The Impact of IMF’ Macroeconomic Policies In Romanian Economy in Economic Crisis Context

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ABSTRACT
One of the main criticisms against the IMF deal is the sparse information on the conditions Romania agreed to. As elsewhere, the Romanian authorities are reluctant to publicize in detail the IMF conditions. As one observer noted, "if we want to have national solidarity in the face of the crisis, we need transparency". Yet transparency is the last thing that the IMF wants when dealing with the countries of Central and Eastern Europe. This is because the IMF is renowned for having a constraining effect on the countries it deals with. It's so-called "structural adjustment programs" have been known to do more harm than good. These programs consist of a set of policies aimed at keeping developing economies subservient to leading world economies such as the US, Germany, and Japan. Hence, what is often recommended by the IMF are the slashing of government budgets, the sale of government assets to local elites and foreign corporations ("privatization"), deregulation of the economy, promoting exports and trade at the expense of local needs, removing protections for local producers growing food or manufacturing for the local market, removing labour rights protections, and more.

KEY WORDS policy package, economic measures, gradual adjustment

JEL CODES E61, F33
Introduction

Since its foundation as one of the 1940s Bretton Woods institutions, the IMF has seen enormous growth in the world economy. The organization of the world economy has also changed, from an era of almost global fixed exchange rates, to one where most major industrialized countries now float their exchange rates. Changes in technology and communications have given rise to a perceived increase in ‘globalizing’ trends. The IMF sits as the central institution of the international financial system, and therefore at the heart of the world economy.

Context

In the popular mind, the IMF is mainly linked with the lending it undertakes to bailout member countries with balance of payments problems. However, the Fund undertakes a wide range of other activities of which lending is, in fact, a diminishing part. One feature of the evidence on IMF was the focus on a particular danger presented to the smooth functioning of the international financial system by global economic imbalances. We agreed that the IMF should focus more on crisis prevention as well as on crisis resolution, and we agreed also that there should be a new focus on surveillance. A clear, focused role for the IMF in the world economy would enable it to deal more effectively with some of the major issues currently facing it, such as global economic imbalances. However, along with clear objectives must come a more inclusive governance structure, so that all countries feel that the IMF is a representative institution.

To help distribute the gains of globalization more evenly, the IMF points to the need for better access to education for low income groups around the world. Broadening access to finance among low-income groups could also help improve the distribution of income. Financial globalization—including foreign direct investment—is also associated with rising inequality, largely because it facilitates the adoption of new technology. The implication is neither to pull back from the adoption of new technology nor to erect new barriers to foreign direct investment. Any kind of protectionism would surely undermine the sustained growth that has raised global living standards. Rather the policy aim should be to help—including through better access to education and affordable health care—to ensure that as many people as possible participate in the opportunities that technological progress and globalization create.

Romania has joined the long list of countries in Eastern Europe to tap emergency aid from the International Monetary Fund (IMF), securing a €20bn (£18.7bn) package to help cover an avalanche of foreign debts in the end of 2008 and 2009. The IMF-led rescue includes €5bn from the European Union's bail-out fund as well as project aid from the World Bank and the European Bank for Reconstruction and Development. As with other countries within the region which fell into the trap of asking for an IMF loan to help stem the effects of the global financial crisis, the Romanian government regards the money as nothing more than a preventive measure.

The Romania package aims to smooth the downturn as the economy struggles with collapsing steel prices and a fall in demand for car exports. The Fund said the country faced a "financing gap" as foreign loans come due in a hostile global market. The objective of the policy package is to cushion the effects of the sharp drop in private capital.
These policies have left shattered economies around the world and consigned untold millions to poverty. Mass privatization has led to enormous concentrations of wealth and encouraged corruption while deregulation has contributed to local financial crises that are independent of, yet exacerbated by, the global credit crunch. Forced government budget ceilings and inflation targets, meanwhile, have prevented countries from expanding desperately needed investments in healthcare and education thereby leading to decreased standards of living (Eun & Resnick, 2007).

Although the IMF has operated these structural adjustment programs under different names in the past, there is no doubt that what is now going on is the same form of exploitation. This can be clearly seen in what the IMF is asking recipient countries in Central and Eastern Europe to do: adopt measures that will lead their economies to contract - which is exactly the opposite of the policies carried out by rich countries (and supported by the IMF, for rich countries only).

Thus, in order to receive loans from the IMF countries like Romania will have to agree to austere conditions including sharp budget cuts, increased interest rates, regressive tax increases, currency devaluation and other measures which will make these poor countries of the EU even poorer. Likewise, the IMF's concept of "capital account liberalization" (CAL) will be duly enforced. Stripping away its high-sounding, technical jargon, CAL is nothing more than corporate welfare in the form of insurance for banks and other large investors.

