The People VS. Corporate Power

Crisis of Credibility : The Declining Power of the International Monetary Fund

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Bangkok - What a difference two decades make! In 1985, the International Monetary Fund (IMF) and the World Bank stood at the pinnacle of their power. Taking advantage of the Third World debt crisis of the early 1980s, both institutions were in the midst of instituting radical free market reforms via "structural adjustment programs" - a cookie-cutter package of economic policies including deregulation, privatization, cuts in government spending and emphasis on exports - in more than 70 developing countries.

Ten years later, in 1995, the IMF stood unchallenged as the centerpiece of the global financial system and was launching its ambitious drive to make capital account liberalization - a requirement that countries remove all restrictions on inflows and outflows of capital - one of the articles of association of the Fund.

But by 2005, the credibility of the IMF was in shreds.

The Unraveling of the IMF

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

East Asian economies were then widely heralded as the leaders of the global economy in the twenty-first century, economies whose average rate of growth would remain at 6 to 8 percent far into the future. 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: over a million people in Thailand and some 21 million people in Indonesia found themselves impoverished in just a few weeks.

Suddenly, the IMF was widely discredited, seen as the architect of the capital account liberalization that created the crisis, and of the severe contraction that followed. The IMF was responsible too in large part for the worsening of that contraction, as it demanded countries plunged into depression restrain government spending - exactly the opposite of sound advice for an economy in contraction.

Throughout the developing world, the January 1998 picture of Michel Camdessus, then the IMF managing director, arms folded, standing over Indonesian President Suharto signing an IMF agreement mandating harsh conditions of stabilization 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.

Indeed, an IMF assessment eventually admitted - though in euphemistic terms - that its whole approach to the Asian financial crisis of fiscal tightening to stabilize exchange rates and restore investor confidence along the way was mistaken: “The 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.”

The Fund’s close association with the interests of the United States - it is often viewed as a vassal of the U.S. Treasury Department - further discredited the Fund.

One of the episodes during the Asian financial 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.” Tokyo proposed the fund, with a possible capitalization of $100 billion, in August 1997, when Southeast Asian currencies were in a free fall. The idea was to create 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.” Not surprisingly, the AMF proposal drew strong support from Southeast Asian governments.

Just as predictably, the AMF aroused strong opposition from both the IMF and the United States . At the IMF-World Bank annual meeting in Hong Kong in September 1997, IMF Managing Director Michel Camdessus and his U.S. 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. Analyst Eric Altbach claims that some U.S. officials “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.” Unwilling to lead an Asian coalition against U.S. wishes, Japan abandoned the proposal that might have prevented the collapse of the Asian economies. The episode left many Asians very resentful of both the IMF and the United States .

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 in over 70 developing and post-socialist economies.

After more than a decade and a half of such policies, it was hard to point to more than a handful of successes, among them the very questionable case of Pinochet's Chile .

Poverty and inequality in most adjusted economies had 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 6 percent in the past two decades. 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 percent, compared to 2.6 percent in the structural adjustment era. In terms of the growth rate of income per capita, the figures were 3.2 percent in the developmental state era and 0.7 in the subsequent two decades.

By the late 1990s, the Fund could no longer pretend that structural 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 Enhanced Structural Adjustment Facility (ESAF) the "Poverty Reduction and Growth Facility" (PRGF). It promised to learn from the World Bank by 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 within the U.S. elite over the role of the Fund to a boil. The U.S. right denounced the Fund for promoting "moral hazard," that is, irresponsible lending that ensured private foreign creditors that they would be paid back no matter what. Some, including former U.S. Treasury Secretary George Shultz, called for the IMF's abolition. Meanwhile, 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 U.S. Congress came within a hair's breath of denying the IMF a $14.5 billion contribution. With arm-twisting on the part of the Clinton administration, the contribution was secured, but it was clear that the long-time internationalist consensus among U.S. 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 agency felt the need for reform 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. The United States argued that the current architecture was basically sound, and that there was no need for major reforms. Though there were differences on some details, this position was shared by the other members of the G-7 group of rich countries.

This approach advocated increased transparency in government finances and national banking laws, tougher bankruptcy laws to eliminate moral hazard, and greater inflow of foreign capital to re-capitalize shattered banks and "stabilize" the local financial system. This latter measure translated in concrete terms into enabling foreign banks to freely buy up local institutions or set up 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 developing 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 developing countries.

Wall Street and other financial centers, as well as their government allies, strongly resisted Tobin taxes (taxes on currency trades across borders) or similar controls designed to slow down capital flows by imposing fees on them at various points in the global financial network. Even when the IMF admitted that capital controls worked to stabilize the Malaysian economy during the 1997 financial crisis, it remained generally opposed to capital controls. The IMF refused to endorse even the gentlest capital controls, like the Chilean encaja, which sought to deter capital volatility by taxing capital inflows that did not remain in the country for a designated period of time and thus avoid volatile movements that could destabilize an economy.

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 gave 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 the Fund had encouraged future acts of irresponsible lending by private creditors by bailing out previous bad loans.

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 view such a move as a sign of crisis, rush to take their capital out of the country, and so precipitate 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 U.S. deputy director of the Fund, Ann Krueger. At the height of the Argentine crisis in 2002, Krueger proposed an orderly work-out process similar to Chapter 11 bankruptcy proceedings in the United States : 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.

Debt cancellation advocates generally applauded the idea of a bankruptcy-type process for debtor countries, but they remained strongly critical of Krueger's proposal. In Krueger's design, the IMF would maintain a great deal of authority to decide when countries were eligible to enter the bankruptcy process and to certify if they had adopted "sound" economic plans for recovery. This scheme might have actually intensified IMF control over poor country economies, they feared.

More decisive opposition to Krueger's proposal came from a different quarter: powerful interests in the U.S. government and financial community were dead set against it. The day after Krueger made her proposal public, John Taylor, the international undersecretary of the U.S. 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.” 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. But when O’Neill was fired by President Bush in December 2002, Krueger lost her strongest supporter. At its April 2003 meeting of the IMF’s International Monetary and Finance Committee, the United States squelched the proposal.

The lack of any real movement in reforming the international financial architecture prompted warnings, by of all people, Robert Rubin, that “[f]inancial crises have continued to rock emerging markets and are likely to remain a factor in the decades ahead.”

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 most significantly by the case of Argentina .

After defaulting on $100 billion of its $140 billion debt, Argentina ’s economy 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 percent of the value of the bonds. He also played hardball with the IMF, telling the Fund, in March 2004, that the country 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.”

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.

P.S.

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