Prescriptions for IMF Reform: The Case Against Market Fundamentalism

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Half the people and two-thirds of the countries in the world lack full control over their own economic policies (Lance Taylor, 1997)

I. Introduction

In 1945, desperate to prevent another post-war economic depression, the western world – under the leadership of the United States – established the Bretton Woods system, a monetary management system intended to regulate the global economic market and to ensure economic security.[1] With the creation of the Bretton Woods Institutions, the International Monetary Fund (the IMF, or simply, the Fund) was established to "promote international monetary cooperation and exchange rate stability, facilitate the balanced growth of international trade, and provide resources to help members in balance of payments difficulties or to assist with poverty reduction."[2] The institution is intended to "provide policy advice and financing to members in economic difficulties."[3] It is composed of 186 countries, and issues loans to member countries on the condition that the borrowing country will reform its economic policies to those that the Fund believes are most conducive to economic prosperity. The IMF's founding ideology, 'market fundamentalism,' is grounded in the assumption of perfect markets – an assumption that rarely holds, especially in developing countries.[4] This inconsistency notwithstanding, economic ideas associated with market fundamentalism profoundly shape the Fund's prescriptions, leading to the IMF's use of strict structural adjustment programs (IMF imposed policies used as conditions for loans) and, more generally, to its prescribed policies of "fiscal austerity, privatization, and market liberalization."[5] As many have by now argued, these IMF prescriptions often carry adverse effects on the countries that adopt them, leaving the country and its citizens in a deeper state of crisis.[6] Indeed, the fact that countries that implement the Fund's conditions have been shown to experience a *decline* in growth should alone raise serious questions about the Fund's policies and practices.[7]

In this paper, I will make the case that the Fund's ideology has led to its neglect of important factors when issuing policies. This paper will be organized as follows: first, it will outline two chief constituents of the Fund's neoliberal policies – market liberalization and privatization – while delineating the problematic implications of each for economic growth. Second, this paper will demonstrate that, despite these prescribed policies' stated purpose, the IMF's structural adjustment programs (SAPs) impose a negative effect on economic growth. Third, this paper will question the IMF's neutrality, demonstrating how its constitutional structure tends to serve the best interest of wealthier nations, notably, the United States. Fourth, this paper will put forth some prevalent arguments in defense of the IMF, concluding however, that they are inadequate in accounting for the Fund's critical shortcomings. Lastly, this paper will advance some recommendations for reform of the IMF, arguing that the principles guiding the IMF's development policies must be modified to recognize economic differences across countries, allow room for flexibility, and shape policies that will not only lead to economic growth or a desired level of inflation, but also to an increased standard of living for the average citizen.

II. Market Liberalization and Privatization

The IMF tends to employ economists who generally assume a "standard competitive model"[8] and accept that free market fundamentalism (sometimes referred to as neoliberalism), will lead to large economic growth, characterized by high GDP and low inflation. Market trade liberalization – i.e. increased openness to international trade – is a key component of this neoliberal doctrine. The IMF's trade liberalization programs are expected to increase efficiency, attract foreign investors, and increase the welfare of the country's citizens. As Joseph Stiglitz (2002) points out, however, "the way it [trade liberalization] has been pushed by the IMF has been far more problematic."[9] While trade liberalization is supposed to create jobs by moving resources from "inefficient, protected sectors to more efficient export sectors"[10], with the IMF's structural adjustment programs, jobs are, in fact, *lost* instead since such programs are routinely accompanied by high interest rates intended to control inflation.[11] Considering that even minor increases in interest rates within *developed* countries such as the United States often severely discourage investment, one can only imagine investor sentiments when the IMF pushes for far higher interest rates in "far less hospitable investment environments."[12] Furthermore, the crisis is often made worse when poorer countries are forced to compete on the global market with highly subsidized American and European (particularly agricultural) industries.[13]

Privatization, another central tenet of market fundamentalism, is a standard condition of IMF agreements.[14] Privatization is the transfer of government owned businesses, agencies, and services from the public to the private sector. Although most economic theories predict that privatization will lead to greater efficiency, productivity, and output, empirical evidence supporting this argument is mixed.[15] To account for this, Stiglitz (2008) explains that the transfer of assets from the public sector to the private must be done at an appropriate pace and to an appropriate degree.[16] Rapid privatization in developing countries, as is often recommended by the IMF, can lead to an "enormous increase in inequality."[17] Such disparities may manifest themselves when basic necessities, such as water and healthcare, are cast into an imperfect goods and services market, thus often becoming unavailable to the poorest majority of the population. Hence, although it is true that businesses and enterprises (which supply private goods) might function better in the private sector, essential public goods often require provision by the public sector.[18]

