The Debt Crisis of the Developing Countries and the IMF Conditionality. Potential Economic and Social Consequences in Somalia

MAHO A. H. AWES and KARL-HEINZ W. BECHTOLD

Institute for Scientific Co-operation with Developing Countries - Tübingen

The International Monetary Fund (IMF): Is it a Crisis Manager or a «Financial Policeman» for the Third World?

1. The Debt Crisis of the Third World

The World Bank estimated that the Third World had a foreign debt of US $ 810 billion at the end of 1983, the Organization for Economic Co-operation and Development (OECD) estimated a figure of US $ 702 billion. In reality, the obligations of the developing countries probably are much higher than this because the international statistics do not include «military» loans and only sporadically cover short term loans with a period of less than one year. In 1983, debts in the amount of over US $ 60 billion for almost 30 countries of the Third World were renegotiated. The rescheduling of debts can, however, bring only temporary relief for the debtor nations. A debt disaster is expected again in the second half of the eighties.

The increasing balance of payments problems of countries in the Third World in recent years, has lead to a growing importance of the IMF. Because IMF loans are more often being granted with strict conditions and also because other lenders in recent years are increasingly making the transfer of financial resources and the process of rescheduling dependent upon obtaining the «stamp of approval» of an adjustment program supported by the IMF, the Fund exercises considerable influence on the economic policy of the debtor nations and the credit granting policy of the commercial banks.

Presently 37 countries have such adjustment programs which are essentially formed in co-operation with the IMF and which are primarily aimed at reaching a medium-term equilibrium of the balance-of-payments. In the present foreign economic situation this requires in general considerable internal structural change within the debtor nations, and therefore the conditionalities imposed by the IMF are also important from the perspective of development policy.

2. *The Basic Priciples of the Conditionalities of the IMF.*

The central and overriding aim of the IMF adjustment programs is a medium-term viable balance-of-payments while the targets with respect to the rate of inflation, growth, employment, etc., have more the character of projections which are compatible with the balance-of-payment goal. This tendency is reinforced by the fact that the Fund still continues to maintain the position that development and distribution goals should not be an aspect of the conditionalities. According to this, none of the 30 stand-by agreements within the period from 1964 to 1979 (with one exception in the sixties) have included a goal such as limiting the burdens of adjustment for the low income groups.

3. *Theoretical Concepts for the Adjustment Programs.*

The IMF's concept of adjustment is closely connected with its perspective of the reasons for the balance-of-payments problems. Although even research by IMF shows that the actual problem of balance-of-payments of the developing countries results from a combination of external shocks, structurally limited leeway for adjustment and an inadequate economic policy, within the parameters of the discussion on conditionalities exogenous factors and different adjustment capacities play only a minor role in the IMF explanatory pattern. Primarily internal economic policy mistakes are indentified as reasons for the balance-of-payments problems.

It is not surprising that the IMF approves only measures which do not restrict the free flow of goods, services and capital. After all, the IMF was founded in order to promote the expansion of international trade. The IMF assumes that free trade and unregulated international division of labour maximize world income. The essential pillars of the adjustment strategy as recommended by the IMF can be stylized as «regard for financial discipline», «liberalization of external economic relations», and «market economy regulatory mechanisms in the domestic sphere».

Within this framework the IMF recommends aiming at external balance with a combination of restrictive monetary and fiscal policies, devaluation and supply-oriented measures. Special emphasis is placed upon limiting the growth of domestic credit for financing budgetary deficits, tax increases and reduction of public spending, among other things by reducing direct subsidies, for example, for basic foodstuffs and implicit subsidies in the area of energy and for public utilities. Instead of protectionist intervention and measures to stimulate demand, the IMF promotes an economic policy which stimulates supply and improves the international competitiveness of the economy.

However, the general preference of the IMF for market economy regulatory mechanism can with good reason be questioned from the perspective of development theory: other cultural parameters than those in western industrial countries, deficient legal systems, great inequality of income and property distribution and a high degree of structural heterogeneity lead to a breakdown of market mechanisms or to results of the market processes which are undesirable from the viewpoint of development policy; correspondingly, one typically finds in developing countries an extensive involvement of the state in the economy.

4. *Social and Political Consequences of the IMF Program*

Even those who favor the IMF adjustment measures as being necessary and efficient can not deny that at least in the short-term they have negative effects on economic growth, the employment level, and the standard of living. Especially the lower social classes are affected by the growing unemployment, the reduction of social programs, the removal of price ceilings, devaluation, etc. Their already low level of consumption drops further. As compared to industrial countries, when such measures are implemented in developing countries, where, the majority of the population has to live at the edge of the existence minimum, there can be deadly consequences for many people.

