
The Fund's Role in Russia¹

Prepared by

Augusto Lopez-Claros

Introduction

The purpose of this note is to share some *personal* impressions on the main transformations affecting Russia, to give some insights into the political and social context in which our work on Russia is taking and will continue to take place and to ask what implications, if any, this may have for our future role. These thoughts are partly motivated by the conviction that, on the fiftieth anniversary of our institution's creation, we can and we should take a look at the way we do things and ask ourselves how well are we doing and where can we improve. To the extent that this paper has some thoughts on this subject, I would hope that, even in the presence of some self-criticism, these will be accepted in the spirit in which they are offered, namely, one of a genuine desire to see us do our job more effectively and to see the Fund better prepared to respond to the evolving needs of this country and, more generally, its membership. I would also hope that my inability to do full justice to the difficult issues raised here will not obscure the substance, as distinct from the particular way in which I may have dealt with it. Being more in the way of personal reflections, I have taken the liberty of using a freer writing style than that normally used in Fund memoranda and papers. Finally, I have attempted to go beyond the short-term concerns of the election and to address issues the merits of which should not depend very much on the nature of the political landscape three months from now.

The Context

In examining the prevailing conditions in modern Russia one is sometimes overwhelmed by the sharp contrasts one sees: ample evidence of positive, constructive processes at work and, at one and the same time, other deeply disturbing trends. One is reminded of Dickens' opening sentences in *A Tale of Two Cities* when, in reference to the French revolution, he said that "it was the best of times, it was the worst of times." This, it seems to me, is a fairly accurate characterization of contemporary Russia.

It might be useful to make a brief listing of some of these processes, by way of illustration and to highlight some of the forces presently shaping Russia. Admittedly the choice is personal and the list itself cannot but be of a partial nature. On the fundamentally constructive trends that allow us to envision the future with a sense of optimism and that lead many to think of these as "the best of times:"

¹ Debriefing paper prepared prior to return to IMF Headquarters; 19 June 1996. (For distribution to senior IMF management.)

1. Russians who in the past felt frustrated and asphyxiated by the rigid controls which existed under Communism often refer to the greater openness in Russian society as being one of the more favorable trends in recent years. Although many of the institutions formerly at the center of the Soviet Union's corrupt totalitarian system have not severed all their interactions with civil society, there is no doubt that the average Russian citizen is freer today than at any time in the recent past and lives and moves in a world where, on the whole, there is greater respect than there used to be for certain basic human and civil rights. Against a background of many decades of unparalleled repression and its impact on the collective psyche of its citizens, this new-found freedom is likely to have as yet unfathomable implications for the future development of Russian society. One can only imagine the hidden reservoirs of pent-up creative energies which the country may have stored and the various ways in which these might be released; indeed, it is interesting to speculate about the long-repressed aspirations of the population as a driving force for social and economic change.

2. This new found freedom itself is a reflection of a much broader process which one might refer to as "the end of ideology as the driving force of political authority." A characteristic of that period, perhaps best exemplified by the centrally planned economies of Central and Eastern Europe, but also by many of the countries in the developing world, was the willingness of policy makers to design and implement policies with the aim of remaining faithful to a certain set of ideological postulates, irrespective of economic or social outcomes. Economic (and other) policies were to be judged not in terms of the extent to which their implementation resulted in measurable improvements in living standards, efficiency, and so on, but rather in terms of the extent to which these were consistent with a given set of prior axioms.² And if, in the process, it was necessary to crucify the population or to make other such "sacrifices," political leaders were willing to make them because the preservation of the ideology was considered to be more important than any other goal, including the protection of the population. This approach to economic policy entailed enormous welfare losses and suffering for the peoples of the countries concerned and its formal abandonment during the past decade, including in Russia, is surely one of the more outstanding and welcome developments of the post-War period.