In many ways, the money given to Romania and other Central and Eastern European countries is merely a cover for bailing out western banks and financial corporations that attempted to make super-profits from an economic liberalization program which operated as nothing more than a fancy pyramid scheme. In essence, money was poured into these countries in order to help stimulate growth which was driven solely by increased consumption. Such a form of economic development was no doubt a risky venture, but one that carried with it colossal returns.

It goes without saying that this model has since collapsed; in Romania, as elsewhere, the country's capital-inflows-driven boom has come to an abrupt end and the real economy, in turn, has slowed down. Having come off an investment and consumption bubble, Romania's reliance on foreign capital has put the country in a very vulnerable position. The threat of redundancy looms large in both the private and the state sectors. The housing market has slowed down considerably, and many construction projects for apartment buildings and luxury residential complexes have been abandoned (Allen, 1997). Romanian producers have also been hit hard because the country's major trading partners are the rest of the EU, all of whom are also suffering from the effects of the global financial crisis.

As a result of this, non-performing loans have increased substantially and bank capital has begun to erode. Consequently the banking sector, made up mostly of Western European banks, has become reluctant to give loans. "To enable banks to lend again", this is the main purpose for which IMF money is to be used according to official statements from Bucharest. This follows a pattern already established in other countries within the region where similar loans were granted, such as in Hungary.

Accordingly, IMF money is first and foremost needed to help soften requirements on reserves to be deposited by banks for the credits granted; this would then make banks more inclined to lend again. In conjunction with this, IMF money would be used to help stabilize the
national currency. There is a fear that countries such as Romania may cause a chain reaction, negatively affecting trade within the EU between those countries that use the euro and those that don’t. The weakness of the Hungarian forint recently has already demonstrated how the weakness of one currency within the region could drag down the rest along with it.

While such arguments for the need to secure IMF loans to help cushion the effects of the financial crisis may sound persuasive, there are yet other, more effective ways at invigorating an economy and stabilising a currency than in the way which the IMF recommends. Among them is the use of capital controls, which could limit the ability of foreign investments to enter and flee a country easily.

This is of central importance, because it is concern about a currency attack that is the rationale for why poor countries cannot undertake simulative measures. Capital controls would be the obvious remedy. But since the Fund rules them out a priori, countries are helpless, and denied the right to use the same Keynesian tools available to the rich countries (Aglietta, 2006). Whereas the IMF deals with Hungary and other countries of Central and Eastern Europe were done with little or no public consultation whatsoever, it appears that in Romania at least some effort was made to mitigate some of the negative effects of the loan. The program contains explicit provisions to increase allocations for social programs, as well as protection under the reforms for the most vulnerable pensioners and public sector employees at the lower end of the wage scale. For its part the government has started negotiating with the trade unions, pensioners, and students to prevent layoffs and cuts in incomes.

The IMF point out that while one of the conditions of the loan and subsequent government deals with the public sector was not to decrease the incomes of state employees, at the same time neither will these same incomes be increased so as to meet IMF conditions for constrained budgetary expenditures. Coupled with inflation which will no doubt increase as a result of the financial crisis and IMF recommendations, this wage freeze will in fact represent a net loss for workers. Such an approach has already been adopted by Hungary where a wage freeze for the next few years means that state employees will continue to experience a substantial drop in real wages.

Thus, it's highly unlikely that the IMF deal will give Romania the cushioning it needs against the global financial crisis. Political leaders themselves also seem uncertain of the consequences of the IMF deal and it's questionable whether the government will be able to pursue a coherent anti-crisis strategy as a result. This is one of the main failings of some other countries which have already received IMF funding, such as Hungary and Latvia. Despite receiving loans early on, these governments have been unable to pursue a coherent anti-crisis strategy and are thus now in a worse position than when they had first acquired the loans.

As for the IMF it doesn't seem to really matter whether a country will be able to properly manage the money it receives or not. The global financial crisis has suddenly become a major business opportunity for the IMF and other international lenders. Over the last few years many countries have risen up against the IMF to the extent that it has severely affected its business. For instance, Latin American countries joined together to launch the Bank of the South in an effort to create a viable alternative to the structural adjustment dictates of the World Bank and the IMF. Not only this, almost all middle-income countries paid back their loans to the IMF and refused to have anything to do with the institution, leaving only poor countries (mostly from Africa) under their control.
Since the IMF depended heavily on the interest payments from middle-income countries to support its budget, the loss of this revenue stream was acutely felt. In fact, last year the IMF’s governing body went so far as to approve a proposal for cutting its staff by about 20 percent and selling some of its gold stock so as to create a trust fund that would fund administrative operations in the future.

It appears that the countries of Central and Eastern Europe have now filled the gap left by middle-income countries, breathing new life into the IMF and other international lending institutions which had been reeling from the financial crisis - a crisis which they had in many ways provoked. Meanwhile, the ignominious role of the IMF as a multi-pronged corporate welfare machine for big business is once again being successfully smothered by the global media establishment. In doing so, the true nature of the credit crunch is being concealed, making progressive solutions to the global financial crisis that much more difficult to introduce.

