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From designers to doctrinaires: Staff research and fiscal policy change at the IMF

Cornel Ban

Abstract

Soon after the Lehman crisis, the International Monetary Fund surprised its critics with a reconsideration of its research and advice on fiscal policy. The paper traces the influence that the Fund's [senior management and](#) research elite has had on the recalibration of the IMF's doctrine on fiscal policy. [The findings suggest and shows](#) that overall [there has been some](#) selective incorporation of unorthodox ideas [in the Fund's fiscal doctrine, while the strong thesis that austerity has expansionary effects has been rejected. Indeed, the Fund's new orthodoxy is concerned with the recessionary effects of fiscal consolidation and, more recently, endorses calls for a more progressive adjustment of the costs of fiscal sustainability. These changes notwithstanding, the IMF's adaptive incremental transformation on fiscal policy issues falls short of a paradigm shift and is best conceived of as an important recalibration of the pre-crisis status quo, and rejection of some elements of orthodoxy that this paper uncovers have been limited.](#)

Keywords: IMF, staff research, Keynesian, New Consensus macroeconomics, austerity

From great expectations to modest recalibrations

In 2008, many expected that the widespread outrage and economic hardship caused by the financial crisis would lead to the replacement of the neoliberal policy paradigm.

The rediscovery of Keynesian macroeconomics in 2008-2009 by the leaders of the G20 seemed to indicate that change was imminent. Indeed, mainstream macroeconomic and finance economics seemed on their way to a historical trial. For a while, decades of debates over the details of the best version of the efficient market hypothesis and the most refined dynamic general stochastic equilibrium models seemed out of place.

In the U.S., mythical figures of mainstream macroeconomists were dragged in front of the Congress to explain themselves, their apathy for lawmakers' concerns about unemployment exposed in full view.¹ Allan Greenspan, the former chairman of the Fed and the guru of neoliberal practice offered a few public admissions of contrition over his beliefs. *Financial Times* editors called for the nationalization of large financial institutions and their transformation in public utilities. In Paris, Nicholas Sarkozy, a conservative president who campaigned on a neoliberal ticket the year before, allowed himself to be photographed leafing through a copy of *Das Kapital*. The world, it seemed, was ripe for a new economic model based on anything but more of the same neoliberal theory. If reality was of any empirical use, the case against mainstream economics was clear:

[g]overning neoliberal ideas pretty much denied such a crisis could ever happen. So when it happened it was bound to open up some room for ideas that said such events were bound to happen if you left markets alone to regulate themselves, which is exactly the Keynesian point. Given this, it was hard to defend publicly the logic of self-correcting markets at a time when they were so obviously not self-correcting [...] Furthermore, as well as denying it could happen, neoclassical policy was entirely focused upon avoiding

¹ When asked why mainstream macroeconomic models have little to say about real-world unemployment, V.V. Chari, a luminary of modern macroeconomics said that "providing unemployment benefits does tend to discourage people from looking as intensively for jobs (...) it tends to make them more unwilling to accept jobs when they do come up." U.S. House of Representatives "Building a Science of Economics for the Real World" Hearing before the Subcommittee on Investigations and Oversight" serial no 111-106, Washington, July 20, 2010, p. 51.

one problem, inflation, and providing one outcome, stable prices. As a result it seemed to have very little to say about a world where deflation was now the worry and price stabilization meant raising, not lowering, inflation expectations (Blyth 2013).

But by late 2009, it turned out that the proponents of neoliberal theory had much to say and that they would go a long way to defend the theory's core. As a result, instead of drastic change, the following years brought a mere recalibration of neoliberal theory, testimony to its adaptability in the face of countervailing political and economic dynamics.

Scholars have showed that international economic organizations such as the IMF have been instrumental in crafting and disseminating neoliberalism.

This paper continues this research agenda through an analysis of the "austerity debate" inside this established "lab" of applied orthodox macroeconomics. It departs from the observation that the IMF's reaction to the Great Recession has been to balance adherence to orthodoxy and the attempt to make fiscal neoliberalism more flexible. While the IMF's shifting views on fiscal policy have baffled its critics, the depth, significance and causes of the shift remain unexplored. This paper addresses this gap by asking how deep the change has been and how has the Fund's research elite contributed to it. It suggests that the contribution of staff research [to doctrinal change](#) has been important but that far from being a Damascene road towards a new economic paradigm, so far this interregnum has spawned a fiscal policy hybrid that does not represent a dramatic departure from the core of neoliberal fiscal policy thinking.

What is fiscal neoliberalism?

This paper defines [fiscal](#) neoliberalism as a set of economic theories. ~~Within these theories, ideas~~ about fiscal policy play a prominent role because they speak to essential problems of distribution in society. Whether they are organized under the aegis of New Classical Macroeconomics, New Keynesian Economic or the synthesis of the two, in the so-called "New Neoclassical Synthesis," neoliberal ideas on fiscal policy are tied together by skepticism about the expansionary effects of government spending and a penchant for spending cuts and regressive tax increases as a preferred fiscal adjustment strategy.

This reading of neoliberalism resists the tendency to see it as an "essentialized, singular model with planetary uniformity" (Peck and Theodore 2012: 184), a revamped version of the universalistic aspirations of liberal political economy and neoclassical economics, or even as market fundamentalism (Stiglitz 2008; Somers

and Block 2014). These popular characterizations have made it harder to grasp the ways in which actually existing neoliberalism has been both pro-market and pro-state.

Both supporters and critics of austerity agree that the macroeconomics of neoliberalism has a considerable Keynesian layer (Arestis 2013; Woodford 2009) and even the IMF now sees Nordic-style labor unions and neo-corporatism as enablers of fiscal rectitude (Blanchard et al 2013). One often forgets that the Washington Consensus was all about markets and fiscal rigor, but it also stressed that healthcare and education should be publicly provided (Williamson 1991). Anti-market ideas and policies prop up the housing sector in the UK (Hay 2011) and the US acts as a developmental state when it comes to using government resources to spur industrial innovation (Mazzucato 2013). Since 2008, both sides of the Atlantic nationalized large swathes of their financial sector and effectively guarantee the balance sheets of too big to fail (in the US) and too big to bail institutions (in the EU) (Blyth 2013).

I propose a definition of neoliberalism that factors in both market-society relations as well as the distribution relations within society. To this end, I see neoliberalism ideas aimed do not at aim to destroying the state, but at transforming-but to repurpose it. When put together, they to remove social constraints on market freedoms, and support the operation of the market and while mobilize ing state power to redistribute freedoms and privilege towards the top of the social pyramid. In the "big tent" represented by neoliberalism, economic ideas about fiscal policy are central because they define what is scientifically legitimate in terms of how the state should distribute resources. It is to this specific niche of the neoliberal ideational universe that this chapter speaks to. Freedom to choose and spend at the top lives next to workfare and the penal state at the bottom. Just like Polanyi's *laissez faire*, neoliberalism was planned and is being propped up by the state.

The Reform of Neoliberal Macroeconomics

Until 2008 the International Monetary Fund upheld the so-called "Treasury view," according to which expansionary fiscal policy is generally a misguided attempt to stimulate an economy in recession. Instead, it is austerity that should be pursued (Krueger 1998; Mussa and Sevastano 1999; Ghosh 2005; Gabor 2010). But three days before the tumultuous year 2008 came to a close, the IMF surprised its critics by endorsing the use of fiscal stimulus as a way to overcome the greatest crisis that capitalism had known since the Great Depression. Two years later, when European policymakers stated that austerity was not just necessary to lower

debt but could even lead to growth, the IMF begged to differ. As one critic of the IMF put it, this revisionism was part of an "*interregnum* pregnant with development opportunities" (Gabel 2011).