3. Partly related to the above, one can point to moves towards greater integration with the rest of the world and the implications this will have over the medium-term for the development of institutions, the acquisition of practical skills by the population, including the emergence of entrepreneurial capacities, the structure of the economy and the distribution of income, the gradual development of pluralistic democratic processes and institutions, and changes in the psychological reflexes of the population, particularly the young. The "opening up" initiated by Gorbachev has unleashed creative forces in Russian society which no one will be able to repress and which are likely to act as

² Thus, if the political leaders of the country decided that, for ideological reasons, agriculture needed to be collectivized then, even if repeated attempts failed to bring about the anticipated improvements and were instead met with famine and ruin, the response was simply to intensify the efforts, as happened in Russia during the 1930s. (For eloquent and graphic illustrations of this principle see, for instance, Volkogonov's biography of Lenin.)

guideposts in the future course of the country, moderating any possibly extreme tendencies.³

4. Closer home to our line of work, it is possible to identify a number of key economic accomplishments, including a much greater understanding of the basic functioning of a market economy;⁴ the hardening of budget constraints; liberalization in key areas such as prices, trade and economic activity in general; the gradual emergence of key pieces of tax and other legislation; privatization, particularly of apartments and small retail shops; greater institutional sophistication and the increasingly civil ways in which the underlying debates on aspects of economic policy are taking place (e.g. the budget process). It is evident that many of these are enduring, essentially irreversible changes which have permanently altered the economic and social landscape and have done so in ways that have laid the basis for further progress over the longer-term. Beyond this, we should derive hope for the future from the vast potential of the country itself, which is richly endowed with natural and human resources. If Russian civilization was once able to confer upon the world the rich fruits of its literature, its music, and its science, surely there is no intrinsic reason why one day it could not do so again.

However, at the same time, and notwithstanding the above favorable processes and trends, there are other forces at work that give cause for concern and lead many to see these as especially dangerous times:

1. First, one must point to the general deterioration of living conditions and the terrible impact that the transition has had on certain social groups. The last several years have witnessed a dramatic deterioration of various health and social indicators, including a 6 year drop in the average life expectancy of males, a 46 percent rise in the death rate, a 36 percent fall in the birth rate (both between 1989 and 1994) and sharp increases in the incidence of certain diseases—conditions which demographers and public health experts have characterized as alarming and "without precedent in the European peacetime history of this century." A comprehensive set of 29 indicators of welfare put together by UNICEF, ranging from those based on measures of income and consumption to others which attempt to capture quality aspects of life (mortality, health, education) show that in Russia, between 1989 and 1994, 27 of these indicators registered a deterioration, often of a very pronounced nature.

³ It is extremely unlikely that, having in recent years enjoyed many new found freedoms, the majority of Russians would easily tolerate being again deprived of them. In the age of instant communications and a growing sense of membership in a global community, the costs of repression are such as few governments can afford, particularly in those countries where the people have already tasted the fruits of representative government and some of the liberties enshrined in the Universal Declaration of Human Rights.

⁴ Although, unfortunately, this does not immediately translate into popular support; note the results of the annual Eurobarometer polls, which eloquently reveal the extent of what we sometimes call "adjustment fatigue" and deep-seated skepticism about the ends and means to the free market, and implicitly highlight the huge chasm between progressive elements within the Russian political leadership and the majority of the population. There is also the issue of the extent to which the "free market" and its underlying principles have reached the regions. Traveling through some of Russia's 11 time zones one cannot help notice the extent to which references to "economic reform" more often than not seem to precipitate distress and cynicism rather than galvanize people into concerted, constructive action.

2. Associated with this, one must also note the trends in income distribution, in sharp contrast to the egalitarian nature of Soviet society.⁵ Income distribution in Russia, however measured, would appear to be now more unequal than in most developed industrial countries. Such trends are particularly disturbing in light of the fairly extensive body of empirical research showing that higher income inequality contributes to social and political instability, which in turn depresses private investment and adversely affects future economic growth. There are at least two aspects to this issue. First, inattention to the plight of large segments of the population is already undermining the sustainability and sapping the vitality of the above favorable processes, many of which have left key vulnerable groups untouched. Such inattention is likely to entail large political costs and could well generate destabilizing unrest; to the extent that it leads to public alienation, the transition will be more painful and drawn-out, more subject to unpredictable swings and thus inefficiencies. More importantly, there is the issue of equity and social justice. It reflects a fundamental failure of governance for political leaders to remain largely indifferent to processes which are so detrimental to the welfare of many. It is also deeply misguided politics and reveals a thorough lack of understanding of one of the more basic elements of a successful development strategy, namely, the notion that only programs that are perceived as meeting people's needs and as being just and equitable in objective can hope to engage the commitment of the people, upon whom successful implementation ultimately depends.

