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Current Problems with the IMF and Challenges Ahead – A Latin American Perspective

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There is broad consensus around the idea that the International Monetary Fund is currently a problematic institution. A brief enumeration of the principal, commonly perceived problems would, at the very least, include the following: 1) the institution is no longer fulfilling the functions it used to fulfil, nor is there a clear vision of any new functions for it; 2) due to a drastic pruning of its loan operations, it is not receiving enough revenue to cover its operating costs; 3) the IMF has not played a notable role in the debate about global imbalances, even though this issue is at the very heart of its institutional remit; 4) it is suffering a crisis of legitimacy, with its power structure questioned by many members; 5) there is a lack of confidence, from quite different perspectives, in its intellectual orientation and the quality of its policy recommendations.

This list brings together problems of quite different kinds. It would probably be helpful to consider each of them in greater detail in order to establish whether they have significant implications for the international financial system. For example, the problem of financial resources in item 2) is a consequence of item 1). True enough, the IMF has stopped doing what it used to do, but its shaky finances derive from its failure to define a new role for itself. Both of these points certainly reflect difficulties that the institution is currently facing, but they have no direct impact on the proper functioning of the international financial system. In that respect, they do not seem to beg an urgent solution.

On the other hand, there is that lack of confidence in the Fund's intellectual orientation and recommendations raised by item 5). This lack of confidence in the IMF's orientation and recommendations has been around a long time, but its present magnitude is primarily the legacy of its last major operations before entering the slippery slope where it now finds itself: the programmes it applied in response to the crises in Asia, Russia and Argentina in the late nineties and earlier this decade. These activities prompted new critical voices, alongside the challenges that had emanated for many years from progressive quarters, and some of these criticisms reflect conservative positions. This mass of criticism has not been silenced, although it should be noted that it does not take issue with current – albeit infrequent – IMF operations. Its focus is the future, and a concern that the IMF should not repeat the strategy and recommendations that first elicited these objections. It is directed towards any potential activity the IMF might undertake if its significance is ever restored.

The third reference, summarised in item 4), is to the legitimacy crisis provoked by the institution's power structure. Challenges to the legitimacy of IMF governance also date back a long way, but they are louder than ever before, probably because of shifts in the relative influence and roles of a number of developed countries (in Europe, for example) and newly industrialising economies (such as China and other Asian countries) that have occurred during the latest stages of globalisation. Nevertheless, this conflict is more or less latent, given that no really big issues are currently being resolved at the IMF. This latent conflict would acquire greater urgency if the institution were to start playing a major role again.

This leaves the final point, the IMF's absence from the most important debate in international finance today, the matter raised in item 3). It is hard to think of any topic more appropriate for the IMF to deal with than global imbalances, given the mission assigned to the institution when it was originally founded. If we think about it, this is a different kind of issue from the ones outlined above. Those of us who regard this absence as a problem are actually articulating a complaint. Something that ought to be a "natural" theme for the IMF as a multilateral forum is not being addressed, there or in any other international institution. The explanation is obvious: it seems clear that the United States administration has no intention of putting this question, in which it is a principal player, to the consideration of the multilateral institution, despite the voting power and right of veto that the United States and the other developed countries enjoy.

In fact, any initiatives in this field that have been triggered recently at the Fund are aimed at the very opposite of a broad exploration of this question. One example is the recently approved amendment to the criteria for bilateral supervision of members' exchange policies – which China voted against and which was publicly criticised by the Chinese central bank. The amendment is designed to subject the IMF to the guidance of the US administration when it comes to global imbalances: blame the foreign exchange policies of China and any other countries with a surplus for the problem and put pressure on the countries concerned to imple-

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ment the alleged remedies. More of the same. Traditionally, when a developing country suffers a deficit, the IMF dictates that it must take individual responsibility for balancing its payments. Nowadays, when developing countries find themselves with a surplus, the rules say that once again they must assume the burden of correcting the balance of payments.

Anyway, while the amendment illustrates the influence of the US administration, it also indicates the IMF's weakness in the present context, because the punishment that the IMF can impose on developing countries with a surplus will be confined to a negative diagnosis in the Article 14 consultation report. This simply means adding the voice of the IMF to the pressure exerted, each in its own way, by the government and parliament of the United States.

There is nothing new about the IMF keeping a low profile on major issues of international finance that affect the United States and the developed countries. As an institution the IMF has focussed its activities on the developing countries and been subject to the controlling influence of the United States and the developed nations, with the latter camp setting the course and defining policies for responding to the international financial difficulties of the former. If we see the IMF's silence over global imbalances as a "problem", it is because we challenge the role the IMF should be playing now, and not the role it has been playing since the late fifties.

