The IMF’s perestroika moment

GEGI Co-directors Kevin Gallagher and Cornel Ban pen a *Washington Post Opinion article* on the IMF’s evolving institutional views and policies. The article ties into a recent special journal issue of *Governance*, “Has the Crisis Changed the IMF?”

The economic crisis that struck in 2008 challenged many myths. One of them is the myth of the International Monetary Fund (IMF) as a global agent of economic orthodoxy. Since the 1970s, the IMF has been heavily criticized for being insensitive to the diversity of domestic conditions. Its rigid commitment to a conservative view of economic development has been dubbed the "Washington Consensus." However, we argue in a forthcoming special issue of the journal Governance that this conventional wisdom is outdated. The IMF is not what it used to be.

In some of its policy thinking the IMF has undergone deep transformations that often point in a more Keynesian direction. The most radical change has been in the IMF’s research on the systemic risks posed by the interconnectedness of global banks, followed by its views on capital controls, and its interventions in the austerity debate.

Surprising its critics, the IMF has endorsed capital controls - of which it was a staunch opponent for decades - as well as state spending to stimulate the economy under certain conditions. Moreover, it has been sharply critical of the theory - popular with E.U. institutions - that spending cuts reignite growth and has become an advocate of slightly more progressive taxation systems. The IMF now holds a strong preference for more spending on public investment and safety nets as the main instruments in the stimulus toolbox.

Most surprising, perhaps, has been the fact that the Fund’s research and position papers recently began to openly embrace a critical approach to global banks by portraying them as "super spreaders" of systemic risk.
Nevertheless, this is not as radical a departure as it might seem. Rather, it seems that a rather schizophrenic division has come to characterize the IMF's approach to policy research on the one hand and policy practice on the other.

While many of these changes shape the IMF's official view, it is less clear how committed it is to translating them into the way it designs loans programs. Indeed, it was precisely on the regulation of global banks, the issue that saw the most radical doctrinal change, that the IMF has seen the most continuity with its past practice. Also, not much has changed in terms of how the IMF acts regarding relations between states and their creditors.

Another important finding is that none of these transformations have been of the revolutionary kind. Instead, change was slow, evolutionary and uneven. It came in the form of layering innovations or revamping old ideas on top of pre-crisis policy orthodoxy. Most of the time, change was articulated in carefully recalibrated mainstream macroeconomic models.

The result has been a compromise between the Fund's pre-crisis concerns with and its re-discovery of less orthodox economic arguments.

For example, although it called for a massive and coordinated fiscal stimulus in 2008-2009, the IMF retained its conventional concerns with how sustainable bond investors would judge these packages. The compromise was to suggest that countries that did well with financial markets should adopt stimulus programs while announcing fiscal consolidation measures in the medium term.

In contrast, countries where the confidence of financial markets had waned, were advised by the IMF to adopt austerity immediately. For them, the only avenues for growth that remained, according to the IMF, was structural policies and fiscal expansions adopted by trade partners having enough "fiscal space" to do so. Many of our findings were subsequently confirmed by the IMF's own Internal Evaluation Office.

The contributors to this special issue identify three factors that explain these patterns of stability and change: the growing and understudied rifts in mainstream economics, a significant revamping of the Fund's staff and the shifting balance between the main donors of this international organization.

1. Changes in mainstream macroeconomics. During the 2000s an increasing number of mainstream economists challenged the view that fiscal policy is always and everywhere a self-defeating way to counter recessions. This was a significant revision of the conventional wisdom that countercyclical government spending was proven wrong by the stagflation of the 1970s.

This "revisionist" view went mainstream in the IMF during the crisis because its proponents had extensive internal institutional support and were careful to be observant of its commitment to the use of mainstream macroeconomic models sanctioned by the academic mainstream.

Since the IMF has a strong scientific culture that screens out research that is not anchored in methodological frameworks that are perceived by all staff as scientific, the revisionist view had to be articulated through recalibrated mainstream macroeconomic models.

2. Staff politics. Doctrinal change owes a great deal to Dominique Strauss-Kahn, the managing director appointed in 2007, who was a sympathizer of the revisionist view of fiscal policy. He asked Olivier Blanchard, the leader of revisionist...
macroeconomics in academia, to take the helm of the research department of the IMF and brought him into the managing director's office by making him the chief economist of the IMF.

Other appointments at the top, as well as a large contingent of newly hired young economists, strengthened the revisionist camp to the point where it became a critical mass that successfully pushed for official doctrinal changes. Similarly, faced with the reorganization of the IMF's financial surveillance function, IMF staff mobilized to defend their turf against private sector consultants ushered in by the reforms initiated by Strauss-Kahn.

3. The politics of the IMF's principals. France and the large developing countries formed strong coalitions within the G-20 in favor of change. Particularly interesting in this regard is how the BRICS leveraged institutional fora both within and outside the IMF, and took advantage of a shift in thinking among IMF staff and prominent academic economists whose research adhered to the scientific standards upheld by the Fund.

Instead of being reliable allies of Western power, in terms of capital flows, the IMF staff have acted as reflexive actors who used their country experience, new econometric evidence, and new economic theories to push for official policy change on this issue in a way that balances a part of the agenda of the emerging global economic powers as well as the interests of the old principals of the Fund.

These findings are important for ongoing policy debates.

The state of the global economy is far from reassuring. While the crisis of the euro zone seems contained, at least for now, economic recovery remains elusive. Many crisis-stricken countries struggle with unprecedented levels of unemployment and badly damaged budgets for social services, leading more and more citizens to feel effectively disenfranchised. After benefiting from high commodity prices early on in the crisis, some of the most prominent players in the middle-income periphery have seen their economic prospects grow dim.

Most importantly, despite the initial anti-banker furore, the causal generators of systemic risk remain at the heart of the international financial system. And finally, the establishments of the BRICS bank might bring competition to the IMF (and the World Bank).

As such aspects of the political economy of crisis and recovery becomes more challenging, the IMF's recalibration of its economic doctrine and its uneven translation into practice might not be enough. In choppier waters, the Fund may have to redesign the ship at sea and that opens up a new set of challenges altogether.

Read the article on Washington Post site

Read the special journal issue of Governance

Follow GEGI's work on Financial Reform and Global Economic Institutions