Bhumika Muchhala and Rick Rowden[*]

IMF Policy on the Global Food Crisis of 2008

The sharp increases in global food and fuel prices in 2007-2008 created significant burdens for many developing countries that rely on commodity imports. A soaring import bill has led to new trade imbalances, higher fiscal deficits, imported inflation and other macroeconomic imbalances. The International Monetary Fund (IMF) estimated that net fuel-importing countries were facing an increase in their fuel bill in 2008 equivalent to 3.2% of their 2008 GDP relative to 2007, or US$60 billion; and for 43 net food importers, the rise in their food bill was estimated to be 0.8% of their 2008 GDP, or US$7.2 billion.[1]

Although global inflation levels have recently begun to recede, inflation clearly accelerated across the developing world in 2008—average headline inflation in low- and middle-income countries reached 12.7% and was projected to rise to 13.3% by the end of 2008.[2] This is well above the IMF's official policy target of maintaining inflation within the 5-7% range. The IMF believes the causes of higher inflation are the recent hikes in world oil and food prices and the limited monetary policy and exchange rate responses by developing countries that reduced their fuel taxes, increased fuel subsidies, and allowed public sector wages to increase. Another cause, according to the IMF, is the "reluctance" of developing countries to ensure exchange rate flexibility by allowing their currencies to depreciate to absorb the shock of higher prices—as this would increase inflation without necessarily raising exports.

To assist countries facing widening trade imbalances and increased deficit spending for needed imports, the IMF augmented existing lines of credit for 11 countries with Poverty Reduction and Growth Facility (PRGF) arrangements, and opened new PRGF programs with four additional countries. While the Fund is temporarily tolerating wider budget deficits and higher inflation, the quantitative economic data outlined in PRGF documents (the Memorandum of Economic and Financial Policies) clearly suggest that the flexibility afforded – through higher fiscal deficit targets and higher inflation rates – is to be temporary, and should revert back to lower levels by 2009 in most country loan cases. Essentially, the IMF's policy advice for crisis-hit countries is to pass on the higher prices of food and fuel imports from the state to the consumer in order to ease budget deficits and external imbalances, while tightening monetary policy to lower inflation levels, and employing exchange rate depreciation as a "shock-absorber."[3]

An examination of the projected future deficit-reduction and inflation-reduction targets for 14 of the 15 PRGF countries (no information is available for Grenada) reveals that the IMF retains its traditionally restrictive approach of tightening fiscal and monetary policy. The numbers detailed in the Memoranda of Economic and Financial Policies of the PRGF loans demonstrate that the IMF is still advising countries to reduce inflation and deficit levels within a limited time span of about one year (2008-2009). For example, 12 of the 14 PRGF loans target inflation levels at 7% or lower for the next couple of years between 2008 and 2010, and 11 of the 14 loans require that fiscal deficits be brought below 3% of GDP within a year or two.

Six of the borrowing countries are members of regional currency unions, which limit their ability to adjust individual exchange rates; member countries are obligated by such arrangements to keep inflation and fiscal deficits at low levels. To achieve these targets, countries will need to raise interest rates and cut back on public spending.

This raises serious concerns because such policies are likely to have the effect of keeping public spending, employment and future GDP growth rates lower than they would otherwise be, thereby undermining efforts at increasing tax revenues, public investment and development. Instead, such a policy approach may exacerbate economic recessions in import-dependent developing countries already reeling from the high commodity prices of this year. The Fund's policy advice thus explicitly contradicts a counter-cyclical macroeconomic approach of lowering interest rates and allowing higher fiscal deficits resulting from increased

[1] "Remarks by Dominique Strauss-Kahn, Managing Director of the International Monetary Fund" at Panel on the Food Crisis in Paris, October 6, 2008. http://www.imf.org/external/np/speeches/2008/100608.htm

[2] IMF, "Food and Fuel Prices—Recent Developments, Macroeconomic Impact, and Policy Responses," June 19, 2008. http://www.imf.org/external/pp/longres.aspx?id=4266

[3] *Ibid.*

public spending—such a policy response is precisely what has been used in the past to reverse domestic economic recessions and ease the pain of exogenous shocks, such as the global commodities price hikes, as well as global recessions.