3. It is clear that the government is having serious problems meeting universally accepted criteria in the area of good governance. There is little doubt that the results of the last Parliamentary election in no small measure reflect not only fatigue on the part of the population after several years of material hardships and deprivation but also a growing sense of revulsion at the particular way in which the transition is being implemented and, more specifically, the arbitrariness with which, within the narrow constraints imposed by the need to bring about much needed financial stability, ample room is nevertheless found to allocate billions of dollars worth of benefits to rapidly emerging ruling elites. Liberally-minded Russians who found Gorbachev's indecisiveness deeply frustrating, who felt that the future of Russia would ultimately depend on the extent and the speed with which the country moved away from the utter failures of communist dogmas and who were aware that this process would be very painful, given the deep roots stemming from more than 70 years of communism and the mental habits and attitudes which this had engendered, are, nevertheless, today, five years later, horrified at some of the excesses in full evidence. Whether in the form of gargantuan tax breaks or the transfer/plunder of state assets under the protection of barely disguised "market-related" schemes, fabulous gifts have been and are being bestowed upon a narrow circle of well-connected operators while the vast majority of the population is told that the demands of stabilization and "economic reform" require additional self-

⁵ For some this may be an arguable point, given the privileges conferred by the previous system to the Communist party elite. Nevertheless, the overwhelming share of the population perceive it this way. In any event, perceptions aside, it seems difficult to deny that income inequality has indeed increased dramatically in the last several years. For instance, the ratio of incomes for the top and bottom deciles rose from 5 in 1991 to nearly 14 by end-1995. In fact, due to (possibly massive) underreporting of income by the well-off, the true ratio is most likely much higher.

sacrifice, sometimes even to the extent of not being paid due wages or pensions for months.

Obviously, one should not be surprised to discover that many of these same Russians have withdrawn their support from what they perceive to be a fundamentally cynical and callous approach to "reform," seemingly more driven by the desire to create abiding future financial security for a select few rather than a desire to improve the standard of living and well-being of the population. An excellent (albeit perverse) indicator of the profound feelings of rejection which that approach elicits is the fact that the Communist party, arguably the twentieth century's most lethal and destructive ideology, is now, incredibly, thought of by many as a possibly viable political alternative. There is no doubt that had equity considerations and concern for the welfare of the masses been nearer the center of the government's economic strategy during the last several years, the stoic Russian population might have been more forgiving last December and thus, tired, spent, naive ideologies would not have enjoyed the wind-fall of a political revival. The negation of history which that revival represents can only be understood in terms of profound public aversion for the present.

4. This section would not be complete without the necessary references to the rise in crime and the pervasive nature of the mafia's activities. Undeniable as the existence and the seriousness of this problem is, the mafia is not a recent phenomenon. What the last several years have seen is a transformation or adaptation of the criminality which was intrinsic in the communist system to the emerging freedoms of the market. Tens of thousands of KGB thugs, their hands literally soiled with the lives of innocents, suddenly cut off from the lifeline of budgetary allocations and thus finding themselves out in the street did not, by and large, decide to become missionaries in Africa. Perhaps more predictably they decided to put their skills to other uses, while remaining in the area of "security." But while in the past their activities were carried out in the middle of the night, under the protection of the Lubyanka walls and other such torture chambers, today, in the context of that very openness which many gladly celebrate, they are to be seen everywhere, their actions amplified by the workings of a free press. I have asked some of my more enlightened Russian friends if there is more crime today than in the old days. Two interesting answers have been: (i) certainly not, if you adjust the old crime statistics upward to account for the unsavory manifestations of communist party excesses; (ii) no, if you think of "all the lies that we had to live and which we are no longer obligated to parrot, but which were a form of 'crime' too."

