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Strings Attached

How the IMF's Economic Conditions Foil Development-Oriented Policies for Loan-Borrowing Countries

Nuria Molina-Gallart and
Bhumika Muchhala

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CONTENTS

1 A CRISIS OF LEGITIMACY FOR THE INTERNATIONAL FINANCIAL INSTITUTIONS 1

2 THE PERVASIVE INFLUENCE OF THE IMF AND ITS MACROECONOMIC CONDITIONS 3

Lender of last resort – few options for low-income countries 3

Long-term pain for a short-term gain? 4

The IMF as “policy trend-setter” and “financial gatekeeper” 5

The wrong prescription for the illness – domestic vs. external shocks 6

3 THE FINANCIAL CRISIS OF 2008-09 – SAME MEDICINE, DIFFERENT BOTTLE? 8

The crisis loans of 2008-09: The proof of the pudding... 10

4 BREAKING THE MONOPOLY – WHAT NEEDS TO CHANGE 15

Counter-cyclical and nationally driven policies 15

A financial paradigm fixated on the free flow of capital 16

5 POLICY RECOMMENDATIONS 19

ENDNOTES 22

NOTE

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"The IMF or any other institution must not be the ones telling us how to run the money that we borrow from them; but they do because they think they are infallible."

Gregory Gondwe,
Malawian columnist

"It was tempting for macroeconomists and policy-makers alike to take much of the credit for the steady decrease in cyclical fluctuations from the early 1980s on and to conclude that we know how to conduct macroeconomic policy. We did not resist the temptation."

Olivier Blanchard, IMF Chief Economist,
"Rethinking macroeconomic policy",
January 2010

Chapter 1

A CRISIS OF LEGITIMACY FOR THE INTERNATIONAL FINANCIAL INSTITUTIONS

IN the past two decades, the economic policy conditions attached to the loans of the Washington-based international financial institutions (IFIs) have become an important vehicle through which orthodox and market-oriented economic policies are carried out in developing and low-income countries. These economic policies, which are designed by the International Monetary Fund (IMF) and the World Bank and integrated into their loans and grants, have been widely criticized by the international community, including academics, civil society and social movements, as well as other international organizations and Southern governments.[1] Critics concur that conditions required by the IFIs often undermine national policy autonomy and economic development and growth in developing countries. In fact, even the World Bank and IMF have found that conditionality has failed to create the right incentives for development-oriented policy reform.[2]

In recent years, this sentiment has had an impact on the Fund's lending practices. When the IMF's recommendations during the Asian financial crisis of 1997-98 exacerbated the financial meltdown in many Asian and Latin American countries, these emerging market economies decided to repay their debts to the Fund ahead of schedule and resolved to avoid new IMF programmes. By accumulating foreign exchange reserves, they indemnified themselves from having to borrow from the Fund.

But now, for the first time in almost a decade – due to the recent financial and economic crisis – the Fund is again signing loan agreements with middle-income countries, particularly in Eastern Europe. In 2007, at the end of its fiscal year, the IMF had about $11 billion in outstanding loans; since the

crisis began, the IMF has committed $165 billion in new loans. In April 2009, the Group of Twenty (G20) major economies re-established the IMF's place on the world stage by committing $1.1 trillion towards the financial crisis, with the lion's share, $750 billion, channelled through the IMF. Some $250 billion has already been issued to all IMF member countries in the form of Special Drawing Rights[3] (SDRs), the IMF's reserve asset. For the remainder, industrialized and reserve-rich governments are lending the IMF up to $500 billion for middle-income countries in need of financial assistance at market interest rates.

But while the IMF is back in business, back at the negotiating table, and back on the world economic stage, is it fit for the task? The G20 has placed the IMF centre-stage in the crisis both politically and financially, but will the IMF rise to the challenge of fundamentally rethinking the monetary and fiscal policies it recommends to developing countries or will it re-enact its pro-cyclical economic policies as it did during the Asian financial crisis? In other words, will the Fund's loan policies be an obstacle or a conduit for fundamental changes in the economic paradigm that has resulted in recurring financial crises?

