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ISSUES IN THE DESIGN OF ENVIRONMENTAL PROGRAMMES

Tony Killick

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WORKING PAPER 71

ISSUES IN THE DESIGN OF IMF PROGRAMMES

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Preface and Acknowledgements

ODI *Working Papers* present in preliminary form work resulting from research under the auspices of the Institute. Views expressed are those of the authors and do not necessarily reflect the views of ODI. Comments are welcomed, and should be addressed directly to the authors.

This paper is the last in a series of drafts for a study currently under preparation at ODI by Graham Bird and Tony Killick. The following titles are already available as *Working Papers*:

- 46 The IMF in the 1990s: Forward to the Past or Back to the Future?
Graham Bird
- 47 What Can We Know About the Effects of IMF Programmes?
Tony Killick, Moazzam Malik and Marcus Manuel
- 48 Country Experiences with IMF Programmes in the 1980s
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Graham Bird
- 69 Continuity and Change in IMF Programme Design, 1982–92
Tony Killick
- 70 IMF Lending: The Empirical Evidence
Graham Bird

Tony Killick is Senior Research Fellow at the Overseas Development Institute and Graham Bird is Professor of Economics at the University of Surrey and Research Associate of ODI. The project under which this *Working Paper* has been prepared is funded by the Overseas Development Administration, whose support is gratefully acknowledged. Neither they nor the authors' respective employers necessarily agree with the contents of this *Working Paper*, which is the author's responsibility alone.

Earlier papers have examined the extent of continuity and change in the content of the IMF's programmes and evidence on their effects. We conclude the series by surveying some unresolved issues concerning the design of these programmes. We commence in Part I with a brief exposition of the basic policy model used by the Fund. The bulk of the paper is then taken up with discussion of issues arising: concerning the limitations of the model; the policy instruments and performance criteria employed in the programmes; the problem of programme inflexibility; and the difficulties the Fund has in handling the political aspects of stabilisation policy.

Part III pulls the discussion together and suggests improvements in programme design.

Tony Killick would like to thank Graham Bird for helpful comments on an earlier draft but to exonerate him for responsibility for what follows.

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I – The Financial Programming Model

The basic model

The analytical core of IMF programmes is what it calls its ‘financial programming’ model, although we will see shortly that this provides only a starting point.¹ This is also known as the Polak model, after the Fund’s former Director of Research who first presented this form of monetary model of the balance of payments (Polak, 1957). It has two chief building blocks. The first is an accounting identity, in which the change in the stock of money is shown as the sum of changes in its international and domestic components:

$$\Delta M = \Delta R + \Delta D \quad (1)$$

where M is the stock of money, R is the local-currency value of the net foreign assets of the banking system and D is the net domestic assets of the banking system, or domestic credit.

The second building block is an assumption that there is equilibrium in the money market, so that any change in the demand for money, ΔMd , is matched by an equal change in supply, ΔM :

$$\Delta M = \Delta Md \quad (2)$$

The demand for money is taken to be a function of changes in real income, the behaviour of which is assumed to be uninfluenced by monetary variables, and in the domestic price level:

$$\Delta Md = f(\Delta Y, \Delta P) \quad (3)$$

If we take the change in international reserves (net external assets) as the key balance of payments indicator, these three equations can be combined in a fourth which shows that balance of payments deficits (reserve losses) will be the result of increases in domestic credit in excess of increases in demand for (= supply of) money:

$$\Delta R = \Delta M - \Delta D = f(\Delta Y, \Delta P) - \Delta D \quad (4)$$

Although monetarist, the model can be re-written in more Keynesian terms, in

¹ See IMF (1987) for an authoritative exposition and discussion of this model, from which I have borrowed heavily.

which excesses of absorption over income which result in balance of payments current account deficits can similarly be related to excess domestic credit creation.² It can be modified in a variety of ways. One is to disaggregate ΔD into credit to the private and public (or government) sectors, which draws attention to the potentially large importance for the balance of payments of fiscal policies and government borrowings from the banking system.

Although the financial programming model, and the monetary theory of the balance of payments generally, can be made a good deal more sophisticated than presented above, equation (4) presents the core of the IMF approach, i.e. as seeing excess domestic credit creation (and often underlying this, excessive government deficit financing) as the chief source of balance of payments difficulties. On the other hand, it is not accurate to characterise the IMF approach as purely monetarist.³ For example, and by contrast with the more 'academic' monetarist models associated with Frenkel and Johnson (1976), it is interested in the *composition* of the balance of payments and in policies to influence the behaviour of the current and capital accounts, and the basic model above can be modified for this purpose. The Fund also regards the exchange rate as an important direct influence on balance of payments performance, whereas monetarists of a more purist bent regard this as irrelevant except as it affects the balance between the supply of and demand for money. More elaborate versions of the model can incorporate the effects of exchange rate changes, with policy solutions derived through iteration (IMF, 1987, p. 41).

How the model is used

When a country requests balance of payments assistance the Fund staff will take a view of the monetary condition of the country, and the extent of any excess of ΔD over ΔM , using equation (4) or some variant of it. However, this basic calculation will be modified by the results of various sub-models, relating to import demand, the likely behaviour of export quantities and prices, feedback connections between the budget and the exchange rate, estimates of the likely volume of aid and other capital receipts, and so forth. There will also be a good deal of to-ing and fro-ing about the accuracy of the data, which often become bargaining chips in negotiations between Fund staff and the government (Martin, 1991, Chapter 2). And there will be a good deal of judgemental 'adjustment' of model results in response to the representations of the government's negotiators, the mission's

² See IMF (1987, p. 14). See also Williamson's 1980 interpretation of the monetary approach to the balance of payments from a Keynesian perspective.

³ See Bird in Killick *et al.* (1984, pp. 87–8); and Killick, *ibid.* (pp. 216–20), for further elaboration of this argument.

common-sense — where this differs from the model results — and the degree of pressure upon it to agree a programme. As is shown in *Working Paper 69* (hereafter *WP 69*), there will also be consideration of policy instruments which go well beyond the basic model and address supply-side weaknesses, particularly in Extended Facility (EFF) and Enhanced Structural Adjustment Facility (ESAF) programmes.

In short, it is not the case that the basic financial programming model is usually applied in a simple, mechanistic way. However, the lack of transparency in the lending policies of the Fund leave it impossible to assess the extent of its flexibility in practice. Equation (4) does still represent the analytical core of Fund programmes. Everything else is modification. This is most evidently the case with stand-by programmes, the content of which, as was shown in *WP 69*, has changed only modestly over the years. But essentially the same calculations, and the resulting domestic credit performance criteria, remain at the core of even the less short-term and more supply-side EFF and ESAF programmes. The more 'structural' policies of these latter programmes have been grafted onto the traditional performance criteria, and have not substituted for them.

It is therefore important to examine the qualities and limitations of the core model when forming a view of the appropriateness of the Fund approach to programme design.

II – Issues Arising

Underlying assumptions and attention biases

To ask about the realism of its underlying assumptions is a good first step in the evaluation of any formal model. The financial programming model is open to a number of criticisms from this point of view. One source of weakness, as the Fund admits (IMF, 1987, p. 22), is that the demand for money is stable and predictable. This condition is often not satisfied, with a general tendency for the income velocity of circulation (v) to vary inversely with ΔM . Of course, if the variability of v in response to ΔM is sufficiently well understood and consistent, allowance for the forecast change in v can be incorporated in the calculations of 'allowable' ΔD . This is sometimes done. However, such adjustments introduce a further element of judgement in the mission's calculations, reducing the 'objectivity' of its results; in most programmes the standard assumption of a constant v is retained, because of the difficulties of forecasting its behaviour during the programme period.

