International Monetary Fund criticised over support for austerity

The International Monetary Fund’s internal watchdog has criticised the fund’s call for austerity in 2010. The move reopens a heated debate among policy makers about the merit of raising taxes and cutting public spending after the financial crisis.

In a review of the IMF’s response, the independent evaluation office praised the fund’s international lending role but attacked the policy advice it gave in 2010 for governments to start cutting their budget deficits.

The criticism revisits one of the most controversial episodes of policy during the crisis: the decision to withdraw fiscal stimulus from the global economy in 2010 when unemployment was still very high. Critics blame the withdrawal of stimulus for slowing the recovery.

The new debate is crucial, because the policy consensus on what happened in 2010 will affect whether and how fiscal stimulus is used in future recessions.

The IMF called for a large, global fiscal stimulus in 2008-09 and its advice was heeded. In the US and UK, governments ran budget deficits larger than 10 per cent of gross domestic product in 2009.

The fund then changed tack and became an important voice validating the UK’s new austerity measures in the summer of 2010 and US moves toward tighter policy that ended in the showdown over the debt ceiling in August 2011.

“IMF advocacy of fiscal consolidation proved to be premature for major advanced economies, as growth projections turned out to be optimistic,” said the evaluation office. It attacked the IMF for worrying about a debt crisis in the US or Japan “even as these countries’ bond yields were falling to historic lows”.

Christine Lagarde, managing director of the IMF, said she stood by the advice the fund gave in 2010. She did not arrive at the IMF until July 2011.

“Considering the information and growth forecasts available in 2010, I strongly believe that advising economies with rapidly rising debt burdens to move toward measured consolidation was the right call to make,” she said.

“As the report acknowledges, this assessment is benefiting from hindsight,” Ms Lagarde noted pointedly. “Once it became clear that the growth outlook had worsened, the IMF quickly changed gear and adjusted its advice for countries where such adjustment was feasible.”

Most of the IMF’s executive directors – the resident board representing national governments – agreed with Ms Lagarde. “The call for consolidation at a measured pace to protect the budding recovery was warranted considering the growth forecasts available at the time and the need to address fiscal sustainability risks,” said the board chairman, summing up their view.
However, a number of directors agreed with the independent evaluators that the call for fiscal tightening was premature, and it was wrong to rely so heavily on monetary policy.

The evaluation office recommended boosting the fund’s resources by completing reform of the “quota” contributed by each country. That has been held up because the US Congress has failed to approve an international deal struck in 2010.

The watchdog also urges the IMF to draw up guidelines that protect its independence when it works with a partner, as the fund has done in the eurozone as part of the “troika” of international lenders alongside the European Commission and the European Central Bank.

Ms Lagarde endorsed the first recommendation but was cautious about the second. “I can see merit in defining some broadly applicable principles of engagement and co-operation, with the proviso that interactions with other organisations should remain generally flexible and pragmatic,” she said.

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