Crises and the Bretton Woods Institutions and the Crises of the Bretton Woods Institutions

Howard Stein

Professor

Center for Afroamerican and African Studies (CAAS)

University of Michigan,

505 S. State St.,

4700 Haven Hall

Ann Arbor, MI 48109-1092

howstein@umich.edu

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"Today, the only crisis faced by the I.M.F. is a crisis of identity. Countries rescued in the 1990s have mostly repaid their debts. With a shrunken loan portfolio, the institution that lectures others about finances has lost operating income and is running a deficit. It faces cuts in its staff and salaries and is even considering the sale of its gold bullion reserves. 'What might be at stake today is the very existence of the I.M.F…' (Dominique Strauss-Kahn" Steven Wiseman "IMF Faces a Question of Identity" New York Times, Sept. 28, 2007)

"In a sign that more national bailouts may be needed to prevent what has become a global financial crisis from worsening, the International Monetary Fund is expected to borrow $100 billion from Japan and may even issue bonds, an unprecedented step in its 64 year existence" Nelson D. Schwartz;. Dominique Strauss-Kahn has already said it needs to double its available resources and the fund was exploring options for further lending to cash-poor nations totaling about half a billion dollars in the next six to eight months"As Bailouts Mount, Monetary Fund Weighs Issuing Its Own Bonds" NY Times, Friday, January 30, 2009

"While the United States debates the details of how to spend a trillion dollars or more to bail out and stimulate the economy, the governments of some other countries find themselves in the credit squeeze. In Latvia, the government got a bailout from the International Monetary Fund by agreeing to draconian measures that include wage cuts, spending reductions and tax increases. There were riots. Floyd Norris "Danger of Government Directing Capital" NY Times, Friday, January 30, 2009

The arrival of Barack Obama to the White House, a democrat of great popularity among the Argentineans, may create a situation in which Argentina will knock again at the doors of the IMF. As a consequence of the pressure created by the need to pay millionaire debts, by the need of dollars, and by the lack of alternative lenders, Cristina Kirchner's administration may renew its friendship with the organization that she criticized so many times and that now can be described as the "Obama Fund", a much more politically correct option for the official discourse. But this sharp shift will not be easy, not economically neither politically? (La Nacion, January 25th 2009).

“Africa is at a turning point… the improvement, in part, [is due] to the fiscal discipline advocated by the World Bank and the International Monetary Fund in the late 1980s and early 1990s….many nations managed to reduce debt, tame inflation and set competitive exchange rates, setting the stage for economic growth.” .” (John Page chief economist for Africa, quoted in NYTimes, November 15, 2007-“ World Bank Reports Progress in Sub-Saharan Africa)

Introduction

The daily focus in the media on the financial crisis in the United States and Europe has overshadowed discussions of the impact of the crisis on the poorest regions of the world where millions of people live the edge of an abyss that threatens their survival. Moreover, in the wake of the crisis, and as a result of the recent G20 meeting in November, there are discussions to greatly increase the resources and authority of the Bretton Woods Institutions with barely a whisper about their role in promoting an agenda which has been largely antithetical to the development process. Countries that had sworn they would not deal with the Fund have reversed course and are back at the door of the IMF with hat in hand now legitimized because (as the quote above indicates) we now have an “Obama” IMF. This policy brief will focus on recent lending patterns of the Bank and Fund, the impact of the new crisis on Bank and Fund policy, and the relationship between their policies and those that have generated the current crisis and the impediments to reform. This are all complicated issues which in the spirit of a policy brief can only be handled with little detail or analysis. However there are dangers in continuing with the past trajectory of the Bank and Fund whose strategies have left poor countries structurally enfeebled and susceptible to feeling the full effects of the global downturn. We will begin with a brief background with a focus on recent Bank and Fund lending patterns.

