

## Seeing Like the IMF:

### Institutional Change in Small Open Economies<sup>1</sup>

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#### **Abstract:**

The International Monetary Fund spends most of its time monitoring its member states' economic performance and advising on institutional change. While much of the literature sees the Fund as a policy enforcer in 'emerging market' and 'frontier' economies, little attention has been paid to exploring the Fund's bilateral surveillance of its Western member states. This article proposes that 'seeing like the IMF' provides a dynamic view of how the Fund frames its advice for institutional change. It does so through 'associational templates' that do not blindly promote institutional convergence, but appeal for change on the basis of like-characteristics among economies. Many Western states, particularly small open economies, consider the Fund's advice as important not only for technical know-how, but because Fund assessments are significant to international and domestic political audiences. This article traces the Fund's advice on taxation and monetary reform to two coordinated market economies, Denmark and Sweden, and two liberal market economies, Australia and New Zealand, from 1975 to 2004. It maps how the Fund advocated 'policy revolutions' and 'policy recombinations' during this period, advice that coincided with important institutional changes within these small open economies.

#### **Keywords:**

IMF; surveillance; institutional change; coordinated market economies; liberal market economies; taxation policy; monetary policy.

## INTRODUCTION<sup>2</sup>

The Fund's surveillance comprises the core of its mandate and is central to its contemporary global role. The Fund's main decision-making body, the Executive Board, now spends approximately sixty per cent of its time discussing economic surveillance (Van Houtven, 2002: 15), and most staff members spend the majority of their time working on surveillance-related activities (Pauly, 1997: 41). As Harold James observes: 'The rule of Bretton Woods has been replaced by knowledge', with the Fund's surveillance exercises creating an 'information standard' to replace the dollar standard of the Bretton Woods era (1996: 612; cf. Best, 2005: Ch. 6). However, international political economy scholars have paid surprisingly little attention to exploring the Fund's bilateral surveillance of its non-borrowing, industrialized member states (for one recent contribution, see Momani, 2006). We seek to address this gap in the literature on the Fund by mapping the evolution of the Fund's bilateral surveillance of and advice to four Western states

While the Fund is most commonly known for its role dealing with 'emerging market' and 'frontier' economies, it also spends a significant amount of its time conducting bilateral surveillance of institutional change in Western states. The Fund's advice is not always influential, nor can it always act autonomously. As with Fund conditionality in loan programs (see Momani, 2004), major powers like the US sometimes seek to use Fund surveillance of non-borrowing states as a tool to achieve their own strategic ends. For instance, the US Treasury has recently made calls for the intensification of multilateral analysis in the Fund's bilateral surveillance to identify global exchange rate imbalances (read: US-China trade deficit) (Adams, 2006). The UK has also supported multilateral surveillance to further 'transparency' (King, 2006).

These recent examples indicate that the Fund's surveillance role continues to be deemed important by its dominant member states. However, as the literature on the Fund's relations with its borrowing member states suggests (Stone, 2002), we can expect the Fund to exhibit greater

autonomy from major power interference in countries that are of less systemic or strategic importance, such as the cases of the small open economies we explore here. Other scholars have shown that non-major power Western states consider change within the Fund to be important, as evidenced by their competition for influence on the Fund's Executive Board (Woods and Lombardi, 2006) and by their commitment of the scarce time of national officials to talk with Fund staff (Pauly, 1997: 41). We identify three main reasons for why Western states might consider the Fund's bilateral surveillance and advice to be important:

1. *The diffusion of technical knowledge.* States consider the Fund to have an advantage in comparative knowledge of institutional change, because the Fund regularly monitors institutional experiments across *all* its member states.
2. *Signalling to an international audience.* If the Fund gives a negative assessment of a non-borrowing country it may affect its credit rating and financial markets. Fund membership legally obligates states to explain their economic policy choices and states risk being 'shamed' before their peers in Executive Board discussions.
3. *Signalling to a domestic audience.* Fund assessments may be used by domestic political actors to claim support for or to criticize a particular policy stance, and may be used by officials to argue for institutional change or continuity in bureaucratic contests.

Following the introduction of the second amendment to its Articles of Agreement in 1978, which charged the Fund with exercising 'firm surveillance' over its member states' exchange rate policies, the Fund has gradually expanded its surveillance role over a wide range of economic policies and

institutions in all its member states (James, 1996: 270–6). As an international organization often seen as being at the forefront of globalization, commentators often impute the notion that the Fund has a ‘one size fits all’ model of how economies should reform to become more institutionally efficient (Woods, 2000; Feldstein, 1999; Stiglitz, 2002). The Fund, as we demonstrate below, does have a clear view on how economies can become more institutionally efficient, but the standard depiction of policy homogeneity blinds us to how the Fund has templates for different types of economies, which leads to variation in the analysis and data that is generated through each Fund mission (see Seabrooke, 2007). The point here is that the Fund does not send staff missions to its member states simply to gather economic data, which is then transmitted to the Fund management and Executive Board as an unmediated snapshot of a country’s economic circumstances. Rather, country missions allow the Fund staff to *interpret* a country’s current economic circumstances and institutions by learning directly from national officials (Harper, 1998: 120), the actors who actually ‘work at the coal face’ with institutional experimentation. We should therefore view the staff reports that are produced from Fund missions not as photographic representations of how a country’s economy works, but as a descriptive interpretation by the staff that builds an analytic picture of what is going on in an economy and generates advice on how institutions may be improved. Templates provide the Fund staff with basic tools for thinking through how an economy can be ‘fixed’ through constant tinkering over time. As such, there is no pre-determined end point of an ‘ideal IMF economy’ that a mission team will push in their dialogue with a Western member state; instead, staff members use a combination of ‘IMF friendly’ policies and associational templates to assist an ongoing process of institutional change.

Templates, as we see them, must be *associational* rather than universal. They are a reflection of how the Fund views an economy within groups of like-units (often with a member state’s encouragement),<sup>3</sup> rather than the Fund imposing a homogenous template as a universal stamp of

authority. Templates are generated by the institutional memory stored in the Fund's country desks in coordination with its policy departments. In this manner, the Fund's 'world's best practice' policies are commonly framed within associational templates – by comparing a state's policy stance with alternatives from states that the Fund sees as confronting similar challenges – to have greater legitimating force.

Our claim in this article is straightforward: by assessing institutional change through the eyes of the IMF, we can gain a dynamic picture of how states were advised to revolutionize or recombine economic policies. In this sense, 'seeing like the IMF' may provide a unique insight into the slow gestation of institutional change over time. This does not mean that we should uncritically adopt its judgments but, rather, that the Fund's advice provides an important means of monitoring change over time in economies that are often viewed as exhibiting a more or less 'fixed' system.

