The Role of the IMF in the Global Financial Architecture

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• Any attempts to reform the global financial architecture will have to deal with the most influential organization of global economic governance: the IMF.

• The IMF is run by Washington and the G-7, with Europeans making decisions in their area.

• What is their role, policy goals, results? How can these be improved?
• 2008-09 financial crisis and world recession:
  • The IMF, charged with monitoring world economy (WEO, Global Financial Stability Report), missed the two biggest asset bubbles in world history.
  • A 2011 report from the IMF’s Independent Evaluation Office (IEO) criticized the IMF for their role in the run-up to the financial crisis, but did not criticize them for this amazing mistake.
  • Could have avoided most of the damage – even with the current international financial architecture
Home Prices

![Home Prices Graph](image-url)
Price-to-earnings ratio

Price-to-earnings ratio
Based on average corporate profits for the previous 10 years, plotted monthly

Source: Robert J. Shiller
IMF response to the crisis:

- Eurozone: pro-cyclical policies mostly beginning in 2010
- Why? Troika (ECB, EC, IMF) had a political agenda that was prioritized over recovery
- Note that Mario Draghi ended the Eurzone financial crisis with just one speech in July 2012:
Figure 2. Financial Market Developments

Sovereign yields, particularly in stressed countries, narrowed markedly following the London Speech.

• Could have been done 2 years earlier, saved Europe and the world economy from trillions in lost output and tens of millions of unemployed

• Why not? They were using the crisis to push for changes in fiscal, labor market, social, and other policies. Changes that people in the affected countries would not vote for.
• Even after the threat of financial meltdown ended, austerity has continued, prolonging stagnation, near-record unemployment, and causing threat of a third recession. Why?

• Crisis As Opportunity: “empirical evidence also suggests that recoveries from economic crises often serve as an opportunity for reform” (IMF Article IV consultation for Spain, 2010, p.13).
• Similar statements from European and ECB officials:
  – “crucial to ensure that ECB decisions did not reduce pressure on governments to reform.” – Joerg Asmussen, the most senior German at the IMF, and ECB executive board member. (Sept 2012)

• IMF Article IV consultations are more evidence of the Fund’s political agenda for Europe, mostly shared and determined by Troika partners
IMF Article IV Consultations in Europe

• Based on a content analysis of 67 Article IV agreements from 1 January 2008 – 31 December 2011 between the IMF and EU countries.
Evidence of a consistent pattern of policy recommendations:

1) Macroeconomic policy that focuses on reducing spending and shrinking the size of government, regardless of whether this is appropriate or necessary.
2) A focus on other policy issues that tend to reduce social protections for broad sectors of the population (including public pensions, health care, and employment protections), reduce labor's share of national income, and possibly increase poverty, social exclusion, and economic and social inequality.
Fiscal Adjustment:

- Recommended for all 27 EU countries.
- Spending cuts preferred to higher taxes.
- Emphasis on cutting public pensions and “increasing the efficiency” of health care expenditure.
• It is the attempt to achieve this political agenda – not debt dynamics or financial markets – that has kept Europe from recovering

• Christine Lagarde has recently called for German fiscal stimulus

• But Germany doesn`t care what the IMF wants

• And in the countries where IMF has real influence: Spain, Italy, Greece, Portugal, Ireland – IMF is still pushing fiscal tightening
• Developing countries also subjected to pro-cyclical policies during world recession
• In October 2009, 31 of 41 low or middle-income countries with IMF agreements had pro-cyclical conditions
• Either fiscal or monetary policies (or in 15 cases, both) that would be expected to worsen an economic downturn
• Even when IMF wants to do what is best for international financial system, can be blocked by U.S. Treasury for political or other reasons

• Example from last year: U.S. Treasury blocks IMF from filing amicus brief supporting Argentina against vulture funds, at U.S. Supreme Court
• What can be done? IMF quota reform is too small to make a difference.
# Top IMF Shareholders: Current and Proposed (Percent Quota Share)

<table>
<thead>
<tr>
<th>Country</th>
<th>Current</th>
<th>Proposed</th>
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</thead>
<tbody>
<tr>
<td>United States</td>
<td>17.69</td>
<td>17.40</td>
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<tr>
<td>Japan</td>
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<td>Germany</td>
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<td>France</td>
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<tr>
<td>UK</td>
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<tr>
<td>China</td>
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<tr>
<td>Italy</td>
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<td>Saudi Arabia</td>
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<td>Canada</td>
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<tr>
<td>Russia</td>
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<tr>
<td>India</td>
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<td>Netherlands</td>
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<td>Belgium</td>
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<tr>
<td>Brazil</td>
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<tr>
<td>Spain</td>
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<td>Mexico</td>
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<td>Switzerland</td>
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<tr>
<td>South Korea</td>
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<td>1.80</td>
</tr>
<tr>
<td>Australia</td>
<td>1.36</td>
<td>1.38</td>
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</table>
• But really the voting shares don’t yet matter very much because the developing countries don’t even use the power that they already have

• Washington and rich country allies make decisions that are rarely opposed

• Very different from WTO, where developing countries have formed blocs and fight against polices that they see as harmful
Alternative: BRICS Currency Reserve Arrangement

$100 billion fund – potential for important balance of payments support without IMF conditions

Limitations: still in early stages; currently has requirement that borrowing country needs an IMF agreement to borrow more than 30 percent of its limit
• But BRICS Currency Reserve Arrangement has the potential to become the first alternative to IMF in 70 years
Conclusion

• Despite recent changes in some IMF research, policies have changed very little during past 20 or 40 years

• Most change has come from the IMF losing its influence over most middle-income countries in the past 15 years

• This has been the most important change in the international financial system since 1973, and could continue, e.g. with low-income countries
• Unless developing countries decide to fight within IMF as they have done within WTO, IMF reform will be very slow
• Alternatives such as BRICS CRA, or regional funds are another possibility
• Both strategies could be pursued at the same time