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Can the IMF be Reformed?

What a difference two decades make! In 1985, the International Monetary Fund and the World Bank, also known as the Bretton Woods twins, stood at the pinnacle of their power. Taking advantage of the Third World debt crisis of the early 1980's, both institutions were in the midst of instituting radical free market reforms via structural adjustment programs in over 70 developing countries.

10 years later, in 1995, the IMF stood unchallenged as the centerpiece as of the global financial system and was launching its ambitious drive to make capital account liberalization one of the articles of association of the Fund. By 2005, the credibility of the IMF was in shreds. What accounted for this dire turn in the fortunes of this once extremely powerful institution?

The Asian Financial Crisis and the Unraveling of the IMF

Distant, feared, and arrogant, the IMF met what amounted to its Stalingrad in Asia in the late 1990's.

East Asian economies were then widely heralded as the leaders of the global economy in the 21st century; economies whose average rate of growth would remain at 6 to 8 per cent far into the future. Thus, when these economies crashed in the summer of 1997, the impact on the reigning ideology of globalization was massive. Perhaps the most shocking aspect of the crisis for people in the developing world was the social impact of the crisis: over a million people in Thailand and some 21 million people in Indonesia found themselves impoverished in just a few weeks.[i]

The IMF was widely discredited, being seen as the architect of capital account liberalization that created the crisis, and of the severe contraction that followed.

Throughout the developing world, the picture of Michel Camdessus, the IMF Managing Director, arms folded, standing over Indonesian President Suharto signing an IMF Letter of Intent agreeing to the harsh conditions of stabilization demanded by the Fund on January 15, 1998, became an icon of Third World subjugation to a much hated suzerain. So unpopular was the IMF that in Thailand, Thaksin Shinawatra and his Thai Rak Thai political party ran against it and the administration that had sponsored its policies in 2001, winning a lopsided victory for them and with it inauguration of anti-IMF expansionary policies that revived the Thai economy. In Malaysia, Prime Minister Mohamad Mahathir defied the IMF by imposing capital controls, a move that raised a howl from speculative investors but one that ultimately won the grudging admission of the IMF itself as having stabilized an economy in serious crisis.[ii] Many eminent establishment critics agreed that the Fund "should have tried unorthodox combinations such as fiscal expansion, monetary contraction, and capital controls." [iii]

Indeed, the IMF eventually admitted—though in euphemistic terms--that its whole approach of fiscal tightening to stabilize the exchange and restore investor confidence as the way to deal with the Asian financial crisis was mistaken: "T]he thrust of fiscal policy…turned out to be substantially different…because…the original assumptions for economic growth, capital flows, and exchange rates…were proved drastically wrong."[iv]

The IMF was further discredited by its close association with the interests of the United States. In great detail, crisis countries were asked to slash their subsidies, end their local monopolies, reform their tax systems, liberalize their financial systems, and more."[v] The staff of the Fund, indeed, "worked in very close cooperation with the US Treasury in designing the most controversial features of the IMF's programs in Asia."[vi]

One of the episodes during the crisis that exposed the IMF as being essentially a tool of the United States was the battle over Japan's proposal for an “Asian Monetary Fund.” The fund, with a possible capitalization of $100 billion, was proposed by Tokyo in August 1997, when Southeast Asian currencies were in a free fall, as a multi-purpose fund that would assist Asian economies in defending their currencies against speculators, provide emergency balance of payments financing, and make available long-term funding for economic adjustment purposes. As outlined by Japanese Foreign Ministry officials, notably the influential Ministry of Finance official Eisuke Sakakibara, the Asian Monetary Fund (AMF) would be more flexible than the IMF, by requiring a “less uniform, perhaps less stringent, set of required policy reforms as conditions for receiving help.”[vii] Not surprisingly, the AMF proposal drew strong support from Southeast Asian governments.

Just as predictably, the AMF aroused the strong opposition of both the IMF and the US. At the IMF-World Bank annual meeting in Hong Kong in September 1997, IMF Managing Director Michel Camdessus and his American deputy Stanley Fischer argued that the AMF, by serving as an alternate source of financing, would subvert the IMF’s ability to secure tough economic reforms from Asian countries in financial trouble. Due to increasing Congressional constraints on the President’s power to commit US bilateral funds to international initiatives, the US had become “more dependent on its power in the IMF to exercise influence on financial matters in Asia. In this context, an Asian Monetary Fund in which Japan was the major player would be a blow to the US role in the region.”[viii] Indeed, analyst Eric Altbach claims that “[s]ome Treasury officials accordingly saw the AMF as more than just a bad idea; they interpreted it as a threat to America’s influence in Asia. Not surprisingly, Washington made considerable efforts to kill Tokyo’s proposal.”[ix] Unwilling to lead an Asian coalition against US wishes, Japan abandoned the proposal that could have prevented the collapse of the Asian economies. Not surprisingly, the episode left many Asians very resentful of both the IMF and the US.

