

Also, by arriving only at the point of crisis, the IMF role became excessively magnified, creating resentment in some circles due to a feeling that the institution threatened national sovereignty.

- (4) While Manley gained the necessary social contract to implement the adjustment program, the drastic effects of the measures, e.g. the severe decline of real wages, created an underlying public resentment which the political opposition exploited.
- (5) A lack of growth orientation in the initial program; when growth did not materialize even after the introduction of drastic measures, the credibility of the IMF and of the government were eroded.
- (6) The bad image of the IMF made it difficult for progressive politicians to openly work with the organization. As long as the IMF has a reputation of being harmful to the interests of labor and lower income groups, government officials will feel awkward dealing with the institution and the IMF will be condemned to "secret meetings in the night", so to speak. In other words, the IMF's "wicked" image hinders collaboration with all but wicked governments.

The meeting went on to remark that the Jamaican failure and resulting bad publicity for the IMF was unfortunate because the alternatives to the IMF are worse, that is, bilateral government assistance and the commercial banks, the latter of which are reluctant to channel resources to those that need it. Thus it was concluded that the Jamaican case demonstrates that the IMF can deal with progressive governments; in the past it may have been wicker with

respect to treatment of some countries, but this was not the case in Jamaica. For the IMF to have more success, the following requirements were cited:

- A good national economic team;
- Better timing, i.e. the IMF should not sit back while the patient is sick, only to arrive when he is at or near death;
- The IMF needs to extend much more resources to avoid unnecessary financial gaps in its programs;
- The IMF should focus more on growth instead of deflation because only with the prospects of growth can an IMF program be sold politically; and
- The IMF must clean up its image so that government officials can openly welcome the institution and cooperate closely with its personnel.

Comments by a staff member of the I.M.F.

The staff member commented that the early IMF initiatives in Jamaica were traditional demand-oriented standby programs. The 1978 program had more of a supply orientation but still relied on macro demand-oriented policy instruments. But by mid-1979, Albertelli realized that the strategy was not working inasmuch as Jamaica continued to experience negative rates of economic growth. Furthermore, there was no more room for compression in the economy. Thus the team decided to switch to a less orthodox micro approach, focussing on utilization of existing capacity and the promotion of certain investments. In order to apply this strategy, the IMF team had

consult unions and business leaders in specific economic sectors and concern itself with such specific issues as the construction of crates for bananas. It was said that the IMF learned much from this exercise, but its efforts were handicapped by political problems and the weak administrative ability of the government. When Manley decided to call elections for 1980, the micro approach had to be abandoned as government priorities shifted from the capital account to current account, reflecting electoral considerations.

Personal Comments

This was by far the most stimulating meeting I have attended so far in Washington. It demonstrates that the Jamaican case is not as black and white as it has appeared in the media. Two things became evident that have not been well expressed in the press and other fora: (i) Jamaica made a valiant effort to adjust its economy, undergoing what was termed by all as "ruthless" compression of its economy and (ii) the IMF reached out to new and unknown frontiers in order to grapple with a sensitive country case. But the failure nevertheless illustrates the difficult road ahead for the IMF in dealing with Third World country problems.

A rigorous treatment of the Jamaican IMF case would require much more investigation and analysis than this brief paper could accommodate. However, I would like to sketch out some tentative ideas on the subject, only because the general issue of stabilization via the IMF will be very relevant to Latin America in the 1980's. The general subject, as

well as the Jamaican case, also may be a good area of new research for CEPAL.

I would like to begin the commentary with a small digression by stating that a major cause of the country's economic difficulties clearly was poor economic management. The government dissipated its bauxite revenue on consumption, while the authorities expanded their role in the economy without having the administrative capacity to effectively oversee the new responsibilities. The budget became a quagmire of inefficiency and inflation.^{1/} Also, the government's warm relations with Cuba apparently had important internal and external political costs.^{2/} This said, it also must be recognized that the problems confronting the government were rather severe. Manley was handed an economy which had exhausted its import substitution possibilities; furthermore, the industrialization process was accompanied by an unparalleled shift of labor to urban manufacturing centers that was not justified by either productivity gains in the former or the absorptive capacity of the latter.^{3/} The result was extra-ordinary open urban unemployment of roughly 20% in the early 1970s and deterioration of agriculture's performance with adverse consequences for food imports,

^{1/} In 1976, the fiscal deficit had reached an incredible 62% of fiscal expenditures. See Jamaica note of 1979 Economic Survey of Latin America.

