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IMF-Supported Adjustment Programs: Economic Compliance and Political Fallout

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An Intelligence Assessment

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IMF-Supported Adjustment Programs: Economic Compliance and Political Fallout [redacted]

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An Intelligence Assessment

This paper was prepared by [redacted] the Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, Economics Division, OGI, [redacted]

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March 1985

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IMF-Supported Adjustment Programs: Economic Compliance and Political Fallout

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Key Judgments

Information available as of 15 February 1985 was used in this report.

The financial community's primary demand on LDC debtors has shifted from simple adoption of an IMF standby agreement to vigorous compliance with economic performance targets. Not only are nearly 90 percent of IMF drawings now tied to strong economic policy conditions, but the IMF is enforcing these conditions with closer scrutiny and greater resolve. Compliance with IMF targets—the key to obtaining official reschedulings and new money commitments from banks—is becoming an increasingly important factor in pledges of bilateral and multilateral assistance as well. We believe that debtors will continue to improve their current account performance but will have more difficulty meeting domestic performance targets set under IMF guidance.

Greater emphasis on compliance will force governments to attempt closer adherence to austerity programs than has been true in the past. For some countries, this could lead to greater levels of political unrest in the short term, especially in cases where restrictive economic policies have been in place for some time. Intensified compliance efforts have already led to civil unrest in a number of LDCs with IMF-supported programs. Sporadic protests have erupted over price hikes in Jamaica and the Dominican Republic, while wage-related strikes have plagued Brazil.

In the absence of other political tensions, the risks of adjustment leading to government-threatening instability are limited, especially in countries with more diversified economies like Turkey and Brazil. However, we believe that in countries like Sudan, with very narrow resource bases and other political problems, the prospects for compliance with IMF programs while maintaining political stability remain dim.

Argentina and the Philippines are countries where we might see increased political unrest this year as the governments strive for compliance to qualify for needed debt restructuring. As key interest groups—labor unions and student groups in particular—are adversely affected by drastic changes in economic policy, we anticipate more riots, protest demonstrations, and strikes.

Over the longer term, we believe the linkage between economic compliance and political stability will take one of three forms:

- If implementation and adherence to an adjustment program is comprehensive and the economic benefits are realized, serious political unrest often can be avoided.

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- In those cases where austerity measures are watered down, few economic benefits will be realized and, as the difficulties of austerity drag on, the potential for unrest heightens.
- Countries that choose to postpone austerity measures risk fueling underground economic activity that would lengthen the adjustment process and increase the likelihood of more serious and prolonged unrest.

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Introduction

As the financial adjustment programs enacted by debtor LDCs have begun to take hold, the pace of drawings on IMF financial resources has slowed considerably. Total drawings equaled $7.3 billion in 1984, down from a peak of $13.1 billion in 1983. [redacted] the reduction in current account deficits in major debtor countries as the key reason for the decline. At the end of 1984, 29 standby arrangements and four extended arrangements were in effect, compared with 33 standbys and 10 extended arrangements in 1983 (see table). [redacted]

While the level of borrowings has abated, the proportion of loans coming from the upper, highly conditional credit tranches continues to increase. Almost 90 percent of the drawings made in 1984—up from 75 percent in 1983—were made by countries under agreements requiring extensive economic policy changes in exchange for IMF funding. Moreover, this high degree of conditionality means that the strenuous economic adjustment process currently under way in the debt-troubled LDCs will continue for the rest of 1985—and well into 1986 in some cases. [redacted]

IMF-Supported Programs: A Basic Framework

As a result of its support of adjustment programs, the IMF has become a key player in the quest for financial stabilization of debt-troubled countries. Neither official government creditors nor commercial banks will act on a debtor's request for a rescheduling until an IMF program is in place. Standby and extended arrangements link a member's use of IMF resources to its adoption of an economic adjustment program designed to correct its balance-of-payments position. Adjustment programs typically include measures that affect key economic policy areas including government expenditures, credit ceilings, foreign borrowings, exchange rate policies, and trade restrictions. It is on the condition of policy changes in these areas that creditors agree to restructuring terms and new

