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G-20 Should Think Twice About Increasing IMF Funding Without Reforms

By Mark Weisbrot

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The G-20 summit meeting in London on April 2nd will have a lot on its plate and will certainly fall short of expectations. [The G-20 expands the G-8 countries of Canada -- France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States, to include Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, Turkey and the European Union]. There is a world recession, the worst for more than 60 years, and the immediate problem of how to get out of it through fiscal and monetary stimulus, as well as possible coordinated action to fix the global financial system. Then there is regulatory reform. And sadly, last on the agenda is aid for the poorest countries - who through the drying up of credit, shrinking exports, and falling commodity prices - pay the biggest price in human terms for a disaster caused mainly by the richest people in the richest countries.

The G-20 will also have to make some decisions about the International Monetary Fund (IMF): how much money will they get and what will be their role in the coming months and years? The Obama Administration has proposed an additional $100 billion, in the hope that this will raise $500 billion of new funding. The European Union has committed a similar amount (75 billion Euros).

This could be a mistake, unless the IMF is required to eliminate the harmful conditions that it often attaches to its lending. About ten years ago, in the last major international economic crisis - which began in Asia - the U.S. led a large funding increase for the IMF, and the results were disastrous. The Fund worsened the crisis in Asia, mostly by attaching harmful economic and structural conditions to its lending to the countries hardest hit by the crisis, including Indonesia, Thailand, South Korea, and the Philippines. The IMF did at least as badly in Russia and other countries, and especially Argentina, in the same period.

These countries learned their lesson and piled up reserves so as to never go back to the IMF again. The Fund, without taking responsibility or firing anyone (much like some American corporations recently) claims to have learned some lessons and also to have changed its policies. But there are too many disturbing signs that it has not.

For example, in at least nine agreements that the Fund has negotiated since September 2008, including Eastern European countries, El Salvador, and Pakistan - contain some elements of contractionary policies. These include fiscal (budget) tightening, interest rate increases, wage freezes for public employees, and other measures that will reduce aggregate demand or prevent economic stimulus programs in the current downturn.

The IMF has long had a double standard when it comes to dealing with economic downturns. For the rich countries, it can be quite Keynesian: it is currently recommending a global fiscal stimulus of 2 percent of GDP. But for the developing countries that are actually forced to follow the Fund's advice, there is often a different story: they "cannot afford" these expansionary policies during a recession.

This attitude can defeat the purpose of loaning money to developing countries in a downturn, which is to enable them to pursue expansionary policies. The main reason they "cannot afford" to do what the U.S. or other rich countries do during this recession - e.g run large budget deficits - is that they may run out of foreign exchange reserves (mostly dollars). In other words, if they grow at a normal pace while other economies shrink, their imports will grow faster than their exports, and their trade balance will worsen. The purpose of external support is to allow that to happen, rather than shrinking the economy to improve the trade balance.

In some sense it is not really fair to blame the IMF for its failed policies, since the Fund has a boss: the U.S. Treasury Department. Although it has 185 member countries, Washington pretty much calls the shots. This arrangement was established with the creation of the Fund in 1944, when Europe was in ruins and much of the developing world was still colonized. China now has the world's second-largest economy and 1.3 billion people, but only 3.7 percent of the IMF's voting shares - and that is after a decade long struggle to reform voting shares, and China getting one of the largest increase in voting shares among developing countries in last year's "reforms." Europe, Japan, and the other rich countries could outvote the U.S., but prefer not to rock the boat for fear that any challenge to Washington's control over this institution (and the World Bank) might result in developing countries gaining a voice.

There was understandably discontent in the U.S. when the Obama administration appointed people who had a large responsibility for the current economic mess to top positions. The IMF has the same problem, but much worse. The Obama appointees will be pressured to resign if they fail, and the Democrats have to worry about re-election. There is no comparable accountability at the IMF.

What hope, then, for reform? For immediate reforms, there is the pressure from organized civil society that successfully forced some $88 billion of poor country debt cancellation over the past decade. Coalitions such as the UK's 138-organization "Put People First" are pressuring the IMF and World Bank to refrain from inflicting harmful conditions on poor countries, and to cancel more debt; and for the rich countries to live up to their aid commitments. In the U.S., the religious-based Jubilee USA and allied groups are lobbying Congress to authorize the IMF to sell some of its tens of billions of dollars worth of gold reserves; and use the money for debt cancellation for poor countries.

More ambitious proposals for longer-term reform come from the UN Commission headed by Nobel laureate economist Joseph Stiglitz. This commission is proposing a Global Economic Council, an expanded global reserve system, and other institutional arrangements - including steady aid to poor countries - that would not be subject to the veto of rich countries as are the IMF and World Bank currently. This week the government of China announced its support for a new global reserve currency to replace the dollar.

In the mean time, the most important reforms will take place at the national and regional level, bypassing the G-7 and the nominally expanded G-20. China has in recent months extended multi-billion dollar currency swaps to South Korea, Hong Kong, Indonesia, Malaysia and Belarus, after refusing the rich country's pleas for more money for the IMF in the absence of governance reform. The ASEAN + 3 countries (ten Association of South-East Asian Nations plus China, Japan, and South Korea) are moving toward a $120 billion Asian Monetary Fund. And South America's Bank of the South is expected to be launched in May with $10 billion in start-up capital from Argentina, Brazil, Venezuela, Bolivia, Ecuador, Paraguay, and Uruguay.

If the developing countries are willing to show the G-7 that they can walk away from any agreements that can harm them, while creating alternatives on the ground at the national and regional level, the governments of the rich countries may eventually see the need for serious international financial reforms.

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