Reforming the IMF for a resilient recovery
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We are at a crossroads. The Covid-19 pandemic and economic crisis could erase the limited progress made on reducing poverty and inequality between countries while supercharging existing problems of rising income inequality within countries, precarious work, uneven and slow economic growth, and a lack of climate action. To avoid a lost decade that fails to achieve the Sustainable Development Goals (SDGs), we must build a new social contract anchored in sustainability and shared prosperity. Recovery will require investment in jobs – especially climate-friendly jobs – universal social protection, and a labour protection floor for all workers as agreed in the ILO Centenary Declaration. Policymakers will need to focus on progressive and corporate tax reform – not austerity or deregulation.

Inclusive and stable growth is needed to underpin this transformative recovery. Fostering growth, including employment, and stability is the heart of the mandate given to the International Monetary Fund (IMF). During the pandemic, the leadership of the Fund has offered an ambitious vision for recovery that stands in contrast to past failures, including the shift to austerity and deregulatory structural reform shortly after the global financial crisis. IMF managing director Kristalina Georgieva spoke at the 2020 Annual Meetings of “massive investments” for recovery and jobs, and of social protection and just transition. A wave of IMF loans are on the horizon and will play a decisive role in the recovery from Covid-19. It is time to swiftly convert this vision for a resilient recovery into action by reforming the IMF.

There is one simple and effective step that the Fund can immediately undertake to ensure that its operations support inclusive growth: make the staff guidance on addressing inequality systematic. In recent years, the Fund has recognised that inequality hampers sustained growth. Guidance for IMF staff advises them to consider whether advice given to governments will increase economic or gender inequality. If so, alternative policy packages or mitigation measures should be pursued. Currently, this is optional and aimed at the annual consultations between member governments and the Fund. This approach should be made mandatory and apply to lending as well as policy advice. In some loan programmes, a social spending floor protects a handful of social assistance programmes. Aligning these spending floors with ILO standards on social protection floors and social security would likewise make an immediate improvement to loans.

An unprecedented number of countries received emergency loans from the IMF in 2020. Alarm bells went off after the future spending plans in these loan agreements indicated that these governments planned – with the evident approval of Fund staff – near or medium-term cuts. This would be disastrous. Likewise, it is possible that the Fund turns away from the past failures of austerity, but only for advanced economies deemed to have fiscal space.

The job of the Fund is to help build fiscal space through growth and effective economic policies. For too long, this has been hampered by ideological assumptions that remain steadfast despite repeated failures. This report unpacks these assumptions and charts a path toward reforming the IMF and its lending.

Sharan Burrow
General Secretary
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Fulfilment of the Sustainable Development Goals (SDGs) was off-track before Covid-19, and the world was beset by inequality, a climate crisis and a broken social contract. Now, the crisis risks erasing progress made in previous decades on poverty and inequality between countries. The International Monetary Fund has pledged to support countries in achieving the SDGs, particularly financing sustainable development and realising sustained economic growth. A macroeconomic framework that sustains inclusive growth and maintains financial stability is a precondition to sustainable development and a new social contract.

During the pandemic crisis, Fund leadership has promoted a green and inclusive recovery:

We cannot afford simply to rebuild the old economy, with its low growth, low productivity, high inequality, and worsening climate crisis.

That is why we need fundamental reforms to build a more resilient economy – one that is greener, smarter, more inclusive – more dynamic. This is where we need to direct the massive investments that will be required for a strong and sustainable recovery.

We know that, in many cases, well-designed green projects can generate more employment and deliver higher returns, compared with conventional fiscal stimulus.  

In this speech, the IMF managing director further called for social protection linked with just transition, tackling debt burdens in low-income countries, and stimulus measures for job creation.

The list of notable priorities enumerated by the managing director included avoiding premature withdrawal of crisis response measures, which will be the first test of governments and the Fund. Already, the spending plans attached to IMF emergency loans indicate that this may not be the case. Realising a fair and sustainable recovery will require a swift reform of the IMF and the scaling-up of multilateral support to developing countries, including through the Fund.

The recent precedent was disastrous. After an initial push for government support of the economy around 2009, the Fund reverted to the same failed policies of the previous decades. It emerged as a loud voice for the end of fiscal stimulus and a shift to “fiscal consolidation” [austerity] and “structural reforms” [deregulatory measures] that failed to deliver on promises of growth. This response shaped an uneven and unequal recovery, with slow growth, lagging productivity improvements, and the hollowing out of social protection systems.

Despite a decade of austerity policies initially billed as a necessary cure for rising debt-to-gross domestic product (GDP) ratios, debt burdens for most governments have increased while the debt of the private sector has also exploded. Measures taken to reduce debt – such as social spending cuts and wage moderation measures - often had devastating social impacts and negatively affected aggregate demand. This in turn reduced GDP and increased the debt burden as compared to GDP.

After the premature withdrawal of fiscal policy support, unconventional monetary policy became the backbone of the long and uneven recovery from the global financial crisis. This approach bailed out the financial system but created further imbalances in the global economy. Speculative cross-border investments rose to the benefit of the financial sector but did little to add value to real economy activities.

The IMF was swift to recognise that Covid-19 is “a crisis like no other” and call for measures to support health and incomes. The initial response has been strong in high-income countries where governments implemented record stimulus measures, including direct income support for people and businesses. A fiscal stimulus gap of at least $982 billion has

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1 Kristalina Georgieva (2020), The Long Ascent
2 Bakvis (2020), The IMF’s Renewed Supply-Side Push
3 Bakvis (2020), The IMF’s Renewed Supply-Side Push
emerged for low and lower-middle-income countries. Multilateral organisations, including the Fund, must do much more to support crisis response and recovery – and the response must be executed better than in the past.

