14

The IMF and the Poor: Soft Loans, Hard Adjustment

When H. Onno Ruding assumed the chair of the Interim Committee in the spring of 1985, one of his top priorities was to lower the barrier of formality that limited the ability of ministers to interact and to introduce and develop fresh ideas. For his first meeting, on April 17, he suggested that after the morning session, in which each member would make his traditional formal statement covering the main agenda items, the afternoon would be devoted to an informal exchange of views with restricted attendance. To give some structure and guidance to the discussion without restricting it to a set agenda, he asked Michael Wilson (finance minister of Canada) and V.P. Singh (finance minister of India) to outline a few key issues that members might address. In the morning session, Singh had raised the issue of the need to provide additional financing for low-income countries, stressing the role that an allocation of SDRs could play in that regard along with increases in official development assistance, Fund quotas, World Bank capital, and IDA (International Development Association) resources. In this less formal setting, he decided to toss another idea onto the table: over the next few years, the Fund would be receiving some SDR 3 billion in repayments from the Trust Fund loans made in the late 1970s. Why not plan now to rededicate those funds to the benefit of low-income countries, whose needs now were even much greater than they had been then? Why not reactivate the Trust Fund and establish an interest subsidy account to provide concessional assistance?[1]

Singh's proposal was eagerly embraced by his colleagues around the table, from industrial as well as developing countries. It avoided the legal and ideological pitfalls that blocked agreement on an SDR allocation, it directed resources where they were most needed, and it provided a means of assisting low-income countries without putting the Fund's general resources at risk. The communiqué for the meeting was redrafted accordingly, to call on the Executive Board to "consider the use of the resources that will be available following repayment of loans that have been made by the Trust Fund, to help forward the adjustment process by providing assistance to low-income developing countries," and asking the Managing Director to make a progress report to the Committee when it next met in October.

[1]Summary record of the informal session; in IMF/CF (G 142.42 "Interim Committee Meeting (24th), Washington, DC, April 17–19, 1985").

This initiative—unusual in that it arose spontaneously from the Interim Committee without prior staff input—led directly to the establishment of the Structural Adjustment Facility (SAF) in 1986 and indirectly to the creation of the much larger Enhanced Structural Adjustment Facility (ESAF) in 1987. It embodied two roles for the Fund that had emerged only in the preceding decade: lending on concessional terms and lending for structural adjustment.

The idea of a concessional or "soft loan" window for the IMF originated with the Oil Facility Subsidy Account in 1975, which was closely followed by the Trust Fund in 1976.[2] Both facilities were administered by the Fund as entities separate from the Fund's general resources.

The Subsidy Account was financed by contributions from 25 countries totaling SDR 160 million ($195 million), plus SDR 27 million ($33 million) in income from investing contributed funds until needed. Those funds were used to reduce the interest cost of borrowing from the 1975 Oil Facility by 5 percentage points for 25 countries deemed to be most severely affected by the sudden rise in oil prices. Over the life of the Oil Facility (through 1983), the account covered more than two-thirds of interest charges due from those countries.[3]

The Trust Fund, which was administered by the IMF as an entity separate from the institution's general resources, was financed by the sale of 25 million ounces (16 percent) of the Fund's stock of gold from 1976 through 1980. Of the $4.6 billion in profits from those sales (bolstered by the sharp rise in the price of gold during the life of the program),[4] $1.3 billion was distributed directly to eligible developing countries and the remaining $3.3 billion plus related income and some transfers (approximately SDR 3 billion) constituted the Trust Fund.[5] That money was lent to 55 low-income countries at an interest of ½ of 1 percent a year, with the principal to be repaid in installments beginning after 5½ years and ending after ten years. Since the initial loans were made in January 1977 and the last ones in February 1981 (Figure 14.1), significant reflows of cash into the Trust Fund began in July 1982 and were expected to conclude in February 1991.[6]

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[2]For details, see de Vries (1985), pp. 351–55 (on the Subsidy Account) and Chapter 34 (on the Trust Fund).

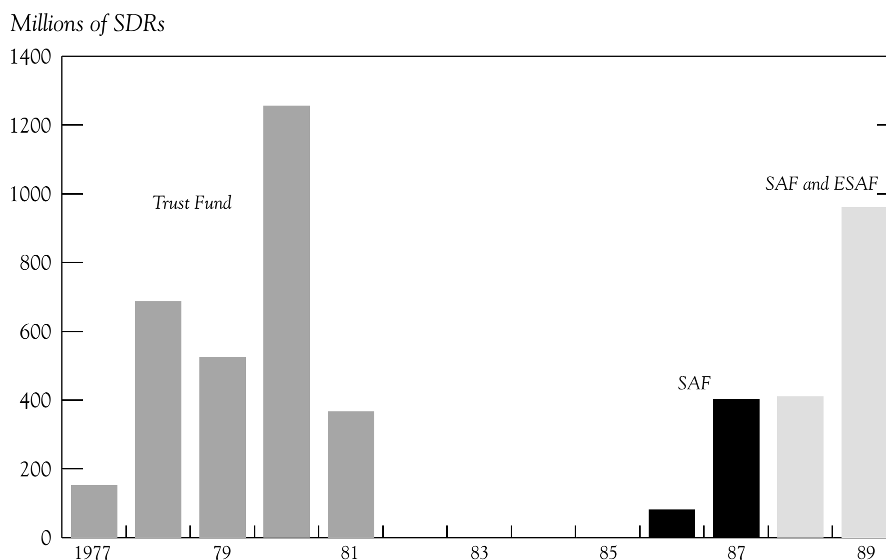
[3]The initial eligibility list included 41 countries, but only 25 of those drew on the 1975 Oil Facility. When the Subsidy Account was terminated in 1983, the Fund distributed its remaining assets in the form of an additional subsidy of 33 basis points; see *Annual Report 1984*, p. 180.

[4]The first auction, in June 1976, yielded a price of $126 per fine ounce. If that price had continued, and if the exchange rate between the dollar and the SDR had remained constant, the auctions would have yielded total profits of $2 billion through May 1980, compared with the actual figure of $4.6 billion. The mean gold price for the four years of auctions was approximately $240, and the mean profit per ounce was about $200. (Aside from the Fund's expenses, profit in U.S. dollars equaled the difference between the sale price and the dollar equivalent of the official price, SDR 35.) At the most profitable auction, held at the height of the speculative boom in gold in January 1980, the Fund sold 444,000 ounces at an average price of $712.12.

[5]For a more detailed summary, see *Annual Report 1980*, pp. 85–89.

[6]At the end of fiscal year (FY) 1991, six countries had failed to repay Trust Fund loans on time, and SDR 158 million ($210 million) in principal remained outstanding. Seven years later, SDR 90 million ($120 million) lent to three countries was still outstanding.

Figure 14.1. IMF: Concessional Lending, 1977–89



Loans from the Trust Fund were subject only to first-tranche conditionality. That is, an eligible member country was required to represent that it faced a balance of payments need for the loan and to demonstrate that it was making a reasonable effort to correct it. Performance criteria, as used in upper-tranche arrangements, did not apply. Consequently, nearly all countries that were eligible on the basis of having low per capita income borrowed their share of the available funds. By the time the Trust Fund was exhausted, however, the idea of making even concessional loans conditional on specific policy commitments was becoming more widely accepted.

When the Trust Fund was established, the IMF had recently established the Extended Fund Facility (EFF), to help countries carry out "comprehensive programs that include policies of the scope and character required to correct structural imbalances in production, trade, and prices."[7] Although EFF credits would have longer maturities and would make it easier for the Fund to provide substantial support to countries for three or more years in a row, the interest rate would be the same market-related rate charged on ordinary stand-by arrangements. For low-income countries, the intention was to make a blend of financing available, including conditional stand-by or extended arrangements at regular rates and low-conditionality loans at concessional rates.

This, then, was the situation at the beginning of the 1980s: part of the IMF's own lending was going to low-income countries, part was conditional on programs

[7]Executive Board Decision No. 4377-(74/114), September 13, 1974; in de Vries (1985), Vol. 3, pp. 503–06.

to implement structural reforms, and a separately administered account was providing loans on concessional and low-conditionality terms only to low-income countries. Partly because the SDR 3 billion in the Trust Fund had been completely disbursed, but also because of the growing reluctance to make low-conditionality loans (as discussed in Chapter 13), the soft-loan window was allowed to lapse in 1980. When discussions of ways to help the least developed countries rose again to the fore in the middle of the decade, an important consideration was whether and how to integrate concessional with conditional lending: how to make soft loans less soft while increasing their value to the countries that needed them most.[8]

Closing Down the Trust Fund

The Trust Fund was designed to be temporary. Low-income countries, many of them newly independent and most of them needing to import oil to fuel economic growth, faced a cruel economic environment in the 1970s. Eventually, they would be expected to compete on the global field, and the concessional loans from the Trust Fund would be one means of helping them reach that stage. By 1980, however, when the resources of the Trust Fund were nearly all committed, it was apparent that the environment was not improving and that the transition was going to take much longer and require a more sustained commitment from creditors and donors. Should the Trust Fund be extended and perhaps made permanent, or should a new approach be tried?

While this question was arising, two seemingly unrelated events altered the course of the debate. First, the IMF was grappling with the effects of extraordinarily high world interest rates. The Supplementary Financing Facility (SFF; 1979–81), like the earlier oil facilities, was financed with money borrowed by the Fund at market interest rates, and the interest charges on the Fund's corresponding credits were matched to the cost of borrowing. While that operation made credit more readily available, it also raised its cost, especially in the inflationary circumstances of the late 1970s. For example, in the second half of 1979, the rate of charge on credits financed by the SFF was just over 10 percent, compared with the Fund's standard rate of charge of 5¼ percent. Low-income countries could not afford to borrow at those rates, and even most middle-income countries were reluctant to do so. Consequently, the Fund began exploring ways

[8]The Compensatory Financing Facility (CFF) was conceived in 1963 as a low-conditionality means of lending primarily to developing countries (Chapter 15). In the course of discussions in 1987 on how to strengthen the utility of the CFF, Hélène Ploix (France) proposed that CFF credits to low-income countries be made on concessional terms by lengthening maturities and subsidizing interest charges; see minutes of EBM/87/36 (March 3, 1987), pp. 5–6. That proposal generated some support but not enough to bring it to fruition. The idea was dropped several months later as part of an effort to concentrate concessional resources on the ESAF, which (as discussed below) had more clearly defined conditionality.

to subsidize the interest charges on SFF-financed credits, as it had with the oil facilities.[9]

Second, the Fund's program of gold sales was coming to an end just as the market price of gold was soaring to unimagined heights. The institution still held the world's second largest stockpile of the precious metal (after the United States), and in January 1980 those 103 million ounces had a market value of more than $70 billion. The potential income from selling and reinvesting that stock, even if the market price fell sharply, could have brought enormous benefits to the poorest countries.

The Managing Director, Jacques de Larosière, proposed in December 1979 that the Fund consider selling up to an additional 9 million ounces of its holdings of gold and investing the proceeds in interest-bearing securities. The income would be used to subsidize the cost of using the SFF and possibly other Fund lending, and to strengthen the Fund's income position. An additional portion of the gold, perhaps as much as 32 million ounces, would be dedicated to supporting a proposed "substitution account," as described in Chapter 18.[10] The goal was to create a consensus for action by presenting these suggestions as a package that included something of benefit to everyone, but in the end it failed to generate much enthusiasm. After extensive consideration by the Executive Board and the Interim Committee in the first half of 1980, the Managing Director's plan to sell gold was quietly dropped.[11]

With gold sales likely to be ruled out, attention focused on the projected SDR 3.1 billion ($3.9 billion) in Trust Fund reflows (mostly principal repayments, plus a small amount of interest), which would begin trickling in during the second half of 1982 but would not peak until 1986.[12] The Fund had three options: renew the

[9]See "Final Texts of Letter of Transmittal and Joint Statement," EBD/79/187, Rev. 4 (August 10, 1979), and "Mechanisms to Reduce the Cost of Using the Supplementary Financing Facility," EBS/79/547 (September 5, 1979). Exploratory discussions with potential donors for SFF subsidies revealed what in retrospect was the first major drop-off in the willingness of some of the wealthiest states to provide budgetary support for low-income countries. The large budget deficits incurred by the United States, the United Kingdom, and other major countries engendered a shift in attitudes toward foreign aid that persisted long after the deficits had been brought under control. By the end of 1979, proposals for financing subsidies on Fund lending therefore focused primarily on options that would not require direct budgetary outlays.

[10]Minutes of EBM/80/5 (January 11, 1980), pp. 3–9. The statement was originally circulated as Buff 79/243 (December 21, 1979), for the January 11 meeting.

[11]A decision to sell gold from the Fund's holdings requires an 85 percent majority. No vote was taken on the proposal in the Executive Board, and it was not formally placed on the agenda of the Interim Committee, as proponents realized that it would not pass; see minutes of EBM/80/96 (June 23, 1980). U.S. support, which was essential, would have required legislative action to overcome a prohibition under U.S. law against using the Fund's gold for the benefit of a subset of the membership. As long as the U.S. authorities favored creation of the substitution account, it seemed possible to win their support by linking the two ideas in a package. That possibility waned as the year progressed. The next serious consideration of gold sales came only in the mid-1990s, as part of a plan to create a permanent fund for concessional lending.

[12]Some SDR 14 million ($18 million) in interest charges was already being paid each year, at an annual rate of 0.5 percent on outstanding balances. Principal payments were scheduled to begin in July 1982.

Trust Fund and channel repayments back into it for new concessional lending, convert outstanding loans into grants, or liquidate it and transfer reflows into the Fund's "Special Disbursement Account" (SDA).[13] Any one of those options could be structured to ensure that low-income countries would benefit, but the value of the benefit and the number of beneficiary countries could vary widely.

The option of converting old loans into grants was quickly dismissed, since it would have arbitrarily prevented new members from sharing in the benefits and would have raised moral hazard problems on future lending. Moreover, staff, management, and most Executive Directors preferred to replace the Trust Fund with some method that would give the Fund more control over how the money was used. Governors from developing countries, however, feared that the diversion of Trust Fund repayments to subsidize the SFF would dilute the resources available to the poor. In April 1980, the Group of Twenty-Four developing countries (G-24) issued a communiqué calling for the continuation and even augmentation of the Trust Fund and urging the completion of talks on finding other means of subsidizing the cost of SFF credits for low-income countries.[14]

Despite the official G-24 position, most Executive Directors from developing countries took the pragmatic view that no new funding was likely to be forthcoming for low-conditionality credits, so they might as well try to have the Trust Fund reflows put to the best possible use.[15] A compromise soon emerged in which subsidies for SFF credits would be limited to low-income countries (essentially to the same countries for whom the Trust Fund had been set up) and would be financed partly by Trust Fund reflows and partly by new contributions from creditor countries.

A specific plan was developed over the next few months and was approved by the Board in November. (For the text of the decisions, see *Annual Report 1981*, pp. 146–51.) The scheme had four main elements. First, the Trust Fund would be terminated as soon as practicable after the last loans were disbursed in February 1981. Second, the first SDR 750 million ($950 million) in reflows would be earmarked for a Subsidy Account, and the remainder would be transferred to the SDA. Third,

[13]The Second Amendment to the Articles of Agreement created the SDA as a separate account within the General Department, and the instrument establishing the Trust Fund provided that repayments of loans could be transferred to the SDA. Article V, Section 12(f), authorized the Executive Board (subject to qualified majorities) to transfer assets from the SDA to the General Resources Account (GRA) for general operations, to use the funds for the benefit of low-income countries, or to distribute the funds to developing countries that were members of the Fund as of August 1975. For the background on the creation of the SDA, see de Vries (1985), pp. 723–24, and Vol. 3, pp. 347–51.

[14]"The Ministers . . . noted the progress report on the supplementary financing facility and urged early completion of discussions on reducing the cost of borrowing under the facility . . . Ministers urged that the Trust Fund should be continued and its resources augmented." Paras. 10 and 13 of the G-24 communiqué; *IMF Survey*, Vol. 9 (May 5, 1980), p. 137.

[15]At the decisive Board meeting on this subject, in July 1980, only S.D. Deshmukh (India) and Semyano Kiingi (Alternate—Uganda) argued strongly for renewing the Trust Fund. Onno Ruding (Netherlands) reported the support of the Yugoslav authorities for the G-24 position, but the rest of his constituency favored placing the reflows in the SDA. See minutes of EBM/80/102 (July 9, 1980).

the Subsidy Account would be used to reduce the interest charge on Fund credits financed by the SFF by up to 3 percentage points (though not to a level below the Fund's regular rate of charge). Fourth, only low-income countries would be eligible for subsidies.

The most difficult issue in those discussions was the dividing line for eligibility. How poor would a country have to be to qualify for a subsidy? A few of the countries that had qualified for Trust Fund loans had grown rapidly in the late 1970s. Differences of view were expressed on whether they had grown by enough to be reasonably excluded from the subsidy scheme, but to include them would require raising the ceiling rather high and making the subsidies much more expensive. After much debate, an inelegant but practical solution emerged: the 69 countries that would have been eligible for a new Trust Fund on the same basis as the old one would qualify for a full subsidy covering up to 3 percentage points of interest, and 14 additional countries would qualify for subsidies at half of that rate.[16]

The SFF Subsidy Account did not enable the Fund to make concessional loans, as it had through the Trust Fund. All it did was reduce the cost of supplementary credit to the same level as for ordinary credits under the Fund's tranche policies. For the next four years, therefore, the Fund was temporarily without a soft-loan window, but it did pay subsidies to low-income countries that averaged SDR 56 million a year (1982–85) and eventually totaled just under SDR 450 million ($530 million).[17] Twelve countries, led by Saudi Arabia, provided SDR 62 million ($68 million) in donations and short-term loans to help pay for those subsidies, and the rest came from Trust Fund reflows and the income from investing those monies until subsidies were due to be paid (Table 14.1).[18]

Once the bulk of the Trust Fund repayments began to flow in, pressure began to mount for a new and more substantial means of helping low-income countries.

[16]Sixty-two low-income countries had been eligible for Trust Fund assistance. Eligible countries in the First Period (1977–78) were those that were members of the Fund in August 1975 and had annual incomes in 1973 of less than SDR 300 per capita (as estimated by the World Bank). Guatemala (which had a slightly higher 1973 income) and Papua New Guinea (which joined after the cutoff date) were added on an exceptional basis. For the Second Period (1978–81), the income ceiling was set at $520 per capita in 1975 (the same level that was then used by the World Bank to determine eligibility for borrowing from the Bank's concessional lending arm, the International Development Association or IDA); that change brought in Zambia but excluded Guatemala, Mauritius, and Paraguay. See de Vries (1985), pp. 670–71 and 682. By 1979, the eligible country with the highest per capita income was Jordan, at $1,180. Setting the cutoff at that level and including new members of the Fund would make 83 countries eligible for SFF subsidies. Alternatively, setting the cutoff at the inflation-adjusted equivalent of the 1975 level ($680 in 1979, the then-current ceiling for IDA assistance) would reduce the list to 69 countries. See "Supplementary Financing Subsidy Account—List of Beneficiaries and Related Matters," SM/80/239 (October 20, 1980).

[17]All subsidies were paid at the maximum allowable rates, either 3 or 1.5 percentage points.

[18]Through FY 1985, SDR 401 million in Trust Fund reflows was transferred from the SDA to the SFF Subsidy Account. Beginning in FY 1986, SDR 72 million in excess balances in the Subsidy Account was returned to the SDA. The bulk of the subsidy payments was completed by FY 1990. As of 1998, however, SDR 2.2 million in subsidies to two countries—Liberia and Sudan—was still pending settlement of those countries' arrears to the Fund (see Chapter 16).

Table 14.1. SFF Subsidy Account, 1982–98
(Millions of SDRs; fiscal years)

Transfers from SDA (net)		328.8
Investment income		62.1
Valuation gains (net)		0.5
Contributions		
Saudi Arabia	32.0	
France	9.3	
Netherlands	4.1	
Switzerland	2.4	
Sweden	2.2	
Australia	2.0	
Denmark	1.5	
Norway	1.4	
Finland	1.3	
Austria	1.2	
Total		57.4
Loans (1982–84)		
Belgium	4.4	
Luxembourg	0.2	
Total	4.6	
Total resources	448.7	
Subsidy payments	446.3	
Ending balance	2.4	

Source: *Annual Reports*, 1982–98.

Structural Adjustment Facility

The idea of creating a replacement for the defunct Trust Fund had widespread support in 1985, but several specific issues had to be resolved. Which countries would be eligible to borrow on concessional terms? What conditions would be imposed in exchange for loans? And what role (if any) should the World Bank play?