Background

The lending from the World Bank’s two main groups the IBRD and IDA grew rapidly in the 1980s and peaked in Fiscal Year 1999 at $29.996 billion. The trend is illustrated in Figure 1.1 below. Table 1 follows up the data in the figure with year by year lending patterns.

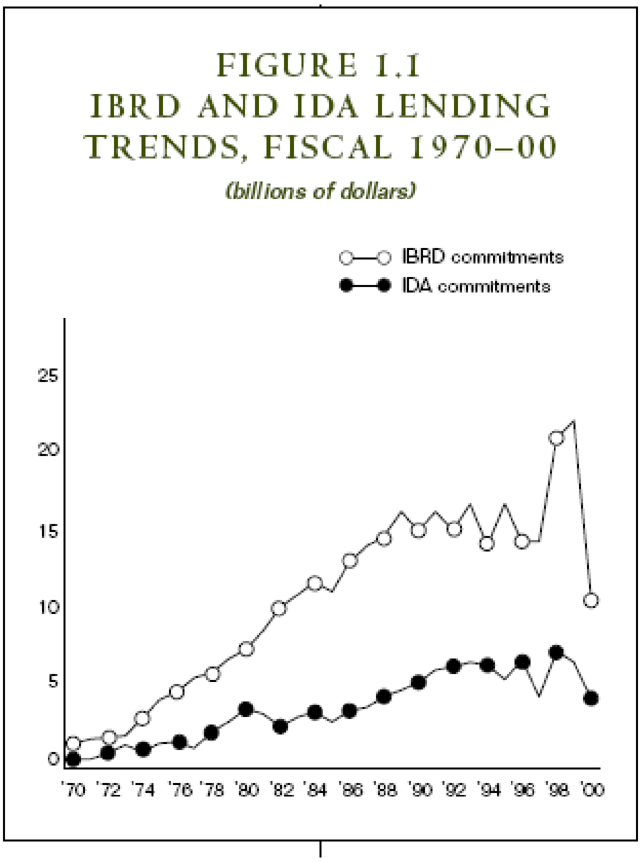

FIGURE 1.1
IBRD AND IDA LENDING TRENDS, FISCAL 1970–00
(billions of dollars)

Source: World Bank, 2000

IBRD and IDA Lending 1992-2008 (millions SDRS)

Year	92-97	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
IBRD	15,368	21,086	22,182.3	10,919	10,487	11,452	11,231	11,045	13,611	14,135	12,829	13,468
IDA	6,175	7,508	6,813	7,282	8,068	6,764	4,358	9,035	8,696	9,506	11,867	11,235
Total	21,543	28,.594	28,996	18,201	18,555	18,216	15,589	20,080	22,307	23,641	24,696	24703

Source: World Bank, 2000, 2004, 2008

In the wake of the Asian crisis in 1997 IBRD lending in 1998 and 1999 dramatically increased by roughly a third and then fell off as countries especially those in the middle range of incomes repaid their loans after the economic recovery. Lending through 2008 by the IBRD never returned to the levels of the pre-crisis 92 to -97 period as richer developing countries got access to alternative financial sources without the baggage of neo-liberal conditionality. The option is not available for poorer countries. IDA loans as a portion of lending increased from around 29%

of the total in the 92 to 97 period to 47% in 2007-8. Increasingly it is the poorest of the poor that have received the lion's share of World Bank money and with it the baggage of conditionality. The share of IDA lending to sub-Saharan Africa went from 36% in 1997-99 to 50% in 2008 (World Bank, 2000, 2008). A similar phenomenon has occurred with IMF lending.

Between 1992-97, concessional credit (to low income countries) as a portion of total outstanding credit averaged 13.6%. By 2007 the average grew to 39% of the total.[1] After 2003 the peak year for outstanding GRA (general resource account) levels, countries rapidly repurchased their GRA balances and did their best to avoid any additional loans with its dreaded neo-liberal conditionality. Poor countries did not have the exit option. [2]After, 2005 reductions in outstanding concessional loans were through the MDRI mechanism for HIPC completion point countries, which contained all the usual neo-liberal baggage.