In the initial months of the pandemic, the Fund deployed emergency loan programmes without the typical conditions attached. While the Fund touted one trillion dollars in available resources, it has only disbursed about 30 billion through emergency lending. A far greater share of IMF resources will be used in the coming years through traditional loan programmes in developing countries. For much of the world, the IMF is set to play a decisive role in shaping the pace and scope of recovery.

Staff guidance from 2018 advises Fund staff to analyse how recommended policies will affect economic and gender inequality. If the results are negative, staff should consider alternative policy recommendations or mitigation measures. In practice, this has usually meant mitigation of the negative effects of “pro-growth” policies the IMF promotes and a lack of appetite to consider alternatives. Moving from guidance to rules and extending this approach to the creation of loan conditions will be essential to the IMF supporting a fair recovery.

Underlying IMF lending and policy advice is a narrative about how economic growth occurs. A close look at the IMF’s growth narrative shows that claims about the benefits of many preferred policies are overblown while the negative effects are well documented. Countries that have successfully moved up the income scale over the past decades did not follow the laissez-faire prescriptions of the IMF. Thus, it is not a track record of results but engrained market fundamentalism that underpins the IMF’s policy advice.

This report describes how the ambitious vision articulated by IMF leadership for recovery can be operationalised through reform, ending decades of failure by learning lessons and abandoning market fundamentalism.

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5 IMF. “COVID Lending Tracker,” 2020
By October 2020, the World Economic Outlook predicted the largest contraction in global output of the century. Managing director Kristalina Georgieva called for a “response like no other” and affirmed the IMF’s role as a “sherpa” for its members in the recovery, stating the Fund stood ready to offer up to $1 trillion in financial assistance. The Fund quickly urged governments to increase spending on measures that protect incomes and health.

The experience of working people is bleak: the International Labour Organization estimates that during the first three quarters of 2020, an equivalent of 495 million jobs were lost and labour income fell by $3.5 trillion, with informal workers and women being the most affected.

The pandemic has highlighted the deep divisions and inequalities within and amongst countries. Lower-earning households are hit harder, both in terms of health outcomes and incomes, while lower-income countries are the most constrained in their ability to respond to the pandemic.

The IMF has committed about $151.5 billion to 83 countries in response to Covid-19. Most countries that received disbursements did so through IMF emergency lending facilities, the Rapid Credit Facility (RCF), which provides concessional loans for the IMF’s lowest-income members, and Rapid Financing Instrument (RFI). The RCF and RFI are available to countries impacted by external shocks and provide upfront financing without traditional conditionality. As part of its Covid-19 response, the IMF expanded access to these facilities, restricting lending to 100 per cent of member quota per year. Member quotas are roughly tied to the size of the national economy, meaning that for lower-income countries the borrowing limit can be low.

Figure 1 illustrates the composition of the IMF’s financial assistance for 2020 contrasting the commitments to the actual disbursements. Out of the committed assistance, the largest part is in the form of pre-approved credit lines offered to Peru, Chile, and Colombia. Only Colombia has utilised its credit line thus far. The disbursements through rapid emergency lending, which comprise the support offered to almost 70 countries, only amount to about $30 billion. Combined with traditional lending arrangements, the IMF disbursed about $50 billion to 81 countries in 2020. Disbursements for 2020 are only slightly larger than in previous years, when IMF assistance went to a much smaller number of countries. The IMF disbursed $45 billion for just one lending programme to Argentina in 2018 and 2019.

To provide debt relief on loan repayments owed by its lowest-income members, the IMF has used its Catastrophe Containment and Relief Trust Fund (CCRT). The CCRT is financed by donations from better-off member countries. Through October 2020, this provided $489 million in debt relief to 29

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7 IMF (2020). World Economic Outlook October.
8 Kristalina Georgieva (2020). A Global Crisis Like No Other Needs a Global Response Like No Other, IMF Blog.
10 Joseph Stiglitz (2020). Conquering the Great Divide, IMF F&D.
13 IMF (2020). Member Quotas.
countries, and the IMF will seek to extend cancellation of repayments through April 2022.\textsuperscript{15}

The IMF has applauded the overall response of governments to the crisis, which it estimated to be around $12 trillion globally. However, it has acknowledged that high debt burdens have hampered the fiscal policy response in emerging market and low-income countries.\textsuperscript{16} Accordingly, most of the measures are concentrated in advanced economies countries where discretionary additional spending came close to 10 per cent of GDP, compared to about 3 per cent in middle-income countries and less than 2 per cent in low-income countries.\textsuperscript{17} The International Labour Organization offers a picture of what that means proportional to employment loss.\textsuperscript{18}

The loss in working hours, along with the amount of stimulus, expressed in terms of working hours needed to produce the same value of output, is shown in Figure 2. The stimulus provided only outpaced job loss in high-income countries, while other groups do not come close. Although employment in lower-middle-income countries has been hit the hardest by a 14 per cent decrease in working hours, the amount of stimulus only amounts to the equivalent of about 2.4 per cent of hours worked.

\textbf{Figure 2: Employment loss (work hours) and fiscal stimulus measures (equivalent work hours value)}

![Figure 2: Employment loss (work hours) and fiscal stimulus measures (equivalent work hours value)](image)


Putting a dollar value to this gap in support, the ILO estimates low-income countries would need an additional $45 billion in spending, and lower-middle-income countries would need an additional $937 billion.\textsuperscript{19} Compared to this need for immediate crisis response, the disbursements from the Fund and its sister institution, the World Bank, are not enough.

