The Role of the International Monetary Fund

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The International Monetary Fund (IMF)

• Ensure the stability of the international monetary and financial system

• Resolve financial crisis where they have arisen

• Promote growth and development in member nations
NOT the World Bank

- World Bank focuses on spurring growth in developing nations, mostly in Africa
- Goal of shortening the gap between wealthy and poor nations
Tools of the IMF

- Surveillance (Bilateral and Multilateral)
- Conditional Assistance
- Technical Assistance and Training
Bilateral Surveillance

- Analysis of individual countries financial situation
- Done in conjunction with member nations
- Goal of moving nations towards open trade policies and responsible fiscal policies
Multilateral Surveillance

- Analysis of global and regional trends
- Done in conjunction with member nations and collaboration between nations
- Publishes three semi-annual publications, the World Economic Outlook, the Global Financial Stability Report, and the Fiscal Monitor
Conditional Assistance

- Collateral for loans comes in the form of a country’s commitment to changing the status quo
- Greece Example
  - In July of 2017, the IMF approved a $1.8 billion loan to Greece, contingent on Greece running a budget surplus of 2.2% GDP in 2018, and continuing its other financial reforms
Technical Assistance and Training

- Helps to craft fiscal, monetary, and exchange rate policy
- Designs policies to promote sound regulation and policy
Asian Currency Crisis (1997)

- The devaluation of the Thai baht in July 1997 was followed by currency crises or financial instability in Indonesia, Malaysia, the Philippines, Taiwan, Hong Kong, Korea, Estonia, Russia, Brazil, Australia and New Zealand.
- Commodity producers in emerging markets around the world suffered.
Why did it happen?

- Thailand, like most Southeast Asian countries at the time, was an emerging market and numerous investors lended funds to these nations, with a promise of a much higher return than in developed nations.
- Private debt and later public debt reached enormous levels as borrowing continued to rise against assets.
- Thailand and other SAC countries experienced a large withdrawal of credit and became effectively bankrupt or close too it.
- Joseph Stiglitz and Jeffrey Sachs compare the crisis to a classic bank run spurred by a sudden risk shock.
IMF Response to Asian Currency Crisis

According to the IMF, the solution entails domestic austerity programs to restore the capacity to repay foreign debt, and radical institutional change, including further liberalization of the financial sector.
IMF Response to Asian Currency Crisis

- **Surveillance (Bilateral and Multilateral)**
  - IMF closed banks and financial institutions

- **Conditional Assistance**
  - Financial restructuring to make the financial system operate like a Western one, though without actually saying so. It includes closing down or recapitalizing troubled financial institutions; letting foreign financial institutions freely buy up domestic ones; requiring banks to adhere to international accounting standards

- **Technical Assistance and Training**
  - The solution entailed domestic austerity programs to restore the capacity to repay foreign debt, and radical institutional change, including further liberalization of the financial sector.
  - Pushed for institutional liberalization in finance, corporate governance and labour markets
Evaluation of IMF Response

- Shuttering many banks despite the absence of deposit insurance caused panicky depositors to withdraw their deposits in return for cash.
- Its insistence on cutting demand and liquidity has caused the bankruptcy or radical devaluation of the value of firms that were efficient and profitable, as well as those that were not.
- Push for institutional liberalization in finance, corporate governance and labour markets convinced creditors that the economics were structurally unsound.
- They will forced SAC nations to give up the developmental advantages of a high debt system based on government-bank-firm collaboration in return for somewhat lower risks of financial crashes.

Source: Robert Wade and Frank Veneroso, The Asian Crisis: The High Debt Model Versus the Wall StreetTreasury-IMF Complex
Russian Economic Crisis (1990’s)

- Russia instituted a variety of capitalist piecewise reforms preceding the collapse of the Soviet Union to gradually transition to a market economy.
- The IMF and other Western financial institutions used shock therapy to revive the Russian economy. This mandated a rapid transition to a market economy.
- With the loss of central planning and state owned control over companies, many state corporations were stripped and moved to other nations in large scale foreign investor driven asset stripping of Russia’s previously formidable industry,
Why it Happened?