^{2/} As the friendship intensified, correlatively with the deterioration of the economy, the Jamaican middle class and private sector became more uncertain about the political direction of the country. Meanwhile, the Carter Administration, which initially appeared willing to work with Manley (unlike Nixon), eventually became very cool to the government.

^{3/} See Jamaica note of the 1978 Economic Survey of CEPAL.

which rose to more than 10% of all imports. Furthermore, after the 1960's bauxite investment cycle, the real contribution of bauxite enclave to the economy diminished, and became all but minor after the 1973 OPEC oil price hike, which was critical to non-oil producing Jamaica. To its credit, the Manley government tackled some of these problems; the successful introduction of the bauxite levy in May 1974 internalized the very high rents of the aluminum companies and there was a serious campaign to revitalize agriculture through encouraging the people to return to the land. And of course, all transformations had to be accomplished within a democratic framework, which conditioned both the intensity and time horizon for economic change. But in the end, neither resources nor public administration were adequate to implement the strategy outlined by the authorities.

If Jamaica was an isolated case, there would be reason to simply blame all the problems on the country's inept economic managers. But in fact the problems in Jamaica are quite common to underdeveloped countries; indeed if all developing countries underwent excellent economic management, the field of economic development would be much smaller and the IMF would be of much less relevance. Thus Jamaica's experience with the IMF merits attention. Moreover, its importance is enhanced for two additional reasons.

First, Jamaica represents a country which was attempting to overcome its colonial socio-economic past with serious economic reforms ^{1/}, all in

^{1/} The Manley program and philosophy for economic development is nicely presented in his book Politics of Change (1973). As already mentioned, two cornerstones of his program were to encourage Jamaicans to go back to agriculture (which has suffered from massive urban migration) and to enhance Jamaican influence and revenues in the enclave bauxite sector.

the context of open democratic processes. In theory, this peaceful experiment for change should have attracted the attention and support of the Western community, as in fact it did to some extent.^{1/} And of course, the failure of the experiment also should be of equal concern to the same community.

Second, Jamaica is a small country (2 million inhabitants) and while the crisis was big for Jamaica, it presumably should have been manageable for the Western Community and for the IMF in particular. But in fact it wasn't because of two factors: (i) the IMF came too late, with too little resources, and perhaps with inappropriate economic instruments and (ii) by the time the authorities and the IMF were able to collaborate, the magnitude of the crisis exceeded the management capacity of the democratic government.

In assessing the failure, I think that the issues of image, and resources brought out in the meeting are crucial; furthermore, they condition the subjects of timing and economic growth.

In dealing with the causes of the failure of the IMF program, it is important to keep in the back of one's mind the behavior of the IMF's chief competitors during the 1970s - the commercial banks. Jamaica (like Peru and Bolivia)^{2/} fell victim to an overly permissive world banking community, and later to the euphoria and false sense of security generated

1/ The Manley government did receive active support from a number of Western European countries, and Venezuela. However, its natural benefactor, the U.S., usually was reluctant to come to Jamaica's aid, basically because of Manley's bauxite levy and his friendship with Fidel Castro.

2/ For the case of Peru see R. Devlin Los Bancos Transnacionales y el Financiamiento Externo de America Latina: La Experiencia del Peru 1965-1976, E/CEPAL/G.1124, 1980. Michael Mortimore and myself are currently working on the case of Bolivia and expect a draft to be available early next year.

by the political success of the bauxite levy. From 1972 to 1974, the banks eagerly gave Jamaica abundant finance, thereby eliminating any immediate need to cope with the underlying structural weakness of the balance of payments. Furthermore, the banks agreed to channel much of their resources into social infrastructure where there was no prospect of generating foreign exchange for repayment. Also, being very inexperienced in international markets, Jamaica often accepted unduly short maturities and high spreads and fees. When the world credit market tightened in 1975, the veil of finance became more transparent, and Jamaica's economic difficulties more evident, thus making the bankers reluctant lenders to the country. Meanwhile, domestic political pressures induced dissipation of the bauxite revenues on consumption.

