markets would by themselves promote growth, and growth by itself should eliminate (or significantly reduce) poverty\textsuperscript{24}. As Stiglitz has persuasively argued, this view, put forward

\textsuperscript{24} Once can compare the difference in treatment given by IMF Research Director Michael Mussa to the need to increase interest rates and curtail fiscal expenditures
as a central element of the so-called Washington Consensus, has no solid basis either in economic history or in theory (cf. STIGLITZ, 1998). On the other hand, it is obviously coincident with the interests of large multinational firms, and international financial institutions in particular, to open economies from which they had been partly, or wholly, barred. Finally, in the 1990s, the world has witnessed a very rapid process of financial and capital flows liberalization, not only in the industrialized countries but also in developing economies. As a result, the influence of international financial investors (including developing countries residents with access to foreign assets markets) on domestic policy-making increased. To preserve a favorable “market sentiment” (in the apt words of Michel Camdessus) makes it very difficult to adopt progressive policies even in normal times. During crises, on the other hand, appealing to the Fund becomes unavoidable. Once help is asked, the Fund will impose, to begin with, steep increases in interest rates to appease market sentiment and convince investors to return to these economies.

The concern the Fund has been voicing with poverty has not changed its strategy, as one can see by documents like Mussa and Savastano’s paper. Poverty relief is no more than an afterthought. It would probably not even be an afterthought had not the impact of the Fund’s policies in East Asia been so disastrous\(^\text{25}\).

Thus, there is no alternative growth model to be considered\(^\text{26}\). The industrial policies that for many were the key for the success of

\(^{25}\text{There were many reports in the press of the social impacts of the crisis and of the Fund’s policies. A particularly interesting piece as published in the Washington Post, in three parts, from September 6 to 8, 1998, under the headlines “Middle Class Plunging Back Into Poverty”, “A Generation Lost to Destitution” and “The Path from Boom to Bust Leads Home”.}\)

\(^{26}\text{There is one last possibility to be considered: that the Fund did not have any theory of poverty because it worked with the WB. In fact, some IMF officials have suggested that this was the cause for the perfunctory treatment of the problem in IMF documents (cf. Mussa and Savastano, 1999). This is not very convincing. Firstly, because the Bank itself has not been a source of a monolithic view of how to promote poverty relief. It is (continued)\)
countries like Korea, for the Fund are little more than manifestations of cronyism, illegitimate channels to favor special interests, mere sources of corruption. Now, these wrongs are being corrected by market liberalizing reforms, a sine qua non requirement to attain sustainable growth\textsuperscript{27}.

The IMF flatly refuses the criticism that financial liberalization, and \textit{not} internal maladjustments, caused the Asian crisis, raised by many economists\textsuperscript{28}. At worst, there could be a problem with the \textit{sequencing} of liberalizing reforms, not with the reforms themselves. The wrong sequencing could create sources of vulnerability, particularly in terms of short-term debt accumulation, that helped to subject Asian countries to liquidity crises. But the Fund declared itself pleased with the fact that, with a few exceptions, most emerging countries, including those

\textsuperscript{27} To be fair, the Fund also recognizes the need for a new financial architecture, although the debate on its main foundations proceeds much more slowly than the definition of conditionalities for crisis economies. Currently, most of the debate on the new architecture has been limited to rules of data disclosure by debtor countries to allow financial markets to better evaluate (and price) risks and a more protracted debate on how should private agents, especially lenders, to be involved in crisis prevention and resolution.

\textsuperscript{28} Studies prepared by the Fund staff, and available as working papers, on financial crises found out the only reliable predictor of financial crises was a previous period of financial liberalization. Cf. Demirgüç-Kunt and Detragiache (1998).
affected by the later crises, maintained course towards liberalization (CAMDESSUS, 1998).

Within this framework, social policies are required to mitigate the costs created in the transition toward a liberal economy. They are not intended to change the course of economic reforms, and they don’t have any priority over the traditional economic goals set in the Fund’s agreements. In fact, social policies have to be accommodated in the fiscal budget that is defined with other priorities in mind, particularly the defense of financial contracts and the service of the public debt. In the case of the Asian countries, client economies were authorized to run deficits given the extraordinary recessive impact that the adjustment program had on them. This was an emergency measure though. The general orientation is to find a place for these expenses without threatening fiscal balance.

