In Praise of Polak, But Fifty Years Is Enough

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It is fifty years since Jean-Jacques Polak published his classic article "Monetary Analysis of Income Formation and Payments Problems" in the *IMF Staff Papers*. This paper provided the theoretical basis for the IMF's financial programming, and continues to do so today. This is remarkable in and of itself. The world economy has gone through major changes over this period, as have corresponding fashions within economic theory as triumphant Keynesianism gave way to varieties of monetarism in the wake of the collapse of the post-war boom.

We also have had fifty years of development economics, during which there have also been shifting and competing perspectives from modernization through the Washington consensus and beyond, to notions of the developmental state, as attempts have been made to understand why the success of East Asian NICs should contrast so much with achievement elsewhere. Is it credible that across this material and intellectual ferment, the "Polak Model" should remain sacrosanct?

To his credit, Polak's initial contribution was extraordinarily modest and qualified in its aims. He made it crystal clear that the main problem addressed is a temporary balance of payments deficit in a developing country, this gap usually the result of excessive domestic credit to fill the gap arising out of a fiscal deficit. He presumed that the only reliable data available are those concerning monetary variables, and that the only corresponding policy variable is control of the domestic money supply.

The model only seeks to determine the level of *nominal* income, with its distribution between the output level and the price level to be determined by some other means. In this respect, in *principle*, the model is not monetarist since it must violate one or other of the assumptions that prices are fixed (at the world level) or that output is fixed (at full employment). In *practice*, not without justification, financial programming is heavily associated with the ideology of monetarism because of the pessimistic stance taken on productive potential.

It has targeted balance of payments and/or fiscal deficits with shifting instruments across countries and over time as fixed exchange rates have given way to floating exchange rates, and control of inflation and liberalization of money markets have been emphasized more or less to suit. Today, for example, the IMF is more likely to advise appreciation of the exchange rate to bring down inflation in middle-income countries than to address foreign or fiscal deficits, although these remain a priority for low-income countries, especially in Africa.

One criticism of Polak is his making virtue out of necessity. Even if monetary variables are the only ones that can be measured and controlled, they are not necessarily best for remedial action. A patient with a broken leg is not best treated with a thermometer to take temperature and aspirin to bring it down, even if these are all that is available in the hospital. This apart, Polak can be judged to have appropriately sought, but failed, to constrain the use of his model for purposes for which it was not designed.

He did, for example, refine the model, in a joint article in 1971, by adding extra variables and equations. But, as was explicitly recognized within this contribution, this was nothing more than an elaboration of the Hicksian IS-LM-BP model, standard across every undergraduate textbook.

This prompts three observations. First and foremost, such a model was constructed in the context of developed countries, raising doubts over applicability to developing countries. Second, as has remained the case throughout the life of financial

programming, the model cannot address issues of development as its scope is confined to the so-called short run, over which everything to do with development is taken as fixed. Third, it is ironic that the Polak model began to embrace Keynesianism explicitly just as the approach was falling into disrepute with the stagflation of the 1970s.

Significantly, in the second half of the 1980s, the IMF did seek theoretically to reconcile growth or development objectives with short-run macroeconomic adjustment in proposing a marriage between its Polak model and the World Bank's growth model. Three further observations follow.

First, the model was fundamentally flawed, bound by export pessimism (as if the world economy did not grow) and leading to declining levels of productivity increase over time. In other words, it remained heavily bound to the short run, and essentially to zero per capita growth in the long run. Second, ironically, this was when new growth theory had begun to flourish, suggesting how productivity growth could be generated over time, but the marriage model was bound to old growth theory in which productivity increase is exogenously determined. And, third, Polak reacted strongly against any attempt to forge a marriage between financial programming (confined and only appropriate to the short run) and growth theory. Indeed, in a personal communication commenting on the marriage model, Polak suggests:

> *My view is that it is not a worthwhile project, and each subject should be approached on its own, provided the practitioners are fully aware of any recommended policies on the other objective (which to be sure has not always been the case between the Fund and the Bank). A possible simile, somewhat limping of course: the jobs of a schoolteacher and a paediatrician are both to do good to a child, and each should be aware of the other … but the professions should remain specialised for greatest efficiency in each field.*

This is well and good as far as it goes, but it neatly sidesteps what has been a major criticism of the stabilization policies of the IMF and the structural adjustment policies of the World Bank, the negative impact of what is adopted in the short run on longer run performance. The latter is better seen as attached to an evolving economy over time, rather than as some given equilibrium around which appropriate policies are targeted. Polak, and his model, simply do not address this issue as he is only too aware.

The recent turn to poverty reduction has intensified the failure to observe the reservations that Polak has expressed over the use of his model. The first, and, for some time, the only model underpinning PRSPs uses financial programming as its organizing framework. It does so while assuming that there is a single labour market and full employment, thereby, for the convenience of the model, abolishing the major sources of poverty – unemployment and low wages -- in one stroke. This is even justified on the grounds that the model is universally and conveniently applicable across all countries.

It is certainly not the case that the Polak model for financial programming determines IMF policy. Indeed, it allows for considerable discretion. But it does set a framework within which policy is discussed, one which prioritizes the short term over the long run, and financial functioning and targets over the traditional concerns of development. It is time for a fundamental rethink and a new framework – one both recognizing, rather than subordinating itself to, increasing financial volatility, and genuinely engaging adjustment with developmental goals, with poverty alleviation and growth as starting points, rather than add-ons.

For a fuller discussion, see Ben Fine, "Financial Programming and the IMF". In B. Fine and K. S. Jomo (eds). *The New Development Economics: After the Washington Consensus*. Delhi: Tulika, and London: Zed Press.

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