Is Time Ripe to Abandon the IMF?

By Raúl de Sagastizabal

Theme: Global Economy
Global Research, October 12, 2011
IDN-InDepth News 12 October 2011

The IMF Independent Evaluation Office (IEO) published on February last their IMF Performance in the Run-Up to the Financial and Economic Crisis, which gives an account of the Fund's "cultures".

Generally, audit or evaluation reports of international organizations, internal or quasi-internal, act as validation for the organization's mistakes and have no practical consequences.

Such reports let us know that the organization has done this or that wrong, or that it was unable to assess the result of a five-year loan period owing to a lack of the relevant indicators, or that a certain policy or practice did not yield the expected results.

Nothing is said about who is accountable for mistakes done. And, once this self-criticism is published, it is assumed that the organization has made a public acknowledgement of its mistakes, the press has taken note, absolution has been given and nothing more needs be done.

Many of the mistakes mentioned by the report are well known, and some have even been criticized by observers from several sectors and authorities from countries which have had to deal with the Fund's staff.

However as reports are published "from within" the organization, they transcend the category of mere opinion to that of an official acknowledgment, and even though in reality they act as nothing else but an excuse, they may be of service to authorities which have the ill fortune of receiving more consultancy missions from the Fund or at a particular moment the Fund might be seeking to impose its adjustment programs on them.

However, it is worthwhile attaching some value to these reports because they reveal to the general public countless highly questionable practices that include in the IEO's own words, the following mentioned in its executive summary:

"The IMF's ability to detect important vulnerabilities and risks and alert the membership was undermined by a complex interaction of factors, many of which had been flagged before but had not been fully addressed."

Chapter IV of the report explains why the IMF failed to give clear warning: "Various factors played a role in the IMF's failure to identify risks and give clear warnings. Many of these factors represent long-standing problems that had been highlighted for over a decade."

This section groups these factors into four broad categories: analytical weaknesses, organizational impediments, internal governance problems, and political constraints.

The IEO report says: "There are considerable interconnections among these categories, and their relative importance is based on subjective judgments. The IMF's ability to correctly identify the mounting risks was hindered by a high degree of groupthink, intellectual capture, a general mindset that a major financial crisis in large advanced economies was unlikely, and incomplete analytical approaches. Weak internal governance, including unclear lines of responsibility and accountability, lack of incentives to work across units and raise contrarian views, a review process that did not 'connect the dots' or ensure follow-up, and an insular culture also played a big role, while political constraints may have also had some impact."

The IEO lists the following as analytical weaknesses to which the IMF felt a prey:

> "41. Analytical weaknesses were at the core of some of the IMF's most evident shortcomings in surveillance, particularly for the largest advanced economies. These weaknesses were of two broad types: groupthink and other cognitive biases, and analytical approaches/knowledge gaps.
>
> "42. Several cognitive biases seem to have played an important role. Groupthink refers to the tendency among homogeneous, cohesive groups to consider issues only within a certain paradigm and not challenge its basic premises (Janis, 1982). The prevailing view among IMF staff – a cohesive group of macroeconomists – was that market discipline and self-regulation would be sufficient to stave off serious problems in financial institutions. They also believed that crises were unlikely to happen in advanced economies, where "sophisticated" financial markets could thrive safely with minimal regulation of a large and growing portion of the financial system.
>
> "44. Confirmation bias is a well-documented cognitive bias that refers to the tendency of people to only notice information consistent with their own expectations and to ignore information that is inconsistent with them (Bazerman and Moore, 2009).
>
> "45. The choice of analytical approaches and important knowledge gaps, some of which were shared by the whole profession, also played a role in the failure to identify risks and vulnerabilities. The linking of macroeconomic and financial sector analysis remained inadequate.
>
> "49. Lack of data and information, while a problem, was not a core reason behind the IMF's performance. First, much available data were ignored or misinterpreted.
>
> "50. An important organizational impediment that hindered IMF performance was its operating in silos, that is, staff tend not to share information nor to seek advice outside of their units.
>
> "53. IMF reports rarely referred to work by external analysts pointing at the mounting risks in financial markets.
>
> "57. Many area department economists felt that there were strong disincentives to 'speak truth to power,' particularly in large countries.
>
> "60. Turf battles, closely related to the issue of silos and incentives, were reportedly a major impediment to cooperation and collaboration. These were further evidence of a lack of sufficient oversight and follow through by senior staff and Management. The IMF was often described as a tightly-run, hierarchical organization, with clearly defined boundaries. According to one senior staff, 'the Fund operates as little fiefdoms'."

