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BEGINNINGS OF IMF STAND-BYs

Transcript of an Oral History Recording

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Participants: David Finch, Walter Robichek, and Phillip Thorson

Thorson: This is a session of Walter Robichek, David Finch, and Phil Thorson to discuss the evolution of stand-bys in the Fund. Today's date: October 27, 1989. I think basically we want to hear more about your experiences with particular countries, Walter.

Robichek: When the staff was reorganized into functional and area departments, I was assigned the Colombian desk, and in this capacity I had the then rare opportunity to visit that country twice in relatively short succession. The contacts made there came in handy when I was called upon to prepare the technical work connected with the initial Article XIV consultation with Colombia, preceded, as I recall, only by those with Thailand. Shortly thereafter I was assigned to the Mexican desk and, having previously known the advantage of good local contacts, I pleaded for the same opportunity in my new assignment, even though Mexico was one of the few member countries that had accepted Article VIII status from the start. I made the argument that a country without exchange restrictions was more vulnerable to changing fortunes than a country with restrictions and hence needed to be watched, if anything, more closely. Somewhat surprisingly my argument was accepted by management and by the Mexican authorities, on condition that I would remain as invisible as possible while in Mexico and confined to the premises of the Bank of Mexico. My visits were fruitful from the start thanks to Rodrigo Gomez, the effective head of the Bank of Mexico, as well as Fund Executive Director and the chief of my first mission in 1947 to Costa Rica. While in Mexico City I was seated in the so-called Technical Office, Rodrigo Gomez' braintrust, together with his principal advisor and eventual successor, Ernesto Fernandez Hurtado. I was allowed to copy a wealth of data and to learn how certain statistical series were being utilized in the Bank of Mexico as tools of analysis, some of it unbeknown to other sectors of the Mexican Government establishment.

Armed with such data and insights, I returned from one of my informal visits apprehensive that a marked deterioration of the government finances in the making could well spell trouble for Mexico's balance of payments. I so informed my superiors, and subsequently I was more specific in predicting the possibility of a devaluation in a note which I wrote at the very moment a high-level delegation from Mexico had secretly arrived in Washington to "propose" such action as well as potential use of Fund resources. The sudden reversal in Mexico's financial situation had gone unnoticed virtually everywhere else abroad. The benefits from the cooperation of the Bank of Mexico which I had enjoyed redounded to the Fund in the form of alertness to changing conditions in an important member country and to Mexico in the form of a speedy response from the Fund--I was given just 24 hours to prepare the paper to the Board and was not allowed to seek any assistance--and the benefits did not go unnoticed in either place. On my next visit Rodrigo Gomez intimated to me that he would welcome help toward pre-empting further peso devaluations. Asked if he thought a special Fund mission could be of assistance, he said he would have to think about it, and after the passage of some time he responded positively and so did Fund management.

The mission that went in early 1955 was to have been headed by J. J. Polak, but he had to be hospitalized, and Dick Goode took his place as well as covering the public finances. Tim Sweeney was assigned the real economy, David Finch the banking sector, and I, the only Spanish speaker of sorts, was everybody's flunky, interpreting and establishing contacts. After the passage of about three weeks, I grew apprehensive. The mission members were all diligently gathering facts and figures, but none of this could have been considered to be the unique service Rodrigo Gomez envisaged. I articulated my apprehensions at a luncheon, practically challenging my colleagues, all of them considered first-rate people within the staff. There was silence for a moment, and then David Finch piped up almost inaudibly with the key formula, i.e., monetary expansion must be held to the rate of real economic growth if an exchange rate devaluation is to be avoided. This formula did the trick, even if the definition was somewhat truncated in that it did not take global inflation into account, and even if a variant of this formulation later was found to apply more closely to Mexico's then exchange rate regime. Not that Rodrigo Gomez was unfamiliar with the relationship that David had enunciated, but David's input did the trick because it gave Rodrigo Gomez the confirmation from a reputable and disinterested party abroad which he needed for an effective defense of his position in Mexico.

