Submission from ITUC/Global Unions[1] to IMF's 2011 Review of Conditionality

Introduction

1. The IMF's decision to undertake a review of conditionality and Fund-designed programmes is welcome. The ITUC and the Global Union Federations, along with many other civil society organizations, have frequently criticized IMF loan conditions because they increased unemployment and underemployment, imposed social costs through reduced government services, were pro-cyclical in their economic impact and represented unwarranted intrusion in countries' policy decision-making.

2. Starting a decade ago, when the IMF undertook a review of its conditionality policy and adopted its *2002 Conditionality Guidelines*, the Fund partially agreed with the critics and announced its intention to reduce the number of conditions and to limit them to "critical" areas that were in the IMF's core themes of responsibility. In 2007, the Fund's Independent Evaluation Office (IEO) undertook a review of IMF conditionality and found that while the focus of loan conditions had shifted over time, the total volume of conditionality had not. The IEO made several recommendations, some but not all of which were subsequently adopted and implemented by the Fund.

3. A new review of IMF conditionality is particularly timely because the Fund has greatly expanded its lending over the past two and half years in response to the global financial and economic crisis. During this period the IMF has implemented certain changes in its conditionality, such as the discontinuation of structural performance criteria in all loans.

4. The IMF has also introduced of the Flexible Credit Line (FCL), a new type of loan devoid of traditional *ex post* conditionality. However it should be noted that the FCL has stringent *ex ante* criteria for eligibility and that, since the FCL's introduction in March 2009, only three countries have been deemed eligible. The IMF has also introduced a Precautionary Credit Line (PCL), which "combines a qualilfication process (similar to that for the FCL) with focused ex-post conditionality".[2] However since the PCL was only introduced in March 2011 it is too early to determine how this new instrument will be applied in practice. The IMF has stated that the current conditionality review will not cover the PCL.[3]

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[1] The Global Unions group is made up of the International Trade Union Confederation (ITUC), which has 175 million members in 151 countries; the Global Union Federations (GUFs), which represent their respective sectors at the international trade union level (BWI, EI, IAEA, ICEM, IFJ, IMF, ITF, ITGLWF, IUF, PSI and UNI); and the Trade Union Advisory Committee (TUAC) to the OECD.

[2] IMF, "Factsheet: The IMF's Precautionary Credit Line (PCL)", March 2011

[3] IMF, "2011 Review of Conditionality and the Design of Fund-Supported Programs: Concept Note", p. 4, fn. 12

More emphasis on social protection and reducing unemployment?

5. In its Concept Note for the 2011 Review of Conditionality the IMF states that, since the crisis broke out, lending programmes have placed "greater emphasis on social protection" and have been "supportive of sustainable economic recovery, including by promoting growth and reducing unemployment".[4] The main object of the following comments is to determine whether or not these assertions bear out in recent loan programmes negotiated in response to the impact of the global recession. Loan programmes for two countries – a developing country, Jamaica, and an advanced economy, Greece – both approved in 2010, are examined here. This is followed by seven recommendations for the conditionality review.

6. From trade unions' point of view, an assessment of whether IMF loan programmes are promoting improved social protection and reducing unemployment must be made on the basis of the binding conditions that are included in the loans, i.e. whether or not they require borrowing countries to take actions that improve social protection and create jobs, and the overall impact of the loan on government's capacity to meet those objectives. Analyses of the loans for the two countries examined here show that there remains a wide gap between rhetorical support for these kinds of objectives and the requirements of the actual loan programmes.

IMF crisis loan to Jamaica

7. When in February 2010 the IMF announced the approval of a Stand-By Arrangement with Jamaica to "help it cope with the consequences of the global downturn", the Fund's communiqué specified that there would be "a significant increase in social spending for targeted programs". Specifically, there would be an increase of "at least 25 percent (equivalent to 0.3 percent of GDP)" in spending for school feeding and cash transfer programmes.[5] Fund spokespersons subsequently cited the Jamaica loan programme as an example of the Fund's increased attention to expanding social protection, especially for the most vulnerable.

