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Has IMF Advice Changed After the Crisis?

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When the International Monetary Fund (IMF) was created, its purpose was to support the new system of fixed exchange rate regimes. With the breakdown of the par-value system, its article on exchange-rate arrangements—Article IV—had to be revised. Per the revised version, the IMF would annually write reports on countries' economic situation and provide policy recommendations.

This shift on the IMF's role, along with the attachment of conditionalities on lending facilities, considerably increased the institution's influence on countries' policies. IMF policy recommendations in Article IV reports were criticised for being orthodox and restrictive, especially for developing countries. Recently, the Fund has published papers and organized conferences that showed some rethinking toward some policies in the institution, especially related to instruments to fight inflation, the role of capital controls, the use of automatic stabilizers and the importance of social stability to growth (see Ostry et al., 2010; Blanchard et al., 2010). The paper on which this One Pager is based (Roy and Ramos, 2011) looks at whether this Headquarters receptiveness has been translated into the Fund's Article IV-based policy analysis and recommendations.

The paper shows that exchange rate assessments, in most cases, relied entirely on econometric exercises that depend on highly uncertain variables. Moreover, some exercises assumed that countries had implemented the policies that the IMF had recommended to them. Many reports downplayed the exchange rate misalignment issue, a consequence of two common analytical practices. First, the reports consider only the averages of the different misalignment estimations—although these often diverged significantly. Second, the reports highlighted the uncertainties inherent in these exercises when they indicated misalignment, concluding that there was no misalignment. Thus, in the case of Guinea-Bissau, it was concluded that estimations "do not suggest that the exchange rate is overvalued" (IMF, 2010c), although estimations indicated overvaluation of 3 per cent to 21 per cent. In the case of Cameroon, the conclusion was that the moderated appreciation "could be corrected if the euro current weakness is sustained" and the focus of policies were on enhancing the "business environment" (IMF, 2010a).

There continues to be a preference for floating exchange rates, with many reports recommending higher exchange rate variability despite recognizing the adverse effects on inflation rates. For example, Paraguay seeks to temper inflation by limiting exchange rate variability, due to its significant exchange rate pass-though effect on inflation and to the limited effectiveness of its monetary policies. Nevertheless, IMF advice was to avoid exchange rate interventions.

The IMF's recent position on the use of capital controls was not reflected in any report. In the case of South Africa, these were said to be ineffective. For India, it was advised that they should be the last resort only.

Regarding fiscal policies, analyses continue to be short-term. In many cases, the IMF recommended tighter policies to countries that were either struggling to recover from the 2008/09 crisis or had weak economic prospects. Fiscal consolidation was even advised in cases where the reports showed that there was no problem of debt solvency. No options were typically offered. Thus, Botswana, which has serious unemployment and HIV/AIDS-related issues, was advised to implement fiscal consolidation, although it has a stabilization fund of about 54 per cent of GDP.

The reports also tended to put low emphasis on domestic resource mobilization and even recommended that some countries opt for external debt due to its lower cost after the crisis. This advice was given even to countries where domestic funding was available and not expensive, such as Egypt. In Colombia's case, international credibility was seen as the driver for fiscal consolidation as it "would likely improve the prospects for an upgrade from credit rating agencies" (IMF, 2010b).

The inflation analyses were rather superficial, with the exception of the analyses for China and India. There was no discussion of the costs of inflation and the costs of the policies proposed to fight it.

Recommendations mostly focused on monetary tightening, although inflation was often attributed to supply factors, such as food prices, exchange rate movements or increases in taxes. In the case of Jordan, the report states that "inflation is projected to increase in line with imported commodity (energy and food) prices" and advises the Central Bank to "tighten monetary conditions if inflation accelerates" (IMF, 2010d). A similar recommendation was made for Indonesia, which, apart from having supply-side inflation, has been challenged by excessive capital inflows—two reasons why a monetary tightening would not be appropriate.

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