I opted for a variant of David's formulation several years later in Colombia. I believe it was in 1958. This variant substituted a credit variable for the monetary one which is appropriate for countries which wish to defend the exchange rate, and paralleled the findings of an earlier seed study conducted under J. J. Polak's leadership. In a stable exchange rate setting, meaning essentially one of domestic price stability relative to a country's trading partners, a central bank lacks control over its total assets, but it has the wherewithal to control the volume of domestic credit and hence the division of its total assets between domestic and foreign claims. Balance of payments performance being measured by variations in the level of the latter, and exchange rate stability being contingent in most cases on a suitable balance of payments performance, the observance of an appropriate domestic credit target is of strategic importance in such cases. The next problem then was how to set a valid credit ceiling. When you set a money ceiling, the number of potential bank accounts that add up to this target is quite limited, but when you set a credit target, the number of potential sub-accounts is potentially unlimited. All kinds of credit and near-credit categories can be devised, and the Colombian authorities displayed great ingenuity in this respect creating new categories after a stand-by arrangement had come into effect and thus exceeding the ceiling de facto without running afoul of the letter of the agreement. Given that assets equal liabilities, the remedy involved was defining the domestic credit variable as the difference between bank liabilities and a readily identifiable net international asset position, rather than by way of an aggregation of elusive domestic asset accounts. This change rendered the definition of the target variable immune from proliferation of accounts. The safeguard was not absolute, as was discovered many years later. It seems that one central banker managed to convert on the books domestic assets into international reserves by calling something a claim on sources abroad that was in reality a claim on sources at home.

The next major step in the technical evolution of critical target variables came in a negotiation with Chile, I think it was in 1962. The problem there was most emphatically not the defense of an exchange rate; the staff had been trying for years to persuade the Chilean authorities to adopt a more flexible exchange rate policy, no rate having in many years proved defensible for any length of time. This led to the adoption of a crawling peg adjustment mechanism within the framework of a new stand-by arrangement. To provide guidance for the frequency and magnitude of the rate adjustments, a balance of payments test was proposed and, after discussions, instituted. This test set minimum net international reserve targets for the ends of each calendar quarter, presumably attainable only by pursuing a flexible exchange rate policy; if any one of these quarterly reserve targets was missed, drawings on the Fund had to be delayed until the shortfall was remedied in a subsequent quarter, presumably by moving the exchange rate enough to make up for the shortfall in their reserves. I had quite a time convincing some quarters within the staff that this was an appropriate mechanism for the Fund to recommend to countries with a record of chronic instability like Chile's. Also, questions were raised by technicians on the U.S. side, the U.S. being interested because it was giving considerable financial assistance to Chile. In the end Don Palmer, who was in the State Department at that time, won acceptance on that side.

So much for the technical evolution. Regarding the negotiating function, I do not recall the same kind of straight-line building process occurring. I believe the staff gained credibility with member authorities over time as its judgements and forecasts were confirmed most of the time. Local technicians ended up copying our analytical techniques based on the figures which they cabled to us weekly or every ten days, arranging them for their own use in the same way as we did. It was mainly the middle-level technicians that had worked with Fund missions who adopted the staff's programming techniques, and quite a few of them were further exposed to the staff's approach in IMF Institute courses which they attended. All these developments tended to facilitate the negotiating process.

We were nowhere near as successful in the political arena. Our missions kept the lowest possible profile abroad, refraining from defending the Fund although frequently they came under particularly virulent political attacks while they were visiting. In our passive stance we were not only following standing instructions from management, we also believed that we were serving in this way as scapegoats and thereby taking pressure off the authorities, leaving them free to alibi that much as they disliked a negotiated program they had no alternative to accepting it. Much later, a senior government official who was generally supportive of our policy recommendations complained to me that the Fund's shyness from publicity had made it more difficult for him and others like him to defend our position. David, I think, is more prepared to see evidence that the Fund gained political support over time.