IMF pronouncements in favour of more spending and warnings against prematurely withdrawing support prompted media coverage on how “austerity was officially buried” at the October 2020 Annual Meetings.\textsuperscript{20} The endorsement of more spending does not apply evenly to all member countries. This advice is directed towards a small number of countries, mostly advanced economies and a few emerging markets that have been able to engage in quantitative easing domestically and take advantage of lower interest rates on their debt. Calls for more public investment are also directed to countries that have “fiscal space.” In general, the IMF continues to recommend fiscal consolidation as a pillar of a medium-term fiscal strategies once the crisis is over.\textsuperscript{21}

While the IMF emergency loans did not include conditions regarding future spending cuts, staff evaluate the economic policy plans of a country when a request is made. In a survey of IMF staff reports for 80 countries, the European Network for Debt and Development found that 72 countries forecast cuts to spending levels below their pre-pandemic baseline as early as 2021, with all 80 countries doing so by 2023.\textsuperscript{22} These future spending plans met with approval from Fund staff.

The IMF currently forecasts that GDP will quickly recover to pre-crisis levels as early for most of the world. Figure 3 illustrates the IMF’s total growth projections using 2019 as a baseline. After a short drop for all countries in 2020, the IMF assumes that output globally and in emerging and developing countries will surpass its pre-crisis level in 2021, and in advanced economies in 2022.

\textsuperscript{17} IMF (2020). \textit{Fiscal Monitor October}.
\textsuperscript{20} Chris Giles (2020). \textit{The week austerity was officially buried}, Financial Times.
\textsuperscript{21} IMF (2020). \textit{Fiscal Monitor October}.
It is unclear what exactly the IMF sees as a “premature” withdrawal of fiscal support, given the expectation of a rapid recovery. Even if IMF growth projections materialise and GDP rebounds in 2021, it is unlikely that other indicators, such as employment and wages, would also recover.

In 2008 and 2009, 136 countries surveyed in the IMF World Economic Outlook increased their spending by an average of 3.2 per cent of GDP. The immediate response to the crisis was effective in stabilising output. After a slowdown in 2008 and negative growth in 2009, GDP growth recovered to its pre-crisis levels.

Focusing on growth figures and ignoring the slack in the labour market, the IMF shifted its focus to “winding down” post-crisis support and implementing policies “to restore the role of market forces”. In June 2010, following advice from the Fund, G20 countries committed to fiscal consolidation to tackle growing debt burdens and to “pursuing structural reforms across the entire G20 membership to increase and sustain our growth prospect”.

This shift became consensus amongst policymakers around the world. An analysis of the IMF’s World Economic Outlook showed that in 2010 and 2011 a majority of countries, including both advanced and developing economies, reduced their public expenditure.

The result was a sluggish recovery, and in the case of the European Union, a double-dip recession, with the economy shrinking again in 2012. Overall, global GDP remained much lower than was expected before the crisis, never making a full recovery. The pre-crisis projection for global GDP for 2013 was $82.5 trillion versus the actual figure of $77 trillion. While it initially seemed like GDP would revert to its pre-crisis trend, the slowdown in growth after 2011 meant that in 2013 the global economy was roughly $5.5 trillion smaller than pre-crisis projections.

Further details on the role of the Fund and the consequence are in the ITUC’s report “The IMF’s Renewed Supply-Side Push: Four decades of structural adjustment and austerity conditionality”.

The IMF’s mandate as stated in its Articles of Agreement is to ensure the smooth functioning of the international monetary system, facilitate “the expansion and balanced growth of international trade, and to contribute to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.” The Articles of Agreement explicitly state it needs to provide support to address balance of payment problems “without resorting to measures destructive of national or international prosperity.” The Articles also recognise “that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability”.

**Market fundamentalism and the IMF**

The policies promoted by the IMF, as advice in regular consultations with its membership (referred to as surveillance), and conditions in its lending programmes, are underpinned by a narrative on how economies function and the achievement of growth and stability through deference to market mechanisms. The IMF follows a supply-side approach to economic growth that focuses on creating ideal conditions to attract private sector investment. The Fund commonly states that the goal of its advice is to boost “confidence” and “competitiveness”, leaving the rest up to markets.

The IMF became the world’s leading promoter of market fundamentalism in 1980s, when it underwent a major institutional transformation orchestrated by Ronald Reagan’s administration. As a result of this institutional shift, the supply-side narrative popular amongst many economists in the United States was incorporated into IMF operations.

One of the observations at the root of this supply-side school of economics is that in markets an invisible hand guides households and firms towards optimal outcomes, attributed to Adam Smith. This simplification overlooks Smith’s more nuanced views on the potential and limits of markets. In “The Uses and Abuses of Adam Smith”, Amartya Sen explains that Adam Smith did not believe that the profit-motive alone would provide optimal outcomes for society and recognised the need for strong institutions and regulation. Otherwise, Smith understood that the pursuit of profit without regulation would lead to excessive risk taking by “prodigals and projectors” that would ultimately destabilise the economy.

Alongside with this idea, Say’s Law states that supply creates its own demand and thus there is no need to focus on income levels, wages, or the demand-side of the economy. This observation was thoroughly debunked by Maynard Keynes in “The General Theory of Employment, Interest, and Money”, which popularised the concept of aggregate demand.

A recent IMF research paper traces the evolution of the dominant growth narratives within the IMF, through an analysis of all Fund surveillance documents since the 1970. The analysis finds that the year 1984 marks the end of the “Economic Structure” narrative, which often foregrounded industrialisation, manufacturing, and innovation as drivers of growth. What follows is the start of the “Washington Consensus”, which shifted focus to government failures as the reason for poor growth performance and advised governments on how to get out of the way of market forces.

In the early 2000s the IMF was losing influence following a series of high-profile failures in its response to the Asian Financial Crisis of 1997-98 and a disastrous loan agreement with Argentina in 2001-02. In the early 2000s, IMF loan disbursements reached record lows, while loan repayments, often ahead of schedule, peaked. In 2007, the IMF disbursed less than the rough equivalent of 2 billion US dollars.
The global financial crisis brought a rebranded IMF to the forefront, which stated it no longer was in the business of “Structural Adjustment Programmes”, as both a source of financing and policy advice.  

