Criticisms of imf

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“ The fund believes it is fulfilling the tasks assigned to it: promoting global stability, helping developing countries in transition achieve not only stability but also growth. ” “ I believe, however, that it has failed in its mission, that the failures are not just accidental but the consequences of how it has understood its mission. ” This is what Stiglitz states in his book, and is also his platform on how he feels about the International Monetary Fund. He believes that the IMF has a narrow view stating that “ what the financial community views as good for the global economy is good for the global economy and should be done”.

Stiglitz criticizes that the IMF has done great damage to the countries wherein they prescribe economic policies that must be followed in order to qualify for an IMF loan, or for loans from banks and other private-sector lenders that look to the IMF to indicate whether a borrower is creditworthy. Stiglitz argues that the International Monetary Fund and its officials have ignored the ramifications of having incomplete information, inadequate markets, and unworkable situations, all of which are particularly present characteristics of newly developing countries.

Stiglitz states that the International Monetary Fund called for policies that conform to logical textbook economics, however, they do not make sense to the country that the policies are going towards to provide relief. “ Stiglitz seeks to show that the consequences of these misguided policies have been disastrous, not just according to abstract statistical measures but in real human suffering, in the countries that have followed the. ” (Stiglitz, 2003).

The most traditional and perhaps best-known IMF policy recommendation is for a country to cut government spending or raise taxes. Either one of these

actions, or both would be used to balance a country's budget and eliminate the need for government borrowing. Most people believe that a lot of government spending is wasteful anyway. Stiglitz accuses the IMF for reverting to Herbert Hoover's economics in imposing these policies on countries during deep recessions.

The deficit, at this time, is mostly the result of a stimulated decline in revenues. Stiglitz argues that cuts in spending or tax hikes only make the downturn worse. He also emphasizes the social cost of cutting back on various kinds of government programs, such as eliminatingfoodsubsidies for the poor, which Indonesia did at the IMF's request in 1998, only to be engulfed by food riots. Another standard IMF recommendation is high interest rates, which make deposits and other assets denominated in the currency more attractive to hold.

Most countries go to the IMF because they find themselves having trouble maintaining the exchange value of their currencies. Stiglitz argues that the high interest rates imposed on many countries by the IMF have made their economic downward spirals even worse. Countries are intended to battle inflation that was not a serious problem to begin with. " Stiglitz repeatedly claims that the IMF's policies stem not from economic analysis andobservationbut from ideology—specifically, an ideological commitment to free markets and a concomitant antipathy to government.

" In part, Stiglitz complaint is that the International Monetary Fund did not understand or even try to understand, his and other economists' theoretical work depicting that markets that are pretty much unregulated do not necessarily deliver positive results when information or market structures

are incomplete (Stiglitz, 2003). A country that currently has loans from the International Monetary Fund is the country of Venezuela. Venezuela first negotiated an economic program with the International Monetary Fund in the year of 1989. In the mid 1970s, oil prices soared and seemed unstoppable.

Venezuela is a country very rich in oil, so at this time, they accumulated a lot ofmoneyfrom oil revenues, but also from loans from international banks. The government then used this money to expand state-owned industries, however, the government ended up supporting the least efficient enterprises, which came to rely on government credits and direct subsidies. Government investments were fruitless from 1974 – 1989. As government expenses continued to increase, the gross domestic product grew very little as a ratio of the government expenditures.

The excess amount of money supply, created by government spending, raised the price index by a factor of 15, interest rates 3. 7 times and the devaluation of the national currency by a factor of 10, all happening during the same period. In addition to all of this, Venezuela's foreign debt increased to a record level of $33 billion and their payments could not be honored. Venezuela undertook negotiations with the IMF when they were under all of this pressure from the decreasing oil prices and the rapidly rising interest rates on their immense foreign debt.

