Crises and the Bretton Woods Institutions and the Crises of the Bretton Woods Institutions¹

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Impacts, Responses & Initial Lessons of the Financial Crisis for Low Income Countries
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“Today, the only crisis faced by the IMF is a crisis of identity. Countries rescued in the 1990s have mostly repaid their debts. With a shrunken loan portfolio, the institution that lectures others about finances has lost operating income and is running a deficit. It faces cuts in its staff and salaries and is even considering the sale of its gold bullion reserves. ‘What might be at stake today is the very existence of the I.M.F…’ (Dominique Strauss-Kahn” Steven Wiseman “IMF Faces a Question of Identity” New York Times, Sept. 28, 2007)

“Today is the proof that the I.M.F. is back.” Dominique Strauss-Kahn, Director, IMF following the completion of the G20 meeting(Landler and Sanger, New York Times, April 2, 2009)

“Strauss-Kahn says the days of "one size fits all" policies have changed and that the institution has learned from its mistakes and criticisms. He says his IMF teams are far more adapting and flexible to the peculiarities of each country.”( Interview with CNN reporter Robyn Curnow, March 3, 2010)

1. Introduction

The daily focus in the media on the financial crisis in the United States and Europe has overshadowed discussions of the impact of the crisis on the poorest regions of the world where millions of people live on the edge of an abyss that threatens their survival. Moreover, in the wake of the crisis, and as a result of recent G20 meetings, there has been an unprecedented expansion in the resources and authority of the Bretton Woods Institutions with barely a whisper

¹The paper draws on work presented in seminars and conferences at Columbia University, University of Amsterdam, Luiss University, Rome, Cambridge University and European Parliament in Brussels in 2009 and 2010. An earlier version will be published in Philip Arestis, Rogerio Sobreira and Jose Luis Oreiro eds. The 2008 Financial Crisis, Financial Regulation and Global Impact: (Basingstoke: Macmillan, 2011) I appreciate the comments of Claudia Kedar on various versions of this paper.
about their role in promoting an agenda which has been largely antithetical to the development process. Countries that had sworn they would not deal with the Fund have reversed course and are back at the door of the IMF now heavily supported by the G20. This paper will focus on recent lending patterns of the Bank and Fund, the impact of the new crisis on Bank and Fund policy, and the role of the G20. The paper will argue that reforms in the governance and policy structures of the Fund and Bank have been wholly inadequate in view of the miserable track record of these institutions. There are dangers in continuing with the past trajectory of the Bank and Fund whose strategies have left poor countries structurally enfeebled and susceptible to the vicissitudes of the global economy. We will begin with a brief background with a focus on recent Bank and Fund lending patterns.

2. IMF and World Bank Lending Patterns

The lending from the World Bank’s two main groups the IBRD (International Bank for Reconstruction and Development) and IDA (International Development Association-poor lending arm of the Bank) grew rapidly in the 1980s and peaked in Fiscal Year 1999 at around $29 billion. Table 1 presents approved loans from 1992 through fiscal year 2010 (July 1, 2010).

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<tbody>
<tr>
<td>IBRD</td>
<td>15,368</td>
<td>21,086</td>
<td>22,182</td>
<td>10,919</td>
<td>10,487</td>
<td>11,452</td>
<td>11,231</td>
<td>14,135</td>
<td>12,829</td>
<td>13,468</td>
<td>32,900</td>
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<td>IDA</td>
<td>6,174</td>
<td>7,508</td>
<td>6,812</td>
<td>4,358</td>
<td>6,764</td>
<td>8,068</td>
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<td>11,867</td>
<td>11,235</td>
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<td>Total</td>
<td>21,543</td>
<td>28,594</td>
<td>28,996</td>
<td>15,276</td>
<td>17,251</td>
<td>19,519</td>
<td>18,513</td>
<td>23,641</td>
<td>24,696</td>
<td>24,703</td>
<td>48,900</td>
<td>58,700</td>
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*Fiscal Year ending in June

In the wake of the Asian crisis in 1997, IBRD lending in 1998 and 1999 dramatically increased by roughly a third and then fell off as countries especially those in the middle range of incomes repaid their loans after the economic recovery. Lending through 2008 by the IBRD never returned to the levels of the pre-crisis 92 to 97 period as middle-income developing countries got access to alternative financial sources without the burden of neo-liberal conditionality. The option was not available for poorer countries. IDA loans as a portion of lending rose from 29% of the total loans in the 92 to 97 period to 47% in 2007-8.
IMF Resources, Disbursements, Repayments, Income and Outstanding Credit Billions
SDRs, 1998-2010