Around this time, there were some shifts in the IMF growth narrative, which evolved into what Cherif, Engher, and Hasanov label the “Washington Constellation”.  

In this iteration, terms such as human capital, inequality, inclusive growth, as well as corruption and governance issues appear alongside elements of the previous Washington Consensus.

Despite the addition of new language and concerns in IMF advice, at its core the same narrative continued to dominate. A study of conditionality in IMF loan agreements between 1985-2014 confirms this pattern and finds that while the number of conditions in loans fluctuated over time, their content was consistently in line with structural adjustment programmes comprised of structural reforms including labour market deregulation, along with fiscal consolidation.

How does the IMF decide what economic advice is “sound”?

To make economic predictions and assess what policies work best, the IMF uses its own adaptation of a Dynamic Stochastic General Equilibrium Model (DSGE), commonly used by academics but not market practitioners. While at first sight these models might seem neutral and scientific, the mathematical aspect and calculations are built upon arbitrary assumptions and beliefs. Pro-market ideological bias can be engrained in these models, which are often built on explicit assumptions about the efficiency of markets, the inefficiency of governments, the rational behaviour of households and firms, and ignore the complexity of modern-day financial systems.

Many of the key assumptions in such models are directly contradicted by evidence and microdata. While many models have additional features that might incorporate real world data on some variables, the core underlying assumptions are the same. These models assume that in most cases markets function perfectly and achieve optimal results. The view extends to all markets, for example assuming that in a labour market, workers are usually paid based on their productivity levels, ignoring dynamics at play, including market power. By ignoring norms, institutions, and power dynamics that exist in the real world, policy advice is biased towards deregulation.

Another major blind spot for this type of model is the omission of the financial sector, the role of money, and credit creation. For example, the IMF’s Global Integrated Monetary and Financial Model (GIMF) explicitly assumes there is a pre-determined quantity of savings in the banking system that banks can lend out to investors. However, it has been documented at length that banks create additional liquidity when they make loans. This assumption has far-reaching implications for both the growth potential of an economy as well as transmission mechanisms to increase investment. Furthermore, it fundamentally challenges the idea that government spending crowds out private investment. This viewpoint is derived from the assumption that all economic actors along with the government are competing over the same limited pool of savings.

Using this type of framework for analysis inevitably leads to advice against government deficits and in favour of deregulation.

38 Reda Cherif, Marc Engher, Fuad Hasanov (2020). Crawling Beliefs, Hidden Biases: The Rise and Fall of Growth Narratives, IMF WP.  
40 IMF Working Paper (2013). Getting to know the GIMF.  
Structural reforms and growth

Deregulatory “structural reforms” are a core pillar of the IMF growth narrative that has survived through its various iterations. These reforms are frequently invoked as a way to “improve the business climate” or “boost productivity, employment, and investment”.

To understand what these reforms entail, and their intended benefits, we will look at Chapter 3 of the 2019 IMF World Economic Outlook. The report follows up on an earlier release that focused on advanced economies and includes data on emerging and developing economies from an internal database. The chapter titled “Reigniting Growth in Emerging Market and Low-Income Economies: What Role for Structural Reforms?” includes an annex that details the methodology used by the IMF, allowing for a closer evaluation of the claims.

The IMF structural reform database scores countries on the depth of reforms, with each score on a scale from 0 to 1, with 0 meaning more “repressed” and 1 the most “liberalized”. Countries receive a score for each of the following six areas:

1. Domestic finance
2. External finance
3. Trade
4. Product market (looks at telecommunications and electricity sector)
5. Labour market
6. Governance

The sixth indicator is not derived from the IMF’s internal database. Instead, it is adopted from the World Bank Worldwide Governance Indicators.

The total score for each country is then obtained by the simple average of each component. The chapter claims that “major simultaneous reforms” (reminiscent of structural adjustment programmes of the 1980s and 1990s) across all areas can boost GDP growth by 1 per cent each year according to empirical results, and double that in medium-term models. It is noted that some reforms can have a delayed payoff of at least three years after implementation.

However, the empirical estimates are constructed by grouping countries together and averaging their performance, without consistency between increases in reform scores and growth performance. While the inconsistent payoffs of reforms are acknowledged, excuses are made for those that performed poorly in terms of growth, while success is attributed to the reforms. The chapter openly acknowledged “the importance – and difficulty – of disentangling the effects of reforms from other drivers of economic growth”.

The annex to the chapter provides data on the changes in scores from 1990 to 2014 for the largest emerging and developing economies for all six policy areas. Even if these reforms are the path to generate more growth, we would expect that overall, even with some exceptions, there would be a correlation between improvements in scores and growth.

Figure 4: Total reform score changes 1990-2014 vs. cumulative per capita growth 1993-2017

Figure 4 illustrates the increases in the reform score on the Y axis, and the cumulative growth in per capita GDP, with a three-year delay (the possible delay for reforms to be effective) on X axis for the largest emerging and developing countries. The top performer in terms of growth is China, where per capita GDP increased almost sevenfold while pursuing a strategy that does not fit in the structural reform orthodoxy. There is no clear pattern to show a correlation between the countries with most reforms and growth performance. Some of the top reformers in this sample, such as Ukraine, Egypt, and Russia, are amongst the worst performers on growth.

The labour market indicator focuses on employment protection legislation, incorporating factors such as procedural requirements for layoffs, the costs for layoffs, and whether valid grounds for dismissal are
needed. When looking at the labour market indicator, we observe the same lack of corelation between improvements in this score and growth performance.