Specifically, in addition to allowing the stimulus option (for some) and discrediting the argument that austerity leads to growth, the Fund's research and general policy advice suggested that where fiscal consolidation is "inevitable," it should be introduced only gradually and by recalibrating its instruments so as to strengthen state investments and improve the economic status of those at the very bottom of the income distribution.

At the same time, rather than place mass unemployment as the main challenge of fiscal policy, the IMF's has not displaced financial market credibility through debt sustainability as the main goal of fiscal policy. By subordinating fiscal policy to the vote of financial markets, the Fund leaves the stimulus option open only to a dozen or so countries at any given time during the crisis. Moreover, even for those cases, the Fund suggests that "entitlement reform" (cuts to social security and other programs) is a way of maintaining long-run credibility with the bond markets.

Given the intellectual path-dependency of credibility as the main goal of fiscal policy, it is not surprising that the staff either obscured or closed more heterodox paths to reducing debt and to creating fiscal space for stimulus. Moreover, its support for more redistributive taxation and spending options has been hamstrung by neoliberal skepticism towards universal social benefits and the value of sharply progressive taxation. This *adaptive* change appears a lot more modest than the *transformative* yet non-paradigmatic change uncovered by some scholars in the Fund's recent capital account policy (Gabel 2011; Gallagher 11; Gallagher et al 2012; Chwieroth 2013).

Nevertheless, even an adaptive shift needs to be explained. To do so, the paper shows that beginning with 2008, the IMF's epistemic community experienced a rapid and important change in personnel that brought to the fore ideational entrepreneurs who built a revisionist network inside the Fund. To this end, they took advantage of the widening rift in academic macroeconomics between fiscal policy pessimists and optimists. To prevail in a professional environment constrained by orthodox thinking, these IMF economists refrained from battling the main goal of fiscal policy and framed their arguments in the lexicon of mainstream methods and models. In so doing, they won the debate inside the Fund at the cost of putting the brakes on a more systematic reconsideration of fiscal policy for hard times.

Theoretical framework

Political economists have begun to examine the *internal* sources of change in IMF's economic ideas and policies. In a constructivist vein, they argued that IMF staff's experience of a crisis is shaped by their interpretations of its causes and remedies (Mommami 2005; Chwioroth 2009; 2013; Park and Vetterlein 2010; Moschella 2011; 2012; 2013; Clift and Tomilison 2012; Broome and Seabrooke 2012; Lutz and Kranke 2013; Grabel 2013). The paper contributes to this emerging scholarship by drawing on the insights of three bodies of scholarship that had not been connected before: constructivist studies of international organizations, the sociology of the economic profession and the sociology of science.

Constructivists argue that international economic institutions derive legitimacy from their exercise of epistemic authority over economic policy (Barnett and Finnemore 2004; Chwioroth 2009; 2013; Broome and Seabrooke 2009; Weaver 2009; Seabrooke 2012). This legitimacy can be threatened by crises that challenge economic orthodoxy. Most of the time, however, such situations trigger changes that are less than paradigmatic shifts, with incrementally adaptive and transformative change emerging as the most likely outcomes (Chwioroth 2009; 2013). Change, then, takes place at the level of policy instruments and settings, while policy goals survive.

Paradigmatic change occurs only when the goals of policy shift (Hall 1991). In the context of this paper, the change from an orthodox to a heterodox (e.g. Keynesian) policy paradigm would entail a shift from the goal of fiscal sustainability through deficit cuts to full employment and the closing of the difference between actual and potential GDP via spending increases, sharply progressive taxation and financial repression. In contrast, policy change is of a lesser order if only policy instruments and policy settings change. If the Fund's growth theory is reliance on public investments and income transfers more than they on tax cuts, the Fund engages in a change of instruments rather than goals. At the level of the settings of policy, if IMF economists plead for "backloading" (gradual introduction of) austerity, this does not show that the Fund has gone through a Keynesian paradigm shift, only that this sequencing is more likely to balance growth with debt sustainability.

Within this non-paradigmatic spectrum, changes are transformative if the new instruments and settings are derived predominantly from heterodox schools of thought and result in an incremental challenge to the main policy goals (the case of the Fund's endorsement of capital controls under certain conditions). In

contrast, they are adaptive if they are drawn from a mixed bag of orthodox and heterodox theories and their cumulative effect is the reproduction of the orthodox policy goal.

To pursue this route, the paper maps out the revisions made by IMF researchers to the traditional content of fiscal policy. Then, to establish the extent to which staff research had an impact in the general policy advice of the Fund, the analysis turns to the general reports of two critical bureaucracies in the Fund: the departments of Research and Fiscal Affairs.

What explains adaptive change on fiscal policy? Some argue that shifts in the dominant economic ideas of the economic profession at large are eventually and incrementally reflected in how the IMF thinks (Woods 2006; Chwieroth 2009; 2013). This is because “the Fund recruits almost exclusively from the economics profession, which leaves it highly susceptible to developments within the academic community [...] (Chwieroth 2010). In other words the Fund and the economic profession are what Seabrooke and Tsingou (2009) called “linked ecologies”. While there has been no scientific paradigm shift among academic economists before or during the crisis (Blyth 2013), the internal diversity that some critics of mainstream macroeconomics (Arestis 2012; Hein and Stockhammer 2012) have uncovered within it should be taken more seriously. Given the “linked ecology”, a widening rift during the crisis and the growing strength of the supporters of activist fiscal policy (fiscal optimists) could be an enabler of revisionism at the Fund.

Growing fiscal optimism in academia was a great opportunity for change at the Fund, but somebody had to grab that opportunity for it to have an impact. The paper hypothesizes that the second mechanism of ideational change is insider entrepreneurship carried via three sub-mechanisms: administrative intervention, conceptual editing and methodological framing. While the first mechanism affects relations of power in the Fund’s research infrastructure, editing and framing are needed to “sell” the revisionist message as long the orthodox in the Fund are not completely displaced.

The widening rift in mainstream macroeconomics

Relaxing the boundaries of fiscal orthodoxy

Contrary to conventional thinking, the crisis seems to have deepened the divisions between fiscal policy optimists and pessimists. When the Lehman crisis struck, mainstream macro was the intellectual universe of New Consensus

Macroeconomics (NCM), a school of thought forged during the late 1990s from the convergence of New Classical economics and New Keynesianism (Mankiw, 2006; Fontana 2009; Colander 2011; Arestis 2012). NCM was skeptical towards fiscal policy and somewhat optimistic towards monetary policy. Indeed, if there was any hope for counter-cyclical macroeconomic management in hard times, NCM economists limited its ambit to the policy action of the central banks.

NCM argued that the rational expectations of economic agents beat the Keynesian effects of fiscal policy. When the government tries to stimulate the economy, households and firms expect tax increases in the future and therefore cut spending and investment (Ricardian equivalence). Some New Consensus economists like Alberto Alesina at Harvard and Roberto Perotti at Bocconi University argued that because of this, both deficit spending and tax cuts will have low multipliers (i.e. output changes less than in proportion to the fiscal shock). Therefore, some argued that in order to improve expectations and kick-start growth, the government should frontload fiscal consolidation measures (expansionary austerity).² The New Keynesian faction inside NCM further consolidated this fiscal policy pessimism when they factored in Keynesian rigidities such as unionized wage bargaining. In the case of developing countries this fiscal policy skepticism was supplemented with remarks about their narrow automatic stabilizers and constrained access to capital markets (Hemming et al 2002).

