The terms "Balance of Payments Adjustment" and the "costs" of such adjustment are often used in a very loose and sometimes distorted fashion. References to adjustment and its costs abound in the recent literature but these are almost never defined, even though, on examination, their meaning is far from self-evident. An attempt is made in this paper to respond to this deficiency before turning to discuss some problems associated with the design of adjustment programs in developing countries and with the long-term retreat from the notion of adjustment as an international process.

On the Meaning of Adjustment

"Adjustment" has come to be used almost exclusively to refer to national economic responses, and, with few exceptions, to responses of deficit countries. However, this usage is more a commentary on the state of world cooperation than it is on the process of adjustment. The logic of balance of payments accounting shows that collective efforts by deficit countries alone, with no associated willingness by the rest of the world to allow their surpluses to diminish (let alone to encourage them to fall), are bound to fail. In this sense, adjustment is necessarily an international process in which surplus countries must also share. This is a rather formal way of pointing out that in a world of large and increased economic...
interdependence, the actions of any one country necessarily impinge upon the well-being of the rest—although some impinge far more than others. To thrust all or most of the task of adjustment on deficit countries is to require them to pursue contractionary policies at home, and thus to impart a deflationary bias to the world economy—precisely what the Bretton Woods institutions were supposed to avoid.

International responses to global balance of payments instability might be thought of as falling into three categories. First, there is the creation and control of international liquidity, intended under the Bretton Woods arrangements to be the task of the International Monetary Fund, in an attempt to avoid the deflation or inflation that can result when the global supply of such liquidity gets out of line with the demand for it. Liquidity management might be linked with schemes for the stabilization of world commodity prices and export compensation, such as the Fund's compensatory financing facility, which are intended to offset and diminish short-term movements in world trading conditions.

The second category of international responses to payments problems are mechanisms for recycling the excess savings of surplus countries to deficit countries. The recycling role of international banks came spectacularly to the fore in the 1970s but recycling can also occur through direct investment, concessional aid, and international agencies like the Fund and World Bank (if they are allowed the resources to play such a role).

The recycling of surpluses can reinforce—but may defer—the third type of international response: adjustment by both surplus and deficit countries. In the broadest terms, this requires deficit countries to achieve a relative shift of resources into the production of tradable goods and services, and surplus countries to shift resources in the opposite direction. Deficit countries have to reduce absorption relative to income and surplus countries must do the opposite. While it is theoretically possible for all governments spontaneously to adopt those policies that would contribute best to international adjustment, experience indicates a need for more conscious coordination of national policies, through the Fund or some other means. Specifically, it requires surplus countries (and countries that can escape the discipline imposed by payments deficits because their currencies are accepted as international reserve assets) to accept that they too have a responsibility for adjustment.

All these, no doubt, are elementary truisms. Yet those who largely confine their advocacy of adjustment policies to the national efforts of deficit countries are slipping dangerously close to accepting an inefficiently one-sided global economic system. While most of the rest of this paper is precisely about the policies of deficit countries, it is crucial not to lose sight of the importance of the three categories of international
responses that have just been described, and the concluding section of this paper returns to the theme of international adjustment.

Consider now the position of a country facing a balance of payments deficit (it is convenient to leave the causes undefined for a moment) and take the mechanisms of international trade and payments and the policies of all other countries as given. In which circumstances should adjustment policies be pursued, rather than borrowing or running down reserves? At least in the period of relatively fixed exchange rates, the answer enshrined in the Articles of Agreement of the Fund was that countries should adjust only in cases of "fundamental disequilibrium" in the balance of payments. As the Fund's official history states (de Vries, 1969, p. 22):

...fundamental disequilibrium (although it has never been formally defined) is distinguished from merely ephemeral balance of payments disequilibria, such as those associated with seasonal, speculative, or possibly even short cyclical, disturbances.

Implicit in this view was the assumption that national and international policies would be such that non-fundamental disequilibria could be financed—that there would be sufficient recycling flows and stocks of international liquidity to permit purely transitory deficits to be accommodated. It was not regarded as desirable to require countries to contract absorption or shift the sectoral allocation of resources in the face of temporary imbalances. However, these assumptions no longer appear secure, for reasons mentioned later. The Fund itself now prefers to talk in terms of the restoration of payments "viability," whose meaning will be discussed in a moment.

According to present views, countries need to adjust whenever they have balance of payments deficits that cannot be financed on acceptable terms, whether these deficits are temporary and self-correcting, or "fundamental." One difficulty here is that the ability of developing countries to finance even temporary deficits has diminished. Many of them suffer from much reduced access to net new commercial bank loans, static or declining real levels of aid and direct investment, often only the slimmest margins of international liquidity, and diminished access to the Fund's compensatory financing and stand-by credits.¹ There

¹At the end of 1983, reserves expressed as months of imports held by non-oil developing countries were estimated as follows:

<table>
<thead>
<tr>
<th>Region</th>
<th>Months of Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa (excluding South Africa)</td>
<td>1.0</td>
</tr>
<tr>
<td>Asia</td>
<td>3.2</td>
</tr>
<tr>
<td>Europe</td>
<td>1.5</td>
</tr>
<tr>
<td>Middle East</td>
<td>2.1</td>
</tr>
<tr>
<td>Western Hemisphere</td>
<td>2.7</td>
</tr>
<tr>
<td>All</td>
<td>2.5</td>
</tr>
</tbody>
</table>

From International Monetary Fund, World Economic Outlook, October 1985 (Washington), Table 42.
is also the prospect of reduced support from the World Bank's soft-loan window, the International Development Agency (IDA). Adjustment, it seems, is coming to the short end of the market.

But what of the relationship between adjustment and what the architects of Bretton Woods described as the "primary objectives of economic policy"—full employment, economic growth, and development? In the past, the idea of a balance of payments equilibrium was regarded as conditional upon the prior or simultaneous satisfaction of other objectives. In this tradition, the present writer recently offered the following definition (Killick, 1984, p. 17):

Balance of payments equilibrium exists when, in a normal year, the basic balance (or that balance chosen as the most appropriate for the country in question) approximates zero in conditions where: there are no major unwanted restrictions on trade and payments; external debts and debt servicing are not regarded as too large; foreign exchange reserves are regarded as adequate; and the equilibrium does not depend upon the maintenance of unwittingly deflationary domestic policies.

The Fund's views on the meaning of payments' viability are of considerable interest here. The first definition of which we are aware is by Manuel Guittián of the Fund staff (1981, p. 3):

For developing countries, a viable balance of payments typically means a current account deficit that can be financed, on a sustainable basis, by net capital inflows on terms that are compatible with the development and growth prospects of the country...

A more recent version is taken from an article by a Fund staff member in the December 1984 issue of Finance and Development (Tseng, 1984, p. 2):

A viable balance of payments position is normally conceived of as a current account deficit that can be financed by normal capital inflows and that can be sustained without restrictions.

In both versions, payments viability is conditional on the satisfaction of certain other goals, although these are stated as growth and development in the first version and the absence of restrictions in the second version. However, to subordinate the balance of payments objective to other policy goals is probably not helpful in present-day circumstances. There is precious little prospect that any developing country will satisfy the earlier description of payments equilibrium, nor is there any prospect that many can achieve a sustainable payments position "without restrictions." Since if a country is not creditworthy or has no surplus reserves the balance of payments constraint is absolute, such other objectives as growth, employment creation, or trade or financial liberalization must be subordinated to the payments target. This is one of the consequences of
concentrating adjustment efforts on deficit countries and of the decline over the past decades in international cooperation referred to in the previous section.

