Reflections on Change and Continuity at the IMF[1]

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By

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Introduction

Let me begin by saying how honoured I am to receive the John Kenneth Galbraith Prize in Economics and to follow in the footsteps of Mel Watkins and Kari Levitt whose work I have long admired and whose friendship I value very highly. More than that, their academic interests and mine coincide in some important ways and they have for many years been very influential in shaping my ideas.

This seems like an opportune time to reflect, as both Mel and Kari did, on the influences in my life, on the circumstances and people that have shaped my intellectual work and my social activism. I have been fortunate to have had supportive colleagues in my various work environments, both in Manitoba and across Canada. Soccer too has been an important influence in my life. Playing with the progressive Crescentwood Saturday soccer team has been good for both body and soul. Coaching young and youth players, both boys and girls, has been humbling! Supporting Sheffield Wednesday at professional club level and Canada at international level has required patience and an unbelievable degree of optimism.

But the foremost influence was that I was born into a large and loving working class family. My father died from industrial disease. We relied heavily on public housing, public health and public education. My political views and my academic preoccupations and values have been shaped by this background.

The second most important influence on my academic and political life was my experience in Africa. It was my work in Africa that led me to think seriously about how the international monetary system functions and to devote much of my life to studying it and arguing for its reform. What I would like to do today is spend some time reflecting on that experience and relate it to contemporary developments in the international monetary system. In the process, I will touch upon some of the difficulties of being a progressive economist working practically and theoretically in this area. I will also draw some links between my experience in Africa and my interest in alternative budgets in

[1] Fletcher Baragar, Robert Chernomas, Aurelie Mogan and Todd Scarth provided helpful comments on the draft. Jim Stanford played a key role in the nomination process and his on-going support is gratefully acknowledged. Marc Lee was a great help throughout the prize process.

Canada, and between proposals made in the Alternative Federal Budget (AFB) and the recent debate about the taxation of banks as a means of stabilizing the international monetary system.[2]

The Colonial Monetary System and Independence

It was through Walter Newlyn that I ended up in Africa studying the colonial monetary system. For my PhD thesis I visited Kenya, Uganda and Tanganyika (as it was then) and interviewed representatives of just about every financial institution which existed, as well as the Bank of England which oversaw the East African Currency Board. What I gradually discovered was that the monetary and financial system of post-colonial East Africa was still very much geared to the needs of a non-African local elite and to those of the former colonial power. It was set up as a very efficient siphon for channelling resources to London, even from post office savings banks at village level, and offered little by way of mobilizing resources for national development of an independent African country. Also, there were almost no African staff of any seniority. I was convinced that wholesale change in the monetary and financial systems would be needed if they were to contribute fully to national development.

That change was to come very quickly in Tanzania in February 1967, when the banking, insurance and other leading sectors of the economy were nationalized. Shortly thereafter, I was asked to join the National Bank of Commerce as its Chief Economist,[3] an incredible opportunity for a young man. For a while, I also sat on the Board of the National Insurance Corporation, and was also initially responsible for the economics side of that organization, and I was fortunate enough to be able to hire a young CUSO volunteer, Lars Osberg, for that task. At that time, in the whole of the nationalized banking and insurance industry there was, after three quarters of a century of colonial and post-colonial rule, only one African manager. I soon learned to appreciate that my personal responsibility was to work myself out of jobs in Tanzania by finding and grooming suitable Tanzanian successors. Also, after my stint in the NBC, I concentrated on the training of economists and others working in the financial sector, teaching at the University of Dar-es-Salaam and helping establish the Institute of Finance Management.

Exchange Rates and the Left: Enter the IMF

I was soon compelled to consider how poor third world countries fitted into the international monetary system when, in November1967, the pound sterling devalued by 14% and Tanzania was faced with the decision to follow or not. A few years earlier, there would have been no decision to make as the East African shilling was tied to the pound. With the creation of the Bank of Tanzania in 1966, a decision did have to be made and there was a debate on whether to stay with the pound or, in effect to follow the dollar. Proponents of the former included the Governor of the Bank of Tanzania, my friend Gerry Helleiner, who at that time was a member of the Board of the central bank and Ed

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[2] Africa was also very influential in shaping my views on community economic development, which draw on the works of Tamas Szentes and Clive Thomas, colleagues at the University of Dar es Salaam.
[3] Thanks to my good friends Lionel Cliffe and the late Amon J. Nsekela, who was Chairman of the NBC.

Clark, currently CEO of TD Bank who was then working in the Planning Ministry. The Ministry of Finance and Reg Green, Economic Advisor, and I, argued that Tanzania should not devalue and instead, should tie to the dollar.[4] This is not the place to go into the details of that debate which ended by Tanzania following the dollar, but the issues were not only technical but also political, as an expression of anti-colonialism. It probably would not have made a huge difference one way or the other at that time in narrow economic terms, but I believe the debate had a lasting and unfortunate impact on attitudes towards changing the exchange rate. I believe that opposition to changing the exchange rate became built into the psyche of many Tanzanians and, regrettably, of many on the left, so that when unilateral devaluation became an issue in the early 1980s there were many who opposed it, even though the objective situation was quite different from what it had been in 1967.