Chapter V of the report mulls ways Toward More Effective IMF Surveillance:

> "66. In considering recommendations, the aim is not to predict a crisis, as crises and their triggers are inherently unpredictable. It is rather to strengthen the IMF's working environment and analytical capacity to better allow it to discern risks and vulnerabilities and alert the membership in time to prevent or mitigate the impact of a future crisis."

The IEO argues, on the one hand, in a sort of unsolvable logical contradiction that crises are 'unpredictable' and therefore 'unpreventable' and, on the other hand, that the IMF must alert on time the countries to prevent or mitigate the impact of another crisis.

However, it is known to all, and the IMF itself makes it public on their web site, that among its functions the prevention of crises and that is precisely what it is accountable for:

> "The IMF is responsible for promoting the stability of the international monetary and financial system. Its job is to promote economic stability, help prevent crises, and help resolve them when they occur, thereby promoting growth and alleviating poverty."

The IMF also makes public that on December 14, 2007, the Fund's Executive Board discussed its interim work program, with focus on crisis prevention: "The Fund's support for crisis prevention has to consider developments in international capital flows and market access, which entails greater emphasis on financial and capital market issues, as well as continued country focus in the context of the Financial Sector Assessment

Program and the Fund's work on standards and codes."

The IEO report appears as a step up on the organization's internal practices; it shows it as an institution capable of questioning itself, and it was picked up as such by many important media around the world.

However, the report itself mentions that many of the problems it analyses had been alerted for more than a decade. In its annex 6 appears a summary of conclusions and recommendations of earlier audit reports, which range from the Whitomme report of 1995 until the 2008 triennial surveillance review, but hadn't been fully attended.

In fact they did not manage to change the organizational practices and its staff philosophy at all, since they addressed this crisis with the approach and shortcomings that the own report reveals.

As for 'Article IV Consultations', under which the IMF attempts to assess each country's economic health and to forestall future financial problems, which the IEO expressly mentions, it is worth considering that the blunders the Fund makes have rather dire consequences. The conclusions of these reports are not forecasts of the organization's personnel; they are assessments according to which countries "pass" or "fail" the consultation.

If the latter happens the country must "adjust" its internal policies according to the Fund's recommendations, whether they belong to areas such as fiscal, monetary, labour, retirement, among others. Until they put in practice such adjustments the country faces a virtual financial ostracism.

The IEO's analysis calls into question each and every one of the Article IV Consultations in general, whether positive or negative, past or future, and the mistakes it quotes in particular are:

> July 2007 Euro Area Article IV Consultation Staff Report: Surveillance of the euro area also conveyed a positive message. For example, according to the 2007 Article IV staff report (issued in July 2007), "[T]he outlook is the best in years. The economy is poised for a sustained upswing, partly because of cyclical considerations, but also because of policies ..." and "The external setting is generally considered propitious."

And regarding the U.S.: "Bilateral surveillance of the U.S. economy failed to warn the authorities of the pertinent risks and policy weaknesses; nor did it warn the membership at large about the possibilities of spillovers and contagion from problems originating in the United States. Indeed, the IMF often seemed to champion the U.S. financial sector and the authorities' policies, as its views typically paralleled those of the U.S. Federal Reserve. The chief concern was about the risks stemming from the large and growing current account deficit, and the main recommendations were for fiscal adjustment and continued financial innovation to attract capital inflows. It did not adequately probe the interplay between financial innovation, foreign capital, and the housing and securitization booms. Nor did it promote the use of prudential regulatory measures as an appropriate response to households' over-borrowing."

