Inventing Conditionality, Exploring Its Politics (1946-1958)

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Abstract

The conflict between Keynes and White, in the run-up to the 1944 Bretton Woods conference, left the IMF with a substantial capital, though without a rule-book on how to lend. The literature then insists on the introduction of the Stand-By Arrangement (1953), which remains till today the Fund's workhorse lending vehicle. Yet, the literature ignores the second step of the re-invention: policy conditionality, hence the capacity for the IMF to suspend lending when countries diverge from their pre-agreed economic objectives. This book chapter analyzes this brake-through, in the case of a policy loans to Paraguay and Bolivia, in 1956-1958. It then shows how this innovation triggered within a few years: 1/ a redefinition of the IMF as a crisis manager, in an entirely novel relation to borrowing countries; 2/ a full realignment of the relationship between the staff, the management and the key member-states, primarily the US; 3/ the adoption of a new economic framework, known as the monetary approach to the balance of payment; 4/ in parallel, the exploration of the legal and political consequences of defining the Stand-By as a *non-contractual transaction*, adequate to a relation to self-standing sovereign states.

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Policy advice from foreign experts often makes good sense, though all governments will not necessarily admit it. The proposition becomes, however, clearly contentious if the visitors start insisting on actual policy changes, for example, as a condition for an international loan which the country may dearly need. Whether they come from the International Monetary Fund, the US Treasury or the European Commission, the chance is that sooner or later these experts will be grandly opposed in the name of sovereignty. None of your business, they will be told. Sacred territory.

Still, the transaction between policy commitments and financial support has been a fixture of international policymaking at least since the 'League Loans' of the 1920s. Then, in the late 1950s, the practice of 'conditional lending' was reinvented and codified by the Fund, at which point it became its main policy tool, when it intervenes in a crisis country. Over the following decades, hundreds of interventions across the world have been backed by conditional loans, or Stand-By loans as they are known. There is hardly a week—perhaps not even a day—when Fund officials do not meet with representatives of some national government to discuss either the structure or the implementation of a typically comprehensive, often painful, economic program.

Uniquely, during the 1980s a place was made at the negotiating table and in the final agreements for commercial banks, which came with a heavy baggage of special interests and developing countries' loans. The whole game was thus redeployed so as to deliver three-way 'burden-sharing' deals based on new policy commitments by the country, financial concessions by the banks and an IMF loan. But the basic structure and rules of the transaction were not changed. Thus, if we want to understand how the Fund acted during the 1980s, we must go back to the early days of conditional lending, three decades before, and look at how the Stand-By loan was framed and thought about from the beginning. Here is not indeed a banal financial transaction, but a rule- and process-based one that addresses specifically the financial needs and the political construction of a sovereign borrower.

Policy and process

The paradox is that whereas the policy content of IMF conditionality has been discussed in hundreds, or perhaps thousands, of publications, little attention has been given to the transaction itself and its construction. A first standard path we could take is thus to follow the classic normative argument about the inherently benevolent, good-willed nature of the multilateral project. Jean Monnet, for instance, who was a founding father of the League of Nations, defended its 1922 program in support of Austria as '… a permanent work, not a more-or-less charitable response to crisis. Not only Austria lost nothing of its independence in asking for foreign aid, but it reinforced it thanks to international guarantees and domestic reforms' (Monnet, 1976, *Mémoires*, pp. 129-130). A century later, the IMF could still put this quote on the front page of its website, although it leaves unanswered the question of how this uncharitable transaction works and why it is so often resisted and contested.

Alternately, conditionality is often framed as a kind of contract, where countries mortgage a slice of their sovereignty against loans. We might thus imagine the IMF with big chunks of sovereignties piled up in its vaults, with tags attached: first a bit of Argentine sovereignty here, then Greece's own pound of flesh, etc. Very soon down this road however we are knee-deep in a private law contractual language, where the parties voluntarily enter mutual commitments and where any

failure to comply should call for redress or damages. Some kind of third-party, typically a civil or commercial court, should then adjudicate the dispute on the basis of a mutually accepted contract law. Talking of an IMF 'as if' it would work broadly along these lines is confusing.

To break out of these unpractical views asks that we historicize conditional lending and look at it as altogether a financial and a political innovation, though a belated one. At Bretton Woods and in the years before, John Maynard Keynes and Harry Dexter White, the heads of the British and American delegations, had toyed with the idea of exchanging a multilateral loan against policy concessions, but they flinched. Sending international experts to tell governments what they should preferably do was not something they were ready to endorse. In 1944, the IMF was thus endowed with a large capital though it received neither a rule-book nor a doctrine on how to lend. The history of conditional lending started with the enigma of a political impossibility.

1. Lending to member countries: Keynes and White at an impasse

Historians have written at length on how, during World War II, the US and Great Britain discussed how the future international economic order should be rebuilt, from scratch and as a political construct. Both parties fully recognized that, in the future, national governments would extend their reach to a whole new set of economic and social policies, including labour market regulation, social security and counter-cyclical policies. Inevitably, they agreed, this broader mandate would result in diverging economic outcomes regarding, in particular, inflation and the current account: exchange rates would have to accommodate them, rather than leaving adjustment to automatic, socially disruptive mechanisms, as under the pre-1914 gold standard. But the pre-war experience of competitive devaluations and regional barter-based arrangements had also made clear that some collective macroeconomic discipline was needed in order to support exchange rate stability, hence trade and prosperity. As the US Treasury wrote on the eve of the Bretton Woods conference, the challenge was to reconcile the fact that 'the interest of a country in its own exchange rate is paramount', while, at the same time 'an alteration of the exchange rate affects the economic life of other countries' (US Treasury, 1944).

Bretton Woods: Rights versus privileges

The strategy of 'embedded liberalism' resolved the dilemma of progressive policies at the domestic level with international economic coordination by way of a rule-based monetary regime based on 'fixed-but-adjustable' exchange rates (Ruggie, 1982; Ikenberry, 1989).[1] Governments would keep some leeway, thanks to capital controls and to the possibility to devalue, particularly in case of a structural or permanent current account deficit. But in that case, it was added, they would first have to receive the green light of a kind of collegial body, de facto headed by our good-willed hegemon,

[1] On the history of Bretton Woods and the wartime negotiations, Gardner's *Sterling-Dollar Diplomacy in Current Perspective* (1980) remains a very strong reference. Steil (2013) is fine, though he delves a lot into White's long relations with the Russian secret services, which eventually brought about his downfall, in 1947. Steil also tends to present the process as being overly dominated by the American side, a point that is clearly contradicted by the long dead-end on IMF lending policies. Skidelsky's 2001 biography of Keynes is of course a superb source. Harold James, in *International Monetary Cooperation since Bretton Woods* (1996) has several chapters on the Bretton Woods conference, its preparation and its immediate aftermath. But he is more interested by the exchange rate mechanism per se than by lending policy and the invention of conditionality. See also Chwieroth (2011) on the Bank vs. IMF evolving roles in the early post-war years. Horsefield's 1969 three-volume official history of the IMF during its early years includes many important documents, especially on the wartime exchanges between the US and the UK. For the years after 1946, however, he is primarily focused on the Executive Board and its documentary sources (reports, minutes, decisions, etc.). He has very little to say on the staff-side of the Fund's evolution, which is problematic when discussing the emergence of conditionality. The later volumes of this official history, which were edited by Margaret Garritsen de Vries, present the same limits, as does the short essay by Dell (1981).

the United States. The IMF was to be this body, hence the diligent, mostly silent keeper of the 1944 rules. By and large, the arguments up to Bretton Woods were primarily about how to make this mechanism work and how to make sure that the Fund could be safely entrusted with it.

Yet the Keynesians and the New Dealers who shaped the Bretton Woods agreements also set their eyes on an even more ambitious international public good: the new IMF would also help smooth the international adjustment mechanism by providing financial support to countries with large current account deficits. Avoiding brutal adjustments and undue devaluations would thus protect member-countries and buttress the exchange rate mechanism. The Fund's capacity to lend against the cycle was thus a full part of the attempt to articulate a new Keynesian policy consensus at the domestic level with a formal regime of mutual help at the international level. The code-word here was *surveillance*: a rather loose, non-binding model of coordination where a few top technocrats would guide the world economy, regulate the cyclical adjustment of current accounts, and authorize occasional adjustments in exchange rate parities (Hirschman, 1989; Hall, 1989).

What this says, incidentally, is that the Bretton Woods conference could well have agreed on an exchange rate mechanism *only*, without creating a fund with financial resources to lend. Who knows how things would have turned out in 1944 if Roosevelt had died two years before, and if Harry Truman had already been his vice-President, rather than the blue-blood New-Dealer, Henry Wallace? A non-lending Fund could have been indeed a conservative, yet forward-looking alternative to the actual Bretton Woods regime.

In practice, the project was stopped half-way between these two options: the Fund received substantial capital, though no guidelines on how to use it. This was weird. What was the point of creating a separate lending institution, side by side with the International Bank for Reconstruction and Development (IBRD, later known as the World Bank), when you didn't even know what to do with this Fund? The conundrum reflected the well-known opposition between the two main countries. Keynes rightly anticipated that post-war Britain would long remain in a weak economic and financial position, and so he defended a policy of easy, quasi-automatic access to Fund resources by deficit countries. For sure, he also agreed that there had to be some limits on the capacity to draw on the Fund, but he did not have much to say about them. As he wrote in 1943, '… in the realm of internal policy the authority of the Governing Board of the proposed Institution should be limited to recommendations, or at the most to imposing conditions for the more extended enjoyment of the facilities which the Institution offers' (Keynes, 1943).

White, on the other hand, expected that easy lending by the IMF would end up being financed by the United States, so that clear limits should be in place, right from the beginning. As he summarized in 1943, for the British, drawing on the Fund had to be a right, whereas for the Americans it had to be a privilege (Horsefield, 1969, I, p. 70). Still, the US team remained at a loss when trying to formalize how access to Fund resources could be conditioned. The Treasury could only state, on the eve of Bretton Woods:

> The recommendations of the Fund should be given the utmost consideration in the formulation of the monetary, economic, and commercial policies of member countries. [They] will have behind them the enormous force of the world's opinion…. Even though the Fund's recommendations carry with them no element of compulsion, it will be difficult for any country cognizant of its responsibility to disregard them. (US Treasury, 1944, reprinted in Horsefield, 1969, III, p. 174)

In other words, don't count on rules, and even less on pressure and coercion. Just expect that somehow, it will work. Or wait until a solution is found. Joseph Gold, the founder of the Fund's legal doctrine and one of the main figures who shaped the institution later acknowledged that: '… the function of the Fund was always conceived to be, even in prenatal days, the stabilization of currencies, but it was given no specific powers over domestic policies…. Even if conditionality was implicit in a number of provisions, the power to apply it … was buried even deeper in the interstices of the text' (Gold, 1974, pp. 51, 54).

Fund governance: Law and license

Interestingly, in those prenatal days the discussion of the future responsibilities of the organization was fully tied up with the question of its governance, i.e., delegation and monitoring by the principals, and staffing. The policy tool and the political hand that would use it had to fit together. Policy and process cannot be fully disentangled one from the other. As usual, Keynes summarized the core problem in the sharpest and most elegant terms:

> If rule prevails, the liabilities attaching to membership of the system are definite, whilst the responsibilities of central management are reduced to a minimum…. If discretion prevails, how far can the ultimate decision be left to the individual members and how far to the central management? If the individual members are too free, indiscipline may result and unwarrantable liberties be taken. But if it is to the central management that the discretions are given, too heavy a weight of responsibility may rest on it, and it may be assuming the exercise of powers which it has not the strength to implement. If rule prevails, the scheme can be made more water-tight theoretically. But if discretion prevails, it may work better in practice. (Keynes, 1942)

And the old man concluded, wisely: 'it may be better not to attempt to settle too much beforehand and to provide that the plan shall be reconsidered after an initial experimental period of (say) five years. Only by collective wisdom and discussion can the right compromise be reached between law and license' (Keynes, 1942).

Despite these early pronouncements, as time went on, the British side evolved towards a water-tight agency relation: arguing for a right to draw loans implied that the organization would keep little discretion, or license, when deciding whether to lend or not. And in that case, there was no need for a staff with its own voice and authority. 'Our object must be, therefore, to secure as much prior certainty as possible concerning the methods of those responsible for daily management … thus keeping them as an instrument, entirely passive in all normal circumstances, the right of initiative being reserved to the central banks of the member countries' (Keynes, 1944). Executive Directors, on the other hand, were to be high-calibre, shuttling officials who would keep strong ties with their home government or their central bank, and would only meet from time to time, preferably in New York. White and his team, on the other hand, favoured from the onset a strong Executive Board and a rather large expert staff—both based in Washington DC, a few hundred metres away from the US Treasury.

> 'The Board will have to include more than a sprinkling of economic statesmen, forward looking and of broad vision (…). The technical staff will have to be headed up by experienced analysts with a thorough knowledge of monetary theory and international economics, with intellectual integrity and aggressiveness, and also include a generous quota of eager, able, young men who have been at or near the top in their scholastic achievements and technical writings.' (White, 1943, reprinted in Horsefield, III, 1959, p. 76)

The Americans men prevailed, of course, and the IMF was soon equipped with both a strong Executive Board, where the representatives of member-states sit, and a large, yet silent, staff of 355 in June 1947.[2] The latter was supposed to stay in Washington, do the back-office work and never enter that highly sensitive territory: policy making of a sovereign member state. Crossing that line would have been like a lowly secretary challenging an Ambassador. So, for instance, in the early years, only Executive Directors would do the mandatory review of payment controls for countries that did not moved to full convertibility on current account, non-financial, payments (the so-called Article XIV reviews, today Article IV reviews). These were peer-based exercises, concluded by a simple exchange of letters. In 1952, when the Managing Director proposed that the staff make these consultations, the Dutch head of the European Department preferred to resign, with horror. 'He

[2] The Fund's staff reached 474 in 1960, 1000 in 1968, and is 2400 today. At its maximum, in 1930, the Economic and Financial Section of the League of Nations, which foreshadowed the IMF, had a staff of 56.

could not accept the idea that the Fund would force his countries, his European countries, to consult with the Fund. (…) the Fund had no business trying to have this direct relation with members (…). He did it in that level that we don't do those sorts of things in Europe' (Irving Friedman quoted in *Beginnings*, 2(1), pp. 10-11).[3]

Deep in the text of the Articles of Agreement were, however, two small clauses, which would have long-lasting consequences on the Fund's governance and on its capacity to evolve and redraw the relationship between the Board and the staff, or between the IMF as a whole and member-countries. Rather than meeting from time to time, like the (British) directors of a large firm, Executive Directors sit in 'continuous session': they work full-time at the Fund, where they deliberate as a collegial body and make decisions on a day-to-day basis, all year long. They are even paid by the Fund and, significantly, in the minutes of the Board, they are mentioned by name only, without reference to their home country.