From outside the mainstream, Neo-Keynesians and Post-Keynesians critiqued the fiscal policy pessimism of NCM by showing that once you take out long time horizons, perfect foresight, perfect capital markets and the absence of liquidity constraints, fiscal pessimism is no longer warranted.³ But given the traditional proximity of the Fund to the mainstream, what truly shaped debates at the Fund were internal critiques coming from the NCM camp itself.⁴

As early as 2001, these critiques began to emerge after prominent NCM economists began to find positive and high fiscal multipliers (well above zero, but below 1.0),⁵ thus implying that fiscal policy could have expansionary effects on

² For an in-depth overview and in-depth critique of expansionary austerity see Blyth (2013).

³ For an overview of external critiques see Arestis (2012).

⁴ Author interview with European Department economist, January 2012.

⁵ The fiscal multiplier is the ratio of change that government spending produce in national income. A positive multiplier means that fiscal expansions increase growth. As far as mainstream economics is concerned, this is an uncontroversial calculative device.

economic output.⁶ One of the champions of this revisionist position to NCM was Olivier Blanchard, a MIT economics professor and IMF consultant who went on to become the chief economist of the Fund after 2008.

To get more specific, I looked at debates on fiscal policy published during between 2008 and 2012 in elite economics journals such as *American Economics Review* and *Journal of Economic Literature*.

Already by 2009, revisionists from top academic departments began to calibrate DGSE models to approximate the conditions of the crisis (tight microeconomic fundamentals, zero lower bound interest rates) and found consistently high multipliers. Some of the most pivotal studies of this kind were authored by a group of economists from Berkeley (Alan Auerbach, Brad deLong, Yuri Gorodnichenko) and Northwestern (Martin Eichenbaum, Larry Christiano, Sergio Rebelo). One of the DGSE papers finding a dramatic bang for the government spending buck at zero lower bound was Gauti Eggertson, an Icelandic economist from the Fed who had done his PhD with Paul Krugman and co-authored with leading NCM economist Michael Woodford.⁷

Some of the articles argue that fiscal policy activism is needed in the Great Recession and deplore lack of attention of macroeconomists to fiscal policy design. Berkeley's Alan Auerbach and Harvard's Martin Feldstein make the case for stimulus from within the parameters of orthodoxy. After they bows to one of neoliberalism's foundational moments (the Lucas critique), they go on to argue that in very special circumstances (an environment with liquidity constraints, zero interest rates, a recession longer than 12 months and credit market disruptions) fiscal policy interventions do have some benefits. With this tight specification in mind, Auerbach and Feldstein propose that such interventions should consist of tax refunds for corporations, lower corporate income tax, the indefinite postponement of higher tax rates on dividends, capital gains and high income individuals and even the resuscitation of Reagan era tax schemes meant to incentivize corporate investment and household consumption.

Surprisingly, it is Martin Feldstein, the economist with a more conservative reputation of the two who makes the case that increased government spending along the lines proposed by the then President elect Barack Obama that should do the heavy-lifting through a stimulus designed to be "big, quick and targeted

⁶ This means that if the multiplier is higher than one, the economy grows more than the amount spent on the fiscal stimulus.

⁷ For an overview of this debate see Batini et al 2012.

at increasing aggregate activity and employment”(Feldstein 2009: 558). Should it fail, the response would be first even higher spending, followed by a combination between currency devaluation and retrenchment in substantial and permanent tax cuts on personal and corporate income.

Prior to the crisis there was a robust consensus that cuts have robust multiplier effects but if they are expected to be permanent and are targeted at low- and medium income, indebted households have the highest multiplier. During the crisis elite economists suggested that same was true of the multiplier effects of welfare payments, unemployment insurance and corporate investment incentives (review by Auerbach et al 2010: 146-150).

Moreover, a recalibrated NCM model with financial frictions finds that increases in government expenditure can be a more powerful stimulus in the short run than tax cuts (Fernandez-Villaverde 2010). Below is a presentation of the affiliation of “revisionists” working on fiscal policy.

The revisionist drive continued as the sovereign debt crisis deepened in Europe. Using New Keynesian models, fiscal policy “mandarin” Michael Woodford further boosted the case for countercyclical government spending, arguing that with sticky prices and wages, fiscal multipliers can be larger than one and can lead to an increase in welfare (Woodford 2011). Lawrence Christiano and Martin Eichenbaum’s supported his findings with an article showing that when nominal interest rates are bound at zero, the fiscal multiplier is significantly larger than predicted under standard NCM models. To this end, they provided empirical evidence for a new pro-stimulus argument: multipliers are large because the rise in government spending increases output, marginal cost, and expected inflation. Since nominal rates are at zero, a rise in inflation causes a decrease in real interest rates, which leads to a rise in private spending. This initiates the process of rising output levels again, and the net result becomes a large increase in output.

The orthodox resistance

Since the multiplier debate did not consume so much of the energies of the profession until 2008, the defenders of the status quo did not mobilize against revisionism until the first few months of the crisis. What triggered this was that Berkeley professor Christina Romer who was then Obama’s economic advisor co-authored a study whose “old” Keynesian model suggested multipliers around 1.5 that justified the need for fiscal policy stimulus in recessions triggered by credit

crunches (Romer and Bernstein 2009). This was a major turnaround considering that the Romer had previously bolstered the orthodox idea that monetary policy is useful in recessions while fiscal policy is not (Romer and Romer 1994).

The orthodox charge against this position was spearheaded by a joint US-German research team who found very low and negative multipliers (Cogan et al 2009). Critically, these economists rejected the Romer study for not using the NCM model (DGSE) that academic economists, central banks and international organizations could find respectable.

As the crisis deepened, it became clear that even when after the Great Recession struck, not all mainstream economists rediscovered Keynes in their foxholes. Some argued that the debate over fiscal policy cannot be settled during the indeterminacy of research on multipliers, thus suggesting that policy should err on the side of conservatism (Ramey 2011). Others showed that higher debt cancels the effects of higher multipliers (Uhlig 2010) while others radicalized fiscal neoliberalism arguing that welfare should be turned into tradeable financial instruments, thus turning welfare recipients into entrepreneurs (Snower et al 2009). Others still deepened the neoliberal tax regime by advocating for the further lowering taxes at the high end of the income distribution and the non-taxation of capital income (Mankiw et al 2009) or for the replacement of progressive income taxation a flat tax consumption tax (Correia 2010)

In contrast to the revisionists, Stanford's John Taylor (2009) and Columbia's Frederic Mishkin (2009) resist the argument that discretionary fiscal policy is effective when the short-term interest rate reaches the lower bound of zero. Modern neo-Keynesian arguments such as those advanced by Summers, Krugman or Romer are written off by Taylor with the argument that they don't use mainstream dynamic general stochastic equilibrium modeling (DGSE) and fail to include New Classical rational expectations.

An ECB study found new evidence for a foundational moment of neoliberalism: Robert Lucas' (1973) onslaught against the Keynesian Phillips curve. Others attacking the New Keynesian "sticky prices" theory by arguing that prices respond quickly to idiosyncratic shocks (like the Lehman Brothers) but only weakly and slowly to nominal shocks such as expansionary monetary policies (Mackowiak and Wiederholt 2009).

