



Imad A. Moosa
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Eliminating the IMF

An Analysis of the
Debate to Keep, Reform
or Abolish the Fund

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To Danny, Ryan and Ivy

PREFACE

This book is written in the normative, rather than positive, tradition to point out what ought to be, rather than what is, with respect to the question of what to do about the International Monetary Fund (IMF). Although the views on this issue vary, they fall under three alternative courses of action: keep, reform or abolish. Calls for the preservation of the IMF are made by those who want to maintain the status quo, those who want to introduce cosmetic changes and those who want the IMF to expand and its mandate broadened. Those calling for reforming the IMF put forward various suggestions that boil down to limiting the damage inflicted by IMF conditionality on poor countries. Then there are those who believe that the IMF should be abolished, either because the purpose for which it was created is no longer there or because the Fund has done so much damage and inflicted so much pain on the developing world that no amount of reform would suffice.

The book is divided into seven chapters. The main issue under consideration, which is what to do about the IMF, is dealt with in Chap. 6, before the concluding thoughts are outlined in Chap. 7. To put the debate into perspective, some background discussion of the issues motivating each course of action (keep, reform or abolish) is necessary. In Chap. 1 we present a self-portrait of the IMF, outlining its history and functions from the perspective of the Fund itself. In Chaps. 2 and 3 we evaluate the principles guiding IMF operations, including the ten commandments of the Washington Consensus and some other variants that can be summarised in three words: liberalisation, privatisation and deregulation. In Chap. 4 we describe some violent reactions to IMF operations (taking the form of

riots, civil unrest and mass demonstrations) and explain why the conditionality associated with IMF loans triggers violent popular reactions in the borrowing countries. Chapter 5 deals with the effects of IMF operations on social expenditure. The conclusion that we reach is that most of the world would be better off without the IMF.

This book is written by a father and daughter. The father is an economist with first-hand information on some of the issues discussed in this book, obtained through employment and advisory roles. The daughter is a clinical health scientist-turned health economist. She primarily wrote the parts of the book dealing with the effects of IMF operations on health and education. The book is an extension of the propositions put forward in two articles that were published in a special issue on the IMF of *Management and Economics Research Journal*: “The Consequences of IMF Conditionality for Government Expenditure on Health” and “Has the IMF Outlived its Usefulness or Gone Past its ‘Use-by’ Date?”

Writing this book would not have been possible without the help and encouragement we received from family, friends and colleagues. Our utmost gratitude must go to our families who had to bear the opportunity cost of writing the book. Therefore our thanks go to Afaf, Mike, Danny, Ryan and Ivy. Afaf used her expertise to draw the diagrams shown in the book, something that we could not have done without her help. We received help and support from Vikash Ramiah, Brien McDonald, Monica Tan, Marie-Anne Cam, Bob Parsons, Greg O’Brien, Greg Bailey, Paul Rule, Peter Murphy, Bob Brownlee and Ron Ripple. We are grateful to Bill Breen for serious comments on some parts of the manuscript. We also thank Kevin Dowd for his insightful comments on the proposal and his never-ending intellectual support. All remaining errors and omissions are entirely ours.

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ABBREVIATIONS

ABC	Australian Broadcasting Corporation
ACFE	Association of Certified Fraud Examiners
AIDS	Acquired Immune Deficiency Syndrome
AT&T	American Telephone and Telegraph
BBC	British Broadcasting Corporation
BCBS	Basel Committee on Banking Supervision
BRICS	Brazil, Russia, India, China and South Africa
CA	California
CEO	Chief Executive Officer
CGD	Center for Global Development
CIA	Central Intelligence Agency
CIGI	Centre for International Governance Innovation
CNY	Chinese yuan
COSATU	Congress of South African Trade Unions
CPI	Corruption Perception Index
CRA	Contingent Reserve Arrangement
DC	District of Columbia
EU	European Union
EUR	Euro
FBI	Federal Bureau of Investigation
FCIC	Financial Crisis Inquiry Commission
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
GAO	Government Accountability Office
GBP	British pound
GDP	Gross Domestic Product
HIV	Human Immunodeficiency Virus

HQ	Headquarters
IBRD	International Bank for Reconstruction and Development
IEO	Independent Evaluation Office
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IPES	International Political Economy Society
JPY	Japanese yen
KBR	Kellogg Brown & Root
LDC	Less Developed Country
MIT	Massachusetts Institute of Technology
MNC	Multinational Corporation
MP	Member of Parliament
NBER	National Bureau of Economic Research
NSA	National Security Agency
OTC	Over the Counter
PA	Pennsylvania
PIGS	Portugal, Ireland, Greece and Spain
PR	Public Relations
PRGF	Poverty Reduction and Growth Facility
R&D	Research and Development
S&L	Savings and Loan
SAP	Structural Adjustment Programme
SBS	Special Broadcasting Service
SDR	Special Drawing Rights
SEC	Securities and Exchange Commission
SIFI	Systemically Important Financial Institution
TB	Tuberculosis
TBTF	Too Big to Fail
TX	Texas
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNISA	University of South Australia
UNITA	National Union for the Total Independence of Angola
USD	US dollar
VA	Virginia
WP	Working Paper

