Handbook of Global Economic Governance

Players, power and paradigms

Editors: Manuela Moschella and Catherine Weaver

Routledge
Taylor & Francis Group
LONDON AND NEW YORK

First edition published 2014
by Routledge
2 Park Square, Milton Park, Abingdon, OX14 4RN, United Kingdom

and by Routledge
711 Third Avenue, New York, NY 10017, USA

Routledge is an imprint of the Taylor & Francis Group, an informa business

Library of Congress Cataloging-in-Publication Data
Handbook of global economic governance : players, power, and
paradigms / editors: Manuela Moschella and Catherine Weaver.
pages cm. – (Routledge international handbooks)
Summary: ""Provides a thorough overview of the governance of the global economic and financial system. Discusses themes such as governance, functions of governance and problems and prospects of governance, analyses the main rules and institutions that make up global economic governance and assesses alternative proposals to reform the international financial architecture"–Provided by publisher"– Provided by publisher.
Includes bibliographical references and index.
1. Economic stabilization. 2. Global Financial Crisis, 2008-2009.
3. International economic relations. I. Moschella, Manuela, editor of compilation. II. Weaver, Catherine, 1971- editor of compilation.
HB3732.H36 2014
337–dc23
2013022048

ISBN: 978-1-85743-635-8 (hbk)
ISBN: 978-0-203-15637-7 (ebk)

Typeset in Bembo
by Taylor & Francis Books

Europa Commissioning Editor: Cathy Hartley
Editorial Assistant: Amy Welmers

Contents

11

The International Monetary Fund's evolving role in global economic governance[1]

Stephen C. Nelson

The International Monetary Fund (IMF) is central to governance of the international financial system. It has long been recognized that the IMF possesses greater resources and authority than other international organizations. When Randall Stone called the IMF 'the most powerful international institution in history' (2002, 1) he echoed sentiments expressed by Cheryl Payer 30 years prior: 'the International Monetary Fund is the most powerful supranational government in the world today' (1974, ix). The IMF's power—like that of any actor in world politics—has both material and social sources. Aside from perhaps one state (the USA) and one supranational organization (the European Union—EU), there is no other governmental or intergovernmental player that can match the IMF in terms of command of material resources. From January 2002 to October 2012 the Fund made US $615,500m. available to member states in economic distress.

An institution's power is durable when material might is coupled with the belief, shared by other relevant actors in the institution's external environment, that the exercise of power is legitimate (Reus-Smit 2007, 61). Legitimacy implies that the rules, principles, rights and obligations set by the institution are congruent with what the actors in that institution's environment believe these elements should be; in other words, they perceive that the institution ought to be obeyed (Hurd 1999, 381). The IMF's legitimacy rests on the collection of 2,000 experts, the majority toting PhDs in economics from prestigious universities, gathered within the walls of its building on 14th and G Streets in Washington, DC as well as the ability of the IMF to act as an interlocutor between the international financial community and national governments.

Since the crisis in the American financial system went global in 2008, the IMF has been resurgent. Of the $615,000m. disbursed since 2002, 85% of that sum accrued after 2008. A handful of wealthy European countries (Ireland, Greece and Portugal) are currently under conditional IMF programmes—a position that the institution has not found itself in since the late 1970s. This was an unexpected turn for the Fund. In 2005 the economist Barry Eichengreen compared the IMF to a 'rudderless ship adrift on a sea of liquidity'. By 2007 interest payments on outstanding loans—the institution's lifeblood—had all but dried up. The IMF's Executive Board announced plans to trim the institution's staff by 15% and to sell a portion of its gold holdings just to stay solvent. In the wake of the IMF's mismanagement of the East Asian financial crisis in 1997–98, developing countries self-insured by accumulating huge quantities of foreign reserves. The institution was moving at an advanced rate down a path to irrelevance.

The IMF's resurgence during a period of economic turmoil frames the questions upon which this chapter focuses. How does the IMF govern the international financial system? Has the IMF changed since 2008? Do the changes explain the institution's resurgence? If not, what accounts for the persistence of the IMF's power?

The IMF is a capacious organization, and conditional lending is just one of its varied activities. Article IV of the IMF's founding charter empowers staff members to conduct annual check-ups with member countries. 'Surveillance', which initially focused solely on the appropriateness of the member state's exchange rate regime, now encompasses many aspects of the economic policy environment, and since 1997 a majority of members have agreed to make their surveillance reports public. The IMF has pushed for harmonization of data standards to ensure that the economic data released by member states to interested private actors are comparable and reliable (Mosley 2003). The IMF devotes substantial resources—over 15% of the administrative budget in the late 1990s—to providing 'technical assistance' to member countries (Boughton 2012, 241). Further, membership in the IMF (which currently stands at 188 countries) involves obligations, the most important of which is the commitment made by members to refrain from enacting restrictions on cross-border transactions that affect their current accounts (Broome 2010a; Nelson 2010; Simmons 2000).

These are all important instruments through which the IMF orchestrates relations within and among states and market actors. However, in this chapter, I focus on conditional lending. The provision of money, conditional on the achievement of pre-specified policy adjustments hashed out by staff members and the borrower's policy team, is the primary instrument enabling the IMF to fight crises that threaten the stability of the global financial system. It is, not coincidentally, also the reason why the IMF is a rather unloved (to put it mildly) institution.

An institution that requires borrowers to undertake painful policy changes will never win a popularity contest, but the IMF's problems may run deeper. In the years before the global financial meltdown, many observers diagnosed the IMF as suffering from a legitimacy crisis (Seabrooke 2007). 'Crisis' implies that the perception of the institution's efficacy or the rightfulness of its rules, principles, rights and obligations 'declines to the point where the actor or institution must either adapt … or face disempowerment' (Reus-Smit 2007, 158). The IMF's resurgence since 2008 indicates that it successfully adapted, thereby averting the marginalization that is the natural resolution of a legitimacy crisis. Yet I argue in this chapter that adaptation has been limited, at best. This suggests a misdiagnosis: the IMF was not in the throes of a legitimacy crisis. For all its problems—the chequered record of its lending programmes chief among them—it has been, and will remain, essentially the only game in town when global financial markets enter, as they have regularly over the past 30 years, a state of turmoil (Reinhart and Rogoff 2009).