An analysis of the EMU finds that it led to the fiscal profligacy, suggesting that tougher and more depoliticized fiscal constraints should be put in place (Beetsma and Giuliodori 2009). In a preemptive strike against demands for increasing the tax burden at the top of the income distribution, some economists argued that

the estate tax has little effect on the investment and saving decisions of small businesses but by distorting the decisions of larger firms it reduces aggregate output and savings (Cagetti and de Nardi 2009)

Christopher Nekarda and Valerie Ramey took the battle further by investigating the effect of growth in government expenditure at the industry level. Their study found that the transmission mechanism that renders fiscal policy ineffective is the "old" neoclassical reasoning where increased labor hours results in lower real wages. This offsetting change causes markups to remain unchanged, and thus fiscal policy has failed to increase output. Similarly, Cavel, Cohen, and Malloy (2011) attack the conventional Keynesian wisdom that government expenditure results in increased income in the economy by using an innovative instrumental variable to produce exogenous shocks in state level expenditure. Their article finds that the significant increase in federal funds to the home state of members of Congress lead to significant reduction in investment, employment, research and development, and payout decisions by firms. According to the paper, this occurs because of crowding out through the mechanisms of labor market and fixed industrial assets.

Five years into the crisis it is safe to say that the revisionists have an edge in the conversation but have not displaced the orthodox. Beyond the multiplier debate, however, the revisionists were much less inclined to rock the boat. At the end of the day, their work intimated that fiscal expansions should be carried out only if there is fiscal space and investor credibility, two variables whose measurements have been subject to a great deal of conservative calculations and market panics. Indeed, the entire debate has taken place in terms that do not challenge the political goal of not "scaring" the markets. Ultimately, the revisionist papers are either oblivious to or are casually dismissive of the use of sovereign debt restructuring or higher inflation as ways to create fiscal space for stimulating the economy. The Keynesian goal of full employment is nowhere to be seen.

How did academic orthodoxy and/or revisionism reach the Fund and with what consequences for its policy advice? It is to these transmission channels that the paper turns to next by focusing on the research cited by the IMF's official reports on fiscal policy doctrine: the *World Economic Outlook* and the *Global Fiscal Monitor*.

Staff papers and the Fund's doctrine

Editing entailed the introduction ideas with Keynesian policy implications into select elements of NCM theoretical continuum. The outcome was a new perspective on the expansionary virtues of austerity, the utility of the fiscal

stimulus and the timing and composition of fiscal consolidation. This section will analyze these patterns by looking first at staff research authored by individual staff and then at general research reports containing the official view of the Fund's Research Department (RED) and Fiscal Affairs department (FAD).

Against the strong neoclassical thesis that austerity can in fact lead to economic expansion, most IMF research suggests that in the specific conditions of the post-2008 crisis fiscal consolidation is in fact contractionary while fiscal stimulus packages are more likely to be expansionary (e.g. Spilimbergo et al 2008; 2009; Ball et al 2011; Guajardo et al 2011; Cotarelli and Jarmillo 2012; Batini et al 2012; Baum et al 2012; Blanchard and Leigh 2013; Eyraud and Weber 2013). Judging by its extensive citation, the defining moment of this shift was the publication on December 29, 2008 of a joint staff position note by two departments tasked with fiscal policy research: the Research Department (RED) and the Fiscal Affairs Department (FAD) (Spilimbergo et al 2008).

The paper was co-authored by RED and FAD directors and laid down the groundwork for macroeconomic policy during recessions: "a timely, large, lasting, diversified, and sustainable fiscal stimulus that is coordinated across countries with a commitment to do more if the crisis deepens"(p.2). [According to that paper, crisis economics had two policy priorities: stabilize the banking sector and increase aggregate demand through monetary and fiscal expansion. New Consensus skepticism about the need for fiscal policy activism in recessions was suspended. Moreover, a few of the IMF policy *doxa* \(export-led recovery, activist monetary policy\) were dismissed in the name of the transnational character of recession and the looming zero lower bound in interest rates. Concerns with low multipliers were brushed aside: all multipliers were declared uncertain and so policy diversification to stimulate aggregate demand was urgent. The orthodox objection that spending increases have long lags was declared irrelevant given the expected long recession. There were to be tax cuts for the most credit constrained, more spending on existing programs \(mainly transfers to sub-national entities\), increased provision of unemployment benefits, expansions of safety nets where these were limited. The Fund economists demanded support for those facing foreclosures, cash transfers to buy cars, government guarantees of new credit for firms in chapter 11 type procedures and public works targeted at long-term growth potential. Higher taxes on high-income brackets were considered a sustainability mechanism. Hoover's America emerges as the poster case for how not to run a crisis.](#)

[Yet upon closer inspection the change looked more modest. Most importantly, the plea for fiscal expansion was limited to countries that did not face volatile](#)

[capital flows, high public and foreign indebtedness and large risk premia. Second, new entitlement programs were criticized for being hard to reverse and already creating long-term problems. Third, there remained orthodox skepticism about wage increases and sectoral subsidies, as they distort the uneven playing field towards MNCs. Finally, to make this stimulus sustainable, the Fund asked for anti-discretionary institutions: reversible measures with clear sunset clauses or certain economic conditions and independent fiscal councils.](#)

[This policy line was bolstered in future IMF staff papers. The most forceful case for expansion or at least neutral fiscal policy during recessions came from IMF staff working with a key methodological problem of the policy area under investigation here: fiscal multipliers. The orthodox studies on multipliers use models that did not allow them to vary between expansion and recession while failing to capture monetary policy. In 2012, the coalition of IMF and Berkeley academic economists took the initiative on this front as well. The Berkeley Auerbach and Gorodnichenko \(2012\) study and two IMF papers \(Betina et al 2012; Baum et al 2012\) addressed these problems and found consistently high multipliers and particularly so in recessions. Using an innovative methodology, Batini et al \(2012\) found that smooth and gradual consolidations are to be preferred to frontloaded or aggressive consolidations. Against conventional IMF studies, they found that this was especially the case for economies in recession facing high-risk premia on public debt, because sheltering growth is key to the success of fiscal consolidation in these cases. Consistent with the analytical framework embraced by this paper, this IMF study stresses layering when they argued that the estimates of the multipliers they estimate for both recessions and expansions are "broadly consistent with the theoretical arguments in both \(old\) Keynesian and \(new\) modern business cycle models" \(Betina et al 2012: 7\). Similar points were made by Baum et al \(2012\), whose study adds that when the output gap is negative at the time the fiscal shock is initially implemented, frontloading consolidation will have a larger short- term impact on output than a more gradual fiscal adjustment.](#)

[Other studies further enlarged the horizons opened by Spilimbergo et al \(2008\). While some find new arguments against frontloading consolidation across national policy contexts, others demanded an enhanced role for public investments. One endorses expansions and stresses increased capital spending, with a bias for public sector investments due to their high multipliers \(Muir and Weber 2013\). It argues that increased capital spending financed by higher indirect tax revenue collections through base broadening has sizeable growth effects over the medium and long- term. Increasing spending by 2 percent of](#)

nominal GDP leads, in the long run, to a 30 percentage point increase in the stock of public infrastructure. This, in turn increases the productivity of factors of production in the economy, so that real GDP increases about 3 percent relative to its baseline value. Moreover, they argue that a permanent increase in government investment can be more effective than an increase in private investment, as government investment is typically on infrastructure such as roads, hospitals, public institutions, etc., which depreciate at a slower rate than the stock of machinery and equipment.

Cautionary notes about frontloading austerity stress not business expectations, as in the standard New Consensus framework, but workers' expectations. A study co-authored by the deputy director of the Research department (Ashoka Mody) found that despite the 2009 recovery, uncertainty of households remained and so did their steep increase in pro-saving behavior. The key explanation was the economy-wide unemployment rate. It was not future taxes, but catastrophic income loss via job loss that is positively correlated with the saving rate even after controlling for disposable income growth and the interest rate (Mody et al 2012). Along the same lines, a study authored by two favorite IMF collaborators from Bocconi university questioned the New Consensus stress on the expectations of the financial sector when they showed that in recessions with sticky prices, the brunt of tax increases is more likely to be expansionary if it favors constrained borrowers rather than savers (Monacelli and Perotti 2011).