Quite apart from the question of the extent to which balance of payment adjustment is compatible with other objectives, there are rather more technical questions about how payments objectives are to be defined, and according to which indicators targets are to be set. The current account (often expressed as a proportion of gross domestic product (GDP)) is a popular variable and most of the specific policy measures generally built into adjustment programs are intended primarily to influence items on the trading and invisibles accounts. On the other hand, flows on the capital account are also likely to be influenced by the perceived adequacy of adjustment efforts. For one thing, the Fund has in recent years played an increasingly active role in organizing supporting finance from aid donors, international banks, and so on to support the stabilization programs it has succeeded in negotiating. Successful adjustment measures, particularly affecting exchange rates and interest rates, may also slow down, and even reverse, capital flight. Thus, the effect of adjustment programs on the current account may be ambiguous—both tending to strengthen it and yet to permit a larger current deficit to be financed. From this point of view, the basic balance may be a preferable indicator, although one would in such cases need to pay careful attention to the debt-servicing implications of borrowings on capital account.

The very severe import compression that has marked the records of many developing countries in the last few years provides a further reason for not placing too much weight upon the current account as a measure of the state of health of the balance of payments. Traditionally, the capital and monetary accounts were thought of as recording the manner by which any current account deficit has been financed; in contemporary conditions, however, the size of the current deficit itself reflects policymakers' judgments about the amount of financing that will be available. The accommodating flows have moved above the line. The volume of imports thus emerges as an indicator of crucial importance, which takes us back to the relationship between the payments position and other economic objectives. For many developing countries, the extent to which they have had to cut back on imports severely constrains their ability to satisfy other goals; and adjustment programs may be judged according to the extent to which they permit import volumes on a scale consistent with the restoration of historically more normal levels of capacity utilization and capital formation.

Given the strong influence within the Fund, as well as in the academic world, of monetary approaches to balance of payments analysis, it is not
without interest that of all the major accounting balances the overall, or monetary, balance is probably the least useful and the least used. Nevertheless, a strengthening of the monetary account may be an important objective and the Fund has to be concerned about countries' ability to repay its credits (de Larosière, p. 156, 1980):

*Adjustment* means that when the Fund lends to deficit countries, it does so on the basis of policies intended to correct such deficits, so that the money is lent wisely and the beneficiary countries are in a position to reimburse the Fund, thereby allowing it to relend the money anew to other countries.

However, the chief point to emerge from this discussion is that the wise policymaker will pay attention to a range of payments indicators: the terms of trade; the volume of imports; the balances on trading, current, and basic accounts; debt-servicing ratios; changes in international liquidity; changes in payments arrears; and so on. The determination of adjustment objectives cannot readily be reduced to one or two simple statistical targets. The outcome may be quite complex, with not all indicators pointing in the same direction—which is one of the reasons why it is difficult to form an adequate assessment of the effectiveness of Fund stabilization programs.²

A search of the literature has rather remarkably led to the discovery of only three attempts to define balance of payments adjustment, all of them unsatisfactory, so we must start from the basics. Dictionary definitions of the word "adjustment" refer to the effects of minor changes in the elements of a system so that the system can be rendered consistent or coherent. The emphasis is on the adaptation of one thing to another and other synonyms offered include accommodation and harmonization. Some stress is placed on adjustment as a gradual process of minor changes.

Economic systems are, of course, constantly adjusting to a wide variety of disturbances, so balance of payments adjustment is simply a member of larger family (OECD, 1978/79, p. 81):

*Adjustment* is a gradual response of resource allocation to changes in taste and the pattern of demand...and to changing technology, to changing relative costs and prices...and to changes in the composition of the labor force.

Or more generally (Congdon and McWilliams, 1976, p. 16):

*Adjustment process:* The process by which an economy adjusts to a change in some economic variable and reaches a new state of balance of

²However, this should not suggest at all that the attempt should be abandoned; it remains essential to form the best view that one can, notwithstanding the methodological and statistical difficulties. For recent contributions to this debate see Donovan, 1982; Killick, 1984, Chapter 7; Loxley, 1984.
equilibrium. A notable example is the adjustment of an economy to a surplus or deficit on the balance of payments.

Now turn to two of the definitions of payments adjustment that we have discovered. First, a Fund formulation (Alves, 1979):

The adjustment process in the balance of payments may be defined as the correction by the authorities of an imbalance, by inducing changes in the structure of the country's external transactions in order to eliminate economic distortions and pressures.

Second, there is this account by (Richard Feinberg and Kallab, 1984, p. 4):

The dual task of stabilization (bringing expenditures into line with available resources) and liberalization (freeing prices to reflect international cost structures) makes for a formidable agenda. This combination of income stabilization and price alteration is commonly referred to as 'adjustment.'

There are a number of issues that arise here. Note, first, the omission in the Fund version of any reference to the restoration of a viable payments position. The objective is instead defined vaguely as the elimination of "economic distortions and pressures." However, even if we were to substitute "restoration of balance of payments viability" the result would still be too general to be helpful. Note, second, Feinberg's identification of liberalization as one of two major components of adjustment and his lack of reference to the internal reallocation of resources, as distinct from "income stabilization." As a matter of actual practice, liberalization is only sometimes regarded as an essential part of an adjustment program—depending, no doubt, on the initial extent of price distortion—which is one of the reasons why his definition is not entirely satisfactory.

One of the other issues thrown up by the comparison of the formulations by the Fund and by Feinberg is the question of what is being adjusted. For Feinberg (and also in the general definitions by the OECD and Congdon and McWilliams) it is the domestic economy—the level of expenditures and the system of relative prices. For the Fund, on the other hand, it is apparently the balance payments itself that is being adjusted, with the emphasis on adjustment "in" the balance of payments and on changes in the structure of external transactions. Clearly, there could be major policy disagreements between those who would adjust the payments positions to the domestic economy and those who would attempt the opposite. Indeed, this type of issue may underlie some of the disagreements that arise in stand-by negotiations between the Fund and its member governments. Nevertheless, there would probably not be any large disagreement that it is primarily the balance of payments that is the constraint to which the domestic economy must adjust. Of course, there is no rigid separation; the tradable goods sectors will be among the prime targets of adjustment measures and, if successful, adjustment will
improve the balance of payments. Nevertheless, the primary emphasis in recent years has been upon how national economies can adjust to the external shocks that have been such a feature of the past decade.

A further question prompted by Feinberg's definition concerns the relationship between payments adjustment and stabilization. By building income stabilization so prominently into his definition, Feinberg differed from those who distinguish between stabilization and adjustment. On the face of it, this is a useful distinction between the short-term demand-management programs associated with the Fund and the longer-term "supply-management" (or structural adjustment) programs of the type introduced in the early 1980s by the World Bank. Not the least of the attractions of the distinction is that it provides a framework within which it is easier to recognize the tensions that may exist between demand and supply measures. At least in the recent past, stabilization has been associated with import compression, whereas structural adjustment is likely to require additional imports—of capital, intermediates, and even consumer goods, the latter acting as "incentives." The restraint of demand in stabilization efforts helps the balance of payments by reducing the demand for imports and releasing resources for exports; with structural adjustment, however, weak domestic demand may be a hindrance to the investment and productive adaptation necessary for the longer-term strength of the balance of payments. Fund-type programs are likely to place particular stress on the limitation of domestic credit—which may, however, inhibit the investments in fixed and working capital necessary for structural change. Similarly, demand management may require severe restraint of government spending, while supply management may need more economic services and infrastructural investment by the state.