Initial Consideration, 1985

Following the April 1985 Interim Committee meeting described in the introduction to this chapter, the staff reacted quickly to ensure that maximum funds would be available to support concessional lending under the proposed facility. The projected reflows from the Trust Fund were expected to amount to about SDR 3 billion, but much of that money was yet to come in. Furthermore, the repayments that were already being made had been set aside to finance the SFF Subsidy Account. By this time, however, the SDR 400 million that had already been transferred was judged to be sufficient to cover all anticipated obligations of the SFF with subsidies being paid at maximum allowable rates. The staff therefore proposed, and the Executive Board approved, that transfers to the Subsidy Account be stopped and that all remaining reflows be deposited in the SDA and invested in short-term SDR-denominated securities, pending a further decision on their disposition.[19]

A major issue to be decided was how closely to adhere to the terms of the original Trust Fund. As a practical matter, a simple reactivation of the original Trust Fund was out of the question, because the termination decision had transferred the assets from the Trust Fund to the IMF under the SDA. The staff therefore decided to respond to the Interim Committee request by proposing to establish a new lending facility within the SDA. More substantively, the staff—notably C. David Finch (Counsellor and Director of the Exchange and Trade Relations (ETR) Department)—regarded the Trust Fund as having been seriously flawed, and felt that the new facility should be designed to remedy those defects. What followed was a major skirmish in the never-ending battle for the soul of the institution, the battle to

[19]See Decision No. 7989-(85/81) SBS (suspension of transfers) and 7990-(85/81) (investment policy), both approved on May 28, 1985; in *Annual Report 1985*, pp. 123–24.

strike the right balance between assistance and prudence. De Larosière maintained that the funds were clearly intended to be used for the benefit of low-income countries and that the economic circumstances that those countries faced had generally deteriorated since the time of the Trust Fund. He concluded that the initial staff paper should be symmetrically agnostic on the question of whether the terms imposed on the use of these resources should be loosened or tightened.[20]

The staff paper on the proposed facility was issued to Executive Directors in early August, as background for a Board meeting to be held the following month. Although the paper was clearly supportive of the Indian initiative, it laid out a vision of a facility that differed in key respects from the way the Trust Fund had worked: loans would be made on the same concessional terms, but they would be available to a smaller group of borrowers and on tighter conditions—though, in deference to the views expressed by de Larosière, less strict than those on upper-tranche stand-by arrangements.[21]

In reviewing the limitations of the Trust Fund, the staff paper argued that easy access to loans with low conditionality, combined with a general deterioration in the external environment that borrowers faced (falling terms of trade for exporters of primary commodities, rising world interest rates, etc.), had enabled financing to prevail over adjustment. Consequently, many countries were in worse straits at the end of the availability of Trust Fund loans than at the beginning. The paper also noted that the policy had been to review borrowers' economic progress only annually, as part of an overall deemphasis of conditionality. Countries had been asked to develop medium-term strategies, on the assumption that the global economy would improve over that term. This review process had been too limited to be effective.

The staff paper noted that although the expected reflows from Trust Fund loans were sizable, they would arrive only gradually. In the meantime, the staff felt that the small currently available resources should be carefully directed toward those countries with the "greatest [balance of payments] need and least access to alternative sources of finance." The problem was how to restrict the number of eligible countries so that each borrower could get enough financing to make a difference, without eliminating countries with a clear need for concessional assistance. For the moment, this problem was still awaiting a solution. The option proposed by the staff was to re-

[20]Memorandum from Finch to the Managing Director (June 17, 1985), in IMF/CF (S 1794 "Structural Adjustment Facility (SAF), April–December 1985"); and memorandum from Walter O. Habermeier (Treasurer), Finch, and James G. Evans, Jr. (Deputy General Counsel) to the Managing Director (same date), in IMF/RD Managing Director file "Special Drawing Account" (Accession 88/274, Box 1, Section 269).

[21]The 1980 termination decision provided that SDR 1.5 billion of the reflow was to be used similarly to the Trust Fund. Funds remaining after that use and the transfers to the SFF Subsidy Account were also to be used on those terms unless the Executive Board decided to dispose of them differently, as long as such alternative use was for the benefit of countries in difficult circumstances and taking account of per capita incomes. See "Use of Resources of the Special Disbursement Account Arising from Termination of the Trust Fund—Preliminary Considerations," EBS/85/183 (August 6, 1985). The complex voting requirements are described in the memorandum from Habermeier and others cited in the preceding note.

strict eligibility to what the World Bank called "IDA-only" countries, excluding the "blend" countries that had enough creditworthiness to qualify for assistance from the IBRD as well as IDA.[22] The mathematical appeal of the IDA-only option—and its political Achilles' heel—was that it would eliminate the two countries that were by far the largest potential users: China and India. Both were low-income countries with serious economic problems, but if allowance were made for their potential borrowings from the facility, the access limits would have to be cut by about half.

While the Fund was developing its response to Singh's initiative, the U.S. authorities were taking up another aspect of the matter. Treasury Secretary James A. Baker III was looking for ways to augment the role of the World Bank in development finance and to promote greater collaboration between the Bank and the IMF. By October, that venture would bear fruit in the form of the "Baker Plan" for strengthening the debt strategy (see Chapter 10). It began, however, in June, at a meeting of the finance ministers of the Group of Ten (G-10) countries in Tokyo. There, Baker supported the Indian initiative of dedicating the Trust Fund reflows to the benefit of low-income countries and added that the facility should be operated in collaboration with the World Bank to ensure that the structural elements of the adjustment that borrowers needed to undertake could be taken fully into account.[23]

These two interrelated ideas—promoting structural adjustment and bringing in the World Bank—were incorporated in the August staff paper, but to a lesser extent than proposed by the United States. The Fund, the paper noted, had expertise in some areas of structural policy—notably, exchange rate, monetary, fiscal, and pricing policies—but not in others, so it was natural that an overall program of structural adjustment should be worked out in conjunction with the World Bank. In addition, the Bank and other multilateral development banks should be expected to help finance countries' overall adjustment programs. In the staff version, however, the facility itself would be purely under Fund control.

The Executive Board met to consider these various facets of the proposal in September 1985, some three weeks before the Interim Committee was scheduled to convene in Seoul, Korea. This meeting was to be merely a preliminary exchange of views, but one issue, at least, had been largely resolved in the days leading up to it. The authorities in both China and India felt that their eligibility was an important issue of principle: they should not be singled out for less favorable treatment from other low-income countries simply because of their size. They recognized, however, that insistence on that position could severely restrict access to the facility by the 50–60 other low-income countries and leave no country with enough resources to alleviate its imbalances significantly.[24] Both countries there-

[22]"Use of Resources of the Special Disbursement Account Arising from Termination of the Trust Fund—Preliminary Considerations," EBS/85/183 (August 6, 1985), pp. 15–17.

[23]Baker's statement to the G-10 was summarized by the U.S. Executive Director, Charles Dallara, at EBM/85/141 (September 13, 1985), p. 35.

[24]For the same reason, the idea of applying only part of the Trust Fund reflows to this facility, a possibility envisaged in the 1980 termination decision, was not seriously considered in the 1985 deliberations.

fore agreed to voluntarily forgo drawing on the facility as long as they were deemed to be formally eligible. Arjun Sengupta (India) noted that since "some poor countries were in greater difficulties than others," his authorities could state that for the two- to three-year period until the facility could be reviewed by the Board, they would not draw on it. Zicun Zhang went somewhat further, stating that China's commitment not to use the facility was based on the authorities' assessment that China did not have, and did not expect to have, a protracted balance of payments need for such assistance.[25] With those two countries out, the eligible country with the largest potential access would be Pakistan, whose quota was less than one-fourth that of India or China.[26]

By this time, the United States had taken the lead in advocating the plan. The U.S. Executive Director, Charles H. Dallara, argued before the Board that the goal of the proposed facility should be to "promote structural adjustment and growth" and—in what he called a "bold step"—that "programs should be developed and negotiated jointly by the Fund, the Bank, and the member" country. He suggested that the member should commit to a two-year macroeconomic and structural economic program; that a joint mission from the two institutions should negotiate a program; that both Boards should consider it around the same time and approve funds under their separate jurisdictions; that there should be semiannual drawings based on targets that would be evaluated judgmentally; and that structural elements should cover a broad range of policies, not just those covered by the Fund's own expertise.[27]

Most of Dallara's points were endorsed in general terms by the Board for transmittal to the Interim Committee for further consideration. Some specific issues remained open, the most important of which was the question of the level of conditionality to be attached to loans made through the facility. The staff paper suggested that disbursements might be linked to performance criteria, similar to those of a conventional Fund stand-by arrangement; but it also suggested that an alternative might be to monitor programs under a looser arrangement involving program reviews but no quantitative performance criteria. E.I.M. Mtei (Tanzania), the lead speaker for the low-income countries, disagreed strongly with the view that the Trust Fund had been remiss in encouraging too easy access with too little conditionality, and he objected to the proposal for performance criteria:

> The structural nature of the imbalances and the depth and duration of the economic problems experienced by these countries, particularly in sub-Saharan Africa, limit the speed at which progress in adjustment can be achieved and therefore would require a longer framework than normally envisaged under Fund programs. Because the

[25]Minutes of EBM/85/142 (September 13, 1985), pp. 16 and 42.

[26]The four largest quotas among IDA-eligible countries (in SDR millions) were China (2,390.9), India (2,207.7), Pakistan (546.3), and Zaïre (291.0). The complete list of low-income countries at the time, with World Bank status, per capita income, and Fund quota, is given in "Use of Resources of the Special Disbursement Account Arising from Termination of the Trust Fund—Preliminary Considerations," EBS/85/183 (August 6, 1985), Table 2.

[27]Minutes of EBM/85/141 (September 13, 1985), pp. 36–39.

> economies of these countries have already been trapped by the low level of demand as a result of continued austerity measures over extended periods, additional demand management conditionality of the type attached to Fund programs would be counterproductive. What is needed is structural adjustment programs developed within a medium- and long-term framework stressing growth. . . .[28]

Mtei also expressed concern over the proposal for joint Fund-Bank negotiations, on the grounds that this practice could give rise to "cross-conditionality"; that is, to one institution withholding approval for a loan until the conditions of the other institution were satisfied. More generally, he asked for assurances that the plan really would raise the total flow of resources to low-income countries and not just displace existing assistance. Without true "additionality," as this concern came to be called, the facility could achieve little more than to raise the barrier of conditionality.

Several other Directors raised questions about the U.S. proposal for joint negotiation of structural adjustment programs, which would have sharply altered the normal working relationships between the Fund and the World Bank and could have led to impossibly complex programs. As Yusuf A. Nimatallah (Saudi Arabia) pointed out, the Fund would be negotiating on the basis of assessments of the member's balance of payments need, while the Bank would be negotiating on the basis of assessments of the requirements for medium-term structural adjustment. Nimatallah, Sengupta, and Jacques J. Polak (Netherlands) all argued that it would be preferable to think in terms of two parallel programs rather than one program that would have to be jointly and "laboriously" (in Polak's term) negotiated.

The Managing Director's report to the Interim Committee, based on the discussion by the Executive Board, noted both the broad agreement on principles and the need for further discussion on modalities. When the Interim Committee met on October 6–7 in Seoul, the ministers did not attempt to resolve those issues. Rather, they endorsed the areas of agreement and asked the Executive Board to reach an accord on the unresolved issues before the next meeting of the Committee in April 1986. Significantly, despite a further appeal from Baker for a "bolder" approach, the Seoul communiqué avoided the term "joint," noting only that "the Fund should work in close collaboration with the World Bank, whilst avoiding cross-conditionality." The communiqué also welcomed India's and China's offers—reaffirmed by Singh and Liu Hongru (Deputy Governor of the People's Bank of China) during the meeting[29]—to abstain from using the proposed facility, and it noted the importance of ensuring additionality by stressing that the plan "should not adversely affect" other concessional lending to low-income countries (*Annual Report 1986*, pp. 106–08).

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[28]Minutes of EBM/85/141 (September 13, 1985), p. 33.

[29]See notes made by the Managing Director during the meeting, in IMF/RD Managing Director file "Interim and Development Committees, October 1985, Seoul" (Accession 87/136, Box 3, Section 168).

Establishment of the Facility, 1985–86

The U.S. authorities were not yet ready to abandon the "bold" approach under which the Fund and the Bank would negotiate programs jointly. For some two months after the meeting in Seoul, officials of the U.S. Treasury attempted to line up support for that approach from other major countries, with little success. By end-year, however, they abandoned the quest in favor of the more limited idea of having the Fund and the Bank, together with the authorities of the borrowing country, jointly develop a "policy framework" that would be consistent with but more specific on structural adjustment than the Fund's usual Article IV report and the Bank's country economic memorandum. The framework then would be considered more or less simultaneously by the two Executive Boards, after which each institution would negotiate a specific program based on its own criteria.[30]

Although the Interim Committee communiqué endorsed the use of IDA eligibility as the primary criterion for eligibility to draw on the proposed facility, Finch and his colleagues on the Fund staff continued to look for alternatives. Apart from the substantive question of which countries should be eligible, the issue of bureaucratic turf arose: relying on IDA eligibility implied that the World Bank, not the Fund, would have responsibility for deciding any future changes in the list of eligible countries. About a month after the meetings in Seoul, the staff and the Managing Director agreed that the Fund should propose a list of eligible countries that would be identical to the list of countries then eligible for IDA financing but that would not be formally or automatically linked to that list. If the IDA-eligible list changed, or if the Fund decided on its own to introduce a change, the Fund's Executive Board would retain full responsibility for changing the list of countries eligible to draw on the Fund facility. Executive Directors, however, wary of getting into debates over eligibility of individual countries, backed away slightly from that proposal and determined that "all low-income countries eligible for IDA resources that are in need of such resources and face protracted balance of payments problems" would be eligible initially to use the Fund's new facility.[31] With this wording, the Board retained its discretion to determine future eligibility independently of IDA.

The most important issue that remained unresolved after Seoul concerned conditionality. When the Executive Board met in February 1986 for its second substantive discussion of the proposed facility, it was presented with a staff proposal to require essentially the same level of conditionality as for an upper-tranche standby arrangement. The main difference would be that compliance would be monitored through semiannual "benchmarks" rather than quarterly performance criteria.[32] Mtei made one last attempt to dissuade his colleagues from that course, which he regarded as "a major departure . . . from the letter and spirit of the Trust

[30]The revised approach is described in a paper transmitted to the Managing Director by Dallara on January 6, 1986; in IMF/CF (S 1794 "Structural Adjustment Facility (SAF), April–December 1985").

[31]Chairman's summing up, minutes of EBM/86/24 (February 11, 1986), p. 40.

[32]"Use of Resources of the Special Disbursement Account," EBS/85/283 (December 17, 1985), pp. 16–18.

Fund." Inadequate and delayed financing, in his view, had been the principal cause of program failures in sub-Saharan Africa; accepting the staff proposals would only aggravate the problem. Dallara responded that the real problem was a lack of progress in policy adjustment and that the facility had to aim at overcoming that weakness. The majority view, which was thought to represent a compromise, was that quantified policy benchmarks could be required, as long as they were distinguished in some fashion from performance criteria.[33] In a formal sense, this procedure was equivalent to the relatively low-level first-tranche conditionality applied to Trust Fund loans, but it was also understood that in practice the Fund would expect borrowing countries to exceed that standard.

Although the Interim Committee had directed that the new facility should not give rise to cross-conditionality between the Fund and the World Bank, the Board had to decide what that meant. A broad interpretation, favored by Directors representing low-income countries, would be that the Fund should not hold up its own lending because of a disagreement with the Bank (or conversely). If the two institutions disagreed on how viable the country's proposed program was, then whichever one took the more favorable view should proceed with its loans. A stricter interpretation, favored by the staff and the Managing Director as well as by a majority of Directors, would be that once a lending arrangement was approved by both institutions, *disbursements* should not be held up simply because the other institution's conditions were not being met. This interpretation would strengthen Fund-Bank collaboration in the *design* of adjustment programs, even if the two staffs initially disagreed on the country's policy requirements. After de Larosière pointedly stated his strong opposition to any cross-conditionality resulting from adherence to this narrower definition, proponents of the wider view decided to back off.

Cross-conditionality continued, however, to be the most difficult issue. The World Bank was expected to provide a roughly equivalent amount of support, principally through IDA loans.[34] Although the U.S. authorities abandoned their proposal for jointly negotiated adjustment programs, they continued to push for as much collaboration as possible. Dallara's January 1986 proposal for a collaborative "policy framework" paper (see footnote 30, p. 649) specified that such a document should be "explicit in defining policy objectives, timetable and areas for priority attention" and should form "the basis for agreement on these issues and priorities between the Bank and the Fund." To many on the Fund staff, however, that proposal raised the danger that negotiations could get bogged down by the quite different working styles

[33]Minutes of EBM/86/23 (February 11, 1986), pp. 12–21; and the Chairman's summing up at EBM/86/24 (same date), p. 41.

[34]Loans from IDA at that time were interest-free, with longer maturities (50 years instead of 10) and grace periods (10 years instead of 5½) than the SAF; see *Annual Report* of the World Bank for 1986, p. 3. In December 1986, IDA resources were enlarged from $9.7 billion (in the IDA-7 period, 1985–87) to $12.4 billion (in the IDA-8 period, 1988–90), but maturities were reduced to 35–40 years. A minimum of $3 billion of that amount (roughly equivalent to SDR 2.5 billion) was expected to be lent "in conjunction with" the SAF. The role of IDA was outlined in "Proposals for Enhancing Assistance to Low-Income Countries Facing Exceptional Difficulties," EB/CW/DC/87/6 (August 19, 1987), pp. 8–9.

and requirements of the two institutions. Since developing countries generally shared that concern, the Managing Director crafted a compromise in February that supported a central role for what would become known as the Policy Framework Paper (PFP) while cautioning that the PFP "should not be overly precise," that the institutions' "respective mandates and expertise" should be preserved, and that "some flexibility must be maintained in the specific working of these arrangements."[35] How precise and how flexible would have to be judged after experience was gained.

One of the last issues to be decided was the name for the new facility. Even at the February 1986 meeting, after several months of discussion, people were still talking about "proposals to use the Trust Fund reflows" ("Trust Fund II," as one Director suggested) or the "use of resources in the Special Disbursement Account" (or "SDA Facility"). Shortly afterward, the staff came up with a phrase that stressed the linkage between these resources and the requirement that eligible countries adopt comprehensive adjustment programs: the Structural Adjustment Facility. That name caught on, and the SAF was formally created on March 26.[36]

Operations, 1986–89

The IDA criterion initially implied that 60 of the Fund's 149 member countries would be eligible to borrow from the SAF. That number rose to 62 by the following year, but with the voluntary withdrawal of China and India, the available funds had to be apportioned among the 60 smaller, low-income countries.[37]

To ensure that the facility would not run out of resources prematurely if all eligible countries borrowed from it, the Board agreed to set a low ceiling on loan size: 20 percent of the borrower's quota in the first year and 13.5 percent in each of the next two years, for a cumulative three-year access limit of just 47 percent.[38] In contrast, countries that had made full use of available Trust Fund loans in the 1970s had borrowed the equivalent of about 80 percent of their quota. But since interest rates on Trust Fund loans were so low, and since a portion of the reflow from those loans had been earmarked for other purposes, the total size of the SAF was smaller, even in absolute size, than the Trust Fund of a decade earlier. Relative to quotas, which had been enlarged in 1980 and again in 1983, it was even smaller. Access

[35]Chairman's summing up, minutes of EBM/86/24 (February 11, 1986), p. 42.

[36]The Executive Board of the World Bank expressed its approval of the proposal, conditional on an adequate expansion of IDA resources, at a meeting on March 17. For the Fund decisions, and the summing up of the March 26 meeting, see *Annual Report 1986,* pp. 92–99. A summary of the World Bank discussion was circulated in the Fund as "Special Disbursement Account—World Bank Board Discussion on the Trust Fund Proposal," EBS/86/53, Sup. 2 (March 20, 1986). The Fund decision to create the SAF was made at EBM/86/56 (March 26, 1986).

[37]Tonga had joined the Fund in September 1985 and had not yet been deemed IDA-eligible when the SAF was established six months later. In early 1987, both Tonga and Kiribati (which joined the Fund in June 1986) were declared by the Bank to be IDA-eligible and by the Fund to be SAF-eligible. For the initial list, see *Annual Report 1986*, p. 98.

[38]The aggregate quota of the 60 eligible countries (excluding China and India) was SDR 4.2 billion. Available resources during the first three years of operation were expected to total just under SDR 2 billion.

limits therefore had to be set much lower. To compound the problem, many of these countries faced balance of payments deficits that were much larger in relation to quota than they had been in the earlier period.

As it happened, these initial limits were overly conservative because a substantial number of eligible countries either did not apply to borrow or were unable to develop adequate adjustment programs. The first SAF loan, to Burundi, was not approved until August 1986, and by the time the Board first reviewed the facility, in June 1987, only 15 loans had been approved. Consequently, the access limit for the second year was raised to 30 percent of quota, making the cumulative limit 63.5 percent. Nonetheless, the facility remained "painfully" small (in de Larosière's words),[39] relative to the former Trust Fund, to the Fund's general resources, and to the financing needs of low-income countries.

Conditionality for SAF loans was applied similarly to the Fund's extended (EFF) arrangements, with a few key differences. As with EFF programs, countries were expected to formulate a medium-term policy framework, but here the PFP process required the World Bank to be involved. Although the SAF decision anticipated that the PFP would be drafted by the authorities with the help of the staff of the two Bretton Woods institutions, in practice PFPs were drafted initially by the staff and then refined with the help of the authorities. This practice was necessitated by a decision in April 1986 that a draft PFP should be made part of the pre-mission briefing papers submitted for approval by management.[40] The process worked as follows. After the country requested a SAF loan, the Fund staff would prepare, in collaboration with the Bank staff, a draft outline for a medium-term policy framework to be negotiated. That draft would be approved by the Fund management as the basis for a negotiating mission in which Bank staff would participate informally.[41] If the negotiations succeeded, the authorities would then submit to the Fund both a final PFP describing their policy intentions in general terms and a Letter of Intent that set out their specific policy commitments for the coming year. While agreement on the PFP was a requirement for loan approval, the Letter of Intent became the basis for conditional disbursements, just as it was for stand-by arrangements.

Once management approved the documents submitted by the authorities, the PFP was discussed first by the Bank's Executive Directors, sitting as a Committee of the Whole and "reviewing" but not formally "approving" the document.[42] The

[39]Speaking notes for remarks to the Development Committee (October 7, 1985); in IMF/RD Managing Director file "Interim and Development Committees, October 1985, Seoul" (Accession 87/136, Box 3, Section 168).

[40]Memorandum from Finch to the Managing Director (April 10, 1986), with handwritten agreement by de Larosière (April 13); in IMF/CF (S 1794 "Structural Adjustment Facility (SAF), April–December 1985").

[41]In practice, this arrangement meant that Bank staff would visit the country at the same time as the Fund mission and would participate in relevant meetings with the authorities but would not act under the direction of the Fund mission chief.

[42]The practice of sitting in committee was designed "to safeguard the fiction that the [Bank's] Board did not discuss countries' general economic programs" (Polak, 1995, p. 29). Polak goes on to note that PFPs did not have a central operational role in guiding the Bank's decisions on requests for IDA loans. PFPs thus became more associated with the Fund than the Bank.