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A research paper co-authored by senior staff at RED demonstrated empirically the importance of expansionary credit policy in a recession triggered by a banking crisis (Classens et al 2008). Similar points were made for developing countries in position papers co-authored by a RED deputy director (Ghosh et al 2009) and the director of the Western Hemisphere Department (Eyzaguirre et al 2008).

In Keynesian fashion, these papers argued that given the collapse in private demand, states were supposed to ramp up both public investments and transfers to those who were more likely to spend (the unemployed and the poor households). Against the orthodox line, they stressed the role of public investments and downplayed the expansionary virtues of tax cuts with the Keynesian argument that they are more likely to be saved. They also dismissed once fashionable items of the IMF policy advice for recessions (export-led recovery, exclusive reliance on activist monetary policy) and spurned as irrelevant for a prolonged recession the orthodox objection that spending increases have long lags.

Yet this fiscal policy optimism was heavily qualified by orthodox concerns. Even if they agreed with the hypothesis that fiscal policy had high multipliers in the conditions of the crisis, virtually all these papers raised the issue of credibility with the markets. Indeed, the main goal of policy remained the reassurance of financial markets through “long-run debt sustainability.” Revisionist studies (Cottarelli and Jaramillo 2012; Baldacci et al 2012) joined orthodox ones (Kumar and Woo 2011; Baldacci and Kumar 2010) in highlighting the negative effects on growth of debt levels over 60 percent of GDP, a much more demanding threshold than the 90 percent threshold proposed by the subsequently discredited study of Reinhart and Rogoff (2010). Therefore, the stimulus was deemed appropriate only for countries with low levels of debt and deficits⁸ and with strong fiscal institutions.⁹ For the others, as the FAD director recently put it, “some adjustment is needed, but at a steady even pace, without frontloading, except in countries facing pressures from markets (and even in this case, there would be a speed limit to fiscal adjustment)” (Cottarelli 2013). As a former deputy chief economist of the Fund recently noted, the Fund’s main mission has been and continues to be reassurance of sovereign bond markets.¹⁰

Even where the IMF papers endorse stimulus, they demand neoliberal institutional reforms: the constitutionalization of fiscal policy-making (budget ceilings, fiscal councils, more power to central banks and finance ministries), long-term retrenchment and especially cuts in the future growth of “entitlement” programs like healthcare and pensions.¹¹ In the same vein, they stress the constraints of institutional depth in estimating the size of the fiscal space in developing countries, whose poorer tax collection capacity and volatile sovereign bond market conditions could only afford smaller (if any) stimulus opportunities.

Perhaps the most dramatic departure from the mainstream is represented by evidence for the (neo-)Keynesian argument advocated for some time by Paul Krugman, Brad deLong and other “unreformed” Keynesians that fiscal consolidation can be self-defeating in countries that had problems with

⁸ IMF research shows that debt levels significantly reduce growth when they exceed the 90 percent threshold (Kumar and Woo, 2011, and Baum, Checherita and Rother, 2012). Other studies, endorsed by Fiscal Affairs (Cottarelli and Vinals 2009), operated with a more demanding 60 percent threshold (Horton, Kumar, and Mauro, 2009).

⁹ A subsequent IMF study found that Australia, New Zealand, Korea, Sweden and Denmark fit these conditions with a high degree of confidence (Ostry et al 2010).

¹⁰ Speech by Michael Dooley, Boston University, April 6, 2013.

¹¹ <http://www.imf.org/external/pubs/ft/fandd/2009/09/blanchardindex.htm>;
<http://www.imf.org/external/pubs/ft/fandd/2009/03/cottarelli.htm>

credibility. After 2011, several teams of IMF researchers—including some led by the RED and FAD directors—argued that the resulting fall in output can trigger a raise in public debt, and lead to potentially higher risk premia in sovereign debt markets (Cotarelli 2011; Cotarelli and Jaramillo 2012; Batini et al 2012; Baum et al 2012; Eyraud and Weber 2013; Blanchard and Leigh 2013). Moreover, one recent study went as far as demonstrating that the most consistent fiscal consolidators end up being punished by the markets because their efforts to get the debt ratio to converge to the official target leads to repeated rounds of tightening that in turn worsen the outcome even more (Eyraud and Weber 2013).¹² Nevertheless, as the next section shows, these charges against the Fund's neoclassical orthodoxy have not travelled into the RED and FAD reports.

Another intriguing pattern is that research moved the debate on the content of fiscal consolidations in a direction that is more sensitive to issues of distribution. Contrary to conventional wisdom about the IMF's indifference to economic inequalities, poverty and unemployment, distributional concerns articulated with unorthodox ideas began to loom large in IMF staff research (Spilimbergo et al 2008; Cotarelli and Vinals 2009; Cotarelli 2009; Baldacci et al 2011; 2012; Berg and Ostry 2011; Bastagli et al 2012; Gupta et al 2012). These papers advised tax cuts for the most credit constrained, increased spending on automatic stabilizers and an expansion of the scope of the safety nets where these were too narrow.

There was support for public works likely to reduce unemployment and boost growth potential. A more progressive tax burden that included higher wealth taxes, externality correcting taxes (carbon tax) and financial sector taxes emerged as appropriate mechanisms to rekindle growth. Moreover, a paper co-authored by a deputy director at RED argued that what is missing from models that estimate future expectations is the specter of catastrophic income loss triggered by unemployment (Mody et al 2012). Such pleas were part of IMF's concerns about the negative effects of austerity on productivity, competitiveness, debt sustainability and financial stability, but one study also found a causal connection between high inequality and high debt (Kumhof et al 2010).

Finally, there has been a great deal of editing in the Fund's view of the composition of fiscal policy. To the IMF's canned sermon on the importance of labor market deregulation, staff research added the imperative of blending centralized wage setting mechanisms with firm-level industrial relations

¹² Recent statements against austerity by the biggest buyer of sovereign bonds (PIMCO) suggest that they continued to inhabit a world that chief economist Olivier Blanchard saw as positively "schizophrenic." <http://blog-imfdirect.imf.org/2011/12/21/2011-in-review-four-hard-truths/>

(Blanchard et al 2013). Critically, tax rises were preferred to expenditure cuts due to the fact the latter improve both private sector expectations and competitiveness (Spilimbergo et al 2008; Guajardo et al 2012; Corsetti et al 2012; Baldacci et al 2010; Kand 2010; Cotarelli and Jaramillio 2012). Several studies suggested that increases in public investments (capital outlays) and cuts in the VAT are critical for growth while income tax cuts are not (Arslanalp et al 2011; Muir and Weber 2011; Baldacci et al 2012). Some papers go as far as arguing that government investments should be prioritized because they create public goods that depreciate at a slower rate than the private sector's stock (Baldacci et al 2012; Muir and Weber 2013).

As for the defense of the old status quo, the studies upholding the expansionary austerity line on fiscal policy rely on country studies done by regional desks (Purfield and Rosenberg 2011; Beschevant et al 2011; Berkmen 2011) and that few choose direct confrontation with the revisionist studies presented above. For example, one study that found much less fiscal space in the countries regarded by fiscal policy optimists as eligible for fiscal expansion and suggested they should frontload consolidation as well (Veleculescu 2010). Another study shows that under some conditions, lenders have neoclassical rather than Keynesian expectations about the future and therefore can help trigger the expansion of corporate credit (Agca and Igan 2013). Other studies strengthened the orthodox line when they showed that households move from non-Ricardian to Ricardian behavior at government debt levels that exceeds 60 percent of GDP (Kumar and Woo 2010; Battacharya and Mukherjee 2010).