This brings us to the assumption that the demand for money, M_d , is independent of ΔD , i.e. that ΔD does not affect either real incomes or the price level. As the

Fund staff have again pointed out, such an assumption will only be valid in restrictive circumstances. In most real-world situations we must expect changes in the level of domestic credit to influence the level of economic activity, for example by influencing the availability and cost of working capital, and the demand for, and prices of, non-traded goods and services.⁴ Here too Fund missions sometimes attempt to make allowance for such interconnections when determining their credit ceilings, particularly in 'growth oriented' programmes, but the extent of any such adjustments is in practice commonly relegated to the central objective of reducing the balance of payments deficit (G24, 1987, p. 13). In any case, the introduction of such adjustments further reduces the 'objectivity' of the numerical results.

As will be shown later, it is also open to doubt whether many developing-country governments are actually in a position to exercise the degree of policy control over ΔD that the financial programming model requires. Moreover, the model can be criticised for the exclusive way in which it focuses on aggregate demand and domestic credit as *the* source of balance of payments difficulties. Often, of course, they result from adverse terms of trade or other external developments, as is shown in WP 48.⁵

Even among domestic sources of difficulty, while excess demand often *is* a cause of payments deficits, structural weaknesses on the supply side of the economy are a no less common cause in many developing countries — a fact acknowledged first by the World Bank when it opened its 'structural adjustment' lending window at the beginning of the 1980s and subsequently by the Fund with the introduction of its SAF and ESAF credits. For example, the financial programming model takes exports to be exogenously determined by world economic conditions and other factors external to the model — an ironic position given that WPs 47 and 48 found that the chief positive impact of Fund programmes was on export volumes. In this area, then, the model gets in the way of, or at least makes little contribution to, the preparation of realistic corrective policies in the common situation of supply-side weaknesses. To be fair, the Fund does almost invariably include devaluations in its programmes and sees the exchange rate as a policy instrument essentially directed to altering the structure of the economy, as between tradeables and non-tradeables (IMF, 1987, pp. 36–9). But, so perceived, this is not a policy instrument which can

⁴ One illustration of this is provided by Khan and Knight (1985, pp. 21–3) who employ a model based on IMF-type demand management policies and find that, while the long-run growth rate is little affected, there is a substantial initial reduction. They also run a variant of the standard model which combines demand-management and supply-side policies, again finding a substantial short-term reduction in growth, but in this case a sustained longer-term improvement.

⁵ See also Khan and Knight (1982) who show for the 1970s that the payments problems of developing countries were chiefly, but not wholly, caused by deteriorating terms of trade.

readily be incorporated into the basic financial programming model.

Even in situations where excess demand is the chief source of difficulty, the model is open to the criticism that by focusing on quantified aggregates it diverts attention from qualitative aspects of policy. This is an implicit line of criticism developed in the Fund's own Fiscal Affairs Department and we shall return to it shortly. The Fund is now paying more attention to the 'quality' of fiscal adjustments — but the financial programming model does nothing to help it, and it took at least a quarter-century for this limitation to be reflected in Fund orthodoxy.

The financial programming model is also unsatisfactory in the way it handles time. Its critics describe it as static but the Fund's staff (IMF, 1987, pp. 20–1) say it works best in the long run. Both are right but both draw attention to further defects. The sense in which it is a 'long-run' model is that it requires sufficient time to elapse for all adjustments to work themselves out, in order to validate the assumption of equilibrium in the money market underlying equation (2). In the short term there can be no presumption of equilibrium. How long is long-run? The Fund staff think that the adjustment lags are likely to work themselves out over the period of a stand-by programme, typically 12 to 18 months, while acknowledging that it will sometimes take longer.⁶ Provided most adjustment lags work themselves out within this type of period the time factor in the financial programming model appears to provide a basis for calculating credit ceilings — *except that it is used for calculating quarterly ceilings, often beginning three months after commencement of the programme!* The model provides no assured basis for such calculations.

While the model is 'long-run' in the sense just described, it is not dynamic and has been criticised for its inability to cope with important time lags, with uncertainty and the formation of expectations.⁷ Edwards (1989b, pp. 19–21) has particularly criticised the model along these lines, suggesting that, in consequence, the Fund has not kept abreast of best practice in the design of macroeconomic policies, e.g. in incorporating the effects of private sector reactions to government monetary policies, and in maximising the credibility of these policies:

[The financial programming] model has failed to formally incorporate issues related to the inter-temporal nature of the current account, the role of risk and self-insurance in portfolio choices, the role of time consistency and precommitments in economic policy, the economics of contracts and

⁶ In our study of the Kenyan case, Killick and Mwega (1993, p. 56) found an average lag of 1½ years in the adjustment of the demand for money.

⁷ See Mundell in Frenkel and Goldstein (1991, p. 482) on the static nature of the monetary theory of the balance of payments and the so far only rudimentary attempts to dynamise it.

reputation, the economics of equilibrium real exchange rates . . . and the theory of speculative attacks and devaluation crises, just to mention a few of the more important recent developments in international macroeconomics (p. 20).

While acknowledging that such criticisms may sound rather carping or academic, he goes on to illustrate ways in which the new developments to which he refers could be utilised to strengthen the basic financial programming model.

This static nature of the model has caused the Fund particular difficulties since it was pushed in the later-1980s towards the adoption of 'growth-oriented' programmes. As its staff have pointed out (IMF, 1987, pp. 27–8), the incorporation of economic growth as a policy objective alongside the balance of payments generates a host of complications, bringing in several new variables and relationships, with complex and lagged interactions. This reduces confidence in the underlying parameter values and increases the difficulties of implementing the model for the purposes of policy formation. As a pragmatic solution, where the growth objective is given weight it is accommodated by more-or-less *ad hoc* adjustments to the balance of payments target value, to allow a larger volume of imports — a procedure that again undermines the 'objectivity' of any resulting performance criteria.

The financial programming model, like any other economic model, takes a particular view of the characteristics of an economy. Some of the behavioural assumptions of the model have been mentioned already. The neo-structuralist school, most closely identified with the name of Lance Taylor, identifies a considerably larger number of variables whose behaviour is viewed as often differing from the postulates of the Fund. Taylor suggests that:⁸

- (a) Many prices are determined by fixed mark-up rule rather than by the 'flexprice' market-clearing assumption underlying the Fund view. Where mark-up pricing is prevalent inflation is more likely to emanate from supply-side weaknesses than from excess demand.
- (b) Stabilisation-related credit restrictions and demand contraction are liable to cause reductions in output, employment and real incomes (particularly induced by the reduced availability and/or higher cost of working capital), and not merely the adjustment of relative prices envisaged in monetary theory.
- (c) The devaluation which is an ingredient of most Fund programmes is likely to have stagflationary effects, driving up prices by raising production costs while simultaneously absorbing demand through higher import and other

⁸ Culled selectively from Taylor (1988, pp. 148–54).

prices. Although there may also be expansionary effects through increased output of tradeables, there will often be a net stagflationary impact, contrary to the Fund model. In fact, the inflationary process it sets off, and the prevalence of supply-side bottlenecks which cannot be resolved simply by altering relative prices diminish the probability that the devaluation will stimulate the production of exports and import-substitutes.