This paper first looks at some longstanding critiques of the impacts of the IMF's policy prescriptions, its influence over global economic policy and the flaws in its prescriptions. It then considers the IMF's response to both these critiques and its new role in the context of the global financial crisis. Then, in analyzing the Fund's present role and lending activities, it explores whether these changes mark a radical shift in IMF policy, or represent old policies dressed up in new clothes. After considering the implications for borrowing countries, it recommends several fundamental changes that would leave countries space to determine the orientation of their own, nationally driven economic policies.

Chapter 2

THE PERVASIVE INFLUENCE OF THE IMF AND ITS MACROECONOMIC CONDITIONS

OVER the years, the scope of conditionality has gone beyond the types of policies countries are expected to follow to guarantee loan repayment and stable macroeconomic indicators. Conditionality now reflects a whole range of indirect, often tacit, policy requirements that ultimately have a more pervasive and intrusive impact on national policy space.

Lender of last resort – few options for low-income countries

Nowhere are the IMF's influence and the negative, anti-developmental impacts of its policy prescriptions more evident than in low-income countries (LICs). Unlike advanced and emerging market economies, LICs[4] cannot access finance in private capital markets and adjust their balance-of-payments disequilibria by manoeuvring their exchange rates. Indeed, the IMF is often the most accessible, or even the only, source of external finance for low-income countries. When LICs were confronted with the food and fuel price increases of 2008, or the financial crisis of 2008-09, they had very little choice but to borrow from the Fund to redress balance-of-payments problems; this widened current account deficits, dwindled foreign exchange reserves and added to mounting debt.

Despite IMF attempts to reform the way it does business with low-income countries (both in 1999 by taking into account the national Poverty Reduction Strategy Papers and in the aftermath of the current global crisis), the fundamentals have not changed – the key problems associated with implementing a pro-cyclical macroeconomic framework still remain.

Long-term pain for a short-term gain?

Critics argue the IMF's involvement has overstepped its mandate as an international lender for balance-of-payments problems as it does not have the expertise or mandate to fill that role.[5] At the heart of this problem is the fundamental mismatch between the long-term nature of LIC economic problems and development needs, and the short-term nature of the Fund's policy advice.

The Fund seeks to address short-term balance-of-payments problems (e.g., within two to three years). Its macroeconomic framework thus focuses on low inflation, budget deficits and public debt levels. These strategies are designed to reassure foreign investors and institutions and project an image of macroeconomic stability to international financial markets. In this way, they help LICs gain access to foreign capital and investment.

In the short term, these policies may help restore investor confidence. Applied consistently over the long term, however, contractionary fiscal and monetary policies have a more pernicious impact, including the following:

- long-term economic growth is undermined;
- public investments for national development and for public services, such as health and education, are inhibited;
- the development of local industries is constrained, particularly by high interest rates; and
- the mobilization of domestic revenue is neglected, as disproportionate attention is placed on securing external capital flows.

In the education sector, ActionAid's International Education Team demonstrated that the chronic and severe shortage of teachers stems largely from IMF policies. Its research in Malawi, Mozambique and Sierra Leone revealed the IMF critically influences the setting of annual ceilings on public budget expenditures.[6] As these countries reduce the public wage bill to meet the ceiling set by IMF loan conditions, the governments freeze or reduce the recruitment and salaries of teachers.

In 2007, a study by the Center for Global Development assessed criticisms that the Fund's fiscal policies challenge the delivery and capacity of the health sector in low-income countries. Based on in-depth case studies from Mozambique, Rwanda and Zambia, the report found the IMF has often been too "conservative or risk-averse," and had not adequately explored "more expansionary, but still feasible, options for higher public spending."[7] The report also demonstrated through empirical evidence that the Fund's monetary policy of targeting low inflation rates, usually in the range of 5-7 percent, is not justified. It called on the IMF to "help countries explore a broader range of feasible options," and with "less emphasis on negotiating short-term programme conditionality."