This is illustrated in Figure 5. For most countries in this sample that moved towards labour market flexibilisation, growth patterns are no different than for those that have more labour protections. Some of the countries that increased employment protection legislation grew faster than most of the countries in the sample that moved towards flexibilisation, such as Indonesia and Vietnam. Other countries, such as Ukraine, South Africa, and Egypt, which weakened employment protection legislation, have some of the worse growth outcomes.

Figure 5: Labour reform score changes 1990-2014 vs. cumulative per capita growth 1993-2017

These results are not surprising given that one of the main transmission mechanisms from these reforms to an increased performance in growth is the reduction of informality. This is expected to automatically happen as a result of having less regulation, claiming “easing job protection legislation increases the profitability of formal sector firms directly; this encourages them to grow, increasing investment and reallocating resources from the less productive informal sector.”

Reducing informality is a much more complex issue requiring comprehensive interventions. Strategies to reduce informality have to be tailored to country specific circumstances, and there is no evidence to support the idea that deregulation reduces informality. India provides an example of a country that has pushed towards deregulation to address informality in the past decade and obtained opposite results, as employment in the informal sector grew faster than in the formal sector despite this push.

Informality has many causes and requires a broad set of policies to tackle it, including measures to promote access to decent work, simplified measures to register businesses and report earnings, simplified tax and contributions assessment and payment regimes, and a balance of incentives and enforcement measures. This is outlined in ILO Recommendation 204 on the Transition from the Informal to the Formal Economy.

The ILO has also published research questioning IMF findings on supposed employment gains from labour market flexibilisation. The ILO points out that IMF findings rely on both faulty data along with faulty interpretation of correct data. IMF research on the topic often uses data collected for the World Bank Employing Workers indicator, which has been suspended due to its methodological flaws and interpreted breaks in data series as reforms.

A recent meta-study of papers evaluating the impact of labour market flexibilisation reforms found that overall, the literature does not show that employment protection legislation increases unemployment levels; furthermore, papers that identify that connection often cherry-pick data.

Looking at the sample analysed in the 2019 IMF WEO chapter, it presents seven countries that have moved up the income ladder from emerging markets to advanced economies: Hong Kong, Singapore, Czech Republic, Estonia, Latvia, Lithuania, and Israel. None of these countries were top reformers based on IMF scoring, especially in the areas of labour, product markets, and governance.

What was the strategy used by countries that moved up the income ladder? Outside of former communist countries in Europe, which were already industrialised and had a highly educated population, the other countries that achieved this actively used industrial policy. However, despite these successes, industrial policy fell out of grace amongst IMF staff, which barely mentioned the approach, and especially since the 2000s cast it in a negative light.

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49 IMF (2019). World Economic Outlook, October.
55 Reda Cherif, Marc Engpher, Fudzi Hasanov (2020). Crouching Beliefs, Hidden Biases: The Rise and Fall of Growth Narratives. IMF WP.
The claim that a push for deregulation is sufficient to attract more investment is not supported by evidence that finds additional interventions are needed to truly improve the business climate. Development economist Ricardo Hausmann compared governments waiting for investors to appear after they pursue structural reforms to "waiting for Godot." Hausmann points out that governments need to play a proactive role in creating an economic strategy for growth and attracting the right type of investors.

Looking at how structural reforms performed in countries with IMF programmes, the IMF itself found in its latest Review of Conditionality that the IMF has a pattern of overestimating the gains from structural reforms. Overall, the review found an overestimation of about 1 per cent yearly GDP growth as a result of structural reforms. This error in projects amounts to about the same as the 2019 IMF World Economic Outlook predicted as the gains in growth from structural reforms.

"Expansionary" austerity and growth

IMF promotion of austerity and deregulatory structural reform are linked. Support for near-constant austerity is rooted in the idea that government spending crowds out private investment, and that deficits reduce the confidence of potential foreign investors. The Fund often refers to austerity measures using euphemisms such as "growth-friendly fiscal consolidation", echoing the concept of "expansionary austerity".

The idea that fiscal adjustments based on spending cuts, not tax increases, are more growth friendly was championed by Alberto Alesina. The findings that support this claim rely on regressions on revenue, spending, and growth on data collected from OECD countries between 1970 to 2007. However, these types of studies are unable to separate specific country circumstances, or correlation from causation. For example, finding that higher growth is correlated with a lower deficit does not determine if lowering the deficit increased growth, or if faster growth led to a reduction of the deficit.

In the aftermath of the financial crisis, a number of prominent economists also warned of disastrous consequences unless debt burdens were lowered. In a now infamous paper, Reinhart and Rogoff claimed that allowing debt ratios to surpass a certain threshold would hamper growth. However, their analysis was not only ridden with calculation errors but also failed to distinguish between correlation and causation in their analysis, failing to answer whether higher debt causes lower growth, or if lower growth leads to an increase in debt. IMF-imposed austerity did not relaunch growth or reduce debt burdens. On the contrary, it pushed countries into deeper recessions. This was acknowledged by then IMF chief economist Olivier Blanchard, who published a paper in 2013 showing how by underestimating fiscal multipliers, the IMF made overoptimistic growth assumptions in its austerity programs.

The pattern of optimism in IMF assumptions and the fantasy concept of “growth-friendly fiscal consolidation” continued after Blanchard published his findings, with regard to both countries with and without IMF programmes. In an analysis of IMF growth projections between 2003-2017, Fund researchers found "strong evidence of an optimism drift over the forecast horizon", meaning the IMF consistently makes overoptimistic assumption on the impact of austerity on growth. Furthermore, higher magnitudes of error are directly correlated with the magnitude of the fiscal adjustment, raising the question for the validity of the IMF’s post Covid-19 growth projections, which assume a rebound in growth along with planned fiscal consolidations.