III. Structural Adjustment Policies and Economic Growth

The IMF's staunch confidence in the free market drives it to impose the policies mentioned above (among others) as conditions for loans to countries in crises. However, the *severity* of the conditions and the *size* of the loans vary from country to country. For instance, countries with the greatest shares in the IMF (that is, the most affluent countries) often receive greater loans with fewer conditions*.[19] Hence, developing countries, which are naturally more vulnerable to crises (due to a high degree of poverty, political instability and/or corruption), are subject to receiving the most austere of conditions. Stiglitz (2002) likens the imposition of IMF policies on a developing country to setting a small boat loose into the rough sea.[20] Even with a prudent and responsible captain, economic liberalization will cause the ship to be thrust back and forth and eventually drowned and left in a deeper state of crisis. This argument, that the Fund's policies leave developing countries in greater financial difficulty, may provide an appropriate explanation for why countries are often required to sign agreements for IMF loans multiple times.[21]

Critics of the Fund claim that the IMF is unaware of its policies' adverse effects. For instance, "the Fund has […] been accused [of] neglecting the needs of the poor and for not taking the social consequences of its conditions into account."[22] Ideally, IMF programs that reduce growth in the short-run would lead to long-run growth once the economy has stabilized.[23] These predictions, however, have not passed the test of rigorous empirical testing and seem to be largely driven by ideology. The Fund's economists are justifiably accused of ignoring the negative short-term effects of their policies on a country's economy, falsely confident that the country's growth in the long-run will outweigh all the short-term adversities.[24]

Actually, significant evidence against this claim (that economic growth will occur in the long-run) has been presented, implying that IMF policies have, in reality, had a direct negative effect on economic growth.[25] While addressing the IMF's mission statement of promoting economic growth, Przeworski and Vreeland (2000) state that "if growth is the primary objective, then IMF programs are badly designed" since the two scholars contend that countries that don't enter into IMF programs grow faster than those who do, even if both are facing deficits or foreign reserve crises.[26] Likewise, Barro and Lee (2005) establish that a nation's increased participation with IMF programs have a direct negative effect on its economic growth, contending that a developing nation would be better off to deal with its financial crises *without* IMF programs. [27] To illustrate the potential counterproductive effects of IMF programs, one should look to East Asia during the late 1990s, a region which was experiencing rapid economic growth during the 1960s, -70s and -80s. It was not until these economies "succumbed to the pressures from the outside" (i.e. from the IMF, the US Treasury, etc.) with the rapid liberalization of their financial and capital markets, that they encountered serious economic problems.[28]

Moreover, critics of the IMF claim that the Fund's ideology has caused it to lose sight of its core objectives.[29] Consider Argentina, for instance, to whom the Fund granted an 'A' grade for the maintenance of a balanced budget and low inflation, in spite of soaring levels of unemployment.[30] This example illustrates how the objective of a stable budget and moderate inflation superseded the welfare of the average citizen. The Fund's neglect of high unemployment rates is often attributed to its economists' fervent neoliberalism, which naively assumes that in a perfect market – where the demand for labour always equals its supply – all unemployment is voluntary.[31]

In other cases, we see the vast majority of a country's population becoming poorer, while a few at the top are receiving ever-increasing incomes.[32] Despite the rising GDP that such a country might enjoy in the aggregate, growing *inequality* means that the average citizen is, in fact, worse off. As such examples demonstrate, the IMF's pursuit of increased national income, low levels of inflation, and balanced budgets, has become an end in itself, rather than the means to "more equitable and sustainable growth."[33]

IV. Lack of Neutrality and American Influence within the IMF

The Fund's role as a *neutral* international organization that oversees the global financial system is often questioned by critics who accuse the United States of using the IMF as a tool to influence foreign policy.[34] The IMF requires each of its members to pay a membership fee in the form of a quota based on its relative economic size. [35] The largest of the Fund's shareholders, the United States, holds 17.5% of the Fund's total quotas, which is almost three times that of the Fund's second largest shareholder, Japan at 6.3%.[36] This advantage has made the United States the most influential member of the IMF, especially when decisions on loan agreements are concerned. [37] In fact, many scholars (e.g. Dreher (2009), Vreeland (2005), Barrow and Lee (2005)) demostrate that countries which frequently vote with the United States on 'key issues' at the United Nations, are more likely to receive a favourable IMF program.[38] Thus, it may be argued that the United States uses IMF programs to reward countries that stand with it on key issues, and punish those who do not.[39]