The evolution of conditional lending

The IMF is the product of the plan, spearheaded by American and British officials, for a more open international economic system in the wake of the World War II. John Ruggie (1982) described the social purpose at the core of the Bretton Woods system as 'embedded liberalism'. By this he meant that the key players (the USA, Western Europe, and a suite of international organizations including the IMF, the World Bank and the General Agreement on Tariffs and Trade—GATT) encouraged the removal of constraints on markets insofar as market forces did not impede or disrupt states' capacities to pursue their own social goals. One of the obligations of IMF membership, built into the Articles of Agreement, was the removal of restrictions that prevent firms and citizens from accessing currency to conduct cross-border transactions that fall under the current account. By encouraging international trade, the IMF created the demand for the thing that it supplied—resources to help states with balance of payments problems adjust without resort to exchange restrictions. In an open international economic system states can run current account deficits by borrowing from the rest of the world. However, deficits are not sustainable indefinitely. They hinge on the willingness of the rest of the world to plug the gap between what a state's citizens consume and the domestic resources that can be mobilized to finance that level of consumption. If the capital inflows that finance the current account deficit dry up, a state finds itself in a payments crisis. Its citizens will have to cut back, perhaps drastically, on their consumption, and it will have trouble paying off maturing debt that had been issued in the years before the crisis. This dynamic posed a threat to the two elements at the core of the embedded liberal regime: (1) states would have to forego full employment and suffer deep recessions if they fell into payments problems, and (2) they would be tempted to pass the costs of adjustment onto other states by erecting trade barriers and using currency devaluations to make their exports more internationally cost-competitive.

The purpose of the IMF was to make liquidity available to members in order to smooth the adjustment process. Borrowers could stay current on their payments without having to make radical, socially disruptive policy changes to free up resources. If IMF officials thought that the member's balance of payments problems were likely to be protracted they could approve a revaluation of the country's currency (from 1945 to 1971 currencies were pegged to the US dollar, which was itself pegged to gold at the rate of $35/ounce).

Conditionality did not become an official part of the IMF's toolkit until the 1960s. An amendment to the Articles of Agreement in 1968 codified the practice which developed in the previous decade: when a member's drawings were small (relative to the amount that the member deposited with the Fund as its 'quota') the loan would be free of conditions, but loans in the 'upper tranches' (above 25% of quota) would be released in segments, conditional on the observance of policy targets agreed upon in advance by the IMF's economists and the authorities in the borrowing country (Barnett and Finnemore 2004, 57–58). There are several possible rationales for conditionality in IMF programmes. One interpretation is that conditions provide the means through which the IMF, acting as the agent of US Treasury officials, Wall Street bankers and hedge fund managers, remakes the borrower's economy to bring it closer to the principals' preferred model (freer markets, less state involvement in the allocation of goods and resources) (Crotty and Lee 2009; Graeber 2011, 2; Payer 1974). Others invoke the role of the financial community but treat the IMF as an autonomous actor with its own interests. In Mark Copelovitch's (2010) approach, the IMF's key policy goal is catalyzing the flow of capital to needy borrowers. Conditions are a way for a borrowing government credibly to signal that it is serious about getting its economic house in order (Fischer 1997, 25). A third view holds that conditions enable the Fund to limit the borrower's policy discretion, thereby safeguarding the institution's resources. If the unwise policies that forced the government to seek the lifeline thrown by the IMF are not corrected, throwing money at the country without forcing it to adjust risks feeds a cycle of permanent crisis (Williamson 1983).

IMF programmes are controversial not because they contain conditions, but because of what those conditions entail. Conditions have to target some policy levers, but there are an almost endless number of policy areas that could be at the root of the borrower's economic troubles. Where should the IMF staff direct their attention when they design a lending programme? A permutation of the basic national income accounting identity, found in every mainstream macroeconomics textbook, helps us understand why IMF programmes look the way they do.

At the core of the IMF's approach to balance of payments problems is the identity describing the components of the current account:

$$CA = S^P - I - (G - T)$$

The identity tells us that a country's current account (CA) is simply the balance of private saving (S^P) over domestic investment (I) less the government's budget position (spending, G, minus income (tax receipts), T) (Krugman and Obstfeld 2006, 289–90). The identity makes it clear that, in order to turn a current account deficit into a surplus (thereby switching from being a capital importer to an exporter), private and/or government saving must increase. For the IMF, the excess of government spending over income is a key driver of persistent current account deficits (which, again, can only be financed by borrowing from abroad) and hence an obvious area to target through conditions. This is why observers sometimes joke that 'IMF' really means 'It's Mostly Fiscal' (Wolf 2005, 289). Lending programmes include measures to clamp down on fiscal outlays and, in some cases, to increase tax receipts.

Political opposition can make it difficult for the IMF to engineer changes in the current account solely through the government's budget. In most cases the burden of adjustment is borne primarily by the private sector. Ghosh *et al.* (2005) reviewed 25 lending arrangements between 1995 and 2000; they found that the current account balance moved, on average, from a deficit of 3% of GDP over the three years preceding the onset of the programme to zero in the first year of the programme. Less than half of the adjustment in their sample came from the fiscal side. The bulk of the improvement reflected 'both a decline in investment and a rise in domestic saving during the program period' (Ghosh *et al.* 2005, 7).

It makes more sense to treat the current account identity as an outcome of adjustment than the route to adjustment, since each of the terms in the identity are shaped by economic policies. Starting in the 1950s a group of IMF economists, led by Jacques Polak, developed a 'flows-of-funds' framework that explained precisely how policies interact to generate payments imbalances; more importantly, the framework enabled IMF staff to forecast the size of the borrower's financing needs in the near future, contingent on the extent of policy changes (Mussa and Savastano 2000, 108–15). 'Financial programming' is used to derive 'the effects of fiscal policies and credit creation on the balance of payments' (Boughton 2012, lvi; see also Barnett and Finnemore 2004, 51–56). Nearly every IMF programme over the past 60 years included limits on the growth of domestic credit.

By the late 1970s the core elements of IMF lending arrangements were in place. Binding conditions—violation of which could lead to the suspension of lending—typically 'were limited to ceilings on credit expansion, government deficits, and borrowing; and prohibitions on current account exchange restrictions and on arrears to external creditors' (Boughton 2012, 194). For the IMF, conditional lending was 'applied economics in action' (Fischer 1997). But, for others, the IMF was reading from the wrong textbook; heterodox economists maintained that the IMF's fixation on the domestic roots of payments crises ignored the fact that countries can get into trouble because of exogenous shocks like the collapse of commodity prices (coffee in the mid-1990s, for example) or a dramatic, unanticipated rise in the cost of imports (oil in 1973, 1979 and 1991, for example). These criticisms had little effect on the content of IMF conditionality. However, the IMF did create new facilities with minimal conditions to provide quick infusions for members that faced problems due to adverse changes in their external economic environment. Demand for the new facilities was generally weak: the two Oil Facilities only survived for two years in the mid-1970s; the Buffer Stock Financing Facility (created in 1969 to help governments deal with commodity price fluctuations) was eliminated in 2000; the Compensatory and Contingency Financing Facility was never used and also expired in 2000.

