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Chapter 9

ENFORCING THE RULES IN A GLOBAL ECONOMY: THE EMERGENCE OF STRUCTURAL CONDITIONALITY IN THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND

by Louis Pauly

9.1 Introduction

When a country joins the emerging global economy, commitments implying much more fundamental change than initially anticipated soon make themselves clear.[1] Over the past twenty-five years, moreover, the nature of those commitments has itself changed dramatically, and so have the mechanisms through which the chief architects of the global economy attempt to encourage them. In this paper, I focus on one such mechanism: financial assistance from international financial institutions now entailing "structural conditionality."

The emergence of that policy instrument, which can seem like an instrument of enforcement to its targets, is puzzling in itself. Sovereignty remains a key organizing principle in a world demonstrating little inclination toward global government.[2] Even if that principle has often been honoured in the breach, for the strong directly to attempt deep domestic transformation in the weak has been rare since the hey-day of European colonialism. Why are the strong, and especially the United States, seemingly embarked once again on a crusade to remake the world in their own image? And why are the weak, despite some

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[2] For a recent treatment of the theme, see Krasner (1999).

evidence of building resentment, now going along? This paper sets recent developments into their contemporary historical context. It offers a political explanation for the emergence of structural conditionality in the lending programs of the World Bank and the International Monetary Fund, which emphasizes patterns of pragmatic adjustment within international organizations to revealed preferences and deep structural rigidities within the leading member-state in both organizations. The crucial decade of the 1980s provides the focal point.

9.2 Context

In the early years after World War II, when the seeds of contemporary international markets were first sown, exports, imports, and accommodating portfolio investment rendered still-autonomous and quite distinct national economies interdependent. Interaction through limited trading arrangements even began drawing in some economies with anti-capitalist ideological foundations. The Cold War, on the other hand, certainly helped submerge considerations of the political costs of economic interdependence among the anti-communist allies and thereby accelerated the integrative thrust of many national policies (see Gilpin, 2000).

During the 1970s, foreign direct investment and mushrooming growth in short-term portfolio flows intensified pressures on idiosyncratic domestic structures and created markets that rewarded conformity to certain expectations of behaviour. For countries seeking economic growth and prosperity, eventual agreement on more than basic economic rules was implied. The alternative of changing the emerging structure of the global economy itself was attempted during the troubled decade of the 1970s. Plans for a "New International Economic Order," one privileging local autonomy, national difference, and at least the possibility of assigning higher priority in national policies to social justice than to economic efficiency, came to naught. Instead, "structural adjustment" within developing countries gradually emerged as the order of the day. Progress toward a global economy, and entry to that economy by those left out, began to imply convergence toward the 'way business is done' in the world's richest countries. Never mind the fact that actual business practices often differed profoundly across the advanced industrial world (see, e.g., Berger and Dore, 1996). Never mind the fact that idiosyncratic economic structures in the developing world reflected distinct histories, cultures, and politics. Never mind the fact that colonialism left persistent legacies across much of that world.

By the late 1980s, the main architects of the global economy – a handful of leading industrial states under the sometimes wavering but never seriously contested leadership of the United States – had constructed a world where

international economic organizations appeared to dictate deep structural change in countries needing financial assistance. By the end of the 1990s, the World Bank, regional development banks, and especially the International Monetary Fund (IMF) were apparently now authorized to promote an expansive agenda of "good governance." As Michel Camdessus, Managing Director of the IMF from 1987 through early 2000, stated in speech after speech, such a rubric now covered not simply prohibitions on outright corruption, but also prescriptions for financial market operations organized around objective commercial criteria, transparency in industrial conglomerates and in government-business relations more generally, the dismantling of monopolies, and the elimination of government-directed lending and procurement programs (Pauly, 2000).

The emerging global economy now seemed to require not simply voluntary adjustment in the context of interdependence, but also the external imposition of intrusive normative standards in return for desperately needed financing. To radical critics from the left, "structural conditionality" now cloaked a new form of imperialism. To their counterparts on the right, the tool proved a handy vehicle for the self-interested agendas of international bureaucrats. To more sanguine observers, it seemed a defensible and rational response to new market realities, a response embedded in a profound transformation in the ideological orientations of national policymakers in developing countries.[3]

Uncomplicated radical, liberal, or realist explanations may be attractive, but they are ultimately unsatisfying. The overarching questions are clear, but the easiest answers seem facile. Why did intergovernmental organizations of nearly universal membership and a founding ethos of political neutrality become the apparent enforcers of political preferences identified most clearly with a few rich countries, and especially with the United States? In a world where political authority remains dispersed but economic power is concentrated, why did a particular form of liberal internationalism develop whereby intermediaries originally organized precisely to allow members to retain a substantial degree of autonomy now became the guardians of a universal orthodoxy? Why did the strong not simply allow market forces to overwhelm those intermediaries and force adjustment among the weak? If their political autonomy meant anything anymore, why did the weak not continue in their resistance to the ministrations of those intermediaries?

The story of the emergence of structural conditionality in the World Bank and the International Monetary Fund revolves around such questions and sheds light on much larger themes in an era now identified with the mystical word "globalization." In order to explain the phenomenon, the perspective informing

[3] According to James (1996, 609), "there is no separate economic truth that applies to developed, or to developing countries."

this paper relates the outcome of integrating markets to intensifying interaction among national political systems, an interaction increasingly buffered by international political organizations, and an interaction with a very long history (see Pauly, 1997). In the end, I argue that a system that increasingly defers to "market" signals but refuses to give up on international political organizations capable of buffering those signals, or to sort out and clarify jurisdictional disputes across those organizations, perfectly reflects deep structures of governance within the political economy of the system leader.

I draw one implication from such an argument. The most sweeping positions taken in continuing debates over a "new international financial architecture" are misguided and misdirected. Skepticism is the appropriate response to calls for the abolition of the Bank and the Fund from the ideological left or the ideological right, to calls for a radical refocusing of institutional mandates across the two organizations, and to calls for a massive recapitalization and expansion of them and other international organizations. Such demands profoundly misunderstand the ultimate political underpinnings of the emerging global economy. A short paper focusing on the historical record cannot do more than point toward those underpinnings and attempt to render plausible an argument that begins with the evolving structure of the American polity. By doing so, however, it can weaken the most common stand-alone explanations for the alleged rise of the Fund and the Bank as rule-enforcers: self-aggrandizement on the part of international civil servants, the inevitable conversion of national authorities in developing countries to sound economic orthodoxy, direct orders from the U.S. Treasury, or self-interested lobbying by private creditors.

