The IMF, World Bank and the G20

Policy Brief: IPD Shadow GN Meeting-May, 2009, Rome

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

"Timothy F. Geithner had led the push to reinforce the monetary fund, and he won more than analysts had expected." Simon Johnson, former chief economist IMF, following the completion of the G20 meeting(Landler and Sanger, New York Times, April 2, 2009)

"Today is the proof that the I.M.F. is back." Dominique Strauss-Kahn, Director, IMF following the completion of the G20 meeting(Landler and Sanger, New York Times, April 2, 2009)

Introduction

The above quote by the Director of the IMF in the wake of the G20 meeting in London, in many ways is an understatement. The economic crisis, G20 meeting and related discussions have not only resurrected an organization who's very existence was in question in 2007, there are proposals now afoot to allocate unprecedented financial and regulatory responsibilities to the Fund. If enacted, the IMF could become the most powerful international financial institution in history. Yet, the discussions about reforming the governance and policy structures of the Fund have been wholly inadequate in view of the miserable track record of the Fund in interventions in developing countries over the past few decades and its history of buttressing US foreign policy. In a similar manner, the crisis has also greatly increased the power of the World Bank who is utilizing the moment to expand its domain and resources with its Cassandra like warnings of the impact of crisis on the world's poor and its self-anointed role as the savior of the indigent and dispossessed. This brief is a follow-up and update of the piece written for the New York GN meeting in February and draws on a recently completed book on the World Bank (Stein, 2008; 2009).

Background

In recent years lending by the Bank and Fund has gone through an extraordinary contraction while increasingly becoming the exclusive lenders to the world's poorest countries. In 2005, Argentina and Brazil were the first that denounced the neo-liberal agenda of the Fund and began repaying their loans. This was followed by repayments from other large debtors including Indonesia, Philippines, Serbia and Turkey. Outstanding GRA (general resource account) credit mostly to middle-income developing countries fell by an unprecedented 91% by 2007 to a mere $6 billion, a level not seen since the 1970s. The reason for the decrease of the lending level was that richer developing countries got access to financial sources free from the burden of neo-liberal conditionality that characterized the Fund and the Bank loans. However, this alternative finance has never been a real option for poorer countries that have been unable to escape the clutches of the Bank and Fund. IDA (the World Bank association that exclusively loans to poor countries) increased from 29% of total Bank credit during 1992-97 to an historically high 47% in 2007-08.

The unprecedented decline in the use of IMF resources through the GRA, the major source of income for the Fund, led to crisis inside the IMF. As a result, it announced in April, 2008 a $100 million dollar cost cutting plan. As early as September, 2007 the Fund's Director Dominique Strauss-Kahn indicated the IMF was in a "crisis of identity". Similar financial pressures affected the World Bank. In 2007, IBRD lending, the main income source for the World Bank, was more than 40% below the levels of the late 90s (Stein and Kedar, 2009).

Like a Phoenix rising from the ashes, the economic crisis has now remarkably improved the fortunes of the Bank and Fund. Between November , 2008 and April, 2009, the Fund, just to Europe, committed nearly $55 to Hungary, Serbia, Romania, Iceland, Ukraine, Belarus and Latvia. In March, the Fund created the Flexible Credit Line (FCL) to replace the Short Term Liquidity Facility launched in November. The latter did not attract any takers do to the fear that it would spook financial markets and foster currency speculation (Chowla, 2009). However, in a very short time the FCL has attracted three major applications Mexico, Poland and Columbia. Mexico's application for a massive $47 billion has been approved while Poland and Columbia's applications for a combined total of $30.9 billion are currently being evaluated. The latter loan to Mexico was "hailed as an historic occasion" by a senior Fund official since it was the both the largest financial arrangement in the history of the IMF and was claimed to "a major step in the process of reforming the IMF and making its lending framework more relevant to member countries' needs."(IMF, 2009). This claim will be critically evaluated below. Other loans through the newly created Exogenous Shock Facilities have been given to the DRC, Ethiopia and Malawi. The ESF is allocated to poor countries experiencing sudden declines in terms of trade. Since November billions more have been lent to countries like Guatemala, Iceland, Armenia, Mongolia and Pakistan (Molina, 2009).

The Bank too has greatly expanded loans in recent months to a variety of countries including middle income countries. Loans to Latin American countries quadrupled between Sept, 08 and Jan. 09 compared to the comparable period the previous years. In April, in line with its position as the savior of poor countries in April, Robert Zoellick announced the WorldBank would triple its safety net to $12 billion "to protect the most vulnerable people in developing countries from facing poverty, hunger or disease because of the crisis" (Laidler, 2009).

G20 and the Expansion and "Reform" of the IMF and World Bank

The G20 meeting in early April anointed the IMF to unprecedented heights. Among other things, the Fund received authority to triple its lending capacity to $750 billion and to expand its SDR allocation by an additional $250 billion. The expansion would be done through the New Arrangements to Borrow in which the funds would come from the G20 countries without any change in the existing voting structure of the Fund. This is rather contrary to the joint statement of financed ministers of Brazil, Russia, China and India at the mid-March G20 finance minister's meeting that the borrowing arrangement was to "be a temporary bridge to a permanent quota increase" which would mean the reduction of the dominant voting share of the wealthier countries. Half of the total was already preannounced and included a 100 billion from Japan in January, 100 billion from the EU in March and 50 billion promised at the meeting by China. Similarly, SDRs would be allocated on the current quota system meaning that two-thirds of the total would go to the rich countries of the world.