The basic approach to conditionality shifted in the early 1980s. Staff members and management had come to the realization that distortions introduced by government intervention in markets often aggravated payments crises, and that macroeconomic reforms were not likely to be sustainable in the absence of deeper reforms. The IMF's agenda swung toward promoting growth in the developing world, and staff members identified many 'structural' impediments bequeathed by 30 years of heavy state intervention in the economies of most developing countries. By the 1990s the typical IMF programme included structural elements—trade and product market liberalization, privatization of state-owned enterprises, banking system restructuring, securing the independence of the central bank, civil service reorganization, etc.—alongside 'macro relevant' targets. Structural conditions proliferated, although most remained 'indicative' (non-binding) targets in the loan agreements (Fischer 1997, 25). Nonetheless, the average number of binding conditions in IMF agreements climbed steadily upward in the decades after 1980. The plot in Figure 11.1, constructed from data collected by Nelson (forthcoming), displays the number of 'performance criteria' (the IMF's term for binding conditionality) in 486 loan agreements signed between 1980 and 2000. Each dot in the figure marks a separate lending arrangement; when several arrangements include the same number of conditions, the dot appears wider.

The upward trend is clear from the figure, but another pattern stands out: there was a significant degree of variation in the extent of conditionality in IMF programmes in each year. Several explanations for this puzzling variation have emerged. Stone (2008) and Dreher and Jensen (2007) identify the strategic importance of the borrower to the IMF's most powerful members (principally, the USA) as a key factor; they find that economically vulnerable but geopolitically important borrowers receive fewer conditions. Copelovitch (2010) argues that the

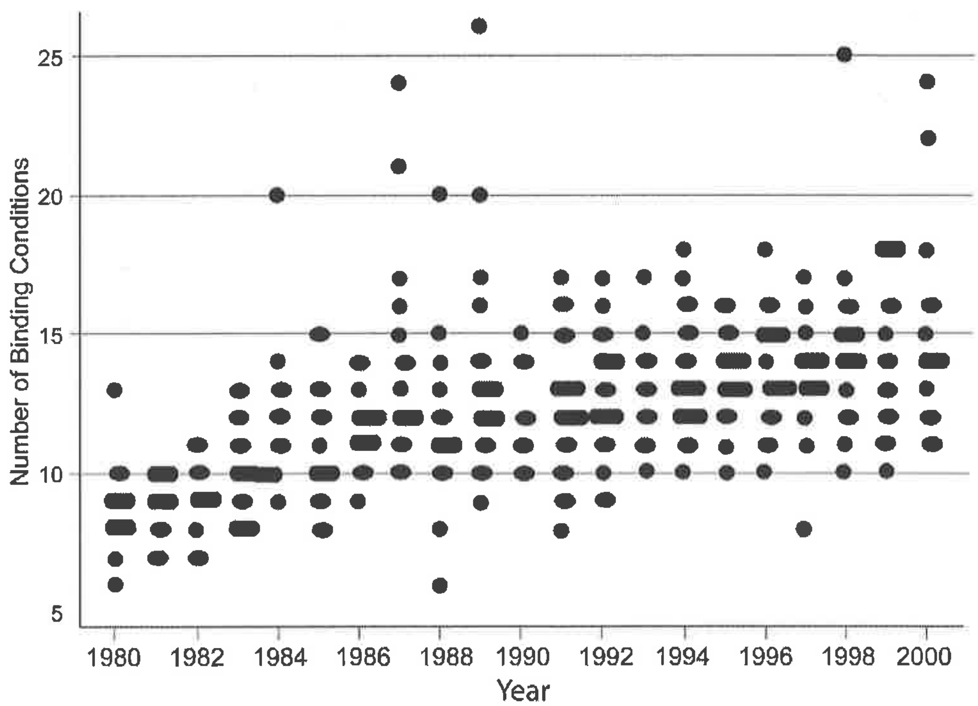

Figure 11.1 Conditionality in IMF loans, 1980–2000
Source: Nelson (2009)

composition of the prospective borrower's external debt is important: when creditors are numerous and scattered across the globe, IMF programmes have to be tough (and large) to prevent a rush for exits and to catalyze new lending. Nelson (forthcoming) argues that the ideational proximity between the top members of the borrower's policy team and the IMF influences the extensiveness of conditionality. As the proportion of officials with graduate degrees from highly ranked American economics departments and/or significant work experience at the Fund or the World Bank increases, the average number of conditions falls (and the average size of the loan rises).

IMF lending after the crisis of 2008

At the end of 2009 the IMF was in an unusual position: its resources had actually grown during the two intervening years of turmoil and recession (by contrast, the Financial Crisis Inquiry Commission estimated that the crisis wiped out $11,000,000m. in wealth held by American households). In April 2009 the Group of Twenty Finance Ministers and Central Bank Governors (G-20) agreed in principle to expand the IMF's coffers to the tune of $750,000m. In January 2012 the Fund, expecting additional demands as the eurozone debt crisis threatened to spread from Greece and Portugal to the much larger Spanish and Italian economies, sought further commitments to raise its war chest to $1,000,000m.

An uptick in lending during the credit crunch that followed on the heels of the chaotic bankruptcy of Lehman Brothers was predictable. Financial globalization meant that the balance sheets of banks around the world were exposed to the collapse of the American housing market; by 2007, at least $3,800,000m. of assets derived from securitized mortgages had spread around the world (Fligstein and Goldstein 2011). Governments scrambled to recapitalize vulnerable banks and to stay current on payments as capital inflows dried up and exports plummeted (the global value of exports fell by 28% ($761,000m.) between Q1 2008 and Q1 2009). At the time the IMF was one of the few actors in the international economy that could mobilize sizeable resources. Yet the IMF's central role in global financial governance did not abate when the waters in financial markets calmed.

Figure 11.2 illustrates the biggest change experienced by the Fund in recent years. The figure tracks the relative size (total disbursement/quota) of 176 loans negotiated during the decade after 2002. It is clear that the average relative size of IMF loans skyrocketed after 2008. Indeed, the average size of the 84 loans concluded between 2002 and 2007 was 94.6% of quota; the average size of the 92 loans after 2008, by contrast, was 398.3% of quota. The difference in means between the two periods is highly statistically significant (t = -5.67, p = 0.0000).

The IMF responded to increased and prolonged demand for its resources in several ways. In 2009 the maximum amount of cumulative access for its members was raised from 300% to 600% of quota (Boughton 2012, 752). In addition to raising limits on the size of loans, the IMF has provided 'exceptional access' to borrowers whose needs go far above the official limit. This is not unprecedented—the IMF has in the past waived limits on loan size for 'systemically important' countries such as Mexico, Brazil, Argentina, Turkey, Indonesia and Republic of Korea—but the size of the recent loans, relative to the borrowers' subscription, are by far the largest in the institution's history. In May 2010 Greece signed on to an agreement that amounted, in total, to 2,399% of quota. A year later Portugal accepted a three-year loan that exceeded 2,300% of quota. Having burned through the initial disbursement in March 2012, Greece negotiated another three-year agreement, this time worth 2,158% of quota.

