Does the Fund Impose Austerity?

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The International Monetary Fund is often charged with imposing austerity. This is a misconception for a number of reasons.

First, *economic adjustment is inescapable*. No country can live permanently beyond its means. Many countries have aggravated their situations by postponing the economic correction made necessary by the oil shock and the world recession. Many of these countries thought they would be able to put off adjustment measures by resorting to external borrowing. We know now that the debt crisis has worsened their already difficult situations and that they must face up to the consequences.

When a government can no longer resort to the expedient of borrowing abroad in order to postpone adjustment—which is true for many countries today—what happens if it refuses to take corrective economic action? In such a case adjustment occurs anyway but without outside assistance and in a disorderly manner. Such a process is often characterized by extremely severe import restrictions and by high inflation. Experience has shown that the combination of import restrictions and inflation induced by a lack of fiscal and monetary discipline leads to a continual deterioration of employment and production in these countries. Therefore, in a situation in which external constraints are severe, the failure to adjust (in the sense of failing to use the instruments of economic policy in order to achieve a more efficient allocation of resources) is no way to create employment and promote long-term growth.

Second, *adjustment as perceived by the International Monetary Fund is not synonymous with lower growth or economic retrogression*. Much public comment persists in identifying the Fund as an institution that advocates economic retrogression. This description is at odds with the facts. The recent decline in economic growth in Latin America began *before* the Fund intervened in any of the affected countries. While the Fund's intervention in these countries began in 1983, the first setbacks to economic growth date from 1981 and 1982. It is not, therefore, the prescriptions of the Fund that have stymied expansion in Latin America, but the impact of the world recession, aggravated by the prolonged maladjustment of economic policies and by excessive external indebtedness. The objective of Fund programs in these countries is to achieve a better balance of payments equilibrium in the medium term and a more efficient use of scarce resources by introducing a number of incentives and measures to generate more domestic savings, more investment, and more exports. These are programs aimed not at recession but rather at a more rational combination of economic policies in order to achieve a better balance of payments equilibrium and thus open the way for more vigorous and lasting growth.

Third, *while these programs do entail sacrifices, the austerity born of adjustment must be compared to the alternatives*. If these measures are not taken to establish a better external equilibrium and to establish greater discipline over national budgets and credit, what can be expected in terms of growth and employment? Our experience in the Fund and the comparative analyses we have conducted show that countries that are now in economic difficulties would be much better off if the policies we advocate had been introduced. The austerity associated with the programs financed by the Fund must, therefore, be compared with what would ensue from "nonadjustment," that by definition would not be supported by the Fund's resources and by the financing for which it serves as a catalyst—financing that quite obviously eases the burden of adjustment. The Fund's lending in 1983 exceeded SDR 12 billion; it also helped secure over SDR 20 billion in new bank lending to non-oil developing countries. If long-term loans from government and development organizations are included, the total exceeds $40 billion. Had these adjustments not taken place, and if this financing had not been forthcoming, what would have been the fate of the countries concerned in terms of employment and growth? The consequences for economic activity and employment and the sacrifices involved would have been far harsher than what actually happened in 1983.

Fourth, with regard to the *social costs of adjustment programs*, by definition any action to restore balance of payments equilibrium entails costs, since it tends to reduce the absorption of external resources. The matter has to be looked at as follows. First, we have to establish the total of the external resources a country can reasonably expect to obtain in a given year. This comprises earnings from exports of goods and services, aid from bilateral and multilateral sources, assistance from the Fund, and financing from banks in the form of debt reschedulings and new money. We have next to see that the necessary steps are taken to assure that these external resources are allocated as effectively as possible and with the lowest possible level of inflation connected with restoring a viable balance of payments position. These actions entail social costs, but the way these costs are divided within the society is not a matter for the Fund to decide but a question of political choices to be made by the governments themselves.

It is often said that Fund programs attack the most disadvantaged segments of the population, but people forget that how the required effort is distributed among the various social groups and among the various public expenditure categories (arms spending or social outlays, productive investment or current operations, direct or indirect taxes) is a question decided by the governments. Generally, people refrain from drawing attention to the choices made in this respect, and instead allow the Fund to come under attack and describe its activities as inimical to the least-favored segments of the population.

A question that may be raised in this connection is whether the Fund should exert pressure in the determination of government priorities and even make the granting of its assistance contingent on measures that would better protect the most disadvantaged population groups. An international institution such as the Fund cannot take upon itself the role of dictating social and political objectives to sovereign governments. The Fund's role is to say: "In view of the external financial resources available to you, the objective of restoring a viable balance of payments position within a reasonable period implies that you must limit your domestic consumption, increase your domestic savings, and expand your exports. If you are resolved to take measures that will make it possible to achieve these objectives, we will help you; it is up to you, within the framework of macroeconomic parameters negotiated by mutual agreement, to arrange your own social and political priorities."

Fifth, as to the *impact of exchange rate adjustments on the least-favored segments of the population*, the effects vary depending on the case. There is no standard model. There are countries where depreciating the domestic currency, as is often advocated by the Fund in its programs, works to the advantage of the least-favored social groups. This applies particularly to countries with a sizable agricultural economy that is export oriented. The excessively high exchange rate that sometimes characterizes these economies prevents the small farmers producing agricultural raw materials from benefiting from the attractive domestic currency prices that would result from a competitive exchange rate. This overvaluation may, on the other hand, protect more-favored population groups who live in the cities and would, of course, be affected by price increases from imported consumer goods. One must, therefore, be rather cautious with social analysis of the effects of devaluation on the poorest segments of the population, which is often oversimplified. More generally, Fund programs always stress the need for offering incentive prices—that is, remunerative prices—to producers, particularly in the agricultural sector. Such measures benefit the vast majority of the rural population (which has all too often been the victim of "disincentive" prices, in Africa in particular) and, over time, restore a better equilibrium between urban and rural areas.

Finally, Fund programs must be supported and extended by *longer-term structural efforts* to promote durable growth in these economies. This touches upon the question of the basic interconnections between the Fund—which is an organization that works with "revolving" financing in the short- to medium-term—and the organizations devoted to development. These interconnections must be improved. Fund programs should be supported in specific ways and with sufficient resources by the development agencies, so that the countries subjected to these essential adjustments and discipline may at the same time be certain that they are working for growth and for the future. To achieve this, coordination must be extensive. The Fund works closely with the World Bank. Our relations are excellent, and there are now many Fund and Bank missions in the field with a staff member from the other institution. Likewise, neither institution prepares a mission without close cooperation with the other. More can and must be done. The Fund's adjustment programs must be supported by increased external financing to assist structural efforts, especially those undertaken by the World Bank. We must move in this direction to avoid seeing part of what is called the "developing" world sink into endemic underemployment.