There is a certain tyranny in the commercial banks' lending behavior. When the banks are highly liquid, they tend to be aggressive lenders, and less than discriminating within certain broad, and often superficial, parameters of creditworthiness. However, when the market turns tight and/or the country has open manifestations of economic problems, the banks retrench. Of course in doing this, the bankers are simply being good bankers, and it would be foolish for them to act otherwise. But a behavior that consecrates the principle "to those who have shall be given" is not necessarily good for development, and the countries involved.

My point is that as long as banks cannot (or do not want to) read into underlying economic trends, they will provide unconditional finance to countries in intermediate, i.e. less than obvious, stages of crisis. Unless the authorities are keenly disciplined and perceptive, there is

strong likelihood that the "easy" bank finance will postpone adjustment. This is especially true in cases where governments are attempting to work within a democratic framework that is not receptive to the close-fisted policies of a authoritarian military regime.

The whole problem could be overcome if the countries went to the IMF early enough, when the economic situation was manageable for the IMF, but more importantly, manageable for the government authorities themselves.^{1/} However, this clearly will not happen as long as the IMF is thought to be the "Dracula" of international finance. This is the image problem, which of course in turn inhibits the timing of IMF assistance.

How could the image be improved? This could be done if the IMF was associated with growth instead of deflation. Growth is something for which authorities could feel comfortable; massive deflation is politically dangerous, and in my subjective evaluation morally questionable in countries with low per-capita incomes.^{2/}

In order to achieve or maintain growth during "adjustment" there are two key elements, one of which is obvious, the other of which is subject to more debate. The obvious requirement for growth is resources; if a country

^{1/} Actually, in today's circumstances, if countries went to the IMF earlier, their bargaining power might be considerably enhanced and the resulting conditionality very different from what we know it to be today. The country could tell the IMF "if you want me to come to you early, these are the objectives which you must respect". The IMF, also under pressure from the international community "to adjust" its behavior, might be willing to consider new forms of conditionality which respected these objectives, especially when problems are not acute and success appears likely.

^{2/} There is no doubt that developing countries are asked to undergo deflation that would never be tolerated in industrialized countries, which ironically have enough "economic fat" to withstand harsh adjustment. One of Carter's greatest liabilities was a 10-12% decline in the U.S. standard of living over the 4 years of his Administration; in Jamaica there was a 30% decline in 6 months!

is to adjust and grow too, it will need considerably more resources than if deflation is accepted during the "transitional" adjustment period, which can be very prolonged.^{1/} My more debatable observation is that the IMF will have to begin attacking the causes of the problems instead of their symptoms.

The IMF appears to follow a narrow neoclassical adjustment framework; all one must do is establish conditions for efficient functioning of private markets by "getting the prices right" and then growth will take care of itself. I think that when an imbalance is serious --as it usually is when the IMF finally enters the scene-- this may not be enough because the deflation necessary to "get the prices right" also destroys other more fundamental conditions for growth of private markets. In other words, private investors --for which the IMF traditionally relies upon for recovery-- become unwilling to invest immediately for numerous reasons: they probably already have excess capacity due to the deflation; they feel battered by strong interest rate adjustments, the conditions of recession generate political uncertainty, etc. Meanwhile, the public sector's investment is hindered by budgetary cut backs, and IMF restraints. Of course, the IMF program attempts to shift resources to the foreign trade sector, but this passive approach to stimulation depends on the vagaries of external demand, which must not be taken too lightly in this uncertain world economy.^{2/} I would therefore argue that a country like Jamaica needed "shock treatment" but in the reverse sense of the

^{1/} In practice the transition implies waiting for external demand to stimulate the economy.

^{2/} Also the deflation and squeeze on real wages may have to be very severe to elicit a strong demand on commodities with unfavourable price elasticities. This of course is aside from problems of supply bottlenecks.

conventional use of the term, i.e. a quick period of growth, even on very modest terms.

To carry this out, a coordinated plan for stimulation via investment and absorption of excess capacity would be required.^{1/} The initial stimulation would have to come from foreign finance, and given Jamaica's limited technical and administrative capacity, it would have to be accompanied by considerable external technical assistance.

Given the existing framework of the IMF, in terms of its limited resources and limited ability to cope with supply side economics^{2/}, coupled with its late entry into the Jamaican problem, there was little chance for success. The further economic deterioration under the deflationary program fostered more erosion of confidence in the government and contributed to greater political polarization, so that the little resources put into the country by the IMF were dissipated in speculation or left the country in the form of capital flight. For the private sector this was the only rational thing to do under the circumstances.