Our wish to 'see' like the IMF is inspired by James C. Scott's *Seeing Like a State* (1998). Scott emphasizes how the creation of technical knowledge requires a 'narrowing of vision' (1998: 78), a process of abstraction and simplification that by increasing the *legibility* of a society increases the capacity of policymakers to design formal institutions to shape social behavior. While Scott sees a perfectly legible and transparent society as impossible to realize in practice (1998: 80), his work invites us to recognize that how an authority sees an economy will shape its advice on what policymakers should tinker with to improve institutional efficiency. Scott's catalogue of errors on how the way states see their societies permits them to plan institutional change therefore holds two key points of relevance for how the Fund sees its member states (1998: 3). First, the way the Fund sees an economy is only intended to represent the slice of economic activity that interests the Fund. While this narrow focus is usually put forward as a trenchant criticism of the Fund, it is, after all, a result of the restricted focus that its founding member states built into the organization. It is also the basis for the 'scientific' authority of the Fund's advice (Barnett and Finnemore 2004: 67–8), and is

efficient given the Fund's (increasing) resource constraints. Second, how the Fund sees its member states' economies informs how it seeks to remake their institutional frameworks over time, especially in conditions where the Fund staff can persuade policymakers to see new institutional challenges in the same way as they do. Exploring how the Fund sees its member states' economies may therefore allow us to understand how an existing institutional framework becomes defined as a problem, how the causes of the problem are diagnosed, and how advice on potential institutional solutions is generated.

The Fund is often seen in a negative light as an organization that seeks primarily to impose Western (and especially 'Anglo-American') policy standards on the rest of the world. While such arguments retain analytical purchase at low levels of magnification of the Fund's activities, we should also consider that the Fund might be engaged in *learning* from states about their own institutional experiments to build its stock of comparative policy knowledge, rather than simply promoting institutional convergence. As this study shows, an important component of the Fund's work is to diffuse knowledge about institutional experiments among its non-borrowing Western members – especially among those within the same associational template – and this is a role which the Fund often performs at the behest of states themselves.<sup>4</sup>

To assess how the Fund has sought to promote institutional change, we compare its advice on taxation and monetary reform to small open economies. We use primary source material from Fund archival documents to compare advice given to what are considered to be two 'liberal market economies' (LMEs), Australia and New Zealand, and two 'coordinated market economies' (CMEs), Denmark and Sweden, from 1975 to 2004 (Hall and Soskice, 2001). By commencing our study of the Fund's advice to these four states in 1975, we incorporate the period in which the Fund sought to reinvent itself to maintain its relevance in the post-Bretton Woods era, after it had been ignored during many of the key events of the early 1970s (Pauly, 2006: 10). Taxation and monetary issues are

targeted because they can be expected to represent the extremes of how national economies change over time, and constitute a vital part of the domestic policy nexus that shapes how states engage the international political economy (Seabrooke, 2006a). Taxation is typically assumed to exhibit strong elements of national path dependence that prohibits harmonization despite a purported ‘race to the bottom’ (Hobson, 2003), while monetary policy can be coordinated among actors to achieve integration and an international consensus on exchange rate flexibility (McNamara, 1998).

Comparing Fund advice to these Nordic and Australasian economies is of particular interest because these economies have changed both rapidly and gradually during the thirty-year period of our study, and especially because the Fund has little coercive power to make policymakers in these countries do anything against their will (Schäfer, 2006: 75). We do not argue that the Fund is the only, or primary, cause of institutional change in the states under investigation. Indeed, we find that Western states are sometimes willing to ignore Fund advice. We do suggest that in these four cases: a) actors consider Fund assessments as potentially important signals for their domestic and international audiences; (b) actors seek comparative knowledge from the Fund to lessen the transaction costs associated with new policy experiments; and, from a) and b), c) how the Fund sees states is important to how actors frame potential policy reforms, placing boundaries on the ‘thinkability’ of different policy options, especially with regard to a state’s integration into broader economic processes of regionalization and globalization. These factors are especially prominent during a period of domestic economic uncertainty and crisis, or when the Fund judges that a state has ‘below average performance’ compared with states that share similar circumstances. As with its borrowing member states, it seems plausible that in a crisis the Fund’s advice to small open economies might help to ‘tip the balance’ in favour of ‘IMF friendly’ reforms (Vreeland, 2003: 13–14), especially if there are ‘sympathetic interlocutors’ among a country’s policymaking community who are willing to work with the Fund to achieve institutional change (Woods, 2006: 73). An

important caveat here is that it is difficult to substantiate the independent causal effect of the Fund's advice to Western states in the absence of the coercive sanctions that are observable when states are dependent upon Fund resources. As such, our conclusions here are only intended to be suggestive, and further work is required to test their validity.

The article proceeds as follows. First, we discuss how 'seeing like the IMF' can provide important insights into tracing economic reforms over time, including the notion of templates, which provide tools for achieving institutional change. Second, we provide a range of 'IMF friendly' policy mixes for taxation and monetary reforms and assess their frequency in reports produced from the regular consultation exercises between the Fund staff and national officials in the four economies in question, and in the minutes of the Fund's Executive Board discussions. This information provides an insight into when, and on what, the Fund advised our small open economies to engage in what we refer to as 'policy revolutions' or 'policy recombinations' to achieve institutional change. Third, drawing on the frequency of 'IMF friendly' advice, we assess policy revolutions and policy recombinations in the Australasian LMEs from 1975 to 2004. Fourth, we do the same for the Nordic CMEs. Finally, we reflect on how 'seeing like the IMF' provides a dynamic picture of the international organization's bilateral policy surveillance and enhances our capacity for counterintuitive insights into how small open economies have dealt with economic globalization in the post-Bretton Woods era.

## **I: SEEING LIKE THE IMF AND ASSOCIATIONAL TEMPLATES**

One of the main complaints against the Fund is that the organization embodies an overly narrow and technocratic approach to understanding its member states' economies, which leads it to inappropriately promote policy harmonization (Öniş and Şenses, 2005; Momani, 2005, 2007; Leaver and Seabrooke, 2000). In contrast, we suggest that the Fund's dialogical process of consultation and

negotiation can help produce the necessary (though not by themselves sufficient) ideational conditions for institutional *bricolage*. This constitutes a process of evolutionary path-dependence, where institutional change is constrained by the range of existing institutional materials that actors have available to them in a given situation, suggesting that new institutions will usually have some degree of continuity with those they replace or transform (Campbell, 2004: 70). Here actors may respond to new challenges by *translating* Fund advice for ‘IMF friendly’ institutional reforms into their particular national context and recombining Fund advice with a state’s existing institutional fabric over time (Crouch, 2005: 154). If the Fund has a broader view of institutional diversity across countries than its critics have acknowledged, this may also help to highlight areas of concern for institutional change that are difficult to see when it is assumed that the Fund’s agenda is geared exclusively towards encouraging institutional convergence.

When a state faces crisis conditions, or when a government is seeking to improve ‘below average’ economic performance, national officials may see the Fund as a vital source of expertise that can provide international comparisons on appropriate policy options. In such circumstances, the Fund can provide a ready source of institutional ‘roadmaps’, and can supply officials with comparative knowledge of reform outcomes elsewhere. This is not to imply a straightforward causal link whereby the Fund is able to *determine the direction* of economic reform. Rather, we want to suggest that the Fund can be an influential *source of ideas* for institutional change by shaping the range of alternative choices that policymakers have at hand (see Chwioroth, 2007).