Outstanding GRA credit from the richer countries fell by an unprecedented 91% by 2007 from $65 billion to a mere $6 billion a level not seen since the 1970s (IMF, 2008). The revolt began in 2005 when Argentina and Brazil denounced the neo-liberal agenda of the Fund and began repaying nearly $25 billion in loans. This was followed by repayments from large debtors including Indonesia, Philippines, Serbia and Turkey. The unprecedented decline in the use of IMF resources through the GRA, the major source of income for the Fund, led to the threat of large losses and the announcement of $100 million dollar cost reduction plan at the Fund in April, 2008 (IMF, 2008).

The economic crisis has now remarkably improved the fortunes of the Bank and Fund and re-empowered these agencies. Between November 5, 2008 and January 12, 2009, the Fund has already committed $47.9 billion of lending to seven countries (Hungary, Ukraine, Iceland, Pakistan, Latvia, Serbia and Belarus)(IMF, 2009d).

Turkey is also on the verge of an agreement. On January 26, the IMF proudly announced in a press release that "The mission and the authorities made significant progress in a number of key areas" and that further focus would be on "the medium-term structural and fiscal reform agenda" (IMFc, 2009). Serious discussion between Turkey and the IMF is an extraordinary reversal in events. Turkey was quite pleased to complete their agreement with the IMF in May. By November they were openly resisting a return to the IMF to avoid "the awkward prospect of

[1] Between 2004 and 2008 concessional loans relative total outstanding averaged 25.8%. IMF figures come from http://www.imf.org/external/np/fin/tad/extcred1.aspx.

[2] Contrast the bold denunciations of the Fund by people like Nestor Kirchner with the comments from the President Ortega of Nicaragua mild rebuke "It is a blessing to be free of the Fund, and for the Fund it will be a relief to rid itself of a government that defends the interests of the poor". Meanwhile he signed a new PGRF arrangement with the Fund in July, 2007 with some vague plans of ending loans after five years (Bretton Woods Project Update 56"Just say no Vocal rejection of Bank, Fund increasing" July, 2007

being forced to accept stringent fiscal conditions" (NY Times, November 7, 2008 Landon Thomas "Turkey Tries to Resist Aid From IMF"). However, the previous decade of relations with the IMF, created extraordinary structural weaknesses, which meant that the May, 2008 completion would be a brief respite before Turkey would be pushed back into the waiting arms of the Fund. As the Turkish economist Erinc Yeldan argued in June, 2008 The high interest rates encouraged by the IMF post-crisis program attracted short-term capital flows. The appreciated exchange rate facilitated a large increase in private consumption and investment good imports leading to an expansion in the current account deficit to 7.5% by 2008 and rising unemployment rates into the double digits. The IMF imposed austerity to reduce the government expenditures and led to a serious shrinkage in education and health infrastructure. In many ways Turkey's predicament is similar to many other countries

> Turkey's post-crisis adjustment under the AKP administration traces the steps of many developing countries which are dependent upon foreign capital and conditioned to adopt or maintain contractionary policies in order to secure "investor confidence" and "international creditworthiness". They are restricted to a balanced budget, entrenched fiscal expenditures, and a relatively contractionary monetary policy with an ex ante commitment to high real interest rates (Yeldan, 2008)

Given the fragility of the economy and darkening external environment Yeldan predicted Turkey's future stability will be "more costly and difficult".

The World Bank too has recently been resurrected in places like Latin America. In Sep. 2007 - January 2008. lloans to Latin America totaled only USD 742 million (104.8 out of that IDA). In the period Sept. 2008-January 2009 the total was a bit more than 3 BILLION! (97 million out of that IDA)(World Bank, 2009).

Bank and Fund Track Record: Has anything been learned?