The IMF argues that without the programs with their painful austerity measures for social policy, many developing countries would get into increasingly greater financial difficulties, which would force the governments sooner or later to limit necessary imports (pre-products, spare parts, foodstuffs, etc.) because of scarcity of foreign exchange, and this could have even worse consequences for the poor than had the government made an agreement with the IMF program at an earlier date. Thus most of the governments of the Third World look upon the stabilization programs with disapproval probably less because of humanitarian reason than, primarily, out of fear of the considerable burdens for the already shaky political systems of the Third World which would result from the sudden reduction of the living standards of the poor. Often implementation of the agreed upon measures has lead to social unrest which either lead to revoking the measures or to the violent suppression of the social protest. Thus, for example, the riots in Egypt forced the government in January 1977 to reinstate the subsidies for basic foodstuffs which they had revoked under the pressure of the IMF.

Governments whose policies do not agree with the economic philosophy and economic policy concepts of the Fund are pushed by the «financial policeman» to follow a course between Scylla and Charybdis: if the governments do not come to an agreement with the IMF, then they risk losing their creditworthiness with the international finance capital, which intensifies the economic crisis and almost inevitably ends in the loss of legitimacy: on the other hand, if they agree to the IMF demands, then their international creditworthiness is re-established but at the cost of domestic economic recession and social polarization which also unavoidably brings the loss of internal legitimacy.

Because many programs are not flexible enough to be accepted by all socially relevant groups — especially by the labor unions — often even the most reasonable economic policy targets are not achieved because of strikes, production stoppages and declining productivity of labor. Evidently the IMF is caught in a dilemma: on the one hand, more flexible, more socially acceptable conditionalities are hardly compatible with the presently very important catalytic function of the Fund (thas is, to make rescheduling possible and to guarantee further credits from the international banks), on the other hand, in the meantime the level of tolerance for the majority of the population in most countries of the Third World has been reached.

In conclusion, it can be ascertained that the IMF no longer fulfills its job as crisis manager in the Third World. Its remedies are only effective in the short-term, if at all; in the conflict between the interest of debtors and creditors it acts as the inflexible advocate of the latter; those who suffer most under this policy are the underprivileged sectors of the population in the developing countries.

Somalia's Present Economic Situation and Growing Foreign Indebtedness

In order to be able to analyse production conditions in Somalia, we really need reliable official statistics; these however, are almost totally lacking in Somalia. We must therefore rely on official estimates, which, however, are subject to a considerable incidence of errors.

In 1984, the real growth rate of GDP was approximately 2.3%. Net growth of cattle stocks was below the 1983 rate; in fact it even fell by 1.1%. Agricultural production improved thanks to good weather conditions, and reached the record growth rate of 10.6%. The production of maize, sorghum and rice thus exceeded the level reached in 1983, whilst the production of sugar cane fell because of the lack of energy sources (above all petrol and oil). Economic activity in the manufacturing sector fell by 3% due to the irregular supply of crude oil; technical problems caused a considerable decline in output of refined petrol, whilst sugar production stagnated as a result of the lack of skilled labour, spare parts and raw materials.

In 1984 the net indebtedness of the state actually rose by as much as 143%, whereas the indebtedness of the private sector (including publically-owned companies) was reduced by 50%. Somalia's disbursed external debt rose from US Dollar 695 million at the end of 1980 to US Dollar 887 million at the end 1981 and to US Dollar 1,056 million at the end of 1982 and in 1983 rose to US Dollar 1.202 million. It is estimated to have risen to US Dollar 1.503 million at the end of 1984. These data refer to a public and publicly guaranteed debt of an initial maturity greater than one year. The debt consists mainly of long-term concessional loans. In the past few years the structure of Somalia's debt has shifted towards a higher proportion of debt owed to multilateral organization.

The IMF's Adjustment Programme and its Economicand Social Effects in Somalia

In order to overcome these economic problems, Somalia's government turned to the IMF. Somalia had to accept harsh enjoinders governing economic policy in order to receive the standby credit.

The following performance criteria were fixed by the IMF the last drawing of 22.1 million Special Drawing Rights (SDRs) for 1985: — A rise in the rate of growth of the gross national product from 2-3% in 1984 to 4% in 1985; — A reduction in the rate of inflation from 92% in 1984 to 20% in 1985; — A reduction in the balance of payments deficit by 57 million US dollars in 1985.