Revisiting Structural Adjustment

The Fund’s performance during the Asian financial crisis led to a widespread reappraisal of the Fund’s role in the Third World in the 1980s and early 1990s, when the IMF, along with the World Bank, became the main instrument for the imposition of “market friendly” structural adjustment programs on over 90 developing and “transition” or post-socialist economies.

After over 15 years, it was hard to point to more than a handful as successes, among them the very questionable case of Pinochet's Chile. Poverty and inequality in most adjusted economies increased. Beyond that, structural adjustment institutionalized stagnation in Africa, Latin America, and other parts of the Third World. A study by the Center for Economic and Policy Research shows that 77 percent of countries for which data is available saw their per capita rate of growth fall significantly during the period 1980–2000. In Latin America, income expanded by 75 percent during the 1960s and 1970s, when the region's economies were relatively closed, but grew by only six percent in the past two decades.[x] A more global comparison has been attempted by Robert Pollin, and this showed that, excluding China from the equation, the overall growth rate in developing countries during the interventionist "developmental state" era (1961-80) was 5.5 per cent, compared to 2.6 per cent in the neoliberal era. In terms of the growth rate of income per capita, the figures were 3.2 per cent in the developmental state era and 0.7 in the neoliberal era. [xi]

The Fund could no longer pretend that adjustment had not been a massive disaster in Africa, Latin America, and South Asia. During the World Bank-IMF meetings in September 1999, the Fund conceded failure by renaming the extended structural adjustment facility (ESAF) the "poverty reduction and growth facility" and promised to learn from the World Bank in making the elimination of poverty the "centerpiece" of its programs. But this was too little, too late, and too incredible.

Indeed, among the key consequences of the IMF's calamitous record in East Asia and the developing world was that it brought the long simmering conflict over the role of the Fund within the US elite to a boil. The American right denounced the Fund for promoting moral hazard, that is, irresponsible lending, with some, including former US Treasury Secretary George Shultz calling for its abolition, while orthodox liberals like Jeffrey Sachs and Jagdish Bhagwati attacked the Fund for being a threat to global macroeconomic stability and prosperity. Late in 1998, a rare conservative-liberal alliance in the US Congress came within a hair's breath of denying the IMF a $14.5 billion increase in the US quota. The quota increase was salvaged, with arm-twisting on the part of the Clinton administration, but it was clear that the long-time internationalist consensus among American elites that had propped up the Fund for over five decades was unraveling.

IMF Reform: Promise versus Reality

As the crisis of legitimacy of the IMF worsened, the need for reform was felt acutely. Reform of the international financial architecture, debt relief, and the approach to financing development topped the agenda.

Calls for a new global financial architecture to reduce the volatility of the trillions of dollars shooting around the world in pursuit of narrow but significant interest rate differentials came from many quarters in the wake of the crisis. The US argued that the current architecture was basically sound, there was no need for major reforms, and what was needed was simply "improving the wiring of the system." Though there were some differences on some details, this position was shared by the other members of the G-7.

This approach advocated increased transparency, tougher bankruptcy laws to eliminate moral hazard, prudential regulation using a set of “core principles,” such as transparency of accounts, drafted by the Basle committee on banking supervision, and greater inflow of foreign capital not only to re-capitalize shattered banks, but also to “stabilize” the local financial system by making foreign interests integral to it, that is, allowing them to freely buy up local institutions or set up their fully owned subsidiaries.

The G-7 also trumpeted the creation of a “Financial Stability Forum.” As originally proposed, this body had no representation from the less developed economies. When this generated criticism, the G-7 issued an invitation to Singapore and Hong Kong to join the body. The developing countries were still not satisfied, however, leading the G-7 to create the G-20, with more representation from the South. As Andy Knight notes, however, even this expanded G-20 has no representation from the poorest developing countries.[xii] Moreover,

> The G-20 also lacks any mechanism for reporting or for accountability to the broader international community; its origins in the G-7 reduce its legitimacy; its membership is not fully representative; its mandate is narrow; its procedures are not inclusive enough to allow for participation by non-governmental organizations; and, its operations are not all that transparent either.[xiii]