In the end, however, adjustment based on a distinction between demand and supply management probably cannot be sustained because of their essential complementarity. While the tensions referred to above are very real, the essential fact is that success in strengthening the balance of payments (or, in effect, the current account) necessitates a reduction in absorption relative to income. While the intention of supply management is to achieve this result principally by raising real incomes, demand management will still be necessary if absorption is not to rise at least as fast as incomes—especially if the supply-side measures require an actual increase in investment. Moreover, as the Fund frequently protests, its programs are not exclusively concerned with the limitation of demand, and measures such as devaluations both absorb excess demand and reallocate productive resources.

"Income stabilization" should therefore not be excluded from the definition of adjustment. Perhaps a more fruitful differentiation between
stabilization and adjustment relates to the time horizon over which measures are intended to have their effects—that is, to the degree of permanence of those measures. The general definitions of adjustment can be taken to encompass a gradual response of resource allocation, a process by which an economy achieves a new state of balance. This view of adjustment would exclude emergency measures introduced as temporary expedients to produce quick results and specifically those measures that merely suppress the symptoms of the payments crisis. There would probably be general agreement that an improvement in the current account brought about, say, by the imposition of severe exchange controls is not best described as adjustment. By the same token, adjustment should not cover an import compression achieved by some draconian repression of aggregate demand, or attack on real wages, that could only be politically tenable for a limited period. It has nonetheless become quite common to describe the import compression of recent years in precisely these terms. Thus Managing Director de Larosière (1984, p. 117):

The weaknesses in export earnings meant that the only avenue to external adjustment in the short term was through a massive cutback in imports, . . . with obvious implications for domestic activity in those countries.

Adjustment, then, is different from suppression. It is more permanent, built into the allocation of resources within the economy. Adjustment is "structural." But that does not make it synonymous with "structural adjustment" à la World Bank. The World Bank’s view of structural adjustment tends to concentrate on achieving changes in the productive system but it is desirable to take a rather broader view of economic structures. It is useful to recall the three ways in which the GDP may be measured: by industrial origin; by expenditures; and by factor rewards. Sustainable adjustment is liable to require changes in all three aspects of the economy:

- **The Productive Structure**: The Bank’s work with structural adjustment is most closely associated with this aspect. The emphasis here is on achieving a relative shift of resources from non-tradables to tradables (there are difficulties about this formulation to which we return later), although there may be related questions concerning the respective sizes of the public and private sectors.

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3See, for example, the concerns listed by Please in this volume. For another recent account see also Please, 1984b, Chapter 3.

4It is perhaps significant that, for the purposes of statistical testing, the World Bank measured structural adjustment as "export market penetration plus import substitution"—see the Bank’s *World Development Report, 1981*, p. 123.
The Pattern of Expenditures: In deficit countries that are faced with limited access to external financing, it is likely to be important to raise the volume of saving relative to consumption. This, in turn, may have important implications for budget revenues as well as expenditures, for interest rates, for the socially desirable level of private sector profits, for the pricing and other policies of parastatal organizations, and so on. In many cases, however, there will be severe limits to how far the savings ratio can be raised, which then shifts attention to the productivity of investment and to measures that will raise it. The long-term policies of demand management mentioned earlier particularly relate to the pattern of expenditures.

Factor Rewards: The desirability of raising the savings ratio in adjustment efforts already carries potentially large implications for the functional distribution of income; because earnings on capital are assumed to be associated with higher marginal propensities to save than returns to labor, higher savings generally imply a shift to higher returns to capital. Often (but not invariably) adjustment may require incomes policies to restrain the growth of wages, for example, to reinforce the real effects of a devaluation.

Adjustment also involves a fourth dimension, beyond national accounting aggregates—the framework of laws, conventions, and institutions that underpin the workings of the economy. These, too, may need to be changed in response to the payments situation. Anti-usury laws, practices that restrict the mobility of capital and labor, and feudal land tenure systems fall into this category.

One or two loose ends remain in the definition of adjustment. A third definition of balance of payments adjustment discovered in the literature search is relevant to these (Pearce, 1983, p. 9, italics omitted):

Adjustment process: The generic name for the adjustment mechanisms which operate in the international economy to remove imbalances in foreign payments. The most important mechanisms which have been advanced to explain the process are the gold standard, the gold exchange standard, the foreign trade multiplier, and the floating exchange rate.

This definition is interesting for two reasons. First, unlike the two earlier offerings, it takes an international rather than national view. Second, and of present interest, it views adjustment processes as operating automatically, rather than by discretionary policy intervention. The Johnson-Mundell monetarist school takes a similar view, regarding the balance of payments as essentially self-correcting, if only the monetary authorities do not interfere. This way of regarding the matter certainly contrasts with the definition by the Fund on p. 70, which speaks
of adjustment as "the correction by the authorities of an imbalance." This latter view is probably more in tune with general usage, for the literature on adjustment is largely about the choice of discretionary policy instruments by national governments. The point here, no doubt, is that the disequilibria and shocks of the past decade have proved too severe to be accommodated with sufficient speed by the automatic tendencies at work through the monetary system, floating exchange rates, the operation of foreign trade multipliers, and the like. Policy initiatives have been needed to reinforce the automatic tendencies. According to our understanding of adjustment, however, we would wish to include both automatic and policy-induced responses, which implies that we should be careful to distinguish between adjustment and adjustment policies.

A closely related issue is the distinction between involuntary and planned adjustment. Even in the face of complete neglect by the authorities, adjustment will eventually take place, but in acutely uncomfortable forms, including a breakdown of import supplies and a near-complete loss of creditworthiness (Gutián, 1984, p. 2):

Under most circumstances, adjustment will take place whether or not there is policy action, in the sense that claims on resources will eventually have to be limited to those that are available. The issue at stake, therefore, is not whether adjustment will be carried out—because it will be—but whether it will be carried out efficiently—that is, without involving unwarranted welfare losses.

It is because the alternative of involuntary adjustment potentially carries such high costs that the appropriate design of adjustment programs is so important.

To sum up the discussion so far:

- adjustment is a concept that is most appropriately applied to the international economy and that should include surplus countries, although it is nowadays largely applied to the national economies of deficit countries;
- adjustment in a deficit country is a response of the economy to an unviable payments deficit and an attempt to reach some equilibrium;
- adjustment should be distinguished from the temporary suppression of the symptoms of the problem;
- it involves changes in the allocation of resources in the economy;
- it can occur automatically, in response, for example, to monetary stringency or a depreciating currency, but will generally also require government intervention.

If one reluctantly accepts general usage and confines the definition of
adjustment to the position of deficit countries, the following definition emerges:

- Adjustment is a gradual, non-temporary response of the economy to the existence of an unviable balance of payments deficit, involving the reallocation of resources among sectors, factors, and categories of expenditure (including savings). Such reallocations may occur automatically in response to changing monetary conditions and price relativities, but governments will often judge it necessary to reinforce any automatic tendencies with the introduction of discretionary policy changes.

**The Costs of Adjustment**

The definition of adjustment just offered avoids normative considerations and mention of the costs and efficiency of adjustment processes. On the issue of costs, consider the following account of events in Latin America during 1983 (Inter-American Development Bank, 1984, p. 183):

The worst possible scenario of default by one or more countries was avoided through severe domestic adjustments that had high social costs in terms of unemployment, inflation, and overall deterioration of living conditions. These adjustments were necessary in order to quickly generate a large trade surplus... Circumstances forced most countries... to adopt restrictive policies that produced substantial reductions in investment and production.

