A Non-Definitive Guide to the IMF

A review article

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This book by James R. Vreeland, Associate Professor of Political Science at Yale, is one in a series on Global Institutions. The editors of the series explain in their Foreword that they wanted it to provide a definitive guide to the IMF. This is a tall order, especially for an institution that is continuing to undergo important changes, and the book falls well short of this objective. Thus it is already somewhat dated: it says little, for instance, about the Medium-Term Strategy (MTS) adopted by the IMF in 2005 or the associated reforms that have subsequently begun to be implemented (IMF, 2005, 2006). Also, the book’s scope is limited. Its subject matter is better described by its sub-title: as the author writes in his Introduction, the book is mainly about the international and domestic politics of IMF lending and the policy programs that it supports. But lending is far from being the IMF’s only activity. Another is surveillance—the regular monitoring of economic developments and appraisal of economic policies at the national, regional, and global levels. This is undertaken with reference to

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the code of conduct that member countries are committed to observing under the Fund’s Articles of Agreement. The IMF usually describes surveillance as its most central and important activity, and it absorbs the largest part of its budgetary resources, but it is discussed only briefly in this book. And the IMF’s third major operational activity—the provision of technical assistance (advice on the building of policy-making institutions and on the design of particular policy instruments) and training for officials—is not mentioned.

The author describes the book as intended for beginning students of international relations, the policy-making and NGO communities, and people familiar with the economics of IMF programs but less familiar with the political science literature on the subject. These are likely to find in the book a useful, clearly written, though often uncritical, survey of this literature, but a much less reliable guide to the IMF itself, not only because of what it omits, but also because of a number of confusions and misunderstandings that they will need to look elsewhere to rectify, and because of the inadequate basis of some of its key conclusions.

The book has six chapters, sandwiched between an Introduction and a Conclusion. Each chapter addresses a particular question: What is the IMF? Who controls the IMF? Why do governments participate in IMF programs? What are the effects of IMF programs? Do governments comply with IMF programs? And finally: Reform the IMF?

The “guide” comes with a message. Vreeland sees scant evidence of success of IMF-supported programs, but convincing evidence that they hurt economic growth and increase income inequality. He explains this partly in terms of inadequate compliance with IMF conditionality by some countries—particularly countries that he believes are given preferential treatment because they are important allies of the United States and other major countries—and partly in terms of misconceived program design. He is uncertain which of these explanations is more important—the former, which he identifies with the political right, or the latter, which he identifies with the left. But he views both as pointing in the same direction, since the proponents of both argue that the IMF should scale back its operations, and even “get out of the development business”. Vreeland concurs at least with the more moderate of these prescriptions. This article examines how these conclusions are reached, reviewing each chapter in turn.
Evolution of the IMF

The chapter on “What is the IMF?” begins with a discussion of the IMF’s origins and purposes, and the confusions begin here also. Consider the following:

…the reason the IMF was formed has little to do with the economic programs in developing countries for which the IMF is famous today. Originally, the IMF was intended to monitor and help maintain pegged but adjustable exchange rates, primarily between the industrialized countries of Western Europe and the United States. The task of promoting economic development—development for war-torn Europe—was assigned to the institution that has come to be known as the World Bank. (p. 5)

The IMF was essentially (by the Marshall Plan) dealt out of the rebuilding process of Europe after World War II—dealt out of the very job the institution was created to perform. (p. 8)

From the beginning, the IMF was assigned—broadly speaking—two main tasks: (1) to monitor members’ economies—especially their exchange rates and balance of payments, and (2) to act as an international lender. Broadly speaking this is what the IMF was doing—and still does—in the developing world. (p. 9)

It is difficult to know what the uninitiated reader is to make of these contradictory statements.

The author could have been clearer about the IMF’s purposes simply by referring to Article I of the Fund’s Articles of Agreement, unchanged since 1944.1 The Fund’s stated purposes, in brief, are to provide the machinery for international monetary cooperation; to facilitate the expansion of international trade, including by helping to eliminate exchange restrictions for current transactions and establish a multilateral payments system; to promote exchange rate stability, orderly exchange arrangements, and the avoidance of competitive exchange rate depreciation; and to provide temporary financing “under adequate safeguards” to help countries “correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity”. So temporary financial support for policies designed to correct payments imbalances has always been one of the Fund’s purposes; and it has never been limited to any particular group of countries. The Fund was never

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1 See http://www.imf.org/external/pubs/ft/aa/index.htm
given the job of financing postwar reconstruction in Europe. And while the Fund’s responsibility for supervising a global system of pegged but adjustable exchange rates ended when the Bretton Woods system collapsed, the promotion of a stable system of exchange rates remains part of its mission.