The IMF also created low-conditionality facilities to disburse funds rapidly to member states. The Flexible Credit Line (FCL), established in April 2009, is intended to 'shift IMF loan policy from *ex post* conditionality to *ex ante* conditionality for ... states that have a good track record of policy implementation under IMF reform programs and strong economic fundamentals'

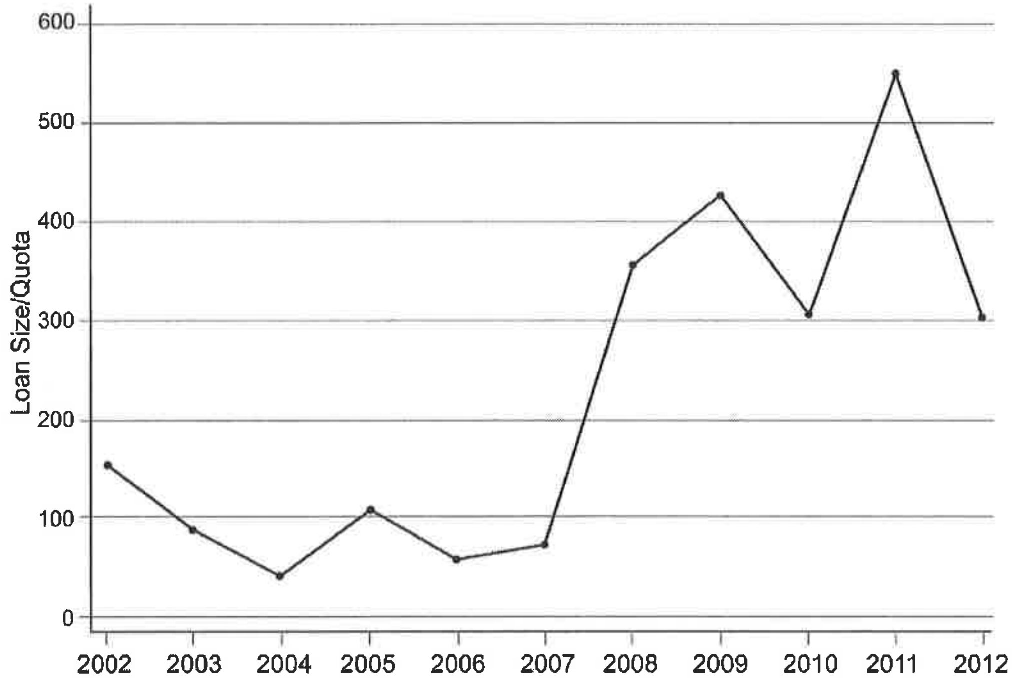

Figure 11.2 Average loan size, 2002–12
Source: IMF Monitoring of Fund Arrangements (MONA) Database, accessed at www.imf.org/external/np/pdr/mona/index.aspx

(Broome 2010b, 49). Members that pre-qualify for access to the FCL do not face conditions. A second new facility, the Precautionary Credit Line (PCL), sets a lower bar for pre-qualification but includes light conditionality. Like previous experiments with programmes for members suffering exogenous and temporary troubles, few members have made use of the new lending facilities (Mexico, Poland and Colombia accessed resources through the FCL; Macedonia is the only member to access the PCL).

The increase in the average size of IMF programmes after 2008 is striking. By contrast, changes in the design of lending arrangements have been subtle (some might say nearly imperceptible). The high degree of continuity is puzzling, because the perceived intrusiveness and inefficacy of conditionality was a major target for critics both within and outside the Fund in the years between the East Asian financial crisis and the crisis of 2008 (Grabel 2011, 823). In 2001 the IMF initiated a review of its conditionality policy. Representatives from low- and middle-income countries on the IMF's governing body, the Executive Board, pushed for a reduction in the number of conditions per programme. In the wake of the review, the IMF devised new guidelines to drastically streamline conditionality, focusing in particular on the structural conditions that were often the target of borrowers' ire. The gap between the initiative's intentions and the observed outcome was wide. A report issued in 2007 by the IMF's watchdog, the Independent Evaluation Office, 'concluded that the streamlining initiative had not reduced the number of conditions' (Best 2012, 12).

Since the crisis erupted the IMF has streamlined its lending programmes, but not dramatically: the data in the IMF's most recent review of conditionality (covering programmes signed between 2002 and September 2011) reveal that the number of conditions per programme has fallen since peaking in 2004—but only back to the 2002 level (IMF 2012). The evidence suggests that the crisis of 2008 was not a breaking point in either the scope or content of conditionality (Grabel 2011, 821). While the IMF's management publicly advocated the use of counter-cyclical macroeconomic policies (lowering interest rates and increasing government spending) to boost economic output during the depths of the credit crunch in 2008 and 2009, the bulk of the programmes designed by the staff look anything but counter-cyclical: stringent fiscal measures, including limits on (or big cuts in) fiscal outlays and tax increases, were enforced in loans drawn by Iceland, Latvia, Hungary, Romania, Greece, Portugal, Pakistan, the Ukraine and El Salvador (Grabel 2011, 821–22). The IMF, in a September 2009 review of 15 post-crisis programmes, contended that enforcement of fiscal targets was more flexible than it had been in the past, with frequent revisions to loosen the conditions. The IMF report admits that this was due at least in part to more dramatic declines in output than the staff anticipated when they negotiated the terms of the programmes. It was not unusual for the IMF to loosen or even waive fiscal conditions in pre-crisis programmes; for example, the Fund granted waivers for missed fiscal targets to allow Argentina to draw down a series of loans that it signed in the 1990s, despite the fact that fiscal rectitude was integral to the success of the country's currency board-like monetary arrangement. The Independent Evaluation Office's report on the Argentine experience noted: 'even though the annual deficit targets were missed every year from 1994, financing arrangements with Argentina were maintained by repeatedly granting waivers' (IEO 2004, 4).