Therefore, the IMF's debt-sustainability analysis is not "dynamic" in so far as it does not consider the growth promoting potential of public spending. If growth accelerates due to public spending, tax revenue should rise and social security payments should fall. The combined effect of higher GDP, higher tax and reduced social security payments should help reduce the debt-GDP ratio.

The IMF's policy advice to borrowing countries to maintain low fiscal deficit targets, and to tighten monetary policy – by increasing interest rates and curtailing public spending – stands in striking contrast to the policies recently adopted by the U.S. Federal Reserve and Treasury, which have lowered interest rates at central banks, adopted fiscal stimulus packages and used billions of dollars of public financing to prop up financial and other institutions.

The key loan instrument that the IMF attempted to revive and reformulate in response to the global food crisis is the Exogenous Shocks Facility (ESF), a loan facility meant to provide rapid and concessional financing to countries hit hard by exogenous shocks. The re-design of the ESF does not resolve the fundamental problems and gaps with the original design of the ESF in 2005. The earlier problems are acknowledged by the IMF as being: speed, conditionality, insufficient access, and the policy prohibiting countries from having both the Policy Support Instrument and the ESF in place concurrently. Conditionality in the revised ESF is "limited to macroeconomic and structural measures considered important for adjustment to the shock."[4]

Civil society advocates, who sent a letter to the IMF Executive Board preceding its discussion of the ESF modifications, contend that merely limiting and focusing conditionality does not suffice; policy conditionality should not be attached to the ESF in light of the challenges posed by exogenous shocks associated with the global food crisis, as many low-income countries can no longer afford imports of basic food staples. The revised ESF also imposes limits on access for countries – 25% of member country quotas for the rapid component of the ESF, and 75% for the high-access component. The fact that the IMF is defining access limits is not consistent with its claim that lending facilities are "country-driven." Civil society advocates underscore that it is critical for member countries to independently assess how much access to facilities such as the ESF the need to ensure national policy space and maximum flexibility in emergency financing.

The ESF reaffirms the IMF's signaling role by stating that it will serve a "catalytic role for grants and more concessional loan resources." A central criticism is that the IMF's signaling role to bilateral and multilateral creditors and donors should not be used at all, as vigorously, in the context of an exogenous shock, as countries require donor aid and access to credit on an immediate, urgent and humanitarian basis. The IMF has to recognize and act on the fact that the current crises create very different macroeconomic scenarios for countries than in normal times.

Furthermore, it is questionable whether the process modalities of the ESF are any different from those of the PRGF process. According to an IMF Board executive director from a developing country constituency, the process entailed in the ESF facility "does not respect the urgency of the commodity crises when it follows the same modalities as that in the PRGF." If the ESF is to address urgent exogenous shocks, it should not be subject to the same process modalities as those of the PRGF, requiring a Letter of Intent from country authorities followed by extensive Board discussions.

The IMF should reconsider its policy formulas in dealing with the recent global inflation spike. Terry McKinley has pointed to several external factors that underlie the higher inflation levels affecting developing countries. Such factors include the long-term problem of slowing global commodity supply growth in the face of rising global demand for food and oil, recent droughts, higher energy and petroleum-based fertilizer prices, the diversion by the U.S. and the European Union of land and feed stocks for bio-fuels production and, speculation in commodity futures by international investors. As the U.S. sub-prime mortgage crisis spiraled and spread around the globe, "speculators started investing in food and metals to take advantage of the 'commodities super cycle' as the greenback's decline relative to other currencies has induced

[4] "Proposed Reforms to the Exogenous Shocks Facility," International Monetary Fund Policy Paper, July 25, 2008. http://www.imf.org/external/pp/longres.aspx?id=4286.

investment in commodities instead."[5] Therefore, speculation in commodities markets has played an undeniably significant role in the food price surge in late 2007 and early 2008.