To assess the extent to which this IMF research travelled into its policy recommendations, the analysis now turns to the content of the general reports put forth by RED (*World Economic Outlook*) and FAD (*Global Fiscal Monitor*). Unlike the staff papers, these reports represent the official views of these departments. They are important for another reason: they function as "epistemic courts" (Toloumin 1969) that adjudicate and enforce what constitutes consensus about the Fund's economists shared problems, methods and ideas about how the economy works.

Doctrinal changes

While they generally integrated the research findings reviewed above, some of the more transformative policy ideas from staff research have not shaped the policy line of the reports.

Certainly, some of the more extreme views on austerity were rejected. Citing staff

papers, the reports rejected both the expansionary austerity thesis as well as the frontloading of austerity everywhere for the sake of credibility. In contrast, the researchers' hostility towards unorthodox debt reduction is emphasized throughout.

On other aspects of the fiscal policy debate, the integration of innovative IMF research is more uneven. The defense of inequality and unemployment-reducing social services, progressive tax reforms and job programs has become part and parcel of the reports and co-habits with the Fund's old neoliberal answer to unemployment (labor market deregulation, lower corporate taxes, tightening eligibility for social benefits, including disability pensions; reducing the duration and level of social benefits when "too high" etc.). But the arguments made in some IMF studies that progressive tax increases are less contractionary than expenditure cuts has not.

An even more complex pattern emerged with regard to the content of the credibility thesis. Stimulus remains an option not only for the handful of "advanced" countries that faced contractions with stronger fiscal positions and lower public debt, but also for low and middle income states that met these conditions.

But reassuring the bond markets via debt reduction remains the main goal and there is only a very limited incorporation of staff research highlighting the self-defeating nature of fiscal consolidation with regard to debt reduction. While the IMF endorsed an expansion of the social safety net in low and middle-income states where it was too thin, it demanded its extensive retrenchment in high-income states where embedded liberalism had left behind generous social services.

The extent to which orthodoxy was thus edited varied over time. There was a great deal of fiscal policy optimism in 2008 and 2009, when reports suggest that where fiscal space, credible institutions and credibility were available, stimulus measures should continue as long as exit strategies are announced for the medium term. By 2010 the tone changes slightly in favor of an earlier, sharper and institutionally bound exit from stimulus. Yet contra the enthusiasm for "growth-friendly fiscal consolidation" prevailing in the G-20 meeting of the same year, the reports caution against an "abrupt withdrawal" (a cut in the deficit greater than 1 percent a year). The 2010 WEO sounded Keynesian when it argued that when the rest of the world is tightening at the same time, the output cost of a 1 percent of GDP fiscal consolidation can double to 2 percent for a small open economy where the interest rate is at the zero lower bound. The door to stimulus

remained open when the report noted that if growth threatened to slow appreciably more than expected, advanced economies with fiscal room, good fiscal institutions and safe haven status should let the fiscal stabilizers operate and slow the pace of adjustment.

In 2011 the reports took a more conservative stance, praising Europe's strong frontloading of austerity and making optimistic projections of its effects on credibility. Moreover, based on a FAD study showing that bond yields in emerging markets are very sensitive to global risk aversion, they counseled low and middle-income economies to rebuild fiscal buffers and cut spending despite the fact that they were facing less market pressure than developed countries. Nevertheless, the report contains an unambiguous denunciation of the expansionary austerity thesis.

Subsequent reports qualify this retrenchment. The 2012 Monitor stresses that 'in the current recessionary context, the negative impact of fiscal adjustment on activity can be expected to be large, as confirmed by new work on the size of fiscal multipliers during periods of weak economic activity' (p. ix). This idea is taken to its logical conclusion in the October 2012 WEO, which incorporates IMF research from 2011-2012 showing that multipliers were much higher than the Fund had thought. The 2012 Monitor also finds the 2008-2009 output shock was in fact greater than anything in IMF datasets and therefore that growth would arrive later than expected. Nevertheless, despite such acknowledgements of revisionist research, debt reduction remained the main policy goal and therefore deficit reduction remained the main policy instrument.

By 2012, following the acceptance of revisionist research on multipliers, both RED and FAD reports demanded a slower adjustment in the countries with low credibility and stressed the importance of expansion in the countries with credibility. The reports of both departments now have a more poignant critique of the excessively harsh budget cuts in the US and Europe based on the argument that such excessive austerity is likely to worsen the downturn and investors' expectations through government's focus on nominal rather than structural deficit targets.

[Suggestively, the October 2012 WEO report reflected the fact that staff that had made the case for higher multipliers in recessions were winning the internal debate. At the beginning of the crisis, an IMF study \(Spilimbergo et al 2009\) found that government consumption multipliers are 0.5 or less in small open economies, with smaller values for revenue and transfers and slightly larger ones for investment. But as the crisis advanced, other staff put forth papers suggesting](#)

that multipliers are significantly larger in recessions (Batini et al 2012, Baum et al 2012). In practice, the IMF used forecasting models using average multipliers of 0.5 to measure the impacts of fiscal consolidation on growth prospects. In contrast, the October 2012 WEO found that in fact they ranged between .9 to 1.7 (the Eurozone periphery is closer to the higher end of the range), an error that explained the IMF's extremely optimistic growth projections for countries who frontloaded fiscal consolidation. Assuming the multiplier was 1.5, a fiscal adjustment of 3 percent of GDP-as much as Spain has to do next year- would lead to a GDP contraction of 4.5 percent. It was momentous finding and those who had been skeptical of the virtues of austerity felt vindicated.¹³

Olivier Blanchard's role was critical in this regard. His research used higher values for multipliers as early as 2001 and his appointment as the Fund's chief economist in September 2008 relaxed the traditional fiscal policy skepticism of the institution. This relaxation was also facilitated by the appointment of Carlo Cotarelli, a skeptic of expansionary austerity as head of the influential Fiscal Affairs Department of the IMF. From this position, he was responsible for the development and publication of the Fiscal Monitor, one of the three IMF flagship publications. With these new appointments, New Keynesian fiscal policy optimism had a better chance to prevail in the Fund.

As early as December 2008, Blanchard co-authored a paper that made the frontloading of fiscal stimulus measures a centerpiece of crisis economics, at least for certain countries. This entailed tweaking balanced budget rules to prevent cuts in existing programs, increasing the state's share in public-private partnerships, increases in public sector employment, more transfers for those at the bottom end of the income distribution (the minimum wage workers, the unemployed, the foreclosed). Where the social safety net was narrow, the state had to step in to expand it. While it cautioned against industrial policies targeted at domestic firms, the paper urged governments to offer guarantees on new credit for firms whose fate was threatened by the credit crunch. This was hardly the bad cop material associated with the IMF medicine in the past decades.

But there was an important caveat to all this: fiscal activism was legit only as long as financial markets deemed it sustainable. At the time, it seemed that the entire Eurozone still benefited from "safe haven" status for bond investors so the IMF

¹³ <http://krugman.blogs.nytimes.com/2012/10/13/times-like-this-are-different/>
<http://notthetreasuryview.blogspot.co.uk/2012/10/more-on-multipliers-why-does-it-matter.html>
<http://mainlymacro.blogspot.co.uk/2012/10/multipliers-using-theory-and-evidence.html>

agreed to fiscal expansions there. But countries that faced pressures in the bond markets (Hungary, Latvia and Romania in 2008-2009) had to engage in fiscal consolidation in order to rebuild confidence. The same applied to Southern Europe and Ireland after 2010. As a result, the Fund was in agreement with the European policy line on the "periphery" –including by marshaling models with low multipliers-but disagreed with them on the need for austerity in the eurozone's "core. The last WEO changes a lot of things, but not the IMF's prescription of austerity where it hurts the most.