IMF Standby and Extended Arrangements, As of 31 December 1984

Million US $

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Country	Expiration Date	Amount Agreed	Undrawn Balance
Total		**14,795.2**	**6,570.6**
Standby arrangements		**6,673.9**	**3,557.1**
Argentina	Mar 86	1,419.0	1,419.0
Belize	Mar 86	7.2	5.9
Central African Republic	Jul 85	15.0	10.0
Chile	Jan 85	500.0	0.0
Dominica	Jul 85	1.4	0.4
Gambia, The	Jul 85	12.8	10.2
Ghana	Dec 85	180.0	120.0
Haiti	Sep 85	60.0	39.0
Hungary	Jan 85	425.0	0.0
Ivory Coast	Aug 85	82.8	41.4
Jamaica	Jun 85	64.0	36.0
Korea (South)	Mar 85	575.8	95.9
Liberia	Jun 86	42.8	34.3
Madagascar	Mar 85	33.0	6.0
Mali	May 85	40.5	6.5
Morocco	Mar 85	300.0	90.0
Niger	Dec 85	16.0	12.8
Peru	Jul 85	250.0	220.0
Philippines	Dec 86	615.0	530.0
Portugal	Feb 85	445.0	185.7
Sierra Leone	Feb 85	50.2	31.2
Sudan	Jun 85	90.0	70.0
Togo	May 85	19.0	3.0
Turkey	Apr 85	225.0	56.3
Uruguay	Apr 85	378.0	226.8
Western Samoa	Jul 85	3.4	1.7
Yugoslavia	Apr 85	370.0	90.0
Zaire	Mar 85	228.0	70.0
Zambia	Apr 86	225.0	145.0
Extended arrangements		**8,121.3**	**3,013.5**
Brazil	Feb 86	4,239.4	1,496.3
Dominican Republic	Jan 86	371.3	247.5
Malawi	Sep 86	100.0	66.0
Mexico	Dec 85	3,410.6	1,203.7

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money allocations. And, in turn, it is this linkage as well as its own lending that provides the IMF with the leverage to insist on meaningful structural adjustment.

Standby arrangements almost always include performance criteria expressed in terms of quantitative targets, which usually are reviewed on a quarterly basis. The criteria normally take three general forms:

- A ceiling on central bank lending and the subceiling on lending to the central government. These ceilings are designed to limit government spending as one method of restoring a balance-of-payments equilibrium. Because official borrowing can put pressure on the availability of funds, these criteria protect against preempting private-sector borrowing.

- Limits on the assets of the central bank, which are designed to limit the expansion of the money supply and, in turn, help to control inflation.

- A limitation on the amount and maturity of new external debt to protect against foreign borrowings being used to circumvent domestic credit ceilings. The ceiling is also designed to improve the debt-servicing burden of the borrowing country.

Adjustment programs may also include qualitative performance criteria that outline such things as the member's intention not to introduce or intensify existing import restrictions.

Compliance with these criteria is the principal monitoring instrument used by the Fund to assess whether adjustment programs are on track. A small violation that does not threaten a program's objectives usually results in the granting of a waiver by the Fund's Executive Board. A more substantial infraction, which suggests the country may have difficulties achieving a program's objectives, will lead to consultations between the Fund and the respective government that will probably result in the introduction of modified performance criteria. In the meantime, the country's ability to draw on Fund resources will be suspended. Only when consultations reach a satisfactory conclusion are the member's drawing rights restored.

