

Lecture 23: The IMF And Its Critics

I. OVERVIEW

- In the last lecture we looked at the events that took place and are taking place in Argentina. The currency board which had proven to be so helpful in reducing inflation in Argentina had become a liability by the mid 1990s as Argentina was hit with negative external shocks. The government and the IMF decided to stick with the currency board, with disastrous implications for the Argentinean economy, including bank freezes, a large depreciation of the peso and rising inflation.
- There was also substantial criticism of the IMF's actions before the collapse in Argentina and then again of its suggested remedies. This type of criticism of the IMF was leveled after each of the preceding episodes of currency crisis as well.
- Therefore, it behooves us to take a closer look at the role of the IMF in episodes of currency crisis and whether or not it has a role to play in the International Financial System.

II. THE ROLE OF THE IMF

- Any criticism or analysis of the role of the IMF must begin with the observation that as the doctor who prescribes bitter medicines to afflicted countries, the IMF is hardly likely to prove popular. Countries that are successful do not call on the IMF and its clients almost always are repeat clients who have to be forced to make tough economic changes that are not always popular.
- Furthermore, while these changes are absolutely essential in most cases if the economy is to survive and in some cases, they are necessitated by the irresponsible actions of governments, very often the same governments that seek help from the IMF tend to give the impression that the suffering of people is because they are "forced" to make changes by the IMF.
- For example there are many African countries where the government budget deficit has become way too large: the bureaucracy is bloated, food subsidies are untargeted and often help the rich more than the poor, government borrowing and red tape have stifled any form of private enterprise turning the state owned enterprises into the sole employers. These countries are forced to borrow from abroad to sustain their deficits and soon have to go to the IMF funds because no private lending is forthcoming.
- At this point the IMF asks them to get their house in order: to embark on fiscal austerity by reducing spending on food subsidies, slashing government spending, reducing the number of people on the government payroll etc. The government now turns to the people and says "we hate to do this to you but the evil IMF is forcing us to undertake these measures", thus effectively transforming the blame for the whole mess from their shoulders to the IMF.

- However, this does not mean that the IMF is without blame. Many observers comment on the fact that the IMF has a "one size fits all" mentality, that whatever the situation the IMF prescribes basically the same set of policies.
- Common features of IMF structural adjustment programs include
 1. Fiscal Balance: Reduce size of government budget deficits by reducing government expenditures.
 2. Privatization of state-owned enterprises.
 3. Financial liberalization: remove interest rate ceilings on banks.
 4. Depreciation of exchange rate to improve BOP position.
 5. Removal of price controls on fuel, commodities, utilities.
- Some people argue that the IMF does not adequately monitor the impact of its decisions on the poor. For example a blanket order to trim government spending in a country with a military leader results in a slashing of food aid to the poor and not a reduction in the purchase of helicopters. These critics argue that the IMF can and should keep a tighter leash on the governments they advise.
- For example, in Indonesia following the East Asian crisis, the IMF imposed conditions on the Indonesian government to get fiscal spending under control. But rather than focusing on the widespread corruption of the Suharto family which was reputed to have siphoned away billions of dollars, the Indonesian government was forced to remove food and fuel subsidies that were a blow to the poor in Jakarta. This may have helped foment social unrest in Indonesia.
- The privatization aspects have also been criticized in that governments sell off state owned enterprises to the highest bidder rather than ensuring that the state monopoly is not just replaced with a private monopoly.
- Depreciation of exchange rates have had the effect of improving balance of payments situations in many countries, but again the criticism has been that the IMF routinely recommends devaluation, regardless of the situation and that this foments more uncertainty and makes it difficult for countries to sustain their fixed exchange rates.
- Some economists have attacked the IMF for allowing the East Asian currencies to devalue or depreciate during the East Asian crisis. They argue that once one currency devalued then the rest had to follow and that the IMF should have taken the lead in helping these countries defend their currencies. This may be somewhat unfair criticism considering the magnitude of the outflows and the extent to which the currencies fell. After all many of the same economists were the ones subsequently critical of IMF attempts to lend Russia money to prop up its currency,
- So what then is the role of the IMF in the international financial system. Is it, as some developing countries claim, a tool of the United States and other developed nations bent on oppressing poor countries and creating conditions of moral hazard that can benefit speculative activities of George Soros and company? Or is it, as some U.S. critics say, an incredibly wasteful organization that takes valuable funds and pours it down the drain of developing economies whose leaders become fabulously rich off the money without any intention of ever helping out anyone?

- If we look at the words of the IMF itself, it obviously says it is neither. The IMF claims that it is “neither a development bank, nor a world central bank, nor an agency that can or wishes to coerce its members to do very much of anything. It is rather a cooperative institution that 182 countries have voluntarily joined because they see the advantage of consulting with one another in this forum to maintain a stable system of buying and selling their currencies so that payments in foreign money can take place between countries smoothly and without delay.”
- They go on to assert that the IMF will lend ”money to members having trouble meeting financial obligations to other members, but only on condition that they undertake economic reforms to eliminate these difficulties for their own good and that of the entire membership. Contrary to widespread perception, the IMF has no effective authority over the domestic economic policies of its members.
- It is in no position, for example, to force a member to spend more on schools or hospitals and less on buying military aircraft or constructing grandiose presidential palaces. It can, and often does, urge members to make the best use of scarce resources by refraining from unproductive military expenditures or by spending more money on health and education. Unfortunately, members can, and often do, ignore this well-intentioned advice. In this case, the IMF can only try, through rational argument, to persuade members of the domestic and international benefits of adopting policies favored by the membership as a whole.”
- The IMF also claims that they have enabled the creation of “widespread convertibility now permits easy exchange between most of the world’s major currencies. Convertibility has allowed virtually unrestricted travel, trade, and investment during the past quarter of a century and has resulted largely from the cooperation of member nations with the IMF in eliminating restrictions on buying and selling national currencies.”
- In my opinion, the IMF is unfairly maligned but by no means should it be unmaligned. Rather than make blanket criticisms, the best course of action is to evaluate the agency by its actions, not by its words (which often are grandiose consultant babblespeak), nor by the words of its ardent critics, who refuse to recognize that the IMF is often blamed for things it has no control over. Hopefully, the IMF will, in the future, also evaluate each crisis on its merits, look at the underlying circumstances and undertake an appropriate course of action.