Yeldan's depiction of typical IMF policies is quite accurate and duly admitted by the Fund. From the IMF factsheet on "Crisis and IMF Lending" from November 2008, it is argued that "the domestic sources" of economic crises can only come from "excessive monetary creation, unsustainable fiscal deficits, an overvalued domestic currency, political instability, and natural disasters". Nothing is mentioned about the behavior of any domestic private sector actors.

The focus on these domestic causes of crises occurs largely because of the theoretical underpinnings of the IMF approach which is based on the Polak model 1950. The approach relies on a monetarist formulation that ties credit growth to the balance of payments and comes out of the fixed exchange world of the Bretton Woods era. Like the monetarists, it assumes full employment of resources. There are two key parts to the model: money supply and a fixed exchange rate. Money supply is defined as the domestic credit to the private and public sector plus a country's monetary reserves. Changes in reserves are tied to the country's balance of trade on goods and services and non-traded related currency flows. According to the model, money demand occurs only for use in transactions and not for other reasons. Since the supply and demand for money are assumed to be in equilibrium, any increase in government borrowing would lead to an increase in prices and nominal income, which in turn would increase the demand for imports. This would occur since government borrowing is essentially an increase in the money supply, which must be met with an increase in money demand if equilibrium is to be maintained.

The nominal rise in income would lead to an increase in imports because domestic production of goods would not have changed. Imports would cause the terms of trade to worsen since the country would now move closer to a trade deficit. Likewise, reserves would also fall, as the country's central bank would have to use its reserves to buy extra domestic currency in order to keep the exchange rate fixed. The subsequent lowering of reserves would eventually offset the rise in the money supply. However, a country in this situation would be left with higher prices, worsening balance of payments, and lowered reserves. The lower reserves would encourage speculation against the currency and thereby threaten the stability of the fixed exchange rate of the country.

In exchange for accessing IMF loans, countries were expected to reach financial targets aimed at improving the balance of payments, lowering prices, raising reserves, and thus ultimately maintaining the integrity of the fixed exchange system. Whether the causes of the crises were domestic or external, the model dictated austerity through domestic expenditure contractions, which would be achieved by fiscal retrenchment and credit reductions.

The real world of developing countries, is of course replete with large-scale unemployment. Employing such a model, which takes as given that all resources, including labor, are fully utilized, is absurd. Indeed, policies based on this model have tended to contract economic activity and further exacerbate the already dismal standard of living for the poorer segments of society which is one reason why governments oppose the IMF.

Recent empirical studies have confirmed the negative impact of IMF conditionality on economic growth (Przeworski and Vreeland, 2000; Barro and Lee, 2002; and Vreeland 2003). In the case of the Asia crisis the imposition of austerity on governments with largely balanced budgets and tight control of the money supply helped turn a panic from a private sector speculation into a disaster. In a recent interview of Wing Thye Woo of the Brookings Institute in the Chinese Daily summed up the feeling in East Asia:

> Asian countries, especially those in East Asia, have a deep distrust for the fund, given its "poor track record" during the 1997 Asian financial crisis and "no proof" that it has improved its competence over the years… at the moment no Malaysian, Indonesian and South Korean government could go to the IMF and expect to survive.(China Daily, Dec. 3, 2008, "Bitter IMF Pills Difficult for Asia to Swallow)

South Korea, for example, which desperately wanted to avoid going to the IMF was bailed out in October , 2008 with a $30 billion swap arrangement with the US Fed.

In recent weeks, the Fund has been increasingly hinting that it might shift its direction and support fiscal expenditures to deal with the current crisis. This has become quite explicit in a now widely quoted paper by Antonio Spilimbergo, Steve Symansky, Olivier Blanchard, and Carlo Cottarelli.

They argue that the economic downturn is being driven both by a financial crisis and the collapse in aggregate demand. The latter is frequently ignored by the Fund for the theoretical reasons I have already discussed. Moreover, they indicate the usual options for addressing aggregate demand through devaluations, which is to stimulate exports through monetary policy, are not available. The former because it is a global phenomena and will only lead to competitive devaluations and the latter because it has already been fully utilized in many countries or because the financial sectors have become too dysfunctional for it to work.