Second is the capacity endowed in the Executive Board to interpret the Fund's own constitution, i.e. the Articles of Agreement, without any cumbersome, external deliberation with governments, like treaty amendments for instance. Interpretations of the Articles—hence, legal innovation—typically take the rather ad hoc form of Board 'decisions', which are the lower, most common type of rules in the Fund's (shallow) internal hierarchy of norms. Moreover, the practice of interpretation itself is not marked by strict guidelines, but by a 'great catholicity in the approach', as Gold again summarized (Gold, 1974). The rationale for this 'remarkable and unusual' constitutional pattern was to 'preserve a certain informality precisely because [decisions] are not given the stamp of final authoritativeness. (…) The practice is thus consistent with the spirit of consultation and collaboration'. Or pragmatism and expediency, if you prefer.[4]

If you take together the continuous session and the self-interpretation of the Fund's constitution, you end up with a uniquely self-contained, flexible model of governance. In practice, as long the Executive Board agrees, there are few external or formal obstacles to experimentation and policy discretion. Of course, in the home countries, ministers and central bankers know almost in real time which proposals and initiative are being discussed within the Fund: Executive Directors are there to inform them, a responsibility they do not shirk. Still, it is hard to underestimate the impact of this decision-making structure on the long-term evolution of the organization, particularly its transformation into an international firefighter; i.e. an executive international agency.

Killing the Fund?

It took time, however, to resolve the paradox of a strong governance in a weak body. For years the very survival of Keynes's and White's child remained in question, if only because the IMF was seen in Washington as a hub of New Dealers, where too many alumni of the Morgenthau wartime Treasury had found refuge. In other words, the Fund was too left-wing. While internationalist and broadly supportive of the Bretton Woods agreements, the Truman administration considered that as long as Europe had not fully recovered and moved to convertibility in the current account, there was a risk that IMF loans would not be repaid fast enough, and that its resources would be soon depleted or frozen over the long run.[5] Well into the 1950s, US bilateral aid and IBRD loans

[3] As late as 1955, the Mexican Central Bank invited the head of the Mexican desk at the Fund, in Washington, to come visit the main government institutions and write an expert report on the conduct of monetary and foreign exchange policies. The Executive Board was not informed of the mission, neither did it receive the report: more than thirty years later, staff witnesses still saw this episode as a memorable victory (Robichek, *Beginnings*, 1(1), p. 20-23).

[4] Gold (1954 and 1967), Hexner (1959); a rather formal yet internal procedure for interpretation had been included in the 1944 Articles (art. XVIII) and an ad hoc committee of interpretation, made up of Executive Directors, was also created in 1967, but neither left a strong mark.

[5] Frank Southard (1907-1989), a major American figure in the first three decades of the IMF, agreed later that: 'For all practical purposes we put the Fund "on ice" financially during that period [the late 1940s]. Not only

remained by far the main sources of international liquidity, with the Fund playing here a very minor role and the private financial sector being essentially absent from the scene.[6]

To make things worse, in 1947 European countries which benefited from the Marshall Plan were barred from drawing on the IMF, while the other members borrowed only the small amounts to which they had essentially free access. Part of the problem was that countries that asked to borrow beyond this limit remained subject to approval or denial by the Executive Board, with little ex ante guidance and at the risk of finding themselves in an embarrassing position if rejected. Even the Executive Directors, who insisted on making these decisions, realized gradually that presenting such a hard answer to one of their peers was not an experience they wanted to repeat. In other words, match-making between supply and demand for loans remained problematic because a lending doctrine was still missing. No one knew what to ask for, nor what to expect.

As a consequence, over the two years beginning in October 1949, the IMF lent only a total of 76.8 million dollars on a gross basis (9.1 million on a net basis, or 79 million in 2020 dollars). In 1950, a low-key debate even asked whether the Fund should be closed altogether. Irving Friedman, one of the dominant American figures in those years, later recounted that Camille Gutt, the first Fund Managing Director, had proposed in September 1950 to close the Fund for the duration of the Korean War, which had started in June.[7] Eugène Black, the President of the IBRD, may have even suggested that the Bank take over the management of the Bretton Woods exchange rate mechanism as a department, while the rest of the organization would be presumably folded.

In early 1951, however, the United States decided to relaunch the IMF as a financing institution, shortly before Ivaar Root took over from Camille Gutt at the helm in August. Apparently, Andy Overby, the American Deputy Managing Director, had mobilized the Fed's Governor, William Martin, in support of the Fund (Friedman, in *Beginnings*, 2(1), pp. 552–53). [8] But a more contingent event may have weighed here: in late November 1950, a 300,000-strong Chinese army had entered the war in Korea and routed the American forces; with the Soviet Union closely beyond, this opened up the prospect of a long and dangerous war, which would have to be financed. Serious tensions immediately arose between the US Treasury and the Fed regarding the overall adjustment of the policy mix and debt financing (Hetzel and Leach, 2001). It thus made sense, at that exact time, to

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were there no agreed policies as to how to use the Fund, but the US was disinterested in seeing the Fund used during that period when the US was providing ERP [Marshall Plan] aid, aid to Korea, aid to Taiwan, aid to other parts of the world. (…) [The] other countries (…) kept pressing to loosen up the Fund; but we held that line, and of course, had the power to hold it.' (Southard, 1973; see also Southard, 1979, p.16). During the war, Southard had worked for the US Treasury under White, i.a. as an economic advisor in China, then in Washington, where he had a direct part in the pre-Bretton Woods discussions. He became the US Executive Director at the Fund in 1949, then moved to Deputy Managing Director from 1962 to 1974. At the Treasury, he worked closely with Edward Bernstein (1904-1996), the principal economist, who became the first head of the Fund's Research Department (1946-1958).

[6] Drawing on Mason and Asher (1973), Schwieroth (2008, p. 485) refers to discussions held in 1946 when banking and insurance groups indicated that they preferred holding IBRD bonds than bonds issued by its member-states.

[7] Irving Friedman (1915-1989) started his career at the US Treasury before joining the Fund in 1946. In 1950, he became the Head of the Exchange Restrictions Department, hence one of the most important positions at the Fund in those years; he moved to the World Bank in 1964, where he supervised the Economics Department (see Helleiner 2014, p. 200).

[8] James (1996, p. 83) refers to a letter from Gutt to Bolton, the Governor of the Bank of England, stating that if efforts to relaunch the Fund failed, 'you can, to my mind, write off the Fund' (14 November 1950). This existential crisis reached beyond the organization, as is attested by the *New York Times* report on the Fund/ Bank meetings held in September 1950 in Paris: 'For the Fund (…) these meetings have had somewhat the atmosphere of rehearsal for a funeral. The organization is split by disagreements among its principal member countries as to what it should do with its resources. (…) If it were not for the unwavering support of the United States Treasury there is little doubt the Fund would either be liquidated or relegated to the status of a research institution' (Hoffman, 1950). See also *The Banker* (1951).

shift some of the weight of international aid from the US budget to the multilateral level, in particular to that unused organization, the Fund.

Still, the old enigma remained of how the IMF could lend to a sovereign member-state with reasonable expectations that it would stabilize its position and repay the loan in time. In 1950, the liberal, American hegemon had not yet built a viable pathway to the Fund's lending window. And because the macro-politics and the microeconomics were not there, supply and demand did not meet.

The solution that emerged over time imposed a full-scale redefinition of the Fund's mandate, its relation with member-states and its own governance. On the one hand, it remained till the early 1970s the keeper of the Bretton Woods exchange rate mechanism, although with a more flexible, or lax practice than initially envisaged. But, in hindsight, this experience did not leave a strong mark on the organization: after 1973 or 1976, it did not thrive on the expertise it had accumulated while managing the Bretton Woods regime.