Bank would then transmit the summing up of its discussion to the Fund. The Fund's Board thus would have four primary documents before it: the PFP, the Letter of Intent, the staff report, and the summary of the Bank's views. Upon approval by the Board, the Fund would disburse the first year's loan proceeds; in contrast to stand-by and extended arrangements, SAF loans were not paid in installments throughout the year.

These various distinctions might seem in retrospect to signify nothing more than technical hairsplitting, but they represented a carefully crafted compromise between those who viewed the SAF as a form of financial assistance administered by the Fund and those who saw it as an extension of the Fund's conditional lending. In the latter view—which was strongly held by staff and management—the policy requirements for a country to restore balance of payments viability were not diminished by the availability of SAF financing. Loan approval therefore was to be conditional on the specification of a detailed set of policy commitments, but the country was to be given a much greater benefit of the doubt on its willingness and ability to carry out those commitments than it would have been with a conventional upper-tranche arrangement.

The expectation that the SAF, like the Trust Fund that preceded it, would be a nearly universal source of finance for eligible countries was far from realized, largely because of the complexities of the PFP process and the World Bank's inevitable ambivalence toward it. On the one hand, because review of the PFP by the Bank's Executive Directors was not directly connected to the Bank's lending decisions, both the Board and the staff on that side of the street naturally viewed PFPs as more of a Fund document.[43] Not infrequently, Bank staff seemed less eager to sign off on a draft PFP quickly than were their counterparts in the Fund. On the other hand, the Bank's senior staff worried that the Fund was not applying conditionality as strictly to SAF borrowers as it did for stand-by arrangements, and the Bank was reluctant to approve its own Structural Adjustment Loans (SALs) to countries without a conventional stand-by arrangement. On that point, at least, many in the Fund were just as worried; without intra-year phasing of drawings and without formal performance criteria, the SAF was sailing in weakly charted seas.

For countries that succeeded in obtaining SAF loans, the money from the facility typically covered only a small part of their total financing needs. As with all Fund loans, it was hoped that the Fund's commitment would encourage (or "catalyze") other lenders to do the same. Most SAF-eligible countries, however, had little or no immediate hope for loans from commercial creditors. Nor could they afford loans on commercial terms, even if they had been offered. The goal, therefore, was to ensure that adequate financing was available from official creditors, especially bilateral aid from donor countries and debt rescheduling through the Paris Club. That goal, however, was difficult to pursue, because donor countries preferred to keep bilateral aid decisions separate from their dealings with the IMF. In

[43]For the Bank staff's assessment of the role of PFPs in the Bank, see "Policy Framework Papers—A First Review of Experience in the World Bank," EBS/88/65, Sup. 1 (March 23, 1988).

most countries, the government agencies that disbursed aid to low-income countries operated independently from the treasury, which dealt with the Fund, and any blurring of those roles could have subjected the SAF and even the Fund itself to greater political pressures.[44] To avoid that problem, the staff focused on trying to persuade donor countries to associate aid decisions in some way with "the PFP process."[45]

Whether the existence of the SAF or the PFP process ever affected bilateral aid, positively or negatively, is difficult to establish. What borrowing countries feared most was that donors, having agreed to support the SAF, would then abdicate their bilateral role. What the Fund aimed for was to make the process effective in promoting policy reform and thereby catalyze substantial additional bilateral financing. The outcome doubtless fell between apprehension and ambition, but a measure of success is evident. The U.S. Treasury used the SAF and the PFP process as levers to persuade congress to approve an enlargement of the U.S. contribution to IDA, from $2.3 billion in 1985–87 (IDA-7) to $2.9 billion in 1988–90 (IDA-8), and it seems likely that the aggregate size of IDA-8 would otherwise have been substantially smaller.[46] In January 1987, after a long battle, the Paris Club agreed to consider rescheduling requests from countries with SAF loans, rather than requiring a regular stand-by or extended arrangement.[47] That agreement offered expanded possibilities for heavily indebted countries to obtain relief from official creditors without first having to obtain more expensive financing from the Fund's general accounts. The Fund also made a concerted effort to persuade creditor countries to link bilateral assistance to the PFP process, but that effort had little success.

Despite the difficulties, the pace of SAF lending picked up somewhat in its second year of operation, before tapering off in deference to its "enhanced" successor, the ESAF (see below). Through 1995, after which all such lending was done through the successor facility, 37 of the 62 eligible countries borrowed a total of SDR 1.8 billion ($2½ billion) through the SAF. A substantial majority of those loans either were fully drawn by the borrower or were replaced by a larger ESAF loan. In 10 instances, the SAF loan program was abandoned before the second or third year, either because the required adjustment policies were no longer being carried out or because the borrower was overdue in payments to the Fund.

Initial fears that access to the SAF would be substantially smaller than under the Trust Fund were not borne out. Owing to the weeding-out effect of requiring a

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[44]For a discussion, see "Structural Adjustment Facility (SAF)—Review of Experience," EBS/87/46 (February 27, 1987), pp. 41–42.

[45]In February 1988, the Fund and the Bank held a seminar for chief officers of aid agencies in donor countries, to explain how PFPs could help in aid decisions. Participants came from 19 donor countries, 7 multilateral agencies, and 3 borrowing countries. See "Policy Framework Paper (PFP)—Seminar on the PFP and Aid Coordination and Related Issues," EBS/88/65 (March 23, 1988).

[46]For IDA contributions, see the *Annual Reports* of the World Bank, 1985 and 1987.

[47]Actual practice began in June 1987, when the Paris Club agreed to reschedule debts of Mozambique and then Uganda, just a few days after the Fund approved SAF loans for those countries. See Keller (1988).

PFP and a Letter of Intent, countries that borrowed from the SAF ultimately could borrow nearly as much relative to quota as had been available under the Trust Fund. Having initially decided that eligible countries could borrow 20 percent in the first year and then having permitted loans of 30 percent in the second year, the Executive Board agreed in March 1989 on a 20 percent limit for the third year.[48] So as not to penalize countries that had qualified earliest, these access limits were applied retroactively, and almost all SAF loan commitments (31 of 38) were for 70 percent of the borrower's quota.[49]

Pakistan

As an illustration of how SAF loans worked in practice, consider the loan to Pakistan in December 1988—at SDR 382 million ($516 million), the largest loan made through this facility.[50] Pakistan had drawn on Fund resources frequently before, most notably through a series of seven stand-by arrangements during the two decades through 1978 and then through a three-year EFF arrangement approved in 1980 (the largest extended arrangement up to that time, although much larger loans were made later on). By 1988, Pakistan had repaid most of those credits and had outstanding obligations amounting to just 68 percent of quota (SDR 370 million, or $500 million) plus a small amount still due from its Trust Fund borrowings in the late 1970s (Figure 14.2). When Pakistan again sought assistance in 1988, the SAF provided a more flexible and less costly medium for Fund financing and conditionality.

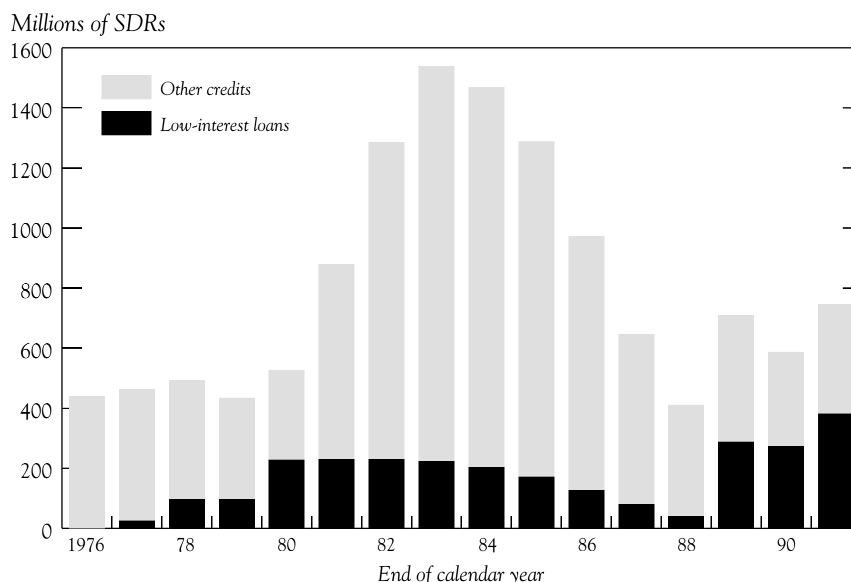
Before the 1980s, the Fund's credits to Pakistan had been classic cases of balance of payments support, predicated on the government's commitment to adjust macroeconomic policies so as to stabilize the economy and to maintain a competitive and stable exchange regime. Pakistan maintained a fixed exchange rate between the rupee and the U.S. dollar throughout much of the turmoil of the 1970s, devaluing by 57 percent in 1972 to correct a major overvaluation and then revaluing by 10 percent the next year in the wake of the floating of the dollar against

[48]The staff first examined the possibility of raising access to 70 percent in the summer of 1988 but rejected that option out of concern that resources could become overcommitted. The Executive Board agreed to accept the staff recommendation, over the objections of 10 Directors. See "Structural Adjustment Facility—Third Year Access," EBS/88/129 (July 6, 1988) and minutes of EBM/88/118 (July 29, 1988); and "Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF)—Review of Operations," EBS/89/35 (March 3, 1989), pp. 17–19, and minutes of EBM/89/40 (March 29, 1989).

[49]Of the seven smaller loans, five were at 63.5 percent of quota (the limit established in 1987) because they expired prior to the March 1989 increase. All five of those countries obtained ESAF loans, and after the final increase in SAF access went into effect, financing for the relevant portion of the ESAF commitment (6.5 percent of quota) was shifted from the ESAF Trust to the SDA. All other commitments through 1992 were for 70 percent of quota. After that date, the Fund approved just two one-year SAF loans, in conjunction with larger three-year ESAF commitments: to Sierra Leone in March 1994, for 35 percent of quota; and to Zambia in December 1995, for 50 percent.

[50]A loan for SDR 346.9 million was approved in December 1988; the amount was raised in March 1989. For another and much more detailed case study, on the SAF loan to the Gambia in September 1986, see Hadjimichael and others (1992).

Figure 14.2. Pakistan: Concessional Loans and Other Credit Outstanding, 1976–91



other major currencies (that is, revaluing to keep the rupee's value roughly constant against major currencies other than the dollar). The exchange rate established in 1973 remained realistic for several years, aided by the weakness of the dollar in 1977 and 1978, but the recovery of the dollar in 1979 exposed the underlying weakness that had crept into the rupee over time.

When the authorities applied in 1980 for a three-year arrangement under the EFF, they initially fended off the staff's recommendation for a devaluation of the rupee by promising to cut the fiscal deficit, liberalize the external sector to promote exports and attract capital inflows, and undertake substantial restructuring of the economy to promote efficiency and mobilize savings.[51] They hoped to gain enough time for reforms to work by drawing heavily on the Fund; the EFF arrangement would provide close to SDR 1.3 billion (445 percent of quota, or $1.6 billion) over three years. Both the fiscal cuts and the restructuring, however, proved to be difficult to achieve, even after the United States committed itself to providing $3.2 billion in official assistance to Pakistan over a six-year period.[52] A year into the EFF

[51]From 1976 through 1979, the staff argued without success that the rupee should be devalued. In the spring of 1980, the staff accepted the authorities' confidence in their ability to correct macroeconomic imbalances through demand management without a devaluation. That agreement cleared the way for negotiations on an extended arrangement. Memorandum from A. Shakur Shaalan (Director of the Middle Eastern Department) to the Managing Director (April 30, 1980); in IMF/CF (C/Pakistan/810 "Mission, El Selehdar and Staff, May 1980").

[52]U.S. aid to Pakistan fell off in the late 1970s but was revived in recognition of Pakistan's strategic importance during the Soviet occupation of Afghanistan. U.S. support, however, remained tenuous, and the U.S. Executive Director (Richard D. Erb) abstained from approving the continuation of the EFF loan in December 1981.

arrangement, after both the staff and Executive Directors pressed for a devaluation and a more flexible policy, the authorities decided to shift course.[53] In January 1982, the government agreed to abandon the currency peg and to let the central bank begin managing the exchange rate against a basket of currencies. Under that regime, the rupee drifted gradually downward against the dollar by enough to strengthen international competitiveness a bit, and the arrangement held together for another year. By mid-1983, however, the staff concluded that both fiscal and monetary excesses had thrown the program off track, despite an overall strong record of policy implementation. The arrangement expired in November of that year with the final drawing unmade.[54]

For the next four years, the economy seemed to do reasonably well despite the persistence of fiscal stresses and structural rigidities and the country's dependence on the fortunes of a few agricultural crops (mainly cotton) in world markets. The exchange rate was managed so as to generate a depreciation of more than 30 percent in both nominal and real effective terms between early 1985 and the end of 1987, and the overall balance of payments was further strengthened by substantial foreign official assistance and by large inflows of workers' remittances. Real economic growth averaged about 7 percent a year for several years, and inflation fell by nearly half, to an annual rate of less than 5 percent by 1987. Nonetheless, the economy remained highly vulnerable to external shocks, owing largely to structural rigidities and a persistently high fiscal deficit.

The creation of the SAF in 1986, which coincided with a renewed weakening of Pakistan's fiscal balance and the end of large-scale official assistance from the United States, induced the government to contemplate taking on new borrowings from the Fund. For a July 1986 mission, the Fund and Bank staff prepared a draft PFP that sketched out a plan for policy adjustment and reform that could be supported by a SAF loan. The authorities, however, decided that the staff proposals were too draconian and that they would do better to forgo the loans for the time being.[55]

Some months later, as the outlook for the balance of payments failed to improve, the government again approached the Fund, to ask for a multiyear stand-by arrangement combined with a relatively small SAF loan. That plan would help to

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[53]The staff's position was summarized in a memorandum from Shaalan to the Managing Director (September 28, 1981); in IMF/RD Managing Director File "Pakistan, 1981" (Accession 83/108, Box 2, Section 376).

[54]The EFF arrangement approved in November 1980 was replaced a year later by a new agreement that provided for the same total amount of credits but on slightly more favorable terms. The improvement was made possible by the increase in Pakistan's quota under the Eighth General Review, which raised the amount available from the Fund's own resources rather than from borrowings. Drawings proceeded somewhat more slowly than initially envisaged, owing to delays in negotiating specific conditions and occasionally because of the need for waivers of conditions. The final drawing was made in May 1983, and when the arrangement expired, SDR 189 million (15 percent of the agreed amount) remained unused.

[55]Memorandum from Said H. Hitti and S. Kanesa-Thasan (both Senior Advisors in the Middle Eastern Department) to the Managing Director (January 20, 1987); in IMF/RD Managing Director file "Pakistan, January–December 1987" (Accession 89/14, Box 7, Section 550).

preserve SAF resources for future loans to other countries, especially those in sub-Saharan Africa that had an even greater need for concessional financing. (Pakistan, in contrast to many SAF-eligible countries, was able to obtain loans from international commercial banks.) Throughout 1987, however, the gap between the staff's and the authorities' views on the need for major policy changes could not be breached, and the government dropped the idea for the time being.

When discussions resumed in the early months of 1988, the type of arrangement that might be offered became a major issue. The Fund's management had no difficulty accepting a proposal for a short stand-by arrangement, but whether Pakistan's policy intentions qualified for a longer-term loan aimed at supporting structural adjustment was less clear. Negotiations—led by Malcolm D. Knight (Division Chief in the Middle Eastern Department)—continued through the summer. Not until the time of the Annual Meetings (held in Berlin around the end of September) was the staff convinced that the authorities' plans for trade liberalization and fiscal reforms were comprehensive enough to resolve the structural imbalances in the economy. Even so, management was not prepared to recommend to the Board that the Fund make the large-scale and long-term commitment that an ESAF loan would have implied. After a sometimes stormy series of meetings in Berlin, agreement was reached on a plan to provide Pakistan with a pair of arrangements: SDR 273 million (50 percent of quota) of the Fund's general resources through a two-year stand-by arrangement, and SDR 347 million (63.5 percent of quota) over three years through the SAF.[56]

By that time, the country was in a political turmoil triggered by the death of President Mohammad Zia ul Haq in an airplane crash in August 1988. The Fund was now negotiating with an interim government, and elections were scheduled for November 16. Although the government would have liked the Executive Board to approve the loan request before it went to the polls, the Managing Director insisted that the Fund had to have a commitment from the newly elected leaders as well. On December 11, three weeks after Benazir Bhutto was elected prime minister, her newly formed government (in which the finance minister who had negotiated the final agreement, Mahbub ul Haq, retained his portfolio) assented to carry out the program. The Board meeting took place on December 28, and more than two months after the conclusion of negotiations, Executive Directors approved the loans without dissent.[57]

The strains on the Pakistan economy that had made it so difficult to reach agreement in the first place also made it difficult for the government to keep the program on track. Refugees from war-plagued Afghanistan continued to flow into

[56]See memorandums to management from Shaalan and Kanesa-Thasan (July 7, 1988) and from Knight (October 11, 1988); in IMF/RD Managing Director file "Pakistan, 1987–1988" (Accession 89/131, Box 3, Section 282). The World Bank provided a similar amount of assistance during the same period. Over the two years beginning in August 1988, the Bank approved four sectoral loans to Pakistan, for a total commitment of $784 million (SDR 580 million).

[57]See "Pakistan—Staff Report for the 1988 Article IV Consultation and Request for a Stand-by Arrangement and for Arrangements Under the Structural Adjustment Facility," EBS/88/250, Sup. 1 (December 27, 1988); and minutes of EBM/88/185 (December 28, 1988).

Pakistan; by the end of 1989, the total number of refugees was estimated to be around 3.8 million. The external terms of trade deteriorated markedly in 1989, and by the second half of 1990, the crisis brought on by Iraq's invasion of Kuwait brought a sharp drop in fiscal revenues. Nonetheless, although some disbursements under the stand-by arrangement were held back, the second year's installment of the SAF loan was approved on schedule and disbursed in December 1989. From then on, between 40 and 50 percent of Pakistan's outstanding obligations to the Fund were long-term, low-interest loans.

The Gulf War of 1991 aggravated Pakistan's economic problems and brought further disbursement delays. Only after additional policy adjustments were made was the SAF loan fully paid out: one year late, in December 1991. The lack of performance criteria and intra-year phasing caused some anxious moments along the way, but ultimately they did not prevent the Fund from maintaining a measure of conditionality in its loans to Pakistan while sharply reducing the country's debt-servicing costs.

Bangladesh

The second-largest SAF loan, after the one to Pakistan, went to Bangladesh in February 1987.[58] The main problems faced by the authorities were long-term and structural: severe overcrowding of the large population; a consequent near-total dependence on external funding for economic development; a very narrow base for output and especially exports, heavily dependent on the market for jute; and frequent natural disasters, notably floods and cyclones that often destroyed much of the country's vital agricultural output.

Bangladesh, despite its extreme poverty and this litany of recurring difficulties, had established a generally strong record of program implementation before applying for the SAF arrangement. Following the breakaway from Pakistan in 1971, Bangladesh (formerly East Pakistan) joined the IMF in August 1972 and pegged its currency (the taka) loosely to the British pound. Throughout the rest of the 1970s, the authorities had frequent recourse to Fund credits, though generally for modest amounts. Drawing on the Compensatory Financing Facility (CFF), the oil facilities, three stand-by arrangements (all successfully completed and fully drawn), and the Trust Fund, by the end of the decade Bangladesh raised its indebtedness to approximately SDR 170 million ($225 million, or 114 percent of quota) to the General Resources Account and SDR 90 million ($120 million, 60 percent of quota) to the Trust Fund (Figure 14.3). The Fund's assistance up to this point helped the country finance its balance of payments deficits, but it was not aimed directly at addressing the chronic underlying structural problems.

In December 1980, the Fund approved a three-year EFF arrangement for Bangladesh, aimed at helping the government to absorb the effects of the 1979–80 oil shock and other external problems, begin to deal with the distortions and struc-

[58]A slightly larger loan was approved for Zaïre a few months later, but it was not fully disbursed.

tural rigidities in the economy, and ultimately reduce the crushing level of poverty in the country. That arrangement ran into trouble, however, largely because of external conditions: a drop in the world market price of the principal export (jute) and an unexpected decline in foreign aid. To compound the problem, the president of Bangladesh, Ziaur Rahman (vernacularly known as Zia), was assassinated in May 1981, after which the government was effectively paralyzed and unable to take remedial action for several months. Credit growth quickly breached the programmed ceiling, the interim government was unable to get the economy back on track, and a new military government—headed by General Hussain Mohammed Ershad—took power in March 1982. In the midst of this turmoil, for the first and only time the Bangladeshi authorities had to abandon a Fund arrangement because of poor policy implementation.[59]

Bangladesh then obtained two more stand-by arrangements from the Fund: a small 5-month arrangement in 1983 and a larger 19-month arrangement beginning in December 1985. The 1983 arrangement was intended to serve as a bridge to a 12-month arrangement for 1983–84, but the authorities decided not to pursue that option. By mid-1983, conditions had improved markedly, if temporarily: policy adjustments had been stronger and more effective than the Fund staff had expected, weather had been favorable for crops, competitiveness had been improved by the appreciation of the U.S. dollar against sterling and other major currencies,[60] and foreign aid commitments had picked up again. Consequently, Bangladesh's balance of payments had improved by enough that the government could get by without the Fund's money, and the authorities were eager not to submit to the Fund's conditionality.

By 1985, conditions worsened again, primarily owing to a further collapse in the international jute market but also because of disastrous weather conditions (floods and cyclones) and a drop in demand for Bangladeshi and other foreign workers in the Middle East. Moreover, the World Bank and other official creditors were getting concerned about the risks of lending to a country without a macroeconomic stabilization program approved by the Fund. So Bangladesh again applied for a stand-by arrangement. Negotiations (led by Kadhim Al-Eyd, Assistant Director in the Asian Department) were long and difficult, especially concerning the need for greater flexibility in managing the exchange rate. Perhaps more than in most low-income countries, the Bangladeshi authorities felt that they held a strong hand in these negotiations, because they had a solid policy record, because at least some external creditors sympathized with their position on key policy issues, and because the amount of the proposed arrangement was not very large in relation to their

[59]The arrangement, as approved in December 1980, provided for SDR 800 million in loans over three years ($1.02 billion, or 350 percent of quota). Of that, SDR 220 million was disbursed through June 1981. After several months of unsuccessful negotiations on a new economic program, the government canceled the arrangement in June 1982.