One more important change that occurred was a growing structural division of labor within missions. Early missions divided the work pretty much in an ad hoc fashion and frequently only on the spot. At that time the Fund staff itself was not yet structured in a way that would clearly predetermine who should do what. Once those individuals specializing in the field of exchange and trade restrictions were brought under one organizational roof, it was quite obvious that their specialization would determine their role on missions and the documentation connected with them. ETR and its predecessor department was created in response to a jurisdictional imperative. The antecedents of the specialization of other Fund staff in fiscal matters are not equally clear. I believe that the emergence of the central role of fiscal policy in the vast majority of financial programs strongly influenced the decision to create a Fiscal Affairs Department. Functional specialization facilitated cross-country comparisons which country specialists were in no position to perform. It also provided functionally specialized institutional backing at headquarters.

Finch: If I could perhaps interrupt at this point to make a few points for Walter to elaborate. I think the key thing which isn't that well documented elsewhere was the significance of the staff's relations with the authorities. I think Mexico was a very important case for all of Latin America. You implied, Walter, that you were the fifth wheel on the Mexico mission. Well, you were the leading wheel in the sense that the whole thing depended on the confidence of the Mexican authorities that the Fund was working for their interests. You had worked them so that that was their belief. We would not have gotten a start if we hadn't been able to do it on that basis. It was the key element on that mission. It's an interesting case in another sense because the report the mission wrote was never released to the Board. It was a case of the staff working purely for the Mexicans, and it was the beginning of the idea in Latin American countries that somehow the staff could be useful. The key was this trust. I think having created it one could hope to work from that base. That background allowed me to go into their accounts and pull files. It's that sort of trust that is so difficult to develop, and that was the essential element in making this work, the issue of being able to get material and being trusted to use it in your own way. That issue is very relevant to current issues, such as, should the Fund's reports be published? In this early phase it became very clear that you were there to help the authorities and that was your main responsibility.

Robichek: The Mexican mission had tremendous educational value for me.

Finch: In other parts of Latin America too, they respected Don Rodrigo and they thought that if he had found it constructive it was something they'd better think about. But I think you also developed similar trust in other cases. I don't know if we want to go into Haiti, but in Haiti the relationship with the Central Bank....

Robichek: My closest relationship in all these years was with Chile.

Finch: .... But these are the issues which probably are going to be unreported in history because there is very little documentation; yet it was with that working relationship and the evidence of solving problems that Fund successes were achieved. The whole thing in Mexico with Don Rodrigo was that he was trying to keep an open economic system and also one that was stable. He had found that each time devaluation occurred it was quickly undermined. He was looking for a technique to support his attempts to get political discipline to back his economic vision. The staff showed they fitted his needs when they wrote a report purely for Mexican use. This helped create that first trust and led to close relationships with the authorities.

On the techniques, just a small elaboration. Right from the beginning it was understood that the feature of money was that it would be held by the public only to the extent needed by the level of national income, including any rise in prices. But if you were to keep a stable exchange rate there had to be limits on the price rise. So if you created too much credit you weren't going to be able to have enough foreign exchange reserves to keep those rates stable. So that from the beginning, although the level of money holdings was being set independently by the fixed exchange rate and the willingness of the public to hold money, it was the amount of credit created which was going to determine your ability to hold on to the exchange rate. This was what Don Rodrigo was looking for, a line of defense, which this technique gave him. The focus on controlling credit creation was crucial pretty much from the beginning. There were complexities of course. Walter has dealt with one, whether you went out of control at gross or net; the gross concept, as Walter indicated, was the first one applied. It was partly thought of as a technique of giving a direct role to the decision makers. In Bolivia, the Fund representative was actually a member of the stabilization council which formally had the responsibility of approving any loans to the government, and the simple recording of the arrangement was that nothing would be approved that wasn't included in the agreed program. This was a gross concept. But as you moved away from that very unusual arrangement in Bolivia, the Fund had much less access to decision-making mechanisms. As Walter was describing, you had much less certainty that you would know about all the decisions on lending when they were made and therefore much less control.

