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The Moral Hazard of IMF Lending

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Two farmers meet. 'I have just insured myself against fire and hail,' says one. 'I can see your point about fire,' replies the other, 'but how do you make hail?'

'In principle, countries always have the ability to pay debt service. . . If the creditor adopts a policy of offering new aid whenever a debtor threatens to default, debtors are likely to increase their threats of default in order to gain more assistance.'

— Wilson Schmidt, in the *National Banking Review* (1965)

'It can be argued that, absent the IMF, individual countries would presumably be less likely to get into balance-of-payments difficulties because they could not rely on the prospect of Fund resources when those difficulties arose.'

— Wilson Schmidt, *The US Balance of Payments and the Sinking Dollar* (1979)

BY CONTRAST to the conventional wisdom about the International Monetary Fund (IMF) and its beneficial importance to today's system of international finance, there is strong evidence that its lending activities are actually unnecessary and probably even counter-productive. In the first part of this article, I will examine the negative effects of IMF lending, then in the second part the arguments that are usually put forward in favour of IMF lending will be criticised.[1]

When the Bretton Woods system of fixed rates of exchange between the major currencies finally collapsed in 1973, many observers expected the demise of the IMF, at least of its lending operations. Yet from 1970 to 1975 the volume of lending more than doubled in real terms. From 1975 to 1982, it increased by another 58 per cent, again in real terms. Even relative to world exports, IMF international liquidity was 35 per cent larger in 1982 than in 1970; and it was 350 per cent larger than in 1960.

Is this an example of Parkinson's Law? Is IMF lending growing even though the need for it has diminished, just as the British Admiralty augmented its administrative personnel by more than three quarters from 1914 to 1928 as the number of

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combat ships diminished from 62 to twenty and, furthermore, as total crew personnel declined by almost a third?

Faced with increasingly widespread floating of exchange rates the IMF grasped the opportunity provided by the oil-price 'shocks' of 1973-74 and 1979-80. The Fund's justification for its lending operations shifted from the goal of exchange-rate maintenance to that of 'facilitating balance-of-payments adjustment' and, most recently, to the prevention of debt crises and bank failures. This is where the interests of the staff of the IMF and of private bankers meet. The politician is faced with an alliance of official and private 'experts' who tell him that more IMF international liquidity is needed. Not surprisingly, the potential borrowers in the less developed parts of the world do not object to this view; and the United Nations Conference on Trade and Development (UNCTAD), the Brandt Commission and the other champions of the developing countries push it on every occasion.

Surprising to some, the IMF not only wants more funds for lending but also demands more emphasis on policy conditions to be attached to its loans. Is the Fund in favour of easier credit (as the request for large increases in quotas suggests) or is it in favour of tighter credit (as the increasing role of 'conditionality' suggests)? What seems contradictory at first glance is resolved once the economic theory of bureaucracy is applied: a bureaucracy, wanting to maximise its budget and its staff, will demand not only more money to spend but also larger powers (conditionality) and the personnel to exercise them.

A bureaucracy will also insist that its products or services have to be subsidised so that demand for them is artificially increased. Almost all IMF credits contain open or hidden subsidies. Open subsidisation has been practised through the IMF's 'oil facility subsidy account', its 'supplementary financing facility subsidy account' and its 'trust fund'. This is also true for loans in the credit tranches and under the 'compensatory financing' and 'buffer-stock financing' facilities. Subsidisation is hidden, but it is still substantial in all cases in which high-risk developing countries can obtain IMF loans at the rates of interest which the United States government, or the governments of the leading industrial countries, have to pay in the market.[2]

The dominant issue today, which is the driving argument behind the recently authorised increase in member-country IMF quotas from 61 billion to 90 billion special drawing rights (SDRs), is the problem of the external debt of the non-oil developing countries, those outside the Organisation of Petroleum Exporting Countries (OPEC). In real terms this debt has been growing steadily. The compound average rate of change has been about 11 per cent annually, with a somewhat slower rate from 1979-81, but an estimated acceleration in 1982. The debt of non-OPEC developing countries to the private capital markets, notably to banks, has been growing faster than total debt almost yearly and the real rate of growth accelerated in 1982. In that year, new international bond issues by the non-OPEC developing countries have been large by historical standards, but not relative to the size of the market. New gross Euro-currency credits to non-OPEC developing countries have declined somewhat, but not relative to total Euro-currency credits. The only significant change is reported by the Bank for International Settlements (BIS): in 1982 the increase in external claims of Euro-banks on non-OPEC developing countries at constant rates of exchange has been only half as large as in 1979-81.