All this would lead me to suggest that the IMF must undergo some of its own "structural adjustment" if it is to cope with the 80s in a reasonably successful fashion.

The first priority would seem to be much more resources, notwithstanding the recent increase in lending to 600% quotas.^{3/} The IMF will simply have

^{1/} After 7 consecutive years of negative growth there had to be considerable excess capacity.

^{2/} The IMF, of course, has traditionally focussed on the demand side of the economy, assuming supply to be autonomous and flexible. Moreover, there has been internal staff resistance to modification of the traditional monetary approach to adjustment.

^{3/} Even though Jamaica now can borrow up to 600% of its general account quota, equivalent to roughly \$600 million (adding the gold tranche) the IMF resources fall far short of the expected gap in external finance. I will not attempt to quantify the amount of additional borrowed resources required for the IMF on a world scale, but it certainly would be much more than the 6-7 billion now contemplated, which is equivalent to only 10% of projected 1980 current account deficits for non-oil LDCs.

to cease to be a marginal source of finance if countries are to be attracted to it before a crisis arrives and if there is going to be growth during the adjustment period. Likewise, lending will probably have to be delinked from quotas so that available resources can be adjusted to the real situation of every borrower.

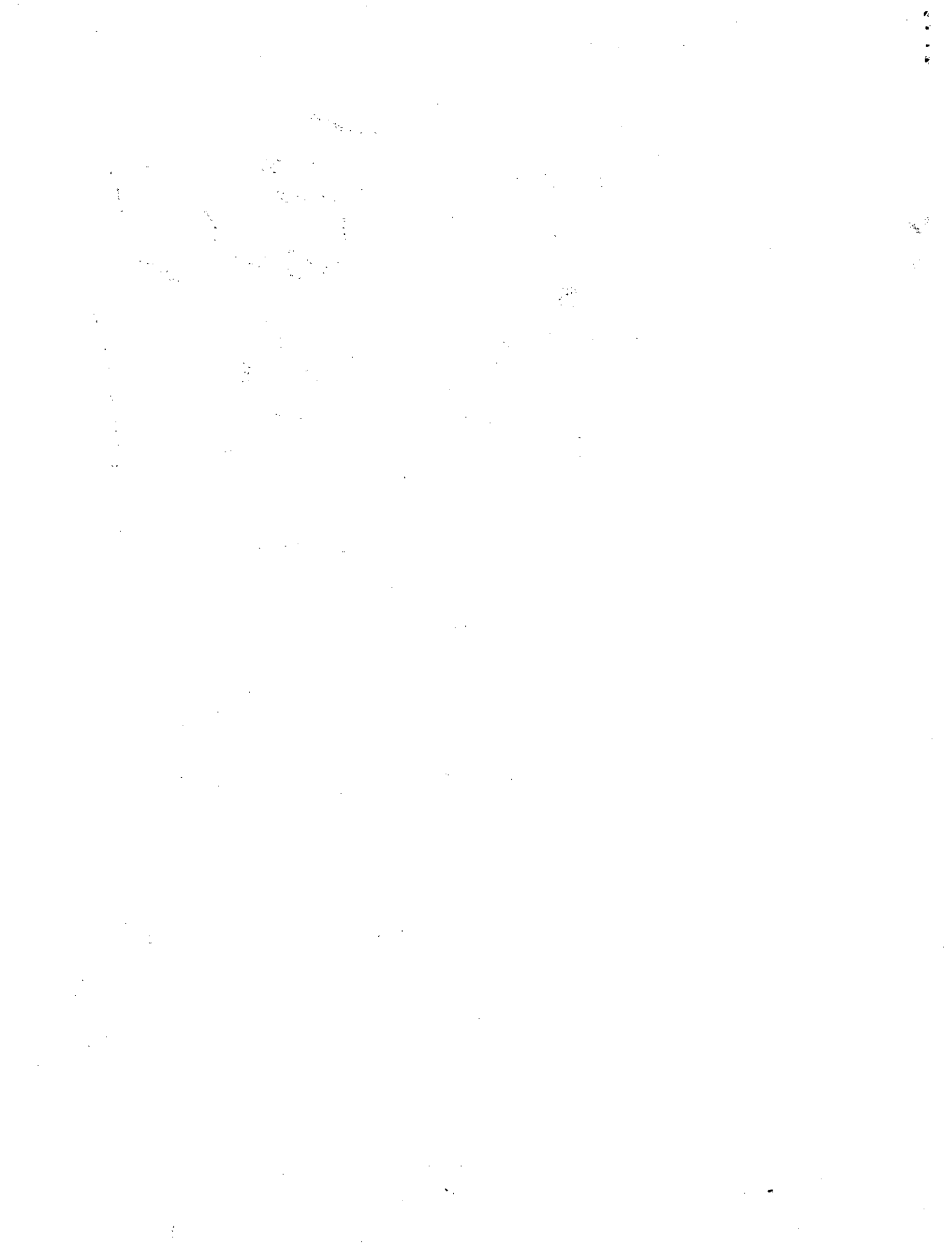
With regard to the second priority, it may in some circumstances be inappropriate to design programs on the sole basis of "establishing conditions" for the private sector investment; the Fund will have to be prepared more than it has been in the past to support public sector investment when private risk-taking seems unlikely, or to appear in untimely or inappropriate forms.