Robichek: One serious limitation to effective control was frequent efforts of the authorities in certain countries to evade ceilings by accounting tricks. When government borrowing from the Central Bank by way of overdrafts, placement of government bonds, and drawings on government deposits had been brought under a ceiling in Colombia, the Government started issuing promissory notes which the Central Bank showed among "miscellaneous debtors", a category not covered by the ceilings.

Finch: I don't want to minimize such specific aspects. But what I want to emphasize is that behind the specific limitations was the intent to have effective limits on official decisions. Let me put it slightly differently--the whole principle of Fund participation was very much set by Don Rodrigo. You were trying to create a framework of decision making in which those that are interested in keeping stability were given a better chance to control the decisions. Having the limits recorded in an agreement with the Fund gave the Don Rodrigos more power to keep control. And that's why you developed all these techniques. The difficulty was that you sensed the politicians learned how these techniques worked and kept asking whether there weren't ways of avoiding sending the Fund figures that would prove that they had not broken the commitment. With that pressure even those officials who wanted to be responsible couldn't keep it purely technical. It was in order to keep the responsible officers from losing power you created a system under which they could say more credibly, if we do it that way, it's still going to show up and create problems with the Fund. It was that aspect which I wanted to bring out. It was that the technicians usually were under pressure from the politicians to see whether more room could be found without, in fact, formally breaking the ceilings; those individuals, feeling constrained, started to search for ways in which they could maintain control, and the refinement of ceilings made it more difficult to subvert the controls.

In that same vein I think it's critically important to acknowledge for the record that the Fund cannot be effective if it hasn't got allies within the governments seeking its help. It's quite clear that in early times in Romania the reports on observance of the Fund ceilings were rigged because you had no allies within the governmental machinery. The officials involved were willing to write down anything because they knew they were under instructions to leave off the record things which didn't fit. There are no techniques of ceilings that can avoid window-dressing unless you've got technicians who are working with you, who believe in the value of keeping the boundaries intact. And over a period of time the Western Hemisphere Department found that the boundaries most likely to be observed could be defined in terms of the net domestic assets of the banking system. Central bank technicians would not in most instances feel ready to distort data that was basic to their work. The Fund being able to be effective was dependent basically on having people who cared about their country and setting up a framework so they could be working with you to make it happen.

Robichek: David, you're quite right that in many instances the central bankers and the Fund staff were allies. I remember, for example, at an early stage of this evolutionary process when we were not yet using specialized subceilings, the central bank authorities, I believe of, Peru who were prepared to tighten credit insisted they could not possibly manage to do so unless governmental borrowing was controlled. Later on other sub-ceilings were devised, for example, on the credit operations of government-owned banks, until in the end the controls applied to the public sector as a whole.

Finch: The whole process was dynamic. It started out, as I said, simple. In the Bolivian stage, no credits were possible without specific approval. That evolved into a more complex system of agreeing on an aggregate gross credit with sub-ceilings, meaning that you've got a total amount that is distributed and supported with firm figures on sub-divisions. This protected the aggregate by applying pressure for firm political decisions up front that nothing would happen in certain areas. Then came the net credit concept, trying to set up a ceiling that was technically more tamperproof or more difficult for politicians to subvert. And, of course, eventually that mechanism went beyond domestic credit ceilings. Countries got into problems with foreign borrowing, so you started setting foreign borrowing limits. You evolved techniques out of experiences with various kinds of problems.

Robichek: Quite so, there was constant experimentation that resulted in improvements all along the line. Improved analytical skills permitted greater precision in identifying problem areas, enabled in turn more refined applications of conditionality, and focused the negotiating process. So effective was this analytical process that it came to be extended to consultations where no use of Fund resources was involved.

On a different point, I would stress that we were very legalistic in judging compliance with the trigger clauses. Even a fractional deviation led to the interruption of access to Fund resources. However, departures from numerical performance clauses were invariably reversible. For example, if a country deviated from credit ceilings or certain other stock variables one day, it could revert to compliance the following day and with it automatically restore drawing rights instantaneously. The situation differed time-wise when it came to flow variables, notably, balance of payments tests that covered cumulative quarterly periods. In those cases, if a country failed the test in one quarter, its drawing rights were interrupted for the next quarter but in that next quarter the country could catch up and exercise its accumulated drawing rights at any time during the following quarter.