Apart from the large size of external debt, or its decelerating rate of growth, various other indicators have been used to predict a debt crisis, notably ratios of debt to gross national product (GNP) and ratios of debt service to exports. The relevance of these indicators is rather doubtful. Does an increase in any of these ratios signal that debt servicing has become more difficult or, on the contrary, that the borrower is considered increasingly creditworthy by the lenders? The ultimate criterion of whether debt servicing has become more difficult or not is whether the borrower's rate of return exceeds the interest he has to pay. The answer to this question cannot be gained from inspection of some macro-economic aggregates or relatives. It depends on the use of the funds.

Another method is to proceed by extrapolation. In the 1970s, external public debt had to be rescheduled in one to four cases each year. In 1981 and 1982, this number rose to eleven and eighteen, respectively (excluding Poland which is not a member of the IMF). If Wilson Schmidt was right that 'countries always have the ability to pay debt service', these reschedulings indicate a liquidity problem, but not a solvency problem.[3] It would also follow that they indicate an unwillingness, but not an inability, to repay.[4]

To reschedule is to invite demands for further rescheduling. This is one of the points Schmidt was making. The argument can be extended. If the IMF steps in and extends subsidised loans to member countries that threaten to default (incidentally, few of them are low-income developing countries), it encourages both further threats of default and further bank lending to borrowers which have proved themselves to be not creditworthy. Like any no-fault insurance, the Fund is bound to generate an avoidable moral hazard. Since debt-service obligations are not enforced for international public debt, the temptation to default, or to threaten default, is much larger for international public debtors than for domestic private debtors. Since the foreign creditors of governments will be correspondingly more impressed by such threats, it is all the more important that third parties, like the IMF, do not aggravate the moral hazard by rewarding demands for rescheduling.

I have studied the history of rescheduling and of IMF standby credits in the period 1960-82. It supports the view of Schmidt that rescheduling begets further rescheduling for the same debtors. Of the member countries that rescheduled their debts in the period 1980-82, new credits under standby or extended arrangements were granted to eighteen out of 21. In the period 1960 to 1982, only 30 members accounted for all cases of debt rescheduling; and only fourteen of those accounted

for more than 80 per cent of the country-years for which debt was rescheduled. Such an outcome would be extremely improbable if random accidents were the reasons why debtor governments needed help.

Even without rescheduling as an incentive, the prospect of cheap IMF lending is likely to generate a moral hazard by reducing the incentive to stay solvent. It would pay a potential borrower to pass the international means test. Far from justifying the Fund's lending as necessary to achieve durable economic adjustment in the recipient countries, the evidence shows that it cultivates client states.[5] Of the total membership, 42 countries account for 78 per cent of all cases in which a member country received a standby or extended credit from the IMF. Once more, this is not the result one would expect if only bad luck, or random accidents, led to the financial problems of borrowers. The Fund has become a recurrent, in some cases almost a permanent, provider of aid. A number of developing countries have come to rely and depend on the Fund's cheap credits — the outcome predicted by the moral hazard hypothesis.

In view of these counter-productive effects of IMF lending and the increasing role which is being given to this institution, it seems appropriate to raise the more fundamental question of whether IMF lending serves any useful purpose at all. Is it true that the negative effects of IMF lending which are indicated by the evidence given above are offset, or more than offset, by positive effects, welfare improvements?

WHY SHOULD THE IMF LEND?

In considering this question, I shall examine nine arguments for IMF lending.

Exchange-rate Argument

Under the fixed exchange-rate system of Bretton Woods, the loans which the IMF would extend to members from time to time would be for the purpose of intervening in the foreign-exchange market to maintain the par value of currencies. Yet there was not even a clear necessity in those days for IMF lending, since the central bank of a country *could* conduct monetary policy in such a way as to avoid exchange-rate difficulties. After all, non-sterilised foreign-exchange interventions are not the only instrument of monetary policy that can be used to attain exchange-rate targets.