9.3 Structural Adjustment at the World Bank

In 1979, the World Bank first broke its standard practice of lending mainly for specific projects and began offering "structural adjustment loans." A major, and continuing, transformation of the Bank's focus and mandate commenced. But the decision did not come out of the blue.

Financial conservatism had genetic roots in the Bank, roots that embedded in the soil of American financial markets. The need to maintain its AAA credit rating, however, did not render the Bank into an automaton. Just as ancient "sound money" orthodoxy did dominate national economic policy-making in Britain and the United States in the 1940s, 1950s, and 1960s, neither did the character of financial markets leave the Bank without room for maneuver. It needed that room, for it was a creature of its leading member-states, few of whom would have appreciated the Bank foisting American values on them through policy-based lending. The Bank was forced to tread a fine line between satisfying

the financial expectations of its main shareholders and respecting the sovereign authority of its main clients.

In fact, the Bank was flexible in its formal and informal policy advice right through the 1960s. It was "Keynesian," in the sense that it accepted a role for government in aggregate demand management, but it was also open to microeconomic interventions intended to influence overall output. Stable macroeconomic frameworks inside client states were sought, frameworks that over time would promote a reasonable equilibrium between internal and external balances. Excessive demand and its symptom, high inflation, could lead the Bank to halt its lending to a country, but the Bank did not question the legitimacy of the efforts of clients to steer markets, adopt and implement indicative economic plans, and control incoming and outgoing investment (Mason and Asher, 1973, 662). It supported the International Monetary Fund's mission of building up a global macroeconomy characterized by unified national exchange rate systems aimed at the kind of financial stability that promised to facilitate the expansion of international trade and long-term investment through well-functioning markets. Without compromising such objectives, however, the Bank was pragmatic in its judgment of the full range of policies influencing the structure of national economies and it was generally cautious in its attempts to use financial leverage to encourage specific changes in macro-policies.

A shift began to occur in the Bank when Robert McNamara assumed the presidency in 1968, but it was not a shift toward what one might call "Wall Street" values. In this respect, it is worth recalling the ideological baseline. In American political terms, the Bank and the Fund were emanations of Franklin Roosevelt's "New Deal."[4] The original plans for both institutions were anathema on Wall Street, for obvious reasons. After recovery from the ravages of war had occurred, the Fund and the Bank as providers of financial assistance to countries in need would be competitors to private financiers, and competitors with the very potent advantage of holding tacit guarantees from leading creditor states. Consequent distrust and resentment would pose larger challenges for the Bank than for the Fund, for the Bank was made dependent on private investors willing to hold its bonds while the Fund was provided with substantial "own resources" through the quota subscriptions of its member-states. That the Bank would attempt to accommodate Wall Street orthodoxies, therefore, is not as puzzling as the fact that it, in fact, resisted those orthodoxies for so long. Its early presidents articulated a conservative vision and kept the Bank focused on projects of relatively limited scale not often directly competitive with the interests of private finance. Any general policy advice they may have given was likely liberated from narrowly defined private interests by the continued legacy of the New Deal right

[4] The fullest exploration of this theme can be found in Ruggie (1998).

through the 1960s.

While some observers in 1968 may have expected the incoming president, Robert McNamara, to steer the Bank in an even more conservative direction, the opposite seems to have been his own intention. As McNamara made clear in later interviews with the Bank's historians, he always opposed fiscal indiscipline in the Bank's client states. But he also moved quite deliberately to expand the Bank's direct engagement with large-scale issues of poverty reduction, population control, and environmental-quality improvement. By way of implication, this engagement included the commitment of the Bank to harness and channel greater financial-resource flows, including loans at concessionary rates effectively subsidized by creditor governments, and the necessity for the Bank to seek leverage points to guide allocation decisions inside client states. In practice, these two objectives existed in tension with one another, and success in raising new resources overshadowed aspirations for enduring policy influence.

During the heady and turbulent decade following McNamara's arrival, a vast expansion in the Bank's size and scope sought to keep pace with the rising expectations linked to rising demands for a "New International Economic Order" and to simultaneously rising financing "gaps" associated with unprecedented oil price shocks. "The net result was that the 1970s (until their final year) were a period in which most of the Bank's policy-influencing efforts were upstaged and ineffective" (Kapur *et al.*, 1997a, 472). Inside the Bank, nevertheless, the ground was prepared for the Bank one day to refocus and reinvigorate an agenda for policy reform in its client states, not least because clients desperately seeking cash infusions during the 1970s had opened the door.

A "great bend in events," as the Bank's historians call it, occurred between 1979 and 1981. The cast of characters in the drama on the world stage is well-known. Margaret Thatcher, Paul Volcker, Ronald Reagan, Milton Friedman, Walter Wriston. Against a changing ideological background, McNamara continued in his quest to increase the Bank's lendable resources, increasingly to be targeted at anti-poverty programs.[5] Advising him and writing speeches for him were such well-known pro-development, anti-poverty activists as Mahbub ul Haq, later Pakistan's Finance Minister. The Bank's chief economist, Hollis Chenery, helped construct the intellectual links between resource claims and deeper policy conditionality. Ernest Stern, the Bank's chief operating officer after 1978, combined pragmatism with a clear vision of the need for policy reform inside the Bank's clients.

[5] Curiously, McNamara's memoirs are silent on this period of his life, but speculation on his motivations then frequently and plausibly highlight the importance of his searing experience as U.S. Defense Secretary during the Vietnam War and its legacy of regret and atonement (see McNamara and Vandemark, 1996).

The Bank's new drama opened on May 10, 1979, with what must at the time have seemed like a fairly innocuous speech by McNamara to the UN Conference on Trade and Development meeting in Manila:

> In order to benefit fully from an improved trade environment, the developing countries will need to carry out structural adjustments favoring their export sectors. This will require appropriate domestic policies and adequate external help. I would urge that the international community consider sympathetically the possibility of additional assistance to developing countries that undertake the needed structural adjustments for export promotion in line with their long-term comparative advantages. I am prepared to recommend to the Executive Directors that the World Bank consider such requests for assistance, and that it make available program lending in appropriate cases. (Kapur *et al.*, 1997a, 506-7)

During the next year, "structural adjustment loans" would be formalized just as demand for them would grow in tandem with rising balance-of-payments deficits occasioned by the second oil-price shock.

The Bank's Board approved the new initiative early in 1980 and authorized structural adjustment lending in the range of $700 million during 1981. (The Board had authorized an increase in the Bank's capital stock from $41 billion to $85 billion.) Individual loans were to adopt the "program" model then used by the IMF. They were to be policy-based, not project-based. They would be phased in on a multi-year basis and would aim at basic reforms in longer-term economic structures. (The IMF, with whom the Bank pledged to coordinate its SALs, would continue to emphasize short-term adjustments needed to correct external payments imbalances.) Moreover, Bank documentation on the thinking behind SALs provided a broad set of examples of the types of policies that might be targeted for reform: policies shaping incentives, infrastructure, and marketing to encourage export diversification, policies affecting domestic resource mobilization, price incentives, and efficient resource use, and policies protecting inefficient industries and preventing the emergence of more competitive industries (Kapur *et al.*, 1997a, 510). As if to symbolize the Bank's new enthusiasm for such a reform agenda, a leading proponent of neoclassical economics, Anne Krueger, was appointed chief economist of the Bank in 1982. Between then and 1986, the Research Department would undergo a major transformation and its work would provide a rationale for the adoption of market-friendly policies by developing countries (Rogers and Cooley, 1999, 1405).

Ernest Stern later recalled that structural adjustment lending was intended to accomplish three main things. It would "support a program of specific policy changes and institutional reforms designed to reduce the current

account deficit to sustainable levels, assist a country in meeting the transitional costs of structural changes in industry and agriculture by augmenting the supply of freely usable foreign exchange, and act as a catalyst for the inflow of other external capital to help ease the balance of payments situation" (Stern, 1983, 89). This emphasis on the payments balance effectively subordinated Bank programs to IMF programs, but this apparently did not bother Stern. In practical terms, the actual procedures put in place to administer a Bank program mirrored those of the Fund. Stern (1983, 101) described the underlying procedures that "may be called conditionality" as follows:

> The Bank must reach a firm understanding with each government on the monitorable action programs, specifying both the steps to be taken and the studies required as a basis for further progress. The practice for this understanding is to be spelled out in detail in a Letter of Development Policies that is explicitly referred to in the loan agreement. The tranching of disbursement involves the identification of a few key actions that are specified as preconditions before the release of the second tranche. However, satisfactory progress on the implementation of the overall program is also a requirement.

The shift allowing policy-based lending to occur through the Bank reflected a clear trade-off. New resources from creditor states implied new opportunities for constituents within those same states. Creditor states, and the private financiers of the Bank based within them, were expected to increase the net resources at the disposal of the Bank. They needed an incentive of their own. Even if policy reform could be depicted as inherently good for the Bank's clients, whether they welcomed it or not in the short-run, the reform agenda itself needed a supportive coalition of beneficiaries within the creditor states. Exports implied imports. The building and rebuilding of infrastructure in developing countries promised opportunities for bankers, engineers, and equipment manufacturers in developed countries. Anti-protectionism in poor countries opened markets for rich countries. Moreover, as services became more important in the economies of creditor states, the range of markets needing to be opened in "emerging" countries broadened. The line between portfolio capital flows needed to lubricate the machinery of trade-in-goods and flows constituting in themselves trade-in-financial services began to blur.

There was nothing cynical about the new trade-off. No conspiracy theory is needed to explain it. Opening markets for goods and services in the Bank's client states promised to open markets for financing in its creditor states. Capitalism of the American-inspired, liberal internationalist variety, the context without which the institution of the Bank itself would not have made sense, logically moved along a two-way street. Whether the complete construction of

such a street was intended or not, certain consequences would follow in the coming decade.

The first use of the Bank's new structural lending tool happened to coincide with a significant transition in its leadership, a transition that paralleled a much broader ideological shift within leading creditor states. Journalists at the time commonly described the shift in terms of the death of Keynesianism and the reemergence of laissez-faire liberalism and of classical "sound money" orthodoxy. In retrospect, that distinction is too stark. Excessive inflation, deepening fiscal imbalances, and threatened financial panics certainly shaped a new policy consensus across many OECD states. But Keynesianism, broadly conceived, survived. Indeed, within the United States its touchstone policy of aggregate demand stimulus took on renewed importance as defense spending increased. Similarly, a widespread movement in OECD macroeconomic policies toward monetary restraint never truly became absolute. Still, classical economics, with an emphasis on market-led solutions, came back into fashion – in the North American academy, in Washington policy circles, on Wall Street and in the City of London, and, hardly coincidentally, in a World Bank now led by the former CEO of Bank of America. The SAL tool was a tool readily remolded in its light.

A reduced economic role for governments, an expanded role for more open markets, export expansion, import liberalization, the privatization of public enterprises, more flexible exchange rates, fiscal austerity, monetary targeting, expanding reliance on private financing flows and foreign direct investment – all of these policy reforms constituted the new agenda. And all of them implied deeper institutional change inside the Bank's client states. If the leaders of those states had once thought that structural adjustment loans represented a low-cost vehicle for increasing net inward resource transfers, they soon realized their mistake. Expanded Bank conditionality, and a subtly threatened evolution of cross-conditionality with IMF lending programs, promised heightened domestic political pressures. Likewise, however, free marketeers forecasting the dawn of a new, post-Keynesian era where efficient markets would ineluctably constrain such pressures would soon also be disappointed.

Bank SALs in practice turned out to be few, relatively small, and far between during the earliest phase of their implementation. An adapted version, targeted on specific sectors of a client's economy, also did not usher in a complete revolution in the way the Bank did its main business. Borrowers, unsurprisingly, turned out to be chary of accepting policy conditions deemed too intrusive, even when they needed the money badly. Before the debt crisis of the 1980s came into its fullest bloom, moreover, many middle-income countries most suitable as candidates for policy-based, reform-oriented Bank loans enjoyed access to other sources of financing – mainly foreign commercial bank loans, which generally came with no conditions except repayment with interest. What

the Bank had done when it invented SALs, however, was to create a relatively quick-disbursing vehicle for partially replacing such sources of capital if and when they dried up.