They had tried to borrow money tofinancesome of their debt; however, the international markets had been apprehensive for Venezuela had refused to work with the IMF. Venezuela had first turned to American banks for proposed financing because it did not want to agree with an economic program with the International Monetary Fund. The International Monetary

Fund cleared a loan of about $453 million to the country of Venezuela. Officials declared the loan as a first installment of what is expected to be a credit package that may total as much as $4.

6 billion from the international agency to support Venezuela's economic reform program over the next three years. They believe that Venezuela's economic adjustment program should " encourage a substantial reflow of private capital" to the South American country. The planned economic reforms were aimed at freeing and unifying Venezuela's foreign exchange rates, deregulating interest rates and opening the country's economy to foreign trade by removing quotas and tariffs. The austerity program is the price that Venezuela had to pay for the aid in financing from the IMF.

Domestic interest rates were allowed to rise substantially and the government had cut several important subsidies as part of a proposed economic program with the IMF. Since Venezuela agreed on an economic program with the IMF, commercial bankers seem a lot more ready to compromise with them. The IMF reform program included many policies. As a result " The per capita gross domestic product fell almost 8% from 1989 to 1993; the inflation index rose almost 10 fold; the outstanding foreign debt increased by $5 billion and the banking crisis that burst out in 1994 erased 10% of the GNP and $6 billion of the country's international reserves.

" What the Venezuelan government basically did was sign an agreement that led to a transfer of money from private sectors to the " pockets of the wasteful government". The government attempted to balance its accounts through its citizens, by increasing the taxes and increasing the interest rates. Little attention was given to increasing the productive capacity of the nation,

but was all focused on the fiscal demands of the state. In recent years, Venezuela's economy has gone from bad to worse. Its deterioration corresponded with the implementation of policies recommended by the International Monetary Fund.

Venezuela has gone through two IMF aid packages beginning in 1989. Since the implementation of the most recent package in 1996, Venezuela’s interest rates have more than doubled to 68 percent annually. The national currency, the Bolivar, has been devalued by 94 percent, accumulated inflation has reached 218 percent and production output has stalled. Capital flight has exhausted more than $2 billion from Venezuela’s international reserves, which are much lower now, than they were before the International Monetary Fund package was signed.

The fiscal deficit has been declared unmanageable and Venezuela’s stock market is down more than 50 percent. This downward spiral was the result of the tax increases, devaluation, few privatizations and public service rate hikes in the 1996 IMF package. The repeated devaluations have increased costs to the private sector and ignited inflation. The IMF also allowed the government to delay reforms of ineffectual state hospitals and public schools. In the case of the country of Venezuela, Stiglitz’s criticisms of the IMF do apply.

The IMF’s policies do not take into account the economic and social circumstances that currently exist in the country where it is applied to. As per usual, the International Monetary Fund used its traditional methods on Venezuela. Increase taxes, and have higher interest rates. The positive effects of any loan obtained from the IMF or other financial institutes are

useless because of the collection of interest and the rising interest rates. For developing countries such as Venezuela, the benefits from an agreement with the IMF cannot be seen for the large burden of clearing away their large foreign debt blocks their view.

The IMF did not take into consideration the social implications that would be caused when such harsh adjustment measures are put into operation. The poor are always the most affected. Their frustration was seen in Venezuela, as outbreaks ofviolence. The Venezuelan currency kept being devalued constantly therefore workers had to pay more for their essential needs, as their wages began to decline. The unemployment rate would then rise and that is why it is no surprise to why the people of Venezuela turned to violence. When bitterness and despair take hold, sometimes violence may be the only way to be heard.

It becomes imperative in times like this to have concrete negotiations on a debt plan to achieve a substantial reduction in debt and in interest payments. While losing many of its systemic functions, the Fund’s operations during the 1980s became dominated by dealing with the debt difficulties faced by a relatively small group of highly indebted developing countries. All the Fund’s lending was to developing countries, and the majority of it was to the highly indebted countries, even though the majority of programmes remained with low-income countries.