Currency depreciation can always be avoided through a sufficiently restrictive, usually disinflationary, monetary policy. Exchange-rate crises are — from a technical point of view — always the fault of the country's own monetary authorities. To extend subsidised loans to such monetary authorities for the purpose of exchange-rate maintenance is both unnecessary and harmful because it creates a severe moral hazard. Indeed, in comparison with domestic open-market operations to restrain monetary growth, foreign-exchange intervention, financed by IMF lending, has the important additional disadvantage of interfering with the money-supply policies of at least one foreign central bank whose currency is provided by the IMF to the offender.

Even those who support foreign-exchange intervention to maintain a fixed relationship among currencies are forced to agree that the transition to widespread floating rates of exchange has reduced the need for IMF lending. Yet the most dramatic increase in its rate of lending occurred in the 1970s. As *The Economist*, London, wrote in 1976, under the headline 'Do We Need an IMF', 'the IMF did its best to resist the change to floating. Now that it has had to be accepted, why is the IMF still bent on credit creation?'[6]

Gradual-adjustment Argument

As floating gained ground, the IMF put increasing emphasis on financing for real adjustment. According to the Fund,

> 'its concern should be with both the financing of temporary payments imbalances and the adjustment of unsustainable ones . . . in the medium term'.[7]

The assumptions underlying this view are that (i) 'payments imbalances' are usually the result of real disturbances in the market for goods that are not caused by the economic policies of the borrowing government and (ii) some gradual adjustment to such real disturbances is more efficient than shock treatment. These assumptions are controversial,[8] but they will not be questioned here for the sake of argument. More damaging are two other arguments.

First of all, the size of payments imbalances cannot be used as an indicator of the need for IMF lending. There are two reasons for this: (i) Whether or not a current-account deficit is sustainable cannot be judged by looking at its absolute or relative size. Large net capital imports should be the signal of a high marginal productivity from investment and, consequently, a high degree of creditworthiness — not an indicator of the need for IMF financing. (ii) IMF lending tends to increase the borrowing countries' current-account deficits because the current-account balance and total private and official capital movements are bound to add up to zero. If the Fund's reasoning were accepted, the IMF could demonstrate an increased demand for international liquidity by increasing its supply of subsidised loans. IMF lending cannot be the cause of a need for it.

Second and more important, the question must be asked as to why countries that have been hit by unfavourable real disturbances should not finance temporary

deficits, or spread out real adjustment, by borrowing in the international capital market. The major advantage of this alternative is that every country would have to borrow at the opportunity cost of lending in the rest of the world. Another benefit of this solution is that such borrowing, unlike borrowing through the IMF, would not entail expanding the money supply in the capital-exporting country.

The Brandt Commission rejects the view that the market can play a key role in financing deficits.[9] It gives four reasons:

(a) private financing 'is very imperfectly subject to international monitoring let alone control and is easily affected by crises of confidence';

(b) 'it is not easily accessible to the poorer developing countries';

(c) 'it tends, because of its terms, to exacerbate the problem of servicing and refinancing debt'; and

(d) 'there are growing doubts as to the continuing availability of adequate private bank financing in the future'.

Similarly, Fred Bergsten, of the Institute for International Economics in Washington, asserts that

> 'we cannot rely exclusively on private markets. Some borrowers will face serious constraints on their access to private markets, and we must assure that official financing is available in adequate amounts to support required adjustment programs and maintain financial stability while adjustment is taking place.'[10]

The critics reject the market solution because they do not expect it to yield their pre-determined preferred result. They are unwilling to use the market as a process that searches for the best way to use scarce resources; they are unwilling to let individuals decide how capital is to be invested. The assertion that the market fails to work, or that there must be a division of labour between the market and government action, is not even defended with some theory of welfare economics. On such a weak foundation surely the IMF should not build its case.

Insurance Argument

There is a widespread view that the IMF acts as a lender of last resort and is needed to prevent the international banking system from collapsing. But this is not how the Fund behaves. Often countries borrow from the Fund without having exhausted their borrowing capacity in the international capital market. To the extent that the Fund offers subsidised loans, it acts as a lender of *first* resort. There is no reason for a country to go to the IMF if it can borrow on equal or better terms in the market, so in order to lend at all the Fund must subsidise. In the extreme case, it lends to countries that the market does not consider creditworthy. It insures member governments against the market's judgment.