[60]In 1979, the authorities began pegging the taka to a basket of currencies rather than to the pound sterling. Nonetheless, because of the importance of the bilateral exchange rate, especially for attracting the repatriation of earnings by Bangladesh nationals working in the United Kingdom, the rate frequently was adjusted so as to maintain stability against the pound.

overall financing needs.[61] A compromise program was finally agreed upon toward the end of the year, and the Executive Board approved the arrangement in December. Economic policy then was still on track, and the economy was doing better than anyone had expected just a few months earlier. Throughout this period, the Fund again focused primarily on macroeconomic stabilization, while the World Bank made several loans to Bangladesh aimed at financing essential imports and promoting structural reforms.

Soon after the 1985–87 arrangement was approved, the staff began discussions aimed at developing a medium-term policy framework that could be supported by a SAF loan. The authorities, however, were initially reluctant. From their vantage point, it appeared that they were being asked to develop a full-scale medium-term adjustment program equivalent to what the Fund would have required for an extended arrangement, but with only a small fraction of the resources that could have been provided through the EFF. Moreover, the medium-term framework would have to be approved by the World Bank even though the Bank was not then committed to providing any additional resources.[62] The authorities understood, of course, that a SAF loan would be on much more favorable (i.e., concessional) terms than a regular Fund arrangement, but they also believed that the nonfinancial constraints would largely offset that benefit.

The Fund's staff and management believed that the SAF was important for Bangladesh, because the economy needed much structural reform if it hoped to raise its growth rate, and because the country could not afford to take on more debt except on highly concessional terms. Negotiations continued through several months in 1986 until a tentative medium-term agreement was hammered out during the Annual Meetings in Washington between the Managing Director (de Larosière) and the finance minister, M. Syeduz-Zaman. A detailed PFP was then drafted jointly by Al-Eyd's team, the authorities in Dhaka, and the World Bank staff. The framework called for a wide range of structural reforms, including strengthened tax collection, a higher rate of "recovery" or repayment of government loans to businesses and farmers, enhanced incentives for both government and private enterprises, and liberalization of the trade and exchange systems. Many

[61]The main dispute concerned exchange rate policy. The Fund staff and management insisted that the exchange rate be managed so as to prevent any appreciation in real effective terms (i.e., that the authorities implement a "real exchange rate rule," as discussed in Chapter 2), and that certain restrictive and preferential practices be eliminated. The government was prepared to implement a real-rate rule but argued that it could not implement all of the Fund's suggestions without weakening incentives for capital investment and for the repatriation of earnings by Bangladeshi workers abroad. The small size of this and earlier stand-by arrangements reflected the view—which was held especially firmly by the Managing Director—that Bangladesh could not afford to take on large amounts of debt except on highly concessional terms. The arrangement approved in December 1985 provided for SDR 180 million in drawings over 19 months ($200 million, or 62.6 percent of quota).

[62]The World Bank was unable to commit IDA funds until the Eighth Replenishment was approved, and Bank officials were reluctant to make new IBRD commitments until disputes were resolved regarding a high rate of defaults on government loans to small farmers and businesses made in conjunction with the Bank's existing sectoral loans to Bangladesh.

of these reforms were structured specifically to minimize any adverse impacts on the poorest groups in the economy.[63] It was a strong and viable program aimed at moderately raising the annual growth rate (from 4 percent in 1983–86 to 5 percent starting in 1987), which the Executive Board enthusiastically approved in February 1987.[64]

The direct financial effect of the SAF loan was to provide a modest net inflow of cash during the three years in which the program was in effect, while restructuring Bangladesh's indebtedness toward low-interest loans (see Figure 14.3). Without this arrangement, the country would have had to make large net repayments to the Fund. When the loan was approved, Bangladesh was scheduled to make approximately SDR 365 million in payments on principal and interest through the end of 1989. The SAF loan covered SDR 201 million of that, another SDR 48 million was offset by forthcoming drawings on the existing stand-by arrangement, and a CFF credit for SDR 89 million was approved at the same time as the SAF loan.[65] After the country was hit by major floods both in 1987 and 1988, the Fund also offered SDR 72 million in emergency relief credits in November 1988. On balance, outstanding obligations rose in 1987 and then stabilized.

Unfortunately, the government, which came under increasing domestic political pressure,[66] did not carry out many of the planned structural measures. Tax collection was especially weak, and public sector investment fell in relation to output. Consequently, the growth rate slipped to 3 percent a year instead of rising to the targeted 5 percent rate. On the brighter side, the authorities did move to liberalize both imports and exchange transactions, and they contained inflation through prudent monetary policies. Foreign aid was stable, and the balance of payments improved. Although the macroeconomic program was broadly successful and the SAF loan was fully disbursed on time, when it was over the economy was not much better off than it had been at the beginning. Lasting improvements would have to wait, aided by a much larger injection of Fund support through the ESAF in the 1990s.[67]

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[63]For example, the PFP noted the government's intention to better enable small farmers to restructure loans if necessary after bad harvests, to phase in the elimination of food subsidies gradually, and to use the revenues from the elimination of subsidies for social programs targeted directly at the poor. For a general assessment of Bangladesh's program for poverty alleviation, see Gotur (1991).

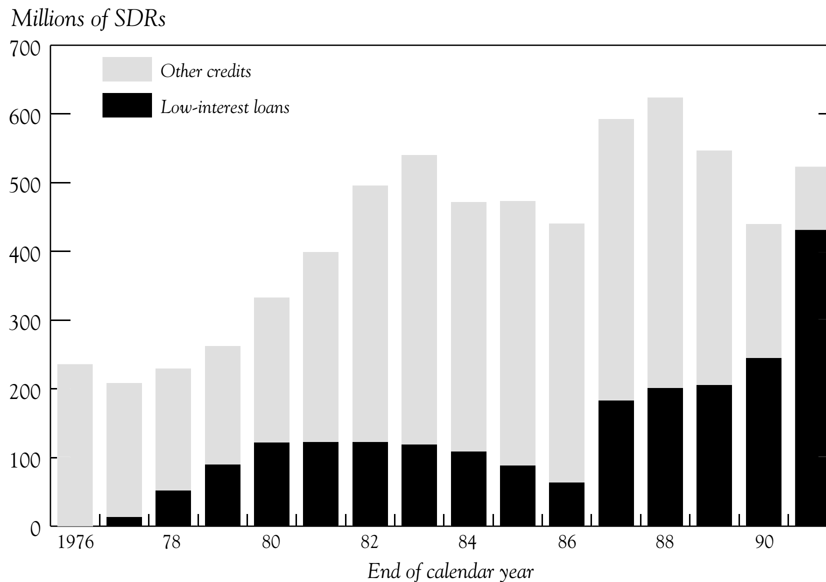
[64]"Bangladesh—Staff Report for the 1986 Article IV Consultation, Second Review Under the Stand-by Arrangement, and Request for Arrangements Under the Structural Adjustment Facility," EBS/87/7 (January 15, 1987), and minutes of EBM/87/23 (February 6, 1987). The poverty alleviation program mentioned in footnote 63 is described on pp. 44–45 of EBS/87/7.

[65]At the time of approval, the SAF loan commitment totaled just SDR 135.1 million, of which SDR 57.5 million was disbursed immediately. The subsequent general increases in SAF access limits ultimately made SDR 201.25 million available through April 1989.

[66]President Ershad held elections in October 1986, which he won, and he lifted martial law the next month. Opposition parties questioned the legitimacy of the elections, and public protests and strikes were held with increasing frequency and success throughout the next four years. Ershad resigned in December 1990.

[67]Bangladesh received SDR 345 million ($475 million) in ESAF loans from 1990 to 1993. By then, all of its outstanding obligations to the Fund were on concessional terms.

Figure 14.3. Bangladesh: Concessional Loans and Other Credit Outstanding, 1976–91



Enhanced Structural Adjustment Facility

Planning and Designing, 1987

Michel Camdessus's first meeting with the Interim Committee as Managing Director came in April 1987, three months after his arrival on the twelfth floor of the Fund's Washington headquarters. Much of his energy that winter had gone into the Fund's surveillance activities, especially in assessing the major industrial countries' Louvre accord and the efforts by U.S. officials to reduce the runaway fiscal deficit (Chapters 4 and 3, respectively). The time was coming, though, for what he would later call his "first major initiative as Managing Director," a drive to "enhance" or raise the resources that the Fund could put into concessional lending to low-income countries. His goal initially seemed hopeless to almost everyone, but not even he could have imagined how far the quest would carry him and how fundamental it ultimately would be to history's judgment of his years in office and of the Fund's ability to contribute to the alleviation of the world's worst poverty.

As discussed above, it was obvious from the beginning that the resources of the SAF were too small to have much of an effect unless they could be supplemented somehow. The strategy during the first year of the facility was to encourage donor countries to provide separate but related bilateral assistance to countries with SAF-supported adjustment programs.[68] After a year of trying, it was clear that this

[68]"Committee members stressed . . . that it would be desirable to enhance the catalytic role of the structural adjustment facility in mobilizing additional multilateral and bilateral concessional resources" (communiqué of September 29, 1986, para. 6; *Annual Report 1987*, pp. 110–11).

strategy was not working. As the Chairman of the Interim Committee, H. Onno Ruding (Netherlands), put it to his ministerial colleagues in April 1987, "the response . . . has been far from impressive."[69] No one yet had an alternative, however, so this time the communiqué merely repeated the call for bilateral aid, though without specifying whether the "necessary additional financial support" should be provided independently or through the Fund's facility.[70]

A few weeks later, in a mid-May meeting with Ruding in Paris, Camdessus informally raised the issue of asking donor countries to contribute additional resources to the SAF rather than just hoping that they would make parallel bilateral commitments. When Ruding encouraged him, the Managing Director was off and running.[71] Over the next two weeks, he met with heads of state, finance ministers, and other senior officials from each of the G-7 countries. At first, his goal was to get the ministers to approve the idea, but they went a step further: their bosses were looking for a way to move the debt-relief process forward at the forthcoming summit meeting in Venice, so why not include a proposal to augment the Fund's resources dedicated to the poorest countries? With especially strong backing from French President François Mitterrand and Canadian Prime Minister Brian Mulroney (both of whom met with Camdessus in Ottawa in late May), the lobbying effort quickly succeeded. Nearly at the last minute, a sentence was inserted into the Venice communiqué of June 10, 1987, stating that the Heads of State and Government of the G-7 countries "welcome the . . . proposal by the Managing Director of the IMF for a significant increase in the resources of the Structural Adjustment Facility over the three years from January 1, 1988. We urge a conclusion [of] discussions on these proposals within this year" (Hajnal, 1989, p. 342).

Meanwhile, on June 1, Camdessus further widened the appeal by writing to the Fund's governors for the G-10 countries and several other potential donors. For the first time, he mentioned a specific goal: tripling the resources of SAF, to SDR 9 billion, by raising contributions from official donors for a new trust fund to be administered by the IMF. On the same day, he brought the Executive Board into the picture for the first time by meeting with Directors from the G-10 countries plus Saudi Arabia.[72]

Camdessus was encouraged by the widespread support he was hearing, but he also knew that warm words did not make a victory. The next day he appointed a high-level staff team to undertake the massive job of designing a trust fund that the

[69]Draft speaking notes, as given to the Managing Director before the meeting; in IMF/RD Managing Director file "Interim Committee, 1987" (Accession 89/14, Box 4, Section 550).

[70]"Committee members noted the forthcoming review by the Executive Board of the structural adjustment facility and they expressed their hope that arrangements under the facility would serve to elicit from bilateral and multilateral donors the necessary additional financial support" (communiqué of April 10, 1987, para. 5; *Annual Report 1987*, p. 115).

[71]Letter from Ruding to Camdessus (June 29, 1987) and Camdessus's reply (July 16); in IMF/RD Exchange and Trade Relations Department file "SAF Correspondence, July 1987–" (RM4387, Section 4, Shelf 1, Bin 6).

[72]Memorandum for files by the Director of ETR, L. Alan Whittome (June 1, 1987); in IMF/RD Managing Director file "G-10 Meetings, June–July 1987" (Accession 89/46, Box 3, Section 224).

whole world could support, and the even more massive job of raising billions of SDRs to fund it.[73] Once the G-7 heads of state endorsed the proposal in Venice, the staff would have to move quickly, because the Managing Director was committed to having the new facility working by the end of the year.

Although the target of "tripling" SAF resources was a bit arbitrary,[74] neither the order of magnitude nor the sense of urgency about fulfilling it was by any means artificial. In mid-1987, the 34 SAF-eligible countries in Africa alone faced scheduled repayments to the Fund totaling SDR 5.3 billion through 1990, approximately triple the amounts that the Fund could extend to them through the SAF over the same period. It was crucial both for the Fund and for the indebted countries that those repayments be made. A few countries already were in arrears to the Fund, and if that problem snowballed, then bilateral aid would dry up just when the wisdom of the Fund remaining involved in sub-Saharan Africa would be increasingly called into question.[75] Without something close to a tripling of resources or an equivalent amount of other forms of aid, the economic plight of many very poor countries would be imperiled. It is no exaggeration to conclude that the economic future of Africa was at a critical juncture.[76]

Designing how the ESAF Trust (as it would be called) would dispense funds turned out to be a fairly straightforward operation, because little dissent developed to the notion that it should work similarly to the SAF in most respects. Notably, eligibility was to be the same (essentially, all countries that were eligible for loans from IDA were also to be eligible for loans from the enhanced SAF, although the Fund would determine the exact list). Both India and China, as they had a year earlier, indicated that they did not intend to draw on the facility, to allow greater access for the other 60 eligible countries. Access limits would depend on whether and how quickly resources could be tripled, but in principle, of course, they might also have been tripled. The key decision made by the Executive Board on that issue was to abandon the tactic embodied in both the Trust Fund and the SAF of granting, in effect, equal access to all borrowers. Instead, loans now would be made

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[73]Report by the Managing Director at IS/87/3 (June 12, 1987), p. 6. The team comprised John T. Boorman (Deputy Director of the Exchange and Trade Relations Department), Thomas Leddy (Deputy Treasurer), and Reinhard H. Munzberg (Assistant General Counsel, Legal Department).

[74]Furthermore, the "triple" ratio was only a rough approximation. At the time, SAF resources were expected to reach a peak of SDR 2.7 billion by 1991; in the event, the peak was slightly smaller, because three countries wracked by civil wars (Liberia, Somalia, and Sudan) accumulated arrears to the Trust Fund totaling some SDR 120 million. Actual SAF loans outstanding peaked in 1993 at just under SDR 2 billion; by that time, as explained below, resources were being transferred to the ESAF Trust.

[75]At the time, more than two-thirds of all outstanding Fund lending arrangements were with sub-Saharan African countries.

[76]For comprehensive assessments of the economic plight of sub-Saharan Africa at that time, see Organization of African Unity (1986) and United Nations (1986). The UN report was cited by the Fund in December 1987 as an impetus for the creation of the ESAF (Press Release No. 87/44, December 29, 1987). The role of the SAF and the ESAF in contributing to the UN "Programme of Action for African Economic Recovery and Development" was assessed in United Nations (1987).

in amounts that reflected the circumstances of each country (financing needs and strength of adjustment program), within broad guidelines and limits (Section II, para. 2, of the Instrument establishing the ESAF Trust; *Annual Report 1988*, p. 121).

More contentious was the question of how strict and detailed conditionality should be on ESAF loans. Ahmed Abdallah (Kenya) argued in November 1987 against adding conditions beyond those already used with SAF loans. While agreeing that "there is no alternative to strong comprehensive adjustment," he suggested that "excessive conditionality will only be counterproductive." The staff and management, however, never doubted that weak conditionality had damaged the effectiveness of the SAF as a vehicle for structural reform, and they were determined to solve that problem with the ESAF. In any case, the issue was essentially moot, because the Fund could never have raised the necessary funds from donor countries without a guarantee of effective conditionality. So the Board agreed that ESAF loans would be disbursed semiannually (not annually, like SAF loans, but also not quarterly, like stand-by arrangements) and would be subject to performance criteria on both structural policies and macroeconomic data.[77] With this change, ESAF conditionality would differ only slightly from that on EFF arrangements.

As soon as general agreement was reached on these broad principles, the Board—spurred on by the Interim Committee in September—agreed on December 18, 1987, to create the ESAF Trust "to support programs [of low-income developing countries] to strengthen substantially and in a sustainable manner their balance of payments position and to foster growth" (Section I, para. 1, of the Instrument establishing the Trust; *Annual Report 1988*, p. 120).

Once the picture clarified on how much money would be available from donor countries, the Executive Board agreed in April 1988 on three other key provisions. First, the access limit was set at a cumulative 250 percent of quota over three years, with a provision that access could reach 350 percent in exceptional circumstances. Under prodding from several Directors from donor countries, the staff and the Managing Director agreed that "exceptional" would be strictly interpreted to mean "highly exceptional."[78] For most countries, actual access was expected to be well below even the lower ceiling, and loans were expected to average about 150 percent of quota (roughly 2½ times the SAF limit that was then in place). Second, the financial terms of ESAF loans were to be identical to those from the SAF: interest would be charged at 0.5 percent, loans would mature in ten years, and repayment was to begin after 5½ years. Third, the ESAF, like its predecessors, would be a temporary facility; November 1989—less than two years away—was set as the cutoff date for approval of loans.[79]

[77]For Abdallah's remarks, see the minutes of IS/87/7 (November 20, 1987), p. 11. For the agreement on conditionality, see the Chairman's summing up, at EBM/87/171 (December 15, 1987), pp. 7–10.

[78]Minutes of EBM/88/61 (April 20, 1988).

[79]In March 1989, the cutoff date was moved back to November 1990. Subsequent decisions extended its life until a successor trust was established in 1994.

Financing, 1987–88

The goal set by Camdessus was to raise SDR 6 billion ($8 billion) and to have enough of it in hand to allow the Fund to start lending early in 1988. Remarkably, although at least some of the senior staff involved regarded that target as the maximum that they could hope to attain and assumed that the final amount would be negotiated downward, the Managing Director's figure quickly became accepted by most creditor countries. Discussions focused on how to allocate the responsibility for contributing to it.

Raising the money required a great deal of political invention and a strong defense of the Fund's own interests. The primary difficulty was that the largest industrial country, the United States, initially was unwilling to contribute to the Trust and eventually made only a modest contribution (a grant of $140 million, or approximately SDR 107 million, pledged in November 1989 for disbursement over 12 years—the tenth largest among the 27 contributing countries and about 4 percent of total grant commitments of SDR 2.5 billion).[80] The U.S. position was not articulated on a lack of concern for low-income countries but rather on a decision to concentrate first on securing appropriations for the eighth replenishment of IDA. Even so, potential borrowers were distressed that the United States would be deaf to their appeals for help, and other creditors were dismayed at the prospect of asking their legislatures and parliaments for appropriations to a multilateral facility that would not be supported proportionally by others.

From the Fund's vantage, a serious complication was that with the United States on the sidelines, the staff was effectively precluded from using any sort of "burden-sharing" formula for determining appropriate amounts to request from each creditor. (For a time, the U.S. authorities argued for a formula based on the size of a country's current account surplus, but Japan and other surplus countries naturally rejected that idea out of hand.) The entire amount therefore would have to be raised through voluntary ad hoc contributions or through another means.

To avoid these complications, officials from several countries suggested financing the ESAF through the sale of part of the Fund's gold stock: the same technique used to finance the original Trust Fund in the late 1970s. In 1987, the staff estimated that selling roughly 20 percent of the Fund's remaining gold stock at the then-prevailing market price could generate the resources to fund the new facility.[81] That idea, though, was strongly opposed both by the U.S. authorities—

[80]A U.S. contribution of $150 million was proposed in the budget submitted by the outgoing administration of President Ronald Reagan. In November, the U.S. Congress approved an appropriation of $139,398,000, heavily backloaded; the first installment, paid in June 1990, was in the amount of $3 million. The United States made additional contributions to the ESAF in the 1990s.

[81]"Further Considerations on the Mobilization of Resources in Association with the Structural Adjustment Facility (SAF)," EBS/87/190 (September 2, 1987), p. 6. The IMF held 103 million ounces of gold, valued on its books at SDR 35 ($45) per ounce. The market price of gold at the time was about $440; if that price held up, each ounce would generate profits close to $400, and the sale of 20 million ounces would yield profits of just under $8 billion.

without whom it could not succeed[82]—and by the Managing Director—who viewed gold as the Fund's "crown jewels." In mid-July, to nip the idea before it could take firm roots, Camdessus rejected it unequivocally during an informal meeting with Executive Directors:

> The Fund's gold holdings are one of the institution's main sources of strength. . . . We must not reduce the Fund's capital base to solve a particular problem of the moment when in all likelihood the Fund will continue to face serious challenges in the years to come. Selling the Fund's gold holdings might well weaken the institution's ability to help its members, including—perhaps especially—the poorest countries.[83]

Although several Executive Directors argued that the Fund should consider selling enough gold to finance at least a substantial portion of ESAF lending—notably those from Germany, Japan, the United Kingdom, Belgium, and Brazil—the majority either were opposed altogether or were prepared only to consider quite small sales, possibly to cover the Trust's credit risks.[84]

Two other ideas were floated during the early stages of discussion. One would have had countries lend for this purpose to the Fund's General Resources Account. That scheme appealed particularly to the Japanese authorities as a means of coping with restrictions under Japanese law on lending to a separate Trust, and to several other potential contributors as a means of shifting the credit risk on ESAF loans from creditors to the Fund. It was, however, judged to be an ineffective alternative, because the Fund could not restrict its general lending to a subset of the membership. The second alternative (favored notably by the Belgian authorities) would have required an allocation of SDRs, after which donor countries would have lent their allocations back to the Fund for onlending to low-income countries.[85] That scheme faced drawbacks similar to those of the one just described, plus the difficulty of securing the 85 percent majority required for an SDR allocation. Both ideas therefore were abandoned in the fall of 1987.

