ECONOMY

In New Tack, I.M.F. Aims at Income Inequality

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ECOnOMIC SCENE

What happened to the I.M.F.?
Stay with me. Don’t go. This is not another column about global financial bureaucracy.

To suffering government officials from developing countries who have knocked on its door seeking cash over the years, the abbreviation for the International Monetary Fund has long been understood to mean “It’s Mostly Fiscal” — a play on the lending institution’s single-minded focus on spending cuts.

As guarantor of global economic stability, the I.M.F. long defined success narrowly: sustained growth, low inflation and a balanced budget. The distribution of income, its many critics charged, ranked far too low on its list of interests, if it appeared at all.

But lately the fund’s definition of success has broadened. Last week I interviewed the I.M.F.’s managing director, Christine Lagarde, ahead of its spring meetings in Washington this week, which are held in conjunction with the World Bank.
“I hear people say, ‘Why do you bother about inequality? It is not the core mandate.’ Well, sorry, it is also part of the mandate,” Ms. Lagarde told me. “Our mandate is financial stability. Anything that is likely to rock the boat financially and macroeconomically is within our mandate.”

The new emphasis is hugely important. The International Monetary Fund is the standard-bearer of the so-called Washington Consensus, promoting open markets, small government and limited regulation as the secret sauce of success for the developing world — however the fruits of this success happened to be distributed.

Its new leanings suggest the emergence of perhaps a new consensus: Economic policy cannot be only about promoting low inflation and robust growth. Healthy, stable economies also depend on a reasonably equitable distribution of the rewards.

Ms. Lagarde rejects the notion that the I.M.F. didn’t care about income distribution before. She noted that over the last two decades the institution has put emphasis on ensuring that its programs don’t hurt the neediest. The fund’s own research concludes that its programs have increased spending on education and health in poor countries.

Still, she acknowledges that the I.M.F. is paying more attention now. “Because inequality rose, we had to look at it more carefully and look at whether rising inequality in those societies in the postcrisis period in particular was relevant for the macroeconomic analysis that we do.”

The I.M.F.’s new interest in income distribution meshes with a spate of seemingly unorthodox positions coming from the fund and some of its experts since the financial crisis of 2008. It has come to support some controls on cross-border capital flows. Its research has argued in favor of fiscal stimulus, pointing out its positive impacts on economic growth.

In the latest edition of the World Economic Outlook, the fund subtly makes the case that inflation in the United States and other developed nations should be higher to help pull the world economy out of its morass.

But the newfound attention to income inequality isn’t just another facet of a more liberal, Keynesian economic worldview. The fund’s economists have been producing research that suggests that inequality could make the world economy less stable.
Ms. Lagarde echoes an I.M.F. staff paper issued in January, which suggested that policies recommended by the fund should also be judged for their impact on inequality. “Income inequality can be of macroeconomic concern for country authorities, and the fund should accordingly seek to understand the macroeconomic effects of inequality,” it says.

Jonathan D. Ostry, the I.M.F.’s deputy head of research, and Andrew Berg, another economist at the fund, published a study three years ago suggesting that inequality makes growth less durable: The average stretch of robust growth among relatively equitable industrial countries lasted more than 24 years. In Africa, a much more unequal place, the average was less than 14 years.

A flatter distribution of income, the study concluded, contributes more to sustainable economic growth than the quality of a country’s political institutions, its foreign debt and openness to trade, its foreign investment and whether its exchange rate is competitive.

Earlier this year Mr. Ostry, Mr. Berg and another fund economist, Charalambos G. Tsangarides, published another study about the relationship between inequality, redistribution and growth, in which they took on the argument that what hamstrings growth is not inequality, but government efforts to redistribute income in unequal societies.

“Redistribution can cut both ways,” Mr. Ostry told me. “If the government safety net is going to rule out the really bad outcomes, I might take more risk and thus help the economy grow. But if the government is going to take away my wealth if I take risks, then I won’t take the risks.”

Mr. Ostry and his colleagues found in the data that efforts at redistribution were generally benign. Extreme efforts at redistribution might hamper growth, but even then the pro-growth effects of greater equality cancel out its growth-slowing impact.

And while the links between inequality, redistribution and stability may be hard to pin down with certainty, they are not hard to imagine.

Deep inequality breeds resentment and political instability, discouraging investment. It can lead to political polarization and gridlock, as it cleaves the political system between the interests of the haves and the have-nots. And it can make it more difficult for governments to deal with brewing crises and economic imbalances.
Work by Carol Graham and Soumya Chattopadhyay at the Brookings Institution finds that recent episodes of unrest around the world, including the Arab Spring, Brazilian street protests and the uprising in Ukraine, were fueled not by the poor but by a middle class frustrated by a lack of opportunity to progress further.

It would be a mistake “to focus on growth and let inequality take care of itself,” Mr. Ostry and colleagues wrote, “not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable.”

The I.M.F.’s new emphasis could make a difference for the fund’s clients. Mexico, where I grew up, was run for much of the 1980s under the aegis of some agreement or other with the fund, aimed at restoring the country’s finances and preventing a default on its foreign debt.

It is a period known to Mexicans as “the lost decade.” Public payrolls were culled. Unemployment soared. Wages collapsed. Poverty jumped.

And Mexico’s lopsided distribution of income got worse. According to the World Bank, the share of income taken by the top 10 percent of Mexicans rose to 40 percent in 1992, from 35 percent in 1984. The portion of the pie going to the poorest tenth shrank to 1.6 percent, from 1.9 percent.

An analysis published last year by economists in the I.M.F.’s fiscal affairs department concluded that efforts to curb budget deficits increase inequality, especially if they take the form of spending cuts. It suggested that targeted government spending and progressive taxes could offset some of these effects.

Ms. Lagarde said the fund was taking this new awareness to heart. “When a country member asks for help and we design together with that country a program, we have that in mind,” she said. “When we redesign energy subsidies with that country, we have that in mind. When we try to put in place a social safety net for the poor, we have that in mind. When we recommend better financing of pension schemes, we have that in mind.”

The world may be a safer place for it.

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