By 1980, Tanzania was in the midst of s a serious economic crisis, an *output gap* reflected in a goods shortage and very high rates of inflation, a *foreign exchange gap* reflected in import compression, falling exports and a growing black market as the shilling became grossly over valued, and a *fiscal gap* reflected in high rates of borrowing from the central bank. Serious disagreements arose with the IMF which made increasing and increasingly unrealistic demands on the Tanzanian government, to the point where President Julius Nyerere was moved to ask, 'When did the IMF become an International Ministry of Finance? When did nations agree to surrender to it their power of decision taking?' (Nyerere, 1980). A massive devaluation was central to IMF demands.

There was a widespread consensus in Tanzania that the policy position of the IMF would have had a devastating impact on urban real wages and inflation. Opponents of devaluation aimed to prevent this and took the position that no devaluation was needed at all. Unfortunately, this undermined an exercise which attempted to develop an alternative adjustment program which sought to preserve many progressive aspects of Tanzania's economic and social policies while dealing with the incredibly large real, foreign exchange and fiscal imbalances. Brian Van Arkadie, myself and a group of Tanzanians which included Benno Ndulu and Sam Wangwe, were the staff people for the Tanzanian Advisory Group (TAG) of three wise men, Gerry Helleiner and Cranford Pratt of the University of Toronto, and Ambassador Ernst Michanek, a prominent Swedish statesman. The program we developed attempted to present a coherent solution to Tanzania's acute import compression, domestic goods shortage, falling export earnings, greatly reduced peasant incomes, high rates of inflation, unserviceable debts and large and growing budget deficits. Moderate and gradual exchange rate adjustments were central to this program as they allowed peasant producer prices to rise without bankrupting the state budget or, eventually as it turned out, the national banking system; they would have freed up foreign loans, debt rescheduling and aid inflows which had been suspended pending exchange rate adjustment, and this in turn would have assisted budget balance through import duties, income and sales tax increases and local currency equivalents of aid inflows. Provision was made for adjustments in minimum wages, for targeting food subsidies to the poor and for equitable sharing of the costs of adjustment. The result

[4] The public debate took place at the University of Dar es Salaam some time after the decision had been taken.

would have been an adjustment program quite different from that of the IMF, but these subtleties were lost on the opponents of devaluation, which included the Minister of Planning who for some years was able to dominate the cabinet's position on the exchange rate.

This was a most difficult time for me, not only because it was a challenge to live in Tanzania at that time due to food and other shortages, but because a portion of the left, including the Minister of Planning, who had been close friends, failed to appreciate what we were attempting to do, even though some international left critics of the IMF, such as Cheryl Payer (1983), recognized that our program had radically different class implications than those of standard IMF/World Bank programs. It was also hard to watch the Tanzanian economy gradually collapse as the stand-off with the IMF continued and as IMF demands became more unreasonable.

Over time, Tanzania was forced to make adjustments without the IMF and without additional donor support, and without much impact on the three deficits, and the poor were hit very hard. While this paved the way for an eventual agreement with the Fund on terms which were much less demanding than earlier ones, it did so only after five or more years of unnecessary economic and social suffering brought about by, on the one hand, mindless belief that the exchange rate should be the only price to remain fixed and , on the other, by what a senior official of the IMF later admitted was 'bloody mindedness' of the Fund with regard to Tanzania and its outspoken opposition to Fund extremism.

Theorizing the IMF experience

This practical experience, of attempting to find workable progressive solutions to economic adjustment, led me to believe that a more systematic analysis of the international monetary system was needed, one which might shed light on global asymmetries in the adjustment process, the appropriateness of IMF/World Bank approaches to adjustment and the position that progressive economists might take on global financial institution reform. I was able to attempt this at the North-South Institute through a SIDA grant which Ernst Michanek arranged for me and, in the process, was fortunate to meet and work with Bruce Campbell.

At that point in time there were two main approaches on the left to the international financial institutions (IFIs), neither of which offered much help to progressive people or governments attempting to deal with them. The first was the 'conspiracy approach' which saw the IMF and the World Bank as drawing poor countries into a 'debt trap' to further the interests of world capitalism (Payer, 1974), so that those governments dealing with them and implementing austerity programs were 'more or less collaborators or co-conspirators against the best interests of their own people' (Payer, 1982b, p. 37). The second approach was a more 'systemic' one, which saw the IFIs as enforcing a body of rules on capitalist rivals to ensure that the law of value or more generally, market forces, arbitrated conflicts among them. Mandel (1978, p. 191) had argued that this view 'is at once more sober and more ominous than the conspiracy theory. For it implies that whatever the composition of the body, and whatever the inclinations of the governments represented in it, there is no way to escape its 'diktats' in the long run, unless the logic of capital is broken, along with the capitalist mode of production, and the international institutions that sustain it.'