External Factors Influencing Adjustment

The performance criteria and targets found in adjustment programs provide little cushion against the impact of an external shock. Shocks such as high interest rates and fluctuating oil prices endanger adjustment programs and any early return to creditworthiness. Debtors feel they are being forced to bear the brunt of global economic conditions that are beyond their control. Their primary concerns include continued protectionism, the relative strength of the US dollar, and high real interest rates. The recent period of unfavorable economic conditions including historically high interest rates and global recession forced some debtors to adopt unexpectedly harsh austerity measures they felt were politically intolerable. Debtors, in particular the Cartagena Group, are calling on the developed countries to do their "fair share" and adopt an attitude of "coresponsibility." In this same spirit, the debtors would like to see the IMF:

- *Establish a compensatory fund to cushion the impact of high real interest rates.*
- *Allow restructuring of arrearages owed to the Fund.*
- *Make conditionality more flexible.*

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Conditionality: The Economic and Political Impact

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Austerity and economic adjustment under IMF programs have led to significant positive economic benefits in many countries. in 1984 those countries under standby or extended arrangements saw their current account deficits decline to one-half the preadjustment levels of 1981. Brazil led all others in eliminating its huge $11.8 billion current deficit. Furthermore, IMF-supported adjustment programs keep international financial markets open to some LDCs because new money packages and

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official and commercial reschedulings are all anchored to Fund arrangements. [redacted] in Mexico, for example, every dollar of Fund lending in 1983 and 1984 unleashed seven times that amount in new loans and refinancing. Restructurings, in turn, have helped to bring about an improvement in the maturity profiles of outstanding debt and have eased the debt service burden. Determined adjustment efforts have resulted in multiyear reschedulings for Mexico and Venezuela. [redacted]

While unrest is often politically or socially induced, as in the Philippines, we believe the high degree of conditionality required for IMF assistance also has had deleterious political effects. Indeed, previous research shows that IMF-supported programs require precisely the type of economic changes that can lead to political unrest.[1] Traditionally, cuts in government subsidies, which result in higher prices on food and fuel, are the actions that are most likely to trigger public unrest. Strikes, protest demonstrations, and riots are the most prevalent forms of unrest and usually are initiated and organized by labor unions or student groups. These forms of protest rarely evolve into government-threatening instability, but they have caused governments to relax austerity measures for fear of further alienating their constituencies. [redacted]

A number of cases of backlash have occurred within some countries under IMF conditionality. [redacted] the Diouf government in Senegal, the Houphouet government in Ivory Coast, and the Barletta government in Panama have all been forced to soft-pedal their austerity programs at one time or another or risk losing their political power base. While averting civil unrest in the short run, implementation of halfhearted austerity measures could compound a government's political problems in the medium term. Watered-down adjustment efforts will bring few of the economic benefits the population has been promised, and, as the difficulties of austerity continue—for a longer period of time than would have been the case under a fully implemented program—political tensions usually will heighten. [redacted]

[redacted]

Government leaders hoping to implement needed economic measures and avoid political fallout face a limited number of options: 25X1

- Publicity campaigns can be initiated to educate the people on the need for adjustment and on the long-run benefits they can expect. There are risks, however, if the government fails to make good on its promises. 25X1

- Exchange rates could be adjusted on a daily or weekly basis rather than through a massive one-time devaluation, thereby partially diffusing a politically sensitive issue.

- Price increases can be implemented in stages to limit negative public reaction. In Egypt, for example, the Mubarak government initiated bread price increases only in wealthy neighborhoods in an attempt to avoid rioting reminiscent of 1977, when more than 100 people were killed.

- In politically tense situations, the government can attempt to move away from the passionate issues of price increases into less sensitive areas such as divestment of publicly owned enterprises. 25X1

- Civil anger can actually be directed away from the local government and toward the IMF and other foreign lenders. In Sudan, for example, the Nimeiri government is aided by the population's perception that international donors, the drought, and the influx of drought refugees are responsible for a large part of their economic ills. [redacted] 25X1 25X1 25X1

A government's prospects for peaceful implementation of austerity measures will be dimmed by political opposition groups using austerity as a rallying point to strengthen their own political power base. In Jamaica, for example, Prime Minister Seaga claimed the January protests against price hikes were politically inspired, while former Prime Minister Manley claimed the protests reflected the people's deep-seated discontent and frustration with the Seaga government. [redacted] 25X1

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Compliance and Political Fallout: A Country Look

The economic gains and political fallout from the IMF-supported adjustment process vary widely among countries. Some countries—Mexico, Portugal, and Turkey—have successfully completed programs while maintaining political calm; their broadly based economies and strong centralized governments have provided an accommodating environment for adjustment. Events of unrest, however, have been commonplace in other countries like Jamaica and the Dominican Republic, where a halfhearted commitment to adjustment has resulted in little or no economic improvement. New price hikes and spending cuts on top of prolonged economic hardships have made for politically volatile situations. As the IMF takes a harder line on compliance, we believe that countries like Brazil and Chile have a potential for higher levels of unrest. These governments may no longer be able to cushion austerity measures through the traditional methods of implementing only partial reforms or coupling price hikes with wage increases.