The turn to austerity in 2010 flatly failed at its stated goal. The negative impact on GDP of these measures, and the slower growth, meant that the debt-to-GDP ratios continued to increase despite spending cuts and deficit reductions.
For most country groups, debt levels in 2019 were higher than in both 2008 and 2010, as shown in Figure 6. In the European Union, despite being home to countries with some of the most aggressive efforts to reduce debt, government debt ratios only decreased from 80.6 per cent of GDP to 79.2 per cent in 2019. In all emerging and developing economies, debt ratios increased faster between 2010 and 2019 than immediately after the crisis.

Although monetary policy operations have kept interest rates close to zero and even negative in some advanced economies, the costs of servicing debt have remained much higher for the rest of the world. On the eve of Covid-19, in 2019, sixty-four developing countries spent more of their revenue on debt payments than on healthcare.

Social consequences and vicious cycles

The gains from a structural reform push are significantly overstated, while the negative impact on growth from fiscal consolidation is consistently underestimated. However, these policies have consequences that go beyond growth performance and have a negative impact on social indicators. That in turn can further feed a cycle of disappointing growth, according to the IMF research that finds increasing income inequality also hurts sustained economic growth.

IMF research acknowledges that the reforms it promotes increase income inequality. For example, IMF research has recognised labour market deregulation leads to a falling share in the income that goes to labour. Similarly, IMF research linked the push for capital account liberalisation, a key part of external finance reforms, to increasing inequality. In 2016, an IMF article titled “Neoliberalism, oversold?” recognised the increase in inequality that resulted from the IMF’s policies, particularly austerity measures and the push for capital account liberalisation. The IMF’s push for full liberalisation of capital flows is also a factor in increasing financial instability, cutting against a core function of the Fund. Despite adopting an institutional view that endorsed capital flow management under certain circumstances, it has rarely translated into country level advice.

Conclusions from IMF research on inequality have not been systematically incorporated in policy advice or loan programmes. After a pilot programme on incorporating the issue of inequality in surveillance, staff guidance was updated, but standard procedures in surveillance remained the same. Although staff guidance for surveillance urges consideration of whether proposed measures will increase economic or gender inequality, staff have shown a reticence to examine consequences or consider alternatives.

Beyond falling short on promises of growth, policy advice has actively hindered growth and furthered financial instability, often trapping countries into vicious cycles of low growth, and increasing poverty and inequality.

Greece was a prime example of this, with economic adjustment programmes coordinated between the IMF, European Central Bank and European Commission (the so-called “troika”) failing to stabilise the Greek economy. Attempts to increase national savings by means of tax hikes, wage suppression and labour market deregulation ultimately lowered disposable income, suffocating private consumption and GDP. Ultimately, austerity and internal devaluation have instead distorted all income-generating mechanisms, thereby provoking a deep liquidity crisis that has contracted internal demand and put strains on the country’s fiscal solvency.

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63 Jubilee Debt Campaign (2020). Sixty-four countries spend more on debt payments than health.
64 Andrew Berg and Jonathan Ostry (2011). Inequality and Unsustainable Growth: Two Sides of the Same Coin? IMF SDN.
66 Davide Furceri and Prakash Loungani (2016). Capital Account Liberalization and Inequality. IMF WP.
Another example of the failure of this approach is Argentina, where a record $56 billion programme resulted in a further collapse of the economy, an explosion in poverty. Meanwhile, most of the funds disbursed ended up financing the capital flight of investors looking to exit investments in Argentina and take money outside the country.71
Covid-19 has exposed pre-existing vulnerabilities of our economic system which need to be addressed. Along with measures aiming to blunt the immediate impact of the crisis, a long-term vision is needed to build back better toward net-zero carbon and full employment, moving beyond the failure of market fundamentalism.

The IMF’s structural reform agenda is designed to pursue the goal of increasing GDP. As shown above, this promise is often unfulfilled. Further, GDP growth with no actual regard for where the growth comes from and how gains are distributed will not deliver on the SDGs. Even when they do not finance the creation of new output, activities in the financial sector are counted in GDP as a factor of growth. This is despite not adding any productive value. On the other hand, activities that provide value for society, such as unpaid care work, are not counted.

Kristalina Georgieva stated “we cannot afford simply to rebuild the old economy, with its low growth, low productivity, high inequality and worsening climate crisis.” We outline five policy areas for the IMF to focus on to deliver structural transformation aligned with the SDGs and its mandate as outlined in its Articles of Agreement:

1. Fair access to the global financial safety net
2. Creating fiscal space
3. Universal public services and social protection
4. Full employment, decent work and a just transition to a net-zero carbon economy
5. Alternative policy packages to align IMF conditionality with the SDGs

**Fair access to the global financial safety net**

The global financial safety net anchored by the IMF has three main objectives: providing insurance for countries during a crisis, supplying financing during a crisis, and incentivising sound macroeconomic policies. The current safety net is not fit for purpose. While the IMF did mobilise quickly to provide financial support to countries impacted by Covid-19, the amount it has lent barely makes a dent in the $2.5 trillion estimated support needed by emerging and developing economies.

Access to the global financial safety net and ability to respond to a crisis are uneven between countries, yet growing trade and financial flows mean that crises will inevitably spill over. Over a decade ago, the global financial crisis showed how the excessive risks and speculation taken in the United States can cause a global financial meltdown. Since then, some steps were taken towards regulating banks, but very little has been done to regulate non-bank financial institutions that manage large portfolios, are often drivers of speculative global capital flows, and have expanded in recent years. The IMF needs to translate its endorsement of capital management measures into country level advice.

In responding to Covid-19, central banks in wealthier countries are once again able to boost domestic liquidity and support additional spending. Most developing countries are unable to follow suit, have unsurmountable debt burdens, and little access to financing. Furthermore, massive sudden capital outflows at the onset of the pandemic occurred in a large number of developing countries and threatened their financial stability. Large overall inflows in later months to a small number of emerging countries issuing debt obscures the continuing damage and difficulties for many developing countries.