SALs had a number of consequences inside the Bank during the 1980s. For one, their logic implied, and their character allowed, a proliferation in policy objectives. Getting incentives right inside client economies meant deeper and deeper structural adjustment. From a bureaucratic point of view, the short-term costs for the Bank to add conditions to its loans seemed very low. If those conditions were not met or if they were regularly ignored, their long-term costs in terms of the Bank's own legitimacy could turn out to be very high. In fact, they deepened the necessity for expanded coordination between Bank and Fund programs. Money is fungible, and certain limited ideological, functional, and even cultural conflicts forced the two institutions to define and redefine their respective turfs over time.

The key example of where such conflicts could lead occurred in 1988 and 1989, and it involved Argentina. The story is well told elsewhere, from diverse points of view (Kapur *et al.*, 1997a, 527-31; Polak, 1997; Boughton, 1999, 49-56). The essence, for our purposes, is that the IMF was trying to negotiate an adjustment program with Argentina that included tough fiscal austerity. New loans from the Bank, for a brief period and likely because of direct political pressure from the U.S. Treasury on its president (now Barber Conable) and on key directors, took the pressure off the government of the day. From the Fund's point of view, this set back the cause of reform and financial stability. Others argued that it represented an emergency lifeline for a struggling democracy. In any event, the Bank soon reversed course, and a new rapprochement (glorified in a document labeled a "Concordat") between the two institutions was quickly negotiated on the basis of a now-traditional but always ambiguous distinction between the Fund's expertise in the area of relatively short-term balance-of-payments stabilization and adjustment and the Bank's expertise in long-term adjustment and development (see Ahluwalia, 1999, 1-26). The incident succeeded nevertheless in highlighting the receding difference between the two mandates and in reminding creditor states of the irrationality of holding back publicly-funded financing with one hand while providing it with another. More importantly, however, it underlined the new overarching context. Public moneys merely primed the pump of private financing. Official creditors needed a strong and compelling rationale for pumping public money into a debtor country while private money was flowing out. Private markets themselves had become the central instrument available for creditor states committed to channeling increased financial flows to debtors.

It is worth quoting in substantial part, the conclusion of the Bank's historians on the implications of the emergence of structural conditionality on the

Bank itself:

> The turn toward heavier practice of macropolicy influence had major effects on the World Bank institution. It shaped the thrust of the Bank's work and program and surely gave many staff and managers a sense of power exercised. But the costs were heavy. With a higher profile, the institution was more exposed to attack. ... The Bank helped cross-reference policy discussion across countries, and the loans that carried [policy] messages sometimes tipped decision balances or facilitated implementation of reform. ... One reason the Bank was interesting as a policy promoter was that it was directed to be, and in considerable measure became, a financially powerful political eunuch. ... The zone of independence around the Bank diminished. (Kapur *et al.*, 1997a, 588-9)

9.4 Structural Conditionality in the IMF

The IMF was originally designed to monitor and defend a global exchange rate system. The underlying aim was to promote the expansion of world trade. Its financial role followed from the need to provide adequate resources in the short-term to enable countries with external payments imbalances to adjust without resorting to system-destructive policies like competitive currency depreciation. Balance-of-payments adjustment was the key. In practice, the kinds of policy conditions attached to Fund credit had to focus on the stabilization of foreign exchange reserves. By way of implication, this translated into a focus on the "soundness" of the macroeconomic policies having the most obvious impact on those reserves. In its early days, then, the words "growth" and "development" would have had no special place in the Fund's lexicon (Polak, 1991).

The situation began to change very gradually after the first concessionary lending facility was created in 1963 in an attempt to help commodity-dependent countries stabilize their export proceeds in the face of increasingly turbulent international markets. There followed various adaptations in the Fund's standard lending arrangements: commodity financing facilities, buffer stock facilities, oil facilities, "enlarged access" to routine funding. To make a long story short, a relatively straightforward line of policy development essentially moved Fund practice from an ethic that equated payments adjustment with monetary stabilization, to one which attempted in principle to balance stabilization with long-term economic growth. One key shift occurred in 1974, with the establishment of the Extended Fund Facility; the Executive Board specified for the first time that financing under this facility would support policies "of the

scope and character to correct structural imbalances in production, trade, and prices" (IMF, 1974). A further step came with the inception in 1976 of a Trust Fund, essentially new financial resources for developing countries garnered from the sale of one-sixth of the IMF's gold reserves.

The US Treasury proposed the Trust Fund in 1974, mainly as a means of building support among developing countries for its belated plan to legalize the post-1971 system of flexible exchange rates. Those countries were about to be disappointed by the refusal of the main creditor states to increase net aid flows by way of the free allocation of the IMF's fiat money, SDR's. That refusal, in turn, was rooted in concerns about excess-liquidity-induced global inflation and the preference of the United States, Canada, Germany, and others not to obfuscate the issue of increasing foreign aid budgets directly. Loans granted under the terms of the Trust Fund did build in an aid element, however, for they were priced at below-market rates and came with relatively easy access conditions.

Ten years later, in 1986, when the original loans from the Trust Fund began to come due, the members of the IMF created a "Structural Adjustment Facility" to recycle the funds to the poorest developing countries, all of whom were asked to submit three-year adjustment programs "to correct macroeconomic and structural problems that have impeded balance of payments adjustment and economic growth." One year later, an "Enhanced Structural Adjustment Facility" was established with grants from Japan, Canada, and others to provide financing at low cost and with long maturity periods to the poorest countries in the world, which soon numbered forty.

By this time the public rationalization for such facilities was to foster growth and to promote sustainable international payments balances. Such a rationalization signaled a potentially far-reaching shift in mandate. Economic growth – a profoundly political matter in both its causes and its consequences – had now achieved something like equivalence with the traditional balance of payments objectives of the Fund. Long criticized for forcing financial stringency on countries really requiring a stimulus to establish a virtuous cycle of economic growth, inward capital flows, and productive investment, the Fund would now be forced to move its adjustment time-horizons outward. Sustainable payments positions and sustainable development were acknowledged as interdependent goals. The Fund remained a global "monetary institution," but by increments it was also becoming an international development agency. For the true believers in politically neutral international organizations, such a transformation presaged much bigger dilemmas in the future. What constituted economic growth? A long series of ancillary questions arise from whatever answer is given. Not least, the following: if growth and development were now the appropriate targets for international financial institutions, could questions of economic justice be

avoided?