Countries on Track

After three years of sustained progress, in 1983 ***Turkey*** suffered significant economic setbacks—notably a deterioration in its external accounts and higher inflation. As a result, the standby arrangement signed in April—Turkey's fifth program in 10 years—was designed to halt the rise in inflation and reduce the current account deficit. To reverse the surge in the rate of inflation, currently projected at almost 50 percent annually, the government initiated measures to absorb excess liquidity and in July started selling high-interest bonds and raised interest rates. Turkey's arrangement with the IMF was amended following its midcourse review in August, and we believe Turkey will meet its revised targets and make its fourth and final drawing on schedule. According to uncorroborated press reports, however, the government of Turkey plans to seek a new $250 million standby agreement in 1985.

Turkey's almost continuous six-year relationship with the IMF has been harmonious, in large part because of its successful reorientation toward free market, export-oriented policies. Internally, martial law, which still exists in some of Turkey's 67 provinces, has limited the amount of social protest. We believe the political stability of Turkey will depend, in part, on Prime Minister Ozal's ability to continue to control the labor unions, but a high rate of inflation and continued wage controls will make this increasingly difficult. 25X1

After years of political instability following the 1974 revolution and the loss of its African colonies, international bankers believe ***Portugal*** is turning around under the leadership of Prime Minister Soares, Minister of Finance Lopes, and a strong economic team. Under its IMF program, originally due to expire 28 February 1985, Portugal has trimmed its current account deficit from $3.2 billion in 1982 to an estimated $400 million in 1984. At the same time, it has reduced its imports and improved its credit rating in the international financial markets, and the structure of its external debt—about $14 billion—is now more manageable. 25X1

Domestically, the Portuguese have exceeded the ceilings on short-term debt and on domestic credit to the public sector. The IMF granted Portugal a waiver on technical grounds for violation of its July short-term ceiling. The Portuguese had planned to seek a waiver for the overrun of the domestic credit ceiling, but this was strongly discouraged by the Fund as waivers are granted only when the problem is being corrected. Because the overruns continued unabated, the Portuguese decided not to pursue a waiver, and the standby was terminated at the end of 1984. 25X1

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The Portuguese met with the IMF in early January and all parties agreed that a formal standby arrangement for 1985 was not necessary, but the Fund will continue to monitor and report on Lisbon's performance. According to Embassy reports, the Fund agreed to a visit in February to prepare a report on 1984 performance and to another visit in June for the midyear review. The Portuguese were pleased at this concession as it coincides with their syndication of a $500 million loan and reassures bankers that the country remains under Fund surveillance. 25X1

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Although economic prospects are improving for Portugal, the domestic price of adjustment has been high. Unemployment is still more than 10 percent and real incomes are down, but there has been no sign of significant political unrest. The presidential elections in December could have a negative impact on Portugal's international credit standing if the coalition government collapses and a replacement is not easily formed as was the case in 1983 when bankers cut off lending.

Trouble Spots

The ***Dominican Republic*** has run into periodic trouble both domestically and with the IMF. The government introduced an adjustment program in 1982 that was endorsed by the IMF in January 1983, at which time a three-year extended arrangement was signed.[2] Performance criteria were met until late 1983, when negotiations with the IMF were suspended because of a disagreement over the prices of essential commodities, especially petroleum products. After bloody protests against food price hikes in April 1984, negotiations for the second year of the arrangement were suspended in May when the government refused to implement further subsidy cuts on petroleum and electricity. According to Embassy reporting, the government felt such actions would prompt additional violence.