What has most marked the IMF, till today, is the second mandate which the Fund discretely took on, in the late 1950s: namely crisis management and economic stabilization, primarily in the peripheries. This marked a complete reversal of mandate and role: rather than trying to regulate the international cycle by controlling *aggregate international liquidity*, in a Keynesian manner, the IMF learnt how to disburse funds *on the margins* of the international payment system and against tough policy conditions, at a time other financiers withdraw and when countries reach breaking points.

Whereas it had operated in its early years as the rather modest keeper of the Bretton Woods exchange rate mechanism, hence as a rule-enforcer, it increasingly endorsed from the turn of the 1960s the role of a rare multilateral crisis-manager—hence an executive agency, endowed with considerable resources and discretion.

The legacy of pre-war crisis management

The main antecedents of this new, de facto mandate were the multilateral stabilization programs launched by the League of Nations during the interwar period, first with Austria and then in a small number of Central European and Balkan countries (Pauly, 1997; Marcus, 2019). Though in policy terms the League interventions were very orthodox, they marked a breakthrough in the history of international policy making: a League official stayed in the country's central bank or Ministry of Finance and had a direct ear and sometimes a hand in actual policy making. But the limits of these experiences were also evident. Conditionality was loosely formalized and the League had no resources to lend, so core member states separately guaranteed private loans to crisis countries, without tranches and explicit attached policy conditions. Moreover, countries like Germany and Poland proved too hot politically to be handled by the League, so the Americans had to be brought in.

The other antecedent to the Fund's new practice were the orthodox economic programs negotiated by the pre-war American 'Money Doctors', which were typically based on large funding loans by New York banks.[9] This practice and its anchor in both Wall Street and the State Department had a large impact, especially in Latin America. But both collapsed with the international financial crisis of 1931-32 and ended up being highly despised by the New Dealers, especially by Henry Morgenthau, Roosevelt's Secretary to the Treasury, and by Harry White's team. In *The Forgotten Foundations of Bretton Woods*, Eric Helleiner (2014) recounts how, in the late 1930s and during the war, the US Treasury developed in Latin America an alternative, more progressive approach.

[9] Flandreau (2005); Rosenberg (1999). The most prominent Money Doctor was Edwin Kemmerer (1875-1945). An Economics Professor at Yale and a supporter of the gold standard, he became at the end of his life a sharp critic of the IMF (James, 1996, p. 64). See also Albert Hirschman (1963) on the Latin American missions by the economic consultancy firm Klein-Saks, during the 1950s.

Rather than the nineteenth-century or the League of Nations orthodoxy, their heritage was the New Deal, in particular the experience of the Tennessee Valley Authority (Patel, 2016, pp. 97-103; Ekbladh, 2010). They thus tried to better articulate foreign exchange stabilization, debt restructuring and domestic objectives of development and industrialization in the borrowing countries; on some occasions they even crossed the path of the young, up-and-coming Raul Prebisch, who after the war became a leading light of the import substitution school in Latin America (Helleiner, 2014, pp. 150-155; Dosman, 2008, chapter 6).

Gardner (1980), James (1996) and Helleiner (2014) underline how the ascent of Harry Truman (April 1945), the resignation of Morgenthau (July 1945) and the demise of White (August 1947) rapidly changed the terms of the policy debate in Washington.[10] But none of these authors follow the historical line up to the reinvention of the IMF as crisis manager, in the 1950s. Symmetrically, the Fund never recognized a legacy, or even a distant source of inspiration, in these pre-war and wartime experiences, whether in the 1950s, when it developed its own concept of conditional lending, or during the 1970s and 1980s, when it took on the new challenges of sovereign debt. This rather reflexive institution has long remained interested in its own history and experience only.

2. Reinventing the Fund: 1951-1958

The first step in this reinvention of the Fund asked that the old 'Keynesian nexus' between lending and a broad concept of counter-cyclical policymaking be dropped. In the early 1950s, Europeans still defended the perspective that if the Fund were to lend more, then lending had to be less constrained, like a water tap. But as they also conceded that there should be no free meal, the old dilemma kept returning: how do you discuss with a sovereign the price of such a meal? And how do you make sure you will be paid on time?

Disposing of the Keynesian overhang and inventing a new practice of crisis lending necessitated that the discussion that had been aborted at Bretton Woods be restarted from scratch. In a small yet significant first step, the Executive Board decided in March 1948 that some kind of link between borrowing and economic policies was actually warranted. This is how far the discussion had to start from: the Fund had the right to challenge the requests for funding made by member states whose policies it considered inadequate (Horsefield, 1969, III, p. 227). Later, in 1950, it was decided that loans would have to be paid back in less than five years, so as to protect the Fund's capacity to lend further and, incidentally, to draw a clear demarcation line with the IBRD. In early 1950, lastly, a principle of proportionality was adopted between the relative size of the loan being asked and the extent of economic demands made by the Fund. The broad parameters within which the Fund might lend in the future were now in place, but a modus operandi was still missing.

The Stand-By and the performance criteria

The first, well-known step forward was the 1952 invention of the Stand-By Arrangement (SBA), commonly known as the Stand-By, which is still today the IMF's workhorse lending vehicle. After a series of internal debates, held with substantial American input, an experiment with Belgium in March 1952 was followed the same year by a first codification.[11] The main feature of the new

[10] White was initially supposed to become the Fund's first Managing Director but instead became only the US Executive Director; his resignation in March 1947 followed a heart attack and public accusations of having been a Soviet informer since the late 1930s, a point that was later confirmed (Steil, 2013). He died in August 1947.

[11] The first Board general 'Decision' on Stand-By was taken on 1 October 1952 (IMF 1952), after long debates at the Board and among the staff. The archives of the Legal Department include a large number of notes and reports left by 'Working Parties', respectively on 'Use of Fund's Resources' and on the Stand-By. They give a detailed view of how the related discussions within the Fund evolved during those years (Legal Dept Fonds, Box 14/6 and Box 15/8). For a (rather formalistic) retrospective of the early development of the Stand-By, see Spitzer in Horsefield (1969, II, pp. 468-491); see also IMF (1968a). The Stand-By has a long series of

'arrangement' was that the amount of the loan was made unconditionally available to the country for a given period of six to twelve months. The money would thus 'stand by' on the table, as indeed a kind of narrow, British-style 'right to draw'. The decision to lend came with a broad review of 'the member's position, policies and prospects in the context of the Fund's objective and purposes'. In the following years, the first generation of SBAs was thus based only on 'understandings', increasingly backed up by a detailed description of the economic program and by close, ongoing discussions with the Fund. But this was not yet conditional lending.

The breakthrough came with three long-forgotten programs between 1956 and 1958. First, in November 1956 a one-year Stand-By with Bolivia stated that after two-thirds of the loan had been drawn, the last third would be made available only after the Fund had agreed. Hence, there would be two *tranches* in the Stand-By (not to be confused with the quota tranches) and the Fund would have to give its green light at both points (IMF, 1956).[12] The Stand-By was now a sequential transaction, in fact a sequential game with its own time horizon. One year later, in December 1957, a second Bolivian Stand-By was agreed on for the balance of unused money, again with tranches, but it failed: in September 1958, the staff declared that 'substantial deviations from this program have created conditions under which it is no longer possible for the Government of Bolivia to use the Fund's resources' (IMF, 1958a). Upon the express demand of the staff, the Stand-By was thus suspended by the Executive Board and a revised version negotiated. Significantly, the decision to resume lending was made by the staff only.[13] Power had shifted at that moment.