A key underlying structural factor contributing to the global food crisis has been the "long-standing under-investment in agriculture." The policy advice and paradigm of multilateral and regional financial institutions is partly to blame, as their lending to agriculture decline from the 1980s. McKinley argues that this woeful lack of public investment in agriculture will be aggravated if central banks in developing countries resort to higher interest rates.[6] Financial sector deregulation has undermined specialized agricultural credit facilities and removed incentives for commercial banks to serve rural areas. Thus, financial sector deregulation has been urban-biased and adversely affected agriculture.[7]

Because inflation is being "imported" from global commodity markets and exogenous forces such as biofuel production and rising global demand, the resulting increase in domestic inflation is not due to domestic policy failures or bad decisions. Thus, monetary and exchange rate policy responses advocated by the IMF may not be appropriate. Increasing domestic interest rates or constraining money supply growth would only "heighten the risk of misguided national policy responses." In the context of the global financial crisis and the associated slowdown of growth in developing countries, tightening monetary policy will only "make matters worse" by reducing local demand and access to affordable credit for domestic borrowers.

Policymakers should instead pursue specific direct measures to limit inflationary pressures resulting from such supply shocks and inertia: "Monetary policy should then target the short-term interest rate rather than the growth rate of the money supply [inflation]. Central banks should retain the capacity to concurrently maintain reasonable control over the short-term interest rate and the exchange rate through making judicious use of capital management policies, such as moderate exchange controls. Finally, it is imperative for governments to dramatically increase access to affordable credit for enterprises at all levels, including small businesses, household enterprises and rural smallholders. The key policy tools here are large-scale loan guarantee programs and the revival and recapitalization of public development banks."[8]

Food price inflation, not overall inflation, matters most for poverty and hunger. General inflation can favor the poor who are net debtors by reducing the real value of their debts. Monetary policy is certainly not the right instrument to address food price inflation. This has to be done either through direct controls or some form of subsidy not involving the monetary authority.[9]

The IMF's monetary policy stance has also raised concerns that the policies are preventing recipient countries from being able to fully spend or absorb their foreign aid inflows. This concern was raised in a recent UNDP study which echoed the findings of an April 2007 IMF Independent Evaluation Office report noting how large amounts of foreign aid are not being spent or absorbed by recipients. The study contrasts the call for more foreign aid with the very real spending constraints in countries due to restrictive IMF monetary policies: "Policies become too restrictive to allow full spending and absorption, even when aid is scaled-up", often because "Macroeconomic policies have not been expansionary enough to increase MDG levels of spending."[10]

Since the record high commodity prices in early 2008, prices have been falling by more than half their peak a couple months ago. The factors driving this price decrease are the global financial crisis and economic recession, the halving of world crude oil prices and the depreciation of the U.S. dollar. However, the Food and Agricultural Organization (FAO) warns

[5] "The 2008 World Food Crisis," by Jomo Kwame Sundaram, International Development Economics Associates Network, August 25, 2008. http://www.networkideas.org/themes/agriculture/aug2008/ag25_World_Food_Crisis.htm

[6] "The Globalisation of Inflation and Misguided Monetary Policies", by Terry McKinley, 14 September 2008. http://www.soas.ac.uk/cdpr/publications/dv/46326.pdf

[7] Chowdhury, A. (2002). "Politics, Society and Financial Sector Reform in Bangladesh", *International Journal of Social Economic*, 29 (12): 963-988.

[8] "Pro-Growth Alternatives for Monetary and Financial Policies in Sub-Saharan Africa", by Robert Pollin, Gerald Epstein and James Heintz. Policy Research Brief No. 6, UNDP International Poverty Centre, Brasilia, January 2008. http://www.undp-povertycentre.org/pub/IPCPolicyResearchBrief6.pdf

[9] Chowdhury, A. (2006). "The 'Stabilisation Trap' and Poverty Reduction – What can Monetary Politics Do?" *Indian Development Review*, 4 (2): 407-432.