After the violence in April 1984, President Jorge Blanco began an extensive program to build support for a standby arrangement among key labor, political, and business groups. In August, the government adopted a set of austerity measures for the next 18 months. The Fund welcomed the informal accord as a transitional measure that could lead to a formal program. President Jorge Blanco's troop deployments to potential trouble spots helped prevent violent confrontations in the wake of food, fuel, and transit price increases announced in January 1985. We believe, however, that growing divisions in the ruling party could sidetrack the President's austerity program and further aggravate the country's economic problems.

Jamaica failed to comply with its performance targets in September and December of last year. In September the Jamaicans exceeded the ceiling on new arrearages because of delays in two loan disbursements, but the Fund expected the loans to be disbursed in November and, therefore, granted a waiver. Targets on fiscal policies, which have been at the core of Jamaica's economic problems, were met only by very narrow margins, suggesting a need for further tightening. The Jamaicans recently instituted a freely floating exchange rate system. Despite a prohibition against multiple currency rates, it was agreed that the Bank of Jamaica would intervene in the spot markets until the rates converge and an orderly transformation has occurred. The intervention is to end no later than 15 March 1985, according to Embassy reporting.

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Jamaica's economy continues to deteriorate. Since fall 1983, the Jamaican dollar has been devalued by 64 percent, and the government continues to remove subsidies on basic food products. In January 1985 the price of gasoline and other petroleum products was boosted sharply. These moves led to widespread protests that left at least four dead. As a result, Prime Minister Seaga is attempting to cushion the impact of further price increases through food relief programs. Economically, the unrest is hurting the tourism industry, depriving the economy of needed foreign exchange, and jeopardizing the entire adjustment process. Politically, we believe public unhappiness with government policies could contribute to a resurgence of popularity for opposition leader Manley.

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Potential Problems

Sudan's standby arrangement became inoperative after its first drawing in June 1984 because of arrears with the Fund—a continuation of Sudan's intermittent difficulties in meeting its financial obligations to the Fund since 1981. Arrearages currently total more than $90 million and will rise to $257 million if no

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[2] An extended arrangement is designed to meet the needs of countries experiencing special balance-of-payments difficulties that require support over a period longer than normally covered by a standby arrangement. Conditionality is in effect for the entire period.

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further payments are made by yearend. Sudan is also in arrears to several regional organizations as well as government and commercial creditors. [redacted]

In response, the Nimeiri government has announced a combination of budget, price, and foreign exchange reforms designed to win endorsement of the IMF and thereby release at least partial disbursement of suspended bilateral funds. According to State Department reporting, a Sudanese economic team in Washington has given tentative approval to IMF demands, but the plan still awaits Nimeiri's approval. However, the resurgence of civil disturbances in the southern region has led to an increase in government expenditures on internal security that will adversely affect medium-term balance-of-payments prospects. Sudan's financial prospects are further complicated by Nimeiri's program of Islamization, which has confused businessmen and limited investment. [redacted]

Chile has been in and out of compliance with its IMF programs as political pressures have led to backsliding on austerity measures. Chile signed a two-year standby arrangement with the IMF in January 1983. The agreement limited government spending, credit expansion, international reserve drawdowns, and the level of public-sector debt. Chile soon fell out of compliance with its program, but rather than terminate its arrangement or negotiate a revised program it instituted a four-month "shadow program." During a shadow program, a country does not draw from the Fund but follows policies that, while different from IMF recommendations, are nonetheless designed to eventually bring the country back in compliance. Chile returned to compliance and resumed its regular program in September 1983. In 1984 the government successfully completed its adjustment program, and [redacted] a preliminary agreement with the IMF for a new $750 million, three-year standby agreement has been reached. According to Embassy reporting, however, Santiago has heightened its financial vulnerability for 1985 by drawing $800 million in short-term credit to help cover a $2 billion current account deficit. [redacted]