One way of trying to justify such a system is to consider the subsidy part of IMF loans as the only relevant insurance benefit. But in an insurance programme the contributions differ according to risk. Borrowers from the IMF, however, tend to be frequent borrowers and a narrow sub-group of the entire membership. IMF lending is not an actuarily fair insurance. It is biased in favour of the main borrowers, mostly developing countries. It provides them with a net subsidy — a form of programme aid. Yet would the recipients of the net subsidy also choose to insure with the IMF if they could use this aid as they liked or for a number of different programmes approved by the donor countries? Does IMF lending create a needless distortion of the recipients' preferences?

Does the international banking system need the IMF as a lender of last resort? First of all, the international banking system does not seem to be in danger of collapsing. Princeton University's Peter Kenen, for example, has argued that

> 'defaults by developing countries, even if widespread, would not seriously threaten the stability of the international financial system, loose talk to that effect notwithstanding. Some banks and other private lenders would be hurt. A few might be wounded mortally. But there is little justification for the fear that defaults could wreck the Eurocurrency market or would do grave damage to national financial systems.'[11]

The Group of Thirty conducted an opinion poll among 111 international bankers.[12] They were asked to express their opinion on the following statement: 'There is a need for a supranational organisation (e.g., IMF, BIS, or a new institution) to assume the role of lender of last resort for the international banking system.' Only 39 per cent agreed; 56 per cent disagreed. The reason is that the national monetary authorities in the developed countries are expected to act as lenders of last resort for the commercial banks in their jurisdictions and for the latter's foreign affiliates. There is no doubt that they are in a position to do so and that, as the guardians of the money supply, they — not the IMF — should be responsible for emergency lending to banks.

If a commercial bank has a liquidity problem, it can go to its central bank as usual. The IMF is not needed. In fact, indiscriminate IMF lending to the debtors of commercial banks would be far inferior because it would not be targeted at the banks that might need help.

If a commercial bank is insolvent, it should not be saved, neither by the national central bank nor by the IMF. But it would be the duty of the central bank to prevent the bank failure from affecting the money supply.

There is a widespread and unfounded fear that bank failures could trigger another Great Depression. Yet there is no reason why bank failures would lead to depression if the monetary authorities perform their duties and maintain the money supply, say by reducing reserve requirements or by purchasing government bonds (open market operations).[13] The Great Depression would have been avoided if the Federal Reserve System in the United States had not permitted a contraction of the money supply by almost a third.[14]

Externality Argument

It is sometimes argued that subsidised credits for balance-of-payments financing, or specifically for debt-service financing, are needed to prevent the recipient countries from adopting protectionist measures, restrictions on convertibility or other beggar-my-neighbour policies. According to a Keynesian variant of this argument, IMF lending is also a welcome instrument for maintaining the developing countries' demand for imports from the industrialised countries. The general idea is that the recipient countries must be bribed so that they do not impose negative externalities, or costs, on the donor countries.

An institution that tries to buy international 'social peace' by giving in to blackmail on a permanent basis behaves myopically because it encourages further threats and ultimately aggravates international discord. Strategic behaviour requires resistance to repetitive blackmail — the more so because restrictions on international transactions would harm the threatening countries as well; and they certainly know it.

It cannot even be argued logically in a Keynesian framework that the level of aggregate demand in the donor countries can be raised by spending public money abroad rather than at home as long as the domestic sector of the donor countries has any excess capacity as well.

Conditionality Argument

According to a widely accepted view, the IMF ought to extend subsidised loans to its members to induce them to adopt the required adjustment policies. The subsidies serve not only as bait but they are supposed also to guarantee the acceptance of policy conditions that reduce credit risks to private lenders and the Fund itself. While it is true that the acceptance of such policy conditions can justify a reduction in the rate of interest which the borrowing country has to pay, it still does not justify IMF lending at lower rates of interest than the country has to pay in the market after it has accepted the policy conditions.

The conditionality argument immediately raises the question of why borrowing countries are supposed to face insufficient incentives to adopt the necessary policies on their own. After all, the extent to which, and the terms on which, a country can borrow in the market will crucially depend on the policies which it is expected to follow. In the market, conditionality is automatic, perfect and unavoidable.[15]

Enforcement Argument

The IMF is probably in a better position to enforce policy conditions attached to international loans and, indeed, to enforce repayment itself. This is because the IMF, as an inter-governmental organisation, can impose sanctions that are not at

the disposal of private banks. This is not an argument, however, that the IMF should co-finance all stabilisation loans. Such an argument would be like suggesting that to enforce private contracts among its citizens a government ought to be a party to each of them. The IMF could be well advised to use its sanctions to enforce private and public international loan contracts, but not to make loans itself.