The IMF as "policy trend-setter" and "financial gatekeeper"

Despite these impacts, the Bank and the Fund have become "trend-setters" since the 1990s, advising other bilateral and multilateral donors on economic policy conditions for their developing-country clients. For example, donors, through their own bilateral budget-support and programme-based approaches, still rely on IMF conditions to establish the agenda of the broader policy discussions related to poverty reduction strategies. This is the case with the Canadian International Development Agency (CIDA) and most European donors, including the European Commission, which require recipient countries to have "stable and sound macroeconomic frameworks." In practice, this policy ends up giving the IMF the power of signalling whether the country deserves aid or not.[8] The IMF may not always be at the table in a multiple-donor budget-support programme with developing-country partners, but it is always preparing the menu in the kitchen.[9]

So why, despite the demonstrated damage wrought by IMF economic conditions, do borrowing countries adhere to such conditions? At stake is not just the next tranche of IMF money, but access to financing from other sources, including bilateral donors, capital markets and other regional development banks. The IMF's advice, and the extent to which recipient countries are "on track" with their IMF programmes or the Fund's policy prescriptions, sends signals to bilateral and multilateral donors, as well as

private investors: it tells them whether to offer or continue grants and loans, or to cut them short.

In 2007, for example, Sierra Leone's foreign aid suddenly dried up because of a negative IMF assessment.[10] Similarly, Ghana and Malawi apparently suspended financing for HIV/AIDS treatment because the governments diverted aid towards international reserves to fulfil an IMF requirement.[11] In 2005, the IMF's declaration that Nicaragua's programme had gone off-track led to the suspension of aid and grants from the Inter-American Development Bank, the World Bank, the European Commission, the United States and Sweden.[12]

The wrong prescription for the illness – domestic vs. external shocks

Promoting macroeconomic stability, which is at the heart of the IMF's mandate, is, of course, desirable. But IMF macroeconomic policy advice, strongly influenced by the US Treasury and key European finance ministries, such as the German, is wrong-footed. It follows the theory that balance-of-payments deficits result from domestic policies – policies that over-stimulate the economy and increase the country's perceived absorption capacity beyond its actual potential output.

In other words, the IMF does not give sufficient consideration to external factors and shocks that arise from the widely acknowledged volatile nature of the global economy. And yet for most of the IMF's developing-country loan borrowers, external factors such as shifts in demand for trade and volatility of capital flows have significant impacts on the national economy's health. For example, capital flow volatility can directly affect a country's exchange rate; subsequently, any movement in exchange rates affects its trade competitiveness.

Instead of pursuing an internationally coordinated solution to redress balance-of-payments problems among countries, the IMF assumes that domestic policy reforms can redress global imbalances. The Fund advises its developing-country members to correct their deficits through two mechanisms:

- contractionary fiscal policies that limit government spending; and
- monetary policies that limit growth of domestic money supply and raise interest rates on government bonds.

The logic is that lowering demand and economic activity in the domestic economy will restore equilibrium to the balance of payments. But this rationale ignores the external origin of large supply shocks, such as the oil price hikes of the 1970s, the debt crisis that hit Latin America – followed by many developing countries – in the 1980s, and, most recently, the food and fuel price hikes of 2008, to name just a few. Most external shocks are neither domestically induced nor temporary in nature. Ironically, IMF policies that recommend liberalizing domestic economies undermine the ability of domestic policy-makers to guard their economies from external shocks.

Chapter 3

THE FINANCIAL CRISIS OF 2008-09 – SAME MEDICINE, DIFFERENT BOTTLE?

THE impacts of the current financial crisis on developing countries have been severe, including the following:

- export revenues have plunged;
- foreign reserve levels have shrunk to dangerously low levels;
- capital flows have switched from robust net positive inflows to net outflows;
- investments and spending have stagnated;
- remittances have dropped; and
- output growth has ground to a halt.