Tobin taxes or similar controls designed to slow down capital flows by imposing fees on them at various points in the global financial network were strongly resisted. Even when the IMF admitted that capital controls worked to stabilize the Malaysian economy during the 1997 financial crisis, resistance to capital controls remained, even the most “market friendly” kind like the Chilean encaja, which applied holding-period taxes or their equivalent, non-interest bearing deposit requirements, on all capital inflows to ensure that they would remain in-country for a period of time and thus avoid volatile movements that could destabilize an economy. [xiv] As economist Barry Eichengreen noted,

> This advice ought not to be controversial, although it

> continues to be regarded as such. If the experience of the 1990's taught us one thing, it is that throwing open the capital account before [developed country standards and practices of prudential supervision] have been put in place is a recipe for disaster. Moreover, developing the relevant mechanisms and capacities is no easy task. It follows that these interim measures may have to be retained for some time.[xv]

When it came to the role of the IMF in financial crisis management, the G-7 supported the expansion of the powers of the IMF despite its poor record. They did give the Fund the authority to push private creditors to carry some of the costs of a rescue program, that is, to "bail them in" instead of bailing them out, an approach that was tried out in the Korean financial crisis. This was a modest response to clamor on both the right and the left that because the Fund had been used in the past to bail out private creditors, it merely encouraged future acts of irresponsible lending.

The G-7 also authorized the creation of a "contingency credit line" that would be made available to countries that are about to be subjected to speculative attack. Access to these funds would be dependent on a country's track record for observing good macroeconomic fundamentals, as traditionally stipulated by the Fund.

The only problem was that no one wanted to take advantage of this pre-crisis credit line, rightly worried that speculative investors would take this as a sign of crisis, move to take their capital out of the country, and so accelerate the crisis that the pre-crisis credit line was supposed to avert in the first place.

Probably, the most far-reaching proposal came, surprisingly, from the American deputy director of the Fund, Ann Krueger. Krueger proposed an orderly work-out process similar to Chapter 11 bankruptcy proceedings in the US: the "Sovereign Debt Restructuring Mechanism. A government suffering a financial crisis would apply for IMF protection. If the IMF found that the country was dealing with its creditors "in good faith," it would grant a standstill in its payments to them. Protected in this fashion, the debtor country would negotiate new terms of repayment to its creditors, with the IMF providing it with emergency funding to finance its imports of goods and services. The IMF then would oversee the creation of some sort of tribunal independent of the Fund that would adjudicate disputes between the debtor and the creditors, and among creditors, and come out with a debt restructuring program that would be binding on everybody. [xvi] According to Eichengreen,

> The merit of this proposal is that it addresses head on the key problems to be resolved in order to make debt restructurings more orderly and predictable and thereby create an alternative to large-scale multilateral [emergency] lending. It would shelter the country from disruptive litigation. It would allow a qualified majority of the creditors to bind in an uncooperative minority. And, it would lay down clear rules and procedures governing that restructuring process.[xvii]

Proposed during the height of the Argentine crisis, there was only one thing wrong with this proposal: powerful interests in the US government and financial community that were dead set against it. The day after Krueger made her proposal public, John Taylor, the international undersecretary of the US Treasury, registered his disagreement, saying that the "most practical and broadly acceptable reform would be to have sovereign borrowers and their creditors put a package of new clauses in the debt contracts."[xviii] In other words, maintain the status quo, where the creditors tend to unite and have tremendous advantage over the debtor.

Krueger apparently had the support of Secretary of the Treasury Paul O'Neill. A sense of the conflicts provoked by the proposal is provided by Ron Suskind's account of O'Neill's tenure:

> Ann Krueger, the progressive number two at the IMF, and O'Neill had become something of an odd couple as well, trumpeting the virtues of extending to troubled nations the same reasonable protections that multinationals enjoy in Chapter 11. Banks and investment houses hated the idea, saying they wouldn't extend credit to the developing countries of Africa, Asia, and South America if those

> countries were protected from creditors. O'Neill's response was that over the past decade their investments had been risk-free, because they knew the US Treasury would bail them out in a crisis.[xix]

When O'Neill was fired by President Bush in December 2002, however, Krueger lost her strongest supporter and at its April 2003 meeting of the IMF's International Monetary and Finance Committee, the US squelched the proposal.