There are other problems in the author’s description of the IMF’s evolution. In the book’s main paragraph on IMF surveillance, multilateral surveillance, “where the economic connections among countries are considered” is referred to as a “recent innovation” (p. 11). But the Fund has always been concerned with the economic connections among countries. Its responsibility to “oversee the international monetary system” has been explicit in the Articles since the second amendment of 1978, and may be considered implicit in the original Articles. And the primary document of the Fund’s multilateral surveillance operations, the World Economic Outlook, has been published regularly since 1981, having been regularly discussed by the Fund’s Executive Board for a decade before that (see Boughton, 2001, Chapter 5).2

Also Vreeland states that special drawing rights (SDRs)—the first international reserve asset created by international law—were introduced as “the IMF sought a more stable accounting currency” (p. 13). This is a misreading of both the purposes of the SDR and the evolution of the international monetary system in the 1960s and 1970s. SDRs were introduced in 1969, by the first amendment of the Articles, to enable the IMF to supplement international reserves when there was judged to be a “long-term global need”. Allocations of the new international reserve asset followed in 1970–72 and 1979–81, and a fourth amendment of the Articles, approved by the Fund’s Governors in 1997 but still awaiting acceptance by the necessary majority of member countries’ voting power (essentially, ratification by the US Congress), is intended to lead to a further allocation. The unit value of the SDR was originally defined as the gold content of the US dollar (that is, as essentially equivalent to US$1), this being the currency to which other countries’ currencies were pegged under the Bretton Woods system, so that it had no significant advantage as a unit of account. Subsequently, following the breakdown of that system (which Vreeland sometimes confusingly refers to as the “gold standard”, the term

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2 Since 2002, the IMF has also published the Global Financial Stability Report, another regular multilateral surveillance document.
usually used for the system that expired in the inter-war period), the SDR was redefined in terms of a basket of major currencies. The SDR does serve as the IMF’s unit of account, and because of the absence of allocations since 1981, this may be its best-known function today. But this was not why it was introduced, and the absence of any mention of the SDR’s role in supplementing international reserves is misleading.

The author is on surer ground in discussing the membership and organization of the IMF, and provides an interesting discussion of voting power and decision-making in an organization that relies to a large extent on the formation of consensus. His first chapter also provides a useful and largely accurate discussion of the evolution of IMF conditionality, recognizing its purposes as being threefold—to provide part of the “adequate safeguards” of Fund resources required by the Articles; to help ensure that, through appropriate economic policies consistent with the code of conduct represented in the Articles, the problems that underlie a country’s need to borrow from the Fund are resolved without undue damage nationally or internationally; and to limit moral hazard (that is, undue risk-taking in policy-making as a result of the availability of IMF “insurance”). He correctly explains that the rise of structural conditionality, beginning in the 1970s—including through the Extended Fund Facility (EFF), introduced in 1974 (not 1963 as he states)—and especially from the late 1980s was motivated by the perceived need to address structural weaknesses in many economies suffering from balance of payments problems. He could have been more explicit, however, about the increased attention being paid to economic growth, and to the objective of ensuring that improvements in the external payments positions of program countries would not be at the expense of prolonged, weak growth, but that they would be associated with restored or improved growth performance, and thus be more durable. He also describes fairly the retreat toward more streamlined conditionality from around 2000 as the Fund paid increased attention to country “ownership” of policy programs, and to the need to focus on its areas of particular responsibility in the macroeconomic and financial areas.

Misunderstandings continue, however. Vreeland writes that the IMF attaches conditionality to loans only when the borrowing country’s problems have resulted from bad economic policies rather than bad luck (pp. 20, 25–26). He thus views countries’ ability to draw, without conditionality, on their reserve tranches (equivalent to 25 percent of their
quotas in the Fund), as an “arbitrary” allowance for bad luck, rather than in the nature of the reserve tranche, which is what it is, and he views the low-conditionality character of the Compensatory Financing Facility (CFF) as explained by the fact that it serves countries suffering misfortune. This view of IMF conditionality as punishment for bad behavior is mistaken. Even when a country’s problems are due to bad luck, their solution may well require policy adjustments, and conditionality may then be expected to apply. Neither the country nor the IMF, as its creditor, can sensibly just hope for a reversal of fortune. The reason CFF loans are made with only low conditionality is that the country’s balance of payments problem is viewed not only as beyond the control of the country’s authorities but also as temporary, because it is attributed to a temporary change in export earnings or import costs. In fact, however, since 2000 the Fund has required that any CFF financing be made in parallel with a conditional loan arrangement when pre-existing balance of payments problems need to be addressed. And since then, the CFF has not been used, partly because of the difficulty of establishing that a balance of payments problem really is temporary—not just “bad luck”.

Who controls the IMF?

Turning to the question of who controls the IMF, Vreeland describes the formal accountability of staff to management and the Executive Board, and the accountability of the latter to the Fund’s Board of Governors from each member country, who are ministers or central bank governors: “So, in principle,” Vreeland writes, observing that the countries with the most votes at the IMF are democracies, “the IMF derives its authority from the citizens of the world” (p. 38). But what happens in practice? Vreeland understandably delves deeper.