Implications for Our Work

The overwhelming part of our work in recent years has been focussed on bringing inflation down. At the center of our vision is the notion that a more stable macro-economy and better-run institutions will be better able to fulfill people's material aspirations and needs. We have argued that the establishment of a stable macroeconomic environment was a necessary precondition for the recovery of economic growth and to this end we have sought to assist the Russians in the creation of such a framework, characterized by low inflation, positive real interest rates, a stable real exchange rate, a viable balance of payments and a stable budgetary situation. Of these elements we have chosen inflation as the best and the most easily measurable indicator of the overall stance

of policies and of the government's ability to manage the macroeconomy. It is probably fair to say that by now the consensus on the desirability of such a goal is nearly universal and what remains as the main topic of discussion is what are the best means to achieve that end, and what priority that goal should be given within the constellation of problems confronting the country.

There is, for sure, the related issue of how quickly the goal of low and stable inflation should be achieved. My sense is that the relationship between inflation and growth is probably highly non-linear; that very high inflation is very harmful and every effort should be made to eradicate it. Nevertheless, there is a threshold below which what the actual rate of inflation is probably does not matter very much for growth, and other factors, country-specific and otherwise, acquire a disproportionately greater importance. What that threshold might be (and whether it is even stable over time) is, of course, a difficult question to answer. However difficult, the question is, nevertheless non-trivial; if there is essentially no difference between 1 and 3 percent monthly inflation, we lose some credibility by pushing for the lower target, which almost everybody regards as unachievable at the outset. Pending the arrival of an empirically satisfactory answer to this question (which may not be fast in coming) I would like to offer the following hypothesis: There is an inverse relationship between the number and seriousness of the problems which remain in the policy makers' economic agenda and the relative importance of low inflation. In relatively well developed market economies where the economic agenda contains what could be characterized as "second order" problems (e.g. the need to continue to improve resource allocation, make the tax system more efficient, and so on) maintaining low inflation is very important. In countries where the economic agenda is full of many fundamental, unresolved, problems (e.g. massive tax evasion, itself a symptom of the absence of the rule of law, catastrophic demographic trends, rapidly worsening income distribution, egregious mismanagement and corruption), the difference between low and moderate inflation is immaterial and the interests of growth are better served by giving overwhelmingly greater attention to the unresolved economic agenda. Without any doubt Russia belongs to this second group. I will come back to this issue later.

Consistent with our emphasis on price stability, we have developed, over the years, certain "architectural" tools, and financial programming is the bread and butter of our country work.⁶ It is not an unfair characterization of this work to say that we tend to see a country's economic agenda through the prism of our one behavioral relationship: the demand for money. This observation requires elaboration on at least two fronts. First, underlying our focus on money and our use of financial programming as the main tool in the design of our programs is the assumption that the demand for money will depend in a reasonably predictable way on a number of identifiable variables. In the rather uncertain climate which has existed throughout the transition period, characterized not only by high and variable rates of inflation but also by a whole range of other "structural" factors (many of them inducing radical shifts over time in the relative rates of return of various assets), projections of money demand (or velocity) have been, to put it mildly, subject to huge margins of error. It is probably not inaccurate to say that throughout much of this period it would have been virtually impossible for the monetary

⁶ The following remarks do not apply to our technical assistance work.

authorities to know if a given departure from the expected monetary target stemmed from changes in the relative rates of return of financial and other assets, the evolution of nominal expenditure and prices, or other financial or non-financial factors. Whether to accommodate such deviations or correct them to prevent unintended effects on the macroaggregates would, in such circumstances, have been far from clear.

Beyond this, we have also faced the additional constraints imposed by the unreliable quality of the data we use as inputs in our analysis. By the huge swings they are subject to and adjustments that are made ex-post, one can infer that Russian nominal GDP figures (monthly or otherwise) must contain a large element of make-believe, giving our estimates of velocity more than the usual component of "uncertainty." Notwithstanding these very clear limitations (and others which we need not go into here, such as the reliability of the figures on which typically we do not expect large measurement errors in other countries—e.g. money supply, net international reserves) we have gone ahead and proceeded with the design of the usual framework, with monthly NDA ceilings, NIR floors and so on, making our disbursements conditional upon compliance with respect to the targets suggested by our "model." Against such serious shortcomings, the extent of which might cast doubts on the overall utility of the type of model-building implied by financial programming, a case could perhaps be made that the operational focus might have been shifted to other factors, less prone to such debilitating drawbacks, as discussed below.

