

The IMF & the World Bank Respond to Criticisms

By Nicole Wendt

In another section of the E-Book, we reviewed the criticisms of the International Monetary Fund (IMF) and the World Bank, collectively called the Bretton Woods Institutions (BWIs). Here we will explore how the BWIs have responded to their critics in order to maintain their legitimacy.

The first part of this section describes the IMF's efforts to respond to its critics. While the Fund has argued that it is uniquely qualified to cope with international financial crises and that member countries experiencing economic difficulties must inevitably face painful adjustments, it has nevertheless tried to be more sensitive to development issues. For example, its current emphasis on "high quality" economic growth includes a focus on "safety nets" for the poor. And, in its periodic consultations with member countries, the Fund now is likely to discuss issues relating to health care, the environment, and military spending.

In the second part, we will describe the changes the World Bank has undergone in order to respond to some of its critics. After the 1980s, the Bank emphasized investing in "human capital" within a market-based framework. Accordingly, it has greatly expanded its lending in areas relating to social development, ranging from the environment to gender issues. The Bank has also responded to criticisms of its project lending by developing projects from the bottom up rather than the top down. It is also trying to streamline its own bureaucracy and improve its efficiency.

Both institutions claim that their respective charters restrict them from freely expanding their operations in response to the critics. After you read this section, ask yourself whether the charters of the BWIs should be amended to permit each institution to exercise more control of social development in member countries. Would this be a good idea? If you were writing the amendments to the charters, how would you negotiate matters of sovereignty with member countries who may not be excited about expanding the power of the BWIs?

A. The IMF's Response to Criticisms

1. There are Certain Functions That Only the IMF Can Perform.

Supporters of the IMF contend that the IMF is not only relevant but more necessary than ever today, given the speed with which an economic crisis can develop and spread. They point to the role that the IMF played during the debt crisis of the 1980s, the Mexican peso crisis in 1994-1995, and the Asian financial crisis. In all three instances, the IMF stepped in and brokered deals to defuse financial crises that threatened the stability of the international financial system. Specifically, the IMF helped arrange credit for the beleaguered nations, aided in negotiations with outside creditors, and assisted with structural adjustments to prevent further problems. According to some observers, there is no other multinational institution, financial or otherwise, that could have performed those functions.

2. Member Countries Must Endure the Short-Term Pain of Adjustment in Order to Enjoy Long-Term Gain.

Many critics have claimed that the IMF has placed most of the burdens of market-based adjustment on vulnerable groups in member countries. During the widespread structural adjustment programs of the 1980s, the IMF frequently required member countries to reduce government spending. Governments responded by cutting back on programs that the poor, women, children, and other vulnerable groups heavily relied on—e.g., food subsidies, health care, and education.

The IMF (and the World Bank) did not respond by apologizing for requiring adjustment. Given the structural economic problems in member countries, the adjustment remedies had to be equally structural and profound. This is especially true in today's globalized economy, where one nation's problems may spread quickly to other regions of the world. Thus, the IMF argues that countries must undergo the short-term pain of adjustment in order to grow economically in the long term. Without the adjustments leading to efficient growth, the IMF contends, vulnerable groups would ultimately be *worse* off.

Although the IMF did not retreat from its position that market-based structural adjustment was necessary, it did respond to critics in the late 1980s by adopting policies falling under the rubric of "adjustment with a human face." This approach involves the use of "safety nets," meaning social programs designed to cushion the effects of adjustment programs on vulnerable segments of society. The spending is "targeted" at vulnerable groups primarily because economists noted that a good portion of government spending intended for the poor was absorbed by the relatively well-off segments of society, leaving very little for the people the government intended to benefit. So, for example, safety nets have involved reworking a food subsidy program available to all citizens into a program

focusing on obtaining basic foods for the poor.

Today, the IMF regularly attends to safety-net spending. For example, in recent agreements with Indonesia, the IMF agreed to the continuation of food price subsidies to protect the citizens of that nation. Not only does the IMF's sensitivity to vulnerable groups help the institution appear responsive to criticisms, but it also reflects the Fund's conclusion that adjustment programs are far more likely to succeed if they are based on sound judgments about domestic (and international) reactions to the economic and social pain the programs typically induce.