Furthermore, the American influence on the Fund's decisions can be further explained by Barro and Lee (2005) who have demonstrated a positive relationship between the number of nationals employed at the IMF (that is, the number of professional staff from a given country), and the size and probability of the same country's IMF loans.[40]

V. Defending the IMF

IMF supporters claim that the institution plays a critical role, by providing a global forum for the exchange of ideas and economic practices – a forum, without which a globalized world such as ours today could not do.[41] Fund advocates stress in particular that, although the IMF's 'sister organization', the World Bank, plays the role of alleviating poverty, poor countries can greatly benefit from the Fund's macroeconomic expertise and resources, especially since the Fund offers loans at rates that are practically impossible to find elsewhere.[42]

The Fund's enthusiasts often feel vexed when the IMF is blamed for being the bearer of bad news, continuously reminding critics that bad financial management of a government often leads countries into crisis, and it is in such times when they turn to the Fund for help.[43] Although the Fund arrives in difficult times, the argument goes, it brings with it programs and conditions that, if completed properly, will assuredly lead to output growth and a decline in inflation.[44]

In defense of the ostensibly short-term negative effects of the IMF's structural adjustment programs, proponents of the Fund claim that these policy conditions play certain vital roles. They argue primarily that the IMF's existence depends on restoring its funds, and these programs' chief objective is "to secure the revolving character of the Fund's resources."[45] It is claimed that a commitment to IMF-style policy reform is the best and only way to guarantee a country's return to economic health and ultimately, a repayment of its debt to the IMF.[46] As stated by Thomas Friedman (1999), "when it comes to the question of which system today is the most effective at generating rising standards of living, the historical debate is over."[47] According to neoliberal thinkers, the free market is the most efficient and effective path to economic growth.

Furthermore, believers in the free market claim that Fund conditions are a perfect way to induce governments to implement 'ideal' policies that they would not otherwise choose. And since, according to free market advocates, aid is only effective in countries with sound fiscal policies, the imposition of such policies is imperative to economic growth. [48] On this view, the IMF takes on a paternalistic role and uses conditionality as a means of restricting the way its loans are spent and preventing the recipient from abusing the money.[49]

Although defenders of the IMF advance some strong arguments (for example, the necessity of an organized forum for global economic communication), evidence that the Fund's conditions serve as an inadequate means of restoring economic health still remains. If the imposition of conditions is necessary to maintain the Fund's 'revolving character', then we should see evidence of two things. First, there should be evidence that the imposed conditions *increase the likelihood of debt repayment*. Second, there should be evidence that, as a result of IMF conditions, the *economic policies of the country in crisis are reformed for the better* , so that a second (or third or fourth) round of IMF aid is unnecessary. Unfortunately, empirical evidence fails to confirm either of these two points.[50] Moreover, the paternalist argument – that the IMF knows what is best for its member countries – is a very weak one, since in practice, the Fund does not seek detailed knowledge about each country, but rather approaches aid as a 'one-size-fits-all' program.[51]

As for the argument that the Fund's conditions constitute the best option available to countries in crisis, Jeffrey Sachs (1999) offers some alternatives that may address these problems more effectively than turning to the IMF. For instance, he suggests that temporarily suspending a borrowing-country's short-term debts may provide a needed sigh of relief. Or, he maintains, there may not be a need for a creditor such as the IMF at all, recommending that countries adopt 'debtor-in-possession' financing, where the government commits a tranche of *x* dollars in savings to recovering debts, as an alternative to seeking IMF loans.[52]

VI. Recommendations for Reform

Not only has it been demonstrated that the IMF's structural adjustment programs rarely generate economic growth, but it is apparent that the inherent principles underlying the SAPs' conditionality policies produce very little empirical support. Moreover, the status of the IMF as an *international* organization has been criticized by many who claim that the Fund's very constitution lacks an indispensable characteristic: neutrality. That said, the concept of a global financial institution, which provides policy advice and financing to countries when needed, is one worth merit and the role of the IMF should not be rejected entirely. Instead, this paper calls for certain crucial structural and policy reforms within the Fund.