<table>
<thead>
<tr>
<th>Time</th>
<th>General Resource Account</th>
<th>PRGF-ESF</th>
<th>Income</th>
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<tbody>
<tr>
<td>1998</td>
<td>53.6</td>
<td>20.6</td>
<td>6.7</td>
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<td>1999</td>
<td>94.9</td>
<td>10.0</td>
<td>19.4</td>
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<td>2000</td>
<td>109.7</td>
<td>7.2</td>
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<td>2001</td>
<td>102.5</td>
<td>23.8</td>
<td>13.3</td>
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<tr>
<td>2002</td>
<td>100.2</td>
<td>25.2</td>
<td>15.1</td>
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<tr>
<td>2003</td>
<td>100.7</td>
<td>20.3</td>
<td>18.9</td>
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<tr>
<td>2004</td>
<td>111.4</td>
<td>4.2</td>
<td>13.8</td>
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<tr>
<td>2005</td>
<td>145.2</td>
<td>2.3</td>
<td>29.2</td>
</tr>
<tr>
<td>2006</td>
<td>161.2</td>
<td>2.4</td>
<td>21.0</td>
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<tr>
<td>2007</td>
<td>165.4</td>
<td>1.0</td>
<td>4.7</td>
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<tr>
<td>2008</td>
<td>152.4</td>
<td>13.4</td>
<td>1.9</td>
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<tr>
<td>2009</td>
<td>290.2</td>
<td>20.4</td>
<td>.7</td>
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<tr>
<td>2010*</td>
<td>308**</td>
<td>11.2</td>
<td>.8</td>
</tr>
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</table>

Sources: IMF (various years), 2010a
*Figures on income are through June, 30, 2010. All others are through July 15, 2010
**Includes borrowing agreements with Japan (US$100 billion), Canada (US$10 billion), Norges Bank (SDR 3 billion), the United Kingdom (SDR 9.92 billion), Deutsche Bundesbank (EUR 15 billion), De Nederlandsche Bank NV (EUR 5.31 billion); and note purchase agreement with People’s Bank of China (SDR 32 billion).

A similar pattern can be observed in the loans from the IMF. Table 2 presents the lending data from 1998 through the first half of 2010. Between 1992 and 1997, concessional lending (to low income countries) as a portion of total outstanding credit averaged 13.6% (IMF, various years). By 2007 the portion reached 39% of the total. After 2003 the peak year for outstanding GRA (general resource account) levels, countries rapidly repurchased their GRA balances and avoided additional borrowing an option not available to poor countries who had no access to commercial credit. Starting in 2005 there was some decline in outstanding debt of the poorest country through MDRI (Multilateral Debt Relief Initiative) for countries reaching the HIPC completion point (with all its neo-liberal conditionality).

Outstanding GRA credit, largely going to middle income countries fell by an unprecedented 91% by 2007 from SDR 65 billion to a mere SDR 6 billion a level not seen since the 1970s. The revolt began in 2005 when Argentina and Brazil denounced the neo-liberal agenda of the Fund and began repaying nearly $25 billion in loans. This was followed by repayments from large
debtors including Indonesia, Philippines, Serbia and Turkey. The unprecedented decline in the use of IMF resources through the GRA, the major source of income for the Fund, led to the threat of large losses and the announcement of $100 million dollar cost reduction plan at the Fund in April, 2008 (IMF, 2008a).

If lending is any indicator, the economic crisis has changed the fortunes of the Bank and Fund. Table one shows the World Bank has seen a huge jump of IBRD lending from $13.5 billion in fiscal year 2008 to $32.9 billion in fiscal year 2009 to $44.2 billion in fiscal year 2010. The largest increase in 2009 went to Latin American and Caribbean countries which took on an additional $9.5 billion in IBRD loans (World Bank, 2009a).

Between September, 2008 and July, 2010, the Fund approved loans from its GRA account to more than 28 countries. As we can see in the table above, disbursements from the GRA grew from merely SDR 1 billion in 2007 to a total of SDR 20.4 billion in 2009.

3. Bank and Fund Policies and Their Impact

Critics like Joe Stiglitz (2002) have long complained about the theoretical and ideological narrowness of the IMF with its almost pathological focus on the state as the source of economic crises. From the IMF factsheet on “Crisis and IMF Lending” from November 2008 (IMF, 2008b), it is argued that “the domestic sources” of economic crises can only come from “excessive monetary creation, unsustainable fiscal deficits, an overvalued domestic currency, political instability, and natural disasters.” Nothing is mentioned about the behavior of any domestic private sector actors.  

The focus on these domestic causes of crises occurs largely because of the theoretical underpinnings of the IMF approach which is based on the Polak model (Polak, 1957). The approach relies on a monetarist formulation that ties credit growth to the balance of payments and comes out of the fixed exchange world of the Bretton Woods era. Like the monetarists, it assumes full employment of resources. There are two key parts to the model: money supply and a fixed exchange rate. Money supply is defined as the domestic credit to the private and public sector plus a country’s monetary reserves. Changes in reserves are tied to the country’s balance of trade on goods and services and non-traded related currency flows. According to the model, money demand occurs only for use in transactions and not for other reasons. Since the supply

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2 The lists includes Armenia, Angola, Antigua and Barbuda, Belarus, Bosnia, Columbia, Costa Rica, Dominican Republic, El Salvador, Georgia, Greece, Guatemala, Hungary, Iceland, Iraq, Jamaica, Latvia, Maldives, Mexico, Moldova, Mongolia, Pakistan, Poland, Romania, Serbia, Seychelles, Sri Lanka, Ukraine. (IMF, various years)

3 More recent versions of the Fact sheet have been renamed “IMF Crisis Lending” and have added “weak financial systems” to the list without specifying which part of the financial system (state or private) or its causes. As many have argued the IMF, itself, has contributed to the weakening of financial systems by encouraging developing countries to deregulate their financial systems. See Stiglitz, 2002.
and demand for money are assumed to be in equilibrium, any increase in government borrowing would lead to an increase in prices and nominal income, which in turn would increase the demand for imports. This would occur since government borrowing is essentially an increase in the money supply, which must be met with an increase in money demand if equilibrium is to be maintained.