Bogeyman Argument

It is frequently argued that the IMF should offer stabilisation loans because it is the ideal bogeyman to be blamed for unpopular policy changes. Politicians and voters in the borrowing countries would not be willing to accept policy conditions from private bankers ('the gnomes of Zurich') or even from particular foreign governments. Defenders of the Fund in this role have claimed that only an international body with no direct interests other than maintaining order in the international financial system can apply policies of conditionality without giving intolerable offence to its members and without a dangerous fanning of nationalistic flames.[16]

It is an open question whether aid should be given in such a way as to minimise the humiliation of the recipient, thus weakening the incentive for self-help. This is part of the classic 'Samaritan's dilemma'. With regard to commercial lending, the situation is different. The lenders will pay attention to the borrower's susceptibilities because they profit themselves if they do. If domestic politics requires a borrower to accept policy conditions only from an international agency, the lenders are likely to entrust the Fund with this task. It does not follow that the Fund should participate in lending.

Coherence Argument

According to John Williamson, the British economist, 'commercial banks are not well suited to fulfill the role of negotiating necessary policy changes with sovereign governments . . . partly because optimal competitive strategies for individual banks may not add up to coherent pressure for rational policies. . .'[17] The incoherence problem is well known from multilateral debt reschedulings. An individual creditor does not want to concede grace periods or commit additional funds unless the debtor would promise not to use the resulting leeway to repay other creditors. This problem, however, has often been solved: the creditors either combine in consortia ('clubs') or individual creditors make their offers conditional on the conclusion of similar contracts with other creditors. It is conceivable that creditors would ask the Fund to act as their coordinating agent in such negotiations, but this does not mean that the IMF itself should lend.

Superior-information Argument

Many observers, notably the officials at the IMF believe that the Fund knows better than private lenders whether a country is creditworthy. It is doubtful whether this view is correct. Creditworthiness depends on specific rates of return on investments that borrowers will make and their willingness to repay. It does not depend on the set of broad macro-economic variables that figure prominently in the Fund's adjustment programmes. Therefore private bankers, not macro-economists, are likely to be at a comparative advantage. Moreover, there are reasons to criticise some of the typical IMF policy conditions, notably the emphasis on devaluation, which is bound to aggravate inflation, and the frequent recommendation of coercive incomes policies.

The Fund is probably at an advantage to the extent that it possesses confidential information, but this very fact raises the obvious question of why the Fund does not disclose all information that is relevant for the evaluation of creditworthiness. To answer that the IMF's members would not agree to disclosure of information is not satisfactory because knowledge is generally recognised as a public good.

The public-good aspect of the IMF's inside information rules out the withholding of information by governmental bureaucracies, but it does not necessarily justify the collection, analysis and dissemination of such information. It is one thing to come into the possession of knowledge by virtue of one's position and pass it on to others, but quite another actively to generate knowledge at public expense. To a large extent the collection of information can be efficiently arranged by private voluntary associations, as shown by the recent founding of the Institute of International Finance in Washington. It has even been suggested that international economic organisations are unlikely to provide reliable forecasts about the effects of the policies of their member governments because the latter press for more favourable appraisals.[18]

If it is assumed for the sake of argument that the Fund possesses superior information, or that private lenders believe it does, does it follow that the IMF should extend subsidised loans to some of its members? Would it not be sufficient for the Fund to act as a (paid?) agent of private lenders, providing information about the required adjustment policies? There are several instances in which private banks have made their loans conditional on the prior acceptance of an IMF stabilisation programme. The bank loans to Peru in 1976 are usually cited as proof that banks cannot formulate and monitor a stabilisation programme on their own; but many of the Fund's standby or extended arrangements have had to be interrupted as well.

Is there any justification for the IMF to participate in lending as a proof that its information is reliable? The argument is that the private market wants to see more than just a seal of approval. It wants to see a commitment. An analogous argument is sometimes made in favour of foreign-exchange intervention. It is logical, but very dangerous in practice. How much public money is a government supposed to spend or commit in order to persuade the public of its views? Is government propaganda good economics?