> The authors then state that "in these circumstances, the Managing Director of the IMF has called for a sizable fiscal response at the global level. Its precise magnitude should depend on the extent of the expected decline in private sector demand and should therefore be reviewed in light of developments…"(Splimbergo et al., 2008, p. 3)

Before one gets too excited about the possibility of a fundamental shift, the authors add an important caveat:

> while a fiscal response across many countries may be needed, **not all countries have sufficient fiscal space to implement it since expansionary fiscal actions may threaten the sustainability of fiscal finances. In particular, many low income and emerging market countries**…face additional constraints such as volatile capital flows, high public and foreign indebtedness, and large risk premia"(my bold)

The qualifications are made even clearer in an interview with Blanchard and Cottarelli in the IMF Survey Magazine on December 29, 2008 after the release of the paper

> In normal times, the Fund would indeed be recommending to many countries that they reduce their budget deficit and their public debt. But these are not normal times, and the balance of risks today is very different…That said, it is critical that this fiscal stimulus isn't seen by markets as undermining medium-term fiscal sustainability. That would be counterproductive, including in its effects on demand today**. Indeed, we've said that not all countries can afford a fiscal expansion** (Blanchard and Cottarelli interview, IMF Survey Magazine December 29, 2008)

What we have is not a serious rethinking by the IMF, but a statement which justifies the double standard where governments in advanced developed countries can intervene to deal with unemployment and the threats to the standard of living of the population while developing countries are forced to focus on austerity and macrostabilzation so that they "live within their means" which is often ever-shrinking once the Fund officials have disembarked in their capitals from their first class seats.

Moreover, the timing of this pronouncement smells of politics. Even as recently as October, 2008, the IMF position in a study published in their World Economic Outlook took a much more tepid position indicating fiscal policy might have a "moderately positive effect on output growth in advanced economies" but "increases in interest rate risk premiums…render fiscal multipliers negative suggesting that fiscal policy does more harm than good" when applied to emerging markets (p.158). The arrival of new handlers in the election of Obama and the strong commitment to fiscal stimulus within his economic team provides strong incentives for the Fund to be more firm in their commitment.

An examination of recent agreement between the fund and developing countries indicates it is business as usual. The quote above from the New York Times on the "draconian" nature of the policies embedded in the standby agreement to Lativia is an understatement. The conditionality includes a massive 25% cut in public sector wages in 2009, and a huge front load reduction in the lower the expected deficit from 12% to 5% of GDP , one-third from tax increases (regressive VAT and excise taxes)) and two-thirds from across the board massive 25% cut in real spending. Interbank spreads compared to European Interbank market rate have gone from below zero in October, 2008 to over 12% in December which will have a depressing impact on investment levels which already fell in 2008 by 10%. The decline in GDP in 2005 is 5%, but this is likely to be much worse as Latvia defends its pegged currency and quasi marketing board system which will undercut its competitiveness as it did in Argentina (IMF, 2009a). Lined behind the Fund and their conditionality was a loan from the World Bank.

There is also little difference in loans to poor African countries. In December, 2008 the IMF approved a Shock Facility loan to Malawi. The Memorandum of Economic and Financial Policies lays out the usual standard array of adjustments including contraction of monetary expansion to levels below nominal GDP increase, fiscal constraint, movement to unified and floating exchange rates, reduction of inflation to levels below 5%, improvements in governance including the upgrading of the invasive public finance and economic management system which allow donors to monitor expenditures, large increases in interest rates and the freezing of borrowing of ADMARC (the parastatal agency that subsidies fertilizer in Malawi) (IMF, 2009b). The IMF has a checkered history in its battle against fertilizer subsidies to farmers in Malawi .