The nominal rise in income would lead to an increase in imports because domestic production of goods would not have changed. Imports would cause the terms of trade to worsen since the country would now move closer to a trade deficit. Likewise, reserves would also fall, as the country’s central bank would have to use its reserves to buy extra domestic currency in order to keep the exchange rate fixed. The subsequent lowering of reserves would eventually offset the rise in the money supply. However, a country in this situation would be left with higher prices, worsening balance of payments, and lowered reserves. The lower reserves would encourage speculation against the currency and thereby threaten the stability of the fixed exchange rate of the country.

In exchange for accessing IMF loans, countries were expected to reach financial targets aimed at improving the balance of payments, lowering prices, raising reserves, and thus ultimately maintaining the integrity of the fixed exchange system. Whether the causes of the crises were domestic or external, the model dictated austerity through domestic expenditure contractions, which would be achieved by fiscal retrenchment and credit reductions.

The real world of developing countries, is of course replete with large-scale unemployment. Employing such a model, which takes as given that all resources, including labor, are fully utilized, is to put it mildly problematic. There is an extensive literature examining the consequences of IMF loans and associated conditionality on social, political and economic indicators. There seems to be considerable evidence that reforms increase unemployment and poverty rates, exacerbate income equality and reduce social services (Kurtz, 2004, Stallings and Peres, 2000, Crisp and Kelly 1999, Garuda, 2000 and Vreeland 2003). The impact on political stability and democracy is also important. Brown (2009) examines the impact of IMF loans in 23 Latin America countries between 1998 and 2003 on democratic variables like political freedom and civil liberties and finds that democracy levels decline with time and the number and types of conditionality. Arguably, the main focus of the IMF is on improving a narrow set of economic indicators. How has the IMF done?

Bird (2001) summarizes the empirical work from 1978-2000 on the economic dimensions (using a variety of methodologies) including the impact on balance of payments, current account, inflation and economic growth. He finds a mixed picture on the balance of payments and current account, neutral or exacerbation of inflation and a mixed picture on economic growth. In some cases such as Killick (1995), the results are rather surprising in view of data indicated a clear decline in investment levels. Overall, he suggests that one explanation for the differentiated results might be that countries do not fully implement the programs. However, other authors have tested whether full compliance and implementation make a difference. Dreher (2006) uses panel data from 98 countries from 1978-2000 to examine the impact of IMF programs on economic growth. He finds that economic growth declines by about 1.7% per year within the first five years of a program. There is little difference with full compliance with average declines
of around 1.6% per year. More recent empirical studies have illustrated the negative impact of IMF conditionality on economic growth (Przeworski and Vreeland, 2000; Barro and Lee, 2002; and Vreeland 2003).4

In the case of the Asia crisis the imposition of austerity on governments with largely balanced budgets and tight control of the money supply helped turn a panic from a private sector speculation into a disaster. In a recent interview of Wing Thye Woo of the Brookings Institute in the Chinese Daily summed up the feeling in East Asia:

Asian countries, especially those in East Asia, have a deep distrust for the Fund, given its "poor track record" during the 1997 Asian financial crisis and "no proof" that it has improved its competence over the years… at the moment no Malaysian, Indonesian and South Korean government could go to the IMF and expect to survive. (China Daily, Dec. 3, 2008)

South Korea, for example, which desperately wanted to avoid going to the IMF was bailed out in October, 2008 with a $30 billion swap arrangement with the US Fed. Other close US allies including Singapore, Brazil and Mexico received the same arrangement (Merco Press, 2008). More recently Turkey walked away from negotiations in March, 2010 when it felt the Fund was demanding excessively onerous fiscal constraint (Wade, 2010).

What of the World Bank? In recent decades, the Bank has had a mix of project and program aid. The latter became more important after the Bank committed to an agenda focused on neoliberalism as it worked more closely with the IMF in the 1980s. The Bank expanded its programs over time to incorporate a host of new conditions related to their programs including governance. Stein (2008) reviews an extensive literature testing the impact of structural adjustment loans on Africa using a variety of different techniques and finds little consistent evidence that economies have improved from World Bank lending and considerable evidence that the region has done poorly in the adjustment era.5

What of the impact on governance which became increasingly central in World Bank loans after the middle of the 1990s? In the late 1990s, the World Bank Institute and the Research Department of the World Bank initiated a research program on governance indicators and their economic impact. The effort was aimed at illustrating ex post the positive impact of governance on economic growth. In other words improvements in governance indicators have a positive impact on economic growth. The enterprise was on the surface a bit strange since governance had already been operationalized for a number of years. However, this is not unusual in the history of the Bank which often used empirics as an exercise in verification rather than as a mechanism of policy formulation (Stein, 2008). The World Governance Indicators (WGI) have gone through numerous permutations which are beyond the scope of this paper to review.6 Even

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4 Even Williamson (2008) of Washington Consensus fame admits that economic growth has not improved under IMF programs.