A better idea, which would produce a higher degree of credibility with much smaller expenditures, would be for the Fund publicly to commit a portion of the salaries of those IMF officials who confer the 'seal of approval' rather than to risk taxpayers' money.

Argument from Capital-market Imperfection

Finally, according to an altogether different argument, the case for IMF lending may be based on the assumption of capital-market imperfection. Capital markets are said to be inefficient because lenders charge a higher rate of interest, or are unwilling to lend at all, if the borrower cannot offer adequate collateral. This is, for example, why the provision or guarantee of student loans is usually considered a proper task of government.

This argument is truly irrelevant if Wilson Schmidt is right. Governments have the power to tax and the power to sell public property. They can grant mineral rights and tax shelters in return for credits. 'Countries always have the ability to pay debt service.'

CONCLUSION

The analysis in this article has shown that there are no valid arguments, on economic grounds, for IMF lending. There may be a need for a public or private 'International Monetary Information Agency', but there is no reason to regard what we have now as efficiently serving that purpose. An international organisation that uses taxpayers' money to grant subsidised credits to governments and, ultimately, banks because they have made mistakes in the past, which they promise to correct in the future, is misconceived.

Not only is there no sound economic case for IMF lending. There is good reason and strong evidence to conclude that such lending is harmful. It weakens the incentive to avoid mistakes. It creates a moral hazard in international finance that would not otherwise exist.

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1. This article is based on a paper presented at a conference in memory of Wilson E. Schmidt, of the University of Virginia, convened in Washington by the Heritage Foundation, which will be publishing the paper along with others in a memorial volume. The original text was printed in the *Congressional Record*, Washington, 22 March 1983, among 'Additional Statements', at the request of Senator Gordon J. Humphrey. Tables and additional references omitted from this article can be found in the *Congressional Record* version. In preparing this article for publication, I am grateful

for the assistance of Joe Cobb, a member of the professional staff of the Committee on Banking, Finance and Urban Affairs in the United States House of Representatives, Washington.

2. Standby credits beyond 200 per cent of quota and extended facility credits beyond 140 per cent of quota can be obtained at periodic charges that are linked to the yield on certain United States government securities. For SDR drawings a weighted average of treasury-bill rates applies. The IMF has also terminated its practice of raising its periodic charges with the relative size of the loan. For details, see Joseph Gold, *Financial Assistance by the International Monetary Fund: Law and Practice*, Pamphlet Series No. 27 (Washington: International Monetary Fund, 1979).

3. For the view that 'few of the developing-country debt crises have involved solvency crises', see also Robert Z. Aliber, *A Conceptual Approach to the Analysis of External Debt of the Developing Countries*, World Bank Staff Working Paper No. 421 (Washington: World Bank, 1980).

4. If this conclusion is not accepted, the following consideration applies: 'Persistent inability to service external debt implies that the capital has been used wastefully, as otherwise incomes in the recipient countries would have increased by more than the cost of capital. . . And this inability is now advanced as an argument for further handouts.' See Peter Bauer, 'Debt Cancellation for Development', *National Westminster Bank Quarterly Review*, London, November 1974, p. 44.

5. This was also Wilson Schmidt's impression. Quoting from Thomas M. Reichman and Richard T. Stillson, 'Experience with Programs of Balance of Payments Adjustment: Standby Arrangements in the Higher Tranches, 1963-72', *IMF Staff Papers*, Vol. 25, No. 2, 1978, Schmidt concluded: 'The Fund has failed to achieve its objectives as set forth in the loan agreements in a quarter of the standby loan program agreements it has made.' See Schmidt, *The US Balance of Payments and the Sinking Dollar* (New York: New York University Press, 1979) p. 142. The opposite impression is generated by Donal J. Donovan, 'Macroeconomic Performance and Adjustment under Fund-supported Programs: the Experience of the Seventies', *IMF Staff Papers*, Vol. 29, No. 2, 1982, pp. 171-203, but this study merely demonstrates that during the period of IMF assistance the recipient countries attained a larger reduction of their current-account deficits, their inflation rates and their consumption relative to gross domestic product (GDP) than the other non-oil developing countries. Since the recipient countries were in deep trouble, they would probably have put more emphasis on corrective policies even if they had not received IMF loans conditional on such policies.

6. *The Economist*, London, 17 January 1976, p. 82.

7. *Annual Report 1982* (Washington: International Monetary Fund, 1982) p. 73.

