Friction at IMF meeting as global economic outlook worsens

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The annual meeting of the International Monetary Fund (IMF) and World Bank, which concluded in Tokyo yesterday, was marked by growing divisions between the major powers amid a worsening outlook for the world economy.

Before the meeting even began, tensions between China and Japan over the disputed Senkaku/Diaoyu islands in the East China Sea led to a decision by China's central bank governor Zhou Xiaochuan not to attend.

Sharp disagreements over the US Federal Reserve's "quantitative easing" came to the surface in the final two days of the meeting. On Saturday, Guido Mantega, Brazil's finance minister, who has warned of "currency wars" as a result of the Fed policy because it lowers the value of the US dollar, branded the policy "selfish".

Fed chief Ben Bernanke replied the next day when he insisted that the ultra-loose monetary policy not only boosted the US economy but helped support the global economy as well.

However, Masaaki Shirakaw, the governor of the Bank of Japan, which is engaged in its own version of quantitative easing, warned that the policy could be creating the next financial crisis as it "may have parallels with the environment that gave rise to the great credit bubble of the 2000s."

Another conflict, between the IMF and Germany, erupted when IMF managing director Christine Lagarde took the conference floor on Thursday to call for Greece to be given more time to implement its austerity programs. She indicated that European countries should hold back budget cuts and tax increases if growth weakened.

Lagarde based her call on a short analysis that had appeared in the opening chapter of the IMF's World Economic Outlook, published earlier in the week. It warned that the so-called multiplier effects of budget cuts may have been underestimated. The multiplier has been estimated at about 0.5, which means that, for example, a $10 billion cut in government spending would bring a $5 billion reduction in gross domestic product.

But according to analysis carried out by IMF chief economist Olivier Blanchard, the multiplier had been "systematically too low since the start of the Great Recession." Instead of 0.5, it should have been between 0.9 and 1.7, meaning that the impact of budget cuts would be much more severe.

Lagarde told the conference that, given the reassessment of the impact of "fiscal consolidation" on output, it was no longer sensible for European governments to stick to budget deficit reduction targets if overall growth fell short of expectations. "It is sometimes better to have a bit more time," she said.

Her comments brought a sharp response from German finance minister Wolfgang Schäuble. Speaking on the sidelines of the meeting, he said Lagarde appeared to contradict the IMF's own stance, noting that "time and again" the fund had warned that high debt levels threatened growth.

"When there is a certain medium-term goal, it doesn't build confidence when one starts by going in a different direction," he said. "When you want to climb a big mountain and you start climbing down the mountain, then the mountain will get even bigger."

Hasty efforts were made to put on a show of unanimity. Lagarde and Schäuble appeared together in a televised debate hosted by the BBC and played down the differences. Lagarde denied the IMF had shifted its approach. It had consistently argued that "fiscal adjustment" was necessary. "Call it adjustment, fiscal consolidation or austerity—it is exactly the same thing," she said.

In the case of Greece, however, Lagarde called for "a bit more time," while Schäuble insisted that Greece had to "stick to what has been agreed."

The dispute does not signify that the IMF, notorious for imposing a "lost decade" on Latin America, driving Indonesia into a deep recession after the Asian Crisis of 1997-98 and inflicting a social catastrophe on Greece, has suddenly had a change of outlook.

The dispute reflects the conflicting interests of the major powers. Germany fears that if Greece and other countries are given more time, this will ultimately have to be paid for by the German banks.

The US and Britain, however, whose positions Lagarde articulates, are both concerned that if austerity measures are implemented too rapidly, there will be an even sharper contraction of the eurozone economy, already in recession, severely damaging their export markets. They also fear that if Greece or some other country defaults on its loans, this will set off a crisis throughout the banking system and impact directly on American and British finance.

The position of the City of London was summed up in an editorial in the Financial Times entitled, "The Solomonic advice of the IMF." It called for additional time to be given to Greece and warned that new cuts should not be imposed in countries where the slowdown was worse than expected. At the same time, the editorial made clear that there should not be a "relaxation" of the austerity measures in Britain.

The attitude of US financial circles was expressed by New York Times columnist Paul Krugman and former US Treasury Secretary Lawrence Summers, both of whom have criticised the European austerity measures.

Writing in today's Financial Times, in a column headlined, "The world is stuck in a vicious cycle," Summers noted that little of immediate value came from the IMF-World Bank annual meetings.

The US still stared over a fiscal cliff, Europe staggered forward to prevent crises with a finger-in-the-dyke approach but no growth strategy, while Japan was happy to achieve any growth at all. "In much of the industrial world, what started as a financial problem is becoming a structural one," Summers wrote, with gross domestic product falling ever further behind where it would have been, had pre-2007 trends been maintained.

The tensions between the major powers resulting from the slide into global recession are certain to increase.

The IMF steering committee statement issued at the end of the meeting said the economic outlook was worsening. Global growth had "decelerated and substantial uncertainties and downside risks remain," it warned. Its summary of the situation in the world economy did not point to any improvement.

In the advanced countries, there was a need to secure a "sustained recovery from the crisis"—something clearly absent. In the so-called emerging markets and developing countries, economic activity was "slowing," reflecting weaker external and domestic demand. Risks for some countries were being compounded by falling prices for non-food commodities and rising prices for some food items. While the IMF statement claimed that growth remained "buoyant" in low-income countries, it noted weakening fiscal and foreign currency reserve positions.