5 For negative trends on income distribution and poverty on the continent and their relationship to World Bank agricultural policies see Stein (2010b).

6 The latest iteration is in “Governance Matters VIII” released in June, 2009. See Kaufmann et al., 2009.
with all the variations over time, the causal link between better governance and economic growth has not been established.

Generally WGI measures use a variety of surveys from multiple counties along six lines:

1. **Voice and Accountability** – measuring political, civil and human rights

2. **Political Instability and Violence** – measuring the likelihood of violent threats to, or changes in, government, including terrorism

3. **Government Effectiveness** – measuring the competence of the bureaucracy and the quality of public service delivery

4. **Regulatory Burden** – measuring the incidence of market-unfriendly policies

5. **Rule of Law** – measuring the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence

6. **Control of Corruption** – measuring the exercise of public power for private gain, including both petty and grand corruption and state capture (Khan, 2007)

The data include more than 300 individual variables provided by more than 30 organizations. Each of those organizations has its own methodology and scale. For comparability, Kaufman et al. (2005) normalize these scores into a 0–1 scale and then use them to produce normally distributed indicators. The estimates for each indicator are then the result of a maximum likelihood function. As such, 99% of the values are between −2.5 and 2.5 with higher scores corresponding to better outcomes.

The literature, to put it mildly, has been very critical of the way the indicators are constructed since they are combining radically different largely subjective surveys using different methodologies into single indicators (Apaza, 2009). It is hard to know what objectively is being measured. For example, the corruption index is a composite of views of corruption in public officials, accountability, transparency and corruption in rural areas and a political risk index measuring things like perceptions of nationalism, corruption and nepotism. It arises from information from the Economist Intelligence Unit, IFAD (international fund for agricultural development) rural sector performance assessments and business environment risk intelligence (BERI) put out by Business Risk Service. They all use radically different methods. One person’s bribe is another person’s way of doing business. There is no way of disaggregating what is important and what is trivial. Moreover, the indicators are overwhelmed by business perceptions. Businesses will likely see governments in a more positive light if there are fewer regulations and lower taxes. In contrast, citizens who are poorly represented in these surveys might see the opposite. So what is governance?

In addition, there is strong evidence that countries that are doing well economically are perceived as having better governance. Rich countries get better scores precisely because they are rich. In fact, a study by Kurtz and Shrank (2007) find a strong link in their econometric testing between previous high levels of economic growth and government effectiveness. This raises the entire question of direction of causation.
Kaufmann et al, 2005 have found positive relationships between their governance indicators and economic growth. Khan (2007) questions the results which he argues are significant but weak. Using a standard scatter diagram he clearly shows that positive relationship is overwhelming among developed countries and argues if you remove the developed countries the relationship disappears. It also shows the likely opposite direction of causation eg. higher growth and income leads to better governance. Moreover for developing countries, nations with similar governance indicators are equally divided between those with above average (convergence countries) and below average (divergent countries) suggesting that cause of economic growth is something different than governance.

4. G20 and the “Resurrection” of the IMF and World Bank

The G20 in meetings in April and September 2009 and June, 2010 allocated unprecedented new powers to the IMF. Among other things, the lending capacity of the Fund tripled to $750 billion while its SDR allocation was increased by an additional $250 billion. In July, 2010, it was reported that Strauss-Kahn would press for yet an additional $250 billion at the G-20 meeting in Seoul in November, 2010 (Seo, 2010).

The expansion was possible through the New Arrangements to Borrow (NAB) in which funds were allocated by G20 countries with a promise of a future reallocation of voting rights. However SDRs would be allocated on the current quota system meaning that two-thirds of the total would go to the rich countries of the world. By the September 2009 meeting, the G20 announced it had fulfilled its obligations of $500 billion in new funds under the NAB (G20, 2009). As of April, 2010, Japan had allocated $100 billion, European Union $178 billion, Norway $4.5 billion, Canada $10 billion, Switzerland, $10 billion, US $100 billion, Korea $10 billion, Australia 5.7 billion, Russia, $10 billion, China $50 billion, Brazil $10 billion, India $10 billion, Singapore $1.5 billion and Chile 1.6 billion (IMF, 2010b)

The expansion of the SDRs occurs at a time when China and others are pressing to to create a new global reserve currency to replace the US dollar. China’s influential Central Bank governor Xiaochuan Zhou called for SDRs to go beyond its current IMF accounting role to become a means of payment in international trade and financial transactions (Zhou, 2009).

The September G20 meeting also gave unprecedented power to the IMF to advise when to reverse fiscal expansion, to analyze how the financial sector can contribute to the burden of intervening in financial systems, to monitor the global economy and to report on the efforts to coordinate country economic activity in the new Framework for Strong, Sustainable, and Balanced Growth. The latter includes the economic assessment of individual G20 countries to ensure they are consistent with a balanced trajectory for the global economy(G20, 2009). In June, 2010, in Toronto, the IMF delivered its first G-20 mutual assessment process report (MAP) that called for significant fiscal contraction in deficit countries which would be “growth friendly” based on the typical monetarist formulation that private spending would be “crowded in” as the “credibility of fiscal policy increases over time”.

