Future Role of the IMF: A Developing Country Point of View

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Introduction

This paper seeks to address some of the issues that have arisen from the recent world-wide debates on the future role of the International Monetary Fund in the wake of its management of the Mexican, Asian, Russian and Brazilian financial crises. The debates have been particularly intense in the USA during and since the passage of legislation in the US Congress for the authorisation of an increase in the US quota and its credit line in the New Arrangements to Borrow (NAB), and following the submission of a report by a US Congressional Commission headed by Professor Alan Meltzer.[1]

At one extreme is a position taken by conservatives like former US Treasury Secretary George Schultz who proposes the abolition of the IMF on the grounds that its crisis lending operations generate an unacceptable degree of moral hazard for the private financial system, as well as for sovereign borrowers. In the same camp are abolitionists on the far left of the political spectrum who regard the IMF as the modern-day replacement of 18th-century 'gun-boat' diplomacy. They are convinced that the IMF serves the imperialist designs of its principal shareholders, and imposes harsh conditionalities on the populations of poor countries to ensure the servicing of debts owed to creditor governments and financial institutions in the advanced capitalist countries. Others with a less hostile orientation advocate the merging of the IMF into the World Bank Group.

At the other extreme is the view that if the IMF did not exist, it would have to be invented. It is regarded by its supporters as playing a constructive role as an international credit co-operative serving its universal membership with impartial macro-economic policy advice, technical assistance and financing for countries encountering temporary balance of payments problems. At this end of the spectrum, the debate focuses on how to enlarge its role in the global economy in a variety of ways: as a genuine lender of last resort and as creator of international liquidity through its prototype SDR mechanism; as an umpire in orderly debt negotiations between creditors, private and official, and their sovereign

[1] International Financial Institution Advisory Commission (IFIAC) Report, 8 March 2000.

debtors; as an international authority endowed with powers to declare a 'standstill' on legal actions that private creditors might take to enforce their claims on sovereign debtors; and, finally, as an overseer of the international monetary system, exercising effective surveillance over the exchange rate policies of the major international currency countries.

Within this broad range of views, a series of intermediate positions have been advanced by official and non-official groups, including academics and representatives of non-governmental organisations and by representatives of developing countries.[1] The majority in the Meltzer Commission would restrict the IMF to a crisis prevention and response role through very short-term, essentially unconditional, liquidity support for a limited number of relatively strong emerging countries which have pre-qualified for IMF assistance. The main report would eliminate the Poverty Reduction and Growth Facility (PRGF), restrict IMF surveillance to non-OECD member countries and write off all IMF claims against its Heavily Indebted Poor Country (HIPC) members. However, four members of the Meltzer Commission have taken a sharply different view on some of the major recommendations made by the Commission's majority report.[2] In an address in London[3] delivered late last year, US Treasury Secretary Lawrence Summers observed: 'to say that the IMF is indispensable is not to say that we can be satisfied with the one we now have'. He then proceeded to argue that in a world dominated by private capital flows, the IMF must accept 'a more selective role that is focused on emergency situations' and 'a more limited role in the poorest countries focused on growth and poverty reduction'. The PRGF would be maintained and selectivity in respect of other transactions would be enforced by lending for shorter maturities and at higher interest charges.

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[1]The US Treasury, responding to the IFIAC Report in a document dated 8 June 2000, finds itself 'in fundamental disagreement' with that Report's core recommendations for further reform. Among recent non-official reports from US bodies, mention may be made of three: (1) Council on Foreign Relations Independent Task Force (CFR) *Report on the Future of the International Financial Architecture*, New York, September 1999; (2) International Center for Monetary and Banking Studies, Geneva and Center for Economic Policy Research, London *Report on An Independent and Accountable IMF*, 1999; and (3) Overseas Development Council (ODC) Report *The Future Role of the IMF in Development*, Washington DC, April 2000. An unofficial G-24 position is articulated in a paper prepared by Montek Ahluwalia titled 'The IMF and the World Bank in the New Financial Architecture' in *International Monetary and Financial Issues for the 1990s*, Vol XI, New York and Geneva, United Nations, 1999; official G-24 positions are stated in the press communiques of the Group issued in September 1999 and April 2000 (reproduced in the IMF *Survey*).

[2]Joint Dissenting Statement signed by four members: C. Fred Bergsten, Richard Huber, Jerome Levinson and Esteban Edward Torres; three of them did not sign the main Report.

[3]'The Right Kind of IMF for a Stable Global System', delivered at the London Business School on 14 December 1999.