According to this report, during 1983 per capita incomes declined by an average of 5.3 percent, leaving average incomes nearly one tenth lower than their real levels in 1980. The report also shows that between 1981 and 1983 the investment ratio in Latin America fell by almost a quarter in real terms, from nearly 26 percent of gross national product (GNP) to under 20 percent; and data is given showing per capita consumption declined by nearly 7 percent in real terms between 1982 and 1983 alone. On this evidence, adjustment does indeed entail heavy costs in terms of foregone present and future economic welfare. However, the matter needs to be disentangled a little.

To begin with, many of the costs reported above were the direct result of a severe short-term compression of imports and aggregate demand, which are excluded from our definition of adjustment. Economic repression gives adjustment a bad name! Even if the losses in output, consumption, and so on had been associated with genuine adjustment policies, however, there is the further question whether these were, in fact, adjustment costs per se. A country running an unviably large

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5 For a fuller discussion of these trends see Inter-American Development Bank, 1984, pp. 183–92.
payments deficit must perforce reduce expenditures relative to income. In the language of the layman, it is living beyond its means. The costs of bringing expenditures within its means should more accurately be attributed to the factors which caused the unviable deficit in the first place. These could be, among others, adverse trends on world markets leading to a deterioration in the commodity terms of trade, rising global interest rates, harvest failures, or past policy failings. "Costs" are implicit in the initial situation, irrespective of the adjustment path chosen.

However, some adjustment paths may be more efficient than others. Inefficient adjustment (or neglect) will add unnecessarily to those costs that are unavoidable, and these costs, which are over and above the unavoidable minimum, are truly adjustment costs. But can they be measured in some unambiguous way? Since these two types of cost cannot, in fact, be easily separated, as a practical solution they will both be loosely referred to as "adjustment costs" in the following.

Viewed in this broad way, adjustment costs are transitional, because adjustment is itself a transition from an unviable to a sustainable situation. In the most general terms, such costs may be defined as foregone welfare and the government's reduced ability to satisfy the material aspirations of the citizenry. Undoubtedly, reduced economic activity, of the type referred to by the Inter-American Bank, are among the most important of these. They need to be measured relative to some trend level, or some estimate of capacity or potential. However, there may be "distributional" costs as well, from shifts in the distribution of income and the incidence of absolute poverty associated with the adjustment process, that are regarded by the government, or by society at large, as undesirable. Finally, there may be less tangible—but perhaps very important—"uncertainty costs" associated with the disruption of activities and the reduced economic security that is liable to accompany adjustment. It is perhaps worth elaborating a little on these three cost components.

The costs associated with lower economic activity are very familiar and only one observation need be made. This relates to the difficult choice to be made in the restraint of aggregate absorption between consumption and investment. In Latin America in 1983 the brunt of the burden fell upon investment, and it is obvious that if investment were continuously held back over a longer period, it could scarcely fail to make structural adaptation more difficult. Of course, not all investments are sacrosanct; some will not promote a more efficient allocation of resources. Nevertheless, there must be a presumption in favor of protecting real levels of fixed investment in the process of structural adjustment—which is where calls for improved Fund-World Bank collaboration tend to come unstuck. On the other hand, it is impossible to state a blanket preference for the
brunt of demand management to fall upon consumption, for in developing countries it may be practically impossible to prevent a substantial part of the burden of this from falling upon the very poor.

This brings us, then, to the distributional costs of adjustment. It is common, especially in criticisms of Fund policies, to allege that adjustment will generally increase income inequalities and absolute poverty. It is essential here to distinguish between the two effects. So far as absolute poverty is concerned, there must be a rather strong presumption that adjustment is liable to worsen the situation, at least in the short to medium term. Adjustment requires the reduction of absorption relative to GDP and it would be very difficult to protect the poor fully from measures designed to curb aggregate consumption and investment, with their adverse effects on employment levels. The presumption is all the stronger because it is apparently rare for governments to design their adjustment programs consciously to protect the disadvantaged, and the Fund has always resisted suggestions that its own conditionality should be modified with this consideration in mind. Indeed, there is substantial evidence of adjustment programs worsening absolute poverty.  

The position with relative income shares is more complex, however. Our own observations suggest that it is impossible to generalize about the effects of adjustment on income inequalities because the outcome will be strongly influenced by the structure of the economy in question and the adjustment measures chosen. It is undoubtedly true, however, that balance of payments adjustment will affect income distribution in a number of ways. Addison and Demery (1985) suggest that these will occur through three main types of mechanism: "changes in the level and structure of output; changes brought about by income transfers; and changes in the accumulation and distribution of assets." They add, however, that changes that occur through these mechanisms are liable to pull in different directions, so that net outcome may be complex and difficult to predict.

One way in which adjustment programs may affect poverty and inequality is through its probably negative effects on government welfare and educational programs. This danger arises not simply out of the general budgetary stringency with which adjustment is normally associated, but also because welfare services are among the least ambiguously nontradable activities in the economy, a point to which we return

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7See Killick, 1984, pp. 242–46.
later. The World Bank's *World Development Report, 1981* was considerably exercised by the threat posed by adjustment to welfare programs and pointed out that the provision of such services could be regarded as investments in future productive capacity, to be cut only at a risk to the future efficiency of the economy (p. 97):

For developing countries everywhere, the exigencies of adjustment over the next 5 to 10 years could undermine the commitment to social programs, whose full benefits are generally felt only in the long term . . . However, specific health and nutrition programs can have strikingly rapid effects: a project to reduce anemia among Indonesian workers improved their productivity within eight weeks. The effects of malaria control can also bring quick benefits.

As regards the third category of “uncertainty costs” these can arise at both the personal and social levels. At the personal level, the restructuring of the productive system will involve the movement of workers and their dependents from one industry to another, often necessitating relocation. The introduction of new technologies and shifts in the factor proportions employed will further increase uncertainties; they may bring alienation, make old skills redundant, and enforce the need to learn new ones. Such changes may be inevitable and in some ways desirable—labor mobility can be a net economic “good”—but many will regard the disruption of settled ways of life and the greater uncertainties of the future with aversion. At the level of society as a whole, there may be analogous costs: heightened class divisions and a loss of social tranquility. At the political level, the introduction of adjustment programs may not merely reduce the life expectancies of governments and ministers of finance. They may actually undermine existing democratic institutions or be associated with politically repressive regimes, and we may agree with Foxley (1981, p. 225) that if one prefers an open, democratic society, then policies “that require a good deal of political repression to have a reasonable chance of success” are certainly not a satisfactory solution.8

This description of the various adjustment costs helps to clarify the meaning of a cost-minimizing adjustment process. Such an adjustment will not be stumbled upon by good fortune, nor through the unfettered operation of the market mechanism; it will need to be carefully designed, so as to minimize the various costs, for example, by explicitly accounting for the likely effect of its policies upon poverty and inequality, and by finding ways of reducing the social dislocations and uncertainties

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8Sheahan, 1980, notes an apparent correlation between stabilization and political repression in countries of the Latin American “Southern Cone” and argues that the socioeconomic structures of those countries considerably increased the probabilities of such an association.
associated with restructuring. But the key factors will almost certainly be the level of economic activity at which it is possible to achieve adjustment and the length of time available for the transition.

It is almost inevitable that a program that has to achieve large results over a brief period will have to concentrate on the repression of demand and the compression of imports. For reasons explored earlier, these are liable to hamper the task of structural adjustment. Supply-oriented measures generally act more slowly, except to the extent that it is possible to bring into utilization excess capacity in the industrial and other sectors. Short-term measures that concentrate on reducing demand and imports represent a high-cost approach for countries faced with structural payments problems, both in terms of the level of activity and the uncertainty costs. In the short term, elasticity values are small; people take time to adjust and so do productive structures; the “shocks” required to produce quick results are, therefore, large. In the longer run the possibilities are greater and the responses to a given price signal are larger; gestation lags can be accommodated, new skills can be acquired, and new technologies embodied in the productive system.