8. Overall the IMF's programme in Jamaica, lasting from February 2010 to May 2012, has required the government to shrink its fiscal deficit through a substantial reduction in spending and increased fees for government services, as well as a debt restructuring whereby bondholders would have to accept reduced interest payments. A public sector wage freeze and reduction of spending for most budget items would be used to bring primary public expenditures (i.e. government spending minus interest payments) from 22.0 per cent of GDP in 2009 to 18.5 per cent in 2014. The programme was to be enforced through Performance Criteria stipulating the permitted level of government deficit, and through a number of structural benchmarks and commitments.[6]

[4] Ibid, pp. 4 & 5
[5] IMF, "IMF Executive Board Approves US$1.27 Billion Stand-By Arrangement with Jamaica", IMF Press Release No. 10/24, February 2010
[6] IMF, *Jamaica: Third Review Under the Stand-By Arrangement—Staff Report*, February 2011

9. However, other than asserting that it was necessary that "adequate room be found to protect and enhance social and capital spending", no mention of social spending is mentioned anywhere in the IMF programme, either for the two specific programmes highlighted in the initial IMF press release announcing the loan or any other social protection initiative. There is no Fund conditionality or any specific commitment made by the government to the Fund to carry out the expenditures mentioned in the IMF press release, not any monitoring by the Fund of expenditures for those programmes. On the other hand, the IMF's loan review documents do monitor commitments by the Jamaican government for reforms such as:

- "Freeze on wage and salary increases"
- "Complete time-bound public employment and compensation reform action plan"
- "Reduce wage bill to 9.5 percent of GDP"
- "Increase JUTC bus fares by 40 percent or more"[7]

10. It may be noted that the wage freeze is occurring in a country where the consumer price index has been at double-digit levels over the past two years. The overall pro-cyclical impact of the austerity programme was expected to produce negative GDP growth in 2011 for the fourth year in a row, according to the Fund's loan documents. In April 2011 the IMF's *World Economic Outlook* revised its growth forecasts upwards and predicted that Jamaica's GDP would grow by 1.6 per cent in 2011. While positive, this rate of growth is well below the 4.2 per cent GDP increase the IMF predicts for the entire Caribbean region in 2011.[8] Unemployment in Jamaica increased in 2009 and 2010, reaching 11.4 per cent; no joblessness prediction was provided by the Fund for 2011.[9]

11. The claim that the IMF loan programme would lead to a "significant increase in social spending" cannot be verified from the reports prepared by IMF staff on the country's performance since no monitoring by the Fund of this spending has taken place, and no conditions are attached to meeting those objectives. This stands in contrast to detailed monitoring carried out by the Fund for the substantial reductions in government expenditures and increased fees for public services that the loan programme requires. Unemployment has been climbing under the loan programme and is likely to increase further due to the heavy austerity measures put in place as part of the loan conditionality.

IMF crisis loan to Greece

12. The three-year loan programme concluded in May 2010 between Greece and the IMF jointly with European Union institutions has received considerable attention, one of the reasons being the unprecedented scale of the loan. The €110 billion combined amount of the lending agreement far exceeds the size any loan ever granted by the IMF. The €30 billion portion that came from the IMF is the second-largest loan granted by the Fund in absolute terms, and the largest ever in proportion to the country's IMF quota.

[7] Ibid, p. 28
[8] IMF, *World Economic Outlook*, April 2011, pp. 78 & 187
[9] IMF, *Jamaica: Third Review Under the Stand-By Arrangement—Staff Report*, February 2011, p.16

13. But even this substantial loan was not sufficient to meet the financing needs of the Greek government, whose level of indebtedness was actually expected to grow under the IMF-EU programme. According to loan documents, the debt/GDP ratio would increase from 115 per cent in 2009 to 149 per cent in 2013.[10] Other analysts expect the level of indebtedness to reach 160 per cent by 2013.[11] At this writing, press reports indicate that an additional loan for Greece is under preparation.