The lack of any real movement in reforming the international financial architecture prompted warnings, by of all people, Robert Rubin, who had promoted capital account liberalization while serving as Clinton's Treasury Secretary, that "[f]inancial crises have continued to rock emerging markets and are likely to remain a factor in the decades ahead."[xx]

The IMF Blinks

The low state to which the fortunes of the IMF had sunk in the estimate of its once compliant pupils in the developing world was illustrated in the case of Argentina. After defaulting on $100 billion of its $140 billion debt, Argentina collapsed in 2002. Then Nestor Kirchner was elected president in 2003. Kirchner told holders of Argentine bonds that it would repay them but only after writing off 75 to 90 per cent of the value of the bonds. He also played hardball with the IMF, telling the Fund, in March 2004, that it would not repay a $3.3 billion installment due the IMF unless it approved a similar amount of new lending to Buenos Aires. According to Stratfor, an agency specializing in political risk analysis, the future of the IMF was at stake in the negotiations: "If Argentina walks away from its private and multilateral debts successfully—meaning that it doesn't collapse economically when it is shut out of international markets after repudiating the debt—then other countries might soon take the same path. This could finish what little institutional geopolitical relevance the IMF has left."[xxi] The IMF blinked. Kirchner stuck to his guns on his radically devalued payment to foreign bondholders, one of the Fund's key constituencies, and the Fund came up with a new multibillion dollar loan for his government.

By 2005, reform efforts had ground to a stalemate at the IMF. Perhaps nowhere was this more evident than in the area of institutional control and decision-making. With IMF voting power based on the size of one's capital subscriptions, the G-7 countries easily dominated the institution with its control of 45% of the voting power. The US alone, the only country accorded with a veto power, controls 17 per cent of the vote, comfortably above the 15 per cent needed to veto vital policy and budgetary decisions. It should come as no surprise therefore that IMF policies were found to be "too responsive to its principal stockholders which are high income, international creditor countries whose interests do not necessarily coincide with those of the global society as a whole."[xxii]

Even mild proposals have very little chance of passing. For instance, Joseph Stiglitz has proposed that "pending a reexamination of the allocation of voting, the direct voice of the borrowing countries in the executive boards of the IFIs be increased, e.g., by establishing two additional seats with half votes or repackaging constituencies."[xxiii] Why such reasonable proposals, in terms of equity, cannot even make it to first base is explained by Mark Zacher:

> [I]t is very unlikely that the major donor states [namely, the Western industrialized countries]are going to sacrifice their veto power (15, 30, 50 per cent of total votes depending on the issue) over the amount of money that they contribute or the policies concerning loans and grants to recipient countries. They may be willing to make some modest changes in the distribution of votes and the majorities that are required for particular types of decisions; but they are not going to sacrifice their ability to block decisions that concern contributions to the IMF and the IMF's dispersements [sic] of these funds.[xxiv]

Given the controversy swirling around the relevance of the two institutions, one would have thought that rich minority would have been willing to do away with particularly aggravating customs, namely that the head of the Fund is always a European. On two occasions in the last few years, in 2000 and 2004, the European bloc had a chance to make the selection of the managing director by merit not nationality. On both occasions, Europeans were chosen.: the German Horst Koehler in 2000 and the Spaniard Rodrigo de Rato in 2004.

Reform of the Bretton Woods system was something that came to be regarded as a sick joke by most developing country governments by the turn of the millennium. In civil society, the failures of reform made the demand to abolish the IMF no longer seem to be the rhetorical outburst of far-left groupings. What would take the place of the current Fund had become a respectable subject of academic discussion

The Alternative

For political reasons, it may prove difficult to abolish the IMF. But it can be disempowered and converted into a research agency tasked with monitoring capital flows.

Today's need is not another centralized global institution but the deconcentration and decentralization of institutional power and the creation of a pluralistic system of institutions and organizations interacting with one another, guided by broad and flexible agreements and understandings. This arrangement would make the IMF just another actor co-existing with and being checked by other international organizations, agreements and regional groupings.

In the global financial architecture, regional arrangements such as a regional financial institution can supplant the IMF as a regulator of global finance. Crises tend to be regional and crisis contagion could quickly spread to neighboring countries. Bound by a common stake, a regional monetary fund is best placed to help in the solution of problems that requires regional expertise and demand close regional focus and coordination.

One of the core tasks of this regional institution is to make available a pool of resources that can be disbursed quickly to provide support in times of speculative crisis and financial safety net to countries. The availability of such funds, even before crisis strikes, makes it a more reliable source of support compared to the IMF's practice of putting together rescue packages in the middle of the crisis and drawing its resources primarily from countries that have a stake in the crisis.

