The Role of the IMF

JOSEPH STIGLITZ, FORMERLY CHIEF ECONOMIST OF THE WORLD BANK, WON THE 2001 NOBEL PRIZE FOR ECONOMICS FOR HIS FOR ANALYSIS OF MARKETS WITH ASYMMETRIC INFORMATION.

NEW YORK — The 1997–98 global slowdown in one region — East Asia — spread from there to Russia and to Brazil, eventually threatening a global meltdown. Even countries that seemingly had had good macro-management, and been given A and A+ by the International Monetary Fund (IMF), were touched. They found their interest rates soaring and faced budgetary problems to which their political systems could not, or did not, adapt well.

The IMF mismanaged that crisis, exacerbating the downturns, and as the economies in East Asia slid into recession and depression, commodity prices collapsed. It was as much through the deterioration of commodity prices and trade as through capital markets that the problems of East Asia spread around the world.

Then, strong growth in the US helped prevent a downward tailspin. Today, America's downturn has been part of the problem rather than the solution.

Meanwhile, Europe is discovering that the strait-jacket in which it put itself may have solved yesterday's problems but left it ill prepared for today's. It has an independent central bank that focuses exclusively on inflation and, like a child, goes out of its way to prove its independence every time political leaders rightfully express their concern about growth and unemployment. Unable to draw upon monetary policy, it also cannot turn to fiscal policy because of constraints on deficits.

America will weather this storm. It may already be recovering. But the rest of the world will not be so lucky. Already countries like Singapore that managed to avoid a downturn in the last crisis have sunk into recession; and many countries in Latin America are being hit hard, even before they fully recovered from the last downturn.

While it would be nice to be able to blame macro-mismanagement in these developing countries — just as the IMF and the US Treasury blame East Asia's crisis on their lack of transparency — this simply will not do: Even countries like Bolivia and Uruguay that have continued to earn the IMF's and Wall Street's respect are now facing recession and worse.

America and the other advanced industrialized countries have a large stake in what happens — if these countries see increasing unemployment, accompanied, as it so often is, by urban crime and violence, a further dissolution of the already fragile social capital, there will be disenchantment with globalization, the market economy and possibly even democracy.

America will weather this storm. It may already be recovering. But the rest of the world will not be so lucky.

Fortunately, the international community has already set up an institution to deal precisely with such a situation. As World War II was coming to an end, the victorious nations worried that the world would again slip into another depression. It had only been the war that had moved the world out of that economic calamity. The same person who had helped us understand the causes of such downturns and what countries could do played the central role in crafting a new global institution. The great intellect and international statesman was Lord Keynes; the institution was the International Monetary Fund. It was to provide liquidity to countries needing to finance expansionary fiscal policies to overcome an economic downturn, in circumstances such as those today, when monetary policy was proving ineffective.

Unfortunately, something happened in the 50 years since.

Today, all too often, the IMF insists as a condition for providing assistance that countries engage in contractionary monetary and fiscal policy, worsening the downturn — in contrast to the IMF's founding principles, in which assistance was to be provided on the condition that countries engage in expansionary policies. Even countries that might be able to obtain funds to stabilize their economy through, for instance, the forward sale of natural resources are pressured not to do so.

And IMF pressure is effective, because without IMF support not only will countries find it difficult attracting investors, but also much foreign assistance is conditional on IMF approval. Today, countries are repeatedly asking, "Why is it that in the US, when you are facing a slump, you have expansionary fiscal policies? These are the policies that we were taught in our economics courses in your universities. Why is it that you go further — pressure was put on Japan to have expansionary policies? But when it comes to the poor developing countries, least able to withstand a downturn, with the most inadequate safety nets for those who will be thrown into unemployment and poverty, you insist on contractionary policies?"

Today, all too often, the IMF insists as a condition for providing assistance that countries engage in contractionary monetary and fiscal policy, worsening the downturn — in contrast to the IMF's founding principles, in which assistance was to be provided on the condition that countries engage in expansionary policies.

Today, we have the kind of problem that Keynes and others worried about 60 years ago: a global insufficiency of aggregate demand. The problem is no surprise: A few countries, like China, are running massive surpluses, in effect spending less than their income, putting the difference into reserves. Other countries, worried about trade deficits, are trying to trim them and put aside reserves. The IMF has the capacity to provide the required liquidity. Even better, it can enhance global liquidity by providing funds to areas of global concern — to promote a better environment, to help the poorest and most indebted countries, to fight diseases, to foster education.

To be sure, for this all to be done in the most effective way might require revisions in the charters of the international institutions, better teamwork between the World Bank, which has as its mandate the reduction of poverty, and the IMF, which controls the availability of funds, and, most importantly, a change of mindset, a return by the IMF to its original mandate, a focus on today's global problems of unemployment and economic downturn.

Much is at stake: Even the countries that have been most faithful in implementing the IMF reform packages are beginning to doubt. Reform brought a few good years of growth, but the growth was not sustained; critics say it was not sustainable.

In Latin America, the record since reforms is little if any better than before (by some calculations it is even worse), and even the good years can be thought of as little more than a partial catch-up from the lost decade of the '80s.

What growth has occurred has largely benefited the already relatively well off — even in a country like Mexico that has seen growth, those at the bottom have not shared in the gains.

They were told that market reforms would bring them unprecedented prosperity. Instead, it has brought unprecedented instability. Why should they continue to believe in these reforms? Why should they not turn to other nostrums, as false as they might be? Time may be running out.

The IMF and the international community can play either a positive or a negative role in how the story unfolds. Will there be a new generation of alienated young men, unable to find gainful employment, disgruntled with a system that has failed them, as it failed so many of their parents and grandparents? We have the knowledge to do better. We even have the institutions to implement it. The question is, will we have the will to do better?

▲