My own view was that these approaches, while both containing a grain of truth (in fact Payer's work is echoed in Perkin's *Confessions of an Economic Hitman*!), were overly simplistic and overly deterministic and did not accurately portray the often ambiguous nature of the IFIs and the changing pressures on them over time especially with the weakening of US hegemony (Loxley, 1986a). In my view, the main function of these institutions is to stimulate global accumulation but they are called upon to ameliorate some of the global distributional problems that accumulation brings. Rivalry among members, fluctuating fortunes of individual major powers and recurrent crises of capitalism, open up space for contradictions between these two functions. Over time, this might allow some room for manoeuvre by individual borrowers and scope for some useful types of reform to help countries with more progressive or nationalistic orientations deal more easily with balance of payments problems. In other words, my conception of the IFIs drew more from O'Connor (1973), than Payer or Mandel. This was my rationale for working on alternative approaches to adjustment and was understood by some of my left colleagues, but not by all.

Theorizing Alternative Approaches

In 1985, the Governors of African central banks organized an open discussion with the IMF about the appropriateness of its approach to structural adjustment. The proceedings were facilitated by Gerry Helleiner, and later published by the Fund itself (Helleiner, 1986). The meeting was remarkable both for its uniqueness, as the first open debate of its kind and for the frank airing of the Fund's position and that of its many critics. Essentially, the Fund was critiqued for its over reliance on short-run demand management ('overkill' as Sidney dell used to call it in the Latin American context), the cutting of important public social spending, its penchant for sudden huge exchange rate changes, its lack of understanding of the structural constraints facing the poorest countries, especially on the export side, its unwillingness to front-end load financing, its over reliance on adjustment as opposed to financing, its lack of appreciation or allowance for Africa's growing debt problems, its unwavering faith in untrammelled market forces, including capital account liberalization, and its failure to be explicit about the distributional consequences of its programs and especially their impact on the urban and rural poor.

On the basis of my research and practical experience with Fund and Bank programs, I was asked to present a paper at this conference on alternative approaches to adjustment. These approaches, I argued, would be tailored to the structural characteristics and specific immediate problems of individual countries (Loxley, 1986b). The basic premise was that while fundamental imbalances had to be addressed, and that African governments had a responsibility to do this, there should be no single approach to adjustment dictated out of Washington. Programs should be designed as much as possible by the governments and local people ultimately responsible for them and should be growth oriented. Shock treatment should be avoided and adjustments phased in gradually, suggesting the need for greater financing and a larger proportion of upfront financing than was the case at that time to relieve import compression. Less emphasis should be put on restraining demand and more on expanding supply and alleviating domestic bottlenecks through targeted spending on transportation, fertilizer etc, aimed at expanding local output, especially food and incentive goods, relieving revenue constraints and the recovery of exports. Some market liberalization would be needed, in common with IMF programs, to raise producer prices, but this would be done selectively and exchange rate adjustments would be more gradual. Less reliance would be placed on pure market solutions and more on targeted controls, especially in the area of capital flows, interest rates and food subsidies for the poor.

Alternative approaches would acknowledge that dealing with structural deficits takes time and the adjustment period should, accordingly, be much longer than that allowed for in the one-year Standby Arrangement which was dominant at that time. Furthermore, less emphasis should be placed on increasing investment quantity and much more on investment quality. The same would apply to foreign aid, the long-term reliance on which alternative programs would seek to reduce. IMF resources should be greatly expanded through issues of Special Drawing Rights (SDRs), expanded quotas and a more liberal compensatory financing facility.

The distributional implications of alternative programs would also be specified and open to public debate. As far as possible, public spending on important social services should be protected and expanded, possibly requiring greater efforts to raise taxes, while low income earners might receive assistance in the form of an increase in the minimum wage or the continuation of food subsidies. Land reform might also be called for to achieve an expansion of food supply and food entitlement. While adjustment programs of necessity require income redistribution, the call was to make these explicit and to protect the poor as much as possible. The approach also called for the use of a different set of performance indicators which would be less stringent and more contingent, adjustable in the light of assumptions about capital flows and export prices and demand not being realized.

These ideas were arrived at after being involved in designing adjustment programs and after examining experience elsewhere in both Africa and Latin America. They were far from being original but what was new was the attempt to give them some coherence and theoretical grounding, and to challenge the emerging Washington consensus which was soon to dominate development theory and policy. As Galbraith had argued years earlier with regard to foreign experts imposing their views on India, 'It may be debated in the matter of religion but no one seems to question the doctrine of immaculate conception where ideas on economic development are involved' (Galbraith, 1972, p. 45). This conference made a modest effort to do just that.

IMF staff were, understandably, quite defensive, justifying their approach, denying that African economies had unique structural features, arguing the need for swift, definitive action in crises and claiming that their programs were, in fact, owned by African countries and not imposed upon them. They argued that the Fund was constrained by lack of resources and, therefore, could not do what was requested of them regarding timing and scale of financing versus adjustment, even if they were to agree that this was desirable. Most tellingly, they argued that ‘distributional issues are so highly political that for an international institution to seek to influence these issues would be regarded by most, if not all governments, as an intolerable invasion of national sovereignty’ (Mohamed, 1986, p. 150). That Fund staff could say this with a straight face knowing that they often demanded huge changes in exchange rates and prices which would have had a significant impact on income distribution is remarkable. It is even more remarkable that income distribution implications of programs were seemingly not made known in any systematic way to governments, or alternatives contemplated.