The basic set of stabilization and adjustment policies the Fund had commonly come to advocate found their ultimate rationale during the 1980s in the idea of stable, long-term growth – "high quality" growth was the term later used by Michel Camdessus, the Fund Managing Director until early 2000. The fact that the term was not innocuous can only be appreciated in retrospect. Traditionally, and in the simplest terms, the typical country coming to the Fund for assistance was driven there by an excess of its international payments over its international receipts, an excess that it could not easily finance on its own. The Fund was then charged with determining whether the cash shortfall was temporary, thus justifying the straightforward extension of short-term Fund credit, or fundamental, thus requiring an adjustment program likely facilitated in part by longer-term Fund credit. In either case, the alternative, assuming private financing, bilateral official development assistance, and other sources of funding were not available in sufficient amounts, was an immediate reduction in outgoing payments, typically payments for imports. In the case of fundamental problems, the ultimate implications for policies giving rise to them were generally the same. As the Fund's "monetary approach" to the balance of payments assumed, fundamental current account imbalances implied that underlying policies were generating excessive financial claims. Common sense seemed to lead to the conclusion that monetary stabilization required macroeconomic adjustments to address the imbalance, for example, cuts in government spending, monetary tightening to rein in excess credit creation, and perhaps changes in exchange rates to benefit exporters and discourage importers. (It takes little imagination to extrapolate the internal political consequences in the typical developing country exporting commodities and unfinished goods and importing finished goods, technology, equipment, and services. From the Fund's point of view, such consequences were inevitable, likely to be worsened in the absence of Fund financing, and, in any event, very much matters for "internal" distributive politics to manage.)

Common sense met hard experience in the 1980s, when middle-income developing countries ,mainly in Latin America, confronted acute debt crises. As two respected critics of the Fund put it, the Fund's traditional approach risked "overkill" if reciprocal processes of adjustment were not undertaken in countries generating current account surpluses, or if the deeper causes of macroeconomic policy problems were "structural" in nature (Díaz-Alejandro, 1981; Dell, 1983; also Dell, 1981). The latter term was already in use by the Fund to refer to difficulties not attributable to normal business cycles and generally resolvable only in the medium (3-5 years) or longer term. Throughout the 1980s and into the 1990s, notwithstanding its public image to the contrary, the Fund's staff, management, and executive board – often in conflict with one another – took such

criticism seriously. The evolution of special financing facilities and more generalized adaptations in the actual practice of conditionality must be viewed in this light.

Small libraries were filled with analytical and policy research coming out of the Latin American debt crises of the 1980s. The standard view now holds that the basic problem in its early phase was misdiagnosed. As foreign bank lending, which dominated flows into many countries throughout the 1970s, suddenly dried up, the Fund and the world's main creditor countries thought they were dealing with a liquidity problem, albeit a serious one. The solution – embedded in the "Baker Plan" named for its chief architect, James Baker, then US Treasury Secretary – was to bolster the confidence of private lenders, coordinate plans to lengthen debt maturities, and, in some cases, coerce lenders into continued lending. Baker himself put the plan's three main elements more diplomatically: the debtors "should adopt comprehensive macroeconomic and structural policies," the IMF should play a central role "in conjunction with increased and more effective structural adjustment lending by the multilateral development banks in support of the adoption of market-oriented policies for growth," and private banks "should increase their lending in support of comprehensive economic adjustment programs" (Interim Committee Meeting, October 1985, cited in Boughton [1999], Chapter 10, p. 3). In the absence of an international lender of last resort, the Fund was available to act as the coordinator of efforts on the part of creditor governments to keep money flowing. Economic growth would eventually return, and a rising tide was clearly expected to lift all boats. The problem, after all, had occurred on Ronald Reagan's watch.

Alas, optimism can sometimes be excessive, even in the United States. Sufficient and enduring growth did not return to Latin America and the problem deepened. Moreover, the Fund had difficulty adapting to its emerging mandate of structural adjustment. Beyond its staff justifiably feeling out of their depth on microeconomic matters – from bank regulation, to tax reform, to public procurement, to legal reform – skeptics in its management and executive ranks clearly saw the institutional risks inherent in the Fund setting itself up for a job that could prove impossible. The staff also considered themselves to be formally restricted by Conditionality Guidelines adopted by the Fund's Board in 1979, which specified a continuing focus on macroeconomic policies. Under the leadership of a dynamic managing director, who identified the urgent necessity for pragmatic adjustment within the Fund itself, those guidelines were to prove flexible, but disquiet remained among those who cherished the Fund's apolitical self-image.

The Baker Plan, alas, met with very limited success, especially from the point of view of indebted countries unable to hold policy lines that continued to build up trade surpluses while growth sputtered and domestic political coalitions

began to crumble. (Of course, it met with very great success if the core threat really arose from the probability of financial panics in the creditor countries, for the plan clearly gave the implicated banks enough time to get their developing country exposure down to manageable levels in relation to their capital resources.) Diagnosticians both inside and outside the Fund began to conclude that many heavily indebted countries faced solvency, not liquidity, crises.

As in any domestic context, insolvency seemed necessarily to imply debt "restructuring," a euphemism for outright debt reduction to sustainable levels. Such a solution lay at the heart of the next "plan" to resolve the regional crisis, this one identified with the name of Nicholas Brady, who had replaced Baker as US Treasury Secretary. In the absence of an international bankruptcy court, the Fund was again called upon to coordinate national efforts, but this time to construct the functional equivalent of such a court. In short, creative debt workouts generally occurred under the umbrella of a Fund stand-by arrangement, which conditioned effective debt reductions on policy adjustment programs emphasizing macroeconomic matters but increasingly encouraging changes in deeper internal economic structures. In practical terms, this entailed coordinating, even mutually negotiating, letters of agreement between the borrowing country and the Fund and between the borrowing country and the Bank. After 1989, moreover, many programs had longer time-horizons and were also implicitly linked to new money flows directly from creditor treasuries.