- (d) Whereas the Fund sees public investment as crowding out private investment, so that reductions in the former may stimulate the latter, the neo-structuralists emphasise the 'crowding-in' effects of public investment, with improved infrastructure, communications and economic services stimulating private investment.
- (e) Given the high import content of capital formation, there is little scope for substitution with locally-produced capital goods, so that reductions in imports results from Fund programmes are liable to limit new investment in export and import-substituting activities, so that beyond the short term the net balance of payments effects may be small or negative.⁹
- (f) The reductions in domestic absorption which result from Fund programmes may hamper export performance (rather than releasing resources for it) by reducing the ability of the domestic market to act as a necessary launching pad for a successful export strategy.
- (g) The stagflationary effects of interest rate increases (also commonly incorporated in programmes), absorbing demand and raising production (working capital) costs are liable to swamp any efficiency-raising effects.

It will be suggested later that the neo-structuralists appear to considerably over-state the stagflationary consequences of Fund programmes but it is not necessary to believe that each of the above points carries great weight to conclude that they add up to a challenge to the orthodox view of economy-wide behaviour that cannot merely be dismissed. They point up a range of variables whose behaviour can vary from one economy to the next — and the dangers, therefore, of taking any uniform view of macroeconomic processes.

It is evident from the foregoing that the Fund model has significant limitations and is open to a range of criticisms. Before considering the implications of these, however, we will briefly examine some outstanding issues surrounding the chief

⁹ Support for this proposition is provided by the results of members of the Fund's own research staff. See Khan and Knight (1988) who found for a sample of 34 developing countries a large and highly significant positive correlation between export volumes and the availability of imports.

policy instruments employed in its programmes.

Doubts about the policy instruments

(A) *The exchange rate*

As was shown in *Working Paper* No. 69 (p. 18), devaluations have become an almost invariable component of Fund programmes, except in currency union countries where the exchange rate is not available as a policy instrument. In the 1960s and 1970s devaluation (although then a less common programme ingredient) was among the most fiercely debated of the Fund's policy stipulations. A good deal of the heat has gone out of this controversy as more countries have moved from fixed to flexible exchange rate arrangements but to the traditional arguments has more recently been added what might be labelled a 'conservative' critique, as described in Graham Bird's *WP* 46 (p. 23). It is a critique which the Fund is obliged to take seriously because it is espoused by some of its most important shareholders, most notably Germany and some of the other European Community countries.¹⁰

The argument here, echoed in debates about the European Exchange Rate Mechanism, is that commitment to a fixed nominal exchange rate serves as an anti-inflationary anchor, avoiding the price-raising effects of currency depreciations and *obliging* the government to pursue the fiscal and monetary rectitude necessary if the fixed nominal rate is not to appreciate in real terms, to the detriment of the balance of payments. By thus committing the government, the fixed rate is seen as adding credibility to its anti-inflationary stance, reducing inflationary expectations. Conversely, exchange rate flexibility can be seen as undermining fiscal discipline, accommodating excess demand and adding, both directly and indirectly through its effects on public expectations, to inflationary pressures. Full flexibility can be seen as a form of indexation, bringing with it all the dangers of a self-perpetuating inflationary cycle associated with other forms of indexation.

Here the conservative and structuralist arguments tend to merge, for both (if for different reasons) doubt governments' ability to make nominal devaluations 'stick' in real terms and hence their ability to bring lasting benefit to the balance of payments. In the structuralist case, to this critique is added elasticity pessimism, because of expected severe (non-price) supply-side production constraints and the claim already mentioned that devaluations tend to be stagflationary. Neither school deny that countries with seriously over-valued currencies need to attend to their exchange rate but, in the absence of large misalignments, both appear to hold that a fixed nominal rate is superior to a flexible one.

¹⁰ For a brief espousal of this argument see Sachs (1989, pp. 114–15).

Against this, the Fund can mount a strong defence, however.¹¹ At the level of principle, it can point out that, if we see the exchange rate as a 'switching' device, altering relative prices in favour of tradeables, there are no satisfactory alternatives, for using taxation to achieve similar results is (a) difficult in practice and (b) induces additional distortions. It can also be objected that the view that a fixed exchange rate imposes fiscal and monetary discipline wishes away all the political and practical difficulties of achieving the macroeconomic control necessary to make a fixed rate workable. With powerful governments such as those of Britain and Spain unable to achieve such outcomes, what chance is there for many of the more fragile regimes of the Third World (and Eastern Europe), operating with weaker fiscal and monetary instruments through more rudimentary financial systems? The Fund can also point to the difficulties created for African Franc Zone countries by the fixity of their exchange rate with the French Franc, unchanged since 1948. As the French Franc has become a relatively 'hard' currency, effectively tied to the Deutschmark, this has forced substantial deflationary costs on the Franc Zone states without avoiding over-valuation and its attendant problems.¹²

At the empirical level, the Fund can point out that the evidence does not bear out the worst fears of either the conservative or neo-structuralist critics. We saw in *WP* No. 47 (pp. 32–3) not only that Fund programmes are associated with substantial real reductions in the exchange rate but that these reductions are sustained at least into the medium term. This result was consistent with the findings of Kamin's (1988, pp. 28–9) survey of the empirical evidence, that there was no evidence that the additional inflation caused by devaluations are sufficient to cancel out real depreciations. Edwards (1989a, Table 1) similarly found that a substantial proportion of nominal devaluations in developing countries 'stuck' in real terms (although there was a significant minority of devaluing countries where this was not achieved). In a separate study (1989b, pp. 45–7), he similarly casts doubt on the argument about the stagflationary effects of devaluation, finding that although there are short-term contractionary effects these are not sustained and, in any case, that the alternatives recommended instead of exchange rate action are also liable to have stagflationary consequences.¹³ Kamin (1988, pp. 29–31) found no evidence that devaluations have a direct contractionary effect. Unpublished IMF staff reviews find positive export responses to devaluations (especially by non-

¹¹ See Aghevli *et al.* (1991) for a discussion for these and related issues by members of the Fund's Research Department. They point out that as developing countries have moved towards greater exchange rate flexibility industrial countries have moved in the opposite direction.

¹² For a brief review of the position of the Franc Zone see ODI (1990).

¹³ See also the influential theoretical analysis by Lizondo and Montiel (1989) which concludes that 'the direction of the impact effects of devaluation on real output is ambiguous on analytical grounds' (p. 182).

traditional exports)¹⁴ and lack of correlation between exchange rate flexibility and lax financial policies.¹⁵ They and others can cite cases where sharp devaluations have been accompanied by *reduced* inflation rates.¹⁶

However, while the stronger criticisms of Fund use of devaluations appear not to be sustained in the general case, this is not to deny that there are circumstances when one or other of them will be validated — and that there is a degree of risk in most country situations that nominal devaluations will be undone by consequential price rises, doing little for the balance of payments but accelerating inflation. To this caution might be added the ‘fallacy of composition’ argument. This suggests that deployment of devaluation in large numbers of developing countries comes near to Fund instigation of a process of competitive devaluations (which would be quite contrary to its objectives), with particular risks for primary product exporting countries that the aggregate effects of the resulting increases in output will cause self-defeating reductions in world prices. While this is a seriously under-researched area and there is little firm evidence on this ‘immiserisation’ hypothesis, there are clear indications that it may have been an important factor for exporters of cocoa and, perhaps, coffee (Koester *et al.*, 1989).

All these considerations point to the desirability of pragmatism and selectivity in the employment of this instrument.

(B) Monetary policy

Although the analytical approach of the Fund is not narrowly monetarist and it is fairly eclectic in its approach, its programmes do nonetheless centre around the deployment of monetary policy, chiefly directed at the control of domestic credit. But monetarism, and monetary policy, have gone through rough times in recent years, with a disillusionment in industrial countries from the large claims made for monetary policy in the 1970s.