In the same report, the IMF argued growth would respond to neo-liberal type “structural reform packages” which included deregulation of product markets and wage cuts through “reducing the minimum cost of labor”, “reducing wage indexation” “reforming the employment insurance system” and “removing the financial disincentives to work” (IMF, 2010c). Despite the uncertainty of the global recovery, the G-20 adopted most of the IMF’s recommendations on fiscal austerity and much of the same language. In the Toronto meeting, the G20 also empowered the IMF to work with the Financial Stability Board to issue a report to the October, 2010 meeting of the G20s Finance Minister’s and Central Bankers to strengthen financial supervision and oversight. In addition at the central component of the G20 sponsored reform program is the IMF/World Bank Financial Sector Assessment Program (FSAP) which will be the main mechanism to evaluate the financial sector of member countries (G20, 2010). The FSAP was launched in 1999 to assess the vulnerabilities and risk of the financial systems with more than 125 countries evaluated. In September, 2009, the program was revamped for better cross country comparisons and to increase the frequency of evaluations (IMF, 2010d). As we will see below, their track record of predicting the current financial crisis is less than stellar which is worrisome given their new anointed role as watch guard for international crises.

There is little doubt that the G20 is heavily focused on strengthening the IMF. Beyond the effort to increase its resources and responsibilities has been an attempt to alter its image through the reform of the governance structure:

Modernizing the IMF’s governance is a core element of our effort to improve the IMF’s credibility, legitimacy, and effectiveness… To this end, we are committed to a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries using the current IMF quota formula as the basis to work from…. Today we build on our earlier commitment to open, transparent and merit-based selection processes for the heads and senior leadership of all the IFIs. We will strengthen the selection processes in the lead up to the Seoul Summit in the context of broader reform. (G20, 2010)

Beyond the FSAP, the resources and importance of the World Bank has also been enhanced by the G20. The G20 asked the Bank to raise lending limits to large countries and to make more money available to poor countries with “sustainable debt positions and sound policies” (G20, 2009). In the September 2009 meeting, the G20 recommended expansion of the capital base of the Bank. In April, 2010, the capital base of the IBRD was significantly increased by $86 billion to $276 billion which was the first time in more than 20 years. The IFC was also given an 7 We agreed today on: ..’growth friendly’ fiscal consolidation plans in advanced countries that will be implemented going forward...There is a risk that synchronized fiscal adjustment across several major economies could adversely impact the recovery. There is also a risk that the failure to implement consolidation where necessary would undermine confidence and hamper growth. Reflecting this balance, advance economies have committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016.” Elsewhere, the declaration commits itself to “product, service and labor market reforms...” which includes better wage bargaining systems, changes in unemployment insurance schemes, reducing barriers to foreign competition and simplifying product market regulations (G20, 2010).
additional $200 million. In June, 2010 the G20 asserted that they had fulfilled the Pittsburgh summit commitment to increase the capital base of the multilateral development banks by $350 billion, and further agreed to fulfill their obligations to ambitiously replenish the IDA and the African Development Fund (G20, 2010).

In line with the expansion in the capital base was a shift of 3.13% of voting power to developing and transitional countries. The largest recipients were to members of the G20 including China (1.64), South Korea (.58), Turkey (.55), and Mexico (.5). Power was mostly taken from countries like Japan, the UK and France. Like all previous reallocations of power, there is no challenge to the veto position of the US which remains well above the 15% threshold (15.85%) (G20, 2010, World Bank, 2010a,b). The World Bank claims that the voting share of developed countries has fallen to 53%. However, their numbers are generated using a rather questionable taxonomy. The actual total is still close to 61% using the “high income” country category of the IMF (Bretton Woods Project, 2010).

5 Have the World Bank and IMF Reformed?

World Bank
The World Bank claims that as part of its post crisis reform mandate it will be “sharpening its strategic focus” emphasizing: 1) Targeting the poor and vulnerable… 2) Creating opportunities for growth with a special focus on agriculture and infrastructure; 3) Promoting global collective action on issues from climate change and trade to agriculture, food security, energy, water and health; 4) Strengthening governance and anti-corruption efforts; and, 5) Preparing for crises’ (World Bank, 2010a).” In essence, the Bank intends to expand its purvey in some areas while continuing to focus on many of the same issues, with no discussion of changing the strategies which it has pursued in recent years with such problematic results.

In April, 2010, Robert Zoellick, President of the World Bank delivered an important speech at the Woodrow Wilson Center in Washington, DC. He stressed the world has become multipolar and multilateral development banks had to adjust. In response, he argued “we have launched the most comprehensive reforms in the institution’s history” (Zoellick, 2010). What are the focal points of the reform? First, he points to the move to 47% developing country voting share and the commitment to review this every five years (discussed above). Second, they intend to “modernize” their products and services by further decentralizing their operations. Third, they will strengthen their anti-corruption and governance efforts, become more accountable and introduce a new access to information policy. To Zoellick, in the new world “Development is no longer North-South…Nor is it about ideological panaceas, blue-prints or one size fits all…development is about pragmatism [and] learning from experience…”