Attention then turned toward finding ways to make investments in a Trust more liquid and especially more secure for creditors. In that regard, the key innovation was to establish a Reserve Account within the Trust to cover possible losses. Once the ESAF Trust was established, all income from SAF and Trust Fund loans

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[82]Any decision to sell part of the Fund's holdings of gold would have required approval by 85 percent of the total voting power. U.S. support (essential for obtaining an 85 percent majority) for a proposal to sell gold for the benefit of a subset of the Fund's membership would have required the explicit approval of the U.S. Congress, which was considered extremely unlikely.

[83]Minutes of IS/87/4 (July 15, 1987), p. 4. This formulation left the door open in principle for the Fund to sell gold, retain ownership of the proceeds to preserve the value of the Fund's capital base, reinvest the money in interest-bearing assets, and use the income to support concessional lending. That proposal surfaced nearly a decade later, during the discussions on how to convert the ESAF into a permanent facility.

[84]Minutes of EBM/87/138 (September 15, 1987).

[85]On the first proposal, see "Further Considerations on the Mobilization of Resources in Association with the Structural Adjustment Facility (SAF)," EBS/87/190 (September 2, 1987), pp. 3–5. On the second, see Annex II to the minutes of EBM/87/138 (September 15, 1987), pp. 47–48.

and from SAF-related investments, all other funds in the SDA that were not otherwise committed, and all repayments of principal on SAF and Trust Fund loans were to be transferred into this new Reserve Account. Over a period of 15 years, the staff projected that the reserve would eventually amount to SDR 4.8 billion and would easily cover any reasonable estimate of possible losses on bad loans.[86] In addition, to cover any residual risk to creditors, the Fund undertook "to consider fully and in good faith all such initiatives as might be necessary to assure full and expeditious payment to lenders" (Decision No. 8759-(87/176) ESAF, adopted December 18, 1987; *Annual Report 1988*, p. 119). This provision was intended specifically to keep open the possibility of selling gold if the reserve and other possible measures were inadequate.[87] Neither staff nor management was particularly concerned about the extremely remote possibility of this clause ever being invoked. In their view, the first line of defense—the quality of the adjustment programs underpinning the loans—and the second line—the Reserve Account—were far more than adequate protection.

When the Trust was created in December 1987, after remarkably quick negotiations, staff and management were still working practically around the clock to raise enough money. To allow each creditor to find a means of contributing that was politically and technically feasible within the country's own constraints, the Fund was seeking contributions for two separate accounts within the ESAF Trust: a Loan Account for receiving loans (at concessional or near-market terms) for onlending to eligible members; and a Subsidy Account for receiving grants and concessional loans for payment of interest subsidies to borrowers, to reduce the interest cost to 0.5 percent a year.[88] (Those two accounts, plus the Reserve Account, constituted the Trust.)

By far the largest contributor was Japan. Several months of discussion culminated in a December 1987 visit to Tokyo by the Managing Director (in conjunction with the annual Article IV consultation—see Chapter 3). Following that meeting, the government of Japan agreed to lend (through its Export-Import Bank) to the Fund (as Trustee) up to SDR 2.2 billion (just over $3 billion) and to provide an additional SDR 329 million ($465 million) in grants.[89] Not only did this contribution make the ESAF viable, it also marked the beginning of a heightened role for Japan in the IMF and in the provision of financial assistance to developing countries.

[86]"Enhanced Structural Adjustment Facility (SAF)—Proposed Financial Arrangements," EBS/87/228 (October 29, 1987), p. 5.

[87]Minutes of EBM/87/168 (December 11, 1987), p. 59.

[88]To make the wide variety of contributions commensurate, the staff computed a "grant-equivalent" value on below-market loans. For example, if a country agreed to make a loan to the Trust at 0.5 percent interest for a fixed period, the present value of the difference between the actual interest cost to the Trust and an estimate of what the Trust would have paid at market rates (assumed to be 6 percent) was treated as a grant.

[89]Japan also agreed to augment its loan by up to SDR 300 million if needed by the Fund to make full use of subsidy grants from other contributors. "Enhanced Structural Adjustment Facility (ESAF)—Proposed Borrowing Agreement with the Export-Import Bank of Japan," EBS/88/69 (March 28, 1988), and minutes of EBM/88/56 (April 4, 1988).

Table 14.2. ESAF Trust: Contribution Commitments
as of April 30, 1990

Contributor	In SDR millions[a]		U.S. dollar equivalent	
	Subsidies[b]	Loans	Subsidies	Loans
Austria	*42*		55	
Belgium	*84*		109	
Canada	*163*	300	212	390
Denmark	45		59	
Finland	38		49	
France	*380*	800	495	1,041
Germany	130	700	169	911
Greece	*25*		33	
Iceland	2		3	
Italy	*201*	370	262	481
Japan	329	2,200	428	2,863
Korea	*47*	65	61	85
Luxembourg	5		7	
Malaysia	*35*		46	
Malta	1		1	
Netherlands	68		88	
Norway	27	90	35	117
Saudi Arabia	*109*	200	142	260
Singapore	*24*		31	
Spain	*22*	260	29	338
Sweden	121		157	
Switzerland	*119*	200	155	260
Turkey		35		46
United Kingdom	411		535	
United States	107		139	
Other (undisclosed or not final)	38	95	49	124
Total[c]	2,570	5,315	3,344	6,917
Adjustment[d]	–32		–42	
Net Contributions	2,538	5,315	3,303	6,917

Source: *Annual Report 1990*, p. 79.
[a]Some contributions were in local currency or U.S. dollars.
[b]Figures in italics are staff estimates of the grant-equivalent value of the contribution.
[c]Columns may not add to total, owing to rounding.
[d]Adjustment to reflect the high cost of one loan.

By the end of May 1988, when the Fund was ready to begin considering loan applications, the ESAF Trust had received at least tentative commitments from 24 countries, for a total of SDR 5.3 billion in loans plus grants or grant-equivalents of SDR 2 billion. Another half-billion in grant commitments came in during the next couple of years, by which time the Trust was essentially complete (Table 14.2).[90] Commitments came from all of the G-10 countries, several smaller industrial countries, two major middle-eastern oil exporters, and even some middle-income developing countries, several of which had recent and painful experience

[90]Data in Table 14.2 that are not shown in *Annual Report 1990* are from "Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF)—Review of Operations," EBS/90/106 (June 12, 1990), p. 56.

Table 14.3. ESAF and SDA: Combined Balance Sheet for April 30, 1990
(In thousands)

	SDRs	Equivalent in U.S. Dollars
Assets	3,576,862	4,658,863
Investments	1,553,148	2,022,975
Loans	1,964,605	2,558,898
Receivables	59,109	76,989
Liabilities and Resources	3,576,862	4,658,863
Resources	2,920,623	3,804,112
Contributions to ESAF	203,890	265,567
Transfers from Trust Fund	2,363,040	3,077,860
Transfers from SFF Subsidy Account	63,945	83,288
Retained income	289,748	377,397
Borrowing	647,352	843,176
Accrued interest payable	8,630	11,241
Deferred Income	229	298
Other liabilities	28	36
Memorandum items:		
Additional commitments:		
Contributions (grant equivalent)	2,332,110	3,037,573
Borrowing	4,667,648	6,079,612
Potential assets	10,576,620	13,776,048

Source: *Annual Report, 1990*. Dollar amounts have been calculated at SDR 1 = $1.3025, the rate prevailing on April 30, 1990.

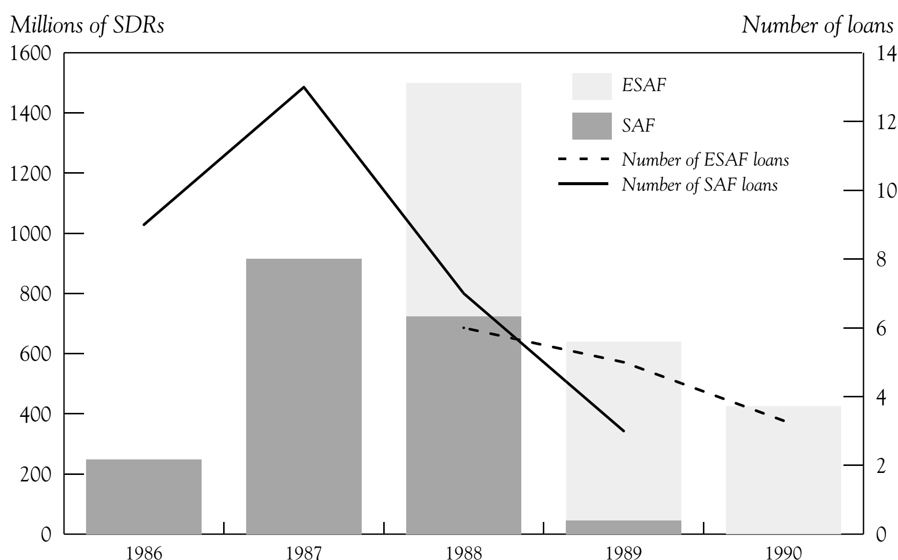
with their own external debt problems. After Japan, the second- and third-largest contributors were France and Germany, respectively.

Although many of these contributions were slated to be paid in over several years, the Fund was able to begin operations in 1988, using a combination of resources: contributions (18 percent of the total for the first two years), borrowings (57 percent), and transfers from the SDA (20 percent).[91] ESAF loans outstanding at the end of 1989 totaled SDR 416 million, and a further SDR 708 million was in hand and invested. As shown in Table 14.3, the combined resources of the ESAF Trust and the SDA at that time were still largely derived from the original Trust Fund and totaled some SDR 3.6 billion ($4.7 billion). Taking future ESAF commitments into account, however, total potential resources amounted to SDR 10.6 billion ($13.8 billion) by that time.[92] Preparations thus were largely complete for a continued flow of concessional lending and subsidies through the first half of the 1990s.

[91]The remaining 5 percent came mostly from income on investments. These percentages refer to the end of April 1990.

[92]Not all of these resources could be lent or disbursed as subsidies. As of April 1990, SDR 273 million was being held in the ESAF Reserve Account to guarantee repayments to lenders.

Figure 14.4. SAF and ESAF Loan Commitments, 1986–90



Operations, 1988–89

ESAF lending activity began with a loan to Malawi on July 15, 1988. Although only a handful of loans was to be approved each year, the new Trust quickly overtook the SAF as the Fund's main window for concessional loans (Figure 14.4).[93]

By this time, the Fund was ready to abandon the practice of providing parallel financing for low-income countries through both the Fund's general resources (at market interest rates) and its concessional lending facilities. While the original Trust Fund was operating in 1976–81, 71 percent of the countries that borrowed from it (39 out of 55) were also drawing on the Fund's general resources. During the first two years of SAF operations, before the establishment of the ESAF, two-thirds of the borrowing countries (18 of 27) also had stand-by or extended arrangements. In the second half of 1988, two of the four countries that borrowed from the SAF (Mali and Pakistan), but none of the ESAF borrowers, had active stand-by arrangements.[94] For loans approved after 1988, none did.

Most commonly, ESAF borrowers in those early years had recently completed adjustment programs under which they had drawn on the Fund's regular facilities. Of the 11 countries that borrowed from the ESAF through the end of 1989, all but one had either completed a stand-by arrangement in the year or so preceding the initial loan, or had abandoned the existing arrangement when the softer loan became

[93]For a detailed review of ESAF lending through 1992, see Schadler and others (1993).

[94]Malawi had entered into a relatively small stand-by arrangement (SDR 13 million, or 35 percent of quota) just a few months earlier and had drawn most of the approved amount (25 percent of quota) at once. Although the arrangement remained in effect until May 1989, Malawi did not draw on it again.

available.[95] A major effect of the new facility therefore was to enable low-income countries to replace expensive with highly concessional and more stable financing.[96]

Although the total amount of ESAF loans in 1988–89 was not large relative to the two earlier facilities (refer back to Figure 14.1), it was much more concentrated on a few countries, and loans were much larger relative to borrowers' quotas (Table 14.4). Compared with about 80 percent of quota or less for the 55 Trust Fund borrowers and 70 percent or less for the 32 SAF borrowers, these first 11 ESAF borrowers obtained commitments averaging just over 160 percent of quota. Reflecting the decision to vary countries' access depending on the extent of need and the strength of the adjustment program, loans ranged in size from a low of 116 percent of quota (to Madagascar) to a high of 180 percent (to Ghana and Uganda).

Ghana

One of the earliest ESAF loans was also the largest. At SDR 368.1 million ($500 million) and 180 percent of quota, the loan to Ghana in November 1988 was the largest commitment in the first two years of ESAF operations, in both absolute and percentage terms.

The Fund had been closely involved in assisting the Ghanaian authorities since 1982, when the military government of Flight Lieutenant Jerry John Rawlings appointed Dr. Kwesi Botchwey—who would become one of Africa's most highly respected monetary officials—as finance minister and began devising a long-overdue program of macroeconomic stabilization and structural reform.[97] In 1983–86,

[95]The sole exception was Uganda, which had last drawn on Fund resources in 1984.

[96]The interest rate charged on stand-by and extended arrangements in 1988 averaged close to 6 percent, compared with 0.5 percent on ESAF loans. For both EFF arrangements and ESAF loans, borrowers received principal over three years and repaid it over a period ending in 10 years, although ESAF borrowers received moneys slightly sooner and began repayments a year later. Overall, the expected discounted present value of interest and principal repayments was cut nearly in half by switching from the EFF to the ESAF. Since in most cases borrowers were switching out of ordinary stand-by arrangements rather than the EFF, they also benefited from longer maturities and grace periods and from a reduced need to negotiate policy conditions with the Fund.

[97]Ghana joined the Fund in September 1957, just six months after becoming the first independent state in sub-Saharan Africa (excluding South Africa). In February 1966, a military coup overthrew the government of Kwame Nkrumah and set out to implement economic reforms with the support of the Fund. In 1966–69, the Fund approved four consecutive one-year stand-by arrangements, most of which were fully utilized. The Fund also assisted Ghana in the late 1960s by helping arrange reschedulings of heavy external debts incurred by the Nkrumah government and by organizing meetings of official donors. From 1970 through mid-1983, Ghana made relatively little use of Fund resources and repaid virtually all of its obligations. By that time, however, the economy was suffering from multiple ills, including a bloated and inefficient bureaucracy, a depressed world market for the principal export (cocoa), a prolonged drought, and the repatriation of more than a million Ghanaians who were being forced out of Nigeria. The combined effect was severe enough that the World Bank reclassified Ghana from a middle-income to a low-income country. Overall, real per capita income fell by 30 percent from 1970 to 1982. For more background on Ghana's early relations with the Fund, see de Vries, 1976, Vol. 1, pp. 471–72 and 597–600, and James (1996), pp. 539–41. For an analysis of the post-1982 reforms and their effects, see Kapur and others (1991). Nowak and others (1996) gives a longer-run overview and references to the more detailed literature on the Ghanaian economy.

Table 14.4. Concessional Loans to Low-Income Countries, 1977–89

			Amount Approved		Amount Disbursed	
Country[a]	Facility	Date Approved[b]	Millions of SDRs[c]	Percent of quota[d]	Millions of SDRs[c,e]	Percent of quota[d]
Bangladesh	Trust Fund	1976, 1978	122.2	80.4	122.2	80.4
	SAF	1987	201.3	70.0	201.3	70.0
Benin	Trust Fund	1976, 1978	12.7	79.4	12.7	79.4
	SAF	1989	21.9	70.0	21.9	70.0
Bolivia	Trust Fund	1976, 1978	36.2	80.4	36.2	80.4
	SAF	1986	57.6	63.5	18.1	20.0
	ESAF	1988	136.1	150.0	136.1	150.0
Burkina Faso (Upper Volta)	Trust Fund	1976, 1978	12.7	79.4	12.7	79.4
Burundi	Trust Fund	1976, 1978	18.6	80.7	18.6	80.7
	SAF	1986	29.9	70.0	29.9	70.0
Cameroon	Trust Fund	1976, 1978	34.2	76.0	34.2	76.0
Central African Republic	Trust Fund	1976, 1978	12.7	79.4	12.7	79.4
	SAF	1987	21.3	70.0	15.2	50.0
Chad	Trust Fund	1976	5.4	33.7	5.4	33.7
	SAF	1987	21.4	70.0	21.4	70.0
China	Trust Fund	1978	309.5	56.3	309.5	56.3
Congo	Trust Fund	1976, 1978	12.7	74.7	12.7	74.7
Dominica	SAF	1986	2.8	70.0	2.8	70.0
Egypt	Trust Fund	1976, 1978	183.7	80.6	183.7	80.6
El Salvador	Trust Fund	1978	19.7	45.8	19.7	45.8
Equatorial Guinea	Trust Fund	1978	4.5	45.0	4.5	45.0
	SAF	1988	12.9	70.0	3.7	20.0
Ethiopia	Trust Fund	1976, 1978	26.4	73.3	26.4	73.3
Gambia, The	Trust Fund	1976, 1978	6.8	76.0	6.8	76.0
	SAF	1986	10.9	63.5	8.6	50.0
	ESAF	1988	20.5	120.0	20.5	120.0
Ghana	Trust Fund	1978	49.0	46.2	49.0	46.2
	SAF	1987	129.9	63.5	40.9	20.0
	ESAF	1988	368.1	180.0	368.1	180.0
Grenada	Trust Fund	1976, 1978	2.0	65.2	2.0	65.2
Guinea	Trust Fund	1976, 1978	23.5	78.2	23.5	78.2
	SAF	1987	40.5	70.0	29.0	50.0
Guinea Bissau	SAF	1987	5.3	70.0	3.8	50.0
Guyana	Trust Fund	1978	11.3	45.0	11.3	45.0
Haiti	Trust Fund	1976, 1978	18.6	80.7	18.6	80.7
	SAF	1986	30.9	70.0	8.8	20.0
Honduras	Trust Fund	1978	14.1	41.4	14.1	41.4
India	Trust Fund	1978	529.0	46.2	529.0	46.2
Ivory Coast	Trust Fund	1976, 1978	50.8	66.9	50.8	66.9
Kenya	Trust Fund	1976, 1978	46.9	68.0	46.9	68.0
	SAF	1988	99.4	70.0	28.4	20.0
	ESAF	1989	241.4	170.0	216.2	152.2

Table 14.4 *(continued)*

			Amount Approved		Amount Disbursed	
Country[a]	Facility	Date Approved[b]	Millions of SDRs[c]	Percent of quota[d]	Millions of SDRs[c,e]	Percent of quota[d]
Lao P.D.R.	Trust Fund	1976, 1978	12.7	79.4	12.7	79.4
	SAF	1989	20.5	70.0	20.5	70.0
Lesotho	Trust Fund	1976, 1978	4.9	69.8	4.9	69.8
	SAF	1988	10.6	70.0	10.6	70.0
Liberia	Trust Fund	1976, 1978	28.3	76.6	28.3	76.6
Madagascar	Trust Fund	1976, 1978	25.4	74.7	25.4	74.7
	SAF	1987	46.5	70.0	13.3	20.0
	ESAF	1989	76.9	115.8	51.3	77.2
Malawi	Trust Fund	1976, 1978	14.7	77.2	14.7	77.2
	ESAF	1988	55.8	150.0	55.8	150.0
Mali	Trust Fund	1976, 1978	21.5	79.6	21.5	79.6
	SAF	1988	35.6	70.0	25.4	50.0
Mauritania	Trust Fund	1976, 1978	12.7	74.7	12.7	74.7
	SAF	1986	23.7	70.0	17.0	50.0
	ESAF	1989	50.9	150.0	17.0	50.0
Mauritius	Trust Fund	1976	9.1	33.8	9.1	33.8
Morocco	Trust Fund	1976, 1978	110.4	73.6	110.4	73.6
Mozambique	SAF	1987	42.7	70.0	42.7	70.0
Myanmar (Burma)	Trust Fund	1976, 1978	58.6	80.3	58.6	80.3
Nepal	Trust Fund	1976, 1978	13.7	72.0	13.7	72.0
	SAF	1987	26.1	70.0	26.1	70.0
Niger	Trust Fund	1976, 1978	12.7	79.4	12.7	79.4
	SAF	1986	21.4	63.5	16.9	50.0
	ESAF	1988	50.6	150.0	23.6	70.0
Pakistan	Trust Fund	1976, 1978	229.7	80.6	229.7	80.6
	SAF	1988	382.4	70.0	273.2	50.0
Papua New Guinea	Trust Fund	1976, 1978	19.5	65.2	19.5	65.2
Philippines	Trust Fund	1976, 1978	151.5	72.1	151.5	72.1
Rwanda	Trust Fund	1978	10.7	46.5	10.7	46.5
São Tomé & Príncipe	SAF	1989	2.8	70.0	2.8	70.0
Senegal	Trust Fund	1976, 1978	33.2	79.1	33.2	79.1
	SAF	1986	54.0	63.5	42.6	50.0
	ESAF	1988	144.7	170.0	144.7	170.0
Sierra Leone	Trust Fund	1976, 1978	24.4	78.8	24.4	78.8
	SAF	1986	40.5	70.0	11.6	20.0
Somalia	Trust Fund	1978	10.7	46.5	10.7	46.5
	SAF	1987	30.9	70.0	8.8	20.0
Sri Lanka	Trust Fund	1976, 1978	95.8	80.5	95.8	80.5
	SAF	1988	156.2	70.0	156.2	70.0
Sudan	Trust Fund	1976, 1978	70.4	80.0	70.4	80.0
Swaziland	Trust Fund	1978	4.5	37.5	4.5	37.5
Tanzania	Trust Fund	1976, 1978	41.0	74.6	41.0	74.6
	SAF	1987	74.9	70.0	74.9	70.0

