Has the IMF Outlived Its Usefulness?

Dalibor Rohac - October 17, 2013

In the weeks leading to the Annual Meetings of the International Monetary Fund (IMF) and the World Bank last weekend, Christine Lagarde, the managing director of the Fund, has been making a lot of headlines. She announced that the IMF would push for more gender equality in labour markets around the world, suggested that the IMF could help protect the planet from environmental damage by promoting reforms of energy subsidies, and urged European countries to move towards a fiscal union in order to help eurozone limit the severity of future financial crises.

That is a lot of ground to cover. While each of these proposals should be discussed on its own merit, jointly they are symptomatic of the spectacular mission creep that characterises the past 40 years of the organisation's existence.

The original purpose of the IMF was relatively narrow — to assist in the post-war reconstruction of the international system of fixed exchange rates agreed on at the Bretton Woods conference in 1944. Specifically, the IMF was to provide a pool of liquidity for countries suffering from temporary payment imbalances.

The Bretton Woods system ceased to exist in the early 1970s. Since then, the IMF has tried to reinvent itself as an organisation doing everything from fostering global monetary co-operation, trade, high employment and growth, to poverty reduction around the world. Alas, the evidence that it has made a difference is rather thin.

Some economies standing at important economic and political crossroads — like Egypt — have chosen to simply ignore IMF's advice and not to tap to its sources of liquidity. Since the events of the Arab Spring, the talks about an IMF loan have led nowhere; similarly, the country is making very little progress on the reform of its unsustainable system of subsidies — in spite of the subsidy reform initiative spearheaded by the Fund worldwide.

Even those countries that have navigated their way through these turbulent economic years have done so with very little help from the IMF. The Baltic countries, which had been hit the hardest by the financial crisis, received no IMF funding other than a small loan for Latvia, worth

€1.16bn, which the government repaid ahead of schedule. The reason these economies got out of their troubles quickly was that their governments pursued bold economic reforms, including massive cuts to public spending and wholesale liberalisation of the economy. In 2009 alone, the fiscal adjustment in Estonia amounted to a staggering 11 per cent of GDP.

The problem is not that the Fund is irrelevant — in many instances, its lending might as well be seen as counterproductive. Its 2008 loan to Hungary, worth $15.7bn, did not help the country restore sound public finances. Instead, the Hungarian government eroded the confidence of investors by its heavy-handed approach to bank deleveraging, by ad hoc levies imposed on the financial industry, telecommunications and retail, and by seizing the assets of private pension funds in 2011.

The central problem with IMF's lending is that it ignores moral hazard problems. If governments know that they can access IMF loans, they will tend to behave more recklessly both in good and bad economic times.

The latest idea from the Fund — a European Fiscal Union — is a case in point. In a perfect world, the idea of pooling resources to help European countries deal with potential unexpected economic shocks would be an appealing one.

However, in reality, that would act as an invitation for the less well-governed members of the EU to spend like there is no tomorrow. To avoid future financial crises, the exact opposite of the Fund's proposal is necessary — namely that national governments in Europe and large financial institutions face the full costs of their decisions, for good or ill.

The debt crisis in Europe, as well as the lingering effects of the global financial crisis of 2008, is an opportunity to rethink the role international organisations, and their lending, have in fostering sound policies and financial stability. In other words, it may be time to start seeing the IMF's expansive mission as part of the problem, rather than the solution, to the world's economic woes.