Thirdly, an unresponsive private sector might become less of a problem if there were more of a growth orientation in adjustment programs; if adequate resources were available there is no reason why maintenance of per capita income could not be a floor objective for the adjustment process. Of course a growth orientation also would require a much greater collaboration with the IBRD because the Fund would have to support investment and supply side (capacity utilization) economics.

The sooner the IMF collaborates with a country with potential problems, the less will be the magnitude of the need for resources and technical assistance. Thus, the fourth final requirement of improving the image of the IMF. One might think that the image could be greatly improved if in the near future the IMF succeeded in rescuing a few progressive governments without severe social costs or potential controversy.^{1/} This might be easiest to

^{1/} If the IMF is successful in turning the economy around for the new Jamaican government, there paradoxically will be a cynical reaction in many parts of the Third World.

accomplish in a small economy where very little resources can do very much good. I think many people's eyes will be on Tanzania, which is currently undergoing an IMF standby agreement. We should all hope for great success. A successful effort to rescue a few small countries, with progressive governments, and under terms which do not erode their progressive objectives --could help to break the IMF's vicious circle of bad image, bad timing, too little resources, harsh deflation, and bad image.



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THE IMF: PHYSICIAN OR MORTICIAN?

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"The IMF: Physician or Mortician?" Report and Analysis of the
Proceedings of the SID Finance Group on November 20, 1980

The meeting was begun by pointing out that the IMF has traditionally had a "wicked" image among progressive elements in the Third World, and it usually has been accused of serving the interests of the industrialized countries. It was commented that this stereotyped image of the IMF was inaccurate. In fact, the failure of the Jamaican case exhibits errors on both sides of the negotiating table.

Why did Jamaica get itself into economic difficulties? According to the meeting, the roots of the problem lie in the second half of the sixties when the country became accustomed to consuming more than it produced --reflected in a trade deficit equivalent to roughly 15% of GDP-- which was made possible by available finance derived from inflows of foreign direct investment in the national bauxite industry. However, when the investment cycle concluded in 1969, on account of completion of the expansion program, a serious gap in finance arose. In other words, the so called "Golden Years" of Jamaica were underpinned by a cyclical

investment program in bauxite that could not be sustained because of it having reached a natural pinnacle.^{1/}

The Manley government was voted into office in 1972 and it had to confront this structural foreign exchange gap, later complicated by the massive increase in OPEC petroleum prices. The government realized that the gap was not sustainable and attempted to reduce the trade deficit, with some modest success, bringing it down on one occasion to 10% of GDP. (The government also introduced a bauxite levy on the transnational aluminum companies, which essentially neutralized the effects of the oil price hike). However, authorities were unable to further reduce the trade deficit; on the other hand, they found international commercial banks more than eager to finance the gap, although on relatively costly terms and conditions. Through borrowing from the banks, and reserve draw-downs, the economy remained afloat and the government managed to be re-elected in 1976 by a large majority.

However, after the elections, the critical nature of the situation became more apparent to the public. Liquid reserves were down to only 10 million dollars; the banks had retrenched their lending to Jamaica (and LDCs more generally) due to an uncertain market environment; and the euphoria behind the bauxite levy began to fade as bargaining power shifted to the aluminum companies on account of slack demand in the world aluminum industry.