Table 14.4 ***(concluded)***

Country[a]	Facility	Date Approved[b]	Amount Approved: Millions of SDRs[c]	Amount Approved: Percent of quota[d]	Amount Disbursed: Millions of SDRs[c,e]	Amount Disbursed: Percent of quota[d]
Thailand	Trust Fund	1976, 1978	131.0	72.3	131.0	72.3
Togo	Trust Fund	1976, 1978	14.7	77.2	14.7	77.2
	SAF	1988	26.9	70.0	7.7	20.0
	ESAF	1989	46.1	120.0	38.4	100.0
Uganda	Trust Fund	1978	22.5	45.0	22.5	45.0
	SAF	1987	69.7	70.0	49.8	50.0
	ESAF	1989	179.3	180.0	179.3	180.0
Vietnam	Trust Fund	1976, 1978	60.6	67.3	60.6	67.3
Western Samoa	Trust Fund	1976, 1978	2.0	65.2	2.0	65.2
Yemen, P.D.R.	Trust Fund	1976, 1978	28.3	69.1	28.3	69.1
Zaïre	Trust Fund	1976, 1978	110.4	72.7	110.4	72.7
	SAF	1987	203.7	70.0	145.5	50.0
Zambia	Trust Fund	1978	42.8	30.3	42.8	30.3
Totals:						
55 countries	Trust Fund	1976–78	2,991	63%	2,991	63%
32 countries	SAF	1987–89	1,955	69%	1,379	49%
11 countries	ESAF	1988–89	1,370	161%	1,251	147%

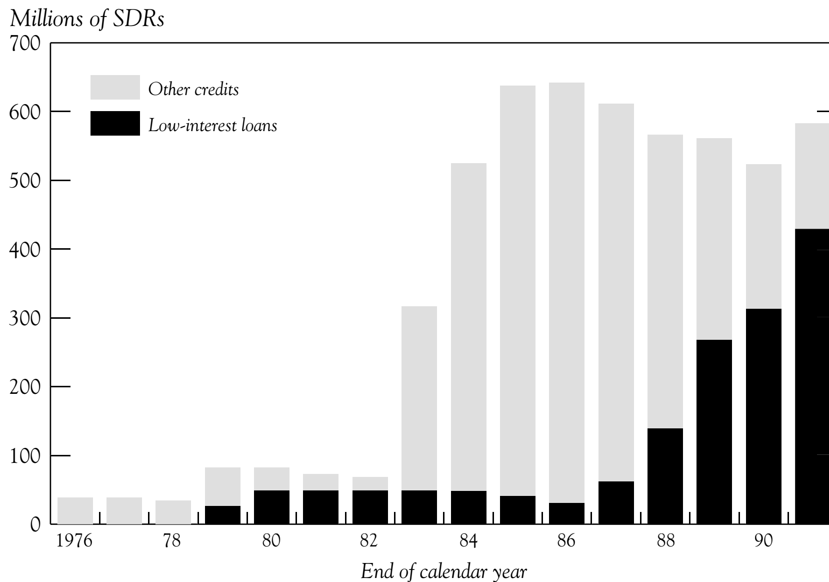
[a]Country names in parentheses were in effect at the time of the Trust Fund loan.
[b]For the Trust Fund, 1976 and 1978 indicate approval of loans for the First and Second Period, respectively.
[c]In some cases, ESAF loans were augmented after 1989.
[d]For the Trust Fund, the denominator is the quota at April 1980; for SAF and ESAF, April 1988.
[e]For SAF and ESAF, this is the total amount disbursed through the end of the arrangement, of the amounts approved through 1989.

Ghana obtained three stand-by arrangements and drew twice on the Compensatory Financing Facility (CFF). By October 1986, Ghana's indebtedness to the Fund (including to the Trust Fund) reached an all-time peak of some SDR 645 million ($780 million or 315 percent of quota; see Figure 14.5). The Fund also provided substantial technical assistance on various structural reforms, reestablished a resident office in Accra in 1985, and worked with United Nations Children's Fund (UNICEF) officials on issues related to the protection of impoverished groups from the brunt of the adjustment program.

The authorities' efforts brought substantial rewards. From 1983 to 1986, real output grew by more than 13 percent, the volume of exports grew by 35 percent, the annual inflation rate fell from well over 100 percent to 25 percent, and the fiscal deficit was virtually eliminated. Nonetheless, the Ghanaian economy was skirting the edge of a dangerous precipice, largely because nearly half of all export revenues were required to service debts to foreign creditors.

Essential though the Fund's support was in the mid-1980s, it added to Ghana's debt burden at a time when the government was struggling hard to keep its grip on the economic foothold that it had just attained. Not only was the debt to the Fund carrying a market rate of interest (then approximately 6 percent); it also had short

Figure 14.5. Ghana: Concessional Loans and Other Credit Outstanding, 1976–91



maturities and would have to be repaid almost entirely over the next few years. When Botchwey first requested an extended arrangement rather than another one-year stand-by arrangement in 1985, he stressed that all he wanted was to stretch out the maturity of Ghana's outstanding obligations to the Fund.[98]

The resumption of concessional lending by the Fund opened a new opportunity, but the small size of the SAF was initially a severe limitation. In the summer of 1987, while Ghana's eighth and final short-term stand-by arrangement was running its course, the authorities requested that the Fund provide a blend of longer-term support through the EFF (on nonconcessional terms) and the SAF (on concessional terms). The request raised difficult issues for the Fund. For one, the EFF was essentially moribund: no extended arrangement had been approved for the past two years, and many in the Fund believed that it no longer served a useful purpose (see Chapter 15). For another, management was wary of entering into a new large-scale and longer-term commitment—even through the SAF—in a region with little record of successful adjustment.

To assess prospects in Ghana, the first negotiating mission (in June 1987) included not only the regular mission chief, Evangelos A. Calamitsis (Senior Advisor in the African Department), but also the Department Director, Alassane D. Ouattara, and the Deputy Managing Director, Richard D. Erb. After meeting with Rawlings and other top officials, the team gave an upbeat assessment. In August, Botchwey went to Washington to meet with Camdessus and resolve the few remaining policy is-

[98]Letter from Botchwey to the Deputy Managing Director, Richard D. Erb (November 14, 1985); in IMF/CF (C/Ghana/1791 "Extended Fund Facility").

sues.[99] A month later, the authorities submitted a PFP (largely drafted by Fund and World Bank staff) that set out their policy intentions for the period through June 1990. The program was approved by the Bank in mid-October, and on November 6 the Fund approved a package of EFF credits and SAF loans totaling SDR 375 million ($505 million; 184 percent of quota). Although the 10-year maturity on these obligations would help reduce Ghana's near-term burden of debt servicing, two-thirds of the commitment (the EFF portion) was still relatively expensive money.[100]

Ghana carried out the agreed policy reforms, and economic performance remained good in 1988. Consequently, the staff soon began negotiations for an ESAF loan. Discussions on economic policies proceeded smoothly, and a new PFP—much of which was drafted in Accra by the authorities—was quickly finished.[101] Some wrangling still took place, however, over the size of the loan and whether it would replace or supplement the more expensive EFF arrangement that was already in place. Finally, at a meeting in Washington in late August, Botchwey persuaded Camdessus that Ghana had established a strong enough track record on both adjustment and reform to warrant unusually large access to ESAF funds. In November, the Board approved Ghana's request, and both of the 1987 loans—the extended arrangement and the SAF loan—were scrapped in favor of the slightly larger and much less expensive ESAF deal.[102]

The ESAF loan brought four main benefits to Ghana. First, it committed the Fund to maintain its loan exposure for several years and freed the authorities from having either to repay large sums or to negotiate a series of short-term arrangements. Second, it sharply reduced the interest cost of the country's external debt. Third, it enabled the government to carry on the process of structural economic reform that it had begun five years earlier. Fourth, it helped convince donor countries and multilateral agencies to increase their own support.

That fourth benefit, the catalytic effect on donors, though perhaps less direct and obvious than the others, was no less important. From 1978 through 1985, official development assistance to Ghana averaged about $160 million a year (around 5 percent of GDP). Aid then began to rise sharply, and for the five years

[99]See memorandums from Calamitsis (July 14, 1987) and Ouattara (August 25) to the Managing Director; in IMF/RD Deputy Managing Director file "Ghana, 1987" (Accession 93/151, Box 3, Section 397).

[100]The EFF arrangement provided for SDR 245 million (120 percent of quota) in credits over three years, drawable quarterly. The SAF loan was scheduled to provide SDR 130 million (63.5 percent) in three annual installments, of which SDR 41 million was available immediately. The scheduled credits were similar in magnitude to Ghana's scheduled repayments to the Fund on the 1983–86 stand-by arrangements, so the Fund's exposure now was projected to show little net change through 1990 (see Figure 14.5) instead of falling sharply.

[101]On the role of the authorities in drafting the 1987 and 1988 PFPs, see memorandums to management from Goodall E. Gondwe (Deputy Director of the African Department) and Boorman (April 27, 1988) and from Reinold H. van Til (Senior Economist in the African Department; May 20, 1988); in IMF/RD Deputy Managing Director file "Ghana, 1988" (Accession 94/026, Box 2, Section 518).

[102]At the time, a total of SDR 237 million remained undrawn on the 1987 loans and available for the remaining two years. The ESAF loan would provide SDR 272 million during those two years, plus SDR 96 million in the third year.

after the ESAF loan was approved (1989–93) averaged over $600 million a year (more than 10 percent of GDP).

One impetus for the increase in aid to Ghana was the government's development in 1988 of a package of measures known as PAMSCAD (Program to Mitigate the Social Costs of Adjustment; see Kapur and others, 1991). The objective of this program was to enhance the delivery of basic services to the poor, raise the productivity of lower-income workers, and enhance their employment opportunities. In support of PAMSCAD and the government's more general efforts to improve social policies, the Fund's assistance via the ESAF was designed not only to ensure the viability of macroeconomic policies, but also to support the establishment of a "Special Efficiency Fund" for the retraining, relocation, and redeployment of public employees displaced by the restructuring of the economy. PAMSCAD itself was financed externally, largely through support pledged from bilateral donors at an international conference convened by Ghana in Geneva in February 1988. The bulk of the aid increase, however, was a generalized and broadly based vote of confidence in the management of the Ghanaian economy, at a time when the aggregate level of aid to developing countries was stagnant in real terms.

Uganda

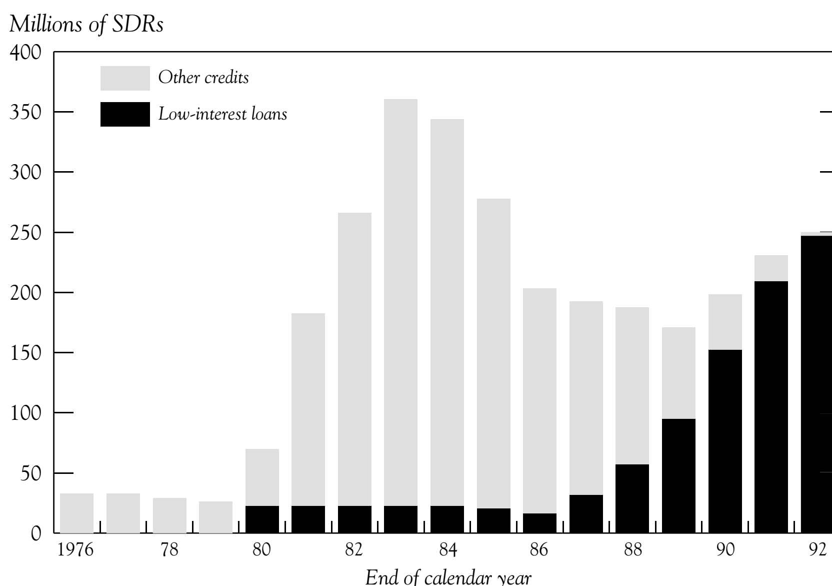
Uganda's drive for economic recovery and development began after the overthrow of the dictatorship of Idi Amin Dada by Tanzania in 1979. Political turmoil lasted for another two years, until former Prime Minister Milton Obote was elected president in December 1980. The new government quickly obtained a one-year stand-by arrangement from the Fund, for what was then the exceptionally large amount of SDR 112.5 million ($150 million; 225 percent of quota), to support an adjustment program that included a massive up-front devaluation of the exchange rate (from a badly overvalued 8.4 shillings a dollar to 96).[103] Over the next few years, supported by three consecutive 12-month stand-by arrangements from the Fund, IDA credits from the World Bank, and other external assistance, the government gradually strengthened the economy.

That initial adjustment phase took place against the backdrop of continuing brutal abuses of human rights, which provoked a renewal of civil war and threw the government's fragile economic strategy off course. The third and last stand-by arrangement was therefore abandoned in the spring of 1984, at which point Uganda's outstanding obligations to the Fund (including Trust Fund loans) amounted to SDR 374 million ($390 million, or 375 percent of quota; see Figure 14.6).[104] After that, a general deterioration set in until Yoweri Museveni became president in January 1986, following the military overthrow of Obote.

[103]The Fund lent about SDR 50 million (125 percent of quota) to Uganda during the first five years of Idi Amin's eight-year reign, starting in 1971. It then provided a small amount of assistance in 1980, in the form of a stand-by arrangement for SDR 12.5 million (25 percent of quota) and Trust Fund loans totaling SDR 22.4 million.

[104]The second arrangement, approved in August 1982, was also for SDR 112.5 million. Both loans were fully drawn. Under the third arrangement, approved in September 1983 for SDR 95 million, Uganda drew 65 million.

Figure 14.6. Uganda: Concessional Loans and Other Credit Outstanding, 1976–92



Museveni inherited a fiscal policy that was in almost total disarray, as the government was unable either to collect adequate tax revenues or to control its spending. Moreover, Uganda faced sizable foreign debt repayment obligations at the same time that it had to rebuild a totally destroyed economy. With advice from a team of outside economists based in Canada, the new government quickly developed a plan for economic stabilization and reform that would retain many elements of the existing system of centralized planning and control and would only gradually phase out other elements.[105] At that stage, the overall policy strategy in Uganda was still far from the advice being offered by the Fund, which stressed the need for a much more comprehensive and rapid liberalization of markets. These internal stresses and problems were aggravated by a severe drop in international prices for coffee, Uganda's principal export commodity.

Uganda's economic and political problems were so severe in 1986 that it seemed obvious that no government could hope to solve them in a short time. When the Executive Board held its annual Article IV discussion on Uganda in July, Directors stressed the need to address a wide range of fiscal and other policy imbalances.[106]

[105]See Uganda Economic Study Team (1987), a report prepared under the auspices of the International Development Research Centre (IDRC) in Ottawa and presented to the Ugandan government in July 1986. The IDRC report itself recommended numerous liberalizing measures within an overall strategy that retained substantial governmental direction and control over economic activity.

[106]Minutes of EBM/86/111 (July 9, 1986).

But during the Annual Meetings in Washington, at the end of September, the finance minister, Ponsiano Mulema, strove to begin to change the world's perception. To that end, he invited Alassane Ouattara (Director of the African Department) to come to Kampala, meet with Museveni, and judge for himself whether Uganda qualified for a new round of international support. Although it was not yet apparent, Museveni was beginning to rethink his initial economic strategy and would eventually become one of the leading advocates of the silent revolution in Africa.[107]

Two months later, Ouattara met with Museveni and other officials in Kampala[108] and agreed to consider the government's request for a SAF loan, which he emphasized would be conditional on a commitment to reverse the three years of backsliding in economic policies. The staff then rapidly prepared a draft PFP, and a mission—headed by Jacques R. Artus (Assistant Director in the African Department)—returned to Kampala in March 1987 and reached tentative agreement with the authorities on a comprehensive adjustment program that would include a substantial depreciation of the exchange rate as part of a comprehensive monetary reform and liberalization of prices.[109]

Negotiating the SAF loan was complicated by the authorities' failure to stay current in their repayments to the Fund on earlier credits. By 1986, the government was running extremely low on foreign exchange reserves and was frequently a few weeks late in its payments to the Fund. These delays got worse in 1987–89 and occasionally resulted in the issuance of formal complaints for brief periods.[110] In April 1987, the Fund urged donor countries to provide new quick-disbursing aid to Uganda, while the staff hastily put together a plan to supplement the SAF loan with the Fund's general resources through the CFF. The authorities then managed to scrape together enough foreign exchange to pay off their arrears in May, just a

[107]Museveni quickly embraced price liberalization, and later embraced privatization and other measures to boost the private sector, as cornerstones of reform. See Museveni (1997), pp. 180–82.

[108]The visit began ominously, as Museveni sacked both Mulema and the governor of the central bank on the day that Ouattara and his colleagues arrived. The new team—C.W.C.B. Kiyonga as finance minister and Suleiman I. Kiggundu as governor—had little time to learn before facing the task of convincing the Fund to support the government's program.

[109]Throughout the 1980s, the Uganda shilling was pegged to the U.S. dollar and was periodically devalued to compensate for Uganda's extremely high rate of domestic inflation. As noted earlier, that process began with a devaluation from 8.4 to 96 shillings per dollar in preparation for the June 1981 stand-by arrangement with the Fund. By March 1987, the official rate was 1,400 per dollar, and the rate in the unofficial market was fluctuating between 12,000 and 16,000. The currency reform, which took effect on May 15, 1987, introduced the new shilling at a conversion rate of 100:1 and set the exchange rate at 60 per dollar (equivalent to 6,000 old shillings). The reform also sought to absorb excess liquidity in the economy by imposing a 30 percent conversion tax and by more strictly controlling credit afterwards.

[110]Fund regulations required the Managing Director to issue a notice to the Executive Board whenever a member country fell two months behind in making scheduled payments of interest, charges, or principal on Fund credits (see Chapter 16). Notices on Uganda's arrears were in effect from April to May 1987, for part of August 1988, and from January to February 1989.

few weeks before the Board was scheduled to consider the SAF and CFF loan requests.[111]

In February 1988, Artus returned to Kampala for a review mission and concluded that the economic program was off track, for familiar reasons: weak export markets (especially for coffee, which accounted for more than 90 percent of Uganda's export earnings), a failure to adjust the exchange rate by enough to compensate for high domestic inflation, and weak control of the fiscal accounts. Nonetheless, to compensate for the effects of the continuing decline in world coffee prices, the Board approved a CFF drawing for an additional SDR 25 million, without which Uganda would almost certainly have developed substantial new arrears in its payments to the Fund.

The problem now was how to get policies and the economy back on track before the Board was scheduled to consider whether to release the second year's installment of the SAF loan. President Museveni was actively involved, not only in policy formation, but also in the effort to keep the Fund's support. In meetings with Camdessus and U.S. officials in Washington and with Erb and the Fund staff in Kampala, Museveni made the case that Uganda not only deserved the Fund's approval: they also were ready to move up to the higher level of conditionality and funding of the ESAF. From the Fund's vantage, however, the case looked shaky. A May 1988 mission—led by Joseph G. Keyes (Advisor in the African Department)—successfully concluded negotiations for the second year's economic program, but Uganda still had to meet the targets for the current program and once again had to find a way to clear its arrears to the Fund. Erb reinforced the mission by going to Kampala himself and personally persuading Museveni that Uganda first had to establish a better track record with the SAF loan before tackling the ESAF. In fact, even for the staff to negotiate terms for continuing the SAF while the country was in arrears was stretching the Fund's normal practices, but Camdessus and Erb were both convinced that supporting Museveni's efforts was essential and would pay off eventually.

By the time ESAF negotiations began, in February 1989 (led now by Michael Edo, Division Chief in the African Department), Uganda's financial position was increasingly precarious. The money it was getting from the SAF and CFF loans was not even sufficient to cover the payments that were still due on earlier credits from the Fund, and it was not yet doing much to catalyze support from other creditors. Even the Paris Club was having difficulty reaching an agreement to reschedule Uganda's obligations to official creditors, owing to a long-simmering dispute between Uganda and Israel over obligations incurred before and during

[111]When the Managing Director issued the complaint at the end of April, Uganda's arrears to the Fund amounted to SDR 15 million, and another SDR 56 million was scheduled to be repaid by the end of the year. Although the SAF loan would provide SDR 20 million immediately, the next installment would not become available for another 12 months. By adding in a proposal for a CFF loan for SDR 25 million (to cover shortfalls in revenues from coffee exports), the Fund enabled Uganda to obtain enough short-term money from other creditors to settle its arrears. See "Uganda—Overdue Financial Obligations to the Fund—Report and Complaint Under Rule K-1," EBS/87/92 (April 29, 1987), p. 13.

Idi Amin's rule. Museveni was nonetheless encouraged by a personal promise from Camdessus that if the government could put together a strong enough program to stabilize and liberalize the economy, he would propose maximum ESAF access for Uganda. Edo thus found a much improved atmosphere: the authorities agreed to devalue the shilling by enough to regain international competitiveness, to give up trying to peg the exchange rate to the U.S. dollar and instead manage the rate flexibly against a basket of currencies, and to introduce fiscal reforms aimed at sharply reducing the government's deficit. And even before the mission left town, the authorities managed to pay off their arrears, this time for good.[112]

As the time approached for the Executive Board to consider Uganda's request for an ESAF loan commitment totaling just under SDR 180 million ($235 million; 180 percent of quota, the same level of access approved for Ghana the year before but more than for any other country), the question was whether the government had enough credibility to convince the world community that it could implement much stronger policies than it had in the past. Without stronger policies, everyone understood that Uganda would stay mired in an inflationary maelstrom, would fail to rebuild foreign exchange reserves to minimum requirements, and would soon slip back into arrears to the Fund. To help persuade wavering Directors, Finance Minister Kiyonga agreed to accept the initial disbursement of the loan in SDRs rather than foreign exchange and to maintain "significant balances in Uganda's SDR account in the Fund's SDR Department in order to facilitate timely payment of forthcoming Fund obligations."[113] Effectively, Uganda agreed to build up its reserves in the form of SDR holdings at the Fund as a guarantee that it would have the means to meet its obligations. While this commitment would reduce the cash that the government could tap directly to pay for imports, it was expected to help mobilize additional support from other creditors. With that capstone in place, the Board agreed to the ESAF loan request without dissent, on April 17, 1989.[114]

The ESAF loan marked the beginning of a period of economic transformation in Uganda. Within six months, despite the disastrous effects of the final collapse in international marketing agreements for coffee and a consequent sharp drop in export prices, policies were mostly on track. Flexible exchange rate policies strengthened and maintained international competitiveness, fiscal and monetary prudence brought inflation down gradually, external official grants and other assistance rose sharply, structural reforms brought a sustained rise in government revenues and stabilized the fiscal deficit, and market-oriented pricing and development policies stimulated growth and broadened both production and exports. Over the next seven years (1989–95), real output growth would average more

[112]Although Uganda still occasionally had some short-term delays in making payments, they did not again face the need for a formal complaint.