The reasons need little rehearsal. How money should be defined and what measure is the most useful for policy purposes have proved elusive, not to say insoluble, problems. The monetarist expectation that credit restrictions would have few or no adverse consequences for output and employment have been decisively disproved, reducing the political attractiveness and sustainability of strict monetarism. The internationalisation of financial markets and the rapid pace of innovation in the

¹⁴ The source here is an unpublished Fund review of experiences with stand-by programmes in 1983–7.

¹⁵ From a 1991 review of experiences with ESAF programmes.

¹⁶ See, for example, Kimaro (1988, p. 17), and Quirk *et al.* (1987, pp. 29–30).

financial sector (besides further reducing the stability of the demand-for-money function) have reduced the practicability of achieving the desired control over money supply within the boundaries of a national economy, and banks have proved resilient in resisting the desires of the monetary authorities when these seemed contrary to the banks' own interests.¹⁷ As these difficulties have made themselves felt and governments have turned away from exclusive reliance on monetary instruments, so the professional consensus — never strong¹⁸ — has been eroded.

But if the practicability of the monetary approach is under question in the conditions of industrial countries, what of the developing (and indeed East European) countries to which Fund conditionality is actually applied? We can start with the following frank admission of the Fund staff (1987, p. 9–10):

... the choice of policy instruments is heavily influenced by the stage of development of economic institutions. In a country with sophisticated financial markets, for example, there are more means available for the government to influence the rate of monetary expansion (although there are also more ways to satisfy the demand for credit, in the face of restrictive official policies, through the layering of financial assets). In a country with a relatively undeveloped, sharply segmented, financial market, the economy is likely to respond much less flexibly to changes in monetary policy. Moreover, where there are severe policy-related distortions — arising from price controls, exchange and trade restrictions, overvalued exchange rates, and official ceilings on interest rates — the efficacy of normal demand-management policies is greatly weakened, and the need for structural changes is all the more urgent.

This comes close to an admission that the Fund's chosen policy instruments are best suited for the 'developed' countries which refuse to use it and least suited for the low-income countries of Africa and elsewhere, where the Fund has a high proportion of its programmes.

Doubts about the suitability of the Fund's stress on the control of money and credit are reinforced by the difficulties in developing country conditions of achieving the required control.¹⁹ The policy variable that can be used to 'solve' equation (4) (page 7) is domestic credit, ΔD : given the expected values of ΔY and ΔP and a target value of ΔR , it is assumed that the necessary value of ΔD can be ensured by

¹⁷ See Stiglitz (1992, p. 300).

¹⁸ See Frey *et al.* (1984) for evidence of only a limited professional consensus concerning some basic propositions of monetarism even in the early-1980s. Cited by Spraos (1986, Table 3).

¹⁹ For a useful survey of the uses and limitations of monetary policy in developing country conditions see Healey and Page (1993).

the monetary authorities. But this is a strong assumption, even if we are willing to allow that the desirable value of ΔD has been accurately estimated. It requires that the central bank, through open market operations, variations in commercial bank reserve ratio requirements, quantified credit maxima or other means, is able to achieve a rather precise control over bank lending to the private sector without inducing a movement into near-substitutes. It requires also that the government has a sufficient flow of accurate, timely information about its revenue and expenditure trends and prospects (and those of the parastatal sector) that it can reliably estimate its deficit financing requirements, and has a sufficiently exact control of these to keep them to a level consistent with the required value of ΔD . The Fund's approach further requires that it is possible to define ΔM and ΔD satisfactorily so as to include all variables which have the essential qualities of that elusive property, 'moneyness'. In many developing countries all these requirements are liable to be breached; at best, the level of control is only approximate.²⁰ In short, ΔD may have fewer of the attributes of a policy instrument, to be varied at will to achieve a given payments target, than the financial programming approach presumes. These considerations may help to explain the weak revealed ability of programmes to limit the actual expansion of ΔD .²¹

In many developing country situations, where open market operations and other alternatives are unfeasible, the most reliable way of holding ΔD within a programme ceiling will be through the adoption of quantitative controls on commercial bank credit. Here too the Fund approach can be criticised as having undesirable biases:

- (a) Quantified ceilings on commercial banks are liable to be economically inefficient, for the banks will give priority to meeting the on-going needs of existing customers, and the larger customers among those, to the disadvantage of the financing of innovations and new businesses.
- (b) Such ceilings reduce banks' incentives to liberalise, by reducing active

²⁰ To give one counter example, Killick and Mwega's (1993) study of monetary policy in Kenya shows that the control of the Central Bank of Kenya over commercial bank lending is highly imperfect because of delayed and unpredictable bank responses to variations in their liquidity; that the central government has great difficulty in arriving at realistic estimates of its own deficit financing requirements for the current fiscal year; and that the growth of near-bank substitutes ('non-bank financial institutions') has, in any case, substantially weakened the authorities' leverage over aggregate credit and demand in the economy.

²¹ See WP No. 47 (p. 33), and No. 48 which concludes (p. 34), 'Programmes have only a limited impact on several key macroeconomic policy variables. The evidence is no better than mixed even on the core programme components of domestic credit, for which there is little statistically significant evidence of effective credit restraint.'

competition for new customers.

- (c) By focusing on quantified targets, the Fund's credit ceilings may also be inappropriate to financial liberalisation, which operates on the demand for and supply of money chiefly through interest rate policy.

We are in danger of protesting too much about these deficiencies. Despite the difficulties, it is a truism that the avoidance of large-scale excess money creation is essential to macroeconomic stability. The issue, however, is whether the Fund's way of going about things is the best or whether it is not too narrow in the policies deployed in its programmes.

Fiscal policies

One line of defence would be to argue that the above criticisms miss the point that the central thrust of the Fund approach is actually directed to fiscal policy. Indeed, Sachs (1989, p. 113) has argued that, 'The Fund's emphasis on fiscal policy mismanagement as the key source of balance of payments problems is its main strength and is indeed the core "truth" of its strategy.' Others have suggested that the Fund pursues an essentially fiscal, rather than monetary approach to the balance of payments.²²

The Fund's past approach to fiscal policy is also open to major criticisms, however. The chief of these, remarkably, has been developed within the IMF's own Fiscal Affairs Department, under the influence of its Director, Vito Tanzi.²³ This agrees that fiscal policy is central to balance of payments management but disputes the usefulness of focusing on the size of the budget deficit on the grounds that it diverts attention from the real problem, which is the 'quality and durability' of the specific fiscal measures used by the government to remain within the programme's budget ceiling. Excessive budget deficits are often accompanied by distortionary tax systems and inefficient expenditure patterns, so that merely reducing the deficit will not go far enough. To make matters worse, when faced with a necessity to reduce budget deficits governments often seek to minimise political costs by inefficient means: cutting disproportionately on capital formation; starving civil

²² See Tanzi (1989, p. 14) and references cited there. See also Mansur (1989) for the development and testing of what can be described as a fiscal model of the balance of payments, applied to the Philippines, finding a significant positive correlation between the fiscal and balance of payments balances, with causation apparently running from the former to the latter: the larger the budget deficit, the weaker the balance of payments current account.

²³ See especially Tanzi (1989) from which the following exposition has largely been derived.

servants of the supporting inputs they need if they are to work productively; executing blanket percentage cuts with little heed to comparative economic costs and benefits. Moreover, presumably on the basis of the Fund's experiences, Tanzi suggests that 'the longer ceilings on macro variables are in use, the more ways countries learn to get around them' (1989, p. 21).

On this view, the connection between the balance of payments objective and the budget is sensitive to precisely how the government raises its revenue and trims its expenditures. Therefore (*ibid.*, p. 24):

. . . provided that a country is willing to implement considerable structural measures early enough in a program so that the positive effects of these measures can be felt relatively soon, the Fund should be prepared to require less reduction in the overall deficit . . .

