The long and winding road to fiscal adjustment: How the IMF judges austerity programmes

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IMF judgements on whether government austerity programmes can be successfully implemented are carefully followed by international financial markets. ***Markus Hinterleitner****,* ***Fritz Sager*** *and* ***Eva Thomann*** *analyse the way the organisation has judged the credibility of austerity programmes in 14 European countries. They find that the IMF considers implementation credibility in its evaluations of austerity programs, and uses these to push its own agenda.*

International Monetary Fund. Credits: World Bank Photo Collection (CC BY-NC-ND 2.0)

During the European debt crisis, numerous states came under pressure from financial markets to consolidate their public finances. Many countries launched austerity programmes that used expenditure reductions and revenue increases to balance their fiscal budgets. Austerity programmes take quite some time to implement and for their effects to become visible. Hence, at the time of their announcement, they constitute mere signals that states send to financial markets to assert their willingness to honour future debt obligations.

Financial markets rely on so called 'informational intermediaries' to evaluate the implementation credibility of announced austerity programmes. These intermediaries are public or private organizations such as the International Monetary Fund (IMF) or Credit Rating Agencies which gather detailed information about the willingness and capability of states to implement announced austerity measures. By communicating their assessments, these organizations make the default risk of states 'legible' to financial markets. In a recent paper, we studied the decision-making calculus of the IMF when it judges whether announced austerity programmes can be credibly implemented.

Why are the views of the IMF about announced austerity plans so important for assessed countries? The IMF is often considered as the most powerful international organisation in history. Its country-assessment teams have unique access to fiscal information. The IMF's evaluations are regularly communicated in its flagship publications World Economic Outlook and Fiscal Monitor and widely considered in financial markets. Through their 'cognitive' authority, IMF judgements can influence the refinancing costs of states. Negative assessment may lead to increased refinancing costs and a reduced ability of a state to service its debt. By triggering even worse assessments, this can power a vicious circle that forces states to adopt ever stricter austerity measures.

Earlier research has shown that in low- and middle income transition and developing countries, the IMF often responds to geopolitical and transnational business interests and uses its assessments to justify its lending activities. However, in the institutionally, economically and politically more stable context of the Eurozone, these variables should play a lesser role, while domestic variables should have more weight. Moreover, the IMF has recently adopted a more differentiated understanding of 'sound fiscal policy'. Therefore, we looked at IMF assessments of 20 austerity programmes implemented in 14 European countries during the recent debt crisis.

As we can show, IMF assessments prove to be heavily influenced by the implementation credibility of an austerity programme. The IMF requires a minimum of institutional capacity – for example, an effective state administration – in order to give an austerity programme a positive assessment. The IMF is also generally sceptical of very ambitious austerity programmes that intend to drastically reduce the size of a public deficit within a very short period of time. Ambitious programmes are only evaluated positively if, amongst other conditions, an IMF rescue programme is simultaneously in place. This allows the IMF to influence the content of austerity measures and actively supervise their implementation. Finally, the IMF favours austerity programmes that emphasise expenditure reductions rather than revenue measures.

This is particularly problematic for institutionally weak countries with high fiscal deficits: the IMF only appreciates the austerity efforts of these countries if it can sit in the passenger seat. If countries reject the IMF they may pay for this rejection by having to pay more to finance themselves on international capital markets. This is an often overlooked way by which international organisations such as the IMF exert influence on states and constrain their scope for sovereign policy-making.

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The findings discussed in this blog post are based on a recently published article in the European Journal of Political Research. The post represents the views of the authors and not the position of the Democratic Audit blog, or of the LSE.

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