The devaluation of the So. Sh. and restrictions on domestic credit were other imposed measures. The selling rate of the So. Sh. rose from So. Sh. 6.35 per US dollar in 1980/81 to So. Sh. 95.9 per US dollar in April 1985. Total credit outstanding within the country was cut back from 17.2% in 1981 to 10.9% in 1985.

The aim of these enjoinders was to curb excessive domestic demand. There is no dispute about the fact that a short-term stabilization of the balance of payments can be achieved by means of this policy. However, the latter has also given rise to an economic recession. Somalia's total volume of exports fell by 14.9% in 1981 and 38.0% in 1984. The domestic utilization of capacity has fallen, particularly in manufacturing plant, agriculture and the livestock sector. Domestic liquidity also fell from 30% in 1981 to 8.6% in 1985.

1. *The Social Effects in Somalia*

The IMF conditions compel the state to restrict public borrowing (to 1% of the state budget in 1985) and to cut subsidies on basic needs, the social sector (schools, universities, hospital) and transport etc. Somalia was forced to cut back on publically-owned companies and to raise charges for public services as well as indirect taxation. Prices had to be liberalized and 20% of employees made redundant in the public sector. The public ability to effect capital expenditure was restricted in favour of private investment. The foreign trade ramparts, designed to shield the national ecomomy, were to be reduced in size. The aim of this measure was to push down the rate of inflation, which rose from 10.2% in 1978 to 92.2% in 1984 nevertheless. The purpose of this was to take pressure off the balance of payments. It has, however, only been relieved to the detriment of the marginal population. These enjoinders represented an attempt at influencing the country's development by means of the market mechanism. The deficit on capital account, which had caused the external disequilibrium, was reduced. In the domestic economy, this was only achieved by means of a reduction in the budget deficits, not however by a substained fight against inflation. On the contrary, price rises within the economy have been accelerated.

The cut-down on total credit outstanding within the country, and the restrictive money-supply and budget policies tend to have a dampening effect on inflation; however this effect is not immediate, but rather medium-term at best. On the other hand, the cuts in subsidies, price liberalization and devaluation, as well as the rise in indirect taxation all led to direct increases. The price index for consumer goods in Mogadishu represents the only index for consumers. This shows an increase from 313.4 in 1981 to 1309.6 in 1985. The IMF's shock therapy (drastic cuts in subsidies, extensive price liberalization and devaluations) set the price merry-go-round in full swing in Somalia, and this immediately gave rise to new «disequilibria» on the balance of payments.

Important as price incentives may be, they are not sufficient with respect to the necessary development of agriculture; and as far as social policy is concerned, these measures are dangerous when they are linked up with the dismantling of subsidies on foodstuffs, since this pushes the standard of living of many previously privileged city dwellers under the subsistence level. What can be termed «contraction of the domestic economy», «increased interaction into the world market» and «reduction of state influence» in the sober terminology of economics means an intensification of the fight for survival for many people in Somalia. The most seriously affected in this respect are the urban marginal groups (such as the poor and the unemployed, etc., urban classes dependent on wages and salaries, workers and the employed middle classes). They also represent the majority of the Somali population.

They are hard hit by the deterioration and the rises in the price of public services, and by the restriction of the state budget and reduced state expenditure. Public transport, has also become substantially more expensive; the quality of medical care and school education has taken on catastrophic forms.

The lower the income of those affected, and the greater their dependence on social services, the greater is the effect of the austerity programme in Somalia. This also applies to the supply of basic foodstuffs, which represent a particulary large proportion of day-to-day consumption in the case of those earning low incomes and have, in the main, risen in price much more quickly than other consumer goods such as vacuum cleaners, refrigerators or television sets, etc.

2. *Outloook*

If it is the aim of the IMF's stabilization policy, to set in motion a self-sufficient economic development in Somalia, then they should examine the economic history of the industrialized countries. This teaches us that permanent economic development (sustained growth) can only be achieved by developing domestic economic structures, by a close link between agricultural and industrial production and by a form of domestic demand based on purchasing power. Furthermore, a minimum level of independence is required in the fields of technology, training and research. In order to do this, however, a leading role must inevitably be played by the state as the planner and navigator of the development process, if a stabilization policy orientated towards basic needs is to be successful. Since the majority of Somalis live in the countryside, agriculture, animal husbandry and fishing must be given priority in state development policy. Labour-intensive technology, «uncomplicated» (adjusted) production on small farms and by nomads, and the building-up of corresponding marketing structures would have to be one component on an IMF conditionality that is oriented towards basic needs.