To some extent, Fund practices have taken this critique on board, for it was shown in *WP* No. 69 that it has been taking a considerably more detailed interest in the composition of fiscal policy than was formerly the case. Resistance to this trend is considerable, however, so that (Tanzi, p. 25):

A perusal of stabilization programmes indicates that despite an increasing awareness of these issues, political difficulties, guidelines on conditionality, and timing concerns have prevented their being taken formally into account in Fund programmes.

One suspects that in the heat of programme negotiations and under pressure to reach agreement, the finer details of fiscal policy are subordinated to preoccupation with the numbers which should make up the performance criteria.

If so, this is also regrettable for a related reason, which concerns the complexity of the connection between the fiscal balance and the balance of payments. The literature on 'fiscal stance' and the economic effects of budget deficits has shown the many interconnections between fiscal and other economic variables — complications which make it difficult to predict the magnitude of fiscal change necessary to achieve a given balance of payments (or other macroeconomic) target. Indeed, Buiters (1985, p. 54) asserts that 'there are no "model-free" measures of fiscal impact on aggregate demand. Different views on how the economy works will give rise to conclusions about the demand effect of fiscal policy measures . . . that may differ not only in magnitude but even in direction.'

Finally it can be asked whether the Fund's programmes actually create the 'hard' budget constraints they are assumed to do and whether, in consequence, they are able to achieve the reallocation of credit in favour of the private sector which the Fund desires. Reviewing the literature on programme effects one is struck by evidence that little such reallocation occurs. Thus, Ground (1984, p. 81) found that,

'contrary to all expectations,' restrictions on credit within Fund programmes appeared more stringent for the private sector than for the public sector. Our own investigations of programme effects found no significant reduction in the share of total credit going to central government and some slight (non-significant) tendency in the other direction (WP No. 47, Table 4 and p. 33). A more in-depth study of the Kenyan case similarly found that Fund programmes made more generous provisions for credit to the government than for total domestic credit (Killick and Mwega, 1993, p. 59). Since the Fund clearly would like to shift credit in favour of the private sector, it may be speculated that it is unable to achieve this in the face of fiscal and political realities. If so, it is among the Fund's best-kept secrets.

More hard evidence on credit shares would be necessary before arriving at firm conclusions. If indeed there is a systematic tendency for the government, or public sector, to be relatively favoured, this would suggest an inability on the part of the Fund to secure implementation of tough deficit-reducing measures.

The indefensibility of performance criteria

If we take the combined weight of the earlier critique of the basic financial programming model and the above comments on the chief policy instruments employed the conclusion seems inescapable, *that quantified credit ceilings and other performance criteria are literally indefensible*. Recall first how performance criteria work. The values for the external asset holdings of the central bank, for credit ceilings, for reduction in fiscal deficits and the like are initially generated by application of the financial programming model. These values are then modified in the light of the Fund mission's judgements and negotiations with the government. Sometimes the underlying balance of payments projections are manipulated to result in 'acceptable' (but unrealistic) figures.²⁴ In stand-by programmes, these are then quantified on a quarterly basis (six-monthly in the case

²⁴ Martin and Mistry's survey of the preparation of Fund programmes in African countries amply demonstrates the frequent spuriousness of apparently objective payments and other projections (1991, p. 107):

Projections . . . often underestimated the amount of external finance or debt relief creditors would provide, forcing lower current account deficit targets than necessary. Sometimes they overestimated external finance or underestimated debt service due, necessitating revisions to projections during IMF programmes. Occasionally they projected an optimistic picture . . . to convince creditors that they were not backing a 'basket-case' this often perversely produced less external finance than hoped . . . Crucially, little of the negotiation or last-minute juggling was matched by changes in conditions.

of ESAFs), with the government's continued access to the credit conditional on remaining within them. If they go above the ceilings the programme is either discontinued or (usually after a delay) the Fund agrees a waiver of the original conditions and access is resumed.

But what claim can a quarterly ceiling on credit to the government have to be objectively derived from economic analysis? And how much confidence can be felt for the 'correctness' of the resulting number? Clearly it is not objective, not only because it is an outcome that has to be negotiated (perhaps initially within the Fund team — with country specialists tending to desire different outcomes from the representative of the Exchange and Trade Relations Department — and then not only between the Fund and government teams but also, increasingly, the World Bank) but also because based on a myriad of judgements — about the behaviour of v ; the response of the balance of payments, and hence ΔR ; the consequences of the currency devaluation which is also likely to be included in the programme; the behaviour of GDP and prices, determining ΔM ; feed-backs between the budget, the balance of payments and other variables and the resulting desirable value of the fiscal balance; the many time lags involved in these processes; . . . and so on. The resulting figure can inspire little confidence, for although it is desirable that Fund staff should be allowed to exercise their judgements in putting the programmes together, the cumulative effect of such a string of judgements (or negotiating compromises) can be large.

To these considerations we can add: unreliable data; the possibilities described earlier that the economy will behave in different ways from those postulated by the Fund; the difficulties of tracing the links between the fiscal balance and the balance of payments; the variable effects of detailed tax and spending decisions; the use of a 'long-term' model to derive short-term ceilings; and the conceptual and practical difficulties of keeping ΔD within the desired range. The numbers written into programmes, *determining access to the Fund's balance of payments assistance*, are just not to be taken seriously.²⁵

A possible rejoinder by the Fund would point out that it is flexible even in its application of quantified performance criteria. It can point out that nowadays it makes greater use of review missions as an alternative to predetermined performance criteria, so that it is now easier to adjust ceilings that appear to have become less appropriate in the light of changing conditions, and it can leave the

²⁵ For a further critique see Spraos (1986). He goes further than the above to argue against placing target values upon policy instruments, as compared with target values for the balance of payments and other objectives being pursued. It is an incisive critique which, however, goes astray when he turns to propose an alternative, for he then quickly runs afoul the difficulty of reducing the balance of payments objective to a single quantified indicator, and of bringing in other goals.

determination of some performance criteria until a later stage, reducing the potential severity of forecasting errors.

Second, it can point out that it uses waivers²⁶ — releasing the government from the ceilings written into the original programme — so as to provide greater flexibility and avoid the problems created by ceilings that turn out to be unfeasible. Indeed, the limited evidence available indicates that the Fund has frequent recourse to waivers. Martin (1991, Table 2.6) records that out of 95 programmes commenced in sub-Saharan African countries in 1980–6 no less than 78 of these were subsequently the subject of waivers. He goes on (pp. 284–5) to report an even higher incidence of waivers in more recent programmes. The necessity for these arose chiefly out of difficulties with performance criteria relating to budget deficits and domestic credit — precisely the areas where our earlier arguments predict difficulties in the setting of meaningful targets.

While the greater use of review missions is to be welcomed, the availability of waivers is a weak defence of quantified performance criteria for a number of reasons. If it is necessary to grant waivers other than exceptionally this is evidence that the quantification process is unsatisfactory. Otherwise, why should waivers be needed so frequently? The fact that waivers are apparently necessary in a large majority of African programmes indicates that the Fund's standard approach does not work well, at least in this large region.

Unfortunately, the Fund's policies and practices on waivers are shrouded in mystery. It is unsatisfactory that this important aspect of the Fund's operations should so lack transparency, leaving governments uncertain about where they stand and about the rules to which they are supposed to conform.