- After experiencing a catch-up period with attendant high growth rates, the command economy began to stagnate in the 1970s. At this point, the flaws and inefficiencies of the Soviet system had become apparent. Rather than saving the economy, various piecemeal reforms instead only undermined the economy's core institutions. Gorbachev’s radical economic liberalization was the final nail in the coffin, with localized interests soon unraveling the fabric of a system founded on centralized control.
Surveillance (Bilateral and Multilateral)

- To Russia's so-called reformers, the enormous concentration of ownership in Russia that emerged in the 1990s, is of no concern, so long as it generates growth.

Conditional Assistance

- Until 1998, the rouble was overvalued, making it impossible for domestic producers to compete with imports. The IMF did not want Russia to devalue, and it provided billions of dollars to prop up the exchange rate. The IMF and the US Treasury worried that any change would restart inflation, because there was little or no excess productive capacity.

Technical Assistance and Training

- Under the preceding years of IMF programmes, the market economy - with high interest rates, illegitimate privatisation, poor corporate governance and capital-market liberalisation - provided only incentives for asset-stripping.

Source: Joseph Stiglitz, The Ruin of Russia
Evaluation of IMF Response

- The move from communism to capitalism in Russia after 1991 was supposed to bring unprecedented prosperity. It did not. By the time of the rouble crisis of August 1998, output had fallen by almost half and poverty had increased from 2% of the population to over 40%.
- This was a remarkable confession: these officials evidently believed that their policies had wrecked nearly half of Russia's economic capacity in the space of just a few years. They shunted aside micro-level data that showed that there was in fact excess capacity, just as they ignored a World Bank analysis showing that fresh IMF loans would not restore economic growth, but would only leave the country deeper in debt.
- These results were predictable: the 1998 bailout did not work, but devaluation did. It turned out that there was enormous excess capacity, and import substitution soon began, even in the midst of financial turmoil. Imports plummeted by nearly 50% in the year after devaluation, as consumers were forced to buy Russian-made food and goods.

Source: Joseph Stiglitz, The Ruin of Russia
Argentine Great Depression (1998)

- Deposit freeze, default on public debt, abandonment of fixed exchange rate
  - 20% monthly inflation
- Ultimately defaulted on $126 billion in government debt
- Economy shrunk 28% between 1998-2002
  - Resulted from lack of public confidence and lack of foreign investment
Why it Happened?

- Relaxed fiscal policy, didn’t take advantage of budget surplus and growth
  - Failure on the part of the IMF
- Convertibility Plan limited fiscal and monetary options
  - Implemented in response to hyperinflation in early 1990’s
  - Had numerous unintended consequences
- Unpredictable capital flows to developing economies
  - $2bn in 1991, $100mn in 1992
- Adverse external shocks
  - Appreciation of $USD, Depreciation of Brazilian Real, Russian Financial Crisis
- Lack of political decisiveness
  - Political division over support of the IMF, currency board, other policies
IMF Response to Argentine Great Depression

- **Surveillance**
  - IMF had been working hand in hand with Argentina since early 1990's, but failed to prevent this crisis
  - Condoned missed deficit cuts and debt slippage

- **Conditional Assistance**
  - $13 billion loan with the stipulation that the economy be reformed

- **Technical Assistance and Training**
  - Convertibility Plan pegged cost of the Argentinian Peso to $USD
    - Limited the government’s ability to implement standard macroeconomic policy
Relevancy: Argentina Crisis (2018)

- Inflation >50% in 2018
- Argentine Peso down 50% in 2018
- Interest rates at world record 60%
- IMF Loan of $50 billion approved in June
Argentina Crisis (2018)

- Unpredictable capital flows to developing economies
- Adverse external shocks
  - Worst drought in 50 years
  - Strong Dollar
- Lack of political decisiveness
  - Support of IMF unclear
Problems With the IMF

- Mission is to transform financial systems into an ideal, Western oriented system.
- Favors US system and dollar as reserve currency.
- In recent years, seen as somewhat adversarial to member nations.
How can They Improve?

- The IMF should be concentrating its attention on organizing debt rescheduling negotiations and then in helping to erect the structure of financial regulation, especially at the border, that will help to minimize the risks of such a melt-down occurring again (Wade)
Questions?
Sources


About the IMF. The International Monetary Fund. 2018. Online. https://www.imf.org/external/about/howwedo.htm