Reviewing the debates at that time one is struck by the depth of frustration the African Governors felt towards the international economic system in general and to the Fund, and the World Bank, in particular, and the double standards they felt were in operation. Thus, ‘only the poor countries are expected to practice rational economic principles (e.g. to rely on the market, not to adopt protectionist measures, to avoid government budget deficits)’ (Ndegwa, 1986, p.223). The participants also stressed the growing burden of African indebtedness and the need to confront it.

The Growth of Fund Conditionality and Public Discontent

Equally striking, is how prescient that conference was. Before the end of that decade over 40 African countries were being conditioned, over a lengthy period of time by the IMF and, later, by joint IMF/World Bank programs. Conditionality became much more demanding and widespread, and much more *structural*, covering many micro policies and institutional arrangements (Killick, 1995, p.25). The African debt problem emerged into a full-blown crisis; aid was constrained and both aid and debt rescheduling were made subject to cross-conditionality with Fund/Bank programs. It was, essentially, Fund/Bank programs that kept poor countries on their debt leash. Economic growth ground to a halt in much of Sub-Saharan Africa. The explosion of HIV/AIDS, recurring drought and civil war compounded Africa’s problems.

Throughout the 1980s and 1990s, public condemnation of the conditionality attached to IMF and World Bank programs grew. Concern was focused on the impact of these programs on gender, the environment, social programs and the poor. The implications of adjustment programs for democracy, human rights and civil society generally also emerged as important issues. The secrecy surrounding programs and the general lack of transparency of the Fund, in particular, caused mounting concern.

Over time, reforms were introduced by the Fund and the Bank in response to the poor performance of program countries and the mounting criticism by Fund members and the global community, suggesting that many earlier criticisms did indeed have validity. Programs were extended with three to five year terms, growth and supply expansion were given greater weight relative to demand restraint, funding of the IMF for poor countries was expanded after many wasted years and debt reduction programs were introduced for both bilateral debt and for IMF and World Bank debt. In the mid-1990s, the Fund even acknowledged that its programs inevitably had an impact on income distribution and towards the end of the decade followed this up by introducing a Poverty Reduction and Growth Facility under which member countries, aided explicitly by civil society organizations, would design their own poverty reduction strategies as an integral part of adjustment programs. Questions still remain about the precise degree of local ownership of programs, which seems to vary greatly from country to country, and about the relative influence of Washington on these programs, and especially where there might be inconsistencies between macro programming and social programming[5]. Conditionality did not seem to be diminished by these developments either but rather, the emphasis on growth was felt to justify the introduction of the more intrusive structural conditionality, covering ownership, trade, utilities and detailed management of the public sector, among other critical policy decisions (IMF, 2001a). And debt reduction strategies were painfully slow and demanding (Serieux, 2001a and 2001b).

In the late 1990s, however, the Bretton Woods twins came under a much more critical microscope to the point where they lost a good deal of credibility. The Asian financial crisis helped to bring into sharp relief the shortcomings of orthodox stabilization and adjustment programs. Criticisms of earlier Fund/Bank programs in Africa, or even earlier ones in Latin America, were repeated but this time gained a much larger and receptive audience because they were made by a Nobel Laureate (Stiglitz, 2002) and the global stakes in this crisis were so much higher. Shock treatment in the form of demand restraint and massive hikes in interest rates in countries where companies were highly geared and debt dependent, and the failure to use controls to reduce capital flight, caused a rapid contraction of GDP. In some countries this was accompanied by sharp cuts to social services and a huge increase in unemployment and poverty. IMF conditions called for a dismantling of long established industrial structures in some countries and led to a sell-off of assets cheaply to foreign investors. The structural conditionality of IMF programs came under attack as being an unwarranted intervention in national decision taking. The questionable handling of subsequent crises in Russia, Brazil and Argentina also damaged the reputation of the IMF as well as raising questions about its governance structure and the under-representation of third world and especially middle-income countries.

Crises are endemic to a global financial system characterized by irrationality, myopia, speculation and turbulence. But their management by the major powers and the IFIs has systematically put the interests of global capitalism above those of the people of third world and more peripheral countries. There was a recurring asymmetry in debt management from the debt crises of the 1980s, through the Asian crisis and other crises of the last decade of the 20th century, which was that resolution was through acute austerity measures in the debtor countries combined with the socialization of private debt in the creditor countries. Debt dependence brought with it the loss of political autonomy of debtor countries. It also transformed development economics, with the emergence of the hegemony of the Washington Consensus model of development as the only

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[5] Some would argue that by the late 1990s, the IMF had put in place or trained many local economists sympathetic to the IMF orthodoxy, thereby reducing the risk of some devolution. Mark Hudson raised this possibility during discussion of the paper.

appropriate one for developing countries, bringing to mind Galbaith's comment that '…so often what was reputable was what served the powerful and the affluent.' (1973, p. 310). The Asian crisis called all of this into question as never before.