It is certainly true that there is a great deal of commonality among Fund policies, to the extent that we can sensibly discuss an ‘IMF friendly’ policy mix, but universality is often overstated, especially because there is little follow-up on tracing policy *implementation* over time. Seabrooke (2006b) and Broome (2005) suggest that it is more common for the Fund to compare neighboring states, states within a region, or states that share common economic characteristics when evaluating

and promoting specific institutional innovations. The Fund therefore constructs what we term *associational templates* in order to customize ‘IMF friendly’ advice to its member states. Templates are created according to, most commonly, regional types, but also according to the membership of international organizations. Fund staff reports and Executive Board meeting minutes commonly use signifiers like ‘Asian’, ‘Anglo Saxon’, ‘OECD’, or ‘EU’ to create templates for different kinds of economic systems rather than a universal model (Seabrooke, 2006b; on the ‘European economy’, see Rosamond, 2002). Such associational templates also provide legitimizing devices on why a member state should see the Fund’s seemingly universal policy mix as appropriate for its own context.

We find that the supply of new policy ideas and institutional innovations between the Fund and its member states is a two-way street, at least in the case of the Fund’s policy dialogue with Western states. Our analysis of Fund archival documents and interviews suggests that national officials see the Fund as having an advantage in comparative knowledge of policy reform. Other scholarship has also noted this point, but has found that the Fund does not convey its comparative policy knowledge to member states (Momani, 2006: 265), while the Fund’s biennial review of its surveillance exercises has highlighted the desirability of incorporating comparative analysis more systematically into its policy dialogue with national officials (IMF, 2004: 19). We find from our study of these four cases that the Fund does use cross-country comparisons in how it sees individual states, and that it does convey relevant comparative policy knowledge to national officials in some cases.

## **II: IMF FRIENDLY REFORMS**

The Fund annually conducts Article IV consultations with its member states to assess their economic performance. In addition, Fund staff conduct surveys, compile statistics, and conduct research on *all* their member states – not only ‘emerging market’ and ‘frontier’ economies. Within

the Fund, Article IV consultations are communicated through staff reports written by members from the relevant area and policy departments (see Harper, 1998: Ch. 9). These reports detail current economic developments and trends, areas of concern in the economy and, importantly, staff appraisals detailing what should be reformed. Staff reports commonly compare an economy according to templates. The Fund's Executive Board then comments on these reports, with a staff representative on the state under discussion also present. The archival materials provide a clear means to trace Fund advice to our chosen small open economies over a thirty-year period.

In order to trace Fund advice over time to Australia, Denmark, New Zealand, and Sweden, we have coded Fund staff reports from Article IV consultations and subsequent Executive Board meetings for the frequency of 'IMF friendly' taxation and monetary reforms. As we have targeted certain types of reforms on taxation and monetary policy, our assessment of frequency is qualitative and context-sensitive rather than quantitative word recognition. On taxation we have coded an 'IMF friendly' mix as follows:

- Suggestion of increase in indirect taxes (primarily VAT) (+2, -2).
- Suggestion of reduction of trade and transaction taxes (+2, -2).
- Suggestion of broadening of direct taxes (income) (+2, -2).

For example, if the Executive Board proposed that the state should introduce a consumption tax, that it should reduce tariffs, and that it should 'broaden' income taxes this would represent 6 points. If the staff also advised the same then we would receive a total, and maximum, 12 points. As we can see from Figures 1–4 (see Appendix), this is rare.

On monetary systems we have coded an 'IMF friendly' mix as follows:

- Suggestion of floating exchange rate reform (+2, -2).
- Suggestion of public debt decrease (+2, -2).
- Suggestion of interest rate liberalization (+2, -2).

If the Executive Board advised a state to change to a floating exchange rate, to decrease its public debt, and to liberalize interest rates then on monetary systems we would have 6 points. If the staff advised the same then a maximum 12 points is obtained. Again, as our figures show, this is not common.

At first, Figures 1–4 provide an overly complicated story of the frequency of ‘IMF friendly’ advice from the Fund to our four chosen states. However, upon closer inspection we may notice some clear differences among them. As we can see, the Fund is particularly vocal about New Zealand in the late-1970s and early-1980s, as well as, less frequently, Australia in the late-1980s and 1990s. In comparison, the Fund’s advice to Denmark and Sweden is less frequent but persistent. We separate the moments of high frequency as indicators of potential ‘policy revolutions’, whereas persistent but lower frequency advice is tinkering that seeks to foster ‘policy recombinations’. Together, high and low frequency, revolutionary and recombinant, Fund advice seeks to build institutional efficiency.

On tax reform, where the range of possibility on the  $y$  axis is  $\pm 12$ , New Zealand is notable for the Fund’s promotion of a policy revolution in the late-1970s and 1980s, particularly as the high frequency of ‘IMF friendly’ advice in the latter period corresponds with sweeping ‘neoliberal’ economic reforms. Australia is also a candidate for policy revolutions, especially during moments in which major changes to revenue, such as the introduction of a consumption tax, were under debate. For Denmark the story here is of interest given the lack of advice and the fact that the Fund also contradicts our ‘IMF friendly’ policy mix. Change here is more often recombinant than

revolutionary. Similarly, Sweden has received a relatively constant level of advice, and here the Fund wants income tax reduction rather than seeking to install a new taxation system.

On monetary reform we have a remarkable amount of similarity after 1994. Once again the range of possibility on the  $y$  axis is  $\pm 12$ . Our figures immediately suggest that perhaps monetary systems are easier to successfully integrate than taxation systems, which speaks volumes on what aspects of the economy are more politically sensitive and path dependent under economic globalization. Still, New Zealand stands out as a state where the Fund frequently advocated a policy revolution in the late-1970s and 1980s. There are also key moments for policy revolutions in Australia, in Sweden (primarily over the reduction of public debt), and in Denmark (primarily over putting the budget in surplus). In the following sections we separate policy revolutions and policy recombinations within the two LME Australasian and two CME Nordic economies, with some unanticipated results.

### **III: THE IMF AND AUSTRALASIAN ECONOMIES**

On some measures, such as tariff walls, the Fund saw Australia and New Zealand as comparatively ‘closed’ market economies at the start of our study. In the 1970s, both Australia and New Zealand were under the jurisdiction of the Fund’s European Department along with Sweden and Denmark, but in 1992 Australia and New Zealand were reassigned to the Southeast Asia and Pacific Department (renamed the Asia and Pacific Department from 1997), as the Fund restructured its area departments to accommodate a large number of new member states from Eastern Europe and the former Soviet Union. Many of the tax and monetary changes that occurred in both countries during the fifteen-year period after 1983–4 were broadly similar in nature, but there were nonetheless clear differences in how Australia and New Zealand were viewed through an Australasian (or an ‘Anglo Saxon’) template. These differences between the Fund’s view of Nordic and Australasian economies were reflected in the pace, scope, and style of reforms in Australia and New Zealand to enhance

their institutional efficiency (for comparisons of economic reform in Australia and New Zealand, see Castles et al., 2006; Hazledine and Quiggin, 2006).