In cost-efficiency terms, there is thus a powerful case for inflows of international capital on a sufficient scale and for a sufficiently sustained period to permit longer-term, more supply-oriented programs to have their effects, and to finance the longer transition. In present circumstances, however, few deficit developing countries have access to finance on the scale required, even though many of them face problems of a structural nature—a point which is elaborated below.

A final point on cost effectiveness. It is suggested as a basic principle that to be cost effective, adjustment programs must be directly related to the causes of the payments problem. If the source of weakness is a persistent tendency to overexpand demand, through government deficit financing or excessive credit to the private sector, then a program that relies upon the restructuring of the productive system is unlikely to restore payments viability. Similarly, developing countries have been faced with the need to restructure their economies in the face of non-reversible deteriorations in their terms of trade and, by the same token, tackling these “structural” problems, principally by means of demand limitation, is also likely to prove both high-cost and essentially ineffective. We have elsewhere criticized a number of Fund-supported programs on these

\[9\text{In the older industrial countries, of course, it is common to provide financial and other “adjustment assistance” to industries suffering from declining international competitiveness, and to those who work in them, in order to reduce the felt costs of adjustment and as an alternative to a protectionism that actually impedes adjustment.}\]

\[10\text{See Schydlowsky, 1982, for a discussion of policy measures designed to mobilize surplus industrial capacity in the adjustment process.}\]
grounds, although recently the Fund has built more supply-side measures into its policy conditionality.  \(^1\)

**National and International Adjustment**

*Capacity to adjust.* There is a variety of issues that relate to difficulties with the design and adaptation of national and international adjustment. National adjustment issues include an economy's capacity to adjust, the state of knowledge about the links between policy tools and the variables they are meant to affect, which goods are tradable and which are not, and the role of prices in production. The main issue concerning international adjustment is that a retreat has occurred away from it. To begin with, it seems an elementary point that to be cost effective, programs need to be adapted to the varying capacities of the countries in which they are implemented, but there are different practical difficulties with this principle. At the theoretical level, the notion of "the capacity to adjust" has been little explored and remains imperfectly understood.  \(^2\)

The hypothesis suggested for future exploration is that the capacity to adjust will be a rising function of the level of economic development. In a mixed economy, this capacity will be determined by the efficacy of the market mechanism, by the structure and technical characteristics of production, and by the quality of decision-making and execution in the organs of the state. It is suggested that the efficiency of the market system (and of the information upon which it depends) is likely to be at its lowest in the least developed countries. Poor communications and transport, low levels of education and literacy, social and other obstacles to the mobility of labor, dualistic capital markets, heavy concentrations of monopoly and monopsony power, as well as the often maligned influence of state interventions all conspire to make it so. Moreover, the least developed countries are more heavily dependent on the export of minerals and agricultural commodities, which are often subject to particularly long gestation lags. Indeed, dependence on primary product exports may have a particularly negative influence on the capacity to adjust.

In a rough and ready way, it is also plausible to think of the efficacy of the state as being positively correlated with economic development, including the government's capacity to achieve its objectives with the

\(^1\)The impact of Fund-supported programs on supply is one of the principal themes of Killick, 1984, Chapters 6-8.

\(^2\)See Killick, 1984, pp. 286–7, for a slightly fuller treatment of this topic.
policy instruments available to it. For example, the government's ability to regulate aggregate demand is likely to be at its lowest in an economy still largely based on primary production, with a limited monetization of economic activity, poorly developed banking and other financial institutions, a narrow tax base, and probably with an inefficient public administration. Demand management should at least become a little less difficult as development proceeds.

One of the difficulties with the present situation is that the practices of the agencies that provide supporting finance seem to take little heed of countries' differing capacities to adjust. This is most explicitly the case with the Fund, whose principle of uniformity of treatment amongst members has not been interpreted to mean uniformity relative to capacities. For example, the hypotheses suggested above would clearly point in favor of longer-term, more gradual programs in most African countries but, if anything, Fund programs in that region tend to be even shorter than in other developing countries. The World Bank's structural adjustment loans are not known to be based on any explicit view of countries' capacity to adjust, but the Bank's programs are probably rather more individually tailored to country situations than the Fund has found possible.

If the capacity to adjust is a rising function of development, then the need to re-examine the lending policies of international agencies and other donors has been made more urgent by the probability that world economic trends have tended to thrust the heaviest adjustment burden on those countries least able to adjust. In particular, the least developed have been hit by the collapse in world commodity prices in the early 1980s and by the slowness of these to respond as expected to the subsequent partial economic recovery in the industrial countries. They have been hard hit, too, by the stabilization of real levels of bilateral aid, by the large prospective reduction in the real size of concessional resources provided by the World Bank (from the International Development Association or IDA), by the reduced size of Fund credits, and by the substantial withdrawal of commercial banks from new lending to

<table>
<thead>
<tr>
<th>Year</th>
<th>Africa</th>
<th>Rest of World</th>
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<tr>
<td></td>
<td>(In months)</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>17.8</td>
<td>18.7</td>
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<tr>
<td>1981</td>
<td>13.0</td>
<td>16.0</td>
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<tr>
<td>1982</td>
<td>12.5</td>
<td>14.8</td>
</tr>
<tr>
<td>1983</td>
<td>14.2</td>
<td>15.3</td>
</tr>
<tr>
<td>1984 (January–June)</td>
<td>13.6</td>
<td>12.4</td>
</tr>
</tbody>
</table>

13 The average intended duration of stand-by credits commenced in each year since 1980 was as follows (calculated from Fund data):
many developing countries.\textsuperscript{14} They now have extremely little financial room for manoeuver. In fact, a recent Fund staff paper suggested that African countries should plan on a net outflow of capital over the next few years, given likely aid trends and the need to improve debt ratios (Bhatia and Tahari, 1984). It seems that those least able to afford them are being forced into high-cost adjustment programs too short term to achieve a fundamental improvement in payments viability.

The knowledge problem. Policymaking is, of course, always conducted in a state of imperfect knowledge, but there appear to be particularly serious doubts about our understanding of the connections between the policy instruments employed in adjustment and the variables they are intended to influence. There also seems to be a widening gap, in the Fund at least, between the state of knowledge and donor practices. These general points can be illustrated by reference to the well-known 1981 article by Khan and Knight on stabilization programs in developing countries. In this, they identify Polak-type monetarist models as having provided the broad analytical framework within which most Fund programs have been designed, in which “there is a fairly well-defined relationship between money, the balance of payments, and domestic prices in which the supply of and demand for money play a central linking role” (p. 3). They build on this basic approach to develop a more dynamic model, which explores relationships between output, prices, international reserves, money, and fiscal policy. They find a complex connection between domestic credit and the balance of payments (p. 42):

When a given increase in international reserves must be achieved within a specified period of time, this model yields quite a complicated path for domestic credit ceilings. . . . The practical implication is that policymakers cannot ‘fine tune’ domestic credit ceilings from quarter to quarter, or even year to year, without having much more comprehensive information about the structure of the economy than they can reasonably be expected to possess.