The adequacy of such flows is a matter of dispute to the present day, especially for the poorest debtor countries. But to cut to the chase in a long and continuing saga, no one involved in the debt crises of the 1980s emerged happy, and everyone confronted but never clarified the fundamental political, economic, and legal ambiguities inherent in the core problem. When economic growth returned in many of the indebted Latin American countries in the 1990s, optimists concluded that international cooperation had worked. Pessimists, conversely, contended that the problem had merely gone into remission and, on balance, bankers and their principal clients in creditor countries and lucky elites in debtor countries had emerged as the true winners. Both optimists and pessimists could not help observing, however, that the trauma of the Latin American debt crises of the 1980s had profoundly transformed the Fund.

Structural conditionality, as opposed to technical advice touching on structural matters, would not become entirely evident in the Fund until the 1990s. But evolving responses to the debt crises and other events during the 1980s presaged the transformation. Throughout the decade, the focus of daily life for the Fund's management and staff, as well as for its Executive Board, shifted from overseeing adjustments in the system of current international payments to managing the more specific consequences of frictions in the flow of capital from international capital markets to middle-income developing countries.

Incrementalism reigned. Pragmatic responses to individual cases cumulated. The Fund itself – that organization comprised of management, staff, and directors – was transformed by that cumulation. The reinterpretation of its legal mandate under political pressure, and the redirection of personnel, financial, and reputational resources, were the end-results. If a lack of clarity remained at the end of the decade – and it certainly did, it reflected the unwillingness of the Fund's member-states to codify the transformation they themselves supported every step of the way. Here was the true "Washington consensus."

The capital-recycling mechanism at the heart of the global system of economic growth and adjustment could not be "reformed." Its underlying norms and rules could not be addressed explicitly. In short, no formal rules equivalent to those governing world trade could be agreed for world finance. Private intermediaries, regulated by national authorities, could not be regulated at the international level. No single international arbiter could be chosen. The die had been cast long ago, when financial regulatory authority was taken off the multilateral negotiating table and when national regulators began giving more liberty to non-domestic intermediaries than to domestic ones (see Helleiner, 1994). The subsequent policy priority assigned to financial markets in allocation of international resources for development was reinforced as the governments of rich countries intentionally reduced the relative and absolute volumes of public financing available for direct foreign aid. The consequences of increasingly free international capital flows through private channels could and would be addressed with available tools adapted for the purpose.

The historical record of international financial turmoil in the 1980s will, like all historical records, be subject to interpretation and debate for many years to come. As it stands now, however, most interpretations place the Latin American debt crisis at its center. In that context, they also strongly suggest that the expansion of the Fund's mandate into the realm of structural adjustment during that decade did not have a single, easily traceable source. It is true that strategic thinkers on the Fund's staff, most prominently in the Research Department, began arguing in the early 1980s that supply-side reforms were necessary to put leading debtor states onto a more sustainable financial track. Certainly not coincidentally, such views paralleled new thinking just then coming into vogue down Pennsylvania Avenue at a U.S. Treasury Department just then taken over by ardent acolytes of the Reagan revolution. Nevertheless, more than one executive director and many line staff members charged with designing and implementing actual country programs firmly rejected calls for a formal expansion in the Fund's responsibilities in this area. The record also indicates reticence on the part of the Executive Board to give Jacques de Larosière, Managing Director during the first half of the decade, its full and enthusiastic support for projecting the organization willy-nilly into the centre of a crisis that

was beginning to require major adjustments in some basic economic and political structures somewhere. Clearly, structures deep inside weak countries desperate for capital looked the most vulnerable. In 1981, 1986, 1987, and 1988, the Board directly addressed the question of explicitly including in its conditional lending instruments performance criteria related to those structures. Each time, however, it – that is, the member-states comprising the Fund's "shareholders" – backed off authorizing a formal, binding role for the organization.

In 1981, Ariel Buira, then Mexico's Executive Director at the Fund, eloquently captured the skepticism the American-led ideological shift to the right was then engendering in the developing world. In reaction to a staff paper recommending a limited economic role for the state, Buira noted that with regard to the "nineteenth century liberal concept in which the state has ... no development responsibilities, [my authorities] did not expect Fund guidance on this matter."[6] By the end of the decade, however, enough directors from the developing world were in agreement to authorize the staff, in conjunction with their counterparts at the World Bank, to experiment with the concept of deeper adjustment in specific cases where structural reform appeared "essential for the achievement of external viability."[7]

Gradual movement in the direction of embedding a structural reform agenda into Fund lending programs did occur, however, for many Latin American debtors. Other significant cases bolstering the constituency for such an agenda include some ironies. In the case of South Africa, for example, the Fund designed a stand-by arrangement that wrapped a cloak of political neutrality and economic reasoning around an attack on labour market inefficiencies directly attributable to apartheid. Supporting structural adjustment in this sense was a broad constituency that included many developing countries. More controversially, signal Fund programs for Kenya, Tanzania, Uganda, and the Philippines during the 1980s edged very close to the inclusion of requirements for anti-corruption, privatization measures, and other structural measures, but formal performance criteria along these lines proved too controversial. Enforced policy liberalization, or "market-oriented" reform, would have to wait until the next decade. The necessity to adjust unsustainable current account deficits overrode rhetorical commitments to 'adjustment with economic growth' at least in the short-run. Formal commitments could still only be tied to that necessity. Throughout the decade, spokesmen for debtor nations continued to echo Buira's point, albeit with apparently declining enthusiasm: even if structural reforms

[6] IMF Executive Board Meeting Minutes, 81/62, April 20, 1981, pp. 13-19, cited in Boughton (1999), Chapter 13, p. 33.

[7] From Managing Director's summing up of 1987 Board review. Cited in Boughton (1999), Chapter 13, p. 34.

were needed in many countries, it was beyond the authority and the competence of the Fund to enforce domestic institutional change. The Fund's historian puts the matter simply:

> Despite a universal agreement that growth was a 'primary objective of economic policy' and that adjustment would often fail if growth was too long in coming all efforts to link adjustment with growth foundered on this simple dilemma. Lacking a well-established and validated model of economic growth, the Fund could not require structural reforms as a condition of its credits. Not until domestic political support emerged for these reforms in their own right – not until the silent revolution was won – would the dichotomy between growth and stability finally fade away. (Boughton, 1999, Chapter 13, p. 61)

That may be, but it is again worth recalling that the adjective "structural" was used throughout the 1980s by Fund directors from poorer countries to refer not just to internal impediments to growth but also to external constraints on that growth. Low commodity prices, oil price shocks, turbulent exchange rates among leading currencies, closed markets for exports, and, again, the vagaries of privatized international finance – these surely constituted "structures" as well. Could reform of such structures really not be linked to adjustment strategies in developing countries? Apparently not. But, as we have seen, special funds and enhancements in standard financing arrangements could be established in the Fund partly to compensate for the one-sidedness of the process.