As currencies began to devalue, many developing countries and transitional economies in Eastern Europe were severely impacted by the financial meltdown, precipitated by the US subprime mortgage loans. Eastern European countries, which had rapidly liberalized their economies in the context of a lending and credit boom from Western European investors and banks, were deeply exposed to the toxic assets of international banks and firms.[13] Many of them could only turn to the IMF for help with their balance-of-payments crisis and soaring debt burdens.

As a result of the crisis, as well as in response to heavy criticism from civil society and academia, the IMF has attempted to streamline its conditions. It has eliminated one type of structural condition[14] in many programmes: structural performance criteria. While this is positive, its absence will likely

just translate into more "prior actions" – laying on conditions to be fulfilled prior to getting a loan.

Structural benchmarks, which are not legally binding but still force policy change, will continue to be used, as well as traditional quantitative targets.[15] Structural benchmarks are long-term performance criteria required for changes in a country's economic policy or the structure of its economy or institutions. Quantitative targets measure a country's economic targets while in receipt of a loan. Not meeting these targets may halt the IMF's loan disbursements.[16]

In March 2009, the IMF also introduced the Flexible Credit Line (FCL), which provides liquidity to build foreign reserves without attaching any conditions. A country can draw from the FCL as needed and on a precautionary basis. According to the Fund, however, FCLs are only approved for "countries meeting pre-set qualification criteria," which involve "very strong fundamentals, policies, and track records of policy implementation."[17] Thus far, the FCL has only been disbursed to three countries – Mexico, Poland and Colombia – even though most developing countries negatively affected by the crisis urgently need such a facility.

The Fund now also allows countries to incur slightly higher deficits compared to historical IMF positions. It has factored in higher national deficits and spending to its loans for 2009 and 2010, and loosened fiscal targets in close to 80 percent (18 out of 23) of African countries that have an active IMF programme.[18] As always, however, the devil is in the details, and the limited resources available in these countries have effectively constrained the governments' opportunities to adopt more growth-oriented counter-cyclical fiscal policies.

Moreover, the IMF has stated that fiscal loosening is only a temporary measure.[19] It hopes former levels of global economic growth will resume in 2010-11. This would allow countries to return to strict fiscal balances and very low levels of inflation, and a growth pattern heavily reliant on exports, foreign direct investment and international capital.

The Fund seems to have learned from past mistakes in one sense: current lending increasingly emphasizes the protection of social spending. Due to

budget cuts forced on many countries, however, social protection spending and creation of decent jobs are dramatically limited.[20] IMF programmes are not assessing the long-term costs of cutting today's expenditure. Fiscal tightening can condemn a whole generation of children to malnutrition as a result of the crisis.

The crisis loans of 2008-09: The proof of the pudding...

Beginning in September 2008, countries started to sign Stand-By Arrangement (SBA) loans with the IMF for the largest financial amounts yet disbursed in the Fund's lending history. The significant expansion in the size and scope of the IMF's loans can be attributed to internal changes to double access limits for LIC loans, increase available resources for loans and provide faster, simplified loan procedures. The Fund's expansion also came from the G20's decision in April 2009 to triple the Fund's lending coffers from $250 billion to $750 billion, and to politically empower it with the central institutional role in the crisis.

Analysis of the SBA loan documents by the Center for Economic and Policy Research, the European Network on Debt and Development and Third World Network is revealing. Despite pledges to address the crisis in flexible and innovative ways, the IMF's key objective in crisis loans remains "macroeconomic stability" through the "tightening of monetary and fiscal policies."

Stand-By Arrangements

During times of financial crisis, the IMF uses the Stand-By Arrangement (SBA) loan, viewed as "the Fund's workhorse lending instrument for crisis resolution."[21] SBAs, which are non-concessional and based on market interest rates, comprise the bulk of the Fund's lending portfolio. They are designed to address problems with the balance of payments in developing and emerging market countries. The SBA was originally conceived to guarantee a country's right to access IMF funds.