Firstly, it should be recognized that the ideology that shapes and directs IMF policies has not offered any sustainable solutions to macroeconomic problems, especially ones that concern developing countries.[53] Stiglitz (2002) explains that currently, the "rules of the game"[54] are dictated exclusively by the *financial* community, a community that adheres to a predominant neoliberal ideology and worldview.[55] Under such conditions, "empirical support for the position [market fundamentalism] is viewed as hardly necessary."[56] Accordingly, the Fund must revise its founding economic principles and expand its vision of the world's economic needs in order to provide meaningful and equitable growth. Likewise, the Fund's decision making, which is currently limited to financial voices only, should be made accessible to concerns from other sectors, such as those which focus on citizen welfare and wellbeing.[57]

Second, the formulation of policies should not be confined to Washington's walls, nor should SAP policies be crafted by economists who have likely spent a mere three or four weeks in the country in question. Rather, IMF policies should be developed by *local* "highly educated, first-rate economists"[58] who are culturally aware and posses a profound knowledge of the political and economic milieu of their respective countries.[59] Furthermore, the receiving governments should be empowered and given the opportunity to experiment and judge what policies work best for them.[60]

As for the Fund's policies, its prescribed fiscal discipline can be more beneficial if it is relaxed. While governments should not divorce themselves entirely from the market, a balance must be established between the two extremes.[61] Although the actual role and degree of the state's involvement may vary from country to country, regulating financial institutions and providing essential public services are often best left to governments.[62] Furthermore, governments should assume greater responsibility in determining the development path best suited to their country (albeit, with the aid of the IMF and professional economists), with the Fund abandoning its 'one-size-fits-all' approach. [63] To be clear, however, although I believe that receiving-governments ought to be given the liberty to decide what policies are best suited for their countries, I recognize that such governments will not always do so in an equitable and non-corrupt way.

Lastly, the success of IMF policies ought to be evaluated by a broader set of criteria. The Fund's strategies should aim to lower unemployment rates, provide an adequate standard of living for the *average* citizen (versus the economy in the aggregate), and make provisions for environmental sustainability.[64] While increasing GDP has been central to the IMF's objectives, the distribution of wealth has been a frequently neglected issue.[65]

VII. Conclusion

Even a passing glance at the development strategies being pursued across countries today confirms the fact that the IMF's neoliberal views have pervaded the global economy.[66] This ideology of the IMF has enabled it not only to ignore the lacking benefits of its policies, but also to disregard the severe costs of imposing austerity measures on developing countries.[67] Stiglitz (2002) describes the current global economic system as "global governance without global government."[68] This claim accurately depicts the lack of "democratic accountability" that characterizes international financial institutions (such as the IMF and the World Bank) today.[69] He further states that these institutions are neither serving the general interest, nor guaranteeing any equitable results, since the Fund is rarely interested in hearing the perspective of borrowing countries on strategies for their own growth and development.[70] Critics have even gone so far as to label the IMF as a "colonial ruler."[71]

In order for the International Monetary Fund's aid to bear fruit, some key adjustments must be made to the Fund's cardinal philosophy. The IMF must allow governments and markets to work as complementary contributors to a country's economy, recognizing that markets can fail, and acknowledging the state's vital role in confronting those failures.[72] Moreover, the IMF must revise its objectives to encompass more than increases in GDP. A sustainable increase in living standards, the promotion of equitable development, and the fair distribution of wealth should become objectives that hold significant weight for the International Monetary Fund.[73]

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* Some might respond to this by asserting that such wealthier nations receive more lenient policy conditions because they have *already* implemented the recommended neoliberal policies necessary for economic growth. This argument is a weak one, however, since, in practice, developed nations such as the US rarely apply the policies advocated by the IMF to their own economies.

Notes:

[1] Michael D. Bordo, "The Bretton Woods International Monetary System: A Historical Overview" in *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*. ed. Michael D. Bordo and Barry Eichengreen. (Chicago: University of Chicago Press, 1993), 28.

[2] "About the IMF Overview"; available from http://www.imf.org/external/about/overview.htm; Internet; accessed 28 October 2009.

[3] Ibid.

[4] Joseph E. Stiglitz, "Is There a Post-Washington Consensus Consensus?" in *The Washington Consensus Reconsidered: Towards a New Global Governance*. ed. Narcis Serra and Joseph E. Stiglitz. (Oxford: Oxford University Press, 2008), 42.

[5] Joseph E. Stiglitz. *Globalization and its Discontents* (New York: Norton, 2002), 53.

[6] Ibid., 44; Adam Przeworski, and James R. Vreeland. "The Effect of IMF Programs on Economic Growth." *Journal of Development Economics* 62 (2000): 399.

[7] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reconsidered*, 44.

[8] Stiglitz, *Globalization and its Discontents,* 35.

[9] Joseph E. Stiglitz, "Globalism's Discontents" *The American Prospect* 12, no. 1 (2002): [no page number available]

[10] Ibid.

[11] Ibid.

[12] Ibid.

[13] Ibid.