At any rate, at least at the doctrinal level.Most importantly, there ~~was~~is a resolute turn against frontloaded austerity in the 2012 WEO. There are warnings about the risk of deflation (Decressin and Laxton 2009) but what is particularly striking is that two new lines of attack appear. The most important is the finding that since 2008 the economic slack was so large, the interest rates so low, and fiscal adjustment so synchronized that fiscal multipliers were constantly well over 1. This finding implies that the IMF underestimated the negative effects of austerity output because it assumed values of the fiscal multiplier that were too low (Batini et al 2012). This concern is echoed in IMF studies cited in the year's GFM (Baum, Poplawski-Ribeiro, and Webel 2012). Second, even as another cited study encouraged spending cuts in health, pensions and public employment in wealthy countries like Italy, its findings also stressed that fiscal consolidation had been ultimately self-defeating in the past because it increased public debt levels (Ball et al 2011). The same finding is echoed in studies cited in GFM that argue that fiscal consolidation when the multiplier is high erodes some of the gains in market credibility as a result of a higher debt ratio and lower short-term growth, which causes an increase borrowing costs (Cotarelli et al 2011; 2012).

IMF research cited in the 2013 reports makes similar points but breaks precedent by emphasizing raising more revenue via increased taxation of the wealthy. In WEO, deflation warnings from a 2002 paper are sounded yet again (Decressin and Laxton 2009) and the need for stimulus in countries that enjoy fiscal space is reaffirmed (Blanchard and Leigh 2013; Spilimbergo et al 2008; Kang et al 2013; Ostry and Ghosh 2013). These ideas share space in the report with warnings about the growth-depleting effects of high debt (Kumar and Woo 2010). The GFM struggles to achieve a similar balance. It cites studies that establish the ineffectiveness of default (Das, Papaioannou, Gregorian and Maziad 2012; Borensztein and Panizza 2009) and inflation (Akitoby, Komatsuzaki, and Blinder 2013) as debt reduction strategies while stressing the importance of reducing debt.

At the same time, the GFM cites studies that seem to represent the emergence of a new taxation philosophy at the Fund. They continue to endorse a few old recipes (the reduction of income taxes while increasing consumption, the scrapping of loopholes in personal and corporate income tax, the elimination of differential VAT rates, resistance to high marginal income tax, reduced employers' social contributions) yet also advocate greater reliance on taxes targeted at the wealthy: property taxes targeted at the top 1 percent (a measure estimated to raise between 2-3 percent of the global GDP in new tax revenue), financial transactions tax, and a coordinated taxation of offshore incomes (Torres 2013; Acosta and Yoo 2012; Norregaard 2013).

Skeptics of fiscal consolidation also tend to be more concerned with the distribution of the costs of fiscal consolidation. However, they frame measures against inequality not as a normative imperative but as consistent with the IMF's concerns with the political sustainability of consolidation and with low productivity challenges (Berg and Ostry 2012). Indeed, contrary to the Fund's previous agnosticism to inequality, a discussion paper authored by a research team involving no less than the Fund's deputy director Sanjeev Gupta sees fiscal consolidation as an opportunity to reverse the shrinking of social benefits and the progressiveness of income taxes. They suggested that equality-friendly fiscal consolidation should include reducing opportunities for tax evasion and avoidance, increasing the progressivity of income taxes over higher income brackets, cutting unproductive expenditures, and expanding means-tested programs. To make this argument they suggested that enhancing the distributive impact of fiscal policy in developing economies will require improving their capacity to raise tax revenues and to spend those resources more efficiently and equitably. Resource mobilization should focus on broadening income and consumption tax bases and expanding corporate and personal income taxes by reducing tax exemptions and improving compliance. Expenditure reforms should focus on reducing universal price subsidies, improving the capacity to implement better-targeted transfers, and gradually expanding social insurance systems (Bastagli et al 2012; Berg and Ostry 2012).

If one looks outside the range of cited IMF papers, one generally finds a similar range of views, although the orthodox voices are more widely represented. One study found much less fiscal space in the countries regarded as eligible for expansion and suggested they should frontload consolidation as well (Vealelescu 2010). Working with firm-level data, a joint GWU-IMF study showed that under some conditions (stable government, lax monetary policy,

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devaluations), if fiscal consolidations are large and focused on VAT and entitlement cuts, lenders have neoclassical rather than Keynesian expectations about the future and therefore can help trigger expansion of corporate credit (Agca and Igan 2013). Other studies showed that households move from non-Ricardian to Ricardian behavior at government debt that exceeds 60 percent of GDP (Battacharya and Mukherjee 2010). Others praise Latvia's orthodox austerity program and even contend that not using devaluation was appropriate (Purfield and Rosenberg 2011) while a case study of several African countries and Japan respectively stresses both the growth-inducing and credibility-enhancing effects of fiscal consolidation (Beschevant et al 2011; Berkmen 2011).

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From doctrine to practice

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Empirical studies show that the way in which the IMF communicated its doctrine to governments via article IV consultations has been broadly in line with the skepticism of IMF researchers about expansionary austerity or the frontloading of fiscal consolidation in all countries. Surprisingly, these studies avoid the developed capitalist core, a gap that this paper attempts to address.¹⁴

With regard to low-income countries (LICs), Wayenberge et al (2011) have found more flexibility in the Fund's approach: in 13 of them, the IMF played the orthodox card but in 6 of them more expansionary policies were employed. At the same time, the Fund remained passive on boosting LIC potential for mobilizing additional domestic revenue, or for creating greater fiscal space with additional debt relief initiatives or further grant assistance. And even where expansion was allowed, the focus was on current expenditures rather than on capital investment, a chronic source of weakness for low-income countries' long-term development prospects. Yet additional studies conducted by the ILO (Ramos and Roy 2011; Islam et al 2012) found a clearer pro-frontloading bias when the sample was expanded to include middle-income countries. For example, in 48 out of 50 cases analyzed by Islam et al (2012), the Fund's standard recommendation was fiscal discipline irrespective of the cycle. Nevertheless, the Fund showed skepticism towards the New Classical arguments that consolidation is best done via spending cuts. The Islam et al (2012) study found that the IMF had a clear preference for additional revenue mobilization (42 out of 50 countries), with expenditure restraint being advised only in 24 countries. These findings confirm the mainstream view among IMF researchers that the confidence effects of fiscal consolidation in low and middle-income countries should take

¹⁴ The exception is the Weisbrot and Jorgensen (2013) study of article IV reports in the EU, but its content analysis is flawed as it does not distinguish between frontloaded and backloaded fiscal consolidation.