Besides, social policies and social safety nets must be devised in such a way as not to threat the “incentives to work” (Cf. HELLER, 1999, p. 3). Thus, as one IMF working paper puts it, ideally emergency labor schemes should be set paying wages that are lower than that paid by the market (IMF, 1999, p. 16). On the other hand, the very need for social safety nets is defined as a result of labor market rigidities that are intrinsically deleterious, but that, one recognizes, cannot be changed in the short term. The ideal solution is the “Mexican” one: “The experience of Mexico in dealing with the crisis in 1994 and 1995 illustrates the importance of labor market flexibility in mitigating adverse effects.” (GUPTA et al, 1998, p. 17)

What are the virtues of Mexican labor markets that allowed it to “deal” with the problem of unemployment? The answer is almost unbelievable:

There were five characteristics of the Mexican economy that allowed labor markets to adjust. First, the lack of comprehensive unemployment insurance limited open unemployment. Second, the urban informal sector was a

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29 Chile was also mentioned once by Michel Camdessus as an example of successful social policies. See Camdessus, 1999a.
buffer that absorbed excess labor supply when activity slowed down. Third, wage flexibility was high, which allowed production costs to adjust, and thereby reduced the necessity to dismiss workers. Fourth, emigration remained an outlet for a significant portion of the population. Finally, part of the rural population that moved to urban area when the economy expanded moved back to rural areas when job opportunities dried up. (Idem, p. 18)

In other words, Mexico is an example because in that country, many people will accept anything to avoid being laid off since unemployment benefits are scarce, or because they can take to the streets to sell trinkets at traffic lights, or still because their wages can easily be reduced, or because they can jump the fences that separate Mexico from the US or, finally, because they can be expelled back to the rural areas they originally left to search for better opportunities! Of course, nothing like that will be necessary if “workers are prepared to accept wage cuts to unemployment” (GUPTA et al, 1998, p. 22)

The same general point should be made related to the HIPC Initiative. It *does* represent an important short-term relief for countries that are being choked by the need to service foreign debt. However, the initiative does not allow any measure of autonomy for these countries to design their own growth strategies. Autonomy is given only to devise strategies to fight poverty. In fact, to qualify for the initiative the client country has not only to commit itself to follow the general economic strategies set by the Fund but its allegiance has

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30 In fact, even this point is not clear. Two main doubts linger on. Firstly, with respect to authorship of PRSPs. In principle, client countries should prepare their own papers. The Fund (and the Bank), of course, expects to be consulted with, as “experts”, in the process of preparation of the paper. What kind of influence does the Fund expect to have in this process? Is it prepared to act as a simple consultant? A second source of uncertainty relates to the approval of the paper by the Fund and the Bank. The statements of policy are always written in terms of how things will happen once the paper is approved. What if not? See International Monetary Fund and International Development Association, Poverty Reduction Strategy Papers – Operational Issues, draft, December 10, 1999.
to be *proved in advance*. The client country has to fulfill three requirements to qualify for the HIPC Initiative:

[...\] be eligible for concessional assistance from the IMF and World Bank; face an unsustainable debt burden, beyond available debt-relief mechanism such as Naples terms (where low-income countries can receive a reduction of eligible external debt up to 67\% in N[et] P[resent] V[alue] terms); *establish a track record of reform and sound policies through IMF- and World Bank-supported programs.* (IMF, 2000, my emphases)

In other words, the HIPC Initiative may contribute to strengthen IMF’s conditionalities since client countries that could be discouraged to keep following the Fund’s recipes by the accumulation of pressures generated by external debt would now have a renewed interest in continuing implementing them to maintain the “track record” of compliance demanded by the IMF to be eligible for the benefits of the plan. There is no guarantee that there will be additional resources available to these countries. Under these conditions, the HIPC Initiative may become a powerful instrument to keep these countries in line with the Fund’s recommendations in order to benefit from debt cancellation.