In July 1957, however, in the midst of this Bolivian cycle, a program with tranches was also agreed on with Paraguay, which included for the first time the notion of *performance criteria*: whereas the Bolivian program would be suspended in December of that year on the basis of a broad judgment about the conduct of economic policies, three quantitative policy objectives were written into the Paraguayan Letter of Intent and included in the Stand-By. The failure to reach any of them implied an immediate suspension of disbursements: 'If, at any time before January 1, 1958, the credit ceiling as described in the annexed Report is exceeded, Paraguay will not draw further amounts under this Stand-By arrangement before consulting the Fund and obtaining its consent' (IMF, 1957a). The exact same wording was used for the other two criteria as well.

In the decades to come and till today, IMF conditionality has continued to work along these lines. After a country has called for help (remember that the Fund never invites itself into a country), a program is negotiated with a staff mission and formalized in a Letter of Intent sent by the country's government to the Fund Managing Director; the Executive Board then decides to formally extend a Stand-By loan, with successive tranches and performance criteria; the latter are thus at the core of the negotiation between the country' government and the Fund mission, and then 'declared' in the Letter. These performance criteria make suspension automatic and predictable, and resumption after negotiation is a staff decision. Only more comprehensive 'waivers', which affect more broadly the overall strategy, need Board endorsement. Otherwise, the staff is in charge of managing conditionality, regardless of Keynes's principled position that it should be 'an instrument, entirely passive'.

The invention of conditional lending, in 1957 and 1958, marks the 'constructivist turn' in the IMF's early development. This was the moment when the organization, particularly its staff, became a self-standing actor, which started to actively shape how the organization acted, rather than being just an expert agent in the hands of sovereigns. On the back of its growing expertise and experience,

descendants, whose logic is essentially similar to its own, in particular the Extended Fund Facility (1974) and the Supplementary Financial Facility (1977). In the following pages and chapters, all references to the Stand-By will include these derivative products.

12 A similar version of this rule was included in March 1957 in a Chilean Stand-By.

[13] 'It is not intended to place this matter on the agenda of the Executive Board unless an Executive Director so requests. In the absence of such request by the close of business on Friday December 5, 1958, the above decision [to resume disbursement] will be deemed adopted' (IMF, 1958b).

the staff started to talk with its own voice, to propose solutions, and to develop its own, distinct conceptual toolbox. And (again) what is most remarkable is how discrete this redeployment was: once a new mandate as a crisis lender had been de facto adopted, the relation with individual member-states, as between staff and Board were soon realigned. Usually, political scientists point to the interstitial character of evolutions like these: organizations shirk and cheat at the margin of their agency contract and so they redraw the perimeter of their mandate by exploiting the incomplete character of their principal/agent relation with member-states. Here, change had a more structural and discrete character: it affected in a powerful way the core terms of the Fund's relation to sovereign member-states, whether at the Board or when lending. And this caused a near-immediate, almost synchronic re-arrangement of many facets of the Fund' activity.

A new economic orthodoxy

Performance criteria and close policy oversight first crystallized a new analytical approach to economic policy making. At Bretton Woods, the only element in the members' policies that was placed under multilateral control was the rate of foreign exchange, and its expert view extended to foreign reserves and the current account, but no more. Venturing beyond those limits would have taken it fully into sovereign territory. The staff soon concluded however, and quite rightly so, that such a narrow discussion did not make much sense, economically. Severe foreign exchange misalignments asked that the Fund inevitably look at the whole set of economic decisions that had led to this situation, including monetary and fiscal policy. If not, the country may well come back and ask for more support after one year or two, and the loans might not be repaid within the expected three to five years. The Fund may thus compromise both its track record and its capital. Yet, no international architect had ever dared to intervene that far.

This shift soon called for a broader, more structured analytical framework—in fact an economic model—that would account for the observed imbalances in the economy and describe a viable adjustment trajectory. Increasingly, this took the form of a quantitative, medium-term macroeconomic model, from which the performance criteria were drawn. This innovation was apparently introduced by Al Costanzo (1917-2011) in 1956: in the case of a (non-SBA, non-conditional) program with Paraguay, he designed the first IMF program backed up by a fully-fledged macroeconomic model, which would certainly look incredibly raw by today's standards.

Following the interviews collected in *The Beginnings of IMF Stand-bys*, this innovation resulted from converging efforts by field officers in crisis-stricken countries and by the experts staff, in Washington. The development of the 'monetary interpretation of the balance of payment' has been associated since then to the name of Jacques Polak, the long-standing head of the Research Department, which would provide the intellectual bedrock of IMF programs for decades. But in *The Beginnings*, staff members are adamant that this framework resulted also from their own practical interest in being able to closely monitor economic policies in the countries that signed on the new conditional programs.

'You could not be delaying a drawing for three months to wait for the data; you had to be able to decide straight away. A lot of the efforts on the missions was to make sure that you had the data sent weekly by cable so that you knew what was happening. This made monetary data the only possibility for monitoring current policy' (Finch, *Beginnings*, 1(1), p. 30). In this view, the Fund's initial interest in money supply and its control was based on an utterly pragmatic concern—the availability of short-term statistics—, rather than on hard theoretical premises.[14] Moreover, they all insisted at that time that they were pragmatic Keynesians, not Old school monetarists. 'I finally found (…) a great comfort in the fact that one guy had made the theoretical framework on whatever

[14] 'That's right, it was pragmatic and later on we found that, gee, somebody can actually explain this theoretically!' (Costanzo in *Beginnings*, 1(2), p. 8).

the hell we were doing, he was telling us what we were doing, and that was Jacques Polak's paper' (Costanzo, *Beginnings*, 1(2), p. 7).

Local politics

Assuming a direct influence on policymaking and possibly a capacity to weigh on elected governments was not a gradual evolution, but an instant experience. As soon as the Fund's missions took on the full scope of economic policymaking and became full participants in the decision process, they inevitably became party to the local political game.

> It is an absolutely essential element of the whole philosophy that you are relying on the monetary authorities to be on your side. You are their ally in trying to see that the country is run right. As soon as they start to shift and to regard the Fund as an alien force, they can come up with all sorts of gimmicks to rig the figures. Then it is virtually impossible for the Fund staff to know quickly what is really happening. (Gold in *Beginnings*, 1(1), p. 39)

Field officers thus learnt to calculate their positions and their alliances in the domestic political scene, hence also to identify and circumvent their opponents. An informal professional know-how developed, which is still an essential dimension of the job of mission chiefs, in particular, who materially enter the hard shell of the sovereign realm. In the very best cases, and in their own discourse, Fund missions would not just be embedded in the local policy-making elite; they would become part of them, with real personal relationships and friendships. In Costanzo's own formulation, much later:

> We weren't there exercising Fund power and that sort of thing. We were there as technicians to help them work their way through, to put a program together. Many times we found strong allies because, you see, the people who wanted to do these things now had support. We didn't have to force anything. (Costanzo in *Beginnings*, 1(2), p. 20)

> The alliance in a sense with the Fund was always with those who said, well, these problems have to be faced and we should face them in a more orderly fashion. (…) So the Fund was brought into the public area [and] (…) you became a symbol of the groups that were trying to change things in various ways. Most of the manoeuvring went on, I suppose, without any real knowledge on our part of exactly what was involved.... (Finch in *Beginnings*, 1994, 1(6), pp. 14-15)

Many authors have analysed how the Fund' officials direct involvement in domestic policy making has come with a practice of looking for local interlocutors who share their professional culture and shared views of how the economy works and should work; in other words, 'authoritative modes of interpreting the world' (Strange 1988). From here flows a dimension of 'informal' influence with a strong sociological dimension, which points in turn to shared academic background and professional track-record (Woods 2006, Schwieroth 2010, 2012).