From the IMF's perspective the consistency of the treatment reflects the fact that many of its patients were suffering from the same disease. The region that suffered the most severe economic contraction during the crisis was Eastern and Central Europe. Figure 11.3, constructed from the World Development Indicators, illustrates that the region's rate of GDP growth fell by over 13 percentage points between 2007 and 2009. Not surprisingly, countries in that region were heavy users of IMF resources. Eastern and Central European countries developed very large current account deficits in the run up to the crisis. Recall that current account deficits are financed through borrowing from foreign investors. Partly on the advice of the IMF, the countries in this region had eliminated exchange restrictions and liberalized their financial systems, making it very easy for citizens (and governments) to borrow at low cost. When capital inflows dried up, these countries had no choice but to turn to the IMF—and the Fund, in turn, supplied resources conditional on policy changes intended to raise private saving and cut government deficits, thereby restoring balance in the current account. The IMF's public proclamations notwithstanding, the basic approach to crisis resolution remained consistent:

> countries that are unable to finance their external payments position on affordable terms, regardless of whether the initial source of the difficulty was fiscal excess, an adverse terms of trade shock, or other developments, would have to restore balance if they are to maintain full employment and growth.
>
> *(Boughton 2012, lv–lvi)*

The concept of 'organized hypocrisy', as developed by Catherine Weaver (2008) in her study of policymaking at the World Bank, helps explain the puzzle of why the IMF's very public rediscovery of the merits of Keynesian demand stimulus during this crisis had little impact on the design of its lending programmes, which remained pro-cyclical. All institutions involved in global economic governance face conflicting demands that emanate from their external environments. However, the internal cultures of institutions impose consistency across the disparate parts of the organization. In Weaver's framework, hypocrisy—the decoupling of talk and

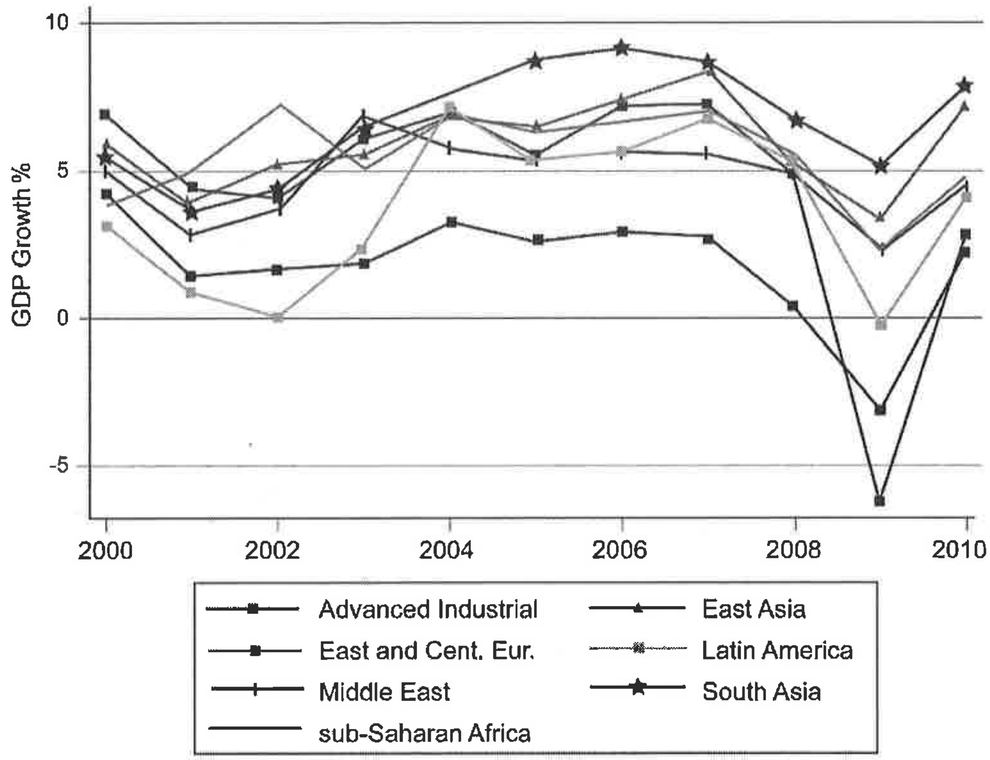

Figure 11.3 GDP growth, 2000–10
Source: World Bank World Development Indicators, accessed at data.worldbank.org/data-catalog/world-development-indicators

action—is a rational way of bridging the gap between external demands and internal strategies of coping (2008, 31). The mouthpieces of the institution have to respond to demands put upon the institution by government officials and NGOs, but the staff members develop behaviours that are consistent with the institutional culture—and culture encompasses procedures ('this is how we do things around here') and principled beliefs ('this is the right way to do things'). The clash between the two logics produces organized hypocrisy.

The crisis of 2008 punctured the market-oriented paradigm that guided economic policy-making in large parts of the world. Sophisticated market players, operating in lightly regulated markets, nearly destroyed the global financial system. Saving the system from total collapse required a dramatic reassertion of state authority in the governance of financial markets. A transnational epistemic community made up of prominent economists coalesced around traditional Keynesian policies as the way to respond to the crisis, which legitimated the renewed role of the state in governing the economy (Farrell and Quiggin 2012). Opposing counter-cyclical measures like large stimulus packages meant swimming against a swift tide. Instead, the IMF's Managing Director, Dominique Strauss-Kahn, became an indefatigable advocate for government spending, even suggesting in November 2008 that members should contribute to a global stimulus fund worth 2% of world GDP. Henry Farrell and John Quiggin, writing on the return of Keynesian ideas after the crisis, remark: 'what was remarkable was not so much Strauss-Kahn's proposal, as the nearly complete absence of dissent within the IMF, an institution which had until recently been associated with very different economic ideas' (2012, 20). Viewed from the IMF's perch, the about-face was a way to curry favour and claw back some of the legitimacy that the institution had surrendered in the previous decade. The IMF had developed a reputation for a reflexively pro-market worldview in the years before the crisis (Stiglitz 2003). For the IMF the outbreak of the crisis was particularly embarrassing, since it had failed to warn its members about mounting risks. It endorsed the views of people like Alan Greenspan, approvingly quoting from one of his speeches in its *Global Financial Stability Report*: 'increasingly complex financial instruments have contributed to the development of a far more flexible, efficient and hence resilient financial system than one that existed just a quarter of century ago' (IMF 2006, 1).

Building the counter-cyclical turn into its lending programmes would require the IMF's economists to jettison the core elements of an approach that it had relied upon for half a century. The gulf between the talk at the top of the institution and the facts on the ground for borrowers was striking: the post-crisis changes in the practice of conditionality were incremental at best (and ceremonial at worst). By the time Strauss-Kahn was replaced by Christine Lagarde as Managing Director, the rhetoric had already shifted away from expansionist Keynesianism and back toward teeth-gritting austerity.

Organized hypocrisy appears in the Fund's position on structural conditionality after the crisis as well. In March 2009 the IMF announced that structural conditions would no longer be included in lending programmes as performance criteria. Performance criteria are the conditions with teeth: violating this type of condition automatically triggers the suspension of a programme (unless the Executive Board approves a waiver for the violation). Structural conditions were not taken off the table, but they were relegated to 'benchmarks'. The enforcement of benchmarks is at the discretion of the IMF's staff members: borrowers that miss benchmarks can continue to draw on the programme even without a waiver.