A policy of satisfying basic needs is incompatible with abrupt cuts in production and restrictions on demand, as the IMF's deflationary policy has caused in Somalia. The ruinous recession policy should have been replaced by an expansive stabilization policy that makes it possibile to broaden the supply of goods and services, and raise exports or replace imports in order to achieve balance of payments equilibrium at a higher level.

The most important thing, in our opinion, is to avoid concepts involving measures that lead to a worsening of the satisfaction of basic needs. And the burdens should not be passed on to those social groups who are least responsible for the debt crisis.

References

Balassa, B. 1982, «Structural Adjustment Policies», *Developing Economies*, in *World Development*, 10, 1: 23-38.

Bird, G. 1978, *The International Monetary System and the Less Developed Countries*, London, Basingstoke.

Brau, E. 1981, «Der Konsultationsprozeß des Fonds», *Finanzierung und Entwicklung*, Dezember, 13-16.

Büttner, V. 1982, «Externe Verschuldung von Entwicklungs ländern: Konfliktbereiche und Lösungsmöglichkeiten im Rahmen einer Nord-Süd Politik, Ebenhausen.

Büttner, V. 1984, «Die Auflagenpolitik des Internationalen Währungsfonds im Kontext der internationalen Schuldenkrise», in: *Externe Verschulung interne Anpassung Entwicklungsländer in der Finanzkrise, Schriften des Vereins für Socialpolitik*, Bd. 144,, hrsg v. U.E. Simonis, Berlin, pp. 13-44.

Daniel, P. 1981, «The New Recycling: Economic Theory, IMF Conditionality and Balance of Payments Adjustment in 1980s», in Stephany Griffith-Jones/Dudley Seers (eds.), *Monetarism. Its Effects on Developing Countries, IDS Bulletin,* 13, 1: 27-37.

Gerster, R. 1982, «The IMF and Basic Needs Conditionality», *Journal of World Trade Law*, 16: 497-517.
Hankel, W. 1984, «Die Schuldenkrise, ein Problem der Dritten oder der Ersten Welt? Umschuldung oder Schuldenerlaß?», *Blätter für deutsche und internationale Politik*, 1; 64-79.
Holthus, M. 1981, «Verschuldung und Verschuldungsfähigkeit von Entwicklungsländern», *Hamburger Jahrbuch für Wirtschafts - und Gesellschaftspolitik*, 26: 239-255.
Johnson, C. and Y. Salop 1980, «Stabilisierungsprogramme und Einkommensverteilung», *Finanzierung und Entwicklung*, 17, 4: 28-31.
Killick, T. (ed.) 1982, *Adjustment and Financing in the Developing World. The Role of the International Monetary Fund*, Washington, D.C./London.
Killick, T. (ed.) 1984, *The Quest for Economic Stabilisation. The IMF and the Third World*, London.
Killick, T, and M. Sutton, 1982, «Disequilibria, Financing, and Adjustment in Developing Countries», in T. Killick, (ed.) 1982.
Körner, P., G. Maaß, T. Siebold, R. Tetzlaff 1984, *Im Teufelskreis der Verschuldung. Der Internationale Währungsfonds und die Dritte Welt*, pp. 9-261.
OECD/DAC, 1983, «Development Co-operation», Paris.
Schäfer, H.B. 1980, «Die Bereitschaftskreditabkommen des Internationalen Währungsfonds in der Kritik», in ders (Hg.), *Gefährdete Weltfinanzen*, Bonn, pp. 227-240.
Schubert, A. 1982, «Von der Verschuldungskrise zum internationalen Finanzchaos?», in *Weltpolitik*, 2: 66-88.
UNCTAD 1979, «The Balance of Payments Adjustment Process in Developing Countries: Report to the Group of Twenty-for», UNDP/UNCTAD-Projekt INT/75/015 vom 2. 1. 1979.
Wetzstein, G. 1985, «Die Beziehungen zwischen dem Internationalen Währungsfonds und den Entwicklungsländern vor dem Hintergrund struktureller Veränderungen in der Weltwirtschaft», Inaugural-Dissertation Universität Erlangen-Nürnberg, pp. 1-260.
World Bank 1981, *Developments in and Prospects for the External Debt of the Developing Countries: 1970-1980 and Beyond*, Washington D.C.
Zulu, J. B. and S. M. Nsouli, 1985, *Adjustment Programs in Africa. The Recent Experience*, International Monetary Fund, Washington D.C., Occasional Paper 34, April 1985, pp. 1-37.