What these quotes also tell us is that the challenge of justifying the Fund's interventions in the policy-making process of member states was never easy and un-problematic. The theme runs across the *Beginnings* interviews and has also been commented on by later authors (Stiles, 1991). It signals the inherently contentious character, hence the continuing fragility of the transaction between policy commitments and a crisis loan. Here is not in the least a quiet, dispassionate relation to be conducted on purely professional or technocratic terms. It is intrinsically political, in its overall conception and its actual conduct.

3. Who's afraid of conditionality?

The path-breaking innovations of 1956-58 were not marginal affairs inside the IMF. Resistance to the emerging practice of conditional lending was very strong at the Executive Board and greatly

anticipated the discourse of generations of IMF critics till today. The discussion of the Paraguayan program, in July 1957, already revealed serious opposition to the very principle of quantitative performance criteria as key instruments in the conduct of Stand-By arrangements. A number of Directors would have preferred to keep making decisions on general merit: a country's economic policy could not be summed up in a few numbers, they argued; it had to be considered as a totality (IMF, 1957b). But beyond these criticisms was of course a more fundamental issue.

The uproar was even greater on December 23 of that year, when the second Bolivian Stand-By (later suspended) was discussed. The Argentine Director recalled solemnly to the Executive Board that 'The Fund is no supranational organization, but rather, a body created by equally sovereign powers—all zealous protectors of their independence—where they can meet and work in common' (IMF, 1957c). The Australian Director agreed with him:

> It was of the greatest importance that the Fund should not interfere, or appear to interfere, in those affairs of a country that came within the details of domestic policy. (…) It would do the cause of international monetary cooperation more harm than good if the Fund put itself in a position where it could be blamed with any degree of plausibility for unemployment, increases in taxes, etc. (IMF, 1957c)

The Indian Director added that 'if the text recommended by the staff were adopted, it had to be made clear that the Board could not be deemed to have approved every detail of the stabilization program nor to have shown any desire to restrict the Bolivian Government from modifying it as circumstances might require….' (ibid). It was essential, the British Director added, that decisions on policy and the responsibility for them should be taken by the country itself' (ibid). Similar objections were raised by the British, French, Dutch and Greek Directors. Does it make sense for the Fund to assume direct responsibility for a stabilization plan which will be subjected, inevitably, to complex and unforeseen evolutions and accidents? Does the IMF, in particular its Directors, have the time and competence to pass judgement on a detailed program from a country on which most of them have minimal knowledge?

But the key, underlying issue was clear. As Jacques Polak, from the Research Department summarized, much later, performance criteria gave to the Fund the 'power to declare the terms on which it would allow its resources to be used'. In other words, he added: the 'policing power, the checking-up power' (Polak in *Beginnings*, 1(1), pp. 28 and 14). Two voices, however, resisted this insurrection of the Board: the higher staff officials, like Polak and Gold, who had developed the new, emerging doctrine and the American Executive Director, who had the last word.

American voices, staff empowerment

There was no way, of course, that these broad, radical evolutions could have been ignored by the United States, or even simply observed from a distance. Prompting, guidance and oversight by the US Treasury leaves no doubt, with a series of strong personalities playing the main go-between roles. We have already met the figures of Irving Friedman and Frank Southard.[15] Merle Cochran, also an alumni from the wartime US Treasury, was Deputy Managing Director from 1953 to 1962, a position in which he pushed strongly in favour of the first conditional programs in Latin America.[16] Al Costanzo had worked as the US Treasury representative in Italy during the Marshall Plan, later in post-civil war Greece (with a right of veto over monetary policy, under the Currency Board arrangement then in place). He then became the Deputy Director of the Western Hemisphere department between 1955 and 1961, where he played the leading role in the first conditional

[15] See footnotes 5 and 6 above.

[16] Cochran (1892-1973) already had a strong experience with Latin America, since his time at the US Treasury, at the turn of the 1940s (Helleiner, 2014, pp 60-62); before that, he had participated in the expert committee at the League of Nations that had drafted the 1939 report on sovereign debt.

programs in Paraguay and Bolivia.[17] David Finch (1924-2002), an Australian national, who was then in the early years of a long career at the Fund, later interpreted Costanzo's move to the IMF as the result of an express, political initiative from the US Treasury:

> It was the US 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 US *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. (Finch in *Beginnings*, 1(3), p. 13)

If we endorse this ex post facto reading by an ultimate Fund insider, the relaunching of the IMF after 1950 was not just a default decision taken by the US under the growing pressure of other member countries or the Korean war. In hindsight, this step marked a new, positive vote of confidence for financial multilateralism, as opposed to bilateral interventions. And of course, the staff adhered to these evolutions, which empowered them. Following Finch again, the staff even saw itself as the driver, or the real entrepreneur, beyond this reinvention, which would have come 'from within', even more than 'from above'. The challenge in the 1950s, he summarized, was:

> … to try to get political acceptance from the US authorities that a role for IMF resources could be developed. It involved creating constructive precedents which when codified gave the staff delegated responsibility [to] (…) talk to a country knowing that the Board would support the arrangements. The stand-by became a key element in making that delegation acceptable. Underlying this evolution was (…) the staff approach that not just changing the exchange rate but getting the necessary changes in the country's policies were crucial. Once the staff established that they could help get such changes (…) the way opened for a large IMF role. (Finch in *Beginnings*, 1(1), p. 11)

These sentences are remarkable, first because of their full recognition of US primacy, which comes together with the intriguing notion of a 'delegation' from the Board; then is the understanding that, in any event, the Board would endorse the terms agreed upon by the staff with the country; and lastly is the full acknowledgment that the staff had to act upon the whole set of economic policies if 'a large IMF role' was to be envisaged.

This description thus delineates a new and problematic dynamic of deliberation and decision-making within the Fund. Not only had the Fund now taken the whole gamut of economic policies in its hands, rather than just foreign exchange affairs. But also, the staff was in charge, as was briefly spotted in December 1958 when the Board silently declined to have its hands directly in the renegotiation of the Paraguayan Stand-By. This move signalled more generally a full realignment of the Fund's internal governance: the 'economic statesmen of broad vision' who sit on the Board, as White described Executive Directors, were neither willing, nor equipped to manage the hard game of conditionality enforcement. Quite soon, they will also realise that the expertise and the whole memory of the Fund' policy experience is concentrated in the staff. Quite simply, turn-over rules in the national bureaucracies made it difficult for Directors to accumulate in time this specific expertise and institutional know-how (Stiles 1991, Martin 2006).

Conditional lending thus killed club-based or paternalistic governance at the Fund and opened the route to professionalization, meritocracy and bureaucratization. Only a formally depoliticized expert body could do this job, which the staff largely invented and adopted with gusto, though with the constant prodding, monitoring and support of the lead principal. The US had informally given to the IMF a new mandate and the staff crafted a new policy instrument adequate to it; they then explored its politics and gradually discovered how flexible and effective it was. The IMF was thus

[17] Read his (oral) auto-biography in *The Beginnings* 1(2). Al Costanzo moved in 1961 to Citicorp, where he played an important role in increasing lending to developing economies, especially during the 1970s. He retired in 1980.

empowered by the Stand-By, which gave it a second lease of life shortly after it had been seen as stillborn.

