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The Bourbons of Global Finance

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Today's International Monetary Fund (and, to a lesser degree, the World Bank) recall Talleyrand's description of France's Bourbon kings: it has learned nothing and forgotten nothing. At a time when rich countries like the United States are running deficits of 12% of GDP because of the global financial meltdown, the IMF has been telling countries like Latvia and Ukraine, which did not start the crisis but have turned to the Fund to help combat it, that they must balance their budgets if they want aid.

Such hypocrisy would be laughable if global economic conditions weren't so dire that even countries that once swore never again to deal with the IMF have returned to its door, cap in hand. Some leading economists in Argentina justify this reversal by arguing that the world now has an "Obama IMF," one presumably friendlier and more attuned to local problems than the "Bush Fund." But, as the IMF programs for Latvia and Ukraine suggest, the main difference may only be a smile.

To be sure, IMF Managing Director Dominique Strauss-Kahn recently called for a global fiscal response to the worsening recession. But will the Fund now abandon its long-held emphasis on government cutbacks, monetary contraction, and overall austerity, policies that – in the opinion of many development economists – do considerably more harm than good? Are the IMF and the World Bank actually willing to reconsider their failed policies?

In recent years, lending by both institutions contracted dramatically, even though they have increasingly become the exclusive lenders to the world's poorest countries. In 2005, Argentina and Brazil were the first of the countries that previously denounced the IMF's neo-liberal agenda to begin repaying their loans. Repayments followed from other large debtors, including Indonesia, the Philippines, Serbia, and Turkey.

Indeed, the IMF's outstanding general resource account (GRA) credits to middle-income developing countries fell by an unprecedented 91% from 2002 to 2007, as richer developing countries gained access to sources of financing that were free of the Fund's conditionality. But poorer countries, for which international capital markets remain off limits, have no alternative but to rely on the World Bank and IMF.

In September 2007, a year before warning signs gave way to a full-blown financial meltdown, Strauss-Kahn himself suggested that the IMF was in a "crisis of identity." Indeed, the unprecedented decline in GRA lending, the IMF's main source of income, forced the Fund to announce a $100 million cost-cutting plan in April 2008. Similar financial pressures affected the World Bank, with its main source of income, IBRD lending, down 40% in 2007 from its late-1990's levels.

But the world's pain has been these institutions' gain. Since the crisis went global last autumn, the IMF has had countries parading to its door. Between November 5, 2008 and January 12, 2009, the Fund committed nearly $50 billion to seven countries (Hungary, Ukraine, Iceland, Pakistan, Latvia, Serbia, and Belarus). The World Bank, too, has recently been resurrected in places like Ecuador, Bolivia, and Peru, with loans to that region of Latin America up four-fold year on year since last September, reaching nearly $3 billion.

Unfortunately, for both institutions, such countries' growing demand for financing merely means business as usual. Consider the recent standby arrangement with Latvia, whose conditions include a massive 25% cut in public-sector wages, a similar reduction in government expenditures, and a huge tax increase.

Ukraine's government, moreover, was told to balance its budget by massively slashing state pensions. Only when conditions in the country deteriorated even more in the wake of the Fund holding back on the second tranche of its loan did the IMF agree to loosen its conditions. However in Latvia, the IMF has continued to demand austerity even in the wake of plummeting growth and rising unemployment which have lead to riots and political instability. Recent World Bank loans are similarly conditioned, in part, on "fiscal discipline."

Insistence on such policies at a time when the US and most of the rest of the rich world are following virtually the opposite economic strategy indicates the need for fundamental rethinking of what actually generates growth and development. There is a growing body of alternative ideas in this area –including work by the Nobel laureates Joseph Stiglitz and Paul Krugman – which the IMF and the World Bank should consider.

More importantly, American control has meant that throughout their history these institutions have been used as an adjunct of US foreign policy. Given the centrality of orthodox stalwarts like Larry Summers and Timothy Geithner in the Obama administration, the prospect of serious reform appears dim. Summers was a key architect of neo-liberal policies while at the World Bank and the US Treasury during the Clinton administration, and Geithner is a former senior IMF official.

Both men are likely to support the prevailing global double standard, which allows rich countries to use fiscal expansion in the face of recession, while forcing poor countries into greater austerity. But the Obama administration can still help – for example, by asking the Federal Reserve to expand the currency swap arrangements that it recently offered to Singapore, South Korea, and Brazil to other developing countries. That way, the world's poor could at least avoid the heavy-handed conditionality imposed by the IMF and World Bank.

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