In practice, crisis loans mean the following:

- lowering fiscal deficits and inflation levels;
- buffering international reserves (as they fell to dismal levels from the impact of the trade shock in this financial crisis);
- reducing or restraining public spending (through public sector wage freezes and pension freezes, cutting minimum wages, eliminating subsidies to fuel, gas and power, and hiking utility tariffs and tax reforms);
- increasing official interest rates or restraining the growth of the money supply;
- preventing currency depreciation; and
- providing financial sector liquidity where needed.

In so doing, the Fund's policies reassure both the IMF's creditors and investors that the borrowing country will repay the loan and honour foreign debts.

In the core areas of pro-cyclical fiscal policies, the Fund continues to impose more of the same. In fact, in programmes for countries like Latvia, Serbia and Ukraine, the Fund delayed or halted loan instalments by adding requirements for deeper reductions or reforms in fiscal policy, primarily in public expenditures and tax reforms.[22]

One notable exception: as the economic recession became more severe than the IMF had forecast, the Fund increased the allowable fiscal deficit (as a percentage of GDP) and, in some cases, increased it significantly. This was a positive move, but these increased fiscal deficit targets are largely temporary, and generally projected to decrease again in 2010.[23] As for the relaxed deficit levels, the IMF's apparent generosity may simply be out of recognition that harder limits would lead each client country "off-track."[24]

With respect to monetary policy, the IMF believes reducing domestic demand for capital is the way to lower wage and price inflation. But high interest rates increase the cost of borrowing and reduce the availability of local money and credit at a time when capital inflows, national revenue sources and consumer demand have decreased significantly.

In Pakistan, for example, the IMF advised raising interest rates to 15 percent, and increasing them as necessary. In Latvia, the IMF advised raising the official interest rate by six percentage points in 2008.[25] Prohibitively high interest rates deny Pakistani and Latvian consumer and business borrowers access to financing and credit, and push existing borrowers to default on existing loans.

Expenditures have been cut in a number of ways. Hungary has frozen public sector wages, while eliminating a salary bonus for public servants. The Fund has also advised Hungary to cap its pension payments, postpone social benefits and trim the resources of government ministries. In Hungary's second loan review, the IMF recommends further expenditure cuts. These include funding for public transport, as well as "tightened and rationalized" transfer schemes at the local government level. "Mandatory expenditures" such as unemployment benefits and sick pay are to be retained.[26]

The Fund also asked Hungary to cancel plans to cut taxes in 2009, and instead increase its value-added tax and income tax.[27] Hungary's explicitly pro-cyclical fiscal and monetary policies leave very little room to stimulate a recessionary economy through public spending. Tax burdens have increased, and yet a low fiscal deficit target restricts the prospect of public investment and social expenditures – funding that could boost domestic economic activity, including consumer demand.

The story is similar in other countries:

- In Ukraine, the IMF recommended freezing public wages, pensions and social transfers, postponing increases to the minimum wage for two years, and eliminating consumer subsidies for imported gas.
- In Iceland, the income policy agreement between unions and the public and private sectors aimed to cut wages across the board.
- Latvia reduced its fiscal deficit by two-thirds (with one-quarter coming from cuts in public sector wages and bonuses in 2009) by placing a ceiling on its public sector wage bill.
- In Serbia, wage growth was tightly restricted, while Belarus had to reduce public sector wages to achieve a zero fiscal deficit.[28]

- In Serbia and El Salvador, gas subsidies were to be gradually phased out.
- Pakistan's second loan review involves tax and electricity tariff increases and a continuation of tight monetary policy to ensure low inflation levels.[29] In the national context of losses in export revenue and capital outflows, electricity tariff hikes and new tax increases recommended by the Fund place undue financial burdens on consumers and taxpayers.

