The IMF’s Next Five Years

No Rest for the Weary

By Robert Kahn
brink of failure; and the fund’s decision to front one-third of all financing for Europe’s rescue packages had been harshly criticized by emerging-market IMF members as a special deal for the West. Meanwhile, as the global financial crisis began to recede, policy coordination among the major industrial economies became less pressing, and the fund’s efforts to offer policy advice outside of its financial programs ran out of steam. In short, it was unclear whether the IMF would be able to deal with threats then facing the global economy.

As the close of Lagarde’s first term approaches, a brighter assessment is possible. A global recovery has taken hold, and although most of the credit should go to national governments and central bankers, the IMF’s steady support for the European periphery played an important role. The fund has also made progress in granting emerging-market countries greater institutional representation and has improved the breadth and depth of its analysis of the global economy. The next five years, however, will bring new challenges as the fund struggles to come to terms with a rapidly changing global marketplace and with lending rules poorly suited for the crises the institution will likely face.

WHAT WENT RIGHT, WHAT WENT WRONG

Any assessment of the IMF’s performance during Lagarde’s first term has to start with the organization’s role in the European crisis—a role that has been subject to much analysis, including by the IMF itself. The fund’s view, which is largely correct, is
has also faced significant criticism for designing programs for Greece, Portugal, and other states on the European periphery that underestimated the drag on economic activity caused by austerity and insufficiently protected social safety nets. The IMF acknowledged the criticisms to this effect and has committed to modify the design of its programs in response; whether the eventual reforms will be sufficient will become clear only when the next major global crisis hits. At the end of the day, however, it is misplaced to criticize the IMF for excessive austerity: the IMF balance sheet was leveraged to, or perhaps beyond, what was prudent given the need at that time to preserve its firepower in case the crisis spread, and the European programs it supported could not have been much more generous given the amount of financing available from regional governments. A more compelling criticism is that the fund’s European programs, and particularly its Greek program, were overloaded with structural measures that were unlikely to be implemented. Holding Greece’s feet to the fire on a more limited set of market-opening reforms might have been more politically sustainable and provided a much-needed boost to demand.

The fund’s decision to take on a third of the responsibility for financing the European relief packages, moreover, cost the organization some credibility among emerging-market countries such as Brazil and put unsustainable demands on its balance sheet. In the future, when countries without independent monetary policies and with significant constraints on their fiscal policy have a crisis meriting IMF support, the
The IMF’s decision to delay the restructuring of Greece’s debt—first in 2010, when no major policymaker was prepared to risk the contagion that could have resulted from a disorderly default and eurozone exit, and then, more troublingly, in 2011—made clear that the fund’s policies, combined with the tendency of creditor and debtor countries to delay hard decisions, encouraged restructurings that were insufficient in both timing and scope. With respect to Ukraine, too, the IMF’s policies have appeared to be out of touch: the fund’s decision to proceed with a highly risky loan to Kiev in 2014 was justified on geopolitical grounds, but it forced the IMF to adopt unrealistic assumptions about growth and financing to meet its lending rules; the failure of that program and the debt restructuring that followed demonstrated that the fund’s lending rules didn’t match the demands of countries with large financing needs and uncertain economic outlooks.
AN EMERGING CHALLENGE

In the years after the financial crisis, the IMF faced a double-edged challenge with respect to the world’s emerging powers. On the one hand, it was under pressure to grant these countries a greater role in the leadership of the international financial institutions, where their power was incommensurate with their economic clout; on the other, it had to continue pushing for policy reform in many of the same countries.

On both counts, the IMF has struggled. With respect to the institutional representation of emerging-market countries, until this year, the IMF was hamstrung by the United States’ failure to approve a package of reforms agreed to in 2010 that aimed to strengthen the position of rising powers. These measures are modest, but they are nevertheless an important signal that the fund is adjusting to the demands of a multipolar world.

Meanwhile, the establishment of the Asian Infrastructure
currency, have raised questions about the coherence and consistency of a global crisis architecture with the IMF at its center.