As was underlined by the Asia bail-out packages, the IMF is ill-equipped to respond to investor panic due to insufficient resources, with regional/bilateral contribution dwarfing that of the IMF's. At the time of the Asian crisis, Thailand was recipient to a $34 billion dollar package one third of which came from the countries in the region.[xxv] The size of IMF financial resources today is considerably lower than at its inception. As a proportion of the total GDP of its member countries, it is now only 1/3 of its resources in 1945.[xxvi] Total quotas have also been overtaken by other indicators: from 8.5 percent to 1.8 percent in relation to global current account transactions, 1.4 percent to 0.8 percent in relation to GDP, 33 percent to 9 percent in terms of foreign exchange reserves, and 9 to 4 percent in relation to world imports.[xxvii]

A regional fund that will have reserves especially earmarked to respond to financial difficulties would ensure that rapid liquidity is injected even before the problem exacerbates to a crisis and crisis contagion arises. It will be significantly more effective at pre-empting a full-blown crisis by providing a ready dosage at the first signs of trouble. The massive dollar reserves of Asian and Latin American governments are sufficient to carry this out. By the end of last year, developing Asia's foreign exchange reserves, including Japan, was estimated at more than $2.4 trillion with the majority held in dollar assets.[xxviii]

In functioning as a regional quasi-lender of last resort, loans should be made available without the strings of conditionalities usually attached to IMF/WB loans. In regional arrangements, the grounds for imposing those very same types of conditionalities are not only principally wrong, but also downright foolish. Forestalling the release of loans in times of crisis due to non-compliance to conditionalities will not only be detrimental to the country in crisis but to the other countries in the region whose economies are closely integrated with one another.

Lastly, this regional institution should create the framework for sustainable development that will not be destabilized by the free flow of capital. Central to this is the framing of agreements centered on capital controls, creation of mechanisms to promote orderly debt restructuring and establishment of international standards and codes in coordination with national authorities with no massive, centralized surveillance institution with coercive capacities, sensitive to the needs of countries and not to speculative capital.

The formation of such an institution should be carried out via a democratic process that would involve NGO's and People's Organizations and not just governments and the business sectors. It is in such an arrangement that a pro-people approach to
development is possible.

More space, more flexibility, and more compromise--these should be the goals of the Southern agenda and the international civil society effort to build a new system of global economic governance. It is in such a more fluid, less structured, more pluralistic world, with multiple checks and balances, that the nations and communities of the South—and the North--will be able to carve out the space to develop based on their values, their rhythms, and the strategies of their choice.

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[iv] Ibid.
[v] Ibid.
[vi] Ibid
[vii] Erich Altbach, "The Asian Monetary Fund Proposal: A Case Study of Japanese Regional Leadership," *Japan Economic Institute Report,* no. 47A (1997), p. 8.
[viii] Ibid.
[ix] Ibid.
[x] "Global Capitalism: Can It Be Made to Work Better?" *Business Week,* Nov. 6, 2000, p. 42-43
[xi] Robert Pollin, *Contours of Descent* (London: Verso, 2003), p. 131. Pollin excluded China on the grounds that during the 1981-99 era, it did not follow neoliberal policies but, much like the other Asian NICs (Newly Industrializing Countries), put into motion heavily interventionist programs even as it integrated into the capitalist world economy. Also, Walden Bello and Stephanie Rosenfeld, *Dragons in Distress, Asia's Miracle Economies* (London: Penguin, 1992).
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[xiii] Ibid.
[xiv] Barry Eichengreen, *Financial Crisis and What to Do about Them* (Oxford: Oxford University Press, 2002), p. 137.
[xv] Ibid. pp. 137-38.
[xvi] See Anne Krueger, " International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring," address at the American Enterprise Institute, International Monetary Fund, Washington ,http://www.imf.or/external/np/speeches/2001/112601.htm>; also Eichengreen, pp. 148-56
[xvii] Eichengreen, Ibid. p. 150.
[xviii] Quoted in Nicola Bullard, "The Pupper Master Shows His Hand," *Focus on Trade,* no. 76 (April 2002), pp. 3-4 (electronic bulletin, pdf file)
[xix] Ron SUskind, *The Price of Loyalty: George W. Bush, the White House, and the Education of Paul O'Neill* (New York: Simon and Schuster, 2004), pp. 243-44.
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[xxiv] Mark Zacher, "Redesigning the International Financial Architecture: Voting Power and Power Sharing in the IMF," paper delivered at the Conference on International Financial Architecture," Center for Global Studies, University of Victoria, British Columbia, and Aug. 29-30, 2001.
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