One conclusion might be drawn from reviewing the diagnosis. The frame for all of this is the poor definition of IMF functions in the present context. The other problematic issues are either derived from this same frame or else represent conflicts that are more or less dormant – redefinition of the power structure and the shift in intellectual orientation and policies – and will only acquire greater weight if the institution returns to the international financial stage in a leading role.

A brief review of the history demonstrates that the functions that the IMF has exercised in practice have never been the result of a carefully considered design rooted in some degree of consensus, but of adapting the institution to deal with situations that had not been foreseen but demanded an urgent response. Repeatedly the institution has been amended "on the fly" to face new problems. It carved its path as it went along.

The IMF was originally conceived as an international institution to complement the fixed exchange rate agreement of 1945. It was supposed to provide short-term finance to palliate any measures needed to correct wobbles in the balance of payments and to encourage autonomous national macroeconomic policies. The active parties to this agreement were the United States and the European countries. The original design did not take account (and this would have been difficult) of developing economies. The fledgling Bretton Woods system became fully effective from 1959, when Europe's economies made their current accounts convertible and abandoned the bilateral approach to international payments and debt. At that point the IMF ceased playing a significant role in responding to imbalances in the accounts of developed countries, the function for which it was conceived and designed. Instead, its activity focussed principally on balance of payments problems encountered by developing countries.

Faced by an emerging crisis in the balance of payments of developing countries, the United States leadership redefined the function of the IMF, dedicating its energies towards this issue. This was the first adaptation "on the fly" of the kind mentioned above. The hallmarks of adjustment programmes and conditionality criteria were defined from the late fifties, initially as part of the response to a balance of payment crisis in Latin America. Argentina was one of the first countries subjected to the experiment.

The period from the late fifties until the early seventies was marked by the virtual inexistence of an international capital market. In this context IMF financing was crucial for developing countries. This explains the influence the institution had during those years and the impact which the IMF's orientation and policies exerted, through its stability programmes and conditionality criteria, on the economic policies of developing countries, especially in Latin America.

The direction and policies pursued by the IMF during that period reaped criticisms and polemics that it would be out of place to rehearse in detail here. Suffice to say that this is when what might be called the corpus of IMF doctrine took shape, crystallising into an institutional tradition and laying a basis for the Fund's action in subsequent years, even though the original conditions had changed. Before financial globalisation, balance of payment crises in developing countries stemmed from problematic flows in external accounts, in particular trading accounts. By contrast, the balance of payment crises in the eighties and later were due in the main to problems with stock (foreign debt) and financial flows. As

we shall see in a moment, the IMF's orientation and policies for these new situations had to be adapted quickly, and yet many elements of the old doctrine survived – dinosaurs at times, at odds with the new reality of these external crises confronting the developing economies. One notable dinosaur remains is the fiscal austerity imposed as a condition in the earliest programmes in response to the Asian crises.

Major contextual changes occurred in international finance from the mid-seventies onwards. After fixed exchange rates were abandoned and the first oil shock hit, financial globalisation set in and expanded. This process not only embraced the developed countries, but from the outset the Latin American economies, too.

IMF activity was downsizing during this first stage of financial globalisation in the second half of the seventies. Many developing countries had access to market financing, and so the Fund focussed on smaller countries that had no access to these sources. Some countries (like Argentina in 1976) agreed to IMF programmes at that time because they wanted its seal of approval as a key that would open the door to loans from international banks. While the first phase of financial globalisation was in full swing, the Fund's own financial activities were on the wane. Instead the institution was supplying the credentials for accelerated borrowing. The IMF explicitly supported the policies that eventually led to the first global financial crisis: the Latin American debt crisis of 1981-82.

Latin America's foreign debt crisis triggered another change in the role of the IMF. Once again the institution was adapted on the fly under the leadership of the US administration. North American banks were the main creditors and the Federal Reserve took on the job of managing the crisis. The IMF was redefined to function as an auditor and finance provider, country by country, in a tripartite negotiating model – national government, international banks, IMF – conceived by the United States. It had begun with the Mexican experience. The Fund became a linchpin in negotiations on restructuring defaulted debt. IMF conditionality established the programmes underlying the restructuring agreements concluded with the banks. Progress reviews of the programmes agreed with the Fund, the condition for disbursements, provided the creditors with the audits they needed to supply the "fresh finance" (that is, refinance part of the original commitment).

From the mid-eighties, starting with the Baker Plan, the IMF was the lead agency channelling the multilateral funds available – its own, those of the World Bank and those of the International Development Bank in the case of Latin America – into restructuring the default debt sustained by the commercial banks. The conditionality for these structural adjustment programmes essentially resulted in the "Washington consensus".