Governments' uncertainties are all the greater because it is known that readiness to grant waivers is used by the Fund as a policy instrument, as a tap to be turned down or opened wide according to the *global* circumstances of the time.²⁷ The situation is made more unsatisfactory by the Fund's practice of suspending access to a credit pending a decision on whether to grant a waiver and agreement on new performance criteria. This withdrawal of access, even if only temporary, can cause severe disruption to governments in often desperately tight balance of payments situations, undermining the credibility of the programme and the likelihood that it

²⁶ On this see Killick (1984, p. 202).

²⁷ See Killick (1984, p. 212) for documentation on how government access to waivers was consciously reduced in the early-1980s as part of a general toughening-up of conditionality.

will stimulate capital inflows and investment.²⁸

In short, as at present practised waivers are an unsatisfactory response to the difficulties created by quantified performance criteria. The position would be improved if the Fund were to introduce greater transparency into its waivers policies, but to do so would lay bare the extent of its difficulties with quantified criteria. If these are to be justified at all it can only be on the pragmatic grounds that it is impossible to think of any better way of proceeding. But before taking up that challenge there are further issues for examination.

Dealing with growth and income distribution

That Fund programmes tend to depress economic growth and impose avoidable economic hardships are long-standing complaints. We have already reported some of the criticisms of Taylor (1988), who emphasises the stagflationary potential of the programmes and the Fund's past disinterest in programmes' distributional consequences. Ground (1984) is another critic in the structuralist tradition who emphasises the deflationary and poverty-increasing nature of many of the Fund's policy preferences, arguing that Fund programmes contain five types of 'recessionary bias': [1] 'the insufficiency of the amount of financing; [2] the inconsistency of domestic economic policies; [3] the use of the stock of net external assets as a performance criterion; [4] the use of specific fixed targets for the performance criteria; and [5] the nature of the link between external financing and adjustment agreements' (p. 80). One specific suggestion (p. 81) is that the difficulties which borrowing governments have in remaining in conformity with performance criteria may cause them to play safe by adopting more contractionary policies than are necessary in order to be sure of remaining in conformity to programme conditions. Sidney Dell (1982) complained of a 'political economy of overkill' and the Group of 24 (1987, pp. 19–20) similarly write of a 'built-in tendency for domestic credit to be tightened excessively as a result of unrealistically low projections of the inflation rate. The consequential overdose of credit controls leads to output contraction . . .'

²⁸ See Martin (1991), Chapter 2, for evidence. The uncertainties just referred to can be linked to a wider-ranging argument developed by Rodrik (1991), who draws attention to the effect of policy changes initiated as a result of adoption of adjustment programmes in increasing investor uncertainties. He suggests that even moderate uncertainty about policy acts as a substantial tax on investment, and that 'reform packages which emphasize policy stability and sustainability are likely to bring greater payoffs in terms of investment and growth than those which focus on economic liberalization and getting prices right' (pp. 240–1).

Against these complaints we should set the conclusions of the literature surveyed and tests undertaken in WPs 47 and 48 on the effects of Fund programmes. These included that 'Most tests indicate that adoption of a Fund programme is not associated with any significant loss of output, or fall in economic growth, although a minority suggest there to be a significant negative correlation' (WP 48, p. 32) and that 'our survey did not uncover evidence of large distributional, political or supply-side programme costs' (*ibid.*, p. 33). We also found little association between programmes and inflation. In short, although the evidence is ambivalent, it is easy to exaggerate the likely extent of adverse stagflationary and poverty consequences.

However, the evidence presented in those papers did unambiguously link IMF programmes with substantial and sustained declines in investment rates. In the short-to-medium-term, such declines may not translate into output losses because of compensating improvements in the efficiency of resource use but it cannot be expected that moving the economy closer to its efficiency frontier could continue to compensate for reduced investment over an extended period.

The jury thus remains out on whether programmes have growth-reducing consequences. Even if they do not, it is possible that a different approach would produce better results. We should recall here the work of Khan and Knight (1985, see Chart 1) showing substantially faster growth for countries adopting programmes which include supply-side measures, as against a conventional stand-by demand management approach — a result consistent with internal Fund reviews which indicate relatively positive growth results from the more 'structural' SAF and ESAF programmes.

In an earlier paper, Khan and Knight (1982) point out that different combinations of stabilisation and structural adjustment measures have different effects on growth and other variables — and the importance, therefore, of searching for cost-minimising combinations. This is a theme also taken up in Killick *et al.*, 1984, Chapter 8, who argue the case for adoption of a cost-minimising approach to programme design and criticise the Fund for having neglected this in the past.

Unfortunately, the situation in this regard has changed little during the past decade. While WP 69 has shown that the Fund does now give the growth objective somewhat greater weight in some of its programmes, and that its SAF and ESAF facilities have been important innovations, Fund missions still do not go about programme design within a cost-minimisation framework. The achievement of some minimum growth rate is still not accepted as a constraint on programme design. In contrast with the approach of the World Bank, Fund missions base their balance of payments projections on estimates of the likely availability of external resources, with growth a residual outcome, rather than on the basis of estimating the volume

of support needed to achieve a desired level of economic activity.²⁹

Like its financial programming model, then, its approach remains essentially static or short-term. Would it be possible to modify the model to make it more dynamic, incorporating growth as a target variable? There is reportedly little interest in such a project among the Fund's country staff, although there is no reason in principle why this should not be done. Khan, Montiel and Haque (1990), for example, have produced a formal integration of the financial programming model and the modified two-gap ('RMSM') model employed by the World Bank which endogenises GDP growth along with the balance of payments and inflation as target variables. However, they point out that the resulting model can only be kept reasonably simple through resort to some rather drastic assumptions, and that making it more realistic would quickly increase its complexity, reducing its operational value. The Fund itself (1987, pp. 27–8) has stressed the complexities involved in building a growth objective into the financial programming model, describing it as 'a formidable task' which researchers have only just begun to undertake; and Mohsin Khan, one of the principal researchers involved, has consistently stressed our limited knowledge of the connections between the key components, e.g. between financial variables and the real economy.

The solution favoured by the G24 is for Fund missions to undertake 'growth exercises' (1987, p. 16):

In order to provide Fund programmes with a growth perspective, it is proposed that a set of "growth exercises" be performed prior to the "financial exercises." From these exercises, the amount of external finance necessary to support a growth-oriented adjustment programme could be determined. The financial exercises should be built upon these estimates of necessary external finance.

Taylor (1988, p. 163) favours a similar approach.

We will consider a fundamental snag with such proposals in a moment but before doing so can conclude from the last few pages that the Fund's traditional financial programming model copes poorly with the behaviour of the real economy over time, and makes no contribution to the reorientation of the Fund towards 'adjustment with growth'. Its staff play down the significance of this deficiency, arguing that in practice programme design is based on a far wider range of considerations and that programmes can be adjusted in *ad hoc* ways to

²⁹ According to a senior World Bank staff member, during the course of negotiations with Malawi Bank and Fund staff presented the government with two alternative sets of projections, with one based on a growth target and resulting financing needs and the second based on likely available finance. Reportedly, however, this caused so much confusion on the Boards of the two institutions that 'we will never do that again.'

accommodate growth. However, the necessity for such *ad hoc*ery adds to the list of respects in which the financial programming model appears seriously flawed.