[113]"Uganda—Request for Arrangements Under the Enhanced Structural Adjustment Facility," EBS/89/62 (April 4, 1989), p.18.

[114]Minutes of EBM/89/42 (April 17, 1989).

than 6 percent a year, while inflation would fall from triple to single digits.[115] Credit for this remarkable turnaround goes of course to the authorities. The financial role of the SAF and ESAF loans was primarily catalytic rather than direct, as was the role of the IMF and World Bank staff in helping the authorities reform the direction of economic policy. Nonetheless, the reforms could not have been carried out without the rise in foreign assistance, that assistance could not have been mobilized without the prior support of the Fund for a medium-term and structurally oriented reform program, and Uganda could not have afforded to borrow the necessary amounts from the Fund without a highly concessional facility. The ESAF therefore was the linchpin for the reform process in Uganda.

Evaluating the ESAF

Despite its modest beginnings, the ESAF was destined to become a success story of assistance to desperately poor countries in an era when such success was elusive. Eventually, nearly 40 low-income countries not only would receive financial assistance from the Trust but also would have the opportunity to establish a track record of economic progress that would bring in bilateral assistance and in some cases private capital flows and direct investment. The question remains, however, whether the ESAF succeeded at the expense of other forms of official assistance, or whether ESAF money was truly additional to funds that would otherwise have been available. In a technical sense, ESAF contributions were no doubt partially additional. Most donor countries took pains to ensure that existing aid budgets were not cut to offset contributions to the new facility, although contributions to the World Bank's IDA probably suffered as a consequence. Whether the long-run effect of the ESAF was to displace or supplement IDA and other forms of official assistance is more difficult, if not impossible, to judge.

Overall, evidence for additionality is scant but not nonexistent. In nominal U.S. dollar terms, official development assistance (ODA) of industrial countries—of which ESAF contributions were a part—rose steadily after the establishment of the ESAF Trust: from $36.7 billion in 1986 to $59.2 billion in 1994. The roughly $4½ billion in grants and low-interest loans to the ESAF Trust by these countries was a significant portion of that increase. Relative to donor countries' GDP, however, ODA declined during those years from 0.35 percent to 0.30.[116] The IMF's structural adjustment facilities were created at a time of se-

[115]For an overview of Uganda's adjustment experience, see Sharer and McDonald (1996). On the contributing role of the SAF and ESAF loans, see Schadler and others (1993). On the broader African context of this experience, see Jones and Kiguel (1994).

[116]Data (except for ESAF contributions) are from the *Annual Report* (various years) of the OECD's Development Assistance Committee (DAC) and are aggregates for all DAC member countries. Also see OECD (1990), esp. Table III.2, which reports a small but steady increase in nominal-dollar net ODA flows to low-income countries starting in 1985.

vere political pressure against external assistance (especially, but by no means only, in the United States, where ODA was stagnant even in nominal terms over those eight years), and it may well be that without a multilateral and high-conditionality outlet, official aid would have registered an even steeper relative decline.

A stronger case for additionality emerges from the details, from examples of co-financing and other forms of "catalyzed" assistance. To jump-start that effort, a group of official donors representing 16 industrial countries plus the African Development Bank and the European Economic Community met in Paris in December 1987 at the request of the World Bank. That meeting produced pledges of an estimated $3 billion in additional grants and other concessional financing to "debt-distressed low-income African countries," to support the structural adjustment facilities of the Bank and the Fund. Over the next four or five years, Schadler and others (1993, pp. 29–31) estimated that 13 of 21 countries with ESAF-supported programs also received increases—in several cases, quite large increases—in official grants.[117] On average for all ESAF countries, grants rose from less than 23 percent of imports in the year before the country embarked on its adjustment path to nearly 28 percent during the life of the ESAF-supported program.

In view of the aggregate weakness in ODA, much ESAF-linked assistance may ultimately have been diverted from other applications or other countries. Even so, by focusing assistance on countries committed to economic reform, the creation of the ESAF almost certainly improved the effectiveness of ODA and may have helped stave off a truly ruinous backlash. It is natural to expect that political pressures against foreign aid would lead not only to a reduction in the overall amount of official assistance but also to a redirection toward countries with the best track records or the greatest potential for recovery and growth. Whatever the ESAF did to enhance that sort of redistribution would also have moderated the overall weakness in bilateral aid.

This view of the ESAF as a means of combating budgetary pressures against foreign assistance is supported further by its coincidence with the emergence of extrabudgetary debt-relief plans for low-income countries. Rather than budgeting new aid to those countries, much of which might be used to repay old debts, donors could achieve a similar outcome by forgiving all or part of the existing debts. Such schemes typically were linked to the Fund's approval of SAF or ESAF loans for the recipients.

Three major proposals for debt relief to low-income countries were made by senior officials in 1987 and 1988. Although none was accepted in its original form,

[117]An earlier internal study of the experience of SAF recipients drew a similar conclusion: 20 of 26 countries experienced an increase in bilateral aid during the first year of their SAF-supported programs. "Policy Orientation and Balance of Payments Assistance of Bilateral and Multilateral Aid Agencies—Status and Current Issues," SM/89/252 (November 30, 1989), pp. 6–7.

they led eventually to a considerable improvement in the opportunities available to qualifying countries.[118]

This effort began at the Development and Interim Committee meetings in April 1987, when the Chancellor of the Exchequer in the United Kingdom, Nigel Lawson, tabled a proposal. The Lawson plan built on an idea originally advanced by UNCTAD in 1978, calling on donor countries to convert all old aid loans to grants and to make all new aid as grants. Lawson proposed to give donors additional flexibility, in that the practice of rescheduling some existing debts would continue but on more generous terms. Neither of the ministerial committees, however, endorsed the proposal. The Development Committee limited its response to a general endorsement of increased concessional flows to low-income countries, while the Interim Committee urged creditor countries to provide debt relief bilaterally. For the moment, the enhancement of the SAF was a higher multilateral priority than debt relief.[119]

Paralleling these initiatives, discussions of debt relief were gaining steam at the Paris Club. Following the January 1987 decision to approve rescheduling requests for countries with SAF loans rather than stand-by arrangements (see above, p. 654), the Paris Club agreed in June to grant longer-term reschedulings on more liberal terms. As a group, however, official creditors were still unwilling to grant interest-rate concessions on rescheduled debts (Keller, 1988, p. 7).

Once the ESAF was up and running, the debt-relief effort intensified. In June 1988, French President François Mitterrand circulated a proposal to the other G-7 leaders, calling for a menu of three options: immediate cancellation of one-third of the debt of qualifying low-income countries, consolidation of all debts with a maturity of 25 years at market rates, or consolidation over 15 years at concessional

[118]For the poorest countries, including most but not all of the 34 SAF-eligible countries in Africa, the debt problem was largely one of obtaining and servicing official credits. However, several of the larger low-income countries, including Sudan and Zaïre, had obtained substantial bank credits in the 1970s that now had to be serviced at much higher interest rates. (The rise in interest payments between the late 1970s and the mid- to late 1980s was especially large in relation to export revenues. In nominal terms, rates on commercial credits, most of which were either floating or applied to short-term loans, rose sharply in the late 1970s in world markets and then remained high through most of the 1980s. When deflated by export prices that were severely depressed by the mid-1980s, that rise was greatly magnified.) Obtaining significant relief on those commercial debts was much more difficult. Even after a secondary market developed in which these credits traded at very deep discounts, the most relief that African countries could obtain from commercial banks (usually through the so-called London Club) was a rescheduling of principal, without the "new money" provisions granted to middle-income developing countries in other regions. In other words, the banks typically insisted on full payment of current interest.

[119]This conclusion was illustrated also by the Venice Summit of the G-7 countries. Although various European proposals for debt relief to low-income countries were discussed, the communiqué breathed life only into the ESAF (see above, p. 664). In December 1987, the European Economic Community followed up on the Venice discussions by enacting legislation to provide 60 million ECU ($78 million) in new aid, targeted at low-income countries that were so highly indebted that their ability to import essential goods was impaired. Notwithstanding that linkage, however, recipients were required to use the money directly for imports rather than for reducing debts.

rates. That proposal, along with the Lawson plan and a similar outline put forward by the Canadian government, was discussed at the G-7 summit meeting in Toronto. This time, with the impossibility of servicing external debt becoming increasingly apparent for an increasing number of countries, the G-7 reached a consensus on a plan very close to what Lawson and Mitterrand had proposed.[120] The precise menu of options for the "Toronto terms" was left for the Paris Club to work out, but the summit achieved the essential breakthrough: for the first time, a multilateral framework was in place for not just delaying payments but also reducing the present value of the official debt-service obligations of low-income countries. Once that principle was established and applied, then the extension and deepening of relief terms occurred naturally and almost inevitably in several stages in the 1990s (see Chapter 1, pp. 31–32).

Protecting the Poor[121]

> . . . the fact that adjustment need not conflict with growth and protection of basic human needs does not mean that the latter automatically result from the former. . . . The extent to which adjustment is compatible with growth and with an improvement in living standards depends in large part on what *form* that adjustment takes.
>
> Jacques de Larosière (1986)

> When I look at the many operations—one could say rescue operations—on behalf of countries in difficulties . . . I can say that the essential missing element—despite the admirable efforts of the United Nations and its specialized agencies—is a sufficient regard for the short-term human costs involved during adjustment or transition to a market economy.
>
> Michel Camdessus (1992)

Even more than a failure to raise overall living standards through economic growth, a failure to confront and alleviate widespread human misery will eventually bankrupt any country's economic policies. As long as the Fund was dealing primarily with countries' short-run financing problems, the inevitability of this conflict interfered but little with the institution's work. As the number, size, and length of arrangements for developing countries increased in the late 1970s and early 1980s, the Fund was led—gradually but inexorably—into a much greater concern with structural issues in general, and with social aspects of adjustment in particular. While other agencies aimed more directly to alleviate poverty in the long run, the role of the IMF in this context became to provide support for adjustment programs that not only would make economic growth sustainable but also would mitigate the adverse effects of adjustment measures on the poor in the short run.

[120]For the communiqué of the Toronto summit, see Hajnal (1989), pp. 362–76. The framework for the Toronto terms is set out in paragraph 30. Also see Lawson (1992), pp. 739–44, for the background to Toronto from the British perspective.

[121]This section is based in part on Bernstein and Boughton (1993).

Those seeking to evaluate the social implications of adjustment programs face three basic challenges. The first is to identify the severely disadvantaged, those who would be least able to absorb the transitional costs of adjustment. The World Bank and other development agencies have produced and analyzed data on relative income distributions, "basic needs" requirements, and numbers of people living in "absolute poverty";[122] for the most part, the Fund has drawn on that statistical and analytical work rather than producing its own data. The second challenge is to assess the effects of conventional macroeconomic adjustment programs on the disadvantaged. The staff devoted considerable effort to that problem in the 1980s, but it was at least as problematic as the more general task of assessing the macroeconomic implications.

The third challenge is to find alternative strategies that could ameliorate the short-term effects on the poor without sacrificing the longer-run macroeconomic benefits. The staff prepared several papers in the 1980s on the social and distributional effects of Fund programs. Two general policy studies, originally prepared for discussions by the Executive Board in 1985 and 1988, were later published, one on the effects of Fund-supported adjustment programs on income distribution (IMF, 1986), and the other more specifically assessing the empirical effects of adjustment programs on low-income groups (Heller and others, 1988). A third study outlined social components of several Fund programs (Gupta and Nashashibi, 1990). The Fund's official position on the institution's role in dealing with poverty was summarized in two Development Committee pamphlets (1989, 1990). Those various papers reveal an effort by the Fund both to explain how conventional macroeconomic adjustment can benefit all groups in society and to refine its conditionality and advice so as improve the distributional effects of adjustment. What follows is an analysis of how and why the Fund's approach to dealing with poverty evolved through the 1980s.

Internal and External Influences

Political Pressures

As the Fund's lending shifted increasingly toward lower-income developing countries, those drawing on Fund resources faced increasingly daunting conditions: large fiscal and external deficits and debt, high unemployment often combined with chronic inflation, low growth aggravated by structural problems, and weak demand for exports exacerbated by protectionism. Especially when adjustment programs included cuts in spending on basic programs such as education, health, and social services in order to meet the required fiscal targets, generating domestic political support often became a formidable task.[123] Moreover, even allowing for

[122]See IBRD (1990), which provides a comprehensive review of the issues and of the World Bank's work on poverty.

[123]For an analysis of the political constraints on implementing structural adjustments under the EFF, see Haggard (1985).

overall gains in efficiency and economic growth from effective adjustment, the political challenge was often aggravated by the need to reconcile the interests of various domestic groups that could be adversely affected by the program.

If an adjustment program is designed without regard to its effects on the poor, its insensitivity may become the subject of protests, and it will be unlikely to command the broad support (either within the country or among potential creditors and donors) that is essential for sustained success. On the other hand, targeting the poor for protection may impose substantial short-term costs on other groups that are better off economically but that have greater political power. Often, ignoring the needs of the influential urban middle class could undermine the program just as greatly as ignoring the needs of the poor. This point has been a recurring theme in internal discussions at the IMF over the years, and it is a political reality that missions face in negotiations with program countries. Nonetheless, the management of the IMF came down squarely and clearly on one side of this debate. The Fund's growing emphasis on targeting the poor emerged from an explicit recognition that importance must be attached to equity and to the development of human resources if programs are to be viable in the long run.[124]

On several occasions in the late 1970s and 1980s, the political pressures from conventional adjustment programs based principally on macroeconomic measures erupted in violent protests. Often the IMF felt the brunt of the attack.[125] Jahangir Amuzegar, a former Executive Director (Iran), wrote in 1986 that "national strikes, riots, political upheavals, and social unrest in Argentina, Bolivia, Brazil, the Dominican Republic, Ecuador, Egypt, Haiti, Liberia, Peru, Sudan, and elsewhere have been attributed directly or indirectly to the implementation of austerity measures advocated by the IMF." As Amuzegar also noted, however, such protests were infrequent relative to the number of conditional lending arrangements undertaken by the Fund. For example, during the 1980s the Fund entered into 61 arrangements with 21 countries in Latin America and the Caribbean. Large-scale demonstrations against austerity measures occurred in fewer than ten of those cases. Perhaps the most systematic study undertaken of this phenomenon, Sidell (1988), concluded that no statistically significant link could be found between Fund conditions and political instability. Nonetheless, violent and even deadly protests arose often enough that the problem cannot be dismissed.

[124]As Managing Director, Camdessus also stressed the interdependence of poverty reduction and preservation of the natural environment. In a visit to Norway in late January 1989, he met with Prime Minister Gro Harlem Brundtland, other government officials, and a joint parliamentary committee, where he addressed concerns being raised about the impact of Fund programs on the environment. Camdessus suggested that poverty can lead to serious environmental degradation, and he concluded that by attempting to alleviate the one the Fund indirectly benefits the other. See minutes of EBM/89/9 (February 1, 1989), p. 3.

[125]See de Vries (1985), pp. 490–94, for a discussion of political criticism of Fund conditionality in the 1970s. Political pressure to impose conditionality based on the distributional effects of programs and the protection of basic needs also came occasionally from creditor countries. For a review of such pressures emanating from the U.S. Congress, see Gerster (1982).

In almost every case, the proximate cause of riots or other protests against Fund-related adjustment programs was an announcement by the authorities of cuts in subsidies for consumer goods, most often for basic foods. Such cuts were frequently recommended by the Fund because consumer subsidies were judged to be inefficient, costly, and only weakly targeted at the low-income groups they were supposed to benefit. Even when the Fund suggested replacing subsidies with more efficient programs aimed at protecting the poor, the prospect of large price increases for basic goods provided a trigger for violent reactions by those who stood to lose.

Protests over adjustment programs may be classified into three types: political opposition to government policies, social disturbances bolstering government opposition to Fund advice, and anger directed at the Fund as a scapegoat for actions the government knows it must take. The first type has been the most common and also the most troublesome, as it weakens a willing government's ability to stabilize the economy. Often cited as an example are the 1977 "bread riots" in Egypt. During the 1980s, similar cases arose in Morocco, the Dominican Republic, and Zambia.

Egypt

In January 1977, the government of President Anwar Sadat was in the midst of negotiations with the IMF over the terms of a possible stand-by arrangement. The staff had been pressing for a combination of exchange rate devaluation (through a unification of the official and parallel markets) and spending cuts, but the government had resisted making major adjustments to exchange rate policy. Since much of the central government budget was politically off-limits to cuts—including public sector employment, parastatal enterprises, and the military—the only way to resolve the budgetary crisis was to reduce outlays for subsidies of basic goods. The government finally agreed to make cuts that would have resulted in retail price increases approaching 50 percent for selected commodities (including flour, fuels, and cigarettes) that were important for low-income consumers.[126]

During the two days after the government announced its intention to raise prices (January 18–19), demonstrators protested in major cities throughout Egypt. At least 79 people (the official total) died in the ensuing tragic violence. Hundreds more were injured, and thousands were arrested. Although the riots were directed primarily at the government, press reports gave prominence to the connection

[126]To mitigate the impact on consumers, the staff accepted a proposal for the government to establish a temporary "price adjustment fund" that would permit certain prices to be raised more gradually. Goods to be covered by the fund would be selected on "social or other considerations" but not to protect "particular companies." See memorandum of December 23, 1976, to the Managing Director from John W. Gunter (Acting Director of the Middle Eastern Department); cable of December 27, 1976, to the governor of the central bank of Egypt from the Managing Director; and memorandum to the Managing Director from Hans W. Gerhard (Assistant Director of ETR); all in IMF/CF (C/Egypt/810 "Mission, Gunter and Staff, December 1976"). The quotations are from the attachment to the December 23 memorandum.

with the Fund negotiations.[127] The budget was withdrawn, the Fund helped the authorities devise a plan under which the subsidies could be reduced more gradually, and a stand-by arrangement incorporating the new budget was approved a few months later.[128]

Morocco

Morocco faced widespread rioting in June 1981 while trying to implement a program supported by an EFF arrangement. External shocks and structural weaknesses had prevented the government from carrying out reforms for some three years. The authorities entered into an extended arrangement from the Fund in October 1980, which was replaced by a larger arrangement in March 1981 to reflect the increase in Morocco's quota through the Seventh General Review (see Nsouli and others, 1995).

The 1981 adjustment program was fully implemented until opposition erupted on June 20, in riots in which at least 60 people were killed. The trigger for the riots was the government's announcement of sharp increases in food prices, mandated by the Fund's demand for reductions in subsidies on consumer goods. Although the authorities publicly accepted full responsibility for the decision to raise prices, enmity was directed as much at the Fund—which had helped "light the powder," as one press account put it—as at the government.[129] The program then quickly went off track, partly because the government was forced to roll back the price increases and partly because external conditions continued to worsen.

Dominican Republic

The Fund approved an EFF arrangement for the Dominican Republic in January 1983, but the program went off track before the end of the year. Negotiation of a program for 1984 was complicated by what the Fund staff saw as the need for a unification of the exchange rate and a large increase in controlled and subsidized prices, especially petroleum but also basic foodstuffs. The authorities were willing to implement a strong adjustment program but feared (correctly, as it turned out) that they lacked the necessary political support at home. In January 1984, President Salvador Jorge Blanco sent a personal letter to de Larosière, pleading that the program requested by the mission was "excessive and . . . could not be absorbed in the short period of one year, without provoking social shocks which would threaten the stability which it has cost the Dominican Republic so much effort and sacrifice to obtain and preserve."[130]

The staff was less sympathetic to this appeal than was the Managing Director, and negotiations remained deadlocked for another three months. President Jorge

[127]See, for example, *The Economist* of January 22, 1977, p. 59, and January 29, pp. 59–60; and Lippman (1989), pp. 114–21.

[128]See EBS/77/90 (April 1, 1977) and minutes of EBM/77/59 (April 20, 1977).

[129] ". . . ces financiers internationaux qui ont mit le feu aux poudres" (Andriamirado, 1981).

[130]Undated letter (in Spanish), delivered by hand to the Managing Director on January 13, 1984, and translated by Fund staff; in IMF/RD Managing Director file "Dominican Republic, 1984" (Accession 85/231, Box 4, Section 177).

Blanco then flew to Washington in early April to try to pry loose some assistance from the U.S. government and to make a personal appeal to de Larosière to ease up on the Fund's conditionality.[131] When his mission generated goodwill but no tangible results, he announced new policies that went partway toward meeting the Fund's requirements, but he warned publicly that high social costs could follow. Austerity was unavoidable, but without external aid the required sacrifices would be severe.

After extremist opposition groups organized protests, both the demonstrations and the response by the police and army got out of hand. An estimated 60 to 80 people were killed in riots that began the same day that the Fund mission returned to Santo Domingo to try to conclude negotiations.[132] The president then concluded that he had no choice but to back off from his commitment to raise oil prices. Negotiations between the Fund and the authorities continued for several months, after which the extended arrangement was canceled.[133]

Zambia

Zambia faced serious opposition disturbances in December 1986. The economy had been deteriorating throughout the year, a two-year stand-by arrangement approved by the Fund in February had quickly been derailed, and the government had gone into arrears to external creditors, including the Fund. The essence of the problem was that when export prices for copper declined sharply, the government weakened its adjustment effort to try to prop up incomes rather than intensifying it to compensate for lost revenues. Urged on by President Kenneth D. Kaunda, the authorities successfully negotiated a program for 1987 that the Fund was prepared to support as soon as arrears were cleared. A Consultative Group meeting was scheduled for mid-December to devise a means of financing the clearing of arrears. But when the government announced a doubling of prices for maize meal in early December, riots quickly spread throughout the country, in which at least 100 people died. The president rescinded the price increase, the Consultative Group meeting failed to generate much financial assistance, and the authorities went back to the bargaining table to look for alternative fiscal measures.[134] That effort failed, and Zambia remained in arrears to the Fund and other creditors for another nine years. (Also see Chapter 16, on Zambia's arrears problem, pp. 787–91.)

