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IMF-Supported Stabilization Programs and their Critics: Evidence from the Recent Experience of Egypt

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Summary. — The IMF-supported stabilization and structural adjustment programs implemented by Egypt in the 1990s were successful in meeting their objectives, and when compared with earlier attempts and the experience of other developing countries. The authorities undertook a sharp reduction in the government's overall deficit and its central bank financing allowing for increased credit availability to the private sector within a framework of a rapidly decelerating monetary expansion. Despite initiating comprehensive market reforms that significantly improved the environment for private investment, the response of the private sector has been disappointing. It is argued that until institutional, regulatory and political constraints are removed, Egypt will not join the group of high-investing and fast-growing economies.

Key words — Egypt, government, policies, IMF, programs, growth

1. INTRODUCTION

For nearly three decades the International Monetary Fund (IMF) and the World Bank have been sponsoring stabilization and structural adjustment programs in developing countries. [1] Member countries approach the IMF for financial assistance when facing balance-of-payments difficulties. These programs have, broadly speaking, three components: first, to achieve the short-run objective of initiating policies that would stabilize and remedy the macroeconomic imbalances which, in the Fund's view, are the cause of the balance-of-payments problems; second, to institute market reforms and structural changes to transform a government-controlled centralized economy to a competitive market-based one that would improve efficiency and restore growth; and third, the program requires the borrowing member country to secure sustainable external financing. [2] The emphasis on each of the components depends on the specific conditions of the member country. Over the years, especially recently as more developing countries sought help from the Fund, criticisms against these adjustment and structural programs have come from many different quarters and, interestingly, from all sides of the ideological and political spectrum. Much of the criticism is directed at the macroeconomic policies pushed by the Fund to correct both the external and internal imbalances, which the critics claim sacrifices growth to achieve stabilization.

The Fund does not support the components of the program with equal zeal, giving greater primacy to the stabilization measures over the structural reforms. The Fund's position is quite understandable given that this goes to the heart of its original mandate. The IMF was founded in 1945 to help countries cope with temporary foreign exchange shortages under a system of fixed exchange rates. As a result, the Fund seems to show little negotiation flexibility when it comes to the stabilization measures needed to cure the balance-of-payments problem. Thus, if there is no agreement between the Fund and the borrowing member on the stabilization targets, there will be no program. While the Fund puts considerable importance on structural reforms to restore sustainable growth, it sometimes reluctantly goes along with the borrowing country's wishes not to implement adequate structural measures—usually for social or

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political reasons—as long as there are assurances that the macroeconomic measures are implemented. [3] Unlike the stabilization costs (arising from aggregate demand restraint) that are widely distributed, the structural reforms affect particular groups who are reaping huge economic rents from the current system. [4]

One critic (Feldstein, 1998) has observed, however, that the Fund does not have the right to impose on borrowing members structural changes, however helpful they may be, when they are not necessary to deal with the balance-of-payments problem and are the proper responsibility of the country. The Fund's response is that the structural adjustment is not only necessary to reduce the macroeconomic imbalances, to cement the stabilization policies and to promote growth, but to the extent that the market reforms address the fundamental weaknesses that tend to produce these repeated crises, they should be part of the program. Regarding the sequencing, while some reforms are at the core of the macroeconomic imbalances (such as financial sector reform) and should be undertaken simultaneously with the stabilization policies, the usual recommendation is that in countries with acute macroeconomic problems the structural reforms should be undertaken only after sufficient progress has been made in reducing the macroeconomic imbalances. [5]

Since the end of the 1973 war until the more recent 1991 Fund-sponsored program, Egypt had been making limited progress in moving from a centrally planned, public sector dominated economy toward a market-based one in which the private sector is to play the leading role in propelling a more rapid and sustained growth. Over that period, Egypt had turned to the Fund for financial assistance and signed a number of agreements, all of which failed. The first agreement with the Fund was in 1977 for a one-year stand-by arrangement during which Egypt utilized SDR 105 million out of a total of SDR 125 million. This was followed in 1978 with an Extended Fund Facility arrangement that allowed Egypt to draw up to SDR 600 million. As a result of policy failures they were allowed to draw only 12.5% of that total until the arrangement expired in 1981. It took Egypt until 1987 to pay down most of its debt to the Fund. This was followed by a one-year arrangement for SDR 250 million. Again Egypt failed to meet the agreed-upon policy conditions, and the total loan was not drawn.

While earlier attempts at economic liberalization were movements in the right direction, the process was too gradual and fragmented to avoid the downward slide in the economy, especially in the second half of the 1980s. During that period, despite debt relief, foreign aid, and attempts at adjustment, economic growth was nonexistent, inflation hovered between 20% and 30%, and the balance-of-payments problems kept intensifying. The economic difficulties became so severe that, by mid-1990, the Fund concluded that Egypt might not be able to finance either its food imports or debt service obligations, with the result that this would interrupt the assistance flows (IMF, 1991). Faced with this precarious situation, and in return for SDR 278 million, Egypt signed an 18-month stand-by arrangement that would forego the piecemeal approach for a strong and comprehensive stabilization and structural program with mutually reinforcing policies. This time the intention was to tackle most of the structural weaknesses simultaneously. This was followed in 1993 by a three-year Extended Fund Facility that allowed Egypt to draw up to SDR 400 million, and the latest in 1996 was a two-year stand-by arrangement for SDR 271 million.

Starting with the 1991 program an all-encompassing market reform package was initiated that involved broad decontrol of economic activity including privatization of public enterprises, price and trade liberalization, and the introduction of market-based exchange and interest rates systems, all within a context of decidedly tight stabilization policies. In addition, besides making the restoration of sustainable economic growth a primary objective, the programs gave specific consideration to social policies that would alleviate some of the hardships caused by the reforms, and policies addressing environmental concerns. By 1998 the Fund concluded that while the transformation of the economy is far from complete, "...the authorities have continued to press ahead with structural reforms, and progress has, for the most part, been in line with the program" (IMF, 1998, p. 34).

The purpose of this paper is to assess the effectiveness of the stabilization adjustment component of the recent programs. This is because, in part, the implementation of all the market reforms is still not complete, and to assess the marginal contribution of each partially completed reform while controlling for all the other factors that affect performance would