The expansion of the SDRs comes in the wake of the call by China and others to create a new global reserve currency free of the encumbrances of a single national currency and it's a baggage of domestic political and economic influence. Zhou's March speech explicitly calls for SDRs to fulfill that role. It would go beyond its current accounting role inside the Fund to become a widely accepted means of payment in international trade and in other types of financial transactions (Zhou, 2009). Yet, there is no recognition of the problems of this approach given the current governance of the IMF, the hegemonic role of the US inside of the Fund with its veto power nor the very problematic policy model of the Fund which would be sustained and expanded by this powerful new role.

Recent claims by the Fund of serious reform are on close examination rather suspect. At the center of the IMF claim of "modernizing conditionality" are the new Flexible Credit Lines with their move from ex ante conditionality to ex post conditionality. In addition the Fund will move away from structural performance criteria to program reviews (IMF, 200b). The movement to an "ex ante" approach is more chimerical than real. If lending is fairly short-term (FCLs are one year), the distinction between an ex ante and ex post conditionality rather blurs since if countries slip from their original position the credit arrangement will not be renewed. This is little different from a multiyear lending device with annual reviews and benchmarks. Moreover, there is absolutely no movement away from the pro-cyclical and neo-liberal conditionality that has been the hallmark of the Fund's operational focus for decades. A review of virtually all of the recent loans through mid-April by the Fund shows no change in the content of conditionality or the patterns of suspension for non-compliance. Latvia's loans were recently suspended for failing to cut government spending sufficiently despite the widespread condemnation of the conditionality imposed on the country in December which included a draconian across the board 25% cut in government expenditures (Molina, 2009).

The recently completed FCL agreement heavily emphasizes the "very strong fundamentals" of Mexico which it lists as low inflation and a strong anti-inflationary bias of the central bank, large reserves, cutbacks in government debt, a balanced budget fiscal policy rule and a flexible exchange rate. Despite the rapidly declining growth of the economy which is forecast to be nearly 4% in 2009, the IMF is confident of " the public debt in Mexico remaining manageable under all scenarios, with public sector gross financing requirements set to continue their trend decline as a share of GDP" (IMF, 2009c, p.15). Expecting a further decline in the deficit under this scenario is little different than imposing austerity as part of a package of conditionality. If the deficit does the opposite, then this can readily be used to point to Mexican slippage from their strong fundamentals which can then block any extension of the FCL after a year.

The World Bank too has attempted to use the G20 process to tap new resources and expand its sphere and importance. The IFC for example is attempting to access some of the promised 250 billion dollars for its new global trade illiquidity program. The G20 also asked the Bank to increase lending limits to large countries and to make more finds available to low income countries at market rates, but to only those with "sustainable debt positions and sound policies" Funding for its new vulnerability funds will occur not through the G20 process but through individual bilateral sources. Along those lines the UK recently announced it would reallocate 200 million pound from its aid budget for this purpose (Bretton Woods Project, 2009).

Conclusions

Obama following the meeting argued that the G20 heralded a new age of power to developing countries in which decisions about the future of the global economy would no longer be made by an elite club of Western powers that have set the global rules(Ladler and Sanger, 2009). Simon Johnson's remarks above are a much more accurate reflection of the reality. Timothy Geithner was very eager to enhance the power and influence of the International Monetary Fund and very much won the day at the expense of the developing world. Arguably, Geithner in line with his other efforts to bail out the US banking system is aiming to resurrect entrenched interests and a system which has been a miserable failure to all but the wealthy and privileged; an all too familiar pattern of US administrations that needs to be confronted if we are to use this crisis to shape a better world.

Bibliography

Bretton Woods Project (2009) "News" Bretton Woods Update 65, April 17, 2009

Chowla, Peter "Bigger but not much Nicer" Bretton Woods Update 65, April 17, 2009

IMF (2009a) "IMF Survey Online" (April 17, 21, 24)

IMF (2009b) "IMF Implements Lending Policy Improvements,"

Landler, Mark "I.M.F. Puts Bank Losses From Global Financial Crisis at $4.1 Trillion" NY Times, April 21, 2009

Landler, Mark and Sanger, David "World Leaders Pledge $1.1 Trillion for Crisis" NY Times, April 2, 2009

Molina, Nuria "IMF Emergency Loans: Greater Flexibility to Overcome the Crisis" Bretton Woods Update 65, April 17, 2009

Stein, Howard (2008) Beyond the World Bank Agenda: An Institutional Approach to Development (Chicago: University of Chicago Press)

Stein, Howard(2009) "Crises and the Bretton Woods Institutions and the Crises of the Bretton Woods Institutions" IPD Brief, Shadow GN Meeting, Columbia University, New York, February

Stein, Howard and Kedar, Claudia "The Bourbons of Global Finance" op-ed published by Project Syndicate, March, 2009

Zhou, Xiaochuan "Reform the International Monetary System" Speech, March 23, 2009 (available at People's Bank of China website).