The Fund frequently became depicted as a development agency offering concessional assistance to developing countries. Even some of its staff bemoaned what they saw as the loss of its monetary characteristics and consequently much of its financial reputation (Finch, 1988). The least subtle

criticisms of this type tended to use the phrase ‘ development agency’ almost as a term of abuse. What the Fund was doing was perceived as being bad in and of itself. The more subtle criticism was that the Fund had largely been pushed by political pressure into lowering its own financial standards.

The criticism here was not so much that development assistance is inappropriate, but rather that the IMF is an inappropriate institution through which to give it. This argument sees it as important to retain the revolving character of Fund resources, as well as the Fund’s short-term monetary perspective—features, so it is claimed, that will be lost if the Fund is forced to lend over the long term on the basis of unviable programmes and unachievable targets. The plea has been strongly articulated to ‘ let the IMF be the IMF’ (Finch, 1988).

An extension of this argument is that unsuccessful programmes will damage the reputation and credibility of the Fund and adversely affect its catalytic role. The claim that financial standards have been sacrificed is intimately related to the debt crisis. In essence, it is that the governments of countries where the private banks are located, and in particular the United States, encouraged the Fund to lend to the highly indebted countries in order to reduce the probability of default. In the early years of the debt crisis, the argument could be made that such action was sustaining the stability of the international banking system.

But as the banks themselves adjusted to the crisis by reducing their exposure, strengthening their capital adequacy, provisioning, and expanding other lines of business, this systemic argument for lending by the IMF disappeared. Even critics who approach the issue from a rather different

angle, having more in common with the ‘ traditional’ criticisms of Fund conditionality, have concluded that the main beneficiaries of Fund lending to highly indebted developing countries during the 1980s were the international banks.

Simply put, the claim is that it was positive net transfers from the Fund that financed negative net transfers with the banks. This is a claim that is at least superficially consistent with the evidence at aggregate level, but it is not an interpretation that finds ready acceptance—publicly at least—inside the Fund, where the accusation that it had bailed out the banks has been, often staunchly, rejected. Yet the criticism that the Fund failed in its dealings with the highly indebted countries during the 1980s has more dimensions to it than this.

First, there is the argument that, along with others, the Fund misinterpreted the very nature of the debt crisis by treating it either as a liquidity crisis or as one of short-term internal adjustment rather than as a more deep-seated problem of structural adjustment which required important supply-side responses as well as the appropriate management of demand. This meant that the Fund opted to support new financing which assisted countries in meeting their outstanding debt-servicing obligations but which did little to restore medium-term viability to their balance of payments.

The nature of the programmes supported by the Fund has, in relation to this, been criticized for an overemphasis on devaluation resulting from a desire to strengthen the tradable sector of the economy and thereby to facilitate debt servicing, and an over-ambitious attempt to achieve stabilization and liberalization simultaneously. A long-standing worry associated with the use

of devaluation is that a shift in the nominal exchange rate will fail to alter the real exchange rate because of the inflation it generates.

Devaluation is seen as destroying the ‘ nominal anchor’, or to use the older jargon ‘ reserve discipline’, that a fixed exchange rate provides. Is this not a particular worry in highly indebted countries where the inflation record is frequently very poor and where the reputation of governments as inflation fighters is often weak? Just as the counter-inflationary merits of fixed exchange rates were being acknowledged and accentuated in the context of the European Monetary System, were they not being neglected by the IMF?

Critics of the Fund’s approach to conditionality within the highly indebted countries have argued that, whereas devaluation may certainly be appropriate in some circumstances it may be inappropriate where the fiscal deficit is under control and where the income redistributive effects, particularly in terms of lowering the urban real wage, spark off political unrest and measures to restore real wages. In these circumstances, the price of non-tradeables may also rise, with the result that the relative price effect of devaluation on the internal terms of trade is lost.