Finch: If I could sort of put a slight gloss on this. It's easy to write provisions, and that's one of the problems for the World Bank. It has written such a large number of quite specific clauses there is virtually certainty some will not be observed, and that devalues non-observance. What Walter is referring to is that the Fund procedures by showing a breach of of a ceiling to be an important and special thing, made the commitments credible barriers. It was absolutely critical to the technician/politician relationship that you had to make it evident to the politicians that breaching a ceiling was not something which was going to be winked at. This was done partly by procedures which potentially involved the Board, and so the news of a breach would go around the world. It was made to be a dangerous thing. That technique made the critical difference between the Fund's and the World Bank's treatment, because the Executive Board in the Fund was a much more serious forum.

Robichek: The line of our argument was that it was no "crime" to breach a performance criterion but the Managing Director, let alone the staff, lacks the authority to condone it. If the Managing Director is prepared to accept the breach for good reason, he will have to take the matter to the Executive Board on the strength of a special staff report which the Directors will want to study for a time; in other words, weeks will pass before the Executive Board will come to a decision and by that time the breach will perhaps have been corrected.

Finch: This is an important operating principle Walter is describing, it's not just a technicality.

Robichek: Management and staff are not judges, neither lenient not severe ones; it's the Board that passes the judgements.

Finch: But the basic element underlying all this goes back to Don Rodrigo. We were trying to jointly create a credible technique for keeping spending agencies under control and making the barriers look significant to the politicians who were always under pressure to change them, and so you were continuously in that alliance and it was something which you were constantly aware of.

Thorson: In the negotiations leading to stand-bys, did you typically meet with politicians as well?

Finch: I am using the words technician/politician. Don Rodrigo was a politician of the highest caliber, but the distinction was between the financial people that felt it was their job to maintain financial responsibility against those who were feeling they had to keep the political party satisfied. It's not so much a job classification, as an attitude--those who identified with financial responsibility for the country and therefore, wanted to get a firmer grip on the way in which spending decisions were being taken. Hopefully, when needed, such people would regard the Fund as a vehicle for trying to get such control. In many smaller countries you'd be dealing certainly with the Finance Minister and in some contexts with the President. In Bolivia when the critical decisions came, it was quite clear you never really got a decision made except in the Stabilization Council which was chaired by the President and included the Ministers of Finance, Economy, and Labor and Planning, and the President of the Central Bank. So in many of the early cases, you looked to the top level for the most difficult decisions. In such cases, you tried to make allies up at the top. The top leaders wanted to survive and you tried to persuade them that meant financial discipline. They wanted to be able to say to the people who came with problems, I can't do it at this stage; I'd love to help, but.....

Robichek: I had very different experiences in this respect. For example, I enjoyed a very strong political standing during President Alessandri's regime in Chile. I dealt directly with him and while on visits there he even invited me to attend his weekly meetings with the Economic Cabinet. On the other hand, I conducted a critical negotiation in Peru during a military dictatorship; Mr. Kafka, who accompanied the mission, was received by the President, but I was not. I suspect that was because the President did not want to make it appear that he was taking responsibility for the program negotiated by a Peruvian team headed by the Minister of Finance and the Central Bank Governor. It stands to reason that where heads of state received a mission or just its head, it strengthened the program, and when they deliberately insulated themselves from any direct contact, it had the opposite effect. More generally, the Fund would have liked not to be involved in internal politics but such involvement, passive though it was, was frequently unavoidable. The more critical the arrangement, the more we were drawn into the political crosscurrents, much to our dislike.