The US Treasury response broadly follows the lines of the Treasury Secretary's London address.

In another recent report from official sources,[1] the UK Treasury Committee is not convinced that 'the IMF has the correct expertise to undertake major debt relief programmes in developing countries'. It wants the IMF to 'pull back from such programmes and concentrate on its original mandate'. It warns that unless the roles of the IMF and the World Bank Group are clarified: 'the level of overlap increases the argument for a merger'. The Committee urges that a major area of the Fund's work – on codes, international standards and financial regulation – should be given a 'higher priority'.

The positions articulated in the preceding paragraphs by authoritative sources in some of the principal shareholder members of the Fund stand in contrast to several major addresses delivered by the former Managing Director of the IMF, Michel Camdessus, in the days just prior to his retirement[2] and to the submission made by Stanley Fischer, First Deputy Managing Director, to the Meltzer Commission.[3] The new Managing Director of the IMF, Horst Köhler, has also now begun to articulate his preliminary thinking on the role of the Fund.[4]

In the following sections, the main issues regarding the Fund's role are discussed, using the arguments of the protagonists but without identifying the source of each argument. Rather the objective is to present both sides of the issue as a backdrop to articulating a developing country position.

Issues Arising from Recent Policy Declarations and Reports

Several issues have been the subject of contention in recent days. It is proposed to review them in the following paragraphs. Some of the argumentation is inevitably repetitive since the issues are overlapping.

Country eligibility for IMF assistance: As noted earlier, a strong case has been made for restricting the Fund's financing role to emerging market

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[1]HM Treasury, Third Report, Treasury Committee, Session 1999–2000.

[2]Remarks at the Council on Foreign Relations entitled 'An agenda for the IMF at the start of the 21st Century' (New York) and at the Institute for the Study of Diplomacy, School of Foreign Service, Georgetown University, entitled 'The IMF We Need', both in February 2000.

[3]Presentation to the IFIAC on 2 February 2 2000.

[4]Notably in a speech delivered to the International Monetary Conference in Paris, 30 May 2000. IMF *Survey*, Vol. 29, No 11, 5 June 2000.

economies in financial crises and to providing them with short-term emergency loans at penalty interest rates. The basic argument for restricting the IMF role to that of a quasi-lender of last resort in a limited number of cases is that Fund operations generate moral hazard for both private lenders and sovereign borrowers. The Fund's intervention is said to allow short-term creditors (such as the international banks whose claims are not 'marked to market') to be paid off in full and, in the case of other creditors, its action is said to delay mutually negotiated debt work-outs. Moreover, interruptions in Fund programmes due to the difficulty of meeting the number and variety of conditions attaching to IMF programmes are said to impair the return of confidence in the borrowing country. Finally, the austerity prescriptions incorporated in Fund programmes are said to impose enormous costs on both debtor governments and the general population, especially wage-earners. Much is made of the 'ambiguous' evidence of the impact of Fund programmes in many countries and their usefulness is said to be confined only to cases where financial crises in 'systemically significant' countries can produce, through contagion, serious consequences for otherwise solvent trading and investment partners.

The fundamental flaw in arguing from the evidence of past IMF programmes is that it fails to consider the counterfactual. The 'before' and 'after' dichotomy leaves no room for 'with' and 'without' considerations, i.e. what would have transpired if the Fund had not intervened. The argument for restricting Fund action to countries that are 'systemically significant' assumes that these can be unequivocally identified in advance. As Michel Camdessus asks: 'who prior to July 1997 would have regarded Thailand as belonging to the "systemically significant" category?'

The growing integration of an increasing number of developing countries into global financial markets has created a powerful case for treating member countries of the IMF on a more, rather than a less, equal basis when it comes to access to IMF financial support. Also not to be ignored are the legal rights and obligations of members as laid down in the Fund's Articles of Agreement and the accumulated precedents and practices of the Fund as they have evolved over the past 50 years. These create a powerful equity case for universal access to the resources of a credit cooperative to which all members have contributed.

Involvement in poverty alleviation and debt reduction (HIPC) cases: The principal argument for pulling the IMF out of the poverty alleviation area is that as a short-term balance of payments adjustment lender, its core competency is, and should remain, macro-economic policy analysis. The

IMF is said to lack the wide expertise required to deal with poverty issues,[1] which have deep-rooted structural and institutional causes, and which are only treatable over the very long term. There is also the argument that if the IMF were to try to build its expertise in the poverty area, this would add to the degree of overlap that already prevails vis-à-vis the World Bank Group and that this would strengthen the argument for merging the two institutions. Finally, there is a strongly held view on the part of some in the NGO community that by clothing it with the mantle of poverty – by changing the name of the Enhanced Structural Adjustment Facility to the Poverty Reduction and Growth Facility G-7 – governments are seeking to maintain the IMF's traditional role as gatekeeper for debt relief operations, and thereby to justify the application of IMF conditionality to even the poorest of its member countries.