The dangers of a vicious circle, whereby inflation leads to devaluation which then leads to further inflation, have long been acknowledged in Latin American economies where there is a legacy of rapid inflation and a low degree of money illusion. Indeed, in the context of forward-looking models of economic policy which emphasise the importance of the government’s reputation, the vicious circle can take on an additional twist.

Here the use of devaluation damages a government’s anti-inflation credentials; private agents anticipate devaluation and mark up prices ahead

of it; the inflation thereby caused itself forces the government to devalue. Expectations become self-fulfilling and generate their own internal dynamics. The Fund has also been seen as being over-ambitious. Its stabilisation and liberalisation objectives have been interpreted as paying inadequate regard to the potential inconsistencies that may exist between them.

Within developing countries, in particular, revenue from tariffs may be an important element in total government income. Tariff reduction can therefore exert a significant adverse impact on the fiscal balance unless this source of revenue is replenished by other tax changes. Evidence suggesting a falling rate of success in achieving programme targets is cited as supporting the claim that Fund-supported programmes in highly indebted countries have been unrealistic.

In the case of intermediate targets, relating, for example, to aspects of credit creation, such a record reflects an increasing problem of non-compliance. Countries have often simply not complied with strategic elements in Fund-supported programmes. Some authors have again sought to explain this phenomenon in terms of the specifics of the debt problems with which highly indebted countries have been faced, the argument being that Fund-supported programmes have offered little domestic rate of return. The principal beneficiaries have instead been private foreign creditors.

The distribution of the costs and benefits of the programmes has established a set of incentives that is antagonistic towards a high degree of compliance. The debt overhang has had the effect of weakening Fund conditionality through acting as a tax on necessary reforms, with one implication being that it has become increasingly difficult to muster the necessary domestic

political support for such reforms (Sachs, 1989; Krugman, 1988). In this context it is claimed that debt relief is needed to create the necessary incentive structure to adjust.

The Fund has been criticised for failing to recognise this. Indeed, its policy of ‘ assured financing’, whereby IMF support was predicated on countries continuing to meet their outstanding obligations to the banks, has been interpreted as systemically discouraging the provision of debt relief by the banks and thereby impeding the resolution of the debt crisis. At the beginning of the crisis the Fund had some success in encouraging new commercial money inflows by making these a precondition of its support, but this insistence faltered as the banks’ reluctance to lend became more pronounced.

Moreover, it is argued that the Fund’s inappropriate approach to the debt problem was reflected by its apparent neglect of the distinction between new financing and debt reduction—a distinction which was being accentuated in theacademicliterature as the 1980s progressed (Krugman, 1988). Critics suggested that this neglect again showed the Fund as being primarily concerned with cash flow rather than medium and longer-term problems.

Yet, even in a short-run context, the different expectational responses to new money and debt reduction can cause different effects, with new money leading to further indebtedness and therefore the prospects of additional domestic fiscal and monetary problems. Statements emanating from the Fund about its own perception of its role in the debt crisis tended to side-step these analytical issues and stick with broader organizational ones,

which emphasized its strategic importance as an ‘ honest broker’ or catalyst (Nowzad, 1999).

The Fund described its objective as that of normalising creditor-debtor relations and restoring country access to sustainable flows and spontaneous lending. The means to this end were to be vigorous and sustained adjustment efforts by the debtors, and a co-operative concerted approach involving creditors, the Paris Club, commercial banks and the export credit agencies. While recognising that progress had been uneven and vulnerable, by the mid-1980s the Fund was interpreting its overall record on the debt problem as ‘ encouraging’ (Nowzad, 1999).

At the same time, however, critics were assessing that, ‘ the IMF’s recent record in the debtor countries is one offailure’ (Sachs, 1989a). Such disagreement persists because there is no universally accepted set of criteria by which the Fund may be judged. Apart from anything else, there is always the basic problem of the counterfactual: what would have happened if the Fund had done things differently?