The Fund's fiscal and monetary macroeconomic targets vary little from its pre-crisis policy – and this poses a serious dilemma of development policy. Such pro-cyclical economic policies are exacerbating the economic downturn in affected countries at a time when rich countries are increasing spending and credit supply to promote recovery.

The United Nations has also critiqued the Fund's contractionary policies in its flagship annual report, the *World Economic Situation and Prospects 2010*, released in December 2009. The report stated:

> Despite pronounced intentions, many recent IMF country programmes contain pro-cyclical conditions that can unnecessarily exacerbate an economic downturn in a number of developing countries. Indeed, amid sharply falling global demand, the Fund has been advocating belt-tightening for many developing programme countries. At the same time, it has been praising advanced economies for their unprecedented efforts in borrowing and spending their way out of recession. The IMF should expand the use of its resources to help support counter-cyclical measures in those developing countries that have sustainable public finances in the medium-term but are impeded in this effort by adverse market conditions.[30]

Instead of increasing government expenditure and boosting domestic demand, local employment and economic activity to overcome the recession, the IMF is cutting spending and increasing tariffs and taxes in already

contracting economies. The burdens of these questionable policies, intended to maintain investor confidence, access to external capital and sustainable debt situations, fall squarely on the shoulders of local taxpayers and consumers.

Chapter 4

BREAKING THE MONOPOLY – WHAT NEEDS TO CHANGE

Counter-cyclical and nationally driven policies

THE IMF's macroeconomic analysis and assessment provided to its developing-country members needs to be more objective, flexible and country-driven. Economic policies recommended by the Fund should be a vehicle for the effective use of aid and should allow for the national policy space to pursue proactive development policies; they should not simply act as a traffic light to international capital.

Instead, the Fund's pro-cyclical macroeconomic advice to its developing-country borrowers is designed with the explicit objective of contracting domestic demand, reducing economic activity and shrinking government spending. The Fund's macroeconomic frameworks have no targets for achieving higher GDP growth, increasing productive investment, increasing employment and diversifying the economy. Consequently, IMF programmes still prioritize financial stability (through tight fiscal and monetary policies) over job creation and growth in productive sectors of the economy. These objectives differ sharply from initiatives adopted by developed countries such as boosting domestic demand, spurring economic activity, facilitating access to credit and enabling employment increases in public sectors that employ the vast bulk of the economy's workers.

Employment expansion supported by job retention and creation programmes would strengthen domestic demand and stimulate economic activity and output. Such counter-cyclical policies are intended to minimize the harmful loss of employment and economic output despite the possible

increase in fiscal or current account deficits. Much-needed public spending increases in developing countries, through temporary deficits, can help spur the longer-term objective of growth and development.

Clearly, a broader heterodoxy of economic policies linked to nationally driven priorities and policy choices is needed. A 2008 civil society report points out that alternative sources and content of economic assessment would

> create competition in the market for macroeconomic assessment, increase the breadth of such assessments, and ensure the use of good practice development principles, such as country ownership and stakeholder participation, which are currently lacking in the Fund. This can improve the information available to both donors and domestic policy-makers while also strengthening the capacity of institutions in the South.[31]

Finally, it is also not just a narrow question of opting for one policy over another. More flexible macroeconomic policies geared towards job-creating growth can be combined with microeconomic interventions to increase the resilience of these countries to external shocks. This can occur through investment in social protection systems and enhancing access to credit by small and medium-sized enterprises, capital controls or more progressive taxation systems.[32]

A financial paradigm fixated on the free flow of capital

Several IMF loan documents, such as those of Serbia and Pakistan, allude to the overarching goal of averting capital flight. In response to the ongoing capital outflow in developing countries, the Fund's motive is primarily to restore investor confidence through pro-cyclical fiscal and monetary policies that generate a stable environment for the free flow of external capital. However, the IMF's loan documents rarely mention possibilities for structural measures for generating such an environment: capital account regulations or capital controls. In fact, Pakistan's loan document openly opposes them.[33]

