

IMF made political recommendations outside its remit

Sir, In its recent 2006 Article 4 Consultation Report on the UK, the International Monetary Fund argues that future government revenues could well turn out lower than expected. It could be right. The IMF also argues that periods like the present, characterised by buoyant growth and high capacity utilisation, are the right time to build a fiscal cushion. It is definitely right there. Finally, the IMF argues that the fiscal cushion should be built through public spending cuts (or "expenditure restraint") rather than through tax increases. Regardless of whether it is right or not, this is not a matter on which the IMF is entitled to give advice.

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The mandate of the IMF in its dealings with individual member countries concerns imbalances and misalignments that threaten financial and macroeconomic stability. The key imbalances are: the imbalance between aggregate demand and potential output threatening inflationary or deflationary pressures; external imbalances threatening external debt unsustainability; currency and maturity mismatch in financial balance sheets, misaligned exchange rates and fiscal imbalances.

As regards the last of these - fiscal unsustainability associated with excessive public debt and deficits - the IMF's mandate does not cover the preferred combination of tax increases and cuts in public spending to restore fiscal balance. It may well be true that higher taxes lower the level or even the growth rate of potential output, through adverse incentive effects on labour supply or demand, saving and investment. Whether that is a price worth paying for higher public spending is a decision that can only be made by the British people through their elected government.

Fiscal sustainability can be achieved with public spending and taxes at 20 per cent of gross domestic product or at 60 per cent of GDP. As long as fiscal sustainability is achieved, it is not the job of the IMF, or any other international organisation, to give advice on the size of the public sector or the composition of its activities. They lack the political legitimacy to make such deeply political recommendations.

Willem H. Buiter
Professor of European Political Economy,
European Institute,
London School of Economics and Political Science
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