Most transactions at the global level, including the largest share of foreign currency debt, is denominated in US dollars. The unevenness of the current system is further highlighted by the fact that the US central bank has extended its liquidity support to select other countries through bilateral swap lines that provide access to dollars. Swap lines allow countries to exchange their domestic currencies for US dollars directly at the prevailing exchange rate, something...
that would be impossible to do in markets during a crisis. However, access to this source of reserves is granted unilaterally by the US Federal Reserve.

In recent years, the IMF has added flexible and precautionary credit lines as an additional instrument to its toolkit. Most recently, the Short-Term Liquidity Line was created during the Covid-19 crisis. However, the IMF has only approved a very small number of credit lines, and they have never actually been drawn from by any country. Unlike the swap agreements, these credit lines offer dollars as additional debt, and not as an exchange for the local currency of the country using the line. The Short-Term Liquidity Line more closely resembles a swap line mechanism than previous credit lines, but it still requires pre-approval and has not been used.\(^79\)

As part of the response to the global financial crisis, in 2009 the IMF issued additional Special Drawing Rights (SDRs), an international reserve asset that can provide a cushion to countries with low levels of international reserves.\(^80\) The IMF is the sole issuer of SDRs, which can be used in transactions with the Fund or can be exchanged into one of six main global currencies. Calls in 2020 for another allocation of SDRs to address the Covid-19 crisis have remained unanswered, mostly due to opposition from the United States, which holds veto power over major decisions at the IMF.

This highlights the issue of IMF governance, in which advanced economies that need IMF support the least have the most voting power and even the ability to block major decisions. The current quota system of the IMF concentrates voting power on all major decision in the hands of a few advanced economies. IMF governance needs reform to fairly represent all its members.

Creating fiscal space: progressive taxation not harmful austerity

Many countries face constraints and have no fiscal space to respond to the crisis or to finance much-needed public services and investments. Past experience demonstrates that austerity measures hurt people and fail to expand fiscal space. The IMF must learn this lesson.

To immediately fill the fiscal stimulus gap between countries’ ability to respond to the crisis, more international solidarity is needed. It is essential for people who are impacted by the virus and lockdowns to be provided adequate income support. To that respect the IMF should support a Global Social Protection Fund that can help meet the urgent financing needs for such measures in developing countries.\(^81\) The Fund has a crucial role to play in increasing tax revenue to replace this external support with reliable revenue and fund other elements of the SDGs.

Supporting progressive measures is essential. Ending corporate tax avoidance, and the use of tax haven by both corporations and wealthy individuals, will help countries raise additional revenue and also tackle growing inequality. Additional taxes on the financial sector through a financial transaction tax would have the added benefit of discouraging speculative trading. A tax on capital flows not directed towards productive investments can similarly raise revenue while promoting financial stability growth in the real economy.

Corporations rarely pay their fair share of taxes in all the countries they operate in. Profit shifting to avoid taxation is a threat to inclusive economic growth. IMF research has provided some input on reducing tax avoidance practices.\(^82\) One possible solution is the implementation of a minimum corporate tax on outbound or inbound investments. Another suggestion is creating a mechanism to allocate tax revenue to countries in accordance with the profits earned in each country.

Tax-motivated illicit financial flows are enabled by a framework that encourages the free movement of capital. Illicit flows are estimated by the UN to cost countries somewhere in the range of $49 to $193 billion, which amounts to over 2 per cent of the combined GDP of Latin America and the Caribbean and Africa.\(^83\) The IMF is in a position to help put an end to this practice by promoting automatic exchange of information between countries and building upon its research on corporate tax and illicit flows.

The IMF currently has a tendency to promote consumption taxes, which have a disproportionate impact on the poorest households. Furthermore, the
IMF’s push for rapid removal of fuel subsidies as both a revenue and climate measure disproportionally hurt lower-income income people and often lead to social unrest that lessens support for a transition to a net-zero carbon economy. While energy production and usage must transition beyond fossil fuels, it cannot be done by placing high upfront adjustments costs on the poorest households.

A large number of countries are at high risk of debt distress and have no avenue to pursue a fair restructuring of their debt. A significant part of sovereign debt is issued under US law, where courts have often sided with US-based creditors, which has also given rise to the practice of “vulture funds” buying distressed debt and litigating to make a profit. Opposition from creditor countries has ensured that many proposals, including one from the IMF in the early 2000s, on creating a global debt restructuring mechanism have gone nowhere.

In response to Covid-19, G20 countries launched the Debt Service Suspension Initiative to allow low-income countries to seek a freeze on repayments to bilateral creditors. The initiative called for private creditors to offer similar treatment. The initiative has failed to deliver any substantial help, and 43 out of the 73 countries covered by the initiative will still spend more on debt repayments than healthcare in 2020. The IMF’s own initiative has covered all payments owed to the IMF but for less than 30 low-income countries that have scheduled repayments.

Through its debt sustainability analyses, the IMF determines how much a country can afford to pay its creditors and whether it can pay its debt or needs relief or restructuring. Furthermore, the IMF’s pattern of making overoptimistic assumptions about growth often delays much needed debt restructurings by overestimating the income countries will have available for creditors.

Debt repayment should never come at the expense of providing services to the population. Sufficient spending for healthcare, education, and social protection needs to be incorporated in all debt sustainability analyses. The IMF can provide realistic

**Universal public services and social protection**

Addressing the health crisis is an immediate priority and includes expanding public health coverage, testing, and vaccine access. Government and multilateral leadership is necessary. The IMF has supported additional spending in these areas as an emergency measure. To build resilience beyond restraining Covid-19, universal public services and social protection for all need to be prioritised.