When considering the modification of the Fund's traditional approach to a cost-minimising, growth-promoting one we should recall the short-term nature of its programmes. It is a further long-standing complaint that these are too brief to be able to address growth and supply-side weaknesses. Although earlier *WPs* in this series have recorded the extent to which the Fund has moved towards medium-term programmes and that it often permits a government to enter into a succession of programmes, these are no more than partial solutions. According to Louis Goreux, formerly Deputy Director of the Fund's Africa Department, the main reason for the frequent failure of its programmes in Africa was that supply responses were slower and weaker than anticipated. This was more important than policy slippages or external shocks. The Fund had thus found itself entering into successions of programmes and into 'structural adjustment' programmes in collaboration with the World Bank. However, 'Plugging a number of supply measures advocated by the Bank into the Fund model is not the appropriate solution . . . Supply and demand considerations need to be integrated into the formulation of the model to determine the speed of adjustment that is both technically feasible and politically sustainable. [This speed] has often been over-estimated, partly because of the length of the grace period attached to Fund purchases was too short' (1989, p. 146). In other words, missions find it necessary to build adjustment speeds into programmes which they know are unrealistic.

The standard IMF response to criticisms along these lines is to point out that its Articles of Agreement only permit it to make its resources 'temporarily' available to members with payments difficulties. Under the Bretton Woods settlement it was the Bank, not the Fund, which was envisaged as the agency for long-term lending. In the 1960s and 1970s 'temporary' was interpreted to justify the 12–18 months typical of stand-by programmes. However, this legalism cannot be the chief obstacle to programme lengthening, for 'temporary' is as long as a piece of string — and has already been stretched to accommodate three-year EFF, SAF and ESAF programmes. Its willingness to agree long, virtually unbroken, successions of programmes similarly reveals the elasticity of this concept. There is no linguistic or legalistic necessity to take 'temporary' as synonymous with short-term. It could equally persuasively be interpreted to mean *non-permanent*, in which case there would be no evident difficulty with programmes lasting five years, even longer.

Money is the real obstacle, as Graham Bird shows in *WPs* 64 and 70. Longer programmes and more extended transition periods require larger amounts of support, to finance the longer period before balance of payments viability is achieved. The G24 recognised this explicitly in connection with its suggestion of

'growth exercises':

This implies a need for an effective acceptance by creditor countries of the concept of symmetry in adjustment and an obligation of those with large surpluses to provide the capital required — an obligation that would constitute, in effect, a reciprocal performance criterion for these countries.

Sadly, there has been a retreat from the norms on international financial co-operation over the last decade and a half. Surplus countries show no signs of accepting the obligations which the G24 reminded them of. This unwillingness to put up more finance is the hole in the heart of all proposals to give the Fund a greater growth orientation, for while representatives of the industrial countries are happy enough to urge the desirability of 'adjustment with growth' they have a proven unwillingness to face up to the financial implications of that.³⁰ At the same time, however, there is much wishful thinking in this unwillingness. For a succession of short-to-medium term programmes is likely to add up to just as much financing as one or two medium-term programmes, while being an intrinsically sub-optimal way of dealing with long-term problems. The creditor countries do not do themselves a favour by providing support in inefficient ways, not least because it contributed to the emergence in the 1980s of a serious problem of arrears to the IMF, as described by Bird in *WP 70*, pp. 13–16.

Nevertheless, their reluctance to enter into additional financial commitments is something with which the Fund has to live, as witness the difficulties it had with the 50% increase in quotas agreed in June 1990 but only ratified at the end of 1992.³¹ Even after ratification the 'access' rules governing credit size were changed, so that maximum credits were little larger than with the old quotas. In consequence of such constraints, staff missions find themselves having to write unrealistically short programmes, as Goreux reports, or manipulating payments forecasts so as to pretend that problems are not as large as they appear.³²

The problem of 'ownership'

In evaluations of its experiences with structural adjustment programmes, the World Bank has long suspected that the extent of implementation of programme stipulations, and hence their likely impact, is strongly influenced by the extent to which the borrowing government regards the programme as its own — what the Bank has called the government's 'ownership' of the programme. A report by its

³⁰ This point is argued more fully in Killick (1987, p. 206–8).

³¹ See *IMF Annual Report, 1992* (pp. 70–1).

³² For ample documentation of this see Martin (1991), Chapter 2 (e.g. p. 61).

Table 1: Correlating programme outcome with borrower ownership

<i>Borrower ownership</i>	<i>Programme outcome</i>				<i>Total</i>
	<i>Highly satisfactory</i>	<i>Satisfactory</i>	<i>Unsatisfactory</i>	<i>Very unsatisfactory</i>	
Very high	9	6	0	1	16
High	6	15	2	2	25
Low	4	10	6	3	23
Very low	0	3	7	7	17
Total	19	34	15	13	81

Source: World Bank (1992, p. 177).

Evaluations Department (World Bank, 1992, Chapter 10 and Annex 8) has recently taken this thinking a good deal further. Assessing ownership by the extent to which the initiative for the programme's policies was local or external, the level of intellectual conviction in the appropriateness of its measures, the extent of support from the top political leadership, and efforts towards consensus-building among the wider public, it tested for correlation between this variable and its assessment of the satisfactoriness of programme outcomes. The results are reproduced in Table 1.

The results are strong and confirmed by various significance tests. Ownership was high in most programmes achieving good results and low in ineffective programmes. Of course, correlation should not be confused with causality and the Bank did not undertake causality tests. On the other hand, given the way the tests were structured, it is not clear how causality could have run from effectiveness to ownership, and the results are consistent with the findings of others who have studied the political determinants of programme success.³³ The Bank certainly interpreted the results to indicate that effective programmes are a *consequence* of borrower ownership, which was found strongly predictive of programme success

³³ See, for example, Nelson (1989 and 1990), who emphasises the importance of the quality of political leadership and writes of the existence of a 'reform syndrome' as presenting the best circumstances for effective adjustment programmes.

Leaders firmly committed to major change, widespread public acceptance or demand for such change, new governments with strong centralized authority, and a disabled opposition constituted the political context for determined adjustment efforts (1989, p. 12).

in three-quarters (73%) of all cases, with most 'deviant' cases apparently explained by the intervention of exogenous shocks. The support of, or lack of opposition from, key interest groups was identified in the evaluation as probably the single most important influence. As the report states (p. 173), 'One of the most important services the Bank can provide is to ensure that the process of policy reform is 'internalised' in the country as quickly as possible, so that the reform program is designed by the country itself . . .'

Sadly, there is no equivalent information specific to the Fund. However, there must be a strong presumption that similar considerations apply to its own programmes, not the least because many of the Bank programmes analysed were accompanied by parallel Fund programmes. Its own tendency to attribute non-implementation to 'lack of political will' points in the same direction. So does the following summary of research into the influence of the IMF on the policies of former communist countries of Eastern Europe (Henderson, 1992, p. 245).

The IMF influenced the adjustment processes of several Eastern European nations in the 1980s through its efforts to promote market-oriented stabilisation and reform. Each country's state structure, policy-making process, and state/society relationships shaped its responses to IMF demands. Romania's centralist political system generated the most intense and successful resistance to the IMF's policies. Yugoslavia's polycentric political system, by contrast, weakened elite capacity to resist IMF demands while simultaneously impeding the implementation of IMF policies at the subnational level. Finally, Hungary's political system allowed the IMF to ally with elite supporters to promote its policies; yet also provided opportunities for lower-level actors to obstruct their implementation. Prospects for collaboration with the IMF have been enhanced by recent changes in Eastern European state structures and policy-making processes, which have encouraged freer political debate and more market-oriented development strategies. Yet impediments to collaborations remain, as political decentralisation has heightened the capacity of lower-level actors to obstruct standby implementation.

That it has been unforthcoming on this subject is not, we suspect, because it thinks ownership is unimportant but because the Fund has particular difficulties in dealing with this subject.