14. The fact that a new bailout is being envisaged a year after the IMF-EU loan programme for Greece began means that it has failed to achieve its most immediate goal of preventing a debt default or restructuring. The programme included a series of heavy austerity measures that have contributed to deepening and prolonging the recession. The IMF had predicted that the Greek economy, which already suffered negative growth in 2009 (-2.0 per cent), would contract by a further 4.0 per cent in 2010 and 2.6 per cent in 2011 before starting to grow again in 2012.[12] Instead, GDP declined by 4.5 in 2010. Independent economists are predicting a 4 per cent fall in 2011 and possibly further declines in 2012 and 2013.[13]

15. The shrinking GDP, falling at a steeper rate than IMF predictions, is making it impossible for Greece to attain the Performance Criteria for the level of deficit and debt that are part of the conditionality established in the loan. This, despite the fact that of some of the most important measures in quantitative terms were imposed as Prior Actions, i.e. measures Greece had to carry out as conditions for receiving the first loan payment. These measures included in increase in the value-added tax (VAT) rate and several other increases in consumption taxes, and a reduction in public sector wages by 14 per cent on average and pensions by an average 11 per cent, with an exception made for those who receive the minimum amount.

16. Other spending reductions announced in the Greek loan programme include means-tested unemployment benefits; cuts in expenditures to municipalities, state-owned enterprises and for public investments; and a comprehensive pension reform to reduce the growth of public spending on pensions. Other revenue measures include increased taxes for highly profitable firms and professionals, increased valuation of real estate and taxation of "unauthorized establishments". The government was also required to prepare a privatization for the divestment of state assets and enterprises so as to generate at least €1 billion per year.

17. As in the Jamaica loan programme, the IMF made much of the claim that in the case of Greece, "there will be protection for the most vulnerable groups. The reductions in wages and pensions are designed largely to exempt those living on the minimum. Social expenditures also will be revised to strengthen the safety net for the most vulnerable

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[10] IMF, *Greece: Staff Report on Request for Stand-By Arrangement*, May 2010, p. 27
[11] See for example: "What is Missing in Deal on Europe's Debt Crisis", *New York Times*, 15 March 2011
[12] IMF, *Greece: Staff Report on Request for Stand-By Arrangement*, May 2010, p. 26
[13] IMF, *World Economic Outlook*, April 2011, p. 183; "Money Troubles Take Personal Toll in Greece, *New York Times*, 15 May 2011

people."[14] However, except for the exemptions for low-wage earners from pension and wage cuts, no other specific measure is included in the programme concerning protecting the most vulnerable. There is no requirement for the government to improve or even maintain social safety nets, nor any monitoring by the IMF of social expenditures, despite the IMF's prediction of a substantial increase in joblessness. The IMF forecast that unemployment, which was 9.4 per cent in 2009, would reach 14.8 per cent in 2012.[15] However because of the steeper than predicted economic decline, most economists predict that the rate will exceed 15 per cent before the end of 2011.[16]

18. Many analysts have identified pervasive tax evasion as one important root cause of the insufficiency of government revenues in Greece. The IMF programme recognizes the problem and includes a condition that the government implement an "anti-evasion plan to restore tax discipline", including through "a strong audit program to defeat pervasive evasion by high-wealth individuals and high income self-employed".[17] However, it may be noted that no quantitative revenue targets are fixed for the anti-evasion programme, in contrast to specific revenue targets established for increases in the VAT and in privatization, and for expenditure reductions such as the wage and pension cuts.