IMF advice on social protection and social spending floors in lending operations needs to align with ILO standards for universal social protection including floors. While the IMF introduced spending floors in some of its programmes to protect provision from cuts, the floors have consistently been set at levels that are too low to provide social protection for all and only protect a handful of basic social assistance programmes. Social spending floors should protect and enable the creation of social protection systems consistent with ILO Recommendation 202 on social protection floors, including health coverage, and Convention 102 on social security.

Public sector activities and services, despite being invaluable to a healthy society, are also undercounted in GDP, which measures market prices of activities that are not designed to generate income or profit. It is by this accounting method that a teacher adds only a fraction of the value supposedly added to the economy by someone working in finance. This extends to measuring the productivity of public sector workers in general, which is calculated in direct relationship with the price of the output they produce.

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86 Kevin Watkins (2020). Delivering Debt Relief for the Poorest, IMF F&D.
89 Mariana Mazzucato, Reda Cherif, Fuad Hasanov (2020). How to End the Pandemic This Year, Project Syndicate.
This measurement bias is what leads to the conclusion that the public sector is unproductive, or less efficient than the private sector. The IMF often asks for public employment spending cuts. In practice, the private sector has not been more effective in the service provision. On the contrary, privatised services and public-private partnership often increase costs, while providing lower quality services and creating barriers to access.93

Universal quality public services and social protection will lay the foundations of a healthy and resilient society that can withstand future shocks and crises.

Full employment, decent work and a just transition to a net-zero carbon economy

Central banks around the world have a mandate to maintain price stability, and in some countries a dual mandate that includes the promotion of “maximum” employment. For decades the idea of a “non-accelerating inflation rate of unemployment” (NAIRU) and trade-off between full employment and inflation has dominated economic thinking at central banks. However, it has become clear that empirically this principle does not hold, with the Federal Reserve acknowledging that unemployment has fallen below their estimate of NAIRU without increasing inflation.94 The IMF should promote a dual mandate that incorporates full employment for all central banks and convene discussions on mandate reviews and full employment frameworks to assist in the recovery from Covid-19.95 The Fund can lead in this area through research and using its unique convening power to bring together central banks to discuss reforms to mandates, frameworks, and operations that support full employment.

The strategy of boosting employment through erosion of labour rights and wage suppression creates precarious work, worsens inequality, and fails to address poverty. Strong labour protections and collective bargaining can assure workers share the gains, and they create a positive feedback loop through the economy, as demand grows for goods and services. An end to IMF hostility towards adequate negotiated and minimum wages is necessary for a successful recovery. The IMF should take the lead from the ILO on all labour-related issues and increase cooperation, including on the formulation of alternative policy packages to avoid fuelling inequality.

The experience of the global financial crisis needs to serve as a lesson that markets alone cannot deliver transformations of the scale needed to achieve the SDGs and a world with net-zero carbon greenhouse gas emissions. Government policies and laws are not intrusive interventions on otherwise free markets but an integral part of the process that shapes markets. Inequality, poverty, unemployment, and climate destruction are not natural outcomes but a consequence of how our economy is set up to operate and the types of behaviours it chooses to reward.

The IMF needs to embrace sustainable industrial policy to guide this transition and ensure it leaves no one behind. Industrial policy can assure that the public investments supported by the IMF are directed towards reaching a net-zero carbon economy.96

Workers cannot be left behind in the transition process, and the creation of green, decent jobs is a priority. Social dialogue needs to be at the core of a just transition, making sure that all those affected have a seat at the table.97

Public investment and public employment programmes can be designed to support sustainable infrastructure and employment. The IMF recognises that green investments can be combined with public employment programmes to maximise the impact on job creation, help retrain people, and protect them from falling into informality.98

To operationalise the Fund’s rhetorical support for public investment and a fair, green recovery, loan programmes and policy advice should incorporate full, decent, sustainable employment as a goal. Progress in this area should be the guiding light of global IMF advice as well, avoiding the pitfalls of using GDP as the only measure of recovery.

93 Maria Jose Romero (2018). History RePPPeated – How public-private partnerships are failing. Eurodad.
Alternative policy packages to align IMF conditionality with the SDGs

The IMF’s current policy advice and conditionality make it difficult for countries to come closer to the goals of the 2030 Agenda. The IMF alone cannot secure achievement of the SDGs. However, if it continues to impose the same failed policies from its past, progress would be impeded.

The IMF undermines progress in direct ways, such as demanding cuts in public wage bills, which often result in a reduction in health workers or teachers for countries that face shortages in those areas to begin with. A macroeconomic framework that prioritises austerity and lowering deficits without regard to necessary public investment is flawed and counterproductive.

Deregulation, privatisations, and liberalisation of the economy result in precarity for working people and worsen inequality. Continuing to push these policies risks a double-dip recession in the recovery from Covid-19 and ultimately a lost decade on both development and climate action.

Aligning policy advice and conditionality can begin with upgrading the staff guidance on inequality to be operational guidelines for all surveillance and lending. In doing so, the Fund must systematically assess the effects of proposed measures and formulate alternative policy packages when proposals will increase inequality.

A demand and wage-led recovery, where full employment and decent work are explicit goals, can create positive synergies that deliver on SDG 8 and the entirety of the 2030 Agenda.
Conclusion

Market fundamentalism has become so deeply engrained within the IMF that the supposed superiority of “market-based” solutions is rarely questioned and has been at the core of all policy advice since the 1980s. However, defining the boundaries of “free markets” and “optimal solutions” is subjective and has evolved throughout history. Research and the experience of policy failure has been ignored at the Fund for too long. With an ambitious vision articulated by IMF leadership for the recovery, it is time do the groundwork of making IMF lending fit-for-purpose.

For a resilient recovery that builds a fair and sustainable economy, we need to change the rules and actively guide markets. The IMF, which has endorsed the Sustainable Development Goals, needs to put forward a policy agenda and operational guidelines that bring the world closer towards realising these goals.