The Fund's historian sums up the experience of the organization during the 1980s in the following terms:

> The reliance of many low-income countries on short and medium-term financing from the Fund in the early 1980s and the attempt of many middle-income developing countries to rely on macroeconomic policy reforms in the mid-1980s exposed weaknesses in the coordination of multilateral assistance. Efforts by the Fund, the World Bank, and other agencies to collaborate more fully in the second half of the decade were only partially successful. That effort did, however, help prepare the institutions for the much greater level of coordination that would be required in the 1990s, when countries in transition from central planning would have to make comprehensive structural and macroeconomic reforms in a very short period of time. ... Throughout the 1980s, the Fund circumscribed its own scope for action by limiting explicit conditionality to macroeconomic policies and avoiding interference with policies that could be

> construed as politically rather than economically motivated. The initial success of countries that liberalized on their own – the silent revolution – drew the Fund out of that reluctance in ways that would enable it to play a more active role in promoting structural reform in the 1990s. (Boughton, 1999, Chapter 1, p. 39)

9.5 Structural Adjustment in the 1990s

The 1990s are still too fresh in historical memory to permit a balanced assessment. Newspaper headlines continue to remind us of the key events relevant to the theme of this paper.

The aftermath of the end of the Cold War on its European field. A remarkable boom in the American economy and an attendant resurgence in the global political assertiveness of the United States. Building resentment abroad to that American assertiveness. The beginnings of deep institutional change in most of the planned economies of central and eastern Europe. A steep relative decline of the Japanese economy. The vast expansion and increased volatility of international capital flows, in the form of both direct and portfolio investment. The attendant securitization of national capital markets in many developed economies, and disintermediation pressures on commercial banking, typically still a nationally controlled and protected sector. The surprisingly swift reversal of capital flows to certain growing East Asian countries, and the surprisingly swift recovery of most from financial crisis. The decisive move toward monetary union in western Europe. The continuing decline of development strategies keyed on import-substitution and central planning and the inception of export-oriented, pro-liberalization policies across most of the developing world (Armijo, 1999). The broadening of the apparent overlap between the institutional mandates of the World Bank and the IMF. The formalization of conditional lending programs in both of these organizations keyed on ever-deeper structural adjustment inside client states, now including explicit anti-corruption measures, a panoply of expectations regarding "good governance," legal reform, educational reform, and even the routine review of local social programs (IMF, 2001; Goldstein, 2001). Inside the United States and other industrial states, a mounting reaction to pretensions of "global governance" from the ideological right and an analogous reaction to "globalization" from the ideological left. The appearance of the Fund and the Bank in the gun-sights of both groups, even as both organizations declined in size relative to burgeoning international capital markets.

For present purposes, the latter themes from this rich agenda for future research and analysis stand out. The seeds of institutionalized programs

encouraging, even attempting to force, structural adjustment in developing countries were sown in the 1980s. In the 1990s, those seeds sprouted upon the terrain tended by the World Bank and the International Monetary Fund. Why? The story of the 1980s recounted above provides a clue.

9.6 The Domestic Roots of International Rule-Making

As noted at the beginning of this paper, there is no shortage of simple explanations on offer for the apparent emergence of the Fund and the Bank as the enforcers of structural adjustment in a new global regime. Public choice analysts ascribe it to the preservationist and expansionist instincts of their employees. Fund and Bank historians assign significant weight to an accommodating conversion of national authorities in developing countries to sound economic orthodoxy. Skeptics surmise a grand design orchestrated by the U.S. Treasury, or faceless private financiers pulling the Treasury's strings. Such readings on their own, however, do not fit comfortably with the story of the 1980s recounted above. Taken together, they only help redescribe the mixed motivations of the 1980s and the ambiguous outcomes of the 1990s. Such an amalgamation does little to advance our deeper understanding, nor does it help us to anticipate future developments.

In the early post-World War II period, the U.S. Congress needed to be convinced that U.S. taxpayers would not be left with the full bill for reconstructing economies destroyed by the war or for easing the transition of European colonies to political independence. In the absence of guarantees to that effect, the Bretton Woods institutions would never have seen the light of day. During each succeeding round of legislation required to allow those institutions to develop, new guarantees were required mainly to convince U.S. legislators that public monies would not be wasted. Conditionality itself was born in this context. Its strengthening and broadening into "structural" variants correlate almost perfectly with increasing reliance on private-sector credit (mainly bank lending into the 1980s and bonds through the 1990s) and on private direct investment (especially in the 1990s) as the world's principal sources of development finance.[8] It also correlated with a declining American interest in the institutions except as they connected to the markets through which such credit and investment flowed (Kahler, 1990).

[8] The dramatic relative decline of official development assistance and official development finance and the relative growth of private flows is well tracked in regularly published OECD data, translated into tabular form in annual reports, for example, OECD (1998). See also United Nations (2000).

In countries like Canada, national policy changes needed to assist in bolstering the resources of the Bank or adapting the formal mandate of the Fund are usually handled by the finance minister, the central bank governor, and a small set of elite bureaucrats.[9] Keeping the national treasury open and legislature supportive is relatively easy. In the United States, however, this has never been the case. Parallel elites have had greater difficulty in maintaining control over such issues. As the Cold War receded, the situation became even more difficult as Congress came ever more obviously to the fore, while the power of the presidency receded. Simultaneously, financial markets became much more prominent as the politically preferred mechanism through which key distributive decisions were taken within American society as a whole. Tax cuts, financial deregulation, and encouragement of broader individual participation in equity and bond markets (through, for example, mutual funds) were all part of a coherent policy package. Those markets also became much more important as mechanisms through which the American polity linked the interests of American society with the interests of both developed and "emerging" economies around the world. Not coincidentally today, therefore, American attention to the Fund and the Bank ebbs and flows with the absence or presence of crises in international financial markets.