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8 Key changes in the operation of the Bank and Fund require a vote exceeding 85%. Since their inception, the US as always maintained a voting power exceeding 15% providing it with veto power.
Zoellick claims the reforms are “transformational”. However, how does the reality measure up? Elsewhere in the speech he seems to reaffirm a strong commitment to the neo-liberal policies of the past. He claims that new financial regulations being proposed “could choke off the financial sector, innovation and risk management in developing countries” and “make it harder to invest across national borders”. He talks of the need to listen to developing countries but claims “[t]hey want free markets to create jobs, higher productivity and growth [and] are exploring how to use the innovation and efficiency of private markets to help provide and maintain public sector infrastructure and services.” He talks of the need for Africans to produce their own consumer goods but instead of calling for industrial policy he calls on increasing the demand from farmers for the products by recognizing their property rights and for the Chinese to move to Africa’s industrial zones. To any long term observer of the Bank all of this seems to be a reaffirmation of the neo-liberal policies of the past with its emphasis on financial and market deregulation, privatization and free trade. Where is the avoidance of “ideological panaceas” and the “one-size fits all” approaches?

What of the other proposals? Emphasis on governance and anti-corruption has been a mainstay of the Bank since mid-1990s as is the increasing access of the public to Bank documents and information. Decentralization has also been in place for some time. As Wade (2010) points out the Bank already significantly decentralized in the Wolfensohn reorganization of 1997-98. At this point already 60% of its 5,200 regional staff already operate in 120 countries throughout the world.

So what is this about? Zoellick pretty much gives it away in his speech: “We will need resources to support renewed growth and to make a modernized multilateralism work in this new multipolar world economy.” This is to be done through the first capital increase in 20 years with over half the resources coming from developing countries. What is important here is the appearance of change and the reallocation of voting right to developing countries without a fundamental alteration in the agenda of the World Bank. What of the IMF?

**IMF and Financial Sector Assessment Program**

As we saw above the IMF and World Bank have been allocated an increasing role in assessing the vulnerabilities and risk of the financial systems in individual countries. The IMF and World Bank claimed that they revamped their program in September, 2009, “to improve the quality of assessments and incorporate the lessons from the recent crisis.” (IMF, 2010d).

One can only hope this is the case. Perhaps due to an unwarranted belief that the private financial sector will be self-correcting, the FSAP reports were woefully inadequate in predicting the crisis or suggesting measures to prevent it. Take the FSAP report on Iceland which was based on an assessment in August, 2008 only a few short weeks prior to the full blow financial crisis of
October, 2008. The report which had a few minor worries about the financial system felt that the regulatory system was up to the task:

Iceland has strengthened its legal framework for effective banking supervision and enhanced the FME’s capacity to supervise credit institutions. All the issues raised in the BCP assessment of 2003 have been addressed and the legal framework for banking supervision provides the FME with sufficient legal powers to perform its prudential tasks.”(IMF, 2008c, p.27)

Even more worrisome was the view that the two largest private sector banks had taken very positive measures to strengthen their balance sheets largely through the expansion of foreign deposits which proved so costly later:

Funding risk is a critical vulnerability for the Icelandic banks…The banks have taken steps to manage this risk. All three have diversified their funding structure, developing new deposit bases through the establishment of deposit-taking businesses abroad, particularly through the marketing of internet banking products. Both Kaupthing and Landsbanki have been particularly successful, with new deposits growing by 90 percent and 112 percent. Banks have also begun to contract and rationalize their asset structures, selling subsidiaries and reducing loan portfolios in noncore areas.”(IMF, 2008c, p.18)

Two months later, in October, 2008, the two banks that they indicated were handling things well collapsed and were nationalized. The foreign deposits the IMF was hailing as a great solution to stabilizing the balance sheets of the banks has created a huge headache for Iceland largely because the supervision by the authorities was so weak.

“The Icelandic financial regulators failed to assert any meaningful control over Landsbanki’s rapid ascension in the 2000s. When the house of cards began to fall after Lehman Brothers’ default, Landsbanki offered high interest saving accounts over the internet for depositors in a last-ditch effort to maintain liquidity. The Icelandic government at least implicitly guaranteed the deposits, as required under European Economic Area (EEA) rules, but failed to properly evaluate the level of risk or to charge the bank an appropriate premium. As a result, the deposit insurance fund was incapable of meeting the 20,887 euro guarantee, or about 3.7 billion euros for the non-Icelandic accounts. The British and Dutch governments seized Landbanki assets within their countries, immediately paid their domestic depositors to avoid a run on their banks, then asked how Iceland intended to repay them.” (Erlingsgottir, 2010)

Iceland's voters in a referendum overwhelming rejected plans to settle their country's dispute with the United Kingdom and the Netherlands regarding the government's liability for losses
suffered by the depositors of the IceSave accounts when its parent--Landsbanki--collapsed in 2008. As one commentor put it:

In the end, however, I am reminded of King Pyrrhus's response to congratulatory messages he received after suffering heavy losses while defeating the Roman army at Asculum in 279 BC: "Another such victory and I am undone….It is almost certain that Iceland's access to desperately-needed capital will be cut off. It is unlikely that the IMF (or anyone else) will provide any additional funds until the matter is resolved. Iceland's already low sovereign rating will be downgraded even further, requiring the government to pay even higher interest rates. Iceland will never get into the European Union without support from the United Kingdom and Holland. (Erlingsgottir, 2010)

Pro vs. Countercyclical Policies

After the start of the crisis, the Fund argued they would shift from their normal position and support an increase in fiscal expenditures to deal with the collapse. This is quite explicit in a now widely quoted IMF paper by Antonio Spilimbergo et al (2008).9 There is little doubt from the discussion surrounding the IMF's G20 Mutual Assessment Process that we are back to ‘business as usual” with the IMF again promoting deficit reduction in the belief that it will crowd-in private spending. Along those lines, recent authors have pointed to the idea that if the Fund has supported fiscal expansion it has been ephemeral.

Van Waeyenberge et al (2010) review IMF programs in 13 poor countries signed between 2007 and 2009. They find that six have fiscal tightening and seven very moderate increases averaging 2.5% of GDP in 2009. Overall, while there was an initial projection of a rise of deficits of 1.5% of GDP in 2007 to 3.7% in 2009, the latest figures show a rise of only 1.5% in 2009. By 2010 almost all countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”. Moreover, all 13 countries are expected to tighten their belts with an anticipated average decline of .5% of GDP. They conclude “endorsed increase has not only been moderate, but also restricted to the short term”.

Although the run up in prices in 2008 was mostly from rising food and commodity prices, the focus in the IMF programs is to curtail aggregate demand through freezing wage and monetary contraction and increases in interest rates. These measures are likely to worsen the recession and harm the standard of living of the poor.

How much evidence was there on even this short-term commitment to counter cyclical monetary and fiscal policy? Weisbrot et al. (2009) examine 41 IMF accords signed in the wake of the economic downturn and find 31 of them with pro-cyclical fiscal (increasing surpluses or lowering deficits) and/or monetary policies (increasing interest rates). In only one country was

9 They argue that the economic downturn was driven both by a financial crisis and the collapse in aggregate demand,. They indicated the usual option for addressing aggregate demand through devaluations, which is to stimulate exports through monetary policy, was not available. The former because it is a global phenomena and will only lead to competitive devaluations and the latter because it has already been fully utilized in many countries or because the financial sectors have become too dysfunctional for it to work. They argued “in these circumstances, the Managing Director of the IMF has called for a sizable fiscal response at the global level….” Spilimbergo et al (2008)
there both anti-cyclical fiscal and monetary policy (Tanzania), five others had either counter-cyclical fiscal or monetary policy alone (Mozambique, Sao Tome and Principe, Guatemala, Zambia and Niger) and the other four had neither. However, a closer reading of the IMF agreements indicates that even this interpretation can be considered generous. Let us work through three examples.

Tanzania received an ESF of SDR 210 million in May 2009 and was allowed to have monetary and fiscal expansion. The IMF claims in a press relief that ‘expansionary fiscal and monetary policies in the current situation are appropriate to cushion the effects of the crisis’ (IMF, 2009a). One might get the impression that they are fully supporting the expansionary policies necessary to deal with the severity of the economic downturn. However, a deeper reading indicates a less than robust intervention and the existence of embedded targets that are rather contrary to counter-cyclical fiscal and monetary policy. For example, Tanzania is expected to reduce inflation to 5 per cent in 2009-2010 compared to 11 per cent in 2008-2009, government revenue is expected to rise to 16.8 per cent of GDP in 2010-2011 compared to 15.8 per cent in 2008-2009, and credit is supposed to diminish by roughly 10 per cent in 2009-2010. These would indicate the usual IMF austerity through fiscal and monetary contraction.

So where is the evidence in support of policy expansion? Government spending is projected to increase to 26.3 per cent of GDP in 2008-09 compared to 24.4 in 2007-08. In 2009-2010 they are to rise to 27.2 per cent. This sounds like fiscal expansion. However, the figure matches the planned level of 2008-2009 that fell short. By 2010-2011, the percentage is expected fall below the planned 2008-09, meaning we are back on the path to austerity.

The deficit is permitted to rise to 1.2 of GDP in 2008-09 and 1.6 per cent in 2009-10 but then expected to fall again by 2010-11 (to 1 per cent of GDP). Interest rates on newly issued treasure bills are to be 12 per cent in 2009-10 down from 13.2 per cent the previous year. In real terms this is a huge jump in interest rate levels! Since inflation is targeted to decline from 11 to 6 per cent, this means a jump from 2.2 per cent to 6 per cent—hardly a way to stimulate the economy through monetary expansion (IMF, 2009b).

Weisbrot et al. (2009) argue that in Zambia the “IMF allowed monetary policy to ease in 2008 in order to accommodate higher food and oil prices…authorities expect to bring inflation down to 10 percent in 2009, while allowing for positive rates of growth of real broad money and real credit to the private sector.” The interpretation is questionable. The IMF’s PRGF third year review states:

“Monetary policy is to be geared to bringing inflation firmly to the single digit range by the end of the year 2010” (IMF, 2010e)

Growth of credit to the private sector in 2010 is expected to be less than 2007 and 2008. Commercial bank rates for loans have been steadily rising through the crisis period and averaged 22% in 2009 (IMF, 2010f). Not surprisingly, recent data indicates that broad money growth has plummeted from 45% in 2006 to only 8% in 2009 and has fallen relative to GDP (IMF, 2010f). One can hardly call this countercyclical monetary expansion.
In Mozambique, Weisbrot et al. (2009) state that the IMF is permitting moderate fiscal expansion because, “the fiscal program is revised to incorporate higher levels of domestic financing, which are increasing by about 1.1 percent of GDP.” In the executive summary of the June, 2009 ESF agreement the IMF claims that “Fiscal policy has been eased to maintain priority spending in the face of lower domestic revenues” GDP (IMF, 2009c).