Second, beyond these limitations, which are accentuated by the unique and complex circumstances surrounding the transition in Russia,⁷ there is also the issue of the extent to which many of the implicit assumptions underlying our model of the economy still hold. For example, the increasing size and volatility of capital flows are diminishing the scope for a truly independent monetary policy even in large countries, as such policies increasingly fall hostage to balance of payments and exchange rate objectives and constraints. In this world of increasingly global capital markets, a number of countries that only recently were hoping to attract private capital inflows and were more concerned with possible capital flight have found that excessive inflows have become a major problem for macroeconomic policy management. More broadly, the world economy has changed dramatically in the last quarter century and the needs of the membership have likewise evolved in response to the forces that shape the lives and destinies of nations. Powerful trends toward greater interdependence and integration as a result of which geographic borders have lost much of their traditional meaning and the very concept of national sovereignty is being challenged and reexamined; publics which have vastly higher expectations than used to be the case as to what and how quickly governments and their economic policies should deliver; continued and rapid technological advances—particularly in the area of communications—which are permanently altering the way nations relate to each other, are but a few of the factors which have contributed to radically transform the context in which we carry out our work

⁷ Including, particularly during the early period of Russia's relationship with the Fund, periods of non-cooperation and secretiveness which imposed additional constraints on our ability to be more responsive to the needs of the country.

and may have greatly diminished the effectiveness of the traditional prescriptions underlying the "technology" of our work.⁸

A legitimate question therefore is whether our present focus is appropriate. One cannot, in this context, attribute a great deal of credibility to the view that our focus on money and money demand reflects, in some clear causal sense, the "fundamentally monetary nature of our institution." Unless one can in some way credibly argue that money and monetary phenomena can be detached from the rest of the macroeconomy and examined in isolation, one cannot but conclude that our institutional mandate is in fact much broader. I refer, in particular, to Article I(ii) and the references contained therein to "the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy."

My sense is that our focus on money and our use of financial programming as a tool has less to do with "the monetary nature of our institution" and more to do with bureaucratic tradition and inertia, with the all too natural tendency to want to continue doing, regardless of the context, what it has taken much time and effort to master. The problem arises, of course, when the familiar "technology" seems hopelessly inadequate to the magnitude of the tasks at hand, or worse still, when its use and the associated demand on our time and energies, detracts our attention from more fundamental concerns.⁹

Achieving low inflation—at any cost—is not enough, obviously. We want low inflation that is consistent with the free play of market forces, for instance. Do we also want an economic program that does not coexist with a sharp worsening of living conditions for large segments of the population and that is thus perceived as being unfair and not worthy of public support at the grass roots level?¹⁰ Do we want a program that is consistent with a more equitable sharing of the tax burden and that does not afford special protection to "politically sensitive" sectors based on criteria other than economic efficiency? If the answer to these (and other such) questions is affirmative, do we believe that our present macroeconomic conditionality helps us achieve these ends? If

⁸ Or, as put by Richard Cooper, "the increasing internationalization of the economy has led to an erosion of our government's capacity to do things the way it used to." Many would argue that similar processes are at work on a global scale. The proliferation of forces (or variables) no longer under the control and/or jurisdiction of even the most powerful sovereign states including: capital flows, contamination, drug trafficking, smuggling of radioactive substances, communications technology, among others, highlight not only the very circumscribed sphere of influence of the nation-state but also the risks that the resulting "no one is in charge" phenomenon poses for our future.

⁹ This latter aspect and the implications it has for our work should not be underestimated. Once the program targets have been set they tend to acquire a life of their own. In particular, they tend to dominate the dialogue with the authorities, forcing all other issues into the background, and giving rise to artificial needs or requirements, such as when, to meet a particular monthly target, the authorities have to rush and "take measures," often involving considerable ad hocery. It is as though having, in the early stages, made heroic assumptions about the demand for money, velocity, likely reserve growth and so on, we quickly forget them and the derived targets are what the economic debate is all about, to the exclusion of much else.