The economic austerity measures have been accompanied by high levels of political unrest since the adjustment program was launched in 1982. The Pinochet government, however, has been able to minimize the political backlash through political repression and selective loosening of the economy at critical times. We believe austerity measures were a major factor in the antigovernment demonstrations in 1983. In an attempt to restore political stability, in early 1984 the government appointed a team of economists who advocated a more interventionist role for the government. This relieved some of the political pressure as the new team offered limited relief to some sectors of the economy. After antigovernment protests in September failed to gain momentum, the government took some stronger steps toward adjustment. Adverse public reaction was limited as the government timed implementation of the measures to coincide with the traditional December-to-March vacation period. If the government continues to concentrate on improving Chile's external accounts by squeezing the domestic internal sector, the political fallout could be more strident than in the past, and we believe Pinochet again will be pressured to relax his austerity program. [redacted]

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Brazil is having difficulty with IMF guidelines in the third year of its three-year extended agreement with the Fund. Under this extended arrangement, performance criteria and targets are set for three-month periods. Brazil has sent the IMF a letter of intent covering the final year of its program, but the Fund has decided to delay any final action until the Neves government comes to power in March. [redacted]

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The contrast in compliance between the external and domestic targets is dramatic:

- The 1984 trade balance showed a surplus of $13 billion—higher than for 1983 and $4 billion greater than the target of $9 billion. The current account and international reserve targets were also surpassed by comfortable margins.

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- Brasilia, however, has had serious difficulty in meeting its domestic sector targets. According to Central Bank figures, the money supply grew by 204 percent and the monetary base by 244 percent in 1984—more than double targeted levels. The IMF withheld a $400 million payment in February

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1985 because of Brazil's failure to meet fourth-quarter public spending and money supply targets. According to press reports, inflation soared to an annual rate of 300 percent in January, more than double the targeted level of 120 percent. Inflation has been fueled by indexation, a larger-than-expected inflow of capital, and uncontrolled state spending.

Because of these shortfalls, the IMF has been dealing harshly with Brazil since late 1984, and the new government will be under intense pressure to meet both IMF requirements and the demands of Neves's constituency. Brazilian workers continue to protest against wage controls and cuts in public job spending. There may be a political temptation for the new government to engage in some populist measures, such as increasing real wages or devoting more funds to social security programs, which would further fuel inflation. Any of these measures would clearly put the government at odds with the IMF and, thus, could jeopardize or at least postpone an agreement with Brazil's commercial creditors.

In the first two years of its program, ***Mexico*** became a prototype for demonstrating how adjustment measures can revitalize an economy. Since the summer of 1981, Mexico has engineered an $18 billion positive swing in its trade balance. In addition, the government has reduced its public-sector deficit to slightly more than one-third its crisis level. Furthermore, the country has made substantial progress in regaining the confidence of international lenders. Begun in 1983, the IMF program aimed at restoring Mexico's economy, primarily through a reduction in the public-sector deficit, slowing inflation while reducing reliance on foreign borrowing, and liberalizing the trade and exchange systems. In 1983 and 1984 Mexico's economic performance was satisfactory to the IMF, and funds were disbursed regularly.

Since then, however, problems have arisen. Talks with the IMF on the program for 1985 have been deadlocked since November 1984. Mexico had proposed a public-sector deficit equal to 5.1 percent of GDP—nearly 2 percentage points over the original goal set in 1982. Mexico City, however, recently announced budget cuts designed to bring the program more in line with IMF demands.

even if an agreement is signed this spring, Mexican officials are concerned about their ability to meet targets. Their concern focuses on falling oil prices and pressures to increase government spending prior to the 1985 local elections. 25X1

Mexico's unique political and social structure has helped the country endure two years of wrenching 25X1 economic austerity without serious political consequences. The key to continued stability has been labor's support for the ruling Institutional Revolutionary Party (PRI). Unlike the situation in Argentina where the unions are the wild card, in Mexico they are among the government's strongest supporters. We believe, however, that the economic situation is beginning to take a political toll. Resentment is growing against the PRI; and, for the first time in 55 years of single party rule, a second party—the center-right National Action Party—is drawing a sizable vote. With midterm elections approaching, there will be heavy political pressure against continued strong austerity measures. 25X1

Outlook 25X1

In our judgment, debtors will make further gains in external sector performance in 1985 but will continue to have difficulty meeting internal monetary and fiscal targets. Banks, official creditors, and the IMF will increase their pressure on debtors to meet these domestic targets or risk forfeiting financial assistance. Recently, the IMF issued a rare statement voicing its concern over Brazil's internal accounts. This marks a change of heart on the part of the Fund which has, until now, been prepared to overlook a series of 25X1 failures by Brazil to meet domestic economic targets. With greater reliance on IMF performance appraisals, 25X1 the Fund will probably be less likely to grant waivers in an effort to maintain its credibility.

