Graham Bird, "The IMF and Developing Countries: A Review of the Evidence and Policy Options" *IO* 50 (1996): 477-511

I apologize for the long summary, but this is essentially a review article looking at various aspects of effectiveness of the IMF. I tried to provide as succinct a summary as possible.

THESIS

The IMF programs actually have marginal impact on the economies of developing countries (penultimate section of the summary). To make the IMF more effective, the IMF and the industrialized countries should adopt a range of reform proposals (outlined in the last section).

INTRO

Initially the IMF had no specific role in developing countries, but now they exclusively are the IMF's clienteles. The criticism for this transformation range from that the Fund had inappropriately become a development agency (and thus should shut down) to that the Fund was an inadequate development agency (IMF policies did more harm than good). Many reform proposals exist for the Fund's future role in developing countries. Some things Bird says he is glossing over: 1) IMF policies and decisions are outcomes of complex negotiating process involving various elements of the Fund's management and the executive board. However, reasonably well-defined policies emerge, even though the IMF is not a unified actor. 2) Individual developing countries differ widely (economic, political contexts, strategic importance, etc.). But Bird focuses on extracting generalizations.

COUNTRY AND POLICY COVERAGE

IMF lending–size and pattern: At the beginning of the 1980s, the IMF was most heavily involved in African and Asian countries. The debt crisis shifted the focus to Latin America. Almost the entire period beyond 1986, net IMF credit to developing countries was negative. A significant feature of the IMF lending to developing countries is the recidivist tendencies of many borrowers. Many countries have credit outstanding for as long as fifteen consecutive years, some even as long as almost thirty years. Proposals are to shorten the duration of the IMF involvement or to have the Fund adopt a longer-term perspective. *Policy coverage*: The IMF has important influence over the design of economic policies in countries that seek the Fund's help—especially when the IMF stipulates preconditions and where quantified performance criteria exist. The IMF has control over ER, domestic credit creation, interest rates and fiscal imbalances. In the context of the enhanced structural adjustment facility (ESAF), the IMF conditionality also covers pricing policy, trade liberalization, privatization, the structure of taxes and government expenditure and the reform of the financial sector. These structural provisions have acquired the status of performance criteria.

EXPLAINING FUND LENDING TO DEVELOPING COUNTRIES

For the IMF to provide financial support the country has to first demand a loan and the IMF has to be willing to supply it. Some relationships: Developing countries draw more resources from the IMF as their BOP deteriorates (due to excessive credit, rapid inflation or deteriorating terms of trade). Countries that borrowed from the IMF in the recent past are more likely to borrow from it in the near future (→some sort of threshold exists for countries, below which countries not willing to borrow). Some policy implications: 1) As long as countries seek help of the IMF due to external shocks, to wean countries off, they need to become less vulnerable. 2) The linkage between economic development and the BOP must be fully acknowledged. 3) If there is a demand threshold that is explained by erroneous ex ante expectations concerning the nature of conditionality, these expectations need to be corrected. 4) The IMF should manage the demand for its loans by modifying the facilities under which it lends and the nature of its conditionality.

THE IMF AS A DIRECT AND INDIRECT SOURCE OF EXTERNAL FINANCE: TOO LITTLE, TOO LATE

When lending relies on commercial capital market, which is focused on shorter-term financial considerations, capital movement might be sub-optimal. In this sense, the IMF fixes the market failure of incompleteness (e.g. poverty alleviation is a justification for the types of resource transfers the IMF organizes). While the availability of finance is important for countries' adjustment, they tend to use the IMF only as a lender of last resort, after exhaustion of all the other options. Countries' aversion to loss of sovereignty associated with the IMF conditionality may explain the existence of the threshold (see #3 above). As for the adequacy of financing, because lower success rate is correlated with low amount of financing, the IMF financing seems to be inadequate in significant number of cases. Although IMF programs should serve as a "seal of good housekeeping" to attract private capital, the bad track record of the IMF, the long-term involvement, and the bad signal the IMF involvement itself sends have the opposite effect. "The Fund's seal of approval does not seem to carry a very high market value." If this condition cannot be improved, should the IMF itself increase its financing?