First, he describes research that he says “substantiates the claim” that the Fund pursues the goals of its own bureaucracy. One piece of evidence he describes (from Vaubel, 1996) is a correlation over time (for the period 1955–94) between the size of the IMF’s staff and the share in total Fund quotas of the quotas of the ten largest member countries. In the period examined, the latter declined and the former grew. The interpretation favored by Vreeland is that the bureaucracy has been able to serve its own interests by growing because of an increasing dispersion of authority
among member countries that has reduced each country’s incentive to
monitor and contain the organization’s activities. But the correlation is also
consistent with an alternative interpretation: that the IMF needed to grow
as the number of member countries expanded—incidentally reducing the
share of quotas held by the ten largest members—and the volume of work
consequently increased. Vreeland does not discuss this possibility, nor
does he mention the fact that the IMF’s staff has remained small relative
to comparable organizations (even relative to many central banks) and not
grown at all since around 2000, even though the share of the largest coun-
tries has continued to decline, albeit slightly.

Another piece of evidence (also from Vaubel) is that IMF lending has
apparently tended to pick up as the Fund has got closer to each five-yearly
quota review. The interpretation favored by Vreeland is that imminent
quota reviews have led the Fund’s officials to boost its lending to create
the impression of a need for an increase in resources. But again there is
another interpretation—that in the period examined there was an upward
trend in the demand for IMF loans and that quota increases really were
warranted by pressure on the Fund’s resources arising from this demand.
In considering these alternative interpretations, the experience of recent
years is interesting. The last increase in IMF quotas was approved in 1998.
In the next review, in 2003, no increase was considered necessary. The
thirteenth review is now underway, to be concluded in early 2008. And far
from the IMF pushing out more loans, the Fund’s credit outstanding has
in recent years declined sharply: in fact, it is now (in May 2007) at its low-
est since the early 1970s! So much for the designs and power of the
bureaucracy! (Incidentally, Vreeland interprets the emphasis often placed
by IMF officials on the need to “safeguard Fund resources” as revealing
their desire to protect the Fund’s budget and make more loans (pp. 40,
48). This is a misunderstanding. In fact, it refers to what the Fund views
as the importance of ensuring that loans are repaid on schedule so that its
financial resources are available for other countries in need. It has nothing
to do with the Fund’s budget and staffing, which are determined by an
annual process quite separate from the quinquennial quota reviews.)

What about political influences on Fund lending? Vreeland provides an
interesting account of anecdotal evidence and econometric research on
this question. Some econometric studies (Thacker, 1999; Bird and
Rowlands, 2001; Barro and Lee, 2005) have found that whether a country
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has received an IMF loan has depended not only on economic variables but on whether it supported policy positions of the United States (or other major industrial countries) at the United Nations, or shifted toward such positions, or on whether it was a temporary member of the Security Council. But the robustness of these results is questionable: more recent research, using arguably better specified models, has found that such variables have had no significant effect (Ghosh et al., 2007). Vreeland also refers to econometric evidence of an association between the incidence and duration of IMF program suspensions and the amount of aid provided by the United States, but this could be capturing the support of strongly performing, or reforming, economies by both the United States and the IMF, and its withdrawal when these conditions do not apply, rather than political influence on the Fund.

Finally, Vreeland reports evidence (from Gould, 2003) that private financial institutions have influenced IMF-supported programs by virtue of their power as “supplementary financiers”, meaning that they provide financing additional to IMF and other official financing to help close the balance of payments gaps of program countries. More specifically, the evidence is that, in cases where there was a private debt restructuring, which supposedly put private creditors in a powerful position, they were successful in shaping IMF-supported programs by pushing for conditions friendly to them, such as that the country make its debt service payments to commercial creditors, and reduce any external payments arrears. But this evidence can be explained in another way, which Vreeland does not consider. The IMF has never made any secret of its view that it is important that countries meet their debt service obligations (unless they are unsustainable, in which case they should seek a restructuring agreement with creditors) and eliminate in an appropriate time-frame any external payments arrears. The Fund considers that this is in the interests of both the debtor country’s credit-worthiness and the health of the international financial system. It is therefore not surprising that when there is a problem of private external debt—reflected in the fact that a restructuring is taking place—a Fund-supported program will tend to include conditions relating to its resolution. It is true that the Fund used to insist on the clearing of any arrears before agreeing to a program arrangement, and that this boosted private creditors’ power in negotiating terms for debt restructuring. But this policy was relaxed in 1983, and changed more fully in 1989,
in association with the Brady debt reduction plan, and since then, the IMF has been willing to “lend into arrears” as long as the borrowing country is making “good-faith efforts” to resolve debt issues with creditors. (See Boughton, 2001, Chapter 11.) The adoption of this policy, which helped to level the playing field in debt negotiations by reducing the power of private creditors, is not mentioned by Vreeland.