Finch: That was the next point I wanted to raise, the role of the Fund as a scapegoat! I would like to delve into the complexity, Walter, of the different issues in this one. First, there is the critical question of who takes responsibility for the actions needed to be taken. I think very clearly it should be the Government that takes responsibility. It arose in the first mission I headed. The Bolivian President, Siles, was being pressed to close the exchange market which had run out of money. Following a meeting starting at 10:00 p.m., he agreed at 4:00 in the morning to close it but said he was going to announce that the "Fund has instructed me to close the exchange market". I said, you are not to say any such thing, you're running the country, you have to make the decision that is right for Bolivia to close the exchange market, and I'm not willing to have you claim that we're giving you instructions. You have to decide what is right for Bolivia. So we adjourned; we didn't get the decision until 4:00 a.m. the next day when he agreed to it on his own responsibility.

I believe it's absolutely essential to push that political decisions are made by the Government and are not delegated to outsiders. But the related issue of whether the Fund's staff ought to be available to the press and others to explain why the decisions came out that way, is a much more open question. It's one you need to be very cautious as to which thought came from the Fund and which from the Government. When skilled interviewers ask that question, it starts to break up the first principle because you are made to look as the ones pushing the final action while the government pushed for something different. As much as possible, the program needs to be presented as an integrated whole and it's pretty difficult for the staff to talk about particular parts without risking an erosion. In addition, the staff must never appear to a politician--(as may be Jeff Sachs' problem in Eastern Europe at present) as if it were trying to take credit for brilliance of design. You've got to try with politicians to make them feel that they are basically in control of the services provided by the Fund staff. If there is any feeling at all that the servants are trying to do something to elevate their own images, I think the trust is affected.

In Jamaica, I gave in and talked to the unions and other groups but solely because the government wanted it. It worked alright but I think it's absolutely essential that the government feels in absolute control of whether such contacts take place or not. If there's any feeling that the Fund is trying to have them for its own purposes, then I think the whole thing loses any feeling of common purpose. But to sum up, my general conclusion is that the Fund should steer clear of serving as a scapegoat as much as possible; it doesn't work well for the President of the country to say, "I'm doing this because the Fund told me to."

Robichek: That's right, we can't prevent it, but we should never aim for it. It's much more efficient for any government to claim it's running the country and taking action because it's the right thing to be doing, than to be blaming someone else for pushing it. It weakens the government's authority. I believe firmly that the Fund staff should avoid publicity because it is so very important that a country's authorities feel the Fund can be trusted to preserve the secrecy of the talks with the authorities. But the problem I encountered on occasion was the opposite. The Governor of the Central Bank or the Minister of Finance would insist that I face the media in his presence. You can't say you just will not do it if such an official feels it would be helpful. What is more, you could be unwillingly drawn into such a situation. I remember my very last negotiating mission, to Argentina where Julio Gonzales del Solar, a former schoolmate, staff member, and Alternate Executive Director of the Fund, was Central Bank President at the time. I was in serious discussion with him when his secretary entered and whispered something into his ear. "Let them come in", he answered, and in trooped a small T.V. crew to interview him about the negotiation, whereupon he introduced me and passed me the buck. In utter consternation that evening at his house I watched myself on the TV newscast in Spanish.

Finch: I recall that in the earlier history of the relationship, Alsogaray, the Minister of Economy in Argentina, also brought a T.V. crew in. You can't resist, and the only thing you can do is to be very circumspect in the way that you deal with it; you talk very much in terms of supporting the decisions the Government is taking and don't get into discussions which could bring out which elements are Fund created and which are not.

Robichek: I must say that I was not as clear as you on what responsibility a government ought to take because I had some sympathy for the scapegoat role, and there is a certain contradiction between being a scapegoat and shoving all the responsibility onto the government. At the end of a negotiation, the question in the public's mind is really if the government doesn't do such and such, can it still have a stand-by arrangement? What do you say? And when you get to this point it is very, very difficult to decide how you should react. You can't say maybe. You can always fudge things around the edges; you can be clever and say, look, that's not up to me, that's up to the Managing Director and the Board, I can't decide that. But then they can come back and say, what is it that you are taking back with you? Is there some specific minimum or are there perhaps options? In cases where you have you take tough positions, is it better for the success of the program for the Fund to play the role of scapegoat to some extent, or should you insist that the government is wholly responsible?