A strategic space at the core of the Fund's governance

The link between this redefinition of the Fund's governance and the innovations brought about by the Bolivian and Paraguayan programs was not circumstantial. Till today, once a member country and the staff have agreed on an economic strategy and a set of performance criteria, most often after several weeks or months of efforts, the capacity of the Board to weigh substantively on the program is extremely limited. With a full rejection hardly an option, the Executive Directors are essentially presented with a *fait accompli*. In 1968, when the first amendment to the Articles of Agreement endorsed the principle of conditionality, some Executive Directors suggested that they should be able to collectively amend the performance criteria. They would thus have re-entered the core policy discussion and become party to the discussion of the individual Stand-Bys. But this proposition was considered unviable and rejected by the General Counsel (hence Gold) and the Director of the Exchange and Trade Relations, hence top level staff officials.[18] As another Director later commented, the Executive Board is 'rather like a parliament called upon to ratify a treaty. All that the Board [can] do, after having expressed its opinion, [is] to approve or refuse the request [for a Stand-By]' (IMF 1968d).

We shall see in a coming chapter how this problem re-emerged during the 1980s in an even more acute form: by the time the Stand-By documents were sent to the Board for approval, they articulated an economic strategy *and* a restructuring agreement already negotiated with the banks, which could hardly be touched upon. Rather than concentrating all the Fund's agency rights in their hands, the Directors' main job since the 1950s has been to guide, monitor and control the staff, who actually negotiates loans, disburses money and manages the Fund's many economic programs. Directors are not meant to micro-manage programs. The continuous session of the Board, as adopted in 1944, revealed in this new set-up all its political relevance.

Yet, at the core of the post-1957 high-powered relation between staff and Board, hence between the case-by-case *fait accompli* and ultimate control, we still find a large, open strategic space. Rather than signalling dysfunctionality or systemic failure, it should be seen as a constructive, if informal, dimension of the Fund's governance, which contributes to its continuing relevance.

In this strategic space we first see at work the Managing Director, because of his dual position as the head of both the Board and the staff: he needs their respective support and incessantly moves back and forth between them. In the mature, grown-up age of the Fund, she or he is the one who has to make sure that the political and the expert wings work in sync, thus protecting the IMF capacity to act. This position gives to the Managing Director a level of political and intellectual responsibilities that extends well beyond anything Keynes and White had envisaged. His or her core responsibilities may not be easily delegated, and thus his or her priorities often bear disproportionately on what the organization does or does not, during a given mandate. In this sense, the Managing Director is more a trustee of member-states than their agent—who conversely would be under their command and would be easily dismissed in case of disagreement (Alter, 2008). His or her legitimacy rests ultimately on personal experience and competence, hence on peer recognition, rather than on remaining entirely faithful to a given, narrow mandate. Among these

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[18] The Director of the Exchange and Trade Relations Department answered: 'While Executive Directors certainly had the legal right to change performance clauses, if they did, it would be necessary to refer back to the member thus affected. (…) Even assuming that the Board discussion led to an easing of a criterion (…) there would be many new problems for the government in relation to other sectors of the economy since its understandings with these sectors were reached in the light of the overall policy package for the period' (IMF 1968c).

peers are the top cadre of the Fund, whose support and adhesion the Managing Director needs, on top of mere diligence.

The other dominant figure which camps in this intermediary zone is the American Executive Director, who also coordinates experts and sovereign interests, primarily American interests. The superior influence of the hegemonic country is exercised in this grey zone just as much as around the Board's table, though other G7 countries occasionally exercise such informal influence, like the French in the case of Sub-Saharan countries for instance ((Stone 2008). Charles Dallara, who held that position during the latter half of the 1980s, offers later in this book a candid and detailed account of how he operated between the Managing Director, the higher echelons of the staff, and the US Treasury. The staff may occasionally suggest that *they* have the stronger hand in this relation;[19] but, if the IMF loses its way, the US can de facto withdraw its multilateral delegation: the whole IMF may then become the instrument of the US Treasury. This was most clearly the case at the time of the Mexican 1994-1995 crisis, then with South Korea in late 1997, and more generally in the relations with Russia, during the 1990s, when geopolitical concerns fully overwhelmed IMF agency.

Lastly, this open space also reflects the epistemic and political trust of its principals in the organization's policy orientation, judgment and professionalism. Officials from Ministries of Finance and central banks who make up most of the Board's recruitment have the same broad professional culture as Fund officials; they speak the same language and essentially share the same worldview. Trust reflects this commonality of perspectives and is also instrumental in allowing the staff, with its relative autonomy and expert authority, to experiment below the radar, in the shadow of delegation, before making formal proposals to the Directors. It is easy to discount this autonomy as 'mission creep' or mere variations around solidly held dogmas. In fact, it is essential to understanding how the Fund operates and innovates, and how in particular it took on and addressed emerging sovereign debt problems from the 1970s onwards.

4. The logic of conditional lending

If we take a few steps back and try to better understand the logic of conditional lending, from a synchronic perspective, the best entry is offered again by Joseph Gold, long the head of the Fund Legal Department. A Stand-By, he used to repeat to outgoing Fund missions, is neither a contract nor an international treaty. It is even not even an 'agreement', but an 'arrangement', or a *sui generis* 'exchange transaction'. For years, he kept insisting on expunging from the reports and communications by the staff any trace of a 'contractual language'. Even a 'contractual flavour' could attract censure (Gold, 1963, 1980).

The Stand-By is not a contract: Joseph Gold

For one thing, Gold commented, it would not make a lot of sense to contract on something as broad and complex as the conduct of a macroeconomic program, even for one year. The range of variables at stake, all the possible external shocks, not to mention the internal politics of the country would make any such commitment extremely hazy, hence unhelpful. Moreover, one should differentiate between intermediary objectives, which are written in the Letter of Intent, and the ultimate one, which is to help the country return to normal market transactions without international support. Nobody cares if, at that time, it has missed every condition it had initially signed on to.

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[19] Robichek, a long-standing member of the Latin American desk, thus said of Frank Southard: 'He had to be educated, but then he was very helpful in conveying Fund staff views to the authorities' (Robichek, *Beginnings*, 1(1), 52).

If anything, the definition of a contract implies that any breach is a very serious problem, which may well lead to a full collapse of the bilateral relation. In the case of a conditional loan, rigid, punishing responses to any deviation from commitments, or to any policy failure, may soon endanger the very principle of cooperation, hence of multilateral governance. Significantly, the development of the Stand-By Arrangement in the 1950s necessitated unplugging the various sanctions envisaged by the 1944 Articles of Agreement against Fund members that act against its objectives. 'Ineligibility for Fund resources', which was then seen as the major instrument to discipline members, has never been used beyond a small number of wayward members, like Cuba and North Korea. In the day-to-day business of lending to crisis countries, this measure would be far too 'censorious' (Effros, 2002; Gold, 1970). The idiosyncratic, non-contractual construction of the Stand-By was developed thus completely on the margins of the Articles of Agreement. The principle of conditionality entered the Fund's constitution only in 1968 and the first formal guidelines were adopted in 1979.

When lending to countries against policy commitments, the Fund should certainly make commitments as binding as possible, otherwise lending would become impossible and moral hazard would destroy the institution; but the Fund's role also hinges on its capacity to always leave the door open to new negotiations, so as to allow for a resumption of the transaction even when performance criteria have been missed, and when all possible evidence of mistrust and bad faith have piled up.