Since Khan and Knight present their model as an interpretation of “the basic theoretical paradigm underlying the financial programming exercises of the Fund . . .” (p. 4), the implicit criticism of the central role of domestic credit ceilings in stand-by programs is quite serious. Their

\textsuperscript{14}Take, for example, the following figures on the average values of stand-by credits agreed with African countries (these are in millions of SDRs and are calculated from data published in the \textit{IMF Survey}):  

\begin{tabular}{ccc}
1980 & 63.5 & 1983 & 132.3 \\
1981 & 70.0 & 1984 (January–June) & 63.6 \\
1982 & 87.6 & & \\
\end{tabular}
model emphasizes that "programs designed to achieve quick results on the balance of payments via sharp deflation are likely to have significant and undesirable effects on output, employment, and factor incomes, particularly in the short run" (p. 43). In these respects they found the effect of longer-term programs on employment "unambiguously" superior. Work by Keller (1980) and Joyce (1981) has also pointed to more complex connections between credit, the balance of payments, and the real economy, and Aghevli and Rodriguez (1979) developed a model which indicated a trade-off between monetary restraint and output, even in the longer term.

The point here is not that there is now some new consensus about relationships between real and monetary variables, or about the theory of balance of payments policy. It is rather that research has raised serious questions about the validity of past approaches at a time when their application appears to be becoming increasingly rigid. Our present uncertain knowledge indicates a need both for more theoretical and empirical research (in which the differentiation of economy types may prove a useful way forward), and for a richer mix of experimentation in the adjustment programs that must meanwhile be implemented.

Tradability. It has become part of the new orthodoxy that payments adjustment requires resources to shift into the production of tradable goods and services and out of nontradables. This seems to mean only that countries with payments deficits need to produce more exports and depend less on imports, which is obvious good sense. But what actually is this quality of "tradability" and what are the sectoral implications of a shift of resources into goods possessing this quality? There should be support for the view that tradability extends beyond those goods and services which happen actually to be traded by the country in question at any particular time. It may, for example be self sufficient in the production of foodstuffs and yet those commodities are capable of being traded: if there is a surplus they can be exported, and when there is a domestic shortfall they can be imported. The test which this line of reasoning suggests is whether or not the item in question is practically capable of entering into international trade.

When one looks at the matter in this way, however, the quality of nontradability becomes elusive, for it is actually not very easy to find items that are intrinsically incapable of being traded across national borders. Domestic water supplies? Think of Hong Kong. Roads? Well, yes, except that countries can earn foreign exchange from the transshipment of goods to neighboring landlocked countries, and tourist earnings can be affected by the adequacy of the roads system. The list seems to boil down to a rather limited number of activities, such as house building, welfare services provided by the state, and private sector
consumer services such as hairdressing. Tradability, in other words, is a quality possessed by most of the goods and services produced by man, but in varying degrees. The prescription to move into the production of tradables can then be interpreted as to shift into goods with a high degree of tradability and out of goods possessing little tradability.

The matter becomes even less clear, however, when one takes into account the extent to which the production of goods with a high degree of tradability requires major inputs of nontradables. Take an export crop like coffee. Its efficient production and delivery to the ports will depend, inter alia, on the extent and quality of government extension services, on the availability of storage facilities, on an adequate network of feeder and trunk roads—even on an efficient and honest police force. No doubt these inputs possess little tradability, but if they provide essential inputs into the production of a major export commodity, does one really want to urge a general policy of shifting resources away from such items?

It is, however, possible to approach the matter from another direction and classify as tradable those goods and services whose local prices will be significantly influenced by the level and direction of comparable international prices. Here again, the degree is crucial, for the key word in the previous sentence was “significantly”—but how can one draw the line between prices that are significantly affected and those that are not? Nevertheless, there is a real difference between this approach and the previous one, in the extent to which it concentrates on items that are actually traded. Suppose our country decided to promote self-sufficiency in food by prohibiting both exports and imports? Assuming the authorities were able to enforce this policy, domestic food prices would be made largely independent of world food prices, and by this test, would become nontradables. Perhaps a more common case is where the importation of various manufactured goods is prohibited as a way of protecting local industry. Or the country may be very remote, so that many goods are neither exported nor imported because of prohibitively high transport costs. Again, within limits, local prices will be independent of world trends.

There are at least two problems with this distinction between tradables and nontradables, however. First, what is counted as a tradable depends, in part, upon the specifics of government trading and protection policies, which can change at short notice. Second, it is by no means clear that payments adjustment is fostered by a relative neglect of those items that could be traded but are not because of government regulations. One only has to go back to the first example of the food self-sufficiency program to realize that.

In the end, then, it is unclear what is actually conveyed by advocating a realloclocation of resources in favor of tradables. Various kinds of services
are probably the items most placed at risk by such a recommendation, but even these can raise the productivity or economic responsiveness of workers engaged in the production of exports or import-substitutes. More research is needed to illuminate the nature of tradability, to explore the extent to which possession of this quality really does give some economic activity a deserved priority in adjustment programs, and to explore the consequences for the productive structure and social welfare of a strategy that favors the production of tradables.

*Prices and supply.* The types of adjustment called for in deficit countries as a result of world economic trends over the past decade have necessarily made the adaptation of productive structures more important. The World Bank's structural adjustment initiative was, of course, an explicit response to this. As noted earlier, the Fund has been criticized for a relative neglect of the supply side but, in the past year or more, has laid down more supply-side measures as preconditions ("prior actions") to its stand-by programs.

But both the World Bank and the Fund apparently identify the solution of supply-side deficiencies with "getting prices right." Take, for example, the following authoritative account of the "sectoral and subsectoral concerns" that are regarded by the World Bank as important to structural adjustment and development (Please, 1984a, p. 84):

- the relative roles of the public and private sectors in economic activity;
- the way markets are permitted to develop or are organized by governments;
- the process and criteria by which the level and structure of agricultural prices are determined;
- the industrial policy framework within which industry operates and expands, as determined by tariffs, import licensing systems, and investment promotion schemes;
- the appropriate structure of energy pricing and taxation that will both induce an efficient supply of energy to reflect projected comparative costs of imported and domestic sources, and at the same time, bring about whatever level of energy conservation is considered desirable; and
- a well-formulated public expenditure program.

Only the last item is not chiefly concerned with improving relative prices.

Similarly, a recent article by a Fund staff member on adjustment recognizes both excess demand and supply weaknesses as requiring
policy correctives, but characterizes the supply problem in the following terms (Tseng, 1984, p. 2):

Where the imbalances are attributable to an inadequate growth in supply because of structural weaknesses reflecting price distortions in the economy, policies would aim to improve the allocation of resources so as to strengthen the productive base of the economy.

The supply problem is thus identified with price distortions and it is, therefore, not surprising that the supply-side conditionality nowadays written into Fund programs emphasizes price corrections. Thus, in addition to the familiar ingredient of exchange rate depreciations, measures which have become common include interest rate reforms, the removal or reduction of consumer subsidies, and reforms in parastatal and producer pricing policies.

There are two difficulties with this view. First, the increased importance of adjustments in the productive system over the past decade is not, it is suggested, due to some sudden deterioration in the efficiency of domestic pricing systems, however imperfect they may be. It is due essentially to the need to shift resources in favor of tradables (q.v.) in the face of a deterioration in the commodity terms of trade. This need arose irrespective of the prior existence of price distortions, although there is no doubt that reducing such distortions can greatly assist adjustment.\(^\text{15}\)

The second difficulty is that, however important, improving the structure of price incentives is only part of the solution to the supply problem. Adequate structural adjustment policies are likely to require a variety of nonprice measures which, however, may be neglected in current prescriptions. Depending on country circumstances, these could include new investments in: an improved maintenance of infrastructural facilities; the state provision of technical advisory services—to farmers, small businessmen, exporters, foreign investors, and so on; the provision of labor training facilities; agricultural (and perhaps other) research and development; land reforms; geological surveys (with special reference to energy sources); rural credit; export credit and insurance...and so on.