The Washington Consensus model has always been at odds with much development experience in Asia in terms of the role of state intervention in industrial policy and structure, capital controls and the provision of finance. Import substitution and selective promotion of exports of manufactured goods have been prominent features of that experience. One might also point to the important role of land reform and the ensuing relative equality of rural incomes in such Asian success stories as China, Taiwan and Korea. The dominance of the development literature by the Fund and, especially the Bank, has made it difficult to show-case and give appropriate attention to alternatives to the Washington consensus model of development. It is for this reason that I have argued elsewhere for the abolition of the World Bank and its replacement by strengthened regional banks and for the reduction of IMF policy conditionality to only those policy measures necessary for the servicing of IMF balance of payments loans (Loxley, 2006). If this were to happen, development models more appropriate to regional realities and aspirations might emerge.

Criticism and Crisis: The Near Demise and Re-birth of the Fund

Between the Asian crisis and the recent banking and sovereign debt crises, the IMF almost became an irrelevance. Outstanding Fund loans fell from $73 billion in 2003 to less than $10 billion in 2007 (IMF, 2009a, Appendix II, p.5). Part of this was the outcome of rapid global growth in the early years of the decade, but part is seen to reflect a loss of legitimacy and credibility by the Fund as a result of its poor performance. Several large borrowers, such as Argentina, Brazil, Indonesia and Serbia, repaid IMF loans early to avoid excessive conditionality, as did several African countries, but in the process and perversely, all had to hold unnecessarily high levels of reserves so that they would not be reliant on the IMF. So acute was the fall in its lending that the Fund found itself in an operating income crisis (Bretton Woods Project, 2006). Regional monetary arrangements also became stronger during this time, posing a potential threat to the Fund. Asian countries established the Chang Mai Initiative which established bilateral swap arrangements which, by early 2009 amounted to $90 billion, and the Euro area expanded and made provision for emergency finance. Latin American countries also made some progress in creating their own regional monetary arrangements through the Banco del Sur (Grabel, 2010). The Asian and Euro regional arrangements, however, retained IMF conditionality as a prerequisite for access to funds, as the recent Greek crisis highlights

The global food and fuel price shocks of 2007-2008 and the recent threats to the international financial system produced by both the mortgage melt-down and the EU sovereign debt crisis have, however, given the IMF a new lease on life. The G-20 have tripled the Fund's lending capacity to $750 billion, and, after many years of US opposition, the threat to the dollar seemed to justify the first issue of Special Drawing Rights since 1981, a ten-fold increase to the tune of $250 billion (IMF, 2010a). While the major powers still refuse to link the allocation of SDRs and hence their seignorage benefits to aid or needs of the poorest countries, this allocation provides immediate liquidity assistance to all members and represents a significant shift in international financial policy. Large new liquidity facilities have been created by the Fund.

With this re-birth born of global financial crisis, the Fund has begun to ask major question about the theory and practice that underlie its operations. Apart from stumbling towards being more representative, it has been grappling with the incoherence of much of its conditionality. More tellingly, three recent policy papers from the Fund also suggest that past-IMF policy in other areas, macroeconomic policy, capital controls and the taxation of banks, needs turning on its head, giving credibility to some of the earlier critiques and taking the Fund into quite unfamiliar policy territory.

a) Representation

Selective quota increases have also attempted to address the question of the representativeness of the IMF by giving additional voice to 54 under-represented countries, including China and Turkey. The influence of China in the Fund is likely to increase in future, not least because of a sizeable contribution to the Fund's recent expansion of borrowed resources.

The IMF continues to be a thoroughly undemocratic institution governed by the most powerful industrialized countries and led by the US which still remains the only single country with a veto over key policy decisions but which also exercises considerable behind the scenes power. Appointment of the leader of the IMF, traditionally by the Europeans, and of the the World Bank, traditionally by the US, is particularly galling to many members of these organizations.

b) Conditionality

Mounting public pressure on the IMF, most visibly at both Seattle in 1999 and in Washington in 2000, began to have an impact on Fund conditionality. Consultations with civil society organizations, a telling departure from past practice, suggested that many of the troubling features of conditionality raised in the 1985 debate were still causes of concern outside the Fund (IMF, 2001b). This led the Fund to reconsider the nature and extent of its structural conditionality (IMF, 2001a), which it claims it began to reduce from around 2000. It has accepted the need to concentrate conditionality on areas deemed necessary for program success, namely the fiscal, financial and exchange rate areas and claims that progress has been made since 2000.

In 2007, the Independent Evaluation Office of the IMF (IEO, 2007) found that structural conditionality had not declined since the 2000 streamlining initiative, remaining at an average of 17 conditions per program, but that the emphasis had, indeed, shifted towards 'core areas' of IMF concern, away from privatization, trade, utilities etc.. One third of conditions, however, still remained non-core and for many countries, Fund rationalization did not necessarily mean a reduction in structural conditionality since such conditions as privatization, utility reform, public expenditure management, pension reform etc., became enforced by the Bank.

Civil society organizations responded to this report by stepping up their attack on the Fund, accusing it of forcing programs on countries, of excessive conditionality and of too tight macro policies (Molina and Pereira, 2008) – all very familiar refrains.