There are several counter-arguments to the preceding view. Poverty alleviation is simply not possible without a strong macro-economic policy environment and the IMF has a unique expertise in designing the essential policy requirements in this crucial sphere. But advice is not likely to be taken seriously unless there is a promise of financial help to go with it. This is not a matter of 'bribing' decision-makers to undertake reform. Rather, it is only realistic to recognise that countries are not monolithic entities and the pressures exerted by the spending ministries (like the military) within the government for larger budgets are difficult for policymakers concerned with financial sustainability to resist unless they can deploy some countervailing arguments in support of their belt-tightening recommendations. Indeed, there are always interest groups outside government that are beneficiaries of the status quo (for example, employers who would rather hire child labour instead of paying adult wages) and who are apt to be well-represented within the governing elites. Reformers within governments must be able to point to some visible, palpable benefit from pursuing pro-poor policies and this means that the IMF must have resources to offer to back up good advice and technical assistance. Moreover, as pointed out by Stanley Fischer: 'governments and markets alike appear to place greater value on financial agreements with the Fund, possibly because the provision of resources is still seen to represent a greater commitment by the official sector'.[2]

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[1]As an example, Paul Collier and Jan Willem Gunning argue that 'both the sectoral and the household-level analyses needed for a reasonable estimation of the social consequences of adjustment . . . are beyond the Fund's traditional expertise . . . . Fund staff have been recruited for their expertise in macro-economics.' *Economic Journal* 109. Royal Economic Society, November 1999, F634–F651.

[2]Op.cit., fn 7, supra.

Moreover, the IMF has a long record of working with the poorer countries in its membership who are just as likely as better-off countries to suffer balance of payments difficulties from a variety of causes, including terms of trade shocks, crop failures, export market disruptions and natural disasters, not to speak of bad economic management. The international community has recognised that poor countries will need IMF help but cannot afford to pay regular Fund charges. It has therefore been willing to entrust the IMF with the necessary means to subsidise its dealings with these members rather than depriving them of the right of access enjoyed by all members under the Articles of Agreement.

The launching of the HIPC in 1996, and its enhancement in 1999, has reinforced the need for the role which the IMF has traditionally played in the Paris Club, and in its handling of the Latin American debt problems of the 1980s and of the problems of transitional countries in the 1990s. Creditor countries want debt relief offered under the HIPC to be used to increase spending on poverty alleviation; they also want an assurance that the debtor country will follow prudent macro-economic policies so that a debt problem will not recur. They have been prepared to allow the IMF to mobilise a part of its 'hidden' reserve (in the shape of gold holdings that are carried on its books at far below the current market price) in order to enable the IMF to provide relief on its own claims against countries eligible for debt relief under the HIPC programme. The IMF has also been able to mobilise additional bilateral funding from as many as 93 of its members (which indicates that a large number of developing country members have contributed) to the PRGF-HIPC Trust for an amount which exceeded $1.5 billion by the end of April 2000. There is no assurance that a large part of the commitments obtained by the IMF will not simply fall away because donor governments will be unwilling to go back to their legislative bodies to authorise the switching of appropriations to the World Bank if the PRGF is transferred to that institution. Indeed there is a strong risk that this might happen.

Nor should IMF involvement necessarily require that it develops its own intensive expertise in all aspects of poverty alleviation. The IMF management has recognised the need for close co-ordination and a clear delineation of responsibilities between the IMF and the World Bank. Stanley Fischer, the IMF's First Deputy Managing Director, in his presentation to the Meltzer Commission, has gone on record to the effect that 'the World Bank *will take the lead* in helping countries formulate their poverty reduction strategies *and in lending for those purposes*. For its part, the IMF has to take into account the fiscal implications of anti-poverty programmes when designing the macro-economic framework. Together with the World Bank, it needs to ensure that the impact of the necessary macro-economic measures on the poor has been properly analysed and the potential adverse effects minimised – *the latter typically by means of World Bank supported programmes*'[1] (emphasis supplied). Similar views are attributed to the new Managing Director. Moreover, as argued elsewhere,[2] the deadline-driven country focus of the IMF work environment provides an essential complement to the undoubted expertise that the World Bank and the other regional development banks deploy in the poverty reduction area; developing countries will want the IMF to be involved to help ensure timely outcomes in the poverty reduction and HIPC areas.