In its relationship with Australia prior to 1983 and with New Zealand prior to 1984, the Fund urged governments to adopt similar reforms on taxation and monetary policies, seemingly without much success. The Fund wanted governments to restructure the fiscal balance from ‘direct’ taxation (on personal income and company profits) toward ‘indirect’ taxation (on consumer goods); to broaden and decrease the progressiveness of income taxation; and to shift from import licensing and other quantitative trade barriers to tariff barriers, then to lower tariffs over the medium-term. The Fund argued that these changes would improve economic competitiveness, improve institutional capacity to adjust to a new external environment following the oil price shocks and the shift away from fixed exchange rates in the 1970s, and improve the state of public finances that had deteriorated as the rate of economic expansion slowed (IMF, 1977, 1978a, 1979, 1980).

On the reform of monetary institutions, from the mid-1970s the Fund wanted Australia and New Zealand to shift to a more flexible exchange rate regime and to liberalize interest rates, as well as to decrease the size of their ballooning public debt (IMF, 1979, 1983a, 1983b). After both governments moved at the end of the 1980s to adopt monetary frameworks based on achieving and maintaining low inflation, the Fund encouraged them to enhance the institutional efficiency of their central banks by making their decision-making processes more ‘transparent’. The Fund argued this would increase their capacity to communicate their credibility to international and domestic audiences (see Bell, 2002; Dalziel, 1993; Lu and In, 2006). The Fund also sought to diffuse New Zealand’s 1989 institutional innovation of setting an explicit ‘inflation target’ to Australia (IMF, 1991a). Australia incrementally translated this innovation to match its own particular circumstances, setting an implicit inflation objective from 1993 as a ‘central tendency’, to be achieved on average over the business cycle, rather than a rigid inflation ‘range’ like New Zealand (IMF, 1996a). Despite the broad

similarities in the advice on tax and monetary reform that the Fund promoted in both New Zealand and Australia, the Fund's view from staff reports and Executive Board meeting minutes suggests that the promotion of 'IMF friendly' institutional reforms was pushed more rigorously in the New Zealand case than in the Australian case. Moreover, the strength with which arguments were delivered ebbed and flowed over time, and the Fund's advice switched to strengthening governments' resolve to 'stay the course' once they had embarked upon the Fund's preferred direction of institutional reform.

### **Policy revolutions**

In New Zealand, the Fund's most frequent advice for the adoption of new institutional solutions occurred at the beginning of the 1980s (see Figure 1), when the country faced chronic 'stagflation' caused by historically high levels of unemployment and inflation. In particular, the Fund wanted to see a broadening of the tax system as a way of moderating wage claims, as well as a shift from quantitative trade restrictions such as import licensing to a more liberal system of qualitative tariffs (IMF, 1981a). With economic indicators worsening during 1982, the Fund criticized the government's adoption of tight controls on wages, prices, and interest rates as well as its refusal to devalue the nominal exchange rate to combat inflation, and urged the government to reduce the rapidly increasing level of public debt. In terms of the government's stated goal of reforming the tax system, the Fund favoured the adoption of a broad-based consumption tax, but recommended that policymakers 'raise the community's awareness' about what it saw as a policy trade-off between either reducing taxes or maintaining 'long-standing social preferences for income equity and high levels of welfare' (IMF, 1983a). As with the other countries in this study, the Fund's evaluation of New Zealand was not based solely on bracketing out domestic political and social concerns from the 'economic distortions' and 'misallocation of resources' that the staff predicted such measures would

produce, but included discussion of the political context within which the government had resorted to these measures. In New Zealand's case, this context involved: (1) the failure of an attempt to negotiate a social consensus with trade unions, whereby income tax cuts would have been exchanged for wage moderation; (2) the negative consequences that wage and price controls would have for the ability of existing institutions to function effectively; and (3) the likelihood of declining public acceptance of the controls over time (IMF, 1983a).

The Fund's overall advice on institutional reforms in New Zealand peaked in the mid-1980s. New Zealand seemed to be ripe for an 'IMF friendly' policy revolution in 1984 following a currency crisis, the election of a new Labour government more receptive to the Fund's advice on institutional change, and with the New Zealand Treasury firmly in favor of economic liberalization (see McKinnon, 2003: Ch. 8). In a remarkably short period of policy revolution, New Zealand adopted many of the institutional reforms that the Fund had been promoting for the previous ten years, leading the Fund to praise the government for having 'embarked on a courageous and enlightened course in setting economic policy' (IMF, 1985a). Key changes included the liberalization of trade protections, the adoption of flexible interest rates and a floating exchange rate regime, reduction of the budget deficit, and a shift in fiscal policy away from the taxation of income and towards consumption. During this period New Zealand turned to the Fund for extensive advice based on its comparative policy knowledge. This is indicated by New Zealand's formal requests for 'technical assistance' from the Fund on the design and implementation of a new goods and services tax (IMF, 1984a, 1985b) and for a wide-ranging review by the Fund of the functions, operations, and goals of its Inland Revenue Department (IMF, 1988a). As the director representing New Zealand noted to the Fund's Executive Board, the country's policy reforms 'conform very closely with the approach that the Fund has advocated in recent consultations' (IMF, 1985c).

In Australia, the Fund's advice on reforming tax and monetary institutions largely followed a similar trend to its advice in New Zealand, but the frequency of 'IMF friendly' policies in the Fund's overall advice to Australia remained consistently below New Zealand's level during the late 1970s and 1980s (see Figure 2). Like New Zealand, the frequency of the Fund's advice peaked in the half decade following the election of a new Labor government in 1983 that appeared to be more receptive to elements of the Fund's advice, especially on monetary reform to enhance institutional efficiency (IMF, 1985d). The Fund showed great interest in the Price and Incomes Accord that the new government put in place to secure the cooperation of trade unions, businesses, and social welfare bodies in moderating wage claims to avoid an inflationary spiral. While noting the difficulty of sustaining a 'consensual' approach in Australia over time, the Fund's Executive Board nonetheless gave the government credit for developing a novel mechanism in an attempt to progress beyond the limits of Australia's historical pattern of industrial conflict. Significantly, several directors observed that there was no *a priori* reason why such a social compact could not be successful (IMF, 1985e), despite the recent failure of the New Zealand government to negotiate a similar agreement with trade unions. This runs counter to the Fund's apparent preference (and the conventional wisdom in the academic literature on the Fund) for the exclusive use of market mechanisms such as flexible interest rates and exchange rates to manage inflationary expectations, and indicates the Fund's support for an 'IMF friendly' policy mix to be recombined with domestic policy innovations through bricolage.