Accepting this difficulty, a superficial review of the empirical evidence suggests that the Fund’s record in terms of dealing with the debt problem of the 1980s was, at best, mixed. Certainly it managed to help avoid a major systemic international financial failure and this was no small achievement. But, by other criteria, no substantial or sustained degree of success can be claimed. By the end of the decade, creditor-debtor relations had not been normalised, and access to spontaneous lending had not been restored.

Indeed, the creditworthiness of the highly indebted countries, as represented by the secondary market price of their debt, had continued to fall; net

transfers to highly indebted countries were still significantly negative; a concerted and co-operative approach to the debt problem had not emerged; most debt indicators failed to show any notable or sustained improvement; and macroeconomic performance in the highly indebted countries was poor and often deteriorating, with forward-looking indicators such as the investment ratio and import volume suggesting bleak prospects for the 1990s.

Even IMF-specific indicators were discouraging, with declining programme compliance, rising arrears and the increasing use of waivers. Episodic successes existed but the overall picture was not reassuring. During a decade in which open economy macroeconomics became more sophisticated, the accusation was increasingly made that the model underpinning the Fund’s operations had failed to be modified and that it was out of date and inappropriate. Research of an excellent academic standard conducted within the Fund’s own Research Department was, according to this view, no longer having a significant operational impact.

Indeed, and again at a superficial level, the empirical evidence seemed to suggest that the conventional caricature of a Fund-supported programme involving a combination of exchange rate devaluation and the deflation of aggregate demand through credit control was more accurate during the 1980s than it had been before (Edwards, 1989). At the same time as Fund-supported programmes were being criticised for lacking intellectual sophistication, evidence as to their adverse social and human implications was also being more systematically collected and coherently presented (Cornia et al., 1997; Demery and Addison, 1997).

Increasing infant mortality and morbidity, malnutrition and falling life expectancy were now being attributed, at least in part, to IMF-backed programmes. And the design of programmes which emphasised reduced government expenditure rather than increased tax revenue was being seen not only as endangering important welfare schemes in developing countries, but also as reflecting the dominant current politico-economic paradigm within the developed countries, where the role of the state was under stark review.

This in turn highlighted another area—the sequencing of reform—in which the Fund came in for criticism. Merely designing an appropriate programme of policies was now seen as inadequate; more consideration needed to be given to the order and inter-temporal distribution of elements of an adjustment programme, particularly as even research conducted within the Fund itself was beginning to suggest that Fund-supported programmes could have a negative effect on output, at least in the short run (Khan et al., 1996; Vines, 1990).

Earlier models, which formed the basis for financial programming within the Fund, most notoriously the Polak model, had basically assumed away such an effect by making output exogenous. Yet even the more outspoken critics of the Fund's handling of the debt crisis suggest that its approach changed towards the end of the 1980s, particularly after Michel Camdessus took over as Managing Director in 1987.

This change of approach found expression in terms of a softening attitude towards debt relief, a change in the treatment of arrears, with the Fund becoming prepared to make loans while countries were in arrears with the

banks, and an increasing concern for the effects of Fund-supported programmes on income distribution and the related recognition that income distributive effects might be important in determining the political, and therefore practical, feasibility of programmes.

Although criticisms still remained, for example that the Fund placed too much reliance on voluntary forms of debt reduction which, given the associated free rider problems, should instead be treated as a public good, they became slightly more muted. If the Fund was still not coming up with right answers, at least, according to some critics, it seemed to be asking more relevant questions. Moreover, some of the broader criticisms relating to the input of the Research Department were suspended awaiting the impact of the appointment of a new Managing Director.

On top of this there appeared to be a growing acceptance that macroeconomic stability was a necessary precondition for sustained economic development, and this took some of the sting out of the old debate about IMF conditionality. At the beginning of the 1990s private capital began to return to some of the lightly indebted countries, to the extent that some commentators claimed that the Latin American debt crisis was over. This was not the case in Africa, and it is unclear as to how significant the Fund's input was in generating capital inflows. References Cornia, G. A. , Jolly, R. and Stewart, F. (eds) (1997)

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