<u>Thorson:</u> I've heard some astute people observe that the Fund has been very good at technical analysis and technical advice, but that it has not been so good in many cases at judging the political capacities of governments to deliver on the commitments that they undertake. And I think I heard you intimating just now that in some cases the topmost authorities separated themselves from responsibility for commitments. How can you make good judgements on political capacity and firmness?

<u>Robichek:</u> I think it is absolutely essential that you come to a judgement on this. It makes no sense wasting time trying to negotiate fine points of financial management when you have judged that the authorities are not prepared to make the policy changes needed. In such a case the best thing is to say "We'll come back some other time when you have changed your mind". This happened quite frequently and I think the staff gave this response correctly in all instances that I could think of.

<u>Thorson:</u> Being unprepared to undertake reforms could be of two types: One is that they rally don't intend to take implementing measures but would just like the money. Maybe you could smell such an attitude. The other is that they would like to undertake an effective reform and achieve stability, but the Government was in such a tenuous position politically that it seems doubtful they could carry through the degree of austerity that would be needed.

<u>Robichek:</u> Generally speaking, you would not want to be drawn into a negotiation if you thought the Government wasn't serious and was just pretending it was negotiating in order to calm public opinion, or bankers, or whomever, and unfortunately that occurred with increasing frequency. But when you thought that the Government was serious and committed but there was a distinct possibility that it would not survive the necessary adjustment effort, the Government is taking responsibility for its decision to negotiate and the Fund cannot be in the position of refusing its assistance because of doubts about the Government's ability to defend its decision.

<u>Finch:</u> If I could go a little further on this. I would think that very often the mission would leave a description of what was needed to be done. The trouble then was that the authorities, if they were under

immediate pressure from the banks or the government would soon be inclined to say, well, come back when we're ready to do it. The Fund staff knowing what was implied by way of implementing measures then had to be really very specific about what would be required to achieve the results. In Walter's case of where the Government was weak, it would be possible to say, well, it's going to take a lot of preparation to be ready for such a serious move; these are some things you have to do. That would provide an excuse to go away until more has happened. You could also breathe some reality into their general outlook by making it clear they would have to take this and this specific action. By asking for more details, the staff could stall without looking political about it.

The other question on the issue Walter has stressed is what if the authorities say they are willing to take the measures, what latitude does the Fund have? The Fund never had the luxury of choice. You had to say to the authorities, if you're willing to do it, we're willing to support you. You could say to them, it's important to explain the action publicly this way, or to tell them this is how the problem of explanation is being handled elsewhere. You could do anything you wished on advice but you couldn't, I think--once the authorities say they're willing to take responsibility--you couldn't say to them, I don't believe you. Let me add one other point. I think in general the staff, and particularly Walter felt that most of the political barriers were not as bad as they seemed if you had the sort of a government willing to act resolutely. In most countries the austerities were already occurring anyway; it's not as if the Fund started negotiating with a country that everything where everything was going fine and you were trying to tell them to create problems; the problems were already in evidence.

In general, I think the experience and the overwhelming feeling of the Fund staff was if only this goddamn government would give the people a feeling that it's coping, that it knows what the issues are and plans to do something about them, the public would give support. Contrary to the belief that acting in the way the Fund staff was advising would create problems, we felt very strongly that if only they damned well acted to show a feeling that they were prepared to face up to the situation, the public would rally behind them. In our experience, this was overwhelmingly the case, but when the authorities were afraid and did not implement properly the agreement with the Fund, were not honest with the public, and seemed to be acting without clear purpose, then they ended up with riots.

<u>Robichek:</u> In '64 I negotiated in the Dominican Republic a program that involved a change of the exchange rate, which at that time was an absolute taboo because the peso was at par with the dollar and the negotiation was with an interim government to boot. On my last afternoon in the country, I called on the U.S. Ambassador to inform him of the outcome of our negotiations, a routine I followed in countries where the goodwill of the United States was particularly important. I learned that on my flight back to Washington the next day there also was a special emissary from the embassy to the White House to warn President Johnson that the agreed

exchange rate move could well cause a revolution in the country. The Dominican authorities were persuaded to desist, but a revolution occurred six months later at least in part because of the mounting economic difficulties, leading to a temporary occupation of the country by U.S. troops. I think the Fund staff handled political judgements rather well, considering we were not trained as political observers. Staff members likewise have had to handle some other professional specialties for which they were not trained, for example, diplomacy and teaching.