Rather than leading to sanctions and to the threat of a breakdown in bilateral relations, Gold concluded, disputes and the failure of conditionality should always lead to 'consultation and collaboration' (IMF, 1968b, 1963). A private contractual relation can collapse, but membership to the Fund is a perpetual relation. In this sense, the Fund lending rules are the farthest away one can imagine from the logic of reputation and retaliation that many still see as the final word in sovereign debt matters. As important, the Stand-By documents do not make any reference to any applicable contractual law, whether American, British, Mexican or other. Neither does the Fund ask that the Stand-By Arrangement be ratified by national parliaments or confirmed by a supreme court, nor does it accept to intervene in domestic courts as an *amicus curiae*. It's not that the IMF insists on ignoring the domestic legal system and its rules of law. In Gold's view, anchoring the Stand-By in the national legal order would have again created unhelpful rigidities, which could have constrained the essentially dynamic, inter-temporal character of the transaction (Gold, 1963).[20] Even the interpretation of the Letter of Intent on an ex post basis, in case of disagreement, is never left to a third-party, which would take a seat above the two parties and provide a binding interpretation of their 'arrangement'; a narrow-based convention to arbitrate has never been considered. More discretionary bilateral 'consultations' are the rule (Gold, 1968b). In other words, the Stand-By is a strictly dyadic structure of governance, not triadic, which would be contrary to classic Westphalian principles (Stone-Sweet, 1999).

The non-contractual character of the Stand-By is materially reflected in the documents that support it, which take the form of two 'parallel declarations'. A Letter of Intent is first sent by the country's authorities to the Fund's Managing Director which describes the program they intend to follow and states the performance criteria; by convention, sending this letter implies that the staff has given their accord and economic negotiations are considered to be complete. An economic memorandum that is attached to the Letter often presents the details of the program. The Executive Board then gives access to a stated amount of refundable cash which 'stands by' until the country draws on it. This two-track exchange of unilateral commitments explains why (even today) no document ever carries the signatures of both parties at the same time, even though there is a bargain made and hard commitments are eventually entered into. As was written at the time of the 1968 review of the Articles of Agreement, Stand-Bys 'are Fund decisions that are adopted after the member has

[20] This uncertainty was resolved with the 1979 Guidelines on Conditionality, which formalized the doctrine that had emerged since 1952, under the form of a Decision taken by the Executive Board.

declared its intention, and that prescribe the circumstances in which specific amounts may be purchased [i.e. borrowed] by a member in the future' (IMF, 1968c).

Bringing these elements together, Gold once summed up in graphic terms this approach by stating, in an internal presentation at the Fund, that 'our objective has been to set forth our understandings with members to the maximum extent within the four corners of the stand-by arrangement' (Gold, 1968b).[21] The Stand-By is a formally closed, self-contained, de facto extra-territorial construction. It is a set of ad hoc rules which countries enter on the day they 'declare their intention' in a Letter of Intent, which will govern their relations as long as support will be needed and commitments entered into. The Stand-By loan thus evades entirely the agonizing dilemma which haunts the debate on sovereign debt: can we reasonably, seriously consider these loans as contracts? Up to which point? And is this contractual thread strong enough to support or mimic what we use to call a market, with all its expected built-in discipline? The Stand-By is the practical and conceptual alternative that extricates us from this invasive contractual language on sovereign debt. And of course, the fact that it enters the scene when the market collapses and payments are stopped is particularly relevant at this point.

A unique inter-temporal transaction

Starting in the 1950s with the successive disbursement of tranches and the performance criteria, a growing set of interaction rules has gradually structured the unfolding of this transaction over time. Today, they make an incredibly long list of meeting points, where information can be exchanged, commitments adjusted, bargains made and arms twisted. Prior actions are generally requested before an arrangement is confirmed; the disbursement of each successive tranche requires review; performance criteria can be renegotiated if the program is suspended; broader waivers on performance criteria may be negotiated; mid-course and 'post-extinction' evaluation of programs becomes mandatory, as do specific reports on standards and codes, financial stability, etc. And being 'under program' does not suspend the review of each member country's economic situation and policies every year, the so-called article IV reviews (article XIV, before 1976).

This long addition may be interpreted as the sign of a runaway bureaucratic machine that has lost all contact with the rude, simple intuitions of the first Paraguayan program. Still, each step also operates as a signpost in a game-theoretical dynamic framework: the options available to each party at each point are well-known to both, the possible responses are predictable, threats of retorsion are open, more or less information can be transferred or hidden. Over time, the relation of the country's government with the Fund thus entails a continuing trade-off between cooperation and confrontation, compliance and renegotiation, declaration of intent and waivers. The Stand-By is a realist, rational transaction which makes policy commitments credible enough for the Fund to disburse credit tranches, while assuming that the sovereign cannot be bound by contract and may well behave accordingly, i.e. in a realistic, opportunistic way.

Most remarkably, the IMF is fully equipped to play that game: over the whole life cycle of a Stand-By, it can always answer in kind and adopt realistic, non-contractual strategies of constructive ambiguity, exercise pressure and hide its game. Open power relationships, supported by substantial discretion and room for judgment, are intrinsic to conditional lending and, to obtain full implementation, the Fund will make liberal use of its resources and discretion. This openness is necessary if the unstable and incomplete character of its transaction with a sovereign State is to be effectively addressed. The Letter of Intent and the rules that organize this realist interaction over time may thus lead to a consensual relation, though also to a highly contentious one, at which point

[21] 'Certain legal questions **...** such as the juridical character of the arrangements and the law by which they are governed and must be interpreted, have not been practical problems. This must not be regarded as a philistine attitude. The Fund has made the effort, and so far successfully, to deal within the four corners of the stand-by documents with the practical problems likely to arise' (Gold, 1963).

the Stand-By may become the rule-based field of an open, continuing fight. Still, the meta-norm is that the relation never ends: a Stand-By can be abandoned, but there is always a path back to the IMF meeting rooms, hence to a new agreement.

Peripheries

The corollary of this realist relation is that all countries are not equal when calling the Fund for help. Economic size, geopolitical leverage, and the country's debt greatly matter as soon as the Fund mission lands in the country, but so will also the strength of the country's economic technocracy. Designing a consistent, credible stabilization program is a challenge which a lonely Minister of Finance cannot address on his own, even with the help of three young PhDs, freshly returned from the US or Europe (or from the IMF). Not least, this program will have to be defended in detail in front of Fund economists who will not give their seal of approval unless they are convinced by the technical quality of the proposed measures. At this point, epistemic views certainly bear: IMF economists are not known for their readiness to endorse views which they consider as adventurous or ill founded. Their mainstream economic background, their sense of epistemic legitimacy, also the full weight of the Fund's capitalized experience are formidable obstacles for countries with limited collective competences. These considerations also weigh on the Fund missions themselves: in terms of personal standing within the organization, it is much more rewarding to join a mission to Brazil or Argentina than to a representative Heavily Indebted Poor Country. In this later case, the risk will also increase that the country will end up with a lazy, run-of-the-mill program, simply because the officials in charge are risk-averse or not that innovative.

Do not forget, indeed, where the whole experience of conditional lending started. Whereas the Bretton Woods foreign exchange mechanism had been designed by the US and Britain, not least for their own use, conditional lending was born twelve years later in Bolivia and Paraguay, the two poorest countries in South America. This shift immediately became a pattern. Well into the 1960s, Western developed countries that asked for Fund support refused to include performance criteria in their Stand-Bys. The 1958 De Gaulle-Rueff economic plan was backed up by a Stand-By loan, though without conditionality. In 1965 the UK also rejected this principle in its negotiations with the Fund and did not even send a Letter of Intent, which had already become at that time the standard, formal declaration of a borrower country's policy aims. Rather, the UK simply sent a casual demand for a loan, with a copy of a public speech by the Chancellor. It was only with the subsequent IMF loan, in 1967, after the failure of the first program, that the now-standard Fund rules were followed, including performance criteria (*Beginnings*, 1(1), p. 16, 42-45). But remember, lastly, the international political shock caused in 2010 and 2011 by the interventions of the IMF in Greece, Ireland and Portugal: more than half a century after the first Paraguayan experiment, conditional lending was still not supposed to extend to rich countries. The stigma persists.