Without the discourse on structural adjustment, would the American political commitment to the Fund and the Bank increase? I doubt it. Indeed, the reverse is more plausible. Throughout the 1980s, as we have seen, the discourse itself arose out of American political debates. Both on the "left," with McNamara's commitment to poverty reduction, as well as on the right, with the rise of supply-side economics, the discourse of structural adjustment engaged or attempted to engage core American interests. Throughout the 1980s, those interests became obvious as American financial intermediaries confronted the prospect of catastrophe arising from their Latin American portfolios. In the 1990s, similar interests would be undeniable when countries in transition from communism as well as dynamic East Asian countries faced sudden withdrawals of liquidity.

Across the cases, demands for ever-deeper structural change in borrowing countries became more insistent. As Miles Kahler points out, "Assuring the confidence of investors and nudging government toward prudent policies in the new environment had become the central task of multilateral institutions and industrialized-country governments in the 1990s" (Kahler, 1998, 21). This nudging really entailed promoting norm-governed behaviour, with the norms drawn from an idealized version of American economic history. The

[9] The situation is similar in many developing countries, where the role of the central bank in particular has recently been gaining in political importance. See Maxfield (1997).

characterization of Michel Camdessus of "financial market operations organized around objective commercial criteria, transparency in industrial conglomerates and in government-business relations more generally, the dismantling of monopolies, and the elimination of government-directed lending and procurement programs" truly describes the history of no industrial country. It does, however, coincide clearly with the vision for a global market-system that came to be advocated by both government and business in the United States after the death of the Bretton Woods consensus in the early 1970s. The shift from "government managed to market-based mode of governance" within the international system has been widely noted (Kahler, 1998, 21). The view that this was logical, inevitable, and unstoppable was widely embraced during the 1990s. Some astute analysts of the implications and prospects for developing countries have nevertheless adopted a less determinist position. Devesh Kapur, for example, sums up one such argument:

> [Norms can] serve as a fig-leaf for more prosaic material interests. There is an understandable skepticism that richer countries are long on norms when they are short on resources, and the increasing attention to norms of governance even as development budgets decline is perhaps not entirely coincidental. As long as the Cold War was on, "crony capitalism" in Indonesia was not considered a problem. Nor was it a problem while the East Asian "miracle" was being trumpeted. But when the Asia crisis of 1997-98 erupted, norms of corporate governance were strenuously advanced to deflect attention from broader issues of the nature and quality of international financial regulation. (Kapur, n.d.; see also Woods, 1998 and 2001)

I personally have considerable sympathy for Kapur's position as it relates to the emergence of structural conditionality in the Bank and the Fund. Pushing reflection on the material presented in this paper one step further, however, promises deeper insight into both the most significant cause of the shift toward market-based governance and the most likely challenges ahead. In short, it seems to me that the shift mirrors precisely the central struggle within contemporary American capitalism, that concatenation of customs, institutions, and processes comprising a still-national but increasingly open economy. That economy manages and deliberately renders opaque the borderlines between state and society. To a considerable extent, the still-mainly internal struggle now revolves around questions concerning the appropriate place of financial markets within the economy. To be sure, those questions have antecedents going back to the founding of the country. During the post-Great Depression period and right up to the 1970s, a set of answers created a relatively stable equilibrium

characterized by public manufacturing and service corporations with diffuse (non-bank) ownership, by fragmented financial markets (the key parts of which now rested on implicit or explicit government guarantees), by an overarching ideology combining free enterprise with "the rule of law," and by an often obscured but highly significant role for government as systemic regulator as well as builder of a massive defense-industrial base (see Roe, 1994; and Doremus *et al.*, 1998). Accelerating since the 1970s, however, a new set of answers coursed through American public policy, the end-result of which was to enable much greater degrees of financial concentration, much less fragmented financial markets, and much more prominence to economic objectives measured and valued in purely financial terms. Necessarily occurring at the same time was a complicated expansion in the scale of implicit financial guarantees provided by government agencies and a deepening sense of disquiet about the moral hazards thereby entailed.[10]

In such a light, the long-term movement away from the provision of public financing to developing countries (through ODA or through international financial institutions like the Bank and the Fund) and toward the provision of private financing through private financial intermediaries tracks a deeper transformation within the world's dominant economy. Here, I am contending, is the true taproot for the changing mandates of the main international financial institutions. Indeed, structural conditionality makes little sense if it is divorced from this context. Deep change within the system leader implies the need for accommodating change among those who seek to benefit from the system it leads, and who sense on the basis of experience little prospect for the near-term construction of an alternative system.

I do not mean to imply that change in the United States reflects a unanimity among relevant elites. The American polity remains fractious and characterized by an array of cleavages. On international financial policy, for example, deep disagreements have been evident in recent years in the debate over what is now commonly called "a new international financial architecture." The final report of the Congressionally mandated International Financial Institutions Advisory Commission (2000), chaired by Allan Meltzer, reflected some of the most important disagreements even as it tried to present a united front for broad institutional reform. My point is that the very fractiousness of the American polity so evident in a more assertive Congress deepens a national reliance on mediation through the indirect but still deeply political mechanism of markets through which short and long-term investments flow. The underlying logic of those markets – a logic now broadly shared among advanced industrial states –

[10] On how internal US politics played out in the most recent Congressional debate on the core funding of the IMF, see Locke (2000).

still implies the need to manage and circumscribe the residual prudential role of government within them. But the point to emphasize here is that the underlying logic itself is what is projected on the rest of the world. In short, even if accommodation by the debtor does not result from overt acts of coercion, it comes naturally from an absence of alternatives placed on offer by the creditor.

Certain outcomes are undeniable – the tiering of developing economies in terms of their creditworthiness, the increasing desperation of those countries deemed uncreditworthy, mounting pressures on national policies aimed at mitigating income inequality, and the expansion in possibilities for exit for the owners of liquid capital. All such outcomes raise difficult international as well as domestic political problems. The forces prompting such outcomes summon a political response. Available to serve as buffers are international financial institutions originally created in an era less sanguine about the inevitability or the irrefutable justice of market-dictated results. A process of adaptation begins. The dynamics of that process, as the story told in this paper suggests, match almost precisely preceding developments within the United States, developments not easily attributable to any one agency of government or to any one sector of the economy. Therein lies the deeper structure motivating adjustment elsewhere.

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