Due in part to its reactions to critics, the IMF today emphasizes development policies that promote "high quality" economic growth. In order to promote such growth, the IMF calls upon member countries to adopt stable macroeconomic policy frameworks, market-based trade and investment policies, principles of good governance that include transparency, participation, accountability, and social safety nets for temporary use during adjustment phases. (Other sections of Part Two of the E-Book describe good governance and participatory development.)

3. The IMF Has Broadened the Range of Issues Addressed in Article IV Consultations.

The changed nature of the international monetary system, along with criticisms of the IMF, has also prompted it to broaden the range of issues it discusses with member countries. The discussions typically take place during "Article IV consultations," regular meetings the IMF staff holds with economic policymakers in member countries. Prior to the collapse of the par value system in the early 1970s, the discussions were limited to traditional macroeconomic variables closely linked to maintaining fixed exchange rates, such as reduced budget deficits and a decreased money supply.

The collapse of the par value system led the IMF to look at additional factors that might affect macroeconomic stability, such as labor, health, and agricultural policies. The Fund justified the more expansive approach by pointing to its charter-based mandate, which requires it to promote orderly and stable exchange rates, oversee a multilateral system of exchange of payments for current transactions (e.g., trade), and help countries with balance-of-payments problems.

Over the years, criticism of IMF adjustment policies, activism by non-governmental organizations, and investor-led lobbying have significantly expanded the topics discussed in

Article IV consultations. The IMF now regularly addresses issues such as health care, environmental protection, welfare, housing, military spending, and public sector management with member nations. Many of these areas, which are sometimes touched upon in IMF conditionality (conditions placed on lending), relate in one way or another to human rights.

One topic of Article IV consultations that relates to criticisms reaching back to the 1980s adjustment programs (and even before that) is income distribution and inequality. This change came about as the IMF realized that inequality could be a barrier to sustainable growth in developing countries. Rather than wait for member countries to ask for advice from the IMF regarding poverty and income distribution issues—the protocol used through the late 1970s—the IMF actively began to advise members on these matters in the context of fiscal policy (taxation and spending).

The IMF's concerns about poverty were also reflected in the Enhanced Structural Adjustment Facility (ESAF), created in 1987. The ESAF is only available to the poorest countries experiencing protracted balance-of-payment problems. The Facility issues concessional loans based on the Policy Framework Paper (PFP), a document prepared by the IMF, World Bank, and the member country. The PFP identifies the country's economic problems and the steps that must be taken to correct those problems with the assistance of the IMF and the World Bank. The PFP also includes measures to help cushion the impact of adjustment on the poor. Today, the IMF is planning to use the ESAF - which has been renamed the Poverty Reduction and Growth Facility - to help reduce the debt burden of "heavily indebted poor countries" (HIPC).

4. The IMF Charter Limits the Expansion of "Conditionality."

Some in the world community believe the IMF is not doing enough about the economic inequalities and social disparities that exist in many developing countries. They believe the IMF should attach more conditions and seek a more proactive role in its members' domestic policies. As we've noted, however, the IMF charter restrains the scope of the Fund's conditionality, i.e., the variables to which it requires borrowing countries to adhere in exchange for financial assistance. Article IV 3 (b) requires that the IMF "respect the domestic social and political policies of members, and in applying these principles . . . pay due regard to the circumstances of members." The IMF believes this provision prohibits it from considering political factors in its operations. Of course, distinguishing between political and economic factors is easier said than done. Observers have pointed out that the Article IV prohibition does not prevent the IMF from linking, say, severe human

rights violations (South Africa in the 1980s) to areas within the IMF's traditional concerns, such as a member country's balance of payments position.

B. The World Bank's Response to Criticism

Like the IMF, the World Bank has also adopted the adjustment-with-a-human-face approach to its programs. However, unlike the Fund, the Bank has been more responsive to criticisms regarding its operations and accountability to the public.

1. In 1990, the World Bank Once Again Focused on Poverty Alleviation, but This Time in a Market-Friendly Framework.

In 1990, after the debt crisis had subsided somewhat, the World Bank returned to a theme it embraced in the 1960s and 1970s—poverty alleviation. This time, however, it took a market-friendly approach to its mission. It published a well-known report laying out its views on development. The report stressed market-based development policies based on labor-intensive growth, investment in human capital (e.g., education and health), and targeted spending on the poor during adjustment—i.e., safety nets. Today, the Bank's lending activities and policy advice cover a broad range of topics relating to social development, such as community participation in development, [gender issues](#), family issues, environmental issues, judicial/legal reform, private sector development, and good governance.