In 1998 and 1999, the Government of Malawi gave smallholder families a free starter pack of seeds and fertilizer. The result was a national surplus of corn. Bank and other donors pressured Malawi to curtail and scrap the program. At the same time IMF insisted that Malawi sell off its strategic grain reserve for reserve agency to settle its commercial debt. After production plummeted and in the absence of the availability of free seed and fertilizer their was a famine in 2000-02 which killed an estimated 1500 people. In the wake of an even worse crisis, in 2005 the Malawi government implemented a fertilizer subsidy program to enable 2 million households to buy fertilizer and seed at a rate of 1/3rd the retail price. The World Bank and donors were dead set against it so Malawi financed it from their own budget. As a result Malawi had a surplus of nearly 1 million tons of maize and became an exporter to other countries (Stein, 2009). The Fund, for the moment is resigned to its existence largely because some bilateral donors like DFID belatedly came around to supporting it after vehemently opposing subsidies. However, as we can see, the loan is being used to apply pressure to limit its activities. In all IMF requires an onerous 35 mostly daily reported quantitative targets to fulfill the terms of the loan.

A review of the conditionality of loans by the World Bank to Latin American discussed above indicates they have has the usual terms including increasing transparency of the public sector, for fiscal purposes – fiscal discipline, to stimulate good governance and a more efficient administration, etc.

Conclusions: Way Forward

A number of the policy strategies in the US and elsewhere that generated the current global crisis (financial liberalization, deregulation, state retraction in social spending, privatization, internationalization of banking, etc.) are similar to those imposed by the Bank and Fund on the least developed countries for more than a quarter of a century. While developed countries are fearfully focused on the possibility of a depression, the least developed countries have been in a Great Depression for decades as a result of these policies.

SSA African GNI per capita fell by more than 40% from 1980 to 2002 (World Bank, 2005). While there has been a rise since then, the boom was largely as a result of a temporary increase in commodity prices particularly in oil which has not funneled down to the most of the population. From 2002 exports from SSA countries (excluding South Africa) tripled. Roughly 88% of the 94 billion rise in merchandise exports from non-South African SSA between 2002 and 2006 are fuel related (UNCTAD, 2008)from a handful of countries and will not be sustained in the wake of the collapse of commodity prices. Despite the Bank's boasting in the above quote Africa has not turned the corner because of its policies, one might cogently argue that it is in spite of their policies and the increase is likely to be all too ephemeral. SSA and other poor countries are likely to be back in an economic rut as countries feel the full effect of the global downturn and the heavy yoke of the Bank and Fund depression style economic policies.

In a manner similar to the crisis of 1997-98, the Bank and Fund have now been re-empowered and resurrected into a more central role in the global economy. Middle income countries will at some point in the future again exit from the tentacles of the Fund and Bank. However, poor developing countries that are caught in a permanent debt trap with few alternative sources of financing will continue to be dependent on the Bretton Woods twins.

As I have argued in a newly published book, Bank and Fund policies are flawed at a theoretical level (Stein, 2008). Changing the policy strategies will mean a fundamental reconceptualization of what generates growth and development. Not only must economists in the Bank and Fund overcome the weighty baggage of an increasingly narrow and irrelevant economics education, they also must deal with the embedded hegemony of the US which has utilized the Bretton Woods institutions as an adjunct of their foreign economic policy for far too long. Prospects of an Obama administration agreeing to serious reform are rather dim given the centrality of Larry Summers and Timothy Geithner in the economic policy arm of the executive branch. Summers was a key architect in the institutionalization of neo-liberal policies at the World Bank when he was chief economist and also played a crucial role as undersecretary of the treasury in the completion of the anti-developmental Uruguay round. Timothy Geithner is of course a former senior IMF official.

The road to reform is daunting but imperative. Like the depression of the 1930s, we must use this moment to intrepidly challenge entrenched interests and the policies that for far too long have been perpetuated at the expense of the poor and dispossessed.

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