Demoting structural conditions from performance criteria to benchmarks thus appears to be a significant shift. But a closer look reveals that the change has not translated into big differences in borrowers' experiences with IMF conditionality. Historically, few programmes included numerous structural performance criteria; in the 486 conditional loans from 1980 to 2000 examined by Nelson (forthcoming), the average number of structural performance criteria in the loans was 1.45. Given severe information asymmetries (the IMF economists working in-country know much more about the details of each case than the Executive Directors back in Washington) and the norm of unanimity that governs Executive Board voting, requests for waivers to allow programmes to continue in spite of non-compliance are almost always approved. Benchmarks are not completely toothless, either: staff members can suggest the suspension of a programme if they feel that the borrower has made insufficient progress toward meeting structural benchmarks. Structural conditions are still important elements of IMF loans. The Greek loans in 2010 and 2012 involved a number of structural reforms; benchmarks related to the privatization of US $68,000m. in state-owned assets, including the national railway company, were extremely controversial (Grabel 2011, 823). A spokesperson for the Papandreou government complained: 'we asked them for help ... not to meddle in our internal affairs' (Hope 2011).

To this point I have emphasized the continuity in the Fund's approach to conditional lending. In the concluding section of the chapter I will speculate on the sources of policy continuity. I wrap up this part of the chapter by noting one significant change in the post-crisis content of IMF programmes. In 1995 the IMF considered an amendment to its constitutional charter that would make full capital account liberalization a condition of membership (Abdelal 2007; Chwieroth 2010; Moschella 2009). This was the culmination of a decades-long wave of support within the institution for the removal of restrictions on the purchase and sale of currency for portfolio investments. The East Asian financial crisis prompted the IMF to back away from the extreme position that it staked out in the mid-1990s (the proposed amendment was permanently shelved in April 1998), but few anticipated the institution's response to the imposition of exchange controls during the crisis: it gave its tacit approval for the use of capital controls (Broome 2010b, 48; Grabel 2011, 812–20). Gallagher's chapter in this volume gives a fuller treatment of the IMF's position on capital controls; here I briefly assay the degree of change since the crisis.

The IMF's role in promoting capital account liberalization should not be overstated. It leaned on member countries to remove restrictions, but rarely used the tool of conditionality to pry open borrowers' financial systems (IEO 2005). However, it was not hesitant to condemn the use of controls by member states, most notably when Malaysia—a member that has never borrowed from the Fund—imposed restrictions during the 1997–98 regional crisis. When Iceland signed an agreement in October 2008, it had already imposed controls on capital outflows. The IMF allowed the Icelandic authorities to retain the exchange restrictions. When Latvia came to the Fund in December 2008 it too was able to maintain controls that had been imposed as part of a deposit freeze at a failing bank (Grabel 2011, 815). The Fund is far from a proponent of capital controls. Yet the institution has adapted to a changed post-crisis world by accepting that exchange restrictions ('capital flow management measures' in Fund parlance) are a legitimate part of a member country's policy toolkit. New guidelines that sketch the institution's evolving view of capital controls (use sparingly, and keep them temporary, transparent and market-oriented) emerged in July 2012.

The political economy of the IMF in hard times

In this concluding section I circle back to three factors (players, power and paradigms) identified in the volume's introductory chapter to explain the pattern of changes in IMF lending during and after the crisis.

In 2008 the IMF's arsenal was under US $250,000m. At the end of 2011 the total assets under management of the 10 best-performing hedge funds in history amounted to $232,000m. (Mackintosh 2012)—and even the largest hedge funds are microscopic compared to money managers such as BlackRock ($3,500,000m. world-wide assets under management), State Street Global Advisors ($1,800,000m.) and PIMCO ($1,300,000m.). Forty years of financial globalization have produced a seamlessly global pool of money, the size of which dwarfs the resources that can be mobilized by any single sovereign state or international organization. The big increase in the IMF's resources since the crisis can thus be understood as a way to level an extremely uneven playing field. The IMF is often described as the world's financial firefighter; it cannot be a very effective firefighter if it is armed with a squirt gun.

The IMF's chief economist, Olivier Blanchard, acknowledged that the crisis heralds a swing of the pendulum back from markets toward the state (2012, 225). The IMF is undoubtedly an advocate for market liberalization, but its advocacy masks the fact that it steps in to prevent national and regional financial conflagrations from igniting the entire system after market players have behaved unwisely. A major threat to the IMF's ability to carry out its mandate is the growing gulf between its lendable resources and the financing needs of its borrowers. As the global pool of money grows, the cost of borrowing falls. Cheap money enabled millions of Americans to purchase mortgages that, once home prices tumbled, they could not repay, and it has allowed governments to accumulate massive debt loads. By 2009 Greece—a country of 11m. people with an economy about the size of Massachusetts—had racked up a debt that exceeded the foreign debts of Argentina, Brazil and Mexico combined (Chinn and Frieden 2011, 187). Doubling or even trebling IMF resources is not enough in an era of financial globalization. The IMF can try to move from the back to the front foot and take a proactive rather than reactive approach to managing the risks of over-lending by the financial community. To do so the IMF will have to answer a criticism posed by the Australian Executive Director Michael Callaghan in discussion of the staff report on a previous crisis: 'What is not sufficiently covered in the paper are the circumstances which resulted in the private financial community being willing to finance a growing borrowing requirement by Argentina to the point that its debt level was unsustainable' (IMF 2003, 32).

The issue of power within the IMF is contentious. The institutional avenue for the assertion of national interest is the Executive Board. The 24 Executive Directors who constitute it are appointed by their home governments and are apportioned voting rights. Many argue that the distribution of votes fails to match the balance of material power among member states. The growing political power of the emerging markets is not captured by a formula that awards more votes to Belgium than India. After years of deadlock (mainly due to European intransigence) voting rights will be reapportioned. The scheduled shift, like changes in conditionality, is far from sweeping; in October 2012, 6% of votes were set to be transferred to low- and middle-income member states and, as a result, Brazil, Russia, India and China would then join the list of the institution's top 10 largest shareholders (Grabel 2011, 809). As of writing the modest but hard-won shift in votes has been tabled indefinitely.