[131]See memorandum from Finch to the Managing Director (April 9, 1984); in IMF/RD Managing Director file "Dominican Republic, 1984" (Accession 85/231, Box 4, Section 177).

[132]On the linkages between the riots and the negotiations with the Fund, see articles in the *New York Times*, April 29, 1984, p. A14, and April 30, p. A9. On the effect of the riots on the negotiations, see memorandum from Sterie T. Beza (Associate Director of the Western Hemisphere Department) to management (May 11, 1984), in IMF/RD Western Hemisphere Department file "Dominican Republic, 1984" (Accession 87/16, Box 2, Section 61).

[133]In April 1985, the Fund approved a 12-month stand-by arrangement for SDR 78.5 million ($78 million or 70 percent of quota). The stand-by arrangement, which provided less than half the annual access of the canceled extended arrangement, was fully drawn.

[134]See memorandum from Ouattara and Kanesa-Thasan to the Managing Director (January 20, 1987), and memorandum for files by Keyes (April 28, 1987); in IMF/RD Managing Director file "Zambia, November 1985–August 1987, Vol. I" (Accession 89/164, Box 1, Section 263).

Sudan

The second type of social disturbance serves to bolster the position of authorities who are resisting Fund advice to stabilize the economy. One example occurred in Sudan in the early 1980s.

After Sudan first developed arrears to the Fund in September 1981 while trying to reactivate a stalled EFF arrangement, negotiations began on a program for 1982 that could be supported by a new stand-by arrangement. Initially, the government agreed to implement strong measures, and took prior actions that included a devaluation and a rise in petroleum prices. Creditors, however, retained doubts about the authorities' commitment to adjustment, especially after President Gaafar al-Nimeiri installed a new finance minister who appeared less than enthusiastic about reform. Discussions with the new minister led nowhere. The Fund, reacting both to Sudan's poor track record and to the need to convince creditors of the authorities' intentions, insisted that much of the adjustment be put in place up front.

Violent protests broke out in Khartoum at the beginning of 1982 when the government announced a partial implementation of the program (notably, a rise in the price of sugar). The government put down the disturbance but used it as a lever to convince individuals in the U.S. Congress and State Department to pressure the Fund to relax its demands. In February, the Executive Board approved the stand-by arrangement, under which Sudan made one drawing after it (temporarily) settled its arrears.

A third type of protest, in which the Fund itself is the principal target rather than the government, arises when the authorities agree to implement an adjustment program but publicly blame the Fund for imposing specific policy changes. Until the late 1980s, the Fund generally accepted that tactic as a necessary strategem to enable governments to implement unpopular policies. When management did protest, it usually did so only in private communications to the authorities. In May 1987, following the deadly outbreak of antigovernment rioting in Zambia described above, the Managing Director took a tentative step toward abandoning that passive attitude. President Kaunda had reacted to the riots by accusing the Fund of being a "killer" and of contributing to unemployment, malnutrition, and starvation in his country. After Kaunda's public statements continued in that vein for a few weeks, Camdessus wrote to him to deny the accusation, but he confined his remarks to the charge that the Fund was deliberately trying to harm Zambia's people or its economy. The Fund circulated copies of the letter to the wire services that had reported Kaunda's attack, but it took no further action.[135] Less than two years later, however, Camdessus was ready to respond more forcefully and publicly when the Fund was blamed for actions that led to rioting in Venezuela.

[135]See memorandums from Azizali Mohammed (Director of the External Relations Department) to the Managing Director (April 17 and May 4, 1987); memorandum from Charles Gardner (Deputy Director of the department) to the Managing Director (May 5); and cable from Camdessus to Kaunda (May 5); in IMF/RD Managing Director file, "Zambia, November 1985–August 1987, Vol. I" (Accession 89/164, Box 1, Section 263).

Venezuela

As recounted in Chapter 11, the riots in Venezuela in February 1989 were a clear example of the use of the Fund as a scapegoat. The newly elected president, Carlos Andres Pérez, had attacked the Fund in speeches throughout the campaign, but he nonetheless turned to the Fund for financial assistance as soon as he was in office. When he sent an open letter to the Managing Director linking the deadly riots to the "unjust terms" imposed by a global system in which the Fund stood at the "apex," Camdessus responded immediately with a personal and equally public rebuttal that signaled a new level of resistance by the Fund to being used as a scapegoat. "It is a prerogative of sovereign states to decide themselves what measures are required for recovery, however unpleasant those measures may be," he wrote. "And it does them honor if they take responsibility for policies in the eyes of their people, even in the most adverse circumstances" (*IMF Survey*, March 20, 1989, p. 82).

More generally, the Fund's position was always that the formulation of specific adjustment policies was an internal matter for the member country and could not be imposed by the Fund. There was a clear delineation of responsibilities, in which the role of the Fund was to provide technical advice and assistance to the authorities in developing an effective adjustment program that would avoid imposing undue costs on the most vulnerable groups, and to both provide and catalyze financing in support of such a program. Nonetheless, the Fund also had an interest in ensuring that the needs of the poor were adequately safeguarded in any adjustment program. The challenge was to reach that goal in situations where the authorities were either unwilling or politically unable to take adjustment measures in ways that would protect or offset the subsidies on which the poor rely in many developing countries.

External Criticism of the Focus on Macroeconomics

Literature on the social costs of adjustment burgeoned in the early 1980s, reflecting the growing importance of the subject as more countries faced the need to implement painful policy changes. Tony Killick's work at the Overseas Development Institute (1984) typifies academic critiques. He recognized both the Fund's insistence on prudent economic policy mandated by its Articles of Agreement and the domestic political constraints faced by governments assisted by the IMF. Though he noted that the specific impacts of an adjustment program could not be predicted or even determined afterward, he held that the Fund should realize that its recommendations might considerably increase inequalities. To enhance the institution's effectiveness, therefore, Killick urged Fund staff to consider the sociopolitical context of economic disequilibria and to explore the distributional effects of its programs. Similar criticisms were made in Helleiner (1987) and Helleiner and others (1991).

The World Bank launched a more fundamental critique of conventional adjustment paradigms in its *World Development Report* of 1984. The report noted that the emphasis given to increased taxation and higher interest rates in many pro-

grams could lead to a squeeze on the private sector and restrict long-term investment and growth. At the same time, reducing or eliminating subsidies for food, education, and health would decrease real income—worsening the plight of the poorest—while damaging the country's growth potential. The Bank's analysis questioned the foundations of the Fund's long-held view that orderly adjustment necessarily benefited the poor in the long run, a view that Jacques Polak (1991) characterized as a "trickle-down" approach that was no longer adequate.[136] A study sponsored by UNICEF (Cornia, Jolly, and Stewart, 1987), similarly encouraged a reorientation to more "people sensitive" adjustment programs.

Jeffrey Sachs (1989, pp. 116–18) also analyzed the distributional impacts of Fund programs. He noted that many of the same critics who attack the effect of adjustment programs on income distribution would object as well to the Fund's meddling in countries' internal affairs. Yet he wrote that there are compelling reasons for the IMF to pay more attention to the linkages between distribution and adjustment. The long-run viability of an adjustment program "may well depend on an adequate distribution of income," because extreme income inequalities generate political pressures that make fiscal mismanagement much more likely. Many governments, Sachs argued, may want to pursue adjustment programs that minimize the long-run costs of adjustment, and Fund staff should be able to design such programs.

Internal Debate at the Fund

The Fund's traditional approach to conditionality included a focus on the importance of orderly and timely adjustment. This approach was derived implicitly on the assumptions that a comprehensive adjustment program would protect the interests of the most vulnerable in the short run, by preventing the inevitable chaotic adjustment process arising from suppressed macroeconomic imbalances; and in the long run would aid the poor, by fostering sustainable growth. The distribution of income, in this approach, is left primarily to the country concerned, to be determined in the light of the country's political and social structure. In countries where the authorities recognized and were sensitive to the needs of the poor and had the political ability to act positively, this approach allowed Fund-supported adjustment programs to include income-supporting measures such as increases in producer prices and improvements in access to credit by the agricultural sector. When conditions were less favorable, the interests of the poor often got short shrift.

Although orderly adjustment is a prerequisite for sustainable growth, experience with financial programming made it increasingly clear that the traditional approach was insufficient in cases where a country's long-term interests were subsumed under shorter-term social hardship and political realities. The Fund's management therefore initiated and encouraged several internal studies, beginning in the late 1970s, to focus attention more specifically on the protection of the inter-

[136]Broad (1988) offered a detailed criticism of what she viewed as the IMF's trickle-down approach in the Philippines in the mid-1970s.

ests of the poor. These studies comprised both evaluations of specific programs for individual low-income countries—which amply demonstrated the difficulties posed for program viability when the poor are unduly affected—and general studies of the links between program design and income distribution.

The first of the general studies was that of Omotunde Johnson and Joanne Salop, undertaken at the request of Managing Director H. Johannes Witteveen in 1977. Witteveen initially was concerned that proposals for lending strategies favoring projects that aimed to provide "basic needs" to the poorer segments of the population raised the risk of softening the loan portfolio, which would defeat the purpose of the adjustment program. Yet he also recognized the dangers of ignoring distributional issues, and he called on the Fund staff to study the problem more carefully.[137] Consequently, Johnson and Salop (1980) analyzed the effects of policies most commonly adopted in Fund-supported programs using a simple model of traded and nontraded goods. They concluded that stabilization programs "necessarily had distributional repercussions," but that the specific effects could be positive or negative and would depend on the structure of the economy.[138] In an economy where the export sector was large and marked by small-scale operators, as in Ghana, a devaluation might have egalitarian effects. In others, implications were not as favorable. In Bolivia, for example, much of the primary export (mineral products) was produced in public enterprises, whereas lower-income segments of the population produced mostly nontraded agricultural products and simple manufactures. The shift in internal terms of trade required by adjustment therefore would tend to disadvantage poorer groups in Bolivia. The study gained wide publicity and, though it contained no policy recommendations for the Fund, grew to be considered by academics as the Fund's response to the question.

A more theoretical internal study, Borpujari (1980), drew favorable attention from de Larosière.[139] Borpujari's work (see also his published 1985 paper) developed a framework for incorporating financial constraints into a model in which development depends essentially on an economy's ability to provide for the population's basic production and consumption needs. In this framework, conventional macroeconomic financial programming is appropriate only for economies where

[137]See memorandum from Ernest Sturc (Director of ETR) to the Managing Director (June 9, 1977); in IMF/CF (B/100 "Liaison and Exchange of Information"). On June 20, Witteveen responded, "It seems important for us to follow these [World Bank] studies closely. The IBRD seems to be on a risky and debatable course that could easily lead to some conflict with Fund policies. I wonder whether we should not do some research of our own in this field"; Historian's files, in IMF/RD.

[138]Blejer and Guerrero (1990) drew similar conclusions on the basis of an empirical study of the Philippines. More generally, Edwards (1989) studied 36 devaluation "episodes" in 23 developing countries and found no link to a worsening of income distributions; the evidence was "remarkably inconclusive" (p. 48).

[139]Memorandum from C. Max Watson (Personal Assistant to the Managing Director) to Borpujari (March 17, 1980); in IMF/RD Managing Director 1980 Chronological file (Accession 87/27, Box 20, Section 536).

development is not constrained by inflexibility in the supply of basic goods. In economies that are so constrained, an increased inflow of foreign exchange will strengthen development potential only if it is used to import investment goods or ease shortages of basic consumption goods. Although this model had little direct influence because it was seen as outside the mainstream of financial programming at the Fund, it did point the way toward modifying the traditional focus on macroeconomic adjustment.

Some years later, the Fund's Fiscal Affairs Department undertook a more comprehensive study of the distributional effects of adjustment programs (IMF, 1986; also see Sisson, 1986). The authors surveyed fiscal economists for 78 IMF program missions to create a stylized, typical Fund-supported program. They compared this program with a synthetic counterfactual experience depicting what would have happened without a stabilization program, focusing on short-term effects. The paper concluded that there was no basis for believing that Fund-supported adjustment programs were more damaging to income distribution than were the practicable alternatives. But it did identify several policies that could have relatively beneficial distributional effects in the context of a comprehensive program. These included elimination of restrictive exchange practices, expansion of access to credit markets, broadening of the tax base, restructuring of indirect taxes, limiting expenditures on defense and "grandiose public works," and—in some circumstances—correction of an overvalued exchange rate.[140]

Developing and Implementing a Policy Framework

Operational Studies

The Executive Board discussed the effects of adjustment programs on income distribution in July 1985, using the Fiscal Affairs study described above as background. Two basic messages crystallized from this meeting.[141] First, Directors were reluctant to draw firm conclusions about the effects of traditional programs without specifying viable alternatives. As had already been apparent after the Johnson-Salop study, there was insufficient evidence to conclude that a typical program would have positive or negative effects on income distribution. To firm up the conclusions would require asking whether another adjustment program would have been as effective at promoting sustainable growth but with more favorable distributional effects. The second message was that, whatever conclusions might emerge from this and further research, the Board still felt that policies toward the distribution of income were essentially a domestic matter and should not be subjected to Fund conditionality. The Fund's role should be to assist member countries—only on request—to determine the likely effects of their adjustment policies, including distributional effects. To further that objective, more detailed staff research

[140]For a related study, see Kanbur (1987).
[141]Minutes of Executive Board Seminar 85/1–2 (July 19, 1985) and 85/3 (July 22).

would be warranted, as would a strengthening of cooperation in this field with development institutions such as the World Bank.

As a follow-up to the Executive Board meeting, the staff prepared case studies on seven countries: Chile, the Dominican Republic, Ghana, Kenya, the Philippines, Sri Lanka, and Thailand. The results were analyzed in Heller and others (1988).[142] The methodology underlying the case studies was eclectic; in some cases, the authors used a "before-after" approach while in others they drew comparisons with a reasonable alternative. The studies focused on the effects on poverty, reflecting a concern for those groups least capable of bearing the burden of adjustment. The review concluded that the effects of adjustment on poverty depended on the choice of policy instruments—the policy mix—and on the structure of domestic poverty. The cases suggested that supply-side policies and compensatory assistance could effectively mitigate the effects of demand restraint.

In 1988, the implications of these case studies were considered in several ways. First, the Executive Board reviewed the analysis and approved the development of additional expertise within the Fund both through continuing research and by calling on the experience of other UN agencies such as UNICEF, the International Labor Organization (ILO), the UN Development Program (UNDP), and the World Bank. Second, the subject was considered as part of the Board's major review of conditionality. That review reaffirmed the 1985 decision not to impose conditions on the use of Fund resources related to the distribution of income, but rather to assist members in evaluating distributional effects of policy changes. Third, the Development Committee urged both the Fund and the World Bank to intensify their efforts, working closely together, to help design adjustment programs and adopt, as needed, well-targeted compensatory measures.[143]

Following the operational discussions in the Executive Board and the recommendations of the Development Committee, interdepartmental groups met on several occasions to discuss work on poverty. Analysis of poverty issues as part of negotiations for Fund loans was gradually expanded, and in 1991 Camdessus directed the staff to expand the consideration of social costs to all Fund-supported programs.[144] Subsequently, he undertook to publicize the Fund's efforts, most notably in his annual addresses to the Economic and Social Council of the United

[142]The full case studies were circulated as "The Implications of Fund-Supported Adjustment Programs for Poverty Groups: Country Case Studies," DM/87/5 (December 23, 1987); summaries were published in the Appendix to Heller and others (1988).

[143]On the first two points, see minutes of Executive Board Seminar 88/2 (February 8, 1988), p. 55, and minutes of EBM/88/60 (April 8, 1988), pp. 3–7. For a summary of staff recommendations to the Development Committee, along with related papers by the World Bank staff and the Committee's conclusions, see Development Committee (1989, 1990).

[144]The Managing Director's directive on extending poverty analysis to all Fund-supported programs was made in a memorandum to department heads on March 8, 1991; Historian's files, in IMF/RD. Also see the "Chairman's Summing Up on Poverty Issues at Committee of the Whole for the Development Committee Meeting 88/4 (9/2/88)," (September 12, 1988); and a memorandum for files (March 13, 1989) by Vito Tanzi (Director of the Fiscal Affairs Department) on a meeting on poverty with the Managing Director on March 7, 1989. The latter two items are in IMF/RD Fiscal Affairs Department file "Poverty, Folder 2" (Accession 94/249, Box 1, Section 540).

Nations. Within the Fund, the Fiscal Affairs Department was designated to coordinate the institution's initiatives on poverty.

Besides the studies prepared for the Executive Board, the Fund held seminars on poverty for staff working on countries with adjustment programs, starting in 1988. Contributors, including Fund staff, experts from universities, and staff of other agencies, particularly UNICEF and the World Bank, examined conceptual and practical questions regarding poverty.[145] In one such meeting in 1990, presentations on social aspects of particular recent Fund-supported programs examined the incidence of domestic poverty and outlined known poverty effects. They related varied country experience with compensatory measures and presented models for the future study of poverty at the Fund. Several of the studies were subsequently circulated as IMF working papers.[146]

Coordination with Other Agencies

Various agencies of the United Nations conduct programs aimed at the alleviation of world poverty. Although the Fund's contacts with those agencies have been sporadic, a few efforts were made in the 1980s to coordinate the Fund's fledgling work on poverty with ongoing UN projects. In 1984, de Larosière asked the Executive Director of the ILO, Francis Blanchard, to help set up informal meetings between ILO and IMF staff to discuss means of ensuring that adjustment programs do not entail unnecessary social costs and do not sap economic development. Shortly afterward, the Managing Director also invited the Executive Director of UNICEF, James Grant, to meet with him and with Fund staff to try to strengthen the social content of adjustment programs. The resulting contacts led eventually to an initiative under which UNICEF would encourage governments of selected countries to redesign adjustment programs to include more measures targeted at the poor, and the IMF would assist governments in that effort.[147]

More generally, the IMF's empirical work on poverty drew on UN agencies' data bases, and many interagency staff meetings were held. During a seminar held at the Fund in October 1990, for example, representatives of the World Bank and 12 UN agencies met with Fund officials to discuss ways to enhance cooperation on social and sectoral aspects of adjustment. Seminar participants recognized the need for cooperation among agencies from the very beginning of the adjustment process and agreed to increase open communication and dialogue, and to share data and assessments. By the early 1990s, the exchange of information and analysis between the Fund staff and various UN agencies was becoming regularized.

[145]See memorandum (December 8, 1988) to the Managing Director from Tanzi on the initial poverty seminar, held November 29 through December 2, 1988; Historian's files, in IMF/RD.

[146]Ahmad (1991) on Jordan; Gotur (1991) on Bangladesh; Gulde (1991) on Sri Lanka; Hicks and Brekk (1991) on Malawi; Liuksila (1991) on Colombia; and Lopes and Sacerdoti (1991) on Mozambique.

[147]The initiative is summarized in a letter from Grant to de Larosière (June 14, 1984); in IMF/CF (I 128.5 "United Nations International Children's Emergency Fund"). See Jolly (1991) for more background. The position paper prepared by UNICEF for the initial meetings with the IMF in 1984 was published much later as Helleiner and others (1991).

Anti-IMF grafitti on the Brandenburg Gate, Berlin, 1988 Annual Meetings

Coordination with the World Bank on poverty alleviation also developed during the 1980s. Although much of the work of the two Bretton Woods institutions proceeded independently, Fund staff occasionally participated in World Bank missions on poverty in countries where the Fund was also actively engaged.[148] Much more systematic collaboration developed in the second half of the decade through the SAF and the ESAF, as described earlier in this chapter. The primary vehicle for collaboration under those facilities was the PFP, designed as a framework for medium-term programs of policy reform agreed among the country, the Bank, and the Fund. Most PFPs included a section on the social implications of the adjustment program, and some also included a discussion of mitigating measures and requirements for social safety nets. Such measures could be divided into four categories: targeted subsidies of essential goods; cash transfers to vulnerable groups; direct support for wages, producer prices, and targeted public works; and protection of education and health expenditures. During the first few years of experience, relatively few ESAF-supported programs contained specific social measures, but the practice became more common in the early 1990s (Schadler and others, 1993).[149]

[148]A published study by Blejer and Guerrero (1990) arose from a World Bank mission on poverty in the Philippines. Guerrero was the Bank's mission chief, and Blejer participated on behalf of the Fund.

[149]For a review of the early ESAF experience with social measures, see "Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF)—Background Information," EBS/91/110 (July 8, 1991), pp. 29–32.

Perhaps the most well-publicized example of the use of the structural adjustment facilities to promote programs that protect the interests of the disadvantaged was the case of Ghana. As discussed above (pp. 673–79), the Ghanaian adjustment programs—supported by the Fund for four years starting in 1987—were initially implemented under the EFF and the SAF (1987–88), and later under the ESAF (1988–91). Throughout this period, the government sought to improve its social policy, especially beginning in 1988 with the implementation of PAMSCAD, with external support from the ESAF and from bilateral donors.

Overall, the dominant constraint on the Fund's work on poverty alleviation was not its mandate as a monetary institution, but its dependency on cooperation from the countries concerned. As Killick and Malik (1991, p. 613) noted, "The priorities of the government in power, rather than those of the IMF, are probably the principal determinant of the ways in which programmes impinge upon the poor." Because the poor are not the only group—and almost certainly are not the most politically powerful group—that could be affected adversely by the need for adjustment, governmental support for measures targeted at the poor was not always easy to secure.[150]

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[150]For an elaboration of the political dimensions of this problem, see Nelson (1989) and Graham (1992).

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