The IMF as lender of last resort (LLR): There is a general acceptance of the proposition that the IMF is the 'closest that the international financial system has to a lender of last resort';[3] but there is an unwillingness 'to confirm the IMF in this role' or to accept the logical implications of its playing this role in an effective manner. These implications were spelt out in two papers prepared for the G-24 Research Programme in September 1999;[4] they received support in one of Michel Camdessus's pre-retirement speeches in which he proposed that 'in the event of a systemic credit crunch' the IMF be 'authorised to inject additional liquidity – and to withdraw it when the need has passed – in a manner analogous to that of a national central bank, through the creation and selective allocation of SDRs'.[5] The Independent Task Force of the Council on Foreign Relations proposed a 'contagion facility [that] would be funded by pooling a one-off allocation of SDRs'.[6]

These proposals have met with strong objections from those preoccupied with the moral hazard problem. Even those who support them have contemplated invoking such a facility in 'rare situations of widespread cross-border contagion of financial crises where failure to intervene would

[1]The US Treasury Response takes a similar line when arguing that there has to be 'a clear division of labour between the World Bank and the IMF, with the Bank taking the lead in providing advice on the design of growth-enhancing national poverty reduction strategies and structural reforms while the Fund will focus on promoting sound macro-economic policy and structural reforms in related areas, such as tax policy and fiscal management'. Op. cit., fn 2, supra, pp.22–23.

[2]In a paper on the 'Future Role of the World Bank Group' prepared by Aziz Ali Mohammed for the Commonwealth Secretariat seminar, 22–23 June 2000. Mimeo.

[3]Op. cit., fn 6, supra.

[4]Montek S. Ahluwalia. 'The IMF and the World Bank in the New Financial Architecture'; Aziz Ali Mohammed. 'Adequacy of International Liquidity in the Current Financial Environment', in *International Monetary and Financial Issues for the 1990s*, Vol. XI. United Nations, 1999.

[5]Op. cit., fn 6, supra.

[6]Op. cit., fn 5, supra.

threaten the performance of the world economy'.[1] However, it is essential to have in place a simple mechanism which could decisively underpin confidence in the international system. The need for some such mechanism has clearly intensified in light of the continued volatility of private capital flows, the powerful resistance of private sector interests to official proposals for their involvement in the management of financial crises and the rather limited use made of the Supplemental Reserve Facility (SRF) and the non-use of Contingent Credit Lines (CCL). Hence there remains a need to continue to explore the merits of establishing an international lender of last resort. Current discussions of the pre-qualification criteria for access to a revised CCL need to proceed in tandem with an analysis of the requirements for an effective LLR, i.e. one able to create international liquidity freely and to deploy it rapidly to deal with widespread financial crises.

The IMF role in debt negotiations: In the absence of an LLR facility, the IMF has been required to provide large multiples of the quota to crisis-affected countries, as well as to call on the Multilateral Development Banks (MDBs) and individual governments for support. Apart from the problems encountered in obtaining funding, these operations are said to have generated unacceptable moral hazard for the private financial system. The solution to both these problems has been sought in options for involving the private sector in the resolution of financial crises. Little progress is noticeable because of wide differences of approach among the major financial authorities and the powerful resistance of the private financial services industry, except in the area of encouraging the use of collective action clauses in international bond contracts. From a developing country point of view, the issue needs to be framed in the broader context of evolving a more *orderly*, as well as a more *equitable*, set of arrangements to deal with the problems of sovereign debtors, so as to create an appropriate sharing of costs and responsibilities between them and their creditors, whether private or official.

In the absence of an international bankruptcy code, the existing patchwork makes for long delays in reaching agreements, during which considerable, if not irretrievable, damage is incurred by the debtor country. A first step in achieving an orderly debt work-out and 'the key to stopping an international financial panic', is 'a temporary standstill on international debt payments, much like the payments standstill that features prominently in most domestic bankruptcy proceedings'.[2] While voluntary

[1]Ibid.

[2]Steven Radelet. 'Orderly Workouts for Cross-Border Private Debt', Vol. XI, op.cit., fn 12 i. supra.

market-based standstills are much to be preferred, a mandatory stay on legal action by creditors has been proposed in order to minimise the risk of disruptive litigation by means of a modification or