Since these changes have yet to be implemented, the redistribution of power cannot be invoked to explain the changes surveyed in this chapter. How important is the Executive Board's vote-casting to the institution's activities in general? Less than one might expect. It is true that some decisions—such as revising the Articles of Agreement—require an 85% supermajority to pass, which gives the USA (possessing just under 17% of the votes) a veto. However, voting on proposals for lending programmes delivered to the Board by the staff and management is informal and recorded on an up-or-down basis, and the Board almost always unanimously approves staff proposals. For this reason, meddling by powerful governments to influence the terms of IMF agreements works mainly through back channels. The limits of the Board's influence on staff decision-making was evident in the approval in July 2009 of a loan for Sri Lanka despite official abstentions by the American and British representatives from the Board's vote on the staff proposal. Abdelal's (2007) study of the push for the amendment to make capital account liberalization a membership obligation illuminates the social sources of power within the institution: the most advantaged state in terms of material resources (the USA) was outmanoeuvred by representatives from a savvier and more determined member state (France). The fact that power has both material and social sources means that formal institutional changes such as the redistribution of voting rights are less consequential for the institution's behaviour than casual observers might imagine.

Shifting power in the global economy has yet to touch the process by which the head of the IMF is selected. Developing countries have twice loudly and publicly supported non-European candidates for Managing Director, to no avail. The Russians strongly backed Czech central banker Josef Tosovsky in 2007, who was passed over in favour of Dominique Strauss-Kahn; Mexico's Agustin Carstens and Grigori Marchenko of Kazakhstan garnered support after Strauss-Kahn's ouster in 2011. The list of nationalities of IMF Managing Directors since 1978 is, in order, French, French, German, Spanish, French and French.

We have already seen that the crisis punctured dominant economic ideas about market efficiency. Olivier Blanchard took the following lesson from a March 2011 IMF conference on the topic of the lessons for economics from the crisis: 'We have entered a brave new world. The economic crisis has put into question many of our beliefs. We have to accept the intellectual challenge' (2012, 225). The clearest evidence for the displacement of old paradigms is the IMF's newfound flexibility on the use of capital controls. However, we should be cautious in taking this stance as evidence for an intellectual revolution within the organization. First, the IMF's endorsement of capital controls is rather lukewarm. The institution does not want to return to the 1950s when countries' financial systems were ring-fenced by severe exchange restrictions. Second, there is no canonical case in mainstream economics for full capital account liberalization. The IMF-organized conference on capital controls—held before the East Asian crisis—revealed a range of views held by top economists on the subject (Boughton 2012, 137).

The IMF is often painted as an organization dominated by neo-liberal economists hell-bent on freeing market forces. A different perspective is that the IMF endorses financial market openness largely because there is no widely shared alternative to the view that market actors are rational and will not blow markets, and themselves, up. The inability to admit that markets behave irrationally is perhaps one reason why it failed to warn about gathering risks in the American housing market and, by extension, financial system, and the European market for sovereign debt. Heterodox views of financial markets, such as those espoused by the late Washington University economist Hyman Minsky, had little resonance with the IMF's staff members (Boughton 2012, liv–lv). The IMF is slow to change, not because of the deep intellectual commitments of its economists to the superiority of markets; rather, it is because the IMF follows the first rule of wing-walking: don't let go of one thing until you have hold of something else. For the IMF's economists, most with graduate degrees from highly ranked American economics departments, there is no credible alternative to the model that ties payments problems to the excess of domestic spending over savings (Mussa and Savastano 2000, 101). In this sense it is more useful to look at the role of 'programmatic' ideas ('Is the idea operationally useful to us?') than 'paradigmatic' ideas ('Is the idea theoretically sound?') in understanding change (or the lack thereof) at the IMF (Clift and Tomlinson 2012).

Conclusion

The global credit crunch and European sovereign debt crisis—like previous events in 1982 and 1997—revealed why the world needs a central monetary authority. The IMF's material resources proved useful to members during the depths of the crisis. The resurgence of the institution is best illustrated by its involvement in the resolution of the European sovereign debt crisis.

The IMF's partnership with the EU and the European Central Bank (ECB) has, paradoxically, generated tensions that threaten the durability of its renewed role in financial governance. It is a partnership of necessity. The IMF alone could not hope to fill the borrowing gaps faced by countries like Greece and Portugal. The European institutions, on the other hand, had the money but needed to import the IMF's expertise and credibility with bond traders. The relationship is now fracturing. The major fissure concerns the depth of the austerity demanded by the so-called Troika. The IMF has been quicker than the northern eurozone member states to recognize the growth-retarding effects of deep cuts in social spending. Big declines in economic output threaten the sustainability of countries' debt loads. The simple identity for debt sustainability, drawn here from Jay Shambaugh (2012, 167–68), illustrates why that is the case.

$$\Delta D_t = (R_t - g_t) \times D_{t-1} + primary$$

The equation tells us that the level of a country's debt-to-GDP ratio (D) is driven by the interplay of the interest rate (R), growth rate (g) and non-interest budget deficit (*primary*). The relevance for the debate on austerity is the result that the debt burden expands when interest payments exceed the economic growth rate, even if the primary budget balance turns positive. In Greece for example, growth under the IMF–EU–ECB programme turned sharply negative; as a consequence, its debt-to-GDP ratio is projected to overshoot the IMF's target of 120% by 72 percentage points in 2014. When the IMF released a study claiming that it and the European Commission (EC) had underestimated the negative effect of austerity on growth, the EC hit back with its own paper in which the impact of austerity on growth was downplayed (Spiegel 2012). The IMF appears willing to lighten the burden of cuts in order to restore growth; the northern eurozone members do not want the southern members that their taxpayers are financing to miss their deficit targets. The tension between the members of the Troika might pave the way for marginalization of the Fund, which, if repeated in other regions, would return the IMF to the uncomfortable position that it held in the years between the East Asian crisis and the 2008 collapse, as a peripheral player in global financial governance.

Note

1 I thank Ilene Grabel, Ian Hurd and the editors of the volume, Manuela Moschella and Kate Weaver, for helpful comments.

References

Abdelal, Rawi, *Capital Rules: The Construction of Global Finance*, Cambridge, MA: Harvard University Press, 2007.

Barnett, Michael and Finnemore, Martha, *Rules for the World: International Organizations in Global Politics*, Ithaca, NY: Cornell University Press, 2004.

Best, Jacqueline. 'Ambiguity and Uncertainty in International Organizations: A History of Debating IMF Conditionality', *International Studies Quarterly*, Vol. 56, No. 4, December 2012.

Blanchard, Olivier, 'Concluding Remarks', in Blanchard *et al.* (eds), *In the Wake of the Crisis: Leading Economists Reassess Economic Policy*, Cambridge, MA: The MIT Press, 2012.

Boughton, James, *Tearing Down Walls: The International Monetary Fund, 1990–99*, Washington, DC: IMF, 2012.

Broome, Andre, 'Stabilizing Global Monetary Norms: the IMF and Current Account Convertibility', in Susan Park and Antje Vetterlein (eds), *Owning Development: Creating Policy Norms in the IMF and the World Bank*, New York: Cambridge University Press, 2010a.