19. The IMF-EU loan programme for Greece also includes a "Memorandum of Understanding on Specific Economic Policy Conditionality" to be monitored by the European Commission and the European Central Bank. It includes several measures for reforming labour market institutions with the overall aim of making the economy more competitive by reducing labour costs through measures that include:

- Reduction in overtime pay and flexibility in working time management
- Decentralization of wage settlements to local and firm level
- Freeze of minimum wage and introduction of sub-minimum wages
- Reduction of severance payments
- Increased use of temporary work contracts

20. The reduction of workers' real income, both in the public sector through wage and pension cuts and in the private sector through the kinds of measures listed in the previous paragraph as well as pension cuts, add to the impact of the austerity measures and prolong the deep recession in which Greece currently finds itself. Overall, it appears that the Greek loan programme accentuated the economic downturn in the country, leading to an economic contraction that will last at least three and possibly five years. The economic decline will be steeper than the IMF's prediction of a year ago and unemployment higher, yet Greece has put itself even more deeply into debt. Additionally, excepting for exemptions to wage and pension cuts for the lowest income levels, no specific and quantified targets have been put in place for improving the social safety nets. Similarly no targets have been adopted for correcting widespread tax evasion

[14] IMF, "IMF Reaches Staff-level Agreement with Greece on €30 Billion Stand-By Arrangement", IMF Press Release No. 10/176, May 2010
[15] IMF, *Greece: Staff Report on Request for Stand-By Arrangement*, May 2010, p. 26
[16] "Money Troubles Take Personal Toll in Greece, *New York Times*, 15 May 2011
[17] IMF, *Greece: Staff Report on Request for Stand-By Arrangement*, May 2010, p. 61

problems among upper-income individuals that undermine the progressiveness of the tax system, even though these are mentioned as objectives of the programme.

Summary and recommendations

21. An examination of IMF loans negotiated in 2010 with two countries undergoing economic downturns show little indication that loan programmes since the onset of the global financial and economic crisis have been "supportive of sustainable economic recovery, including by promoting growth and reducing unemployment", as is asserted in the Concept Note prepared by the Fund for its 2011 Review of Conditionality. The heavy austerity programmes put in place appear to have deepened the downturns and contributed to increased unemployment.

22. Nor is there evidence that the loans placed "greater emphasis on social protection", with the exception of exemptions to pension and wage cuts granted to low-income earners in Greece. Other social protection measures are announced as being among the government's intentions, but no conditionality or monitoring by the IMF is attached to them. Some measures that could reduce inequality, such as improving tax collection among the wealthy, are devoid of any quantitative targets or monitoring. By subjecting fiscal austerity measures to conditionality and regular monitoring but not including any requirements for employment creation or social spending, the IMF implicitly encourages countries to prioritize the austerity measures.

23. Recommendations:

a. **The IMF's should ensure that its conditionality criteria do not contradict or undermine national recovery and development plans that seek to achieve full employment, universal social protection and reduced income inequality.**

b. **In countries affected by economic downturns or slowdowns, IMF programmes should give priority to restoring the sustainable growth and reducing unemployment and underemployment.**

c. **Employment targets and adoption of specific social protection measures should be established in IMF loan programmes and jointly monitored with the International Labour Organization (ILO).**

d. **Deficit reduction or fiscal consolidation plans should be designed so as to avoid accentuating economic downturns through austerity measures applied in the midst of recession, which means that IMF financial assistance should be extended over a longer period than the two- to three-year period that loans are typically negotiated for.**

e. **The IMF loan programmes should encourage countries to reduce deficits through tax measures that have the least impact on employment levels**

and that help reduce income inequality, such as more progressive income taxes, measures to tax undeclared incomes and formalize informal economy activities, and financial transactions taxes.

f. **The IMF should pay special attention to maintaining and increasing support for programmes vital to long-term social and economic development, such as infrastructure programmes, health care and education, and to avoid measures that, for example, create a generation of young people with insufficient and inadequate education**

g. **The IMF should ensure that its loan programmes give equal weight, importance and specificity to objectives such as employment creation and social protection coverage as it does to objectives such as deficit reduction, by applying consistent rules for quantitative targets and monitoring to both types of objectives, and to apply them jointly with the ILO.**

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