It would be a pity if, in their efforts to adapt conditionality to changing needs, the international agencies—to say nothing of bilateral donors—were to fail to give adequate weight to such nonprice components. In economies subject to large distortions, price reforms will be a necessary but probably not sufficient condition of adjustment. And some relatively undistorted economies will still need nonprice measures, or have needed them in the past.

\(^{15}\)For example, Hasan's (1984) review of adjustments in East Asian countries stresses the beneficial effects of price-correcting measures.
Finally, the topic of international adjustment returns. It was pointed out earlier that, although adjustment is most appropriately regarded as an international process, it has come to refer largely to the national policies of deficit countries. To go beyond this now, a series of decisions has been taken that add up to an attack on the basic philosophy and institutions of international adjustment.

Over the past three or four years, the following developments have occurred, largely as a result of initiatives by the U.S. Administration, but with the support of a number of other major industrial countries:

- The decision around the middle of 1981 to reverse the attempted liberalization of Fund conditionality that had gained pace during 1979–80. Among other things, this involved placing the Fund’s extended facility into virtual suspense, apart from a small number of special cases. This facility is widely regarded as having been set up in response to complaints by developing countries about the excessively short-term nature of stand-by credits. At the same time, the conditionality associated with stand-bys was made more rigorous in a number of respects.

- The de-liberalization during 1983 of the compensatory financing facility (CFF), which one observer has now dubbed “the fifth credit tranche.” The underlying philosophy of the CFF has always been that it is inappropriate to require countries to undertake adjustment policies in response to temporary fluctuations in export proceeds, as a result of changing commodity prices, or such other temporary phenomena as harvest failures. It has always been regarded as an important feature of the scheme that access to the CFF should be as near automatic as possible and access, at least to the first “tranche” (or up to the equivalent 50 percent of quota) of CFF drawings, has never in the past been subject to much more than pro forma conditionality. This is no longer the case. Increasingly, countries that wish to draw even the first tranche are being denied access unless they already have a stand-by program in place or are willing to observe various policy conditions. Indeed, the British Government was, in 1985, reportedly urging that the CFF be wound up altogether.

- The decisions in 1983 and 1984 to scale down the enlarged access policy, reducing the normal maximum size of credits that the Fund can offer to members.

- The refusal in 1983 and 1984 to authorize a further allocation of SDRs, notwithstanding management and independent support for

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16 This subject is discussed in fuller detail in Killick, 1984, pp. 211–12.
17 This is from Dell, 1985, who documents and discusses the changes in the CFF.
such a move.\textsuperscript{18} Notwithstanding the declaration by the Fund's Interim Committee in 1976 that members should collaborate with the Fund to make the SDR the "principal reserve asset in the international monetary system," it has remained the system's small change, constituting at the end of 1983 only 2 percent of total international liquidity—a statistic which reveals as bogus the protestations of those who have argued that an SDR allocation would increase world inflation.\textsuperscript{19} A probably more genuine motive was a desire to avoid the provision of more non-conditional resources to deficit countries. Given the current structure of international reserve assets, world liquidity is a largely uncontrolled, indeed whimsical, magnitude.

\begin{itemize}
\item The effective refusal of the major surplus countries (and of the United States as a major deficit country freed from payments constraints by the role of the dollar as a reserve asset) to submit to any meaningful surveillance of their exchange rate and other policies, as was referred to by the Managing Director in his address to the 1984 Annual Meeting of the Fund and the World Bank.
\item The general decline in the size of the Fund's resources relative to world trade and the stated refusal of the U.S. Administration to countenance any further quota increase until 1989.\textsuperscript{20}
\item The Seventh Replenishment of IDA at $9 billion, regarded by all major World Bank shareholders except the United States as well
\end{itemize}

\textsuperscript{18}See Williamson, 1984, for a cogent statement of the case for an allocation.

\textsuperscript{19}The press communiqué of the Interim Committee of January 1976 included the following: "The amended Articles of Agreement should include a provision by which the members of the Fund would undertake to collaborate with the Fund and with other members in order to ensure that their policies with respect to reserve assets would be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system" (IMF, 1976 Annual Report, p. 123). From data in the Fund's Annual Report for 1984 and valuing official gold holdings at the prevailing market price, the composition of official reserve assets at the end of 1983 was:

<table>
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<th>Percentages</th>
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<tr>
<td>SDRs</td>
<td>2</td>
</tr>
<tr>
<td>Other Fund-related assets</td>
<td>6</td>
</tr>
<tr>
<td>National currencies:</td>
<td></td>
</tr>
<tr>
<td>US dollar</td>
<td>30</td>
</tr>
<tr>
<td>Other</td>
<td>14</td>
</tr>
<tr>
<td>Gold</td>
<td>49</td>
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\textsuperscript{20}The total value of Fund quotas relative to world trade is currently about 5 percent compared with 14 percent in 1950 and 8 percent in 1971. In September 1984, Secretary Regan of the United States stated that any suggestion of another quota increase before the due date in 1989 was "not acceptable" to the United States.
below the desirable level; the subsequent failure of attempts to put together a scheme of supplementary financing for IDA; and the highly uncertain future of the World Bank’s mooted special facility for Africa.\textsuperscript{21} This situation is likely to have a serious effect on the World Bank’s ability to provide soft loans to low-income developing countries to support structural adjustment.

- The resistance, at least until recently, of the United States and other industrial country shareholders to a general capital increase for the Bank, raising the prospect of depressed levels of net lending by the World Bank to developing countries during the next two or three years. The lack of support for the proposal to increase the World Bank’s gearing ratio is also an issue.

- The declining relevance of the GATT (the General Agreement for Tariffs and Trade), with only about half of world trade covered by its most-favored-nation rules and the spread of non-tariff barriers.\textsuperscript{22} The relative failure of the November 1982 Ministerial meeting, which was unable to agree even upon a standstill on the imposition of new non-tariff barriers, to make effective progress on agricultural protectionism and on the inclusion of trade in services. The tendency in the United States to talk of such measures as a general import surcharge and of going it alone on trade policy with like-minded states, with its grave implications for the future effectiveness of the GATT as a truly international arrangement.

Each of these items is familiar. What is important, however, is to see them in the round, as parts of what amount to an attack on the foundations of international cooperation and adjustment. The effect of these and other policies has undoubtedly been to thrust a larger burden of adjustment—and high-cost adjustment because of the scarcities of supporting finance—onto the deficit developing countries and thereby to impose an asymmetrical deflationary bias on these countries and, to some extent, on the world economy as a whole, in stark contrast with the intentions of those who met at Bretton Woods.\textsuperscript{23}

\textsuperscript{21}These issues are discussed in Overseas Development Institute, 1984.

\textsuperscript{22}See Diaz-Alejandro and Helleiner, 1982, for a discussion of these issues.

\textsuperscript{23}The conference was, however, given reasons for believing that the magnitude of the deflationary bias may not have been large for the world economy in recent years. This presumably reflects (a) the still limited importance of developing countries in total world economic activity; (b) the fact that at any one time there is only a limited number of Fund programs in operation; and (c) that the effects of these are often less than intended (Killick, 1984). There may also be some problems with the methodology employed in assessing the extent of deflationary bias.
Among the consequences of these actions has been the frustration of attempts by the Fund and the World Bank to adapt themselves to meet the changing needs of the system. This was most obvious with the 1981 reversal of the liberalization of Fund conditionality. It was presumably to this that the Fund was referring in the following wistful plea in its Annual Report, 1982 (p. 40):

Another form of international cooperation is the support of member countries for the Fund in its continuing endeavors to adapt its policies and facilities in the light of changing circumstances so as to play an important role in promoting and assisting balance of payments adjustment.