Following a decline in Australia's economic performance, with rising inflation and a deteriorating balance of payments, the consistency of the Fund's advice for further 'IMF friendly' institutional change spiked upwards in 1989. While still not directly critical of the government's preference for a negotiated settlement of wage claims and the setting of tax rates, the Fund urged the government to adopt a better 'policy mix' that could prove more sustainable in enhancing institutional efficiency

over time. In particular, the Fund viewed Australia as having a relatively low share of revenue derived from consumption taxes, and advised the government to reorient taxation away from income toward consumption. The Fund also encouraged the government to reduce tariff rates further, to stabilize and then reduce public debt, and, while cautious about the short-term effects of exchange rate depreciation, to allow the exchange rate to adjust to ‘real shocks’ over the long term, with central bank intervention restricted to smoothing ‘temporary’ exchange rate fluctuations (IMF, 1989a).

### **Policy recombinations**

In the cases of New Zealand and Australia, the key push from the Fund for a shift from import licenses and other quantitative trade restrictions to tariffs came in the mid- to late-1970s and early 1980s. While the push for tariff reduction was a constant refrain from both the Fund staff and the Executive Board, by the mid-1990s both countries had removed the majority of their tariffs and the Fund’s advice was geared toward maintaining the existing policy orientation rather than seeking to shift governments to a new policy trajectory. Similarly, once each state embraced ‘IMF friendly’ reforms such as a flexible exchange rate regime and liberalized interest rates, further reforms in these areas did not form a large part of their policy dialogue with the Fund.

In its 1990 consultation with Australia, for example, the Fund noted that the government had acted on some of its previous concerns and that policymakers now agreed with the Fund on other elements of its advice, indicating that the Fund was now dealing with ‘sympathetic interlocutors’ in the country’s policymaking community (Woods, 2006: 73). This included agreement between the Fund and Australian officials on the limited economic benefits of using monetary policy to drive down the exchange rate to enhance trade competitiveness or reducing interest rates to stimulate investment. The Fund therefore urged Australia to ‘stay the course’ to continue to benefit from

institutional reforms, as well as to establish the government's policy credibility and thus anchor economic actors' expectations as they adjusted to a new 'IMF friendly' institutional environment (IMF, 1990a). Notably, in both Australia and New Zealand the Fund framed its advice as offering a way for governments to send a confidence-boosting signal to domestic and international audiences, especially with regard to the need for urgent action to reduce budget deficits in the late 1980s and early 1990s (IMF, 1987, 1992).

One component of the Fund's advice on increasing institutional efficiency continued to be pushed vigorously long after the previous policy trajectory had changed – the reduction of income taxes. The Fund continued to prompt Australia and New Zealand to reduce their 'excessively high' marginal tax thresholds and rates in order to 'improve the incentives for saving and employment' (IMF, 1998), and urged policymakers to align the top rate of income tax in each country with the company tax rate to diminish the incentives for tax avoidance (IMF, 2002). However, we should be cautious about seeing the IMF's clear advocacy for tax reform as proof of a 'neoliberal' agenda on low tax. Here it is worth noting that the Fund warned New Zealand *against* its plans for income tax cuts in 1997 (IMF, 1997a). Furthermore, the Fund advised against tax cuts for the next two years in its discussions with New Zealand officials in May and June 1999 (IMF, 1999), in the run up to a November election where tax cuts versus an income tax rise to pay for an increase in social spending was a major issue of political contention (Broome, 2006).

The main divergence in the Fund's advice on taxation reforms between Australia and New Zealand in the 1990s resulted from the Fund's promotion of a general consumption tax in Australia, which New Zealand had adopted with the Fund's advice in the 1980s (IMF, 1996b, 1997b). Once Australia eventually introduced a Goods and Services Tax in the late 1990s, and both countries adopted and gradually achieved the objective of decreasing public debt, the advice for 'IMF friendly' institutional change on tax and monetary policy that the Fund developed over the period of this

study was well-established. The Fund's ongoing dialogue with these countries from the mid-1990s mostly revolved around the promotion of two aims. First, the recombination of fiscal and monetary policies to achieve more efficient outcomes in the context of specific political goals; and, second, encouraging new governments (in 1996 in Australia and in 1999 in New Zealand) to maintain an 'IMF friendly' institutional framework.

#### **IV: THE IMF AND THE NORDIC ECONOMIES**

Unlike Australia and New Zealand in the early 1970s, the Fund viewed Sweden and Denmark as comparatively 'open' economies (cf. Katzenstein, 1985: Ch. 2). The agricultural sector aside, the Nordic economies at the start of this study maintained a low level of tariff protection for most sectors of the economy. The only context in which tariffs are mentioned in the Fund's policy dialogue with Denmark is when the Fund praises Denmark for maintaining a liberal trading regime, within its European Community (EC) obligations, despite facing deteriorating terms of trade in the 1970s and early 1980s (IMF, 1975, 1984b). In Sweden, the Fund also commended the government's support of trade openness and its low level of tariff protections (IMF, 1983c), while encouraging policymakers to reduce or remove remaining tariffs on textiles and agriculture in the mid-1980s (IMF, 1986a).

In significant respects, the Fund viewed the Danish and Swedish economies through an EC template that led to an emphasis on institutional change in a manner quite different to the Australasian economies. That the Fund viewed these states through an EC template (and that the EC is the basis for comparison for Sweden even before the country joined the European Union in 1995) rather than a 'Nordic' template is itself of interest (especially given the emphasis within the region on similarities between economies, see Mjøset, 1987). It illustrates how the Fund saw the EC as a project unto itself, choosing to stress how Denmark and Sweden should behave according to

EC benchmarks, rather than to Nordic benchmarks. This also contradicts the notion of a *universal* IMF programmatic discourse to enhance institutional efficiency in a country's taxation and monetary architecture.

For example, while the Fund wanted Denmark and Sweden to 'broaden' income taxation by reducing the top marginal rates and thresholds like Australia and New Zealand, income tax policies in Denmark and Sweden were specifically assessed against an EC template (IMF, 1981b, 1988b, 1997c). Unlike the Australasian economies, the Fund viewed the Nordic economies as already having overly high rates of indirect consumption taxes – again in comparison with the EC average. While the Fund saw Denmark as a high income tax country 'by international standards', Fund staff emphasized in 1989 that Denmark had a rate of indirect taxation that far exceeded most other EC countries, and was unique in setting VAT at a single rate while most other EC economies set VAT at two or more levels (IMF, 1989b). On monetary institutions, Denmark remained within the European Monetary System during the 1980s, while Sweden pegged the krona to a basket of currencies after it left the European Currency Snake in August 1977 and devalued the krona by 10 per cent. When the Nordic economies made it clear to the Fund that they would continue to pursue stable exchange rates within a semi-fixed exchange rate regime, the Fund voiced support for this policy, and encouraged governments to use a fixed exchange rate to stabilize inflationary expectations and to secure the confidence of international and domestic audiences in their policy intentions (IMF, 1989b).