Bear in mind that what the Fund's staff did not see what was so obvious. One did not have to be an expert to perceive things as they were, nor was it necessary to scrutinize complex data; it was enough to follow up the news to know that something was amiss: the toxic assets crisis had begun in 2006 and by the first semester of 2007 signs of collapse were coming one after the other uninterruptedly. In fact the paragraph 27 of the IEO report mentions that the Fund's first analysis on these matters appeared more than six months after problems in this sector had already surfaced.

The quoted Article IV Consultation reports were prepared by Fund technical teams (which the IMF calls staff); the Euro Zone one was approved in July of 2007 by Michael Deppler and Michael Hadjimichael, and the United States one was approved by Anoop Singh and Carlo Cottarelli.

Anoop Singh was then the Director of the IMF Western Hemisphere Department, and on November 2008 he became Director of the Asia and Pacific Department. Michael Deppler was in 2007 the Director of the European Department. Carlo Cottarelli, IMF professional official since 1988, was appointed on November 2008 Director of the IMF Fiscal Affairs Department, and Michael Hadjimichael was a IMF professional official.

The aforementioned reports were prepared by the Fund's technical personnel and approved by Department Directors. These were not produced by employees dealing with statistics or data collectors, but by the officials in charge of evaluating the economies and alert on their possible unbalances. Despite their erroneous recommendations, the officers-in-charge remain in the Fund; they simply have changed hemisphere or department.

Summing up, the IEO holds the view that the Fund lacks analytical capability, does not correctly assess risks, their officers do not admit contrary opinions, they impose their points of view on the authorities of developing countries but fear expressing them before the ones from developed nations.

The IMF has internal governance problems and “long-standing” organizational ones, and not only did it not alert countries early on the possible risks of the financial system, but, on the contrary, told them for long months that the perspectives were good, that the system was working well and would withstand the American housing bubble and other disturbances, and that the outlook was the best in years for Europe; ultimately, it told them there would be no crisis, neither local nor global, and that there was nothing to worry about.

If we rigorously stick to these conclusions, each and every one of the recommendations the Fund has formulated to the nations along the history, as well as each and every one of its adjustment programs should be placed under judgment.

Such conclusions might as well be used as evidence by the Asian countries to hold the Fund accountable for their fatal advices during their time of crisis, from which only Malaysia come out unscathed, by firmly opposing the application of the Fund’s programs; or Argentina, for the Fund’s performance before, during, and after the 2001 fall, which determined the most devastating crisis the country has any memory of.

The Fund on its part does not hold on to its flawed conclusions anymore; after getting it wrong again and again and issuing forecasts, which announced good prospects of world recovery, their experts now recognize that they did not “perceive” what was really going on, and warn that the world is entering the danger zone and to avoid it advice the developed nations to apply the same adjustment programs which devastated for decades the developing world.

It would be a surprise indeed if, after so many blunders, anyone would pay serious attention to the IMF. Nonetheless, ignoring it is not advisable either. The governments would do well to ask themselves whether the time has not come to withdraw their endorsement to the organization.

Raúl de Sagastizabal *is an international analyst and consultant, specialising in international organizations. This article is posted in Spanish at www.politicapress.com [IDN-InDepthNews – October 11, 2011*

The original source of this article is IDN-InDepth News
Copyright © Raúl de Sagastizabal, IDN-InDepth News, 2011

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: **Raúl de Sagastizabal**

Disclaimer: The contents of this article are of sole responsibility of the author(s). The Centre for Research on Globalization will not be responsible for any inaccurate or incorrect statement in this article. The Centre of Research on Globalization grants permission to cross-post Global Research articles on community internet sites as long the source and copyright are acknowledged together with a hyperlink to the original Global Research article. For publication of Global Research articles in print or other forms including commercial internet sites, contact: publications@globalresearch.ca

www.globalresearch.ca contains copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available to our readers under the provisions of "fair use" in an effort to advance a better understanding of political, economic and social issues. The material on this site is distributed without profit to those who have expressed a prior interest in receiving it for research and educational purposes. If you wish to use copyrighted material for purposes other than "fair use" you must request permission from the copyright owner.

For media inquiries: publications@globalresearch.ca