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CHAPTER 1

The IMF at Face Value

1.1 INTRODUCTION

The International Monetary Fund (IMF), also known as the Fund, was established in July 1944 as a product of a conference that was held in Bretton Woods (New Hampshire, US) to formulate and implement monetary arrangements, pertaining to exchange rates and international payment mechanisms, for the post-war period. Exchange rate arrangements were the prime focus of the 44 participating countries in view of the damage inflicted on the world economy by competitive devaluation and the extensive use of *beggar-thy-neighbour* policies in the 1930s. Those policies contributed to the intensification of the Great Depression and led to dwindling international trade. In essence, the primary function of the IMF was set to be the supervision of the Bretton Woods system of fixed but adjustable exchange rates.

In 2012, however, the Fund's mandate was upgraded to give it more responsibilities encompassing issues that pertain to international macro-economic and financial stability. This may sound peculiar, given that the Bretton Woods system of fixed but adjustable exchange rates collapsed in 1971 following the announcement by President Richard Nixon of the decision to abolish the convertibility of the dollar into gold, which was one of the main pillars of the system. By 1978, and following years of drifting towards floating, a new international monetary system emerged whereby countries are allowed to adopt the exchange rate systems that they deem suitable for their economies. Hence the extended IMF mandate

must have been in place long before 2012—otherwise, the Fund would have had nothing to do in the absence of a system that it was created to supervise. Currently, this is how the IMF describes its responsibilities in the factsheets posted on its website:

The International Monetary Fund, or IMF, promotes international financial stability and monetary cooperation. It also facilitates international trade, promotes employment and sustainable economic growth, and helps to reduce global poverty.

In a way, therefore, the IMF has turned itself into many things, including a financial and macroeconomic advisor, a trade promoter and a development agency. These functions are invariably performed and the underlying responsibilities assumed by other international organisations, including the Bank for International Settlements, the World Trade Organisation (the United Nations Conference on Trade and Development [UNCTAD] before that) and the World Bank.

The objective of this chapter is to present an overview of how the IMF perceives itself, particularly with respect to its responsibilities and accomplishments. We present a description of these responsibilities and accomplishments as portrayed by the IMF—hence it is a portrayal of the IMF at “face value”. We start by examining the origin and growth of the IMF. An account of the international monetary systems in operation before and after the establishment of the IMF is presented in Sect. 1.8.

1.2 ORIGIN AND GROWTH

The 1944 Bretton Woods conference materialised as a result of the work of John Maynard Keynes (then of the British Treasury) and Harry Dexter White, of the US Treasury, on the development of ideas pertaining to the post-war international monetary system. H.D. White believed that the IMF should function like a bank, making sure that borrowers would not default and meet their repayments on time. J.M. Keynes, on the other hand, was in favour of the idea that the IMF would be a cooperative fund upon which member states could draw to maintain economic activity and employment through periodic crises. The view of H.D. White prevailed, eventually leading to the use of conditionality provisions to make sure that borrowing countries repay their debt.

Following negotiations, mainly between British and American officials, a “Joint Statement by Experts on the Establishment of an International Monetary Fund” was published simultaneously in a number of Allied countries on 21 April 1944. In the following month, the US government invited the representatives of 44 countries to participate in a conference that was held in the Mount Washington Hotel in Bretton Woods, New Hampshire, to discuss a framework for a post-war international monetary system. The conference became known as the “Bretton Woods Conference” or, more formally, “the United Nations Monetary and Financial Conference”. A total of 730 delegates participated in the conference over the period 1–22 July 1944. Schuler and Bernkopf (2014) provide a “nearly complete list” of the people who attended the conference by collating published documents containing lists of participants.

The main products of the Bretton Woods conference were (i) articles of agreement for the establishment of the IMF to supervise exchange rate arrangements; (ii) articles of agreement for the establishment of the International Bank for Reconstruction and Development (IBRD), which subsequently became the World Bank, to supervise post-war reconstruction and foster economic development; and (iii) other recommendations and thoughts pertaining to international economic cooperation. The IMF agreement comprised the following components: (i) an exchange rate system of fixed but adjustable exchange rates whereby adjustment is resorted to only to correct a “fundamental disequilibrium”; (ii) currency convertibility for the purpose of settling current account transactions; and (iii) subscription to the IMF’s capital (the quota system). The articles of agreement for the IMF signed at Bretton Woods did not come into force until its ratification by countries commanding at least 80% of capital subscriptions—that threshold was reached on 27 December 1945 with the participation of 29 countries.