### **Policy revolutions**

The frequency with which the Fund's advice to Denmark matched an 'IMF friendly' policy mix peaked on three occasions over the period of our study: in the late 1970s, in the mid-1980s, and in the mid-1990s (see Figure 3). In 1977, the Fund stepped up its advocacy of a policy revolution to

implement institutional change to cope with deteriorating economic performance, with the country suffering from a ballooning current account deficit, stagnant growth, and weak domestic investment. The Fund staff supported moves to raise indirect taxes to dampen consumer demand for imports and for flexible interest rates to constrain inflation, while the Executive Board also encouraged Denmark to lower income taxes, pay down public debt, and adopt a more flexible exchange rate regime to aid external adjustment and international economic integration (IMF, 1978b, 1978c).

The next peak in the content of Fund advice in the mid-1980s followed several years of economic reform under a new Conservative government elected in 1982 (Mjøset, 1987: 446). Here the advice of the Fund centered on the need for Denmark to push forward with reform of the tax system, to lower income tax rates and to eliminate tax deductions to improve individual incentives and private savings. The Fund advised Denmark to achieve tax reform through lower public spending, and to gradually move toward achieving a ‘structural budget surplus’ to compensate for low levels of private savings and lower public debt (compared with a budget deficit that reached 9 per cent of GDP in 1982, Gaard and Kieler, 2005: 5). As with the other countries in this study, the Fund explicitly framed its advice as a way for Denmark to send a positive signal to an international audience, with Fund staff arguing that achieving a structural budget surplus would shore up the country’s credit rating in financial markets. The Fund staff also compared the country’s current account balance with those of other EC countries, and suggested that Denmark’s current account would have to converge with EC trends to avoid undermining the fixed exchange rate regime (IMF, 1986b). Denmark implemented some of the Fund’s advice on tax reforms in 1987 by reducing the tax deductibility of mortgage interest payments to increase savings incentives, with significant political, economic, and social fallout. Policymakers recombined this ‘IMF friendly’ move with the ‘potato diet’ policy shift the state had embarked upon in 1986, which strengthened existing administrative controls over mortgage credit (Gaard and Kieler, 2005: 8). The last peak in Fund

advice to Denmark occurred in the mid-1990s, but this can mostly be accounted for by the Fund's renewed drive for Denmark to shift the fiscal balance to indirect taxation (IMF, 1995).

The four peaks in the frequency of our 'IMF friendly' policy mix in the Fund's dialogue with Sweden were in 1981, 1983, 1986, and 1993 (see Figure 4). In 1983, the Fund staff strongly recommended a policy revolution, advising Sweden to broaden income taxes, liberalize interest rates, and reduce public debt, while Executive Directors added a recommendation for a floating exchange rate reform (IMF, 1983c, 1983d). This advice followed several years of large current account deficits, large budget deficits, high inflation, and falling levels of domestic savings, leading to the election of a new Social Democrat government in 1982 (Mjøset, 1987: 446). While previous governments had responded to economic difficulties by expanding public borrowing to fund increases in spending and to maintain domestic economic activity, the rapid rise in public debt and growing budget deficits led the Fund to call for immediate fiscal retrenchment and institutional reform over the medium-term to put the state back on a fiscally sustainable setting. Put bluntly, the Fund argued that Sweden could no longer afford its prized welfare state, and instead needed to pare back social transfers and industry subsidies, reduce income taxes, and hold down wages to regain corporate profitability and improve its international competitiveness (IMF, 1983c, 1983d). Within Sweden, academic economists and, increasingly, policymakers gradually made a 'neoliberal ideational shift' constructed around the notion that an excessively large public sector was a policy problem (Blyth, 2001: 17).

The Fund saw Sweden in the early 1980s as a recalcitrant state, unwilling to face the economic realities of the 'brave new world' of the post-Bretton Woods era and initially unresponsive to the Fund's call for a policy revolution to improve its economic performance. In the second peak in the Fund's advice for an 'IMF friendly' policy revolution in 1986, previous governments received harsh criticism from the Fund, with the staff judging that 'Sweden's tardiness in adjusting to the two major oil price increases of the 1970s was responsible for weak economic performance in the decade to

1982' (IMF, 1986a). Sweden's response was a 'November Revolution' in 1985 to deregulate domestic credit markets, which involved liberalizing bank interest rates and removing all ceilings on loans (Svensson, 2002: 200).

Similar to Denmark, Sweden maintained a fixed exchange rate regime during the 1980s, albeit with large discrete adjustments such as a 10 per cent devaluation in 1981 and a further 16 per cent devaluation the following year (Anderson, 1990: 196). The size of Sweden's 1982 devaluation was opposed by other Nordic finance ministers and central bank governors as well as by Fund staff and the managing director, Jacques de Larosière, which prompted the new government to modify its original plan to devalue the krona by 20 per cent (Boughton, 2001: 111). Against the advice of the Fund for a single digit devaluation, this action led to an Executive Board decision to hold 'special consultations' with Sweden, with four IMF staff members visiting the country for a week of talks with officials in November 1982. This unprecedented situation for a non-borrowing member state was resolved in a restricted session of the Executive Board on 22 December 1982 (IMF, 1982), after the Fund staff urged the Swedish minister of finance, Kjell-Olof Feldt, to write to the managing director detailing a policy strategy to mitigate the potential adverse effects of the devaluation on neighboring countries. Feldt agreed to do so on the condition that it would be a personal letter so that it could not be used against the government by opposition parties (Boughton, 2001: 112-13), which indicates the salience of our point that the Fund's policy dialogue can resonate with a domestic audience in Western states.

Sweden's fixed exchange rate regime was abruptly abandoned in November 1992 following a major currency crisis. In contrast to our 'IMF friendly' ideal type, the Fund advised Sweden to decrease VAT in 1993 to converge with EC countries, but the same year saw the most recent peak in the frequency of an 'IMF friendly' policy mix in the Fund's dialogue with Sweden. The focus here was almost solely on monetary reform, as the country faced what the Fund called 'its worst

economic crisis since the 1930s', encompassing a series of speculative attacks against the Swedish krona, declining economic output, the highest level of unemployment in the post-WWII era, an increasing fiscal deficit, and structural problems in the banking system. The Fund saw these serious difficulties as resulting from structural defects in the institutional architecture of the state, especially the high level of public expenditure that required a 'cripplingly high level of overall taxation' and fed a large fiscal deficit. Like the two previous peaks in 'IMF friendly' advice for Sweden, the Fund framed its advice through an EC template, arguing that Sweden's public spending had well exceeded an affordable level, and that social transfer payments were 'substantially out of line' with those in the EC (IMF, 1993).

### **Policy recombinations**

In comparison with either Australia or New Zealand, the content of the Fund's advice to Denmark and Sweden on taxation and monetary reform was more stable over the thirty-year period of our study. Both the Fund staff and the Executive Board focused much of their advice on continuing to encourage the Nordic economies to broaden income taxes, and to reduce public debt once it began to increase rapidly from the late 1970s. Following discussions about a floating exchange rate reform that surrounded Denmark's entry to the European Monetary System in 1979, the Fund subsequently endorsed the country's fixed exchange rate regime for the krone as an appropriate policy mix for Denmark. Over time the staff concluded that the fixed exchange rate had 'served Denmark well, and... should continue to guide monetary policy', so long as the government maintained a tight fiscal policy and recombined its policy mix by adopting more flexible labour market institutions (IMF, 1991b). Within the Danish 'negotiated economy' from the mid-1980s through to the early-1990s, consensus-building among trade unions, employer associations, and the state fostered a new attitude towards 'structural competitiveness' in the world economy (Pedersen, 2006), followed by

innovative reforms to Denmark's labor institutions and fiscal consolidation (IMF, 2006). By the end of the 1990s, when the level of public debt had declined and diminished in frequency as a key concern of the Fund, only the level of income taxation among our 'IMF friendly' policy mix remained as an outlying reform issue (which had remained relatively stable over time, see Figure 3).