Recently, Brazil imposed a tax on some types of foreign capital inflows in order to address the volatility inherent in financial liberalization, or in other words, the free flow of capital into and out of national borders. Two economists from the Institute for International Economics (IIE) in Washington, DC – Arvind Subramanian and John Williamson (the originator of the term "Washington Consensus") – wrote in the *Financial Times* that Brazil's tax on foreign capital

> is of great importance, substantive and symbolic. The symbolic value lies in signalling an end to an era in which emerging markets were enamoured with foreign finance, and in expressing willingness to take action to moderate inflows of foreign finance. Substantively, it is important in increasing the arsenal of weapons that countries can deploy to moderate overheating of their economies. It is a good illustration of the type of measure policy-makers can use to arrest incipient asset price overheating.[34]

Not surprisingly, perhaps, the IMF was unsupportive. A senior official said that "governments should not be tempted to postpone other more fundamental adjustments." The same official argued the difficulty of implementing such taxes: since governments apply the taxes to every possible financial instrument, they have proven to be "porous" over time in a number of countries. Clearly, as the IIE writers noted, such a response demonstrates how little has changed in the IMF's intellectual approach to financial globalization, where preserving foreign flows is still "considered sacrosanct."

More recently, the IMF has published a staff position paper where it considers the use of taxes and other capital control techniques to address the problem of capital volatility.[35] Although this is a step forward, it is an extremely tentative one. It only considers such instruments in very exceptional and occasional circumstances, rather than as a policy option that should be regularly available for developing-country decision-makers.

Economist Joseph Stiglitz asserts that the dangers associated with capital market liberalization are one of the most important lessons of the Asian crisis. He points out, "It was not an accident that the only two major developing

countries to be spared a crisis were India and China. Both had resisted capital market liberalization."[36]

The Malaysian experience during the Asian crisis shows that developing countries that have liberalized their financial sector can still manage their capital flows through certain policy tools. These tools include selective capital controls or regulations to discourage or prevent speculation.[37]

The financial crisis of 2008-09 may not have had the same root causes as the Asian financial crisis. But the Fund's continued policy and signalling role with respect to capital account liberalization, and its pro-cyclical macroeconomic policies, have done little to help developing countries respond to the crisis or protect themselves against future crises.

Chapter 5

POLICY RECOMMENDATIONS

THE IMF's economic conditions need to make a fundamental departure from the pro-cyclical orientation of fiscal and monetary policy advice. They should leave countries to determine the orientation of their own, nationally driven economic policies.

Support counter-cyclical spending and investment in countries

The IMF should support counter-cyclical measures through Fund loan programmes in developing countries affected by the financial and economic crisis. Priority should be given to countries that are experiencing difficulties accessing the financial resources to pursue counter-cyclical policies due to adverse market conditions.

Provide substantial and unconditional emergency resources to countries that need them

The IMF should issue and allocate Special Drawing Rights at a fixed interest rate, convert them using a flat user fee and subsidize conversion charges with available funds – for example, using proceeds from the Fund's gold sales. It should stop allocating SDR resources according to quotas, which results in rich countries obtaining the overwhelming share of SDRs. Instead, the Fund should allocate SDRs on the basis of need and urgency, which an independent mechanism can assess for the Fund.[38]

Macroeconomic policies should foster equitable growth

Macroeconomic policies are not neutral. They have distributional impacts in different sectors of the economy; in addition, they can be narrowly focused on macroeconomic stability or also focus on equitable growth. The IMF must give countries adequate policy space to focus on the latter, and make significant and long-term investments in employment creation and local growth, as well as social protection for the most vulnerable in society. Such policies would prioritize active labour market and industrial policies. These policies could enhance economic diversity by building capacity for value-added production and services to stimulate both domestic and external demand.