^{1/} The companies had begun to realize that they were excessively dependent on one country for bauxite (Jamaica was the No.1 producer in the world) and they began to look elsewhere (basically Australia) for new supplies. The last round of bauxite investment in Jamaica in the late 60's was induced only because of extremely lucrative tax concessions offered by the government. CEPAL has done some very good work on bauxite in Jamaica; I especially refer the reader to David Hoelscher's Evolution of Bargaining Capacity: the Case of the Aluminum Industry. CEPAL/CTC Joint Unit March 1979.

The IMF had a standby program in Jamaica in the early 1970s, but buoyed by the revenues of the bauxite levy in 1974, the government asked the IMF to leave the country, with both the Jamaican left and right supporting the measure. Confronting mounting economic difficulties, the Manley government had planned to invite the IMF back immediately after the 1976 elections, but this strategy had to be abandoned when the extreme left of the party exercised its power and rejected the idea.

By mid-1977 the economy --facing continual negative growth rates-- was in such sad state that there was no alternative but to return to the IMF. The meeting deemed that the program designed by the Fund and Jamaica was a poor one, because it had "sloppy" guidelines. It also was stated that the government was not fully committed to the program, and its administration of the agreement was poor. Moreover, because of the country's poor administration of the standby agreement, end of the year targets were not met, although failure was by a very thin margin (the monetary target fell short by only \$9 million). It was argued that with better accounting skills, the Central Bank could have easily met the established target.

In 1978 a new program had to be designed, this time with much tighter guidelines. The new adjustment program was "drastic" with a 40% devaluation and a 30% decline in real wages over less than half a year. The government attempted to gain a political consensus to undertake this program and it eventually won general public support for the measures. The main weakness, according to the meeting, was that the program had a \$60 million unfinanced gap. The Fund could not finance the gap because its Articles of Agreement had a restrictive formula concerning the amount

of funds available to any one country; on the other hand, there was no room for further compression of the economy. Thus both parties agreed to go ahead with the program even though there was uncertainty on how the needed resources would be secured. This apparently was a crucial mistake.

As it turned out, the \$60 million could not be raised. Pledges were received from the IBRD, IDB, etc. for the \$60 million, but only \$10 million were disbursed by end-year.^{1/} Jamaica managed to pass the IMF targets only because of some last minute accounting techniques, suggested by the IMF, which apparently were legitimate within its institutional legal framework.

By June 1979, it appeared that the Jamaican economy may have been turning the corner, as non-traditional exports and tourism became more buoyant. There also was at least passive public support for the austerity program. But in fact, the economy did not recover and actually began to deteriorate further; by March 1980 the authorities decided to break relations with the IMF, under the argument that the cure was worse than the disease.^{2/}

^{1/} The notoriously slow disbursement capacity of the IDB and IBRD was aggravated by the Jamaicans' notoriously limited administrative capacity with regard to project design and implementation.

^{2/} There also undoubtedly were domestic political considerations involved in the decision, as manifested by the fact that the PNP used the IMF as its main campaign issue.

It was concluded that the IMF's behavior in Jamaica did not represent a horror story for the following reasons:

- (1) The IMF was not against the progressive forces in Jamaica; indeed the IMF felt that the only party capable of restoring the economy's health was the Manley government;
- (2) The IMF did not undermine the Manley government; in fact, the opposition JLP argued that the IMF was propping-up the administration;
- (3) The IMF conditionality was not inappropriate; in fact, after the break with the IMF in March 1980, the same austerity measures were employed because the economic situation provided no alternative;
- (4) The IMF was not elitist; in fact, the economic team maintained broad contacts with all sectors of the country.

Accordingly, the IMF efforts failed because:

- (1) The amount of resources committed was entirely inadequate. The \$60 million gap in the 1978 program should never have been let go unfinanced because it was the difference between possibly positive growth rates and the negative growth rates that actually resulted from the agreement.
- (2) The Jamaican government did not have the capacity to administer the broad-reaching program that the crisis demanded.
- (3) The timing of the program was bad --it should have been introduced five years earlier when the problems were manageable for the government. Furthermore, negotiations for the IMF agreements --upto 6 months-- were far too prolonged, generating uncertainty in the economy and hindering recovery.