After the peaks in its advice to Sweden during periods of policy revolution in 1981–3 and 1986, the Fund sought to gain greater policy recombination at the end of the 1980s, especially the recombination of the fixed exchange rate regime with a decline in public expenditure and income taxation (IMF, 1990b). Following the next period of policy revolution in the early 1990s, when the fixed exchange rate regime was abandoned and the krona's value substantially depreciated, the Fund again encouraged policy recombination, arguing that the level of public debt would have to be brought down in order to stabilize the currency and to allow a reduction in high interest rates. Sweden continued to be compared with EC countries when the Fund looked at its high level of social spending, and the Fund noted that despite official economic statements from the government that emphasized the importance of reducing public debt and embracing the principle of tax reduction, actual budget measures agreed in the mid-1990s provided for tax increases (IMF, 1994).

## **V: CONCLUSIONS: THE ROLE OF THE IMF IN SMALL OPEN ECONOMIES**

The Fund spends a great deal of its time assessing and learning from institutional change in its member states. For Western states the Fund is not a policy enforcer. It does provide Western states with comparative knowledge on the experience of implementing institutional change, all seen through what we have called 'associational templates' and its favored economic policy orientations. The Fund's capacity to learn and act as a source of knowledge is particularly important for small open economies that are especially sensitive to changes in the international political economy. In an era of globalization such economies must adapt to prosper, and, for good or bad, the Fund has

assisted these economies with policy advice. This article demonstrates how ‘seeing like the IMF’ provides an insight into how the Fund relates to Western states, how the Fund’s advice has changed in recent decades, and how looking through the Fund’s eyes allows one to map institutional change over time within a comparative context to understand how reform has been seen by the same actor. We also demonstrate that the Fund plays more than one role in giving advice; it acts as a diffuser of technical knowledge, a soothsayer to audiences in the international political economy, and a weapon to be used by domestic political audiences. In sum, we have made four suggestive arguments here about the Fund’s role in Western states:

1. The Fund is useful to states as a source of comparative knowledge on policy reform and as a diffuser of institutional innovations.
2. The Fund sees economies through a number of associational templates rather than blindly promoting institutional convergence.
3. The Fund’s advice is most likely to have a visible influence during periods of uncertainty, crisis, or below average economic performance; but it continues to nudge states to recombine their policy mix on an ongoing basis.
4. The Fund’s advice is most likely to shape the *thinkability* of alternative economic reforms that policymakers choose from, rather than simply determining the direction of change.

While we do find that the Fund uses ‘associational templates’, our interviewees confirmed a point, already suggested by Bessma Momani (2006: 265), that Western states would prefer for the Fund to

adopt a more OECD-like process of surveillance and consultation to become more directly driven by the specific policy interests of individual states. Further research may develop insight into how the Fund, normally considered in the same breath with neoliberal policy homogenization, actively seeks to tinker with Western economies to enhance their institutional efficiency. Such findings have important comparative lessons not only for Western states, but also for 'emerging market' and 'frontier' economies that are considered to be on the receiving end of Western-style institutional convergence. In closing, looking through the eyes of the IMF is useful to not only trace the policy decisions made, but also to gain some insight on why alternative options were not taken. Discovering 'non-decisions', as Susan Strange (1988: 22) put it, is a useful corrective to an overly path dependent view of an economy and can expose the sources of change in the international political economy.