[10] "The Macroeconomics of Scaling-Up Aid: What We Know in Kenya, Malawi and Zambia," by Degol Hailu, UNDP International Poverty Centre, Brasilia, September 2008. http://www.undp-povertycentre.org/pub/IPCOnePager67.pdf

against a "false sense of security" from reduced commodity prices in its biennial Food Outlook report.[11]

In the context of the current economic recession sweeping across the globe, two key issues are made worse for developing country farmers. First, the costs of agricultural inputs, from fertilizer to high-quality seeds, have become more expensive, particularly as developing country currencies depreciate as a result of the financial crisis. Second, access to credit has become more difficult as global liquidity sources contract and developing country monetary policies tighten in response to the financial crisis. The FAO warns that these key factors may again result in declining world food supplies and that lower production and higher input costs in 2009 could sharply exacerbate developing country problems in obtaining credit and foreign exchange to pay for the agricultural imports they depend on. As a November 7 *Financial Times* article aptly points out, the financial crisis will make "export finance" more difficult to obtain, encouraging commodity barter agreements such as the one between Thailand and Iran to barter rice for oil.[12] Furthermore, the FAO also notes that despite the fall in world food prices, the global food import bill is still high, projected to surpass $1,000 in 2008 billion for the first time in economic history. Developing countries, as a block, will spend $343 billion on food imports, 35% higher than 2007's $245 billion.

As the world economic recession jeopardizes purchasing power, demand for commodities is projected to decline and the risk of decreased food intake—particularly for the poorest in developing countries—is set to increase. The FAO projects that "more people are likely to fall below the hunger threshold in 2008."[13] A contraction in demand for food products, coupled with low prices for farmers' agricultural harvests, high input costs and more difficult access to credit, may lead farmers to cut their plantings or to switch to non-food production, further endangering world food supplies.

The financial crisis has also adversely impacted the political will of rich countries to fulfill their pledges of increased Official Development Assistance increase. During the Rome Food Summit in June 2008, several billions of dollars for agricultural development were pledged by world leaders. Since then, the severity of the global financial crisis has resulted in a diversion of trillions of dollars into rich world financial institutions. Meeting aid commitments during the financial crisis will also be a significant determinant of what direction the food and fuel crises will take.

In the current context of a deepening global economic recession, high prices for imports and declining donor aid flows, the IMF must change its traditionally restrictive fiscal and monetary policies. The IMF should allow the same sort of counter-cyclical monetary policies that the U.S. and other G-7 countries are currently implementing – lowering interest rates and increasing public spending, while incurring fiscal deficits, for the sake of revitalizing domestic economic activity and growth.

The IMF's chief, Dominique Strauss-Kahn, has publicly reaffirmed the critical importance of a coordinated global fiscal stimulus effort as "essential to restore global growth"[14]. It is imperative that this global effort also includes space for developing countries to exercise the same fiscal and monetary policy flexibilities rich countries are currently able to exercise.

Bhumika Muchhala, is with the Bank Information Center, while Rick Rowden is with ActionAid USA, both based in Washington, D.C.

[11] "Food Outlook: Global Market Analysis," Food and Agricultural Organization, Rome, November 2008. http://www.fao.org/docrep/011/ai474e/ai474e00.HTM

[12] "FAO warns of food crisis repeat," by Javier Blas, *Financial Times*, 7 November 2008. http://www.ft.com/cms/s/0/b9efc5b2-ac70-11dd-bf71-000077b07658.html

[13] *Ibid.*

[14] "IMF Managing Director Dominique Strauss-Kahn Calls G-20 Action Plan Significant Step toward Stronger International Cooperation," Press Release No. 08/256, International Monetary Fund, Washington, D.C., November 15, 2008. http://www.imf.org/external/np/sec/pr/2008/pr08286.htm