The IMF was organised formally in a meeting held in Savannah, Georgia, during the period 8–18 March 1946. By the end of 1946 the IMF had grown to 39 members, and on 1 March 1947, the Fund began its financial operations when France became the first borrower on 8 May of that year. Because of the damage inflicted on Europe in World War II, the Bretton Woods agreement allowed for inconvertibility of the currencies of European countries while they were rebuilding their economies. It was not until the late 1950s that European currencies became convertible again. The Japanese yen (JPY) did not become convertible until the early 1960s.

The IMF's influence was enhanced by the growth of membership as more and more countries joined the Fund following their independence from colonial powers. It is noteworthy, however, that not all member countries of the IMF are sovereign states, in the sense of being members of the United Nations (UN). Examples are non-sovereign regions that are officially under the sovereignty of full UN member states, such as Aruba, Curaçao, Hong Kong and Macau. Former members include Cuba (left in 1964) and Taiwan, which in 1980 was replaced as a member of the UN by the People's Republic of China. However, the IMF recognises the "Taiwan Province of China", at least for statistical purposes. Apart from Cuba, other UN members that are not members of the IMF include Andorra, Liechtenstein, Monaco and North Korea. The former Czechoslovakia was expelled in 1954 for failing to provide the data required by the IMF, which is a condition of membership, but it was readmitted in 1990 following the collapse of the Soviet Union. Poland withdrew from the IMF in 1950 but resumed membership in 1986.

To qualify for IMF membership, a country must (i) make periodic membership payments towards their quotas, (ii) refrain from currency restrictions unless granted IMF permission, (iii) abide by the code of conduct in the IMF articles of agreement and (iv) provide national economic data and information. During the period between 1945 and 1971, when the Bretton Woods system was in operation, member countries agreed to maintain their exchange rates at levels that could be adjusted only to correct a "fundamental disequilibrium" in the balance of payments, and only with the IMF's approval. According to the IMF, the benefits of membership include (i) access to information on the economic policies of all member countries; (ii) the opportunity to influence other members' economic policies; (iii) technical assistance in banking, fiscal affairs and exchange matters; (iv) financial support for countries experiencing payment difficulties; and (v) increased opportunities for trade and investment (see, e.g., https://www.imf.org/external/np/exr/center/mm/eng/mm_bnfts.htm).

1.3 SURVEILLANCE

Surveillance is a formal system used by the IMF to monitor economic policies and indicators on national, regional and global levels, with the objective of maintaining stability and avoiding crises. By monitoring economic and financial developments, the IMF is in a position to provide advice to member countries and promote policies. According to the IMF's website,

the Fund supports policies that “foster economic stability, reduce vulnerability to economic and financial crises, and raise living standards”. Surveillance is believed to be important for the purpose of “identifying stability and growth risks that may require remedial policy adjustments”. The IMF describes “vigilant monitoring” as “critical” because “the problems or policies of one country can affect many others”.

The function of surveillance involves annual visits to member countries to enable the IMF staff to meet government and central bank officials for the purpose of conducting discussions about exchange rates, monetary policy, fiscal policy and regulatory policy, as well as “structural reforms”. The visits also involve meetings with members of the legislature and representatives from the business community, labour unions and civil society. The results of the discussions are presented in a report to the Executive Board, which subsequently transmits the findings and recommendations to the country in question as part of what is known as “Article IV consultation”. The country may issue a press release summarising the analysis and recommendations coming out of the exercise.

A product of the function of surveillance is a set of reports, including *World Economic Outlook*, *Global Financial Stability Report*, *Fiscal Monitor* and *External Sector Report*, as well as a series of regional economic outlooks. The *World Economic Outlook* provides analysis of the global economy and its growth prospects, dealing with issues such as the macroeconomic effects of global financial turmoil and the potential for global spillovers. The *Global Financial Stability Report* monitors financial imbalances and vulnerabilities that pose potential risks to financial stability. The *Fiscal Monitor* updates medium-term fiscal projections and assesses the state of public finance in member countries (government revenue, expenditure and fiscal balances). *External Sector Reports* analyse and assess the external positions of the world’s largest economies. The analysis presents a systematic assessment of current accounts, exchange rates, external balance sheet positions, capital flows and international reserves. Twice a year the IMF issues a *Global Policy Agenda* that pulls together the key findings of and policy advice derived from various reports, proposing a future policy agenda for the IMF and its members.

The IMF periodically reviews its surveillance and monitoring activities as the global economy changes and crises erupt. The 2011 review focused on multilateral surveillance, laying the foundation for the 2012 Integrated Surveillance Decision, which focuses on domestic and balance of payments stability, as well as systemic stability. In September 2012 the Financial

Surveillance Strategy was endorsed to strengthen IMF monitoring. The 2014 review recognised the need to make surveillance adaptable, emphasising selectivity. A key priority was to fine-tune surveillance through better tailoring of advice on the fiscal, monetary, external and structural policy mix, based on cross-country experiences and supported by a more client-focused approach. Five operational priorities were identified for the period 2014–2019: risks and spillovers, macro-financial surveillance, structural policy advice, cohesive and expert policy advice, and a client-focused approach.

1.4 FINANCIAL ASSISTANCE

The IMF provides loans to member countries for the purpose of dealing with actual or potential balance of payments difficulties. The financing function is typically a component of an adjustment programme that is designed “in close cooperation with the IMF”. In April 2009, in the aftermath of the global financial crisis, the IMF “strengthened its lending capacity and approved a major overhaul of its financial support mechanisms”. A change was introduced in 2009 to boost the loan resources available to low-income countries such that the average limits under the IMF’s concessional loan facilities were doubled. In 2016 the limits under non-concessional lending facilities were reviewed and expanded. In addition, zero interest rates on concessional loans were extended through the end of 2018, whereas the interest rate on emergency financing is permanently set at zero. In 2014 loan resources were replenished to support the IMF’s concessional lending.

The main source of financing for the loans granted by the IMF to member countries are the quotas assigned to member countries, which constitute contributions to the IMF capital. These quotas, which are based on the relative positions in the world economy, are reviewed regularly. A formula is used to determine the quotas by considering as primary determining variables the size of the economy (measured in terms of gross domestic product [GDP]) and the level of openness (with weights of 0.5 and 0.3, respectively).

The quotas determine resource contributions (the maximum amount of financial resources provided by a member country) and voting power (such that one vote is equal to SDR100,000), which means that the total number of votes for a country is its quota divided by 100,000. Figure 1.1 shows the percentage of quotas of the top 20 countries, with the US appearing on top (as expected) whereas Indonesia is number 20. The pattern of the corresponding votes is exactly identical.

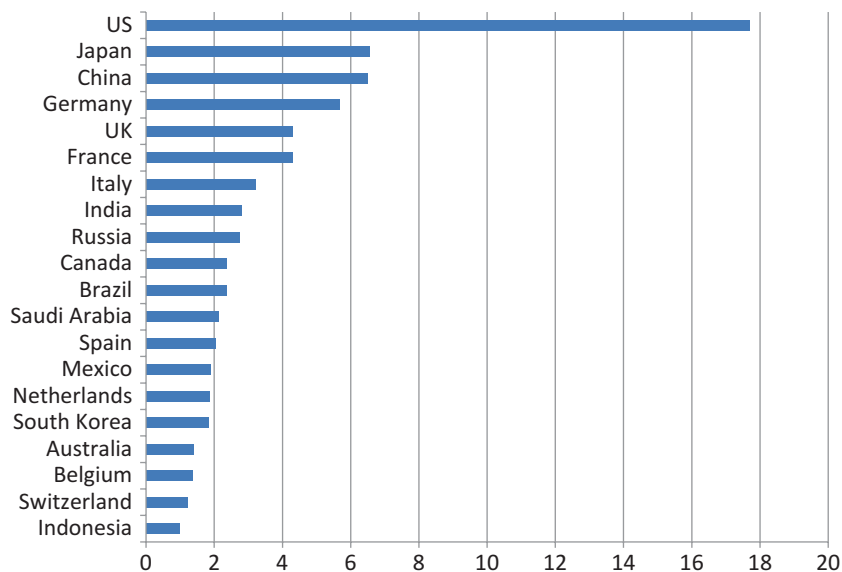


Fig. 1.1 IMF quotas (%)

1.5 CAPACITY DEVELOPMENT

The IMF provides technical assistance and training with the objective of helping member countries to “build better economic institutions and strengthen related human capacities”. Technical assistance and training cover a number of areas including policy design, regulation and supervision, legislation and economic statistics. As far as fiscal policy is concerned, the objective is to “enable governments to maintain fiscal sustainability, enhance infrastructure (such as schools, roads and hospitals), improve social safety nets, and attract greater investments”. The areas covered under fiscal policy include the mobilisation of revenues, management of public expenditure, budget formulation, management of domestic and foreign debt, and the establishment of social safety nets. With respect to monetary policy, the objective is to help central banks pursue sound monetary and exchange rate policies. The Fund also works with financial regulators in member countries to boost financial regulation and supervision, with the objective of establishing macroeconomic and financial stability. With respect to the legal framework, the objective is to align the legal and governance frameworks to the international standards