

Has the IMF Abandoned Neoliberalism?

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IMF public-relations offensives before the joint IMF-World Bank Spring Meetings are not uncommon. But in the wake of the recent chastening impact of the Great Recession, this year's Spring campaign has heightened expectations of real macroeconomic concessions.

After all, the IMF cannot argue that tight financial restrictions are preventing it from offering more flexible conditions. The G-20 Summit in April 2009 pledged to treble the IMF's lending resources to a level of US\$ 750 billion. As a result, the Fund is now disbursing dramatically enhanced levels of credit to client countries since 2006-07 (see Chart).

In light of these factors, should we realistically expect the IMF to abandon some of its guiding Neoliberal tenets? Early signs are not, to say the least, encouraging. This is the conclusion of a newly released Eurodad and Third World Network report, "[Standing in the Way of Development? A Critical Survey of the IMF's Crisis Response in Low Income Countries](#)" (Van Waeyenberge, Bargawi and McKinley 2010).

This report comments that the title of a bell-weather February 2010 IMF Staff Position Note, 'Rethinking Macroeconomic Policy', by Chief Economist Olivier Blanchard and co-authors Giovanni Dell'Ariccia and Paolo Mauro appears to promise significant reform. Seemingly taking a self-critical view of conventional assumptions about its macroeconomic policies prior to the Great Recession, the IMF Note announces on the first page that it seeks to identify "the contours of a new macroeconomic policy framework".

In the end, however, there appears to be an acutely insufficient supply of real rethinking relative to the recent upsurge of aggregate demand for such reform. The Note basically defends the essentials of the pre-crisis IMF framework. As it states on the last page, "in many ways, the general policy framework should remain the same".

But it does appear to open up a few channels for potentially fruitful

discussion. For example, it notes that 1) policymakers should monitor multiple targets, not just the inflation rate, and 2) they should use multiple instruments, including fiscal policies and exchange-rate policies as well as monetary policies. This sounds like it could be an opening to greater policy flexibility. However, the Note is quick to set restrictive boundaries on any reform agenda.

While re-asserting the Fund's pre-crisis macroeconomic position that "the ultimate goals should be to achieve a *stable* output gap and *stable* inflation" (italics added, p. 16), the IMF Note acknowledges that output stability should be accorded more importance than previously was the case. But, in the current context, this stance serves mainly to reaffirm the Fund's fundamental assumption that macroeconomic policies are suited to deal only with short-term stability issues.

This conventional view assumes that if macroeconomic stability is ensured, then private-sector led growth and development will surely follow. The paper published by Eurodad and the Third World Network takes, in contrast, a more development-oriented view of macroeconomic policies, emphasising, for instance, the use of public investment and directed credit allocations to stimulate economic growth and human development. But in this Development Viewpoint, we have space only to focus on the IMF views.

More Targets and Instruments

What does the IMF Note mean when it recommends adopting more 'targets and instruments'? Promisingly, it does question why, prior to the crisis, central banks had been encouraged to adopt as their "primary, if not exclusive, mandate" achieving "stable and low inflation" (p. 3), and to target, in particular, a very low inflation rate of 2%.

The Note offers a significant concession that "the behaviour of inflation is much more complex than is assumed in our simple models and that we understand the relationship between activity and



Source: IMF, <http://www.imf.org/external/fin.htm>

inflation quite poorly” (p. 7). Nevertheless, the authors of the Staff Note focus mainly on the deflationary danger of a Keynesian ‘liquidity trap’ brought on by a severe recession (such as the current one).

Under such a condition, the central bank would be powerless to push the policy interest rate below the obvious 0% nominal limit even though it urgently needed to expand economy-wide liquidity in order to forestall an impending depression. Having been shaken by the prospect of such a trap during this Great Recession and wishing to avoid it in the future, the authors of the IMF Note recommend that the general inflation target should be raised to 4% to give room for more downward adjustment.

So, in the end, it appears that low-inflation targets remain an IMF policy priority. The Note does not even contemplate that inflation in the higher single digits, or even between 10% and 15%, could be compatible with output stability and growth. In fact, it is difficult to understand how such a target would apply to developing countries, where domestic and external supply shocks—not necessarily policy excesses—often produce levels of inflation higher than 5%.

The IMF authors do claim to question the adoption of only one instrument for monetary policy, namely, the policy interest rate. This is the short-term rate over which the central bank can, it is assumed, exercise some influence through open-market operations. However, there is a very shallow market for domestically issued bonds in most low-income countries. So, marketing bonds usually confronts persistently high real rates of interest for either public or private borrowing.

The authors purport to recognise that central banks must also take account of the impact of exchange-rate policies on inflation. And they claim to favour supplementing standard monetary policies with such exchange-rate policies as “reserve accumulation and sterilized intervention”.

But it is difficult to determine how such a new stance fits with the IMF’s long-standing advocacy of fully flexible, ‘market-determined’ exchange rates. In fact, countries that have managed their exchange-rate (such as China) still seem to be suspected of mercantilist ‘manipulation’ of their currency’s relative value for their own unfair export advantage.

Re-evaluation of Fiscal Policies

The IMF Staff Note appears to open up the possibility of according fiscal policies a greater role in macroeconomic management. However, after having recalled that active fiscal policies became the main Keynesian macroeconomic tool in the wake of the Great Depression and that fiscal and monetary policies were later given “roughly equal billing” during the 1960s and 1970s, the IMF authors proceed to justify why, for various reasons, fiscal policies have had to take a backseat to monetary policies in the last two decades.

Revealing a closely held secret, the authors claim that Keynesian *discretionary* fiscal policies have remained valid, all along, for combating “severe shocks”—such as the current Great Recession. But they still insist on confining fiscal policies to this limited, time-

bound counter-cyclical function—as well as (in symmetrical fashion) prudently *restraining* expenditures (namely, building up budget surpluses) during booms.

Revealing their fundamental lack of faith in national fiscal authorities, the authors hasten to place tight limits on any discretion for fiscal policy. In response to the impact of the Great Recession on developing countries, for example, the authors prefer relying on the operation of ‘automatic stabilizers’, such as progressive taxes or social insurance programs.

However, as other IMF Staff Notes (e.g., Berg et al. 2009) have readily acknowledged, such stabilisers as social insurance—whose expenditures would rise automatically during recessions—are virtually non-existent in low-income countries. Hence, providing additional stimulus through a Keynesian-inspired widening of fiscal deficits would most likely have to rely on significant declines in revenue. This is a strange approach, indeed, to endorsing a stimulus package in poorer countries—without pro-actively boosting expenditures.

Such an approach would end up proposing fiscal stimulus a) only at a lower point in a deepening recession, b) only indirectly through assuming, heroically, that rising private expenditures would soon compensate for lower public revenue, and c) only by weakening, in the process, long-term state capacity for revenue mobilisation.

Concluding Remarks

Hence, despite having recently raised expectations about reforms in its fundamental policy stance, the IMF remains a long way from jettisoning the neoliberal underpinnings of its governing macroeconomic framework.

If the Blanchard et al. Staff Note is any guide, there are likely to be very few changes indeed in its standard recommendations to developing countries on monetary and fiscal policies. The IMF’s monetary policies remain wedded, it appears, to strict targeting of a very low inflation rate (apparently only two percentage points higher than before); and its fiscal policies remain restricted to ineffectual, or even non-existent, automatic stabilisers.

On either front, there is virtually no room for national policymakers to exercise any real *discretion*. Thus, the IMF is engaging in only a rhetorical opening up, at best, of any ‘policy space’ for developing-country governments to determine their own macroeconomic framework.

References:

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