This characterization is suspect when examined more closely. The deficit figures for 2008 actually show a decline due to rising revenue and falling spending relative to GDP (IMF, 2010f). In the December, 2009 review of the ESF, the IMF confesses that fiscal policy was “less accommodating than expected”. Moreover, the IMF emphasizes “The return to a prudent fiscal policy stance will be conducive to preserving Mozambique’s low debt indicators and low risk of debt distress.” In the same memo, the government emphasized that the growth of the deficit by about 2% in 2009 was partly due to policies to reduce wage compression in the civil service (which has been a big priority of the Bank and Fund10), was kept low by a “temporary cut in priority expenditures” and that in 2010 it fully expects to reduce the deficit. In essence, the slight rise in the deficit for only a single year was largely a product of fulfilling other IMF/World Bank priorities rather than a serious commitment to countercyclical policies. They assured the IMF that “The Government remains committed to its medium-term fiscal strategy geared toward preserving debt sustainability, containing inflationary pressures, and limiting recourse to domestic financing to make room for sustainable private sector credit growth.” (IMF, 2009d).

In sum, arguments that the IMF has become an adherent of anti-cyclical policies seems overly generous. What of other reform efforts?

From Ex Post to Ex Ante Conditionality: Do we have real reform?

At the core of the IMF claim of “modernizing conditionality” are the new Flexible Credit Lines with their purported move from ex poste to ex ante conditionality. The Fund will also shift from structural performance criteria to program reviews (IMF, 2009e). The extent to which this is a real change is certainly subject to debate. If lending is short-term (FCLs are renewed annually), the difference between an ex ante and ex post approach seems to blur. If country policies indicate slippage the credit arrangement will simply not be renewed. How is this any different than multiyear lending, the most common IMF facility, with annual reviews and benchmarks?

The FCL agreement with Mexico in April, 2009 heavily emphasized the “very strong fundamentals” including low inflation and an anti-inflationary bias of the central bank, large reserves, a balanced budget fiscal rule, cutbacks in government debt and a flexible exchange rate. Despite the rapidly deteriorating growth, the IMF was confident of “the public debt in Mexico remaining manageable under all scenarios, with public sector gross financing requirements set to continue their trend decline as a share of GDP” (IMF, 2009f, p.15). Expecting a further decline in the deficit under this scenario is almost identical to imposing austerity as part of a package of conditionality. If the deficit moves in the other direction, then this can lead to a blocking of the

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10 Reversing wage compression is a central part of the civil service reform component of the World Bank’s poverty reduction support credits to Mozambique (World Bank, 2009b)
renewal of the FCL. The Mexico government was clearly aware of this and replaced falling oil revenues with new taxes allowing the IMF to renew the FCL in March, 2010 (IMF, 2010g).

7. Summary and Conclusions

A number of the policy strategies in the US and elsewhere that generated the current global crisis (financial liberalization, deregulation, state retraction in social spending, privatization, internationalization of banking, etc.) are similar to those imposed by the Bank and Fund on the least developed countries for more than a quarter of a century. While developed countries are fearfully focused on the possibility of a depression, the least developed countries have been in a Great Depression for decades as a result of these policies.

Sub-Saharan Africa per capita income fell by more than 40% from 1980 to 2002 (World Bank, 2005). The number of people living under $1.25, the international poverty benchmark, increased from 213 million in 1981 to 390 million people in 2005 and constituted more than half the population of the continent (Chen and Ravallion, 2008). While there was an increase in GDP growth after 2002, the boom was largely as a result of a temporary increase in commodity prices particularly in oil which has not funneled down to the most of the population. The region has felt the full effects of the global downturn. In 2009 SSA GDP growth fell by 4.4% compared to the rates of 2004-08(IMF, 2010h).

In a manner similar to the crisis of 1997-98, the Bank and Fund have now been re-empowered and resurrected into a more central role in the global economy. Middle income countries will at some point in the future again exit from the tentacles of the Fund and Bank. However, poor developing countries that are caught in a permanent debt trap with few alternative sources of financing will continue to be dependent on the Bretton Woods twins.

Changing the policy strategies will mean a fundamental reconceptualization of what generates growth and development. Evidence supporting Zoellick’s claims that reforms in the World Bank are “transformational” or Strauss-Kahn’s claims that the IMF has “learned from its mistakes” and “flexible to the peculiarities of each country’ seems rather hollow in view of the above evidence. The road to reform is daunting but imperative. Like the depression of the 1930s, we must use this moment to intrepidly challenge entrenched interests and the policies that for far too long have been perpetuated at the expense of the poor and dispossessed.
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