Many of these arise from the crisis conditions in which governments often turn to it, the intense pressures of work under which its country staff commonly operate, the speed with which its programmes are prepared and their often short-term nature. In such circumstances, with negotiating missions commonly lasting two or three weeks, its staff do not have time to ensure that the government is fully 'on board', just as the government often will not have time (even when it has the desire) to undertake the consultations and public education necessary for consensus-building.

These intrinsic difficulties are not uncommonly aggravated by a certain arrogance of approach. Although we recorded in *WP 69* (pp. 23–7) some increase in IMF negotiating flexibility, including occasional willingness to settle for technically sub-optimal but politically more sustainable programmes, we also made it clear that this change was only marginal. The introduction of procedures for tripartite ‘Policy Framework Papers’ described there has been a useful device in the case of SAF/ESAF programmes. While it is widely conceded that in the early years the preparation of these was dominated by the Bank and Fund, there have been greater efforts subsequently to bring governments into the drafting process. That only limited progress has been made is, however, indicated by references in the IMF’s 1991 *Annual Report* (p. 57) to the desirability of bringing governments more into the PFP drafting process.³⁴

In any case, the key document for the Fund is the ‘Letter of Intent’ in which the borrowing government formally presents the policies it will undertake to strengthen the balance of payments and to promote other programme objectives. Herein, it might be said, lies the ‘ownership’ of Fund programmes — but these Letters, although ostensibly from the government, are still almost invariably drafted in Washington, with the government left trying to negotiate variations in a draft presented to them. It is difficult to imagine a procedure less likely to leave the government regarding the programme as its own. The practices of the Fund flatly contradict the obvious good sense of the Bank report (1992, p. 15) that, ‘One good indicator of ownership is the borrower’s willingness and capacity to prepare the Letter of Development Policy’ (the Bank’s equivalent of the Letter of Intent). They do not encourage the desirable internalisation of policy reform mentioned earlier and, while it could be retorted that these practices ease the way for governments to use the IMF as a scapegoat, blaming it for unpopular measures they privately know to be inescapable, the Fund has become unhappy about in cast in such a role, on the grounds that governments ought to accept responsibility for the management of their countries’ economies.

While acknowledging that Fund-government relations are nowadays rarely adversarial³⁵ and that the Fund is more sensitive than formerly to the need to

³⁴ It is also significant that the positive assessment of PFP procedures in the Bank’s evaluation of its structural adjustment programmes already cited (World Bank, 1992, pp. 206–8) is largely couched in terms of its effectiveness as an way of co-ordinating the Bank and Fund.

³⁵ Recall the conclusion of *WP 48* (p. 26) that situations in which programmes are dictated by the Fund to a recalcitrant but desperate government are untypical. However, the absence of an adversarial relationship is not necessarily sufficient to ensure that the government will regard itself as owning the programme, for the *WP* went on to point out that implementation was often poor even when there was broad agreement between the two parties.

bring governments into programme preparation, there is evidently a long way to go on this. It would be most valuable to have evidence for the IMF comparable to that presented in Table 1 on the Bank. Pending that, there remains a strong suspicion that a weak sense of ownership remains a major problem for the implementation of programme stipulations, and that this helps to explain the frequent programme break-downs reported in *WP 47*.

III – Towards Greater Country Selectivity

As always, it is easier to find fault than to see solutions. Nonetheless, the Fund cannot be happy with the position portrayed above and in earlier papers. It appears that its ability to secure the results it desires, and its leverage over key policy instruments, is quite restricted. To this its own modes of operation contribute substantially. It is instructed to give its programmes greater growth orientation but denied the financial resources necessary for that task. Its basic financial programming model and reliance on quantified fiscal and monetary performance criteria are open to severe, not to say devastating, objections. If we take the availability of finance as a given, how might it respond to these deficiencies?

There is, of course, no simple solution but we see a change of strategy towards the negotiation of programmes as responding to a number of the difficulties analysed above. At present the Fund operates what can be called a 'pro-programme' strategy. By this is meant an approach which leads to programmes in a large number of countries, so that most governments which turn to the Fund with payments difficulties can expect to be able to agree a programme and secure financial assistance. This sounds desirable enough but has serious disadvantages.

One is that it encourages 'agreements' that exist only on paper. This contributes to frequent programme break-downs and to a waste of scarce resources in countries whose governments are not serious about stabilisation, or are unable to deliver it. This, in turn, adds to the problem of arrears mentioned earlier. The Fund's desire to avoid arrears further adds to the pressure on it to make further loans to governments of dubious seriousness. More generally, the pressure to reach agreement results in the absurdity of the doctoring of projections in order to achieve a cosmetic improvement in projected outcomes, and recourse to 'paper conditionality' which both sides know are unlikely to be honoured.

The number of programmes stretches the resources of the Fund thin. This leads to the under-funding of programmes, suggested in *WP 47* (p. 27) as a source of programme breakdown, and reduces the Fund's ability to successfully pursue 'growth-oriented' programmes, which generally require longer time periods and

more financing.

The growth in the number of country programmes, combined with an American-led campaign to hold down the size of the IMF staff, has resulted in serious over-work and limited the time that can be devoted to any one programme. This reduces the Fund's ability to design programmes according to individual country circumstances, and strengthens institutional impulses towards application of a standardised approach, dealing with a rather narrow range of variables and uniform behavioural assumptions, of the type encapsulated in the financial programming model.

Apart from a laudable desire to be able to offer assistance and an understandable difficulty about, in effect, telling governments that it does not believe their promises, defenders of the Fund could point to the political pressures that are often brought upon it to agree programmes to favoured countries (see *WP 48*, pp. 28–9). It has often not felt in a position to refuse assistance to governments, however sceptical it may have been about the seriousness of their commitment to macroeconomic prudence, unless it was willing to take on one or more of its most powerful shareholders. It has a history of timidity in the face of such pressures.

However, the end of the Cold War has created a new situation, and it is already evident that geo-political considerations are impinging less on Fund lending decisions. What is suggested here is that the IMF should take greater advantage of this new-found freedom to move from what we have called a 'pro-programme' approach to a strategy of greater country selectivity, an enhanced willingness to say no in order to concentrate on helping 'serious' governments.

What constitutes seriousness must be a matter for judgement case-by-case but one good test is that suggested by the Bank: a government's willingness to prepare its own Letter of Intent, to design its own programme. Of course, the Fund (and others) should stand ready to provide technical assistance for this task, and in other ways to safeguard against decisions biased against governments with limited domestic capacity for policy analysis. But its guiding principle should be that the resulting package of measures should genuinely be those of the borrowing government.

This would involve a considerable change from present practices but would have a number of advantages. By definition, it would solve the ownership problem, enhancing implementation and the extent of policy change. It would increase the probability that programme content was adequately based on local knowledge, facilitating a more eclectic approach. There could be reduced reliance on quantified performance criteria, with correspondingly more attention to what has been called in the fiscal context the 'quality' of programme content. Provided that its access rules were revised in the light of this change, it would enable the Fund to concentrate its resources on a smaller number of 'deserving' countries, safeguarding against under-funding and permitting the growth objective to be given greater

weight. Greater realism in programme design would be encouraged.

There would, of course, be objections to this change and difficulties to deal with. The details would have to be worked out. In particular, there should be stringent safeguards against this policy working to the disadvantage of countries just because they were poor and/or with weak public administrations. It is not the intention here to unveil a full-blown scheme, merely to point out a direction. Moreover, this suggestion in no way weakens the case for reversing the retreat from international co-operation, including increased resources for the Fund and agreement on a renewal in some form of the Fund's ESAF medium-term soft-credit facility. Nevertheless, it should be possible to enhance the effectiveness of the Fund without large extra money.

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