2. The World Bank Uses Conditionality to Address Poverty Alleviation.

Observers have also noted that the World Bank has used conditionality to address poverty alleviation in developing countries. As we've noted above, countries facing rigorous market-based adjustment programs have sometimes chosen expenditure reductions that hurt the poor. Increasingly, the Bank has relied on charter provisions (relating to raising the productivity and living standards of labor) to include loan conditionalities. The conditions protect and even increase spending benefiting the poor, such as for primary education, basic health care, nutrition, water supply, and sanitation. The Bank also helps countries implement anti-poverty measures and poverty monitoring systems via various loan programs.

3. The World Bank Has Instituted Internal Changes to Become More Responsive and Efficient.

In addition to responding to criticisms regarding the content of adjustment policies in developing countries, the World Bank is responding to criticisms of its operations and procedures. In many cases, the problems relate to Bank practices that began well before the 1990s.

Many observers, such as Andrew Kamark, claimed that the World Bank lost its focus during and after the McNamara era—Robert McNamara was the Bank's President from 1968 to 1981—due to the shift in focus from outcome-oriented projects to an output/volume approach. Under that approach, the Bank measured its success by the number and size of Bank loans to developing countries. The Bank leadership paid little attention to whether the projects were implemented successfully; in fact, most were failures.

After the pressures of the 1980s debt crisis had subsided, the World Bank conducted an intensive review of its own procedures, projects, and personnel by the Portfolio Management Task Force. Its 1992 report, better known as the Wapenhans Report (after Willie Wapenhans, who led the group), identified the counterproductive "loan approval" culture of the World Bank. The quality of projects and their success had fallen, employees were unhappy, and member countries as well as communities within the countries claimed the project cycle (the way the project is designed and implemented) was not responsive to their needs.

The Bank has responded to the criticisms in a number of ways. First, it has tried to adopt a "smaller is better" lending philosophy by refocusing on quality or outcome-oriented analysis, which stresses project viability and includes funding loans for smaller projects, including very small businesses run by individuals or small groups in localities throughout the world (known as "microenterprise lending").

Second, it has begun to encourage "participatory" development by seeking information and feedback from the people the project is intended to benefit—the stakeholders. Moreover, it has begun to assess more closely the social impact of its operations. And through "country assistance strategies," the Bank has tried to broaden its focus to the national level (as opposed to the region in which the project is located) in order to help the Bank and its members implement development strategies more effectively.

Third, today's emphasis on participatory development has prompted the Bank to become more accessible to the public. It now releases information to the public regarding its projects. It has also developed formal ties with non-governmental organizations, as described elsewhere in the E-Book. The Bank has also established an Inspection Panel that allows private groups to monitor whether it is abiding by its own policies and procedures.

Many of these initiatives have been rolled into the Strategic Compact, an administrative plan intended to streamline the Bank and improve its effectiveness and

efficiency. The Compact's goals include cost reductions at the Bank, increased technical staff, expanded partnerships with other institutions, more openness and release of materials, decentralization of staff, and an increased emphasis on the social impact of development.

4. The World Bank's Charter Limits the Extent of Its Responsiveness.

The Bank's responsiveness has required it to walk a fine line with respect to its charter, which prohibits the Bank from interfering with domestic politics. Specifically, according to Article IV, section 10, the Bank and its officers cannot "interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member. . .[o]nly economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially." The Bank has formulated a test to distinguish between "economic" factors, which it can take into account, and "political" factors, which it cannot.

However, the test, which focuses on whether a factor has a "direct and obvious economic effect" relating to the Bank's work, is hard to apply. This has made some human rights observers wonder how the Bank can conclude that genital mutilation is an economic issue while at the same time refusing to extend that interpretation to freedom of press issues.

Although expanding the factors included under the "economic" realm may seem just from a human rights point of view, continued expansion of the Bank's operations into other areas would eventually lead to a situation where any matter would fall within the Bank's jurisdiction. The question then becomes whether the World Bank can be everything to everybody. The experience of the 1960s and 1970s suggest that it cannot do so successfully.