¹⁰ One would, presumably, also want an economic program that is consistent with a minimum of respect on the part of the government for the principles contained in the Universal Declaration of Human Rights. No "growth-oriented" program would be worth supporting if one of its components, for instance, was the creation of forced labor camps, to take an imaginary, admittedly preposterous, example.

not, then how can it be refocussed; how can the emphasis be shifted in a way that maintains our primary focus on price stability (and hence money) but that gives effective operational meaning to some of these other worthy economic goals, as opposed to "lip service," which is all that they often get in the context of our programs, at least thus far. (By this I mean that since the authorities quickly latch on to the fact that, as far as we are concerned, for instance, lack of action on social safety net issues has zero operational implications, then references in Letters of Intent and other policy documents to these are largely dead letter.)¹¹

I would like to elaborate briefly, by way of illustration, on one of these important "other" factors. Perhaps one of the very first things we notice as Fund economists is the very direct connection that exists between the quality of governance and economic development. Just as we have come to believe that high inflation is an evil which should be eradicated and we have developed over time an array of weapons to help countries do it, we have also come to recognize that the exercise of political authority must be guided by the desire to improve the well-being of the population. When we discover situations where ruling elites use political power for personal gain rather than public benefit we cannot help but feel that the development process has gone awry and that, to the extent that no corrections are introduced, the potential vitality of every initiative and program will be undermined. It is for this reason that there is growing consensus on the importance of and the desirability of such elements of good governance as representative government and political pluralism, involving the periodic legitimization of governments through popular choice, the rule of law, transparency, participation and consensus. This is not the place to go into a detailed discussion of the merits of each and their place in the development process. The arguments are more or less familiar to most of us. For instance, on the issue of political legitimization we argue that only those governments which derive moral authority from the will of the people are likely to be responsive to the needs of society and that only when people have a say on who they are ruled by, can they be expected to support the government's development strategies and policies, support without which, as we have seen countless times among our members, well-designed and/or well-intentioned plans will ultimately fail.

Crucial as these insights are and undeniable though their role is in the development process, they find little echo in the work of our organization. It is as though, having been given by the international community much responsibility in the area of economic management (Article I (ii) quoted earlier is certainly broad enough), we have decided to

¹¹ A well-known mathematician friend of mine says that it is by now a well-accepted proposition in the field of systems theory that the optimal value of a multiparameter system is hardly ever (except in trivial cases) to be found at an extreme point. If attempts are made to optimize only one parameter in such a system the "solution" will not only be suboptimal for the system as a whole, but might actually lead to the degradation of the system and undermine its future ability to maintain stability even for the one parameter with respect to which an optimal value is being sought. It is not clear that we have given enough thought to the implications of these insights in systems theory for the work we do. If, in addition to bringing inflation down (call it variable X1) there are other variables that are **central** to the sustainability of economic adjustment (the level of social protection received by the population in the context of the program, income distribution aspects, equitable tax burden considerations, governance issues; to name X2 to X5) then what is being lost by an overwhelming focus on X1 and lack of effective, operationally meaningful, attention to X2 through X5?

exert our influence and to transfer our experience and collective wisdom through the single-minded pursuit of price stabilization and a few other attendant secondary objectives lumped under the general heading of "structural reforms." To a sympathetic outside observer this approach might appear curious, involving as it does the simultaneous intellectual recognition of the fundamental importance of other factors (in this particular example good governance, though a similar case can be made, for instance, for social safety net issues) and our inability to do anything about them. Why? Because: (i) we don't have the expertise; (ii) it is the responsibility of others; (iii) it infringes upon the sovereignty of states; (iv) being difficult to quantify it could pose insurmountable technical problems; (v) it contradicts the monetary nature of our institution; (vi) we are too busy doing the essential part of our work and, in any event, our resources are always strained; (vii) our involvement in such issues might pose thorny legal problems, and many other things we tell each other by way of justifying our narrow approach. Indeed, many among us see the narrowness of that approach as being a source of strength of the organization, which does not then have to spend much time worrying about such things as corruption, poverty and the environment.