Despite his view that the evidence shows that various political influences have been at work, Vreeland also infers from the evidence on “Who Controls the IMF?” that “the expected economic factors definitely do play a role in the activities of the IMF”, and that, after all, the IMF “is staffed by economists who pursue the very tasks laid out in the Articles of Agreement”.

**Reasons for borrowing**

But why have countries wanted to borrow from the IMF? In his least controversial chapter, Vreeland suggests that apart from the obvious economic reasons—a weak balance of payments, pressure on the country’s foreign exchange reserves, high external debt, etc.—political factors have again been important. One is the supposed “stigma” or perceived sovereignty costs of a Fund program, which is likely to be stronger for countries that have not borrowed in the past. Another may be the government’s desire to use the Fund as a scapegoat, which it can blame for the policy measures it needs to take. A third may be the desire for the Fund’s “seal of approval” to encourage investors. And a fourth may be the leverage provided by a Fund program to overcome domestic opposition by potential “veto players” to reforms and other policies that the government wishes to implement. Vreeland describes a statistical analysis of his own that tested for each of these influences on the likelihood of entering into an IMF arrangement. He finds that, among economic variables, the levels of foreign reserves and debt service payments have had significant effects in the expected directions (negative and positive, respectively), and that per capita income has had a significant negative effect. He also finds significant positive effects for the two political factors tested—past participation in IMF programs, which he interprets as an indication either of the “stigma” effect or of other causes of country recidivism; and the number of “veto players” in the country’s political system.
The effects of IMF-supported programs

Vreeland then turns to the question of the economic effects of IMF-supported programs. He provides a good discussion of the problems that arise in estimating these effects, particularly the difficulty of identifying the counter-factual—that is, what would have happened in each program case if there had not been an IMF-supported program but everything else had been the same—and of the methods which have been used to address it. He pays particular attention to the need to deal with the selection bias problem—which is that there are likely to be independent factors affecting both a country’s participation in a Fund arrangement and the success of the program, so that a comparison of the economic performance of program countries with non-program countries is likely to be misleading.

Summarizing the evidence from research at the IMF and elsewhere, he finds, first, a “broad consensus that the IMF has had success in addressing balance of payments problems”, which, he observes, the IMF is mandated to address “first and foremost”. “In fact, no study cited in the literature finds a statistically significant negative effect of IMF programs on the BOP.” (pp. 84–86) Second, IMF-supported programs have generally had a positive effect on fiscal balances, though he notes two findings of a 2003 study of IMF arrangements during 1993–2001 by the IMF’s Independent Evaluation Office—that improvements in fiscal balances, on average, have been about one-half of the improvements targeted, and that, contrary to the widely held belief that IMF-supported programs follow a “one-size-fits-all” approach, about one third of Fund arrangements in this period called for fiscal deficits to widen (IEO, 2003). Third, evidence of effects on inflation is less clear, although more studies seem to have found that programs have lowered inflation than raised it.

Fourth, what have been the effects on economic growth? Vreeland observes that growth is an objective espoused by the Fund. He indicates that by the late 1990s a consensus had emerged that IMF-supported programs tended to depress growth in the short run as the demand-reducing elements of the program dominated, but that over time positive effects on growth took over, partly because of the effects of structural reforms. He argues, however, that more recent studies, including his own 2000 study with Adam Przeworski of programs between 1971 and 1990 (also Hutchison and Noy, 2003; Barro and Lee, 2005; and Dreher, 2006), have
found statistically significant negative effects on growth, and that as a result there is a “newly emerging consensus…that IMF programs hurt economic growth” (p. 90). But the assumptions used in these papers are susceptible to criticisms. For example, Barro and Lee assume that output is a determinant of a country’s demand for a Fund-supported program, without taking into account its endogeneity. Przeworski and Vreeland impose implausible assumptions about which variables determine, and do not determine, a country’s “demand” for and the IMF’s “supply” of IMF financial support—with international reserves, the budget deficit, and debt service affecting demand but not supply, and the external balance and political regime affecting supply but not demand. All these questionable assumptions potentially affect the estimated effects on growth of IMF-supported programs.