In 2009, the Fund announced the abolition of structural performance criteria, reducing the stigma attached to countries that needed formal waivers to continue borrowing when such conditions had not been met (Andersen, 2009). Critics point out that it continues to use 'structural benchmarks', which are longer term conditions, and appears to be putting greater emphasis on 'prior conditions' where action has to be taken before a program is agreed upon. They also fear that this may concentrate fund finance on good performing countries at the expense of those struggling. Macro-conditionality also continues unchanged (Eurodad, 2009).

c) Macro theory reconsidered

A recent paper by Blanchard, Dell'Ariccia and Mauro (2010) acknowledges that the Fund's *approach to macro economics* since the early 1980s was fundamentally flawed. Following the New Keynesian model, it relied too heavily on monetary policy, to the neglect of fiscal policy and financial regulation. It relied on one target, a low and stable inflation rate, and one instrument, the policy rate to minimize the output gap. It believed, incorrectly, that stabilizing inflation would take care of other real variables in the economy and that fixing short rates would fix medium and longer term rates. It now acknowledges that it was lulled into a false sense of security by the 'Great Moderation' or by reductions in the variability of inflation and output in advanced economies. Its inflation/output trade-off was too crude and failed to capture important developments in certain markets and in the composition of output. It set too rigid inflation targets at around 2% and maintained too low interest rates so that when the crisis hit, monetary policy was constrained by rates being close to zero. It neglected financial intermediation, credit market segmentation and speculative bubbles. It downplayed the possible usefulness of an active fiscal policy, and mistakenly saw financial regulation as macro neutral. In fact, some approaches to financial regulation exacerbated the macro crisis.

The paper argues that the crisis has made it clear that macro policy needs many targets, each with its own appropriate instrument. Monetary policy and financial regulation need to work hand in hand, preferably under central bank control. It also argues that the inflation target of around 2% is too low and consideration should be given to raising it to 4%, as the benefits of doing so would outweigh the costs. Small open economies should also recognize exchange rate stability as an important objective. Central banks should continue their recent departure from past practice by providing liquidity to a broad range of financial institutions. Governments should create more fiscal space in the medium term so that fiscal policy can be more effective in a down turn, and greater use should be made of new automatic stabilizers. These might involve low income households receiving higher, reversible, social benefits or tax rebates, or companies receiving cyclical investment tax credits, if certain real economic thresholds are crossed.

This is a remarkable admission by senior advisers to the Fund. It confirms what many critics of the Fund have argued for years and seems to put another nail in the coffin of monetarism and neo-liberal economic policies. The New Keynesian model relies on many simplifying assumptions that, while allowing elegant models to be built, reduce its practical relevance. It allows little room for finance becoming unhinged from the real economy and was not able to forecast the current crisis. Galbraith reminds us, economists 'can, if they are determined, be unimportant; they can, if they prefer a comfortable home life and regular hours, continue to make a living out of the infinitely interesting gadgetry of disguise. …They will…have few or no words of guidance or advice on great issues' (Galbraith, 1973, p.324). This seems apt when applied to New Keynesian models and their relevance in the current crisis!

Many hope that this recent policy note will lead to more flexibility in IMF programs, especially in developing countries. Others see this possible change in direction as a reflection of the crisis now affecting richer countries, able to demand policy concessions that have never been made for poorer countries. Current programs of the Fund in poor countries are ambiguous. Several involve tighter monetary and fiscal conditions, while several take measures to protect social programs and the poor (Grabel, 2010). My own sense is that the IMF is in as much turmoil as the economics profession generally and is groping towards a new model and a new mandate. One thing is for certain, the greater reliance on fiscal policy has greatly increased the debts of industrialized countries and a 4% inflation rate will enable governments to reduce their real debts much more quickly than a 2% rate, by over 50% in twenty years as opposed to a third. This may not be the intent of the Blanchard piece but it would definitely be the result were the recommendations to be adopted.

d) Capital controls reconsidered

The Fund's long-held position on *capital controls* appears to have been turned on its head in a staff paper by Ostry et al, (2010). This addresses the potential for renewed flows of capital internationally to lead to exchange rate overshooting, asset price bubbles and increasing financial fragility and instability. Such flows may be quite irrational, reflecting over-optimism of investors; herd behaviour might ensue and flows might also reverse sharply as interest rates begin to rise in advanced industrialized economies. The paper finds that in the recent crisis countries with controls shifted the inflow of capital away from short-term debt and unstable financial FDI, towards more stable non-financial FDI. They helped limit domestic credit booms and the growth of un-hedged foreign exchange denominated lending by local banks. This contribution to greater financial stability also helped countries using controls to avoid the worst falls in GDP during the crisis. Though cautious about the impact of widespread adoption of capital controls, the paper concludes that there might, indeed, be a role for controls on the inflows of capital alongside other forms of policy and prudential regulation, that 'capital controls are a legitimate part of the toolkit to manage capital inflows in certain circumstances' (p.15).