Put in place institutions to ensure macroeconomic policy advice meets basic human rights obligations

In the short term, the IMF could work with other UN agencies such as the International Labour Organization (ILO) to help ensure its advice and conditions do not hinder governments from protecting and promoting basic economic, social and cultural rights. As the IMF lacks a development mandate, however, it will be necessary to empower or create alternative bodies or institutions. Such bodies should be mandated to conduct assessment and provide advice on a macroeconomic level that respects the particular development needs of low-income and developing countries. The responsibility for these institutions lies with the IMF, national authorities and social partners. Each should play a part to ensure that agreements reached between the IMF and governments are progressive and in line with international human rights obligations.

Addressing the Fund's monopoly in developing-country assessment and policy advice

The IMF should not be the sole international organization shaping macroeconomic policies in developing countries. Other agencies should be

urged to help assess macroeconomic policy in developing countries, and to help formulate policy recommendations. This would break the Fund's monopoly in these areas and give others the opportunity to "signal" the stability and suitability of governments' economic policies to the international financial community.

Promote an environment conducive to domestic resource mobilization

Highly indebted countries with limited access to external finance need greater resource mobilization alongside counter-cyclical fiscal policies. Both the effectiveness and efficiency of domestic resource mobilization would be enhanced if institutions with true expertise and authority over development finance could provide policy guidance to developing countries.

Endnotes

1 For perhaps one of the most comprehensive and inclusive assessments of the Fund's economic policies, see "The Structural Adjustment Policy Review Initiative," launched by the World Bank in 1997 with civil society, governments and the Bank. The final report was released in 2004. http://www.saprin.org/global_rpt.htm.

2 For further arguments on the ineffectiveness of conditionality, see World Bank, "The Theory and Practice of Conditionality: A Literature Review," 2005.

3 SDRs, an international reserve asset and the IMF's "currency," automatically increase central banks' foreign exchange reserves, but also come without any of the conditions typically associated with the IMF. Allocated relative to a country's IMF quota, through this issuance of $250 billion, the largest share will go to the US ($42.6 billion), with developing countries expected to get around $90 billion. Low-income countries will get $18 billion and sub-Saharan Africa will get $10 billion.

4 Most commonly, the term "low-income countries" refers to a classification created by the World Bank, which defines those countries with a gross national income per capita of $975 or less as low-income. The World Bank divides middle-income countries into two sub-categories: lower-middle-income, $976-$3,855; and upper-middle-income, $3,856-$11,905. There are currently 43 LICs.

5 Bretton Woods Project, Christian Aid, Save the Children and ActionAid International, "Reforming the role of the IMF in low-income countries: Questioning the IMF's current involvement," February 2008.

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STRINGS ATTACHED: HOW THE IMF'S ECONOMIC CONDITIONS FOIL DEVELOPMENT-ORIENTED POLICIES FOR LOAN-BORROWING COUNTRIES

The International Monetary Fund (IMF) has long attracted criticism for attaching to its loans contractionary economic policy conditions that undermine growth and development in borrower countries. The nature and scope of these conditions now assume even greater importance in light of the significant increase in IMF lending to countries affected by the 2008-09 financial crisis.

This paper finds that, apart from some limited reforms in its crisis loans such as a new focus on social safety nets, the Fund remains essentially wedded to the objective of securing macroeconomic stability in debtor states through the tightening of both fiscal and monetary policies. The prescribed policy measures, such as curbs on public spending and hikes in interest rates, carry a serious risk of exacerbating the downturn in economies already hit by the crisis.

Given such damaging impacts, this paper argues the need for a fundamental departure from the pro-cyclical orientation of IMF loan conditions. The authors advocate increased flexibility for borrowing countries and, more importantly, a counter-cyclical strategy to pursue nationally driven development policies that can boost domestic economic activity and support equitable growth.

NURIA MOLINA-GALLART *is Director of Policy and Research at Save the Children UK and former Director of the European Network on Debt and Development (Eurodad).* **BHUMIKA MUCHHALA** *is a researcher with the Third World Network in the area of finance and development.*

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