The latest trio of suppliants comes as the IMF introduces a new lending system aimed at giving countries longer to sort out problems and avoid the wrenching – and often self-defeating – adjustments forced on East Asia’s tigers in 1997 and 1998. The IMF’s policies not only do not work, but often make matters worse for the countries in crisis. Here are several misdirected policies:

- **Capital market liberalization.** The IMF pressures countries that petition for IMF loans to open their markets to outside investment capital. Rather than help matters, this approach often makes matters worse as it destabilizes the economy of the country as well as the global economy. Investors may invest huge sums in a country only to pull those investments at a moment’s notice, causing acute economic crises.

- **Latin America as the template.** Many of the ideas of the “Washington Consensus” were based on the experience with Latin America. The economic growth in these countries had not been sustained, governments had let budgets run out of control, and loose monetary policy had led to rampant inflation. The belief of the Washington Consensus was that this had happened as a result of excessive government intervention in the economy. So, if government intervention was the problem, then government intervention should be limited. The Washington Consensus pushed for policies such as capital market liberalization. Even if this approach was appropriate for some Latin American countries, it did not make sense to apply this policy blindly to other countries in very different situations where this kind of policy might make matters much worse.

- **Insensitivity to strength of local markets.** The IMF policy forcing rapid trade liberalization has not only worked, but does not follow lessons learned from history. U.S. and Japan had trade protection policies in place until their industries were strong enough to compete in a global market. However, IMF policies forcing trade liberalization on a developing country where industries are not strong enough can actually cause more harm. Local industries could not compete, and rising interest rates made job creation virtually impossible. Says Stiglitz, “Liberalization has, thus, too often, not been followed by the promised growth, but my increased misery” (Stiglitz, 2002)

In the past, the IMF was criticized for its stringent lending conditions. The institution learned the lessons from the Asian crisis and now IMF has changed a lot since then. The IMF reviewed the way we work many times and there has been continuous improvement in how
the Fund deals with crisis countries. Since the Asian crisis, the IMF had much more targeted structural conditionality. Conditionality in Fund programs now has to be “macro-critical”: any condition in a program has to meet the test of criticality from a macroeconomic perspective.

The IMF continuously assessing how the programs are evolving, how conditionality is evolving, and how the general framework of the programs is evolving. Even in the current crisis, IMF had approved several programs. The early lessons for IMF are rather positive. For example, conditions in non-core areas of the Fund are almost nonexistent in the new programs. They are all very focused on those key issues that need to be addressed in the short run to get over the immediate crisis. And the overall number of structural conditions in design of the initial programs has gone down.

Core measures under the IMF program in Romania are designed to strengthen fiscal policy further to reduce the government’s financing needs and improve long-term fiscal sustainability, thus preparing Romania for eventual entry into the eurozone. In addition, the program aims to maintain adequate capitalization of banks and liquidity in domestic financial markets; bring inflation within the central bank's target and maintain it there; and secure adequate external financing and improving confidence. The program contains explicit provisions to increase allocations for social programs, as well as protection under the reforms for the most vulnerable pensioners and public sector employees at the lower end of the wage scale. These strong policies justify the exceptional level of access to IMF resources—equivalent to around 1,127 percent of Romania’s quota—and deserve the support of the international community.

IMF also is looking at the broad range of facilities the Fund is offering to member countries, whether they are low-income or middle-income countries. And IMF is looking at ways of providing crisis prevention instruments and, in particular, at facilities that provide precautionary help to countries. This is an option for countries that may not need immediate help but would like a safety net, should a need arise. For Romania, the IMF said core measures under the plan are aimed at "strengthening fiscal policy further to reduce the government’s financing needs and improve long term sustainability, thus preparing Romania for eventual entry into the eurozone or to adopt the measures for reduce the economic downturn. The Romanian economy is likely to plunge this year to negative values, seeing a possible recovery no sooner than end-2009-early 2010. The International Monetary Fund would consider a decrease in the economy by 6%. In this case, Bucharest has accepted a series of tough conditions for the borrowed money, like freeze the public sector wages and try to reduce the budget deficit to 4.6% of the GDP.

Conclusion

This is really a key issue for the Fund, both in terms of gaining acceptance of IMF programs, and in terms of making them sustainable. You could say that IMF new programs now have a degree of social conditionality attached to them. There are two strands of work that are relevant in this area. At the outset of the crisis IMF put in place a new facility, which basically was based on ex-ante conditionality (essentially the member’s good track record of sound economic management), and had no ex-post conditionality (ongoing conditions) when it went into effect. This short-term liquidity facility is aimed at countries with a good track record that face difficulties in the financial markets. For those countries the Fund is prepared to provide
rapid financing on a large scale based on their track record without the conditions that countries normally must meet during the programs. IMF now carrying out a more generalized review of conditionality. IMF is looking to see how far it takes the concept of ex-ante conditionality, and how more generally it can make program conditionality less intrusive.

References:
