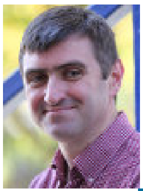
IMF ‘doves’ versus German ‘hawks’? The Fund and Europe’s politics of austerity



The International Monetary Fund (IMF) has a major role in promoting ‘sound’ economic policies. But as **Ben Clift** *writes, there have been important evolutions in the IMF’s economic ideas since the global financial and Eurozone crises. The IMF is now often at odds with some European leaders over key issues, undermining the notion that economic policy can be viewed as a purely technocratic and scientific undertaking, and reducing the IMF’s impact on policy in Europe.*

Discussion at the IMF/World Bank Spring Meetings at the IMF Headquarters April 22, 2018, Credit: IMF Staff Photo/Stephen Jaffe (CC BY-NC-ND 2.0)

The recent IMF and World Bank Spring meetings with finance ministers and central bankers are one key forum where the IMF performs its mandated role as conduit of international economic co-ordination, and its self-appointed role as global arbiter of ‘sound’ economic policy. Christine Lagarde recently set out the IMF’s policy priorities, offering some pointed messages for European policy-makers about how to improve economic growth and stability on the continent. Continuing a now well-established IMF tradition, Lagarde implored Germany to ‘use its excess savings to boost its growth potential’, highlighting additional growth-enhancing opportunities for ‘investments in physical and digital infrastructure.’

As this indicates, amidst the (at best partial) resolution of the Eurozone crisis, there is considerable daylight between IMF policy recommendations and the views on appropriate economic policy emanating from the German Government, other European fiscal hawks, and key European institutions, notably the European Commission and European Central Bank.

The IMF seeks to influence and shape the European economic policy debate, urging more activist domestic economic policies in support of growth, and to strengthen the systemic-risk reducing capacity of the Eurozone architecture, thus expanding European governments’ policy space. Counter-cyclical policy can, the IMF underlines, be hugely significant in reducing the losses in output arising from recessions and economic crisis. The positive role of public investment and fiscal policy in boosting economic growth is consistently underlined – especially for advanced economies enjoying ‘fiscal space’.

Not your grandmother’s IMF

As I detail in my new book, there have been important evolutions in Fund economic ideas since the eruption of the global financial and Eurozone crises. These shifts in Fund thinking have made for more lively debates within the European politics of austerity, with the Fund's post-crash views on fiscal policy efficacy and conduct, and on the size and shape of firewalls and financial backstops required for effective financial stabilisation, increasingly at odds with key European players.

IMF claims to legitimate economic knowledge hinge on generating a perception that economic policy decision is a technical, scientific process. This is important for Fund authority, for its views to gain 'traction', and be taken up. The IMF's quest for 'traction' sees it attempt to exert its influence through the shaping of meanings attached to 'sound economic policy'. This involves the Fund choosing or prioritising which economic ideas to draw on to inform policy recommendations, and the yardsticks by which policy will be judged.

There have emerged, ever since 2010, significant differences of view about economic policy amongst members of the Troika (EC, ECB, IMF) engaged in the European programmes. These political contestations over economic ideas have their roots in underlying ideological assumptions about the efficacy of fiscal policy. They have been difficult to contain within the confines of a façade of economic policy as a purely technocratic and scientific undertaking.

The battleground over 'sound' fiscal policy

A central battleground during the Eurozone crisis has been over what constitutes 'sound' and 'unsound' fiscal policy, with the ECB, the German Finance Minister and others often calling for more powers to enforce budgetary austerity. The IMF mobilised its knowledge bank and scientific reputation to correct what key Fund figures saw as mistaken premises of austerity policies.

Fund research into higher fiscal multipliers proved influential in the depths of the Great Recession. The IMF, along with some European governments, pressed the case for slower, less harsh fiscal consolidation to protect growth as the Eurozone economies struggled to recover. IMF support for French calls to loosen the strictures of the Stability and Growth Pact was an important factor in the European Commission's more lenient approach to delaying deficit reduction.

The IMF also counselled against precipitate exit from stimulus, debunked the notion that fiscal consolidation is in itself 'growth friendly', and underlined that fiscal consolidation can be self-defeating. As the recession in the Eurozone drew on, the IMF advised further counter-cyclical fiscal policy interventions to support the recovery. The Fund's empirically-backed policy advice advocated a 'less now, more later' approach to consolidation for those with fiscal space.

Firewalls, banking union, and breaking the 'doom loop'

Another key ongoing point of difference is over how to rebuild European financial stability and credibility. The IMF called relentlessly for the muscular use of public power, the Eurozone architecture, and central bank actions to limit financial market contagion. IMF research consistently underlined the take-home point from the financial and Eurozone crises: financial stability needs to be more actively nurtured and sustained by governments, by central banks, and by bodies like the IMF. It cannot be taken for granted. As Lagarde puts it, 'we must keep our financial systems safe by avoiding a rollback of the regulatory framework put in place since the global financial crisis to boost capital and liquidity buffers.'

The ECB, the German government and others saw bail-outs, ECB bond-buying and the building of firewalls in 'moral hazard' terms. This was tantamount to letting profligate governments off the hook and throwing good money after bad. They saw market pressure which under-developed 'backstops' prolonged as a spur to necessary competitiveness-enhancing reforms and fiscal discipline. The IMF have consistently hoped that banking union could reduce financial systemic risks by breaking the 'doom loop' between fragile financial institutions and over-burdened sovereigns. Yet Fund aspirations for 'full' banking union foundered due to a lack of support from European partners, the European Commission, and the ECB.

The limits of IMF 'traction' and influence in Europe

This highlights a consistent theme – the limits of IMF influence, despite its central role in Eurozone crisis responses through the Troika. In the formulation of European programmes, the Fund argued unsuccessfully with Troika partners for upfront debt restructuring, and lower levels of fiscal consolidation. On both fronts, the Fund's failure to prevail deepened the crisis, especially for Greece. Overall, the IMF has had limited impact on the austerity-centric policy settings of European authorities and governments. Its persistent calls for systemic risk-reducing strengthened fiscal and financial backstops for the Eurozone have gone largely unanswered. Given the limits of the IMF's influence on European economic policies, there are grounds to doubt the durability of Europe's economic and financial stability.

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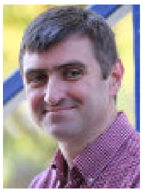
Note: This article gives the views of the author, not the position of EUROPP – European Politics and Policy or the London School of Economics.

About the author



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Ben Clift is Professor of Political Economy at the University or Warwick, UK. His latest book, The IMF and the Politics of Austerity in the Wake of the Global Financial Crisis has recently been published with Oxford University Press. His wider research interests lie in comparative and international political economy, and he has published widely on the IMF, French and comparative capitalisms, the politics of economic ideas, and economic policy autonomy.