This is pretty much in line with the conclusion of the Fund's *Global Financial Stability Report* for 2010 (IMF, 2010), that 'capital controls may have a role in complementing the policy toolkit' (p.17), but GFS Report is much more negative and cautious about their use. This is consistent with the Fund's discouraging response to Brazilian action in 2009 to tax capital inflows, which was roundly criticized by a number of prominent international economists as clinging to an increasingly irrelevant free market orthodoxy which might send negative signals to investors with adverse consequences for countries grappling with the problem of hot money. Subramanian and Williamson (2009) for instance, put Fund opposition into a broader ideological and narrative framework, arguing that 'If the global crisis stems, in part, from a belief system that unduly elevated the status of finance, the IMF contributed to sanctifying, implicitly or explicitly, foreign finance…. By recognizing that in some instances sensible curbs on inflows might be a reasonable and pragmatic policy response, the Fund can eliminate the market-unfriendly stigma that actions of the Brazilian type might otherwise risk incurring.'

So the Ostry report can be viewed as a less ideological stance on the issue of capital controls. Rodric (2010) sees it as the Fund 'rediscovering the common sense which had strangely eluded (it) for two decades' and a signal of a significant shift in the thinking of economists. He concludes that 'Shorn of support from economists, the financial industry will have a much harder time preventing the fetish of free finance from being tossed into the dustbin of history'.

e) Taxing the Banks

A paper on *the taxation of banks* is yet to be published but its likely content is to be found on the Fund's web site (Cottarelli, 2010). Before turning to this, I would preface my remarks by referring to the Alternative Federal Budget in Canada and its position on bank taxation.

My interest in budgeting developed in Africa, after observing Reginald Green, Economic Advisor to the Tanzanian Treasury, using a blunt pencil to fill several foolscap pages with numbers, all from memory. It had never occurred to me before that someone had to do the numbers and they had to add up! Later, demonstrating the coherence of alternative adjustment programs to those of the IMF required budgets that made sense, that linked closely to available real resources and reflected social and political priorities. The Alternative Federal Budget in Canada has been driven by these same necessities and continues to offer a sensible and achievable progressive alternative approach to fiscal policy. It was democratically based with input from people and organizations all across Canada and its content was vigorously debated. This approach, I believe, was consistent with my position on the IMF that programs should be locally constructed and locally owned. The AFB can be seen, in fact, as an alternative to the kinds of neo-liberal approaches of organizations like the IMF. But it has always had an international financial dimension and the point to be emphasized here is that this is now very relevant for the current discussion of bank taxation.

From its inception in 1995 the AFB was an advocate of the Tobin tax, a small tax on international financial transactions. The idea was to raise tax revenue while, at the same time, discouraging short term speculative flows of capital. I don't think any of us involved in the AFB felt that this tax would be an answer to large-scale, sudden speculative flight, but it was felt it could help as a stabilizer in less extreme situations, that it could be a useful source of additional tax revenue and that it might open up possibilities for increasing assistance to those most in need. The popularity of such a tax, recently termed the Robin Hood Tax and extended to domestic as well as international financial transactions, is now growing globally, driven by a hugely successful web campaign (http://robinhoodtax.org.uk).

The AFB has for many years also advocated two other forms of taxation in the financial area. The first is a tax on the 'super profits' or rents of banks which with the explosion of financialization, the rapid growth of consumer debt and the oligopoly structure of Canadian banks, have been a steady feature of bank performance in Canada for many years now. These monopoly profits, aided by public regulation of banking, seem relatively impervious to the state of the economy (Mackenzie, 1997, p.356). The second tax measure that would apply to all corporations, but would be particularly relevant for financial institutions in the habit of paying huge salaries and regular, large annual bonuses, would be a limit on the level of salaries etc that could be claimed as an expense for tax purposes (Mackenzie, 1997, p.355).

In a strange twist brought about by the global banking crisis, the IMF has been asked by the Group of 20 to look at the possible different ways of taxing of banks. The IMF's mandate is a relatively narrow one, to examine "… the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burden associated with government interventions to repair the banking system" (Cottarelli, 2010). The Fund estimates that government support for financial institutions among the G-20 has so far cost 2.7 per cent of GDP (ibid) and the idea of any new tax would be partly to help pay for this but also to discourage, but if necessary also cover, what the Fund clearly sees as possible recurring crises. While these bail-out costs are high, they are only of the order of roughly one-tenth the financial risk exposure and one tenth the loss of GDP which the crises caused.

The IMF has been considering three options for the June meeting of the G-20, two of which have been advocated by the AFB: a financial stability contribution (FSC), a financial activities tax (FAT), and a financial transactions tax (FTT), or Robin Hood Tax. The FSC, which the Fund seems to favour, would be a combination of a base charge on all financial institutions plus a charge related to the degree of risk involved in their on- and possibly off-balance sheet items: the greater the risk exposure, the larger the up-front cash contribution payable to a crisis reserve fund. The FAT is a combination of the AFB's excess profits tax on banks and tax on high remuneration of employees. It is, in effect, a tax on value added of financial institutions above a certain 'normal' level; a tax on the rents of banks, exactly as proposed by the AFB. As the IMF puts it, 'Some might find taxing that excess fair' (Cottarelli, 2010) and it might also reduce excessive risk taking.