And yet, it seems to me, such an approach sidesteps the far more fundamental question: are we here primarily to assist our members in furthering the goals of balanced, sustainable development, or primarily to protect the nature of our institution and our work as we have come to understand it over the years? Would refusing to disburse the next tranche because there has been a flagrant violation of some key component of good governance contradict the monetary nature of the Fund?¹² Maybe. If so, perhaps the time has come to move beyond, to consider a more comprehensive interpretation of our mandate, given the integrated nature of the world, the interdependent character of its economic problems and the systemic nature of the macroeconomy and the very acceleration of processes which are gradually delivering one world economy and one global community of nations. Less sympathetic observers might argue that, given the effective breadth of our influence and leverage (which has not been small in Russia), not giving at least as much attention to the above issues as we give to the latest monetary target is an abdication of our responsibilities and an ultimately extremely inefficient way to go about our work.

Succinctly stated, our approach has been to set a low inflation target as the primary objective of our programs and to view everything else as of secondary importance. It might be argued that even our interest in fiscal policy in the context of a program is indirect: we look at the deficit only to the extent that some of it may need to be financed by credit which would then have an influence upon the monetary aggregates.¹³ Hence the lack of interest which we have shown on the actual path of fiscal

¹² To anchor this question in the real world, a real example might be useful: the head of state issues a decree granting a comprehensive tax exemption to a sports organization. In time, this organization becomes the country's largest importer of cigarettes, alcoholic beverages and other luxury goods, with a yearly turnover of several billion dollars. The impact of the decree is thus ultimately to deprive the budget of several billion dollars of revenue (the exemption applies to customs duties, VAT and excises), equivalent to a significant share of the total magnitude of Fund financial support.

¹³ I don't claim originality for this observation; see for instance the Research Department's Theoretical Aspects of the Design of Fund-Supported Adjustment Programs, Occasional Paper 55, September 1987, Chapter III.

adjustment, not especially concerned if this came through possibly unsustainable expenditure compression affecting, in some cases, socially vital areas.¹⁴ Thus compliance with respect to monetary targets is rewarded even in the presence of, say, large drops in the real value of pensions received by 25 percent of the population, as was the case in Russia in 1995. An alternative approach might be to say, for instance, at the outset, "the program will not allow a further deterioration in the standard of living of the old" and then ask ourselves what are the non-inflationary policies that might support that goal (e.g. better taxation of the gas sector). In the first case the binding constraint is the rate of growth for monetary expansion dictated by our humble financial programming framework. In the second case the binding constraint is one that emanates from social equity and, yes, moral considerations. I would like to offer as a thesis that the second approach is the far more effective one, both in terms of the sustainability of the development process, the extent of public support for the program, and the ultimate achievement of permanently low inflation. It is, of course, also the more difficult one, demanding of us skills we have not yet done a great deal to acquire and develop.

It is outside the scope of this note to suggest how, for instance, good governance (or many other such not easily quantifiable concerns) might be given operational meaning in our program work, and, more generally, in the work of our organization. Difficult as that might be, it is impossible to imagine that, as an intellectual challenge, it could possibly defeat our collective inventiveness, especially if supported by an adequate degree of political commitment at the higher levels of decision-making. The point here rather is that ignoring these issues itself involves a decision on our part, a passive one no doubt, but one with clearly identifiable implications for our work and our membership.

Why is all the above important? Partly because we want to serve the membership as well as the current state of knowledge of economics and other social sciences will allow, partly because if in fact our focus is not well-balanced and we are largely ignoring key aspects of the macroeconomy under the intellectual protection of a narrow interpretation of our mandate perhaps most appropriate for the world of yesterday, then we risk undermining the credibility of our institution against a background of rapid (and accelerating) systemic change in the world's economic and political environment. But also because by improving our macroeconomic adjustment "technology" we will find ourselves less frequently having to react to crises and more often helping stem crises, and thus eventually emerge in a much stronger position, both in terms of our ability to be of real assistance to our member countries and ultimately vis-a-vis public perceptions of our role in the world.



¹⁴ I don't mean to say that, as staff members, we don't especially care about these issues. (I remember quite clearly our mission head in early 1994 making a strong case for the introduction of better unemployment benefits.) I mean to say that, at the end of the day, our conditionality does not hinge, for instance, on whether the government is making progress on the social safety net front, thereby safeguarding the medium-term sustainability of its economic reform program, or whether the fiscal adjustment is being made tougher than it would otherwise be because the government is sheltering from an equitable tax burden certain privileged sectors and/or enterprises. Our conditionality does hinge, however, on whether base money on a given day, is a trillion rubles more or less.