IMF CONDITIONALITY: WEAKNESSES IN DESIGN, BUT SLOW TO CHANGE

1) The IMF conditionality model, based on a monetary model of BOP, creates an attention bias toward monetary excesses as the principal cause of BOP problems and away from fiscal imbalances and problems that stem from structural weaknesses in production and trade. IMF conditionality offers a demand-based solution to what is frequently just as much a supply-side problem. 2) Financing program by the Fund is too static, failing to deal adequately with the time lags, uncertainties, and elastic expectations that underlies the adjustment process. Financing based on these models gives rise to inflexibility and alienation of receiving governments. Responding to criticisms, the IMF has reduced its reliance on quantified indicators, increased ongoing reviews to adjust programs and increased

attention to the "quality" of fiscal adjustment. On overall success: Most of the program break down, quickly. Extended fund facility (EFF) break down more than standby arrangements do. Non-completion became increasingly more common at the end of the 1980s. Potential explanations: size of the initial disequilibrium; overambition of the targets; external disruptions. Most importantly, the degree of government commitment, which depends on the government's sense of ownership of the lending programs. Governments must feel their superior knowledge of the country-specific circumstances must be taken into account.

THE MUTED EFFECTS OF IMF-BACKED PROGRAMS

IMF programs are hard to measure. NGOs and IGOs like Oxfam and UNICEF want the measurements in terms of poverty alleviation. The effect on living standard is hard to distinguish, since the falling living standard may be result of the initial economic crisis. As long as the Fund encourages economic growth, the opportunity for helping the poor is expanded and any negative effects can be offset by appropriate domestic policies. In general, "while improvements in economic performance do not guarantee human development or falling poverty, economic failure surely will constrain them. Apart from the theoretical problems, more practical methodological issue exists. IMF performance may be measured by comparing targets and actual performance (but it assumes the targets are set correctly) or by comparing before and after (but it assumes ceteris paribus). Bird, therefore looks at both types of tests with the dependent variable of the demand for Fund credit. Some conclusions: 1) Overall and current account balances strengthen over a three-year period, in part by import compression. 2) Inflation may be another cause of borrowing, especially when it causes currency overvaluation. 3) Association with economic growth is neutral. Some other observations: 1) While involving the IMF leads to significant currency depreciation, there is much less evidence of any influence on monetary variables (e.g. rate of growth of credit). 2) The idea that the IMF is able to orchestrate a "quick fix" is not supported. 3) No clear evidence exists as to whether macroeconomic performance in countries that completed the programs is superior than in those that did not (but inflation achievements of completers stand out). ***While IMF-backed programs seem to nudge countries toward better overall BOP performance, their impact is rather muted. They generally have rather insignificant effects on inflation and economic growth. The programs are thus unlikely to have strongly significant effects either on social and human variables or, therefore, on political stability.***

POLICY CONCLUSIONS

IMF's useful role in developing countries would be: 1) offset sources of market failures that severely limit the countries' access to external finance 2) provide support and advice with regard to economic policy. The issue is not whether the Fund should be associated with dramatic turnarounds in economic performance but rather whether its contribution toward securing improved economic performance might be raise. Proposals: 1) The Fund should continue to pay greater attention to supply-side factors. 2) The use of review missions should be further expanded; Governments should be encouraged to draft their own program when they seek support. 3) Fund-backed programs should contain strong growth orientation, both in design and presentation. 4) The Fund should move away from the assumption that governmental failure is a greater problem than market failure and should explore the synergy between the state and markets. 5) An eventual higher success rate of programs will strengthen the Fund's catalytic impact of attracting private finance for the countries. 6) The Fund can increase the success rate by providing additional supporting finance as and when needed to cover unforeseen contingencies. 7) Changes in design permitted by greater and more secure financing will increase the level of governmental commitment in borrowing countries. 8) Providing more time for negotiation might enable better thought-out programs with greater consensus. The pressure on the Fund's resources can be solved by 1) greater credit rationing by selecting governments with greater level of commitment and 2) raising quotas. Moreover, Fund lending should be streamlined by rationalizing the range of facilities under which members can draw into three windows: standbys, extended arrangements, and compensatory and contingency lending. To increase the IMF's effectiveness, industrialized countries should 1) resist intervening for essentially short-term political reasons 2) manage their own economies in ways that create an international economic environment that facilitates adjustment in developing countries.