Thorson: David, in the late '60s and the '70s, the influence of the Fund was increased a great deal because donor governments and multilateral banks would follow the example of the Fund and put in additional money. Was this true in the very early days?

Finch: If anything, it was stronger in the first programs. In Bolivia, the main money was USAID. It was the U.S. that directly decided that their bilateral negotiations weren't working. In despair as to how to handle it, Costanzo was brought into the Fund and given, in a sense, an experimental case with Bolivia. In effect, the U.S. said, if you can handle this, maybe we could work better through having an international agency promote the stability we seek; we would link to that rather than negotiate ourselves. The Fund negotiated in Bolivia in 1956 a program which interestingly enough, was very similar to the recent one in '86 or '87. It broke the inflation, created exchange stability, and brought political stability. From memory, in that first program the U.S. money was US$10 million and the Fund was US$1.2, or something like that. The U.S. money was very clearly the more significant, particularly because it was mostly non-repayable, sort of gift money, while the Fund's was repayable.

Thorson: And other cases were similar?

Finch: Usually in those early stages the EXIMBANK was willing to give cash advances parallel with the Fund, all repayable. But some smaller countries, maybe Paraguay and the Dominican Republic, were given USAID grants parallel to the IMF. Chile, in a way, began in a different pattern, that's why Walter was talking about Alessandri, who was President years later. The U.S. relied on a private advisory group to work with Chile. But it did not work well so by the time that Walter was involved it was agreed that the advice should be given by the Fund.

The same thing of developing the leadership of the Fund was happening, of course, in Europe, and Sturc worked there to facilitate assistance to Finland, Yugoslavia, and Turkey. While the U.S. Government was the main source, some of it came from others. Other governments were willing to open up official export credits parallel to the Fund advances. It didn't always have to be tightly organized, sometimes it was just that they had previously put in decisions to holdup on giving further credits. When the Fund moved, obviously those decisions to stop had to be reviewed. And when some governments were willing to allow export credits, others obviously were put under pressure to reverse their decisions to stop.

Thorson: But it wasn't until later that commercial bank lending came in to a big extent?

Finch: Commercial banks weren't heavy in medium-term lending at that time. I remember some association a bit differently than the response Al Costanzo gave to you at our taping session with him. He said that there wasn't early parallel lending. I think the record will show, however, that CITIBANK was at least involved in short-term credits with Argentina in 1959 and I believe there was a line of credit associated with the Fund at that stage. Immediately after the war, Argentina was left with large foreign exchange reserves and was relatively a rich country; Peron ran them down fast and accumulated debts. When he was deposed, Argentina had to negotiate with these European countries on these bilateral balances. In these circumstances, Argentina was out trying to seek trade financing which it hadn't ever gotten before. Certainly, the banks were very interested in the Fund's attitude. Staff members were invited to dinner parties in Buenos Aires so they could hear what we were thinking about Argentina. This was how Al met Walter Wriston (later the CEO of CITIBANK) the first time. So there's no question that banks were interested in the Fund's programs. Now, how formally they were tied in, I am not certain. It's my understanding that it may have been in the second negotiation at the end of 1959. Then I think there were bank monies which pretty clearly would be available only if the Argentines were able to get the Fund to support them. It was probably different than the later medium-term credits but it was certainly, from an Argentine point of view, a release of commercial bank monies consequent on keeping within the good graces of the Fund. Certainly CITIBANK and the Bank of Boston were showing great interest in what the Fund was doing after December '58. There's no question in my mind that countries perceived that there was a connection between getting things right with the Fund and getting commercial banks' monies, even at that time.

Thorson: Well, thank you; very interesting.