The Fund seems to have ruled out the Robin Hood Tax because it doesn't address the systemic risk element, doesn't directly tax rents and, according to the Fund, is likely to be more easily avoidable/evadable than the other two taxes and when effective, more likely to hit consumers.[6] Once again, the IMF seems to be out of step with popular movements globally, but the fact that it is considering possible sources of new taxes at all is, perhaps an encouraging sign. Generally, the Fund has recognized the importance of fiscal stimulation as the only way out of the current crisis and, while calling for 'fiscal prudence' and the gradual nursing down of debt in the medium term, it has not been specific about how this will be attained; through economic growth, expenditure restraint or raising taxes. The Fund advises in its most recent Article IV report on Canada (IMF, 2009b, Annex 1, p.2) that our UI benefits are too generous and that there should be greater use of pricing and market based systems (read 'commodification') in our health care system, a reduction of marginal tax rates on incomes, capital and savings and a Canada-wide adoption of the HST, but these are merely recurring neo-liberal themes. A tax on financial institutions could mark an important departure from the fixation of tax cutting that dominated fiscal policy in the decade before the crisis. Whatever impact it might have on the risk exposure of financial institutions, it could, at the same time, make an important contribution to preserving and strengthening essential services in future by being earmarked to an infrastructure/social services investment fund.

There is no support from the Harper government for any form of financial institutions tax, not least because it feels that our own financial system was less exposed to risk because of tighter prudential controls and regulation. On the contrary, the government has been actively lobbying against it. The Fund anticipates that countries which avoided large bail-outs might balk at introducing a new tax and cautions that 'If financial history teaches us anything, it is that no one should think themselves immune from failures and crisis' (Cottarelli, 2010). Canadian banks did make losses which were partly offset out of taxation and they were backstopped by a variety of quite large guarantees and liquidity facilities provided by the public sector. The attitude of the Canadian government might change if it transpires that the worst is not yet past for our own housing market or economy generally and that contingent liabilities need to be called upon, or if the current five year fiscal plan fails to deliver promised revenues.[7] The Five Year Plan, in any event, envisages restraint on spending on social services and on provincial and personal transfers that many feel is unacceptable. New sources of revenue would be called for in the medium term to address these shortcomings and public pressure is needed to ensure that this happens.

Given the obscenity of recent profit levels and bonuses paid to senior bank staff, which even the IMF now seems to acknowledge, the recurrence of bank-induced international crises and the massive bank bail-outs, one has to wonder why there are not louder and more persistent calls for the nationalization of banks and possibly other financial

[6] The final report advocates for the Financial Stability Contribution (IMF, 2010c)

[7] The Canadian government is said to be promoting the alternative of 'embedded contingent capital' or the selling of debt by banks, convertible to equity in the event of a crisis (*Globe and Mail*, June 3, 2010, A9).

institutions, not just for temporary bail-outs but for their long-run operation and regulation as, effectively, public utilities.

Conclusion

The recent crisis appears, therefore, to have thrown traditional Fund thinking and practice into some disarray. This is what one can expect in a crisis as old theories and ways of doing things become discredited and new ones struggle to evolve. But of the five areas where change is being discussed, representation, conditionality, macro policy, the use of capital controls and taxing the banks, the Fund has changed its *policy and practice* only marginally in the first and second and, as we have seen, much remains unchanged or contradictory in its approach to conditionality. In the other areas staff is coming out with ideas that contradict previous neo-liberal stances and possibly current practice, without any formal commitments from the Fund's governing bodies or members to actually support them. Nonetheless, it is remarkable that the ideas are being published by the Fund and made available for public discussion. It does indeed, seem that the Fund is going through a period of 'productive incoherence' (Grabel, 2010). Whether or not new, more sensible and more equitable approaches will actually emerge remains to be seen.

Scepticism over recent reforms at the IMF would not be out of order, given the Fund's long track record of excessive and inappropriate conditionality and its equally long record of denial and obfuscation. A combination of public pressure on the Fund, relatively poor or indifferent performance by countries governed by Fund conditionality and the increasing instability of global capitalism have, no doubt caused some important shifts in Fund behaviour over the years. There is greater transparency than ever before, as can easily be seen by a glance at what is now published on the IMF website; there is a much greater willingness to engage with civil society, both in individual programs and on global policy issues; there is an awareness of the impact of IMF programs on income distribution and social spending and it is clear that several countries play a major role in the design of their own programs. But concerns about local ownership of programs and excessive conditionality remain pretty much the same as they were 35 years ago.

Perhaps it is time to stand back and rethink the role of the IMF. It has been proposed to confine the Fund to 'reform of the international monetary system; surveillance over the policies of systemically important countries; and providing rapid access, conditionality-free finance to countries facing crisis' (Bretton Woods Project, 2010) and this seems to be worthy of support. If achievable, it might help democratize the global financial system, rectify some of the more grotesque asymmetries in global adjustment, allow for more national choice in economic policy making and restore the credibility and usefulness of the Fund. Scepticism that this can happen has recently led Gerry Helleiner (2010) to argue that IMF activities should also be devolved to regional and sub-regional levels, along with Bank activities, and that both short-term and longer term financing should be managed by the same devolved institutions. It is important to put such reform possibilities on the public agenda but neither possibility is likely to happen without public pressure and, regrettably, possibly not without further international financial crises and their attendant human cost.

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