8. Even leading IMF officials admit that 'the issue, usually referred to as the choice between a "shock" versus a "gradual" approach to the adjustment process, has not been conclusively resolved . . . because it is not at all obvious that a gradual adjustment is preferable to a rapid one in all circumstances'. See Gold, *op. cit.*, p. 39. But in John Williamson, 'Economic Theory and International Monetary Fund Policies', in Karl Brunner and Allan H. Meltzer (eds), *Monetary Institutions and the Policy Process*, Carnegie-Rochester Conference Series on Public Policy, Vol. 13 (Amsterdam: North-Holland, 1980) pp. 255-78, the British economist expresses the view that 'the Fund has (at least up to now) been over-disposed towards shock treatment'. This is also the view expressed in the report of the Independent Commission on International Development Issues, *North-South: a Programme for Survival*, Brandt Report (London and Sydney: Pan Books, 1980) p. 216. By contrast, the Group of Thirty regrets that 'the oil facility had even slowed down adjustment in the sense that it made money too easily available': see *The Outlook for International Bank Lending* (New York: Consultative Group on International Economic and Monetary Affairs, 1981) p. 39.

As for the first assumption, it is suggested in Sidney Dell, *On Being Grandmotherly: the Evolution of IMF Conditionality*, Princeton Essays in International Finance No. 144 (Princeton: Princeton University, 1981) pp. 19 and 35, that the availability of IMF loans should depend on whether the member country itself is responsible for its payments imbalance.

9. Brandt Report, *op. cit.*, pp. 212 *et seq.*

10. C. Fred Bergsten, 'The International Monetary System in the 1980s', in Bergsten, *The World Economy in the 1980s: Selected Papers of C. Fred Bergsten* (Lexington, Massachusetts: D.C. Heath, 1981) p. 29.

11. Peter B. Kenen, 'Debt Relief as Development Assistance', in Jagdish N. Bhagwati (ed.), *The New International Economic Order: the North-South Debate* (Cambridge, Massachusetts: MIT Press, 1977) p. 54.

12. *How Bankers See the World Financial Market* (New York: Consultative Group on International Economic and Monetary Affairs, 1982) p. 42.

13. See also Robert E. Weintraub, *International Debt: Crisis and Challenge* (Fairfax, Virginia: George Mason University, 1983).

14. In this connection, see the classic by Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton: Princeton University Press, for the National Bureau of Economic Research, 1963) ch. 7.

15. Irving Friedman, 'The Role of Private Banks in Stabilization Programs', in William R. Cline and Sidney Weintraub (eds), *Economic Stabilization in Developing Countries* (Washington: Brookings Institution, 1981) p. 241.

16. See: Carl R. Neu, 'The International Monetary Fund and LDC Debt', in Lawrence G. Franko and Marilyn J. Seiber (eds), *Developing Country Debt* (Oxford and New York: Pergamon Press, 1979) p. 240; Gold, *loc. cit.*, p. 20; and Williamson, *loc. cit.*, p. 274.

17. Williamson, *loc. cit.*, p. 274.

18. See Michele Fratianni and John Pattison, 'The Economics of International Organizations', *Kyklos*, Vol. 35, No. 2, 1982, p. 259.

Bastiat on Protection and Employment

'Explain to me the functioning and the effects of protectionism.'

'That is not so easy. Before considering the more complicated cases, one should study the simpler ones.'

'Take the simplest case you wish.'

'You remember how Robinson Crusoe managed to make a board when he had no saw?'

'Yes. He cut down a tree; then, by trimming the trunk, first on one side and then on the other, with his axe, he reduced it to the thickness of a plank.'

'And that cost him a great deal of labour?'

'Two full weeks.'

'And what did he live on during that time?'

'On his provisions.'

'And what happened to the axe?'

'It became very dull as a result.'

'Quite right. But perhaps you do not know this: just as he was about to strike the first blow with his axe Robinson Crusoe noticed a plank cast up on the beach by the waves.'

'Oh, what a lucky accident! He ran to pick it up?'

'That was his first impulse; but then he stopped and reasoned as follows:

'"If I go to get that plank, it will cost me only the exertion of carrying it and the time needed to go down to the beach and climb back up the cliff.

'"But if I make a plank with my axe, first of all I shall be assuring myself two weeks' labour; then, my axe will become dull, which will provide me with the job