The IMF began to play a new role as both judge and party in negotiations on restructuring the default debt of developing countries. The developed countries exercised considerable weight in the running of the IMF, and this granted them political control over the process. As we shall see below, the role the IMF played during this period was later the object of unsuccessful revival efforts in the form of the Sovereign Debt Restructuring Mechanism (SDRM), initiative driven by Anne Krueger's team.

Financial globalisation picked up speed and spread geographically from the early nineties, when Latin America returned to the stage in the wake of the Brady Plan, along with the rise of new, emerging markets in the former socialist economies and the opening up of capital accounts in the economies of Asia. The process was on a roller until the Mexican crisis of late 1994.

The Mexican crisis marks another redefinition of the IMF's prime function. Building on the role the Fund was to play in rescuing Mexico (and the similar package offered to Argentina in March 1995), the main role of the IMF gradually shifted towards that of lender of last resort in balance of payment crises within the globalised financial system. The IMF not only assumed the task of leadership and establishing the conditionality for these rescue packages, but was also providing large and growing volumes of finance. New instruments were devised to serve this. Some were poorly designed, such as the Contingent Credit Line (CCL), which no country sought to take up. A more notable instrument was the Supplemental Reserve Facility, which allows the IMF to make big sums of money available quickly. The SRF was first used in the programme to support Korea and later, for example, during the Brazilian crisis and for the "*blindaje*" (shield) put together for Argentina at the end of 2000.

As we have seen, this further adaptation reflected the context of financial globalisation in the nineties and the recognition that balance of payment crises and foreign borrowing were now a frequent occurrence. Once again, the IMF's role was redefined "on the fly". This time the adaptation meant a growing function as lender of last resort. Like previous adaptations, this innovation was led by the US administration and motivated by specific urgent circumstances, such as the Mexican and Asian crises. Once again, the changes hobbled along behind events.

The Asian crises provoked concern, and the idea of redesigning the multilateral institutions or creating new ones better attuned to the new features of the globalised financial system began to take hold. Discussions about the "international financial architecture" now began, and initiatives and agreements for improving the dissemination of information and access to it began to take shape. There was considerable academic debate and a number of proposals emerged for reforms and new institutions. However, the debate and the initiatives petered out as the international financial situation stabilised again. In the late nineties, the international financial architecture was no longer a fashionable topic, basically due to a lack of interest on the part of the governments of the developed nations, and above all because of the stance of the US administration.

The new role assumed by the IMF during the latter half of the nineties was criticised by the progressive camp and the conservative camp alike. In general terms, the progressives took a favourable view of the IMF's new role, but they criticised the orientation and policies surrounding conditionality. To sum up, the progressives demanded a greater volume of available funds, speedier access to these for countries in crisis, and conditionality that was more specific and less targeted at national policies or institutions that had not had much to do with the emergence of the crises in the first place.

The new quality was the vigour of conservative criticisms. These related mainly to the "moral hazard" that IMF intervention was generating in the international financial system, provoking irresponsible behaviour by governments and audacity on the part of lenders. The criticisms indicated that the IMF's growing role as lender of last resort was tending to foster excessive debt and instability, rather than shoring up the stability of the system.

This latest shift in the principal role of the IMF, which began with the Mexican crisis, took place under the Democratic administration in the United States. The conservative criticisms voiced about the IMF's new role figured among the arguments put forward by Republicans in the election campaign that resulted in their victory. The fact that the last rescue package granted by the Fund during the Democratic administration was the one offered to Argentina in late 2000 helped to discredit its intervention and fanned the flames of the conservative case. In 2001, with a new government in the United States and the subsequent change in the IMF's own administration, criticisms of the Fund focused on its own good governance.

The thwarted initiative to define a new role for the IMF through the SDRM seems to have been an effort by the institution itself to retain an important position within the international system. Rather than acting as the lender of last resort, a role it had been building only to retreat again now, the IMF was to become a force for restructuring debt following default scenarios triggered by the new crises that inevitably developed, as there were no more rescue packages. As suggested above, the SDRM initiative seems to have been greatly inspired by the role the IMF played in Latin American debt negotiations during the eighties. The idea was to recreate this role within a context where the creditors were now numerous bond holders rather than a handful of lending banks, as in the eighties. The role the IMF played within this concept was that of judge and party alike. Although the initiative had been instigated by the government of the United States, this very same administration now terminated it under fierce pressure from Wall Street.