**VI. Conclusions**

The IMF has long been criticized because its short-term policies are recessive, causing bankruptcies to increase and unemployment to pile up. More recently, long-term evils have been added to the list, since the Fund now pursues also long-term goals to force liberalization on client countries. The concern with poverty, announced in 1999, did not represent a reexamination by the Fund of the foundations of its strategic views. It did represent the realization that its political support was getting weaker and weaker, particularly because, to a large extent, fairly or unfairly, the depth of the Asian crisis was being attributed to their policies.
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So, to the question whether there is any new strategy being pursued by the Fund or whether there is any substantive change in its views and policies the answer can only be: hardly. It is always difficult, and perhaps useless, to judge intentions that are unobservable anyway. Therefore, it may be idle to discuss whether the change in rhetoric and the new programs and recommendations incorporated to the agreements signed with the Fund just spring from expediency, to mitigate criticism, or to a genuine perception that it is necessary to deal with side effects of reforms that the Fund still believes to be fundamentally sound. The objective fact, in any case, is that the new rhetoric opened the possibility of pursuing the old goals of market liberalization that define the ideology of the IMF, despite the criticisms showered on the Fund lately.

Of course, one cannot discard out of hand the possibility that, by making what seems at first sight to be small concessions, the Fund may see itself forced, in the future, to accept more fundamental changes by triggering some political dynamics it is unable to control. It will depend largely on how successful progressive groups are in keeping the political pressure on the Fund. But one should not be deceived into thinking that the concessions made so far, by themselves, can decisively contribute to these developments. Firstly, the defensive mood that assaulted the Fund in the aftermath of the Asian crisis has largely waned. Currently, the Fund seems to be cautious, more than defensive, giving particular attention to criticisms and possible hostility coming from conservative Republican quarters, in the US, rather than to progressive groups’ concerns. On the other hand, the concessions actually made in its anti-poverty strategy were really too limited to trigger significant further changes. Safety nets were created in Asian countries, but labor market liberalization is still pursued. Trade unions’ attempts to protect employment met with hostility and were largely defeated. As we saw in Gupta et al.’s paper quoted above, free markets, including deregulated labor markets are promoted as being beneficial even to workers themselves. The containment of the crisis reduces the leverage the Fund has over borrowing countries but, on the other
hand, increases the rewards for good behavior a country can reap in international financial markets.

If one cannot expect much from the Fund’s strategy for middle-income countries, it is nevertheless possible, but by no means assured, that for some African countries in a more desperate condition, the PRGF can actually represent some relief. The price may be the loss of degrees of freedom in policy-making in the future, but one cannot deny that there is a potential for some short- and medium-term improvement in living conditions for the poor. In addition, if the IMF honors its pro-basic-education rhetoric in the PRGF, it may be that, in the long term, a better educated electorate can actually change the situation for the better.

Objectively, however, IMF’s present strategies, on balance, are still a factor to worsen poverty. Poverty was, of course, not created by the Fund, for sure, but IMF adjustment programs actually increase poverty in three main ways. Firstly, short-term policies such as raising interest rates and cutting fiscal expenditures lead to a contraction of aggregate demand and cause unemployment. A second channel of influence is given by the fact that cutting fiscal expenditures is a very selective process in which financial commitments are preserved (to avoid violating the “sanctity” of contracts) so paying for social policies has to be accommodated in what is left. Thirdly, IMF agreements impose “structural reforms” that preclude the possibility of adopting alternative growth strategies that would encroach in the “freedom of markets”. No poverty relief measure advised or accepted by the Fund is supposed to stand in the way of these three sets of policies.

In open, integrated emerging economies, policies are always restricted by the effect they may have on “the sentiment of markets”, meaning by that the confidence of international financial markets. This is the first and most fundamental criterion to decide on which policies to follow. The general strategy of the Fund is to strength this criterion. Social policies and social safety nets or even programs designed to alleviate foreign debt burden are needed to reduce tensions and increase political stability. If the groups of people that usually pay most of the
cost of adjustment can have their lot improved, even if slightly (because one should not meddle with “incentives to work”), you can not only promote stability but also actually gather support for the Fund’s policies. In objective terms, this is the rationale of the new rhetoric and is also the limit for the concessions the Fund may be willing to make in their programs. Ultimately, it is all a matter of gathering forces to allow the continuance of long-term market-friendly reforms.

References


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