As pledges of official aid become more closely tied to compliance, we anticipate that a number of ad hoc committees, similar to the one established by the official creditors of the Philippines, will be set up to

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The Changing Nature of Economic Adjustment

A large part of the international financial community is pressuring the IMF and IBRD to become more involved in the LDC longer term economic stabilization process. At the upcoming IMF/IBRD Interim and Development Committee meetings in April, discussion will focus on moving beyond adjustment and toward sustained balance-of-payments positions and stable levels of economic growth in the medium term. [redacted] 25X1

Debtors that have complied with a short-term IMF standby and have improved their economic situation feel they deserve a longer leash than another standby or one-year Paris Club rescheduling can provide. As more countries seek multiyear reschedulings similar to Mexico's, requests for IMF surveillance without a formal standby arrangement are growing. However uncomfortable the IMF may be in this new role, we believe commercial creditors—who insist that some monitoring take place—will demand continued Fund involvement. [redacted] 25X1

We believe debtors who have been unsuccessful in their adjustment programs will intensify their efforts to circumvent the IMF. Nigeria, for example, in a deadlock with the IMF, issued promissory notes to its uninsured trade creditors and, in effect, converted its short-term debt into medium-term debt. Others will avoid a formal IMF arrangement for political reasons. In countries like Venezuela and Indonesia, better economic situations grant the governments the flexibility to take adjustment measures on their own without a politically less palatable arrangement with the IMF. [redacted] 25X1

follow the progress of economic policy implementation. In the case of the Philippines, several key bilateral donors in January postponed making aid commitments until satisfied with Manila's policy-reform efforts. [redacted] 25X1

We believe the increased emphasis on economic compliance in the next year could lead to greater levels of political unrest as governments are forced to make more painful economic adjustments. We anticipate an increase in events of political unrest mainly in the form of riots, protest demonstrations, and strikes especially in countries—like Argentina and the Philippines—where new IMF-led programs will be taking effect. In other countries, for example Jamaica, continued unrest is quite likely because austerity has been in place for some time and economic gains remain unrealized. Moreover, government leaders who are forced to recant after having taken a strong stance against an IMF program are the most likely to be weakened. This could prove true for Nyerere in Tanzania as well as Buhari and the Federal Military Government in Nigeria. [redacted] 25X1

For those debtors who back away from adjustment, the consequences of delay will add to already serious problems:

- Bolivia, which declared a moratorium on debt payments in May 1984, has an inflation rate of more than 2,000 percent and high unemployment. An IMF-supported program would, we believe, boost short-run inflationary pressures and unemployment much higher.
- Similarly, Peru stopped making interest payments in June 1984 and is now more than $300 million in arrears. Concerns about the July elections have prompted the Belaunde government to postpone negotiations with the IMF, which, in turn, has delayed discussions with Lima's creditors on debt restructuring.

In both cases, continued economic stagnation will enhance the attractiveness of illegal drug activity and further jeopardize the legitimacy of the respective governments. Moreover, postponing needed austerity will lengthen the adjustment process and, in our judgment, will increase the probability that more serious and prolonged unrest will occur. 25X1

In the medium term, we believe the potential for political unrest will decrease as the economic benefits of the adjustment process are realized. Provided improvements do occur, and in the absence of other political tensions, the risks of government-threatening instability should diminish, especially in countries with more diversified economies like Brazil, Argentina, and Turkey. For other countries, like Sudan—with very narrow resource bases and other serious political problems—prospects will remain dim. 25X1

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