——'The International Monetary Fund, Crisis Management and the Credit Crunch', *Australian Journal of International Affairs*, Vol. 64, No. 1, 2010b.

Chinn, Menzie and Frieden, Jeffrey, *Lost Decades: The Making of America's Debt Crisis and the Long Recovery*, New York: W. W. Norton, 2011.

Chwieroth, Jeffrey, *Capital Ideas: The IMF and the Rise of Financial Liberalization*, Princeton, NJ: Princeton University Press, 2010.

Clift, Ben and Tomlinson, James, 'When Rules Started to Rule: the IMF, Neoliberal Economic Ideas and Economic Policy Change in Britain', *Review of International Political Economy*, Vol. 19, No. 3, pp. 477–500, 2012.

Copelovitch, Mark, *The International Monetary Fund in the Global Economy*, New York: Cambridge University Press, 2010.

Crotty, James and Lee, Kang-Kook, 'Was IMF-Imposed Economic Regime Change in Korea Justified? The Political Economy of IMF Intervention', *Review of Radical Political Economics*, Vol. 41, No. 2, pp. 149–69, 2009.

Dreher, Axel and Jensen, Nathan, 'Independent Actor of Agent? An Empirical Analysis of the Impact of U.S. Interests on IMF Conditions', *Journal of Law and Economics*, Vol. 50, No. 1, 2007.

Farrell, Henry and Quiggin, John, 'Consensus, Dissensus, and Economic Ideas: The Rise and Fall of Keynesianism during the Financial Crisis', unpublished paper, George Washington University, Washington, DC and University of Queensland, March 9, 2012.

Fischer, Stanley, 'Applied Economics in Action', *American Economic Review Papers and Proceedings*, Vol. 87, No. 2, pp. 23–27, 1997.

Fligstein, Neil and Goldstein, Adam, 'The Roots of the Great Recession', in Grusky, Western, and Wimer (eds), *The Great Recession*, New York: Russell Sage Foundation, 2011.
Ghosh, Atish, *et al.*, *The Design of IMF-Supported Programs*, Washington, DC: IMF, 2005.
Grabel, Ilene, 'Not Your Grandfather's IMF: Global Crisis, "Productive Incoherence" and Development Policy Space', *Cambridge Journal of Economics*, Vol. 35, No. 5, pp. 805–30, 2011.
Graeber, David, *Debt: The First 5,000 Years*, London: Melville House, 2011.
Hope, Kerin, 'Greece Mends Relations with EU and IMF', *Financial Times*, 11 April 2011.
Hurd, Ian, 'Legitimacy and Authority in World Politics', *International Organization*, Vol. 53, No. 2, pp. 379–408, 1999.
Independent Evaluation Office (IEO), *The IMF and Argentina, 1991–2001*, Washington, DC: International Monetary Fund, 2004.
——*The IMF's Approach to Capital Account Liberalization*, Washington, DC: International Monetary Fund, 2005.
International Monetary Fund (IMF), *Minutes of the Executive Board Meeting EBM/03/106*, 17 November 2003.
——*Global Financial Stability Report: Market Development and Issues*, Washington DC: International Monetary Fund, April 2006.
——*Review of Recent Crisis Programs*, Prepared by the Strategy, Policy and Review Department, 14 September 2009.
——*2011 Review of Conditionality Overview Paper*, Prepared by the Strategy, Policy and Review Department, 19 June 2012.
Krugman, Paul and Obstfeld, Maurice, *International Economics: Theory and Policy* (7th Edition), Boston, MA: Addison Wesley, 2006.
Mackintosh, James, 'Dalio Takes Hedge Fund Crown from Soros', *Financial Times*, 28 February 2012.
Moschella, Manuela, 'When Ideas Fail to Influence Policy Outcomes: Orderly Liberalization and the International Monetary Fund', *Review of International Organizations*, Vol. 16, No. 5, pp. 854–82, 2009.
Mosley, Layna, 'Attempting Global Standards: National Governments, International Finance, and the IMF's Data Regime', *Review of International Political Economy*, Vol. 10, No. 2, pp. 331–62, 2003.
Mussa, Michael and Savastano, Miguel, 'The IMF Approach to Economic Stabilization', in Ben S. Bernanke and Julio J. Rotemberg (eds), *NBER Macroeconomics Annual 1999*, Cambridge, MA: MIT Press, 2000.
Nelson, Stephen C., 'Playing Favorites: How Shared Beliefs Shape the IMF's Lending Decisions,' *International Organization*, forthcoming.
——'Does Compliance Matter? Assessing the Relationship between Sovereign Risk and Compliance with International Monetary Law', *Review of International Organizations*, Vol. 5, No. 2, pp. 107–39, 2010.
Payer, Cheryl, *The Debt Trap: the International Monetary Fund and the Third World*, New York: Monthly Review Press, 1974.
Reinhart, Carmen and Rogoff, Kenneth, *This Time is Different*, Princeton, NJ: Princeton University Press, 2009.
Reus-Smit, Christian, 'International Crises of Legitimacy', *International Politics*, Vol. 44, pp. 157–74, 2007.
Ruggie, John Gerard, 'International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order', *International Organization*, Vol. 36, No. 2, pp. 379–416, 1982.
Seabrooke, Leonard, 'Legitimacy Gaps in the World Economy: Explaining the Sources of the IMF's Legitimacy Crisis', *International Politics*, Vol. 44, No. 2/3, pp. 250–68, 2007.
Shambaugh, Jay, 'The Euro's Three Crises', *Brookings Paper on Economic Activity*, pp. 157–211, Spring, 2012.
Simmons, Beth, 'International Law and State Behavior: Commitment and Compliance in International Monetary Affairs', *American Political Science Review*, Vol. 94, No. 4, pp. 819–35, 2000.
Spiegel, Peter, 'EU Hits Back at IMF Over Austerity', *Financial Times*, 7 November 2012.
Stiglitz, Joseph, *Globalization and Its Discontents*, New York: W.W. Norton, 2003.
Stone, Randall, *Lending Credibility: The International Monetary Fund and the Post-Communist Transition*, Princeton, NJ: Princeton University Press, 2002.
——'The Scope of IMF Conditionality', *International Organization*, Vol. 62, No. 4, pp. 589–620, 2008.
Weaver, Catherine, *Hypocrisy Trap: The World Bank and the Poverty of Reform*, Princeton, NJ: Princeton University Press, 2008.
Williamson, John, 'On Seeking to Improve IMF Conditionality', *American Economic Review Papers and Proceedings*, Vol. 73, No. 2, pp. 354–58, 1983.
Wolf, Martin, *Why Globalization Works*, New Haven, CT: Yale University Press, 2005.