To sum up, the last role of significance played by the IMF in the international financial system was terminated by the government of the United States without anything new to replace it. That is one reason why the institution lacks direction. As we cast our minds back across the evolution of IMF functions, it does appear that the developed countries, and above all the United States, have lacked the motivation to propel the IMF towards renewed significance. The institution is languishing because these governments have not been confronted by any new emergencies emanating from the developing world that might require treatment under their control, using the IMF.

The fact is that, since the crises in Argentina and Turkey earlier this decade, there has not been any major crisis in the balance of payments of an emerging economy. Two kinds of factors coincide to account for this striking change in the evolution of the global financial system. First, many countries have introduced changes in the macroeconomic policies. Following the Asian crisis, a number of them entered the currency exchange markets to preserve their competitive position and build international reserves. These competition policies took the form of "managed floating", regimes that – while reserves are accumulating – reduce vulnerabilities to volatile capital flows and other negative external shocks. Apart from China and India, other Asian countries have pursued this course in the wake of crisis. Russia joined them from 1999 and Argentina from 2002. In reality, these "managed floating" regimes combined with reserve-building are more broadly practised than competitive exchange rate policies. Countries that have notably appreciated their domestic currencies in recent years, such as Brazil and Russia, frequently still participate in the exchange markets and have accumulated major international reserves.

Parallel to this, the present decade has witnessed the biggest change in the process of financial globalisation since it began over thirty years ago. Net flows of capital now move from developing to developed countries, reversing the former situation. The increase in oil and commodity prices that began in 2002 has combined with the exchange rate policies of certain countries to generate substantial current account surpluses in a number of developing economies. Current accounts in surplus coupled with large reserves are features of external solidity, and they are seen as such by the world's financial market. Although some current accounts in major emerging market economies are still displaying deficits – including, strangely enough, Turkey, which has remained an IMF debtor – these deficits are few in number. The relative isolation of deficit economies contributes indirectly to their strength, as it reduces the risk of contagion and herd behaviour in relation to the asset "class" of emerging markets. These data shed clear light on the reasons why country risk premiums for the emerging markets have reached their lowest levels in recent years – hitting rock bottom, for example, in early 2007. In the critical episode that exploded in mid-July 2007 – the biggest this decade – the assets of emerging markets responded with relative stability. Neither this episode nor the other critical episodes that had occurred in the course of the decade triggered a balance of payment crisis in an emerging market.

Briefly, the decision to deactivate the function of lender of last resort that took place in the latter nineties has not yet been put to the test due to a major, unforeseen shift in the globalisation process.

Any discussion of the IMF's future role within the globalised financial system must begin by considering the overall context that has been unfolding over this decade and what will happen next. The new financial context for developing economies is another side of the coin to the current account deficit in the United States (remembering that Japan and Germany are also showing a big surplus). It follows that any discussion of future trends in the financial system and preventive policies to avoid what some call a "disorderly adjustment" – a possible international financial crisis – must be global in nature, addressing the macroeconomic policies of both developing and developed countries. However, as we have already seen, the United States does not intend to submit consideration of this question to either the IMF or any other multilateral forum.

Meanwhile, the official doctrine of the IMF does not seem to recognise the virtues of this new context for developing countries in terms of financial solidity and growth. For example, the institution continues officially recommending macroeconomic policies based on pure floating and inflation targeting. In the present context pure floating means appreciating exchange rates and ceasing to accumulate reserves, consequently reducing the current account surplus and the rate of growth. At the same time, and contrary to official doctrine, the institution's research department recently published several works covering a broad historical and geographical spectrum that show the correlation between growth, net income on current account and maintaining depreciated exchange rates. The contradictions seem worthy of an institution that cannot find its rightful place.

So far we have expressed a mixture of optimism and pessimism – optimism about the new financial context for developing economies with no need for the functions that the IMF has exercised in the past, and pessimism in that we see little chance of the institution recognising the virtuous aspects of this context and working on the risks

entailed. It would take a revival of the Bretton Woods spirit for a reformed IMF, with a governance structure more in tune with the real weight of its members, to constitute a forum that would consider the problems of coordinating macroeconomic policies as required by the globalised system. That would be desirable, but there are no signs of a will to revive that spirit in the United States or the other developed nations.

Within the above framework, the countries of Latin America are taking their place in the new context with a diverse range of economic policies. Comparative analysis would certainly be useful, along with debate about the various treatments accorded to macroeconomic policies, strategies for engaging in the international financial system, the development of the financial sector, inflation, tax and trade incentives. But the IMF does not appear to be the most suitable place to conduct this analysis and debate. I still believe, for the time being, that the Fund is best kept at arm's length.

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