In fact, if we consider the Fund's own statement of its principal functions as consisting of (a) the surveillance of the exchange rate system; (b) the financing and adjustment of balance of payments imbalances; and (c) the regulation of international liquidity, then it is evident that it is today being prevented from undertaking these roles effectively.

In the light of the increased volatility in the world system of trade and payments over the last decade, the attack on the institutions of international adjustment is to be viewed with concern. It means, among other things, that the risks associated with participation in world trade and financing have grown and that countries—especially the weak and vulnerable—need increasingly to concern themselves with how to minimize these risks. Comparative advantage may no longer be an adequate guide to the efficient allocation of resources, for the theory of comparative advantage does not take risk minimization into account. And in continuing to urge an outward-oriented approach to adjustment, the Fund and the World Bank may be implicitly assuming the existence of an orderly and symmetrical world economic system which they are not able to deliver.

Comment

Stanley Please

My comments on Tony Killick's paper must be read in the context of agreement with most of what he has to say. Specifically, I agree with his emphasis on the need for symmetrical adjustment (of surplus and deficit countries in the framework of a multilateral approach); the need, nevertheless, for developing countries to live in the world as it is—warts and all—and to formulate their policies accordingly; and with his reservations about the relevance of the tradables concept for policy purposes and his emphasis on the need for cost-minimizing adjustment programs and on programs that stress not only pricing issues but other aspects of economic reform.
My comments are on the policy and operational implications of his analysis for the Fund and the World Bank—the weakest part of his paper. These comments fall into three sets of issues: global issues; the problems of moving from a balance of payments adjustment target to growth and poverty alleviation as priority objectives within a viable balance of payments program; and finally comments on the pace and content of adjustment programs, particularly for sub-Saharan African countries.

**Global Issues**

Killick asserts the need for surplus countries to share the burden of adjustment to avoid the dangers of an inefficient one-sided and deflationary world economic system. But what, as a practical matter, can the Fund and the World Bank do, other than encourage and berate the surplus countries? Neither Killick nor any of the many other contributors to this seminar, who have taken a similar line (such as Tsoukalis) have any answers to this question in a situation in which only deficit countries borrow from the Fund and only developing countries borrow from the Bank. Neither institution has an operational handle on the surplus or developed countries that would permit them to support or to “insist” on their contributing to the adjustment process.

The challenge to the Fund and to the Bank is, however, different, and Killick does not explore it. It is to take a more active role in leading developing countries as a group to take joint action on commodity issues (such as tropical beverages in which they have a monopoly), on counter trade (by, for instance, increasing tea and coffee quotas to African countries in exchange for preferential import concessions to Indian and Brazilian industrial goods), and on the management of external debt obligations. The objective of such leadership would be to encourage solutions to these and other serious problems. These solutions would be reasonably efficient even in a second-best situation. The Fund and the Bank, in their pursuit of first-best global solutions, count the danger of encouraging the adoption of solutions that are both unfair and inefficient.

Specifically, the Fund should be using its surveillance responsibility to examine the appropriate exchange rate structure for developing countries as a group. At present this surveillance is limited to developed industrial countries. It is, in fact, very curious that the Fund makes devaluation the centerpiece of virtually all its national adjustment programs for individual developing countries, yet it offers no analysis, advice, or leadership regarding the appropriate structure for the exchange rates of developing countries as against those of developed countries. Would a simultaneous devaluation of all developing country currencies be desirable for stimulating efficient South-South trade, for instance, or for providing
immediate preferences for exports from developing to developed countries, or for mitigating the inflationary impact of isolated devaluation in any particular developing country? I would have liked Killick to have focused his analysis on these issues. Are these proposals sensible conceptually? Are they politically and administratively feasible? The time has come to move from simply reprimanding the industrial countries toward determining what unilateral action can be taken by developing countries. Failure to do so will mean that the best global solutions pursued by the Fund and the Bank will be the enemy of the good.

**Growth and Poverty Alleviation**

There is also a need to give increasing priority to what Killick refers to as the “primary objectives” of the Fund—full employment, growth, and economic development. Killick emphasizes that balance of payments viability has had to be accorded pride of place in recent years. This is true, given the failure of so many countries to implement structural adjustment programs during the 1970s when they were borrowing heavily from commercial banks. As a consequence, an emphasis on demand management programs has been the only feasible approach to the financial emergencies facing so many developing countries.

I would have liked Killick to have given more attention to what needs to be done now if developing countries are going to move beyond financial crisis management to putting growth, development, poverty alleviation objectives back on center-stage. Aiming for these objectives must still recognize the importance of balance of payments viability in the likely context of a continuing shortage of external resources—given terms of trade projections, likely levels of interest rates and of concessionary and nonconcessionary funds, estimates of market access for exports to industrial countries, and so on. For instance, more attention needs to be given to public expenditure programs with greater discipline in targeting spending on the vulnerable groups in society (such as children and the poor) and to more low-cost and replicable investments in health, education, sewerage, water supply, housing, and so on.

If this movement from crisis management to a longer-term development strategy is to be commenced, then the World Bank’s role must be enhanced as against that of the Fund. Yet Killick gives no attention to the issue of Bank-Fund collaboration. For instance, instead of the Fund always being the lead institution in the negotiation of a package of economic measures, should this responsibility not pass to the World Bank?
Finally, I have a reservation to express about Killick's discussion of the pace and content of adjustment programs, particularly as this discussion relates to the problems of sub-Saharan African countries. Killick argues, first, for more external financial support to enable adjustment efforts to become effective and, second, for less demanding programs in African countries because their capacity to adjust is limited.

I have no difficulty in accepting the proposal for more external support for adjustment programs, except that it is politically unrealistic. The World Bank's 1984 Joint Program of Action for Africa argued for a $6 billion special facility for Africa to be disbursed over three years. In fact, only £1.1 billion was mobilized, and much of this was not additional for Africa or for developing countries as a whole. With this being the present and prospective political reality, would Killick still argue for less demanding programs of policy reform when, unlike Latin America and Asia, many African countries have to adjust to a trend decline in their economies? Major changes in African economic strategies are required if the African disaster is to be reversed. The operational problem for the Fund and the World Bank is how to keep the feet of governments to the fire of policy reform, and how much action should be expected up front to reflect a commitment to policy reform.

The other operational question for the World Bank and Fund in Africa relates to the composition of programs. Killick observes that action on those variables that determine the speed and extent of supply responses to changes in prices, are not preconditions for Fund drawings—these include agricultural marketing reform, improvements in transportation, availability of incentive goods, and so on. Nevertheless, price changes and particularly exchange rate adjustment are still the centerpiece of Fund programs and the issue which receives most prominence both in negotiations and in public discussions. Although currency devaluation is critical in all African countries, it will prove ineffective unless matched by the institutional and other changes that are required to evoke appropriate supply responses. Such ineffectiveness will bring into disrepute the whole effort at policy reform in Africa.

Here again, Killick fails in his paper to examine the relevant roles of the Fund and the World Bank in Africa. The World Bank, rather than the Fund, has the appropriate staff and experience and also the relevant time horizon for the formulation and implementation of action that will affect the components of the policy packages that are required to address the African problem. The programs must be as "tough" as Fund programs, but different in content. Killick weakens his argument for the latter by emphasizing the need for less harsh programs.
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