# APPENDIX

Figure 1: IMF Friendly Advice to New Zealand on Taxation and Monetary Reform

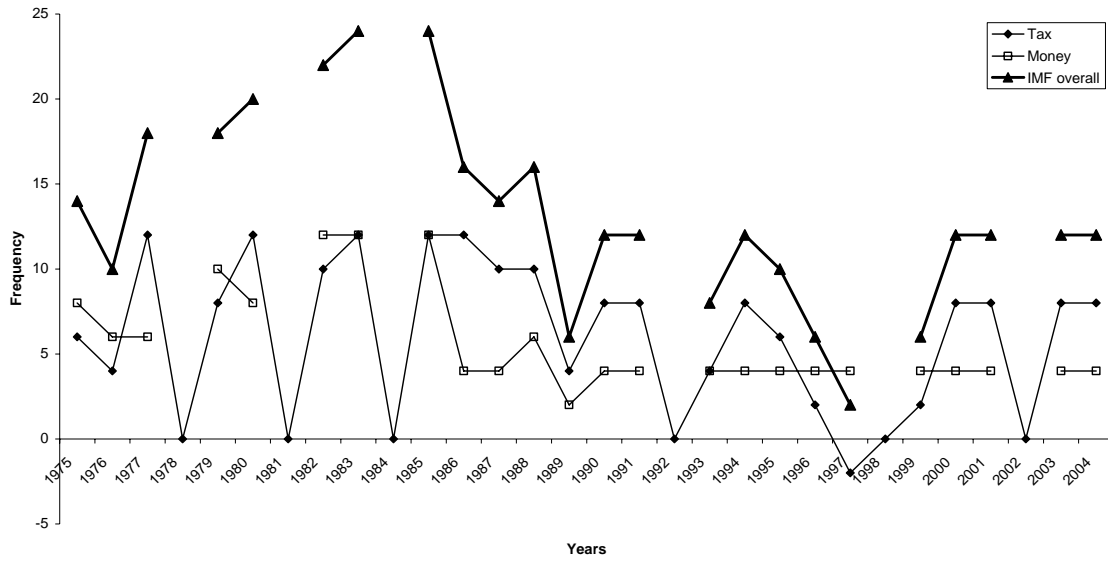


Figure 2: IMF Friendly Advice to Australia on Taxation and Monetary Reform

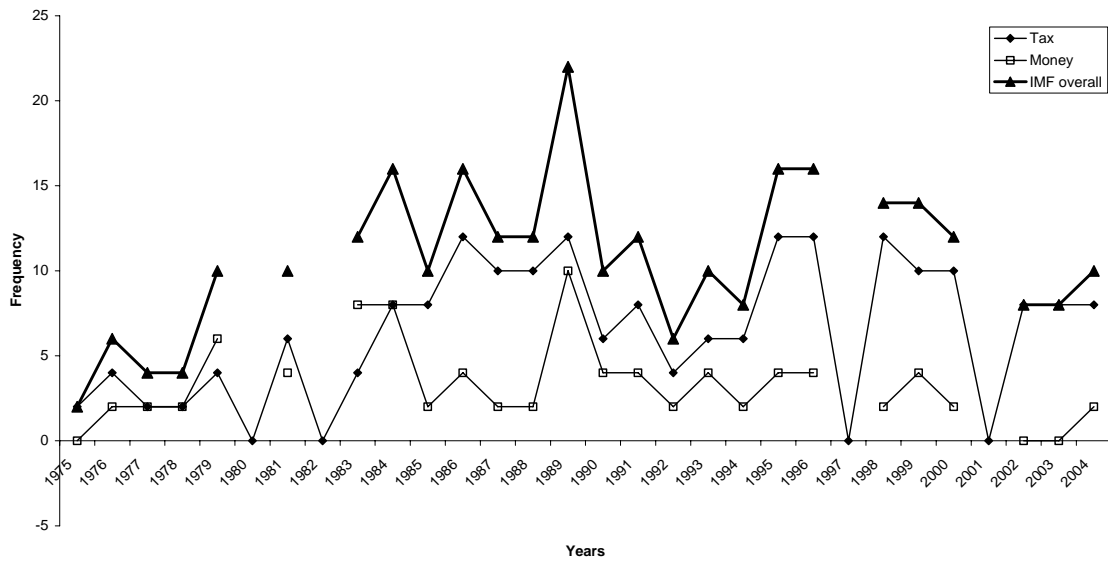


Figure 3: IMF Friendly Advice to Denmark on Taxation and Monetary Reforms

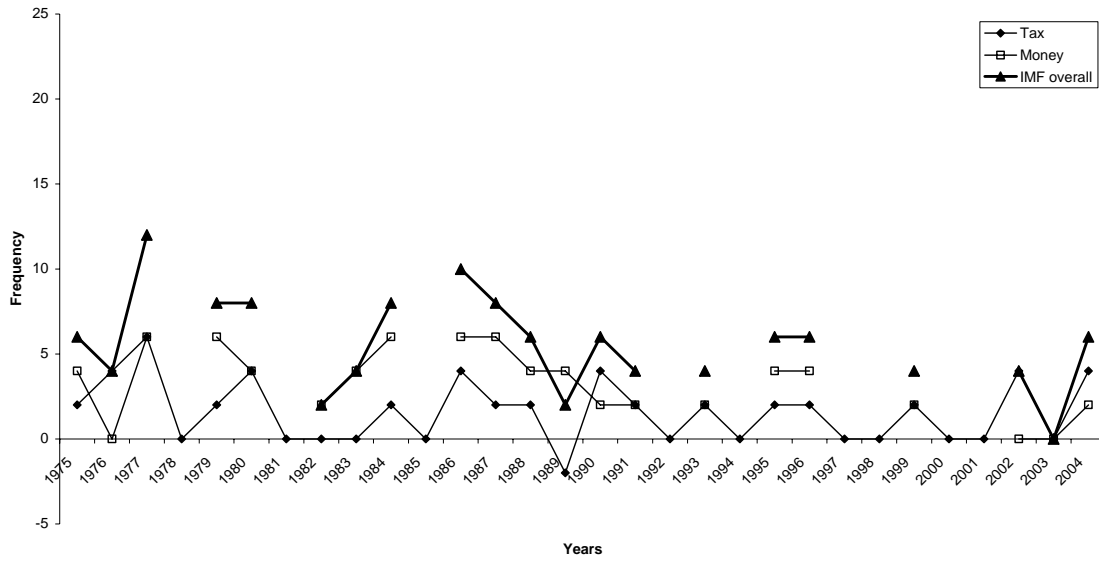
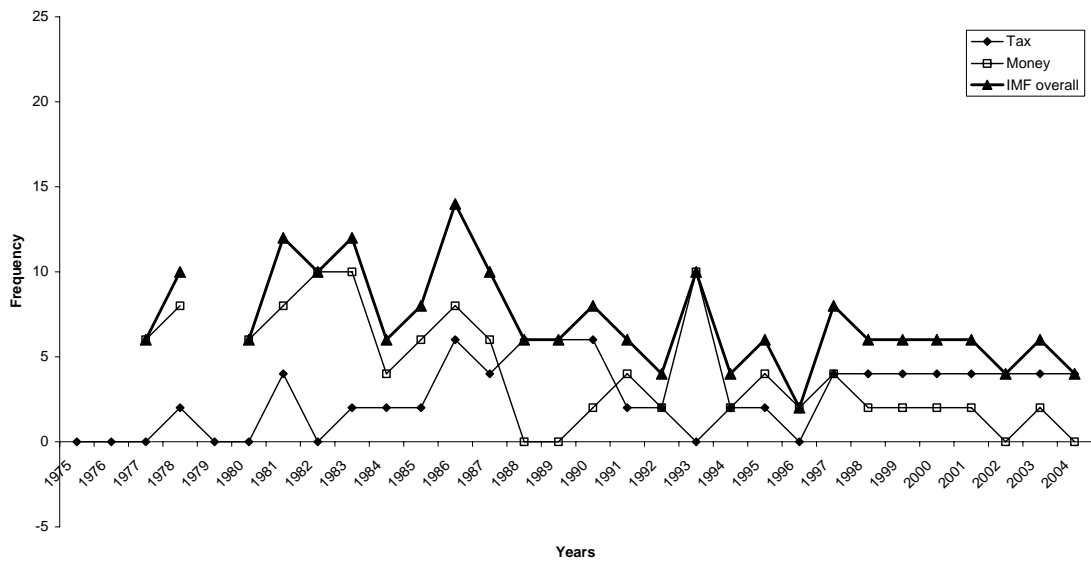


Figure 4: IMF Friendly Advice to Sweden on Taxation and Monetary Reforms



## NOTES

<sup>1</sup> Forthcoming as: Broome, A. and Seabrooke, L. (2007) 'Seeing Like the IMF: Institutional Change in Small Open Economies', *Review of International Political Economy* 14(4): 576–601.

<sup>2</sup> Our special thanks go out to Madonna Gaudette, Clare Huang, Premela Isaacs, and Jean Marcoyeux in the International Monetary Fund Archives, Washington D.C., for their research assistance during our numerous visits to the Fund. We thank Fund policy staff and the staff of the macro-policy branches of the New Zealand Treasury and the Danish Ministry of Finance for generously affording us time for interviews. We also thank three anonymous reviewers for RIPE, as well as Manuela Moschella, Ove K. Pedersen, and John Ravenhill for their helpful comments on earlier drafts. The views expressed in this article are those of the authors, and do not represent the views of the Fund or national officials.

<sup>3</sup> Our thanks to a staff member of the Macroeconomic Policy Branch in the New Zealand Treasury for stressing this point.

<sup>4</sup> For example, during the interview period in Denmark, the Fund was actively learning from the Danish government about its policy experiment in 'flexisecurity', which has already roused interest from other member states as a potential policy model for emulation (IMF, 2006). This example is especially significant given that the Fund is commonly associated with the diffusion of 'neoliberal' economic policies, while 'flexicurity' is an employment system that seeks to mitigate, not heighten, social risk.

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