The bigger problem, however, is that the IMF failed to fully come to terms with the large imbalances in the Chinese economy that have persisted for much of the period since 2004. To be sure, the fund’s annual reports on China have included warnings about the very macroeconomic problems that have now started to roil global markets. But it seems that deference to Chinese authorities led IMF officials to mute those warnings, limiting their efficacy as signals to markets and the general public. To its credit, the IMF urged Chinese authorities to approach financial deregulation carefully, stressing the importance of carefully sequencing the reforms and placing hard budget constraints on firms before markets were opened. Nevertheless, the fund is still seen by some as having been a cheerleader for the market reforms that led to China’s current crisis. Today’s market turmoil will inevitably damage the credibility of its future efforts on the issue.
years, the organization has made significant progress elsewhere. It has voiced its support for policies that could limit the rise of income inequality; made a compelling case, especially to the energy-exporting emerging-market economies, that trimming down and better targeting energy subsidies can benefit their fiscal and political sustainability; and, in its research papers and public statements, advanced the idea that enhancing the economic power of women in developing countries can profoundly benefit global prosperity. As a predictor of the world’s economic performance, the IMF’s record is less impressive: it has consistently overestimated future growth, a troubling systemic bias that damages the credibility of its policy advice.

WHAT’S NEXT?

In some respects, the issues that the IMF will face in the next five years will reflect the natural evolution of its recent challenges. But the fund will also have to confront new problems that will force the organization to scrutinize and adjust its lending rules.

The first of these challenges involves the constellation of shocks now confronting policymakers: China’s economic crisis, instability in emerging markets shaken by lower commodity...
economic threats in the year ahead, and a crisis in any of those countries would have profound spillover effects. None of the three are close to asking the IMF for financial support, but if that changes, the odds that the IMF will be pulled into sizable interventions on multiple fronts will be higher than it has been in years. Unlike in the case of Europe, however, industrial nations are not prepared to provide large-scale bilateral assistance to address a systemic shock in Latin America, and the fund has a controversial history in the region that might discourage governments from speedily seeking its assistance. These factors make the risks of a potential crisis there especially serious.

A woman stands next to empty shelves at a supermarket in Caracas,...

With heightened risk of a new global economic crisis, it is more
So far, its efforts have fallen short. Although the IMF produces a number of high-quality global reports, such as the World Economic Outlook and the Global Financial Stability Report, and has also created new reports on spillovers and contagion, it has failed to convince countries to adjust their own policies with these risks in mind. The one effort that has explicitly attempted to strengthen multilateral policy coordination—the G20-led Mutual Assessment Process, in which the IMF has played an important advisory role—failed to do so because it couldn’t bridge the divide between trade-surplus and trade-deficit countries over the responsibility of surplus countries to support global demand.

SHARING THE BURDEN

There is a broader issue at play here: the world is getting bigger faster than the IMF is. The rapid growth of financial markets over the past two decades, along with the expansion of the major emerging-market economies and their integration into the global financial system, means that the financial demands of potential rescue packages have ballooned. The IMF attempted to come to terms with these developments in 2002, when it created exceptional access rules allowing lending in excess of what had typically been called for by procedures linking lending amounts to a debtor country’s contributions to the fund. Then, in 2010, the IMF went further, creating the so-called systemic exemption, which allowed it to lend large amounts to Greece, Ireland, and Portugal, ostensibly based on the finding that
shareholders believed the fund needed to act decisively to resolve an economic crisis.) Regardless, it has become increasingly clear that IMF money is insufficient on its own and that in the future, the timing and scale of debt restructurings will increasingly be a function of the funds available rather than whether a country’s debt is above an arbitrary threshold.
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Last month, the IMF eliminated the systemic exemption and announced new rules to guide lending. For one, it has embraced “reprofiling”—restructurings aimed at keeping creditors in the game by extending debt maturities with little loss in market value. It also wants to limit its lending in risky, high-profile cases and to look for other official creditors to take on a significant portion of the burden when the capacity of a government to pay off its debts is uncertain.

The reforms are generally sensible, but they do little to prepare the IMF for crises in regions that lack groups of official creditors willing to provide junior financing, such as Latin America. This deficit will hopefully encourage a broader debate about how to best distribute the burden of rescue packages among the IMF and its partners. How that debate is resolved will help determine whether the fund is an effective leader of the global effort to prevent and resolve economic crises in the coming decades.
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