Also, Vreeland could have looked at other recent results, which seem closer to the earlier consensus. A 2005 IMF study (Ghosh et al.) of more recent programs—begun during 1995–2000—argues that a distinction needs to be drawn between programs in low-income countries, supported by loans from the Fund’s “concessional” low-interest rate facilities (since 1999, the Poverty Reduction and Growth Facility (PRGF)), and programs in middle-income countries, supported by the Fund’s General Resources, usually through stand-by arrangements or the EFF. The latter group of programs tended to focus mainly on the objectives of balance of payments improvement and macroeconomic stabilization, while the former were geared more toward structural reforms aimed at promoting growth, subject to the achievement and maintenance of external viability. The study found that in the middle-income countries, growth tended to dip in the program period but subsequently recover to, though not exceed, its pre-program rates. But in the low-income and transition countries, programs tended to be followed by sustained improvements in growth—both because of a more benign environment and because of better policies in the context of the IMF-supported programs. These results suggest that the findings in the studies that Vreeland quotes of a significant negative association between IMF-supported programs and growth may not be robust, and that Vreeland’s conclusion that IMF-supported programs clearly hurt economic growth is therefore too strong, although it would also be too strong to argue that the evidence shows that IMF-supported programs generally boost growth.
Finally, Vreeland examines evidence on the effects of IMF programs on income distribution. He reports on three studies, all of which found that “IMF programs increase income inequality” (p. 92) But much of this evidence is old—the data for one of the studies end in 1981, for another in 1993—and since the 1980s the Fund has increased its emphasis on the need to protect the poor from the negative short-term effects of economic adjustment, especially through social safety nets and the maintenance of public spending on health and education. Indeed, Vreeland acknowledges studies that have found that IMF-supported programs have tended to raise such spending, at least in some political systems. IMF-supported programs are likely also to have helped the poor via macroeconomic stabilization, given the well-established costs to the poor of high inflation and economic dislocation.

On the various effects of IMF programs, one of Vreeland’s findings is that “the conclusions in the literature are tentative. With each generation of studies come new and often contradictory findings” (p. 94). But this thought does not deter him from carrying forward, and building on, his strong conclusion that IMF programs hurt economic growth and income distribution.

**Compliance with IMF-supported programs**

The effects of IMF-supported programs may be expected to depend on the extent to which governments comply with them, and Vreeland next examines the evidence on this. He asks what could explain his observation that IMF-supported programs hurt growth. One answer, which he associates with the political right, is that countries do not comply with IMF-supported programs, with IMF loans only having the effect of subsidizing bad, unchanged policies. An alternative answer, which he associates with the left, is that IMF-supported programs impose inappropriate, contractionary policies that can only be expected to lower growth: in this view, the policies more appropriate to an economic crisis are expansionary, and such policies are followed by developed countries not subject to IMF conditions when they face economic difficulties. (I return to these views later.) To settle this debate, analysis of compliance is required.

Vreeland provides a good account of the difficulties involved in measuring compliance, both through such aggregate measures as the proportion
of an approved loan that is actually drawn or the non-occurrence of program interruptions, and through disaggregated approaches that distinguish among different types of condition. On the question of what determines compliance, he describes a number of empirical studies (Ivanova et al., 2003; Nsouli, Atoian, and Mourmouras, 2004; Dreher, 2006; Joyce, 2007), some of which have been able to find links to such domestic political factors as political cohesion (good for compliance), political instability (bad for compliance in some studies, good in others), and democracy (good for compliance), but some of which have found no clear pattern. Vreeland concludes that “both international and domestic politics influence compliance”, the reference to international politics apparently being based on work by one author, Stone (2002, 2004), who found that although “the IMF tends to be fairly consistent and technocratic when initially punishing a country that has failed to live up to” policy conditions, such countries that are “favored by the United States tend to get shorter punishment intervals” (pp. 99–100). This conclusion is hedged, however: Vreeland considers that “the question of what drives compliance has not yet been adequately researched”. Based on the work of one author, and hedged; but nevertheless, Vreeland asserts on this basis that “Countries important to the IMF major shareholders face less pressure to comply” (p. 108).

With regard to the effects of compliance, Vreeland reports that two of the recent studies that found a negative effect of IMF-supported programs on growth (Dreher, 2006; and Hutchison and Noy, 2003) also found that this effect is at best mitigated by high degrees of compliance, and that another study, by IMF staff (Nsouli, Atoian, and Mourmouras, 2004) found that compliance had no effect on growth. One of the former studies (Dreher) also found that the size of the IMF loan had no effect on growth. Vreeland argues that this evidence, while “not conclusive” tends to favor the “leftist” view that the reason IMF programs seem to have hurt growth lies in program design, rather than in the subsidization of unchanged policies by IMF financing. With regard to the effects of IMF programs on inflation, however, Vreeland finds evidence that compliance has helped inflation control, which favors the opposite view. It is not surprising that Vreeland, in the end, considers that the work that has been undertaken on compliance “raises more questions than it answers” (p. 96).
IMF reform

Vreeland turns finally to the question of reform of the IMF—more specifically, reform of the IMF’s lending operations in developing countries. He distinguishes calls for reform that have come from the left of the political spectrum from calls from the right. He identifies the former mainly with Stiglitz (especially his 2003 book), and the latter mainly with the majority report of the “Meltzer Commission” (IFIAC, 2000). He provides accounts of both that are remarkably uncritical.

One of the problems with his account of the Stiglitz critique is that it fails to recognize the primary reason for the IMF’s provision of financial assistance—at least, its non-concessional financial assistance. IMF loans are generally provided, often in circumstances of financial crisis, in order to support policies designed to help restore macroeconomic stability and a viable balance of payments—and thus to re-establish an essential basis for sustainable economic growth. This will usually, though not always, require increased fiscal discipline, partly because this is the most reliable means of raising national saving relative to domestic investment, which is a necessary condition for an improvement in the current account of the balance of payments. Reduced fiscal deficits are also needed in many situations of macroeconomic instability to reestablish a sustainable government budget and to help restore monetary stability and financial market confidence. Monetary policy may well also need to be tightened in these circumstances to raise short-term interest rates, both to increase the relative attractiveness of domestic assets so as to stabilize the exchange rate and halt the decline of international reserves, and to help bring inflation under control.

Increased fiscal discipline is not always required, however. Indeed, as indicated above, the IEO’s 2003 study found that about one-third of IMF arrangements during 1993–2001 programmed a widening of the fiscal deficit. In particular, in crises dominated by large-scale capital outflows that force an improvement in the current balance through a collapse of domestic demand and the exchange rate, it may well be appropriate to use fiscal policy to support economic activity.3

3 The Asian crisis of 1997–98 provides examples. The initial setting of fiscal policy in the IMF-supported programs was too tight because it was based on overly optimistic assumptions (shared with most observers) about capital flows and economic growth. After it became clear in early 1998 that domestic demand was declining sharply, taking care of the need for current account adjustment, fiscal targets were modified to provide support for economic activity, with expanding fiscal deficits. See Boorman et al., 2000.
But Stiglitz’s objection to increased fiscal discipline, as described by Vreeland, is different: it is that “fiscal austerity under an economic crisis can increase unemployment and deepen the crisis”, and that, after all, “advanced industrialized countries do not follow austerity policies themselves when they face economic downturns”. For example, “when the United States faced a recession in 2001…Contractionary policies, such as those suggested by the IMF were certainly not considered by the US government. Stiglitz thinks that similar stimulus packages could serve to help developing countries grow their way out of economic crises.” (p. 115)

There are several confusions, and disconnections from reality, in this argument. First, it is true that reducing the fiscal deficit may well increase unemployment in the short run, although this is not certain in situations where there is a major problem of financial instability and lack of confidence—situations where increased fiscal discipline can boost private sector demand and economic activity by leading to lower market interest rates. But even when there is a resulting short-term increase in unemployment, reducing the fiscal deficit may nevertheless be necessary, for the reasons described above. Then, without it, restoring macroeconomic stability and external viability is likely to be more difficult, and employment and growth are likely to suffer in the longer term. Vreeland seems to identify an economic crisis with a downturn in economic activity and employment, ignoring the problems of instability and non-viability; and he fails to document when the IMF has recommended contractionary economic policies to any country in an economic downturn unaccompanied by financial difficulties that needed to be addressed.

Second, the situation of the United States in 2001 was one of recession, not balance of payments crisis, and contractionary policies would have been quite inappropriate to the circumstances. To remove any ambiguity, the IMF did not suggest contractionary policies to the United States at the time: it endorsed the supportive monetary and fiscal policies adopted by the US authorities.4 However, the IMF has for several years argued for improved fiscal discipline in the United States—meaning reduction of the structural fiscal deficit over the medium term, while allowing counter-

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4 In its July 27, 2001, assessment concluding the IMF’s 2001 Article IV Consultation with the United States, the Fund’s Executive Board “considered that the principal policy priority is to revive near-term growth and welcomed recent actions on the monetary and fiscal fronts as appropriate and timely. They welcomed the Federal Reserve’s aggressive easing of monetary policy since the beginning of 2001...” (http://www.imf.org/external/np/sec/pn/2001/pn0187.htm)
cyclical “automatic stabilizers” to operate—to help address the country’s chronic current account deficit and its longer-term budgetary problems related to population ageing. And it has also supported tightening actions by the Federal Reserve when these have seemed necessary to counter inflationary pressure.

Third, Vreeland fails to provide any example of a country that has successfully “grown its way out of” a crisis of macroeconomic instability and balance of payments weakness. The reader may reasonably wonder whether any such examples exist.

The Stiglitz critique described uncritically by Vreeland goes further. It refers to the Fund, for example, as extending loans to countries in crisis “so that the currency does not have to be immediately devalued. This buys time for foreign financiers and the domestic elite to exchange the collapsing currency for a stable currency at favorable terms. These actors can get their money out of the country through the liberalized markets which the IMF has imposed on the country. After this, the currency is finally devalued, and labor and the poor are left with the debt of repaying the IMF loan with a devalued currency”. Why does the Fund allegedly do this? According to Stiglitz, because it is “pursuing the interest of the financial community”, as evidenced, according to Vreeland, by the study whose findings were questioned above (Gould, 2003). Vreeland again does not refer to specific cases. There have, of course, been IMF arrangements in support of policy programs with pegged exchange rates that ultimately collapsed, Russia in 1998 and Argentina in 2001–02 being perhaps the best-known recent examples; but in both these cases many foreign and domestic investors suffered large losses when collapse occurred. In other cases, including Mexico in 1995 and Asia in 1997–98, the Fund provided its loans to help stabilize currencies that had already fallen dramatically and again, many private asset holders suffered severe losses. Vreeland could have helped the reader assess the validity of Stiglitz’s charge if he had referred to such cases.

To what reform proposals does the Stiglitz critique lead? Vreeland identifies several. With regard to program design, first, Fund lending should be redirected “to restore aggregate demand in countries facing an economic recession”. Vreeland does not question the economic sense or feasibility of this proposal, or acknowledge that it would require a radical revision of the Fund’s mandate, or consider its implications for the Fund’s ability to help
countries facing balance of payments crises. Second, Stiglitz stresses the dangers of capital account liberalization, and proposes the use of capital controls in crises. Here, the IMF has tended to be pragmatic, emphasizing the potential long-term benefits of capital account liberalization (illustrated by the realization of these benefits by many countries, including all industrial countries), but also the need for liberalization to be undertaken cautiously, and to be supported by, and appropriately sequenced with, appropriate macroeconomic and financial sector policies. The Fund has tended to view capital controls as being of some potential use in some circumstances in the short term, but as instruments whose benefits tend to erode substantially over time relative to their costs. (For a statement of such views before the Asian crisis, see, for example, Camdessus, 1995.)

Third, the IMF should focus more on sovereign debt restructuring or “bankruptcy”—which the IMF has done, particularly since the late 1990s, including through the debate on the proposal for a Sovereign Debt Restructuring Mechanism and its support for collective action clauses in bond contracts.

Apart from the design of policy programs, Vreeland refers to Stiglitz’s call for greater transparency of the IMF, a subject to which I return below, and reforms of its governance, including reforms of country representation through quota reform. (Reform of “basic votes”, the votes distributed equally among the Fund’s member countries irrespective of quotas, is also important to the reform of country representation, but not discussed by Vreeland.) Such governance reform is currently in process as part of the MTS, with progress having been made since Vreeland’s book was written. But although Vreeland argues in favor of such governance reform, he questions its usefulness, pointing to four reasons to question whether it would make much difference to Fund policies: the United States would likely still have the most votes (true, especially given that it remains the world’s largest economy, but governance reform could produce more effective counter-weights); the IMF would still be “beholden to private financiers” (premise questioned above); elites from finance ministries and central banks all have similar views anyway (belied, for example, by differences of view on a variety of issues in the IMF’s Executive Board); and the IMF would remain unaccountable and undemocratic—in fact, “international organizations simply lack the capacity to be as accountable as domestic political systems because they are not subject to the major mechanisms
that citizens have to hold their officials accountable: elections” (p. 120). From this last point, Vreeland infers that too much authority should not be ceded to the IMF. But the last two points really seem like a vote of no confidence in the possibility of worthwhile international cooperation through multilateral organizations more generally!

Vreeland’s discussion of the “critique from the right” begins with the charge that the IMF has failed to enforce conditionality and contributed to moral hazard. He sets out the recommendations of the majority of the Meltzer Commission (IFIAC, 2000): that to qualify for IMF loans, countries would need to satisfy certain pre-conditions; that countries in compliance with these pre-conditions would automatically qualify, in emergencies, for IMF loans, with no further conditionality; and that the IMF should restrict its loans to the provision of short-term liquidity at a penalty interest rate, to discourage moral hazard and to encourage prompt repayment. Without any critical comment on these proposals, Vreeland proceeds to note the agreement between the “right” and “left” that the Fund should “get out of the development business”.

But in fact, there are many problems with the Meltzer proposals, some of which were raised in a minority statement by four of the eleven members of the Commission. This charged that the majority’s conclusions were based on “misinterpretations of history and faulty analysis” (IFIAC, 2000, p. 119), including exaggeration of the problem of moral hazard (particularly given the dearth of evidence that it had had much to do with any of the recent crises), and failure to note the success of the strategies pursued by the IMF in recent financial crises—success shown in sharp economic recoveries in almost all the countries concerned. It described as “fatal flaws” the recommendations that conditionality be discontinued and replaced by pre-qualification, because this would sanction IMF support for countries with weak policies—enabling a country to continue with policies that caused a crisis, and increasing the risk of global instability—and potentially preclude IMF support for countries of systemic importance, substantially increasing the risk of global disorder. The minority emphasized: “No reform of the Fund should block it from fulfilling its central responsibility as the defender of global financial stability through providing emergency financial support for all countries that could generate systemic threats”. These are not marginal objections! But they are not mentioned by Vreeland.
A few of the other problems with the Meltzer report are worth mentioning. It specified what it meant by “short-term loans”: it proposed that IMF loans should have a maturity of only 120 days, with the possibility of only one rollover. Experience suggests that this would be inadequate for the resolution of many, if not most, crises. Its recommendations would make it impossible for the Fund to provide balance of payments support to countries that had not pre-qualified, probably including many developing countries. Even for countries that are not systemically important, this would be contrary to the Fund’s purposes and its Articles; and it would, in effect, eliminate a major, if not the main, source of international support for prudent macroeconomic policies in these countries.

How has the IMF responded to the critics? Vreeland argues, reasonably, that increased transparency and increased emphasis on country ownership of policy programs have been the two main IMF reforms over the past decade, at least prior to the MTS launched in 2005.

But again, his account of the Fund’s increased transparency is somewhat misleading. Thus, he writes that “The first move the IMF made regarding transparency targeted IMF members” (p. 125), referring to the adoption in 1999 of the Code of Good Practices on Transparency in Monetary and Fiscal Policies. But the Fund had already, in 1994, liberalized policy on access to its archives; in 1996 it had introduced data standards to encourage the dissemination of economic and financial statistics by countries; in 1997 it had introduced Press Information Notices summarizing its country surveillance consultations (later to become known as Public Information Notices); and also in 1999 it launched a pilot for the publication of country surveillance staff reports, subject to the agreement of the country concerned. He also omits to mention that since 2004, the publication of such reports has been presumed. In 2006, 84 percent of the IMF’s country staff reports were published, along with 94 percent of country program documents. (See IMF, 2007.) And IMF transparency has increased, in other ways, more than Vreeland recognizes, as may be seen from the daily flow of documents and other information on to the Fund’s website, www.imf.org.5 For example, for information on IMF financial operations and transactions, he directs readers to IMF Annual Reports (p. 129), but the

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5 In its 2006 Global Accountability Report, One World Trust ranked the IMF third out of 10 inter-governmental organizations in terms of transparency, and fourth out of 30 inter-governmental organizations and private transnational companies (http://www.oneworldtrust.org/?display=index_2006).
relevant data have been released on the Fund’s website on a weekly basis since 2000. But even where he sees transparency, Vreeland is not entirely happy: observing that the conditions attached to loans are often complicated, he complains that “Too much information—or ‘noise’—transmits little more information than non-transparency”. But the problems tackled in Fund programs are, in fact, often complicated, and although the streamlining of conditionality in recent years has involved an attempt to make conditionality less complicated, it would hardly make sense to give simplicity such a high priority that effectiveness is sacrificed.

With regard to the promotion of country ownership of programs, Vreeland describes how the IMF has paid more attention to outreach, particularly with civil society, and especially in the context of the PRGF. He notes that as the demand for its non-concessional loans has declined in recent years, the Fund has shifted its lending toward PRGF arrangements. But he misinterprets this as a deliberate shift, which “flies in the face of” the proposals of the Meltzer Commission, and as “a bold stand by the IMF that the institution can do better at development than critics believe” (p. 129). This misinterprets IMF lending as development lending; misses the fact that PRGF lending has declined in recent years (from SDR 6.8 billion at end-2004, to SDR 6.3 billion at end-2005, to SDR 3.9 billion in April 2007); and ignores the related introduction by the Fund in late 2005 of the Policy Support Instrument, designed to enable it to provide low-income countries with explicit support for policy programs without financing, and of an accompanying Emergency Financing Mechanism to make financing available for such countries in emergencies.

Vreeland concludes his chapter on IMF reform by putting together some of his key arguments to deduce that IMF conditionality can be expected to be effective and worthwhile only in countries not favored by the United States (for otherwise it will have no bite), where the government agrees with IMF-prescribed policies (for otherwise there will be no “ownership”), where the government does not mould IMF conditionality to favor “domestic elite interests” (for otherwise conditionality will be abused), and where the government faces domestic opposition (for otherwise conditionality will be unnecessary). He argues that the “dearth of evidence of program success in the area of economic growth” indicates that all these conditions are seldom satisfied—pointing to the need for the Fund to “scale back its operations,…lending only in the direst economic circumstances” (p. 131). The
The foregoing discussion indicates that while the components of this argument are not all invalid—ownership is important—neither are they all well founded. As it happens, however, IMF lending has fallen substantially in recent years, as a result of a decline in demand attributable partly to benign global economic conditions and partly to improvements in the conduct of policy in many countries, which have contributed to the avoidance of financial crises. It is unclear whether this decline will be temporary or sustained. But currently, at least, IMF surveillance—to which some of these policy improvements can be attributed—is, as much as ever, the central activity of the IMF. The Fund is currently engaged in implementing its MTS, which aims to increase the organization’s effectiveness across the range of its operations—surveillance, financial assistance, and technical assistance—including through reforms of its governance. The IMF is thus continuing to evolve, as it has done through its history, to meet the changing needs of its increasingly interdependent member countries and the increasingly integrated global economy. Perhaps there will be no good time to write a definitive guide to the IMF.

References