[14] Nancy E. Brune, Geoffrey Garrett, and Bruce Kogut. "The International Monetary Fund and the Global Spread of Privatization." *Occasional Paper Series: UCLA International Institute* (2003): 2.

[15] Ibid.

[16] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reonsidered*, 48.

[17] Ibid.

[18] Stiglitz, *Globalization and its Discontents,* 53.

[19] Robert J. Barrow, and Jong-Wha Lee. "IMF Programs: Who is Chosen and What are the Effects?" *Journal of Monetary Economics* 52, no. 7 (2005): 1249-1250.

[20] Stiglitz, "Globalism's Discontents," [no available page numbers]

[21] Joseph P. Joyce. "The Adoption, Implementation and Impact of IMF Programs: A Review of the Issues and Evidence." *Comparative Economic Studies* 46, no. 3 (2004): 467.

[22] Axel Dreher. “IMF Conditionality: Theory and Evidence.” *Public Choice* 141, (2009): 234.

[23] Przeworski and Vreeland, “The Effect of IMF Programs on Economic Growth,” 399.

[24] Stiglitz, *Globalization and its Discontents,* 36.

[25] Przeworski and Vreeland, “The Effect of IMF Programs on Economic Growth,” 399; Barrow and Lee, “IMF Programs: Who is Chosen and What are the Effects?” 1246-1247.

[26] Przeworski and Vreeland, “The Effect of IMF Programs on Economic Growth,” 403.

[27] Barrow and Lee, “IMF Programs: Who is Chosen and What are the Effects?” 1265.

[28] Stiglitz, “Globalism’s Discontents,” [no page numbers available]

[29] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reconsidered*, 43.

[30] Stiglitz, *Globalization and its Discontents,* 27.

[31] Ibid., 35.

[32] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reconsidered*, 47.

[33] Stiglitz, *Globalization and its Discontents,* 53.

[34] James R. Vreeland. “The International and Domestic Politics of IMF Programs.” *The Midwest Political Science Association”* (2005): 3.

[35] “About the IMF Overview”; available from http://www.imf.org/external/about/overview.htm; Internet; accessed 1 November 2009.

[36] Barrow and Lee, “IMF Programs: Who is Chosen and What are the Effects?” 1247.

[37] Ibid.

[38] Vreeland, “The International and Domestic Politics of IMF Programs,” 4; Dreher, “IMF Conditionality: Theory and Evidence,” 251; Barrow and Lee, “IMF Programs: Who is Chosen and What are the Effects?”, 1247.

[39] Vreeland, “The International and Domestic Politics of IMF Programs,” 4.

[40] Barrow and Lee, “IMF Programs: Who is Chosen and What are the Effects?” 1250.

[41] Kenneth Rogoff. “The IMF Strikes Back.” *Foreign Policy* 134 (2003): [no page numbers

available]

[42] Ibid.

[43] Ibid.

[44] Joyce, “The Adoption, Implementation and Impact of IMF Programs: A Review of the Issues and Evidence,” 463.

[45] Dreher, “IMF Conditionality: Theory and Evidence,” 233.

[46] Ibid., 238.

[47] Thomas Friedman, *The Lexus and the Olive Tree: Understanding Globalization* (New York: Farrar, Straus and Giroux, 1999), 103.

[48] Dreher, “IMF Conditionality: Theory and Evidence,” 257.

[49] Ibid., 241-242.

[50] Ibid., 251.

[51] Stiglitz, *Globalization and its Discontents,* 34.

[52] Jeffery Sachs. “The International Lender of Last Resort: What Are the Alternatives?” *Federal Reserve Bank of Boston*, (1999): 185-186.

[53] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reconsidered*, 41.

[54] Stiglitz, “Globalism’s Discontents,” [no page numbers available].

[55] Ibid.

[56] Ibid.

[57] Ibid.

[58] Stiglitz, *Globalization and its Discontents,* 35

[59] Stiglitz, *Globalization and its Discontents,* 35.

[60] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reconsidered*, 54.

[61] Ibid.

[62] Ibid.; Stiglitz, *Globalization and its Discontents,* 53.

[63] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reconsidered*, 53.

[64] Ibid., 54.

[65] Ibid.

[66] Stiglitz, “Globalism’s Discontents,” [no page numbers available]

[67] Ibid.

[68] Ibid.

[69] Ibid.

[70] Ibid.; Stiglitz, *Globalization and its Discontents,* 40.

[71] Stiglitz, *Globalization and its Discontents,* 40.

[72] Stiglitz in Serra and Stiglitz, *The Washington Consensus Reconsidered*, 47.

[73] Ibid.

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