[precedence over concerns with their short-term contractionary effects on output. The findings of some IMF research showing that frontloaded fiscal consolidation is bad for confidence have yet to travel in IMF advice to the global periphery.](#)

[These studies only code the early crisis years and do not look across the Global North-Global South frontier. To address this gap, this study did a content analysis of article IV consultations conducted with low, middle and high-income states between October 2011 and October 2011. This analysis is then supplemented with a close reading of all article IV reports published since the October 2012 WEO in order to identify potential echoes of the high-level endorsement of high multipliers at the IMF's "grassroots" level. The content analysis reviewed 20 IMF article IV consultations and the coding unit was the policy recommendation. This was understood to be any recommendation that either \(a\) confirmed a policy adopted or planned to be adopted by the government under review or \(b\) went beyond policies being implemented or that are planned to be implemented.](#)

[All coded reports do not give any indication in the growth effects of fiscal consolidation. On the contrary, they see this policy as a contractionary policy option, but one that is imposed on some countries by concerns with debt sustainability. For low-income countries fiscal measures the analysis revealed a preference for neutral fiscal policy \(in three out of five\). In addition to standard IMF policy measures, these fiscal packages reflected the Fund's new enthusiasm for increased social security and infrastructure spending \(Angola, Bolivia, Guatemala, Nepal\). Of particular interest was the Fund's praise for Bolivia's poverty and inequality-reducing programs.](#)

[In contrast, a preference for consolidation is clear in the case of the middle-income sample of countries. However, in line with the mainstream tone of the IMF research: backloaded consolidation where bond market and deficit constraints were weak \(Brazil, South Africa\) and frontloaded where they were strong \(Hungary, Lebanon\) or where the state collected too little, close to ten percent of GDP \(Pakistan\). The menu of fiscal measures from outside of the usual menu but reflecting of IMF research findings included higher public capital investment \(Brazil, South Africa\), more investment in public infrastructure \(Pakistan\), more progressive tax system \(Hungary\), higher social spending \(Lebanon, Pakistan\), the introduction of universal health coverage \(South Africa\) and higher taxes on capital gains and property \(Lebanon, Pakistan\).](#)

[Article IV reports on high-income countries are also in line with IMF staff research: expansions for fiscally virtuous countries facing recessionary dynamics \(Sweden, Germany\), frontloaded fiscal consolidation where deficits and bond](#)

market vulnerability is high (Ireland, Spain). Interestingly, a slower and more gradual fiscal consolidation (although no backloading) is suggested both where the government (a) has still high deficits but faces no sovereign bond market problems (Britain) and where the deficit is high but the contraction is so big that it risks undermining credibility with bond markets (Spain). In terms of specific measures, one finds consistent advice for reducing reliance on expenditure cuts and increasing revenue measures (Ireland, Spain), higher property taxes on the wealthy (Britain, Ireland), strengthening the safety net for the most vulnerable (Ireland, Spain).

How much has the WEO 2012 report changed article IV reports? My analysis suggests that three patterns of fiscal crisis economics have emerged: putting austerity on hold for the fiscally virtuous, further expenditure cuts and tax increases in the countries with fiscal imbalances, higher and more progressive taxes in countries that used fiscal consolidation to orchestrate libertarian attacks against the state. The dominant pattern has been the reassertion of orthodoxy. In Bulgaria, Romania, Hungary, Portugal, Lithuania and Estonia the Fund praised the frontloading of consolidation and urged its continuation irrespective of the cycle to this policy option in conjunction with privatizations and structural reforms whenever its staff noted flagging commitment going forward. Advice for privatizations centered around the use of privatization revenues for cutting debt and/or building buffers for future shocks. Throughout the Fund stresses poor tax collection capacity, yet not all revenue-maximizing measures are applauded. Indeed, the Fund makes some clear choices on this front that reflect the endurance of supply-side economics and conservative social policy. Revenue-boosting measures not certified by the IMF that forced largely multinationals to share the burden of adjustment (the Hungarian sectoral taxes on banks, privatized energy companies and retailers) are criticized by the Fund as distortionary. Similarly, the Fund remains cold on higher taxes in high-income states. Thus, the Portugal report stresses that Portugal's level of taxation is high enough and that consequently further cuts in social transfers and public sector wages are advisable instead.

Second, the October 2012 WEO did produce some limited effects. In two cases the Fund was more at ease with suggesting/endorsing the backloading of fiscal consolidation as a countercyclical policy. Puzzlingly, this was the case not only in the IMF advice to a country that has traditionally enjoyed safe haven credibility and a reputation for fiscal rigor (the Netherlands). The IMF also applauded short-term expansionary policy in a middle-income country whose economy imploded in 2008 (Estonia) and in low-income economy whose state nearly collapsed a

decade ago (Albania)(Kajisiu 2010; 2013). What the first two have in common are sustainable debt levels and an impeccable record with budgetary discipline during the crisis. Moreover, in the eyes of the IMF Estonia validated its theory that recoveries can be obtained through internal devaluation. Once budgetary discipline was achieved, the Fund endorsed projected increases in public capital spending, social spending, unemployment benefits, means-tested child allowances, the wage bill (following a 3-year wage bill freeze) and an increase in public investment associated with EU structural funds. This was a qualified endorsement. First, in Estonia such measures were accepted only so long as they were offset by reductions in current spending and were, as a result, budget neutral. Second, to forestall future deviations from orthodoxy, the Fund's blessing of expansionary measures came together with praising the adoption of multi-year expenditure ceilings (already applied in Holland) and suggesting it them where they were not in the books (Estonia).

The third pattern is the Fund thinks that fiscal consolidation measures have been too anti-state and anti-poor in some countries. This is clearly the case in Lithuania, where the IMF critiques a revenue-to-GDP ratio that is the lowest in the EU, capital taxation levels well below the EU average and where excessive reliance on (regressive) indirect taxes is matched by very low taxation of wealth, notably real estate and motor vehicles. Similar remarks have been made in the case of Romania. Consequently, the Fund advises a bigger and more progressive government in terms of taxation for this exemplar of libertarian political economy (Greskovits and Bohle 2012; Blyth 2013). The report on Lithuania also provides an insight on what the IMF has to say about high unemployment when the country under review has already deregulated the labor market. In such cases the IMF's last bullets are education reforms aimed at reducing skill mismatches and boosting capital formation by reducing administrative burdens and streamlining territorial planning procedures would help raise investment.

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Conclusions

This paper makes two related claims. First, the crash of 2008 has not led to a Berlin Wall moment for neoliberalism. Although there has been greater acceptance of fiscal stimulus and gradual, rather than frontloaded austerity--where the Fund deemed that the stimulus was unaffordable--overall the emphasis on states' credibility with the financial markets has remained the primary goal of the Fund's fiscal policy paradigm. In this way, the expansion of the policy space has taken place in parallel with the further entrenchment of the

market-disciplinary modes of governance associated with neoliberalism. As such, the Fund's revisions of its traditional fiscal policy thinking may be seen as part of an effort to reprogram the instruments and settings of neoliberalism for the political and economic characteristics of the Great Recession.

Second, the explanation of this cannot be complete without examining the way in which IMF staff interpreted the fiscal policy dilemmas brought by a depression in developed economies that was triggered by the financial sector. The paper shows that given the tight epistemic interconnectedness between IMF researchers and mainstream academic economics, the long-run debate in mainstream economics over the value of fiscal multipliers was eventually internalized in the Fund, carving space for "revisionist" ideas that eventually filtered into the IMF's official doctrine.

At a more general level, this paper suggests that the observed hybridity, co-existence with incongruous intellectual formations, incompleteness and even temporary breakdowns should not be equated with imminent paradigmatic changes. It also intimates that one should not dismiss the possibility that the adaptive incremental transformation noted in fiscal policy will morph into a transformative one or, more ambitiously, into a paradigm shift. Alternatively, some of the evidence presented here can be read in a more skeptical register. The Fund's fiscal revisionism could be construed as an opportunistic, experimental and perhaps reversible intellectual contradiction. Far from being the symptom of a metastatic development, a skeptical eye might see this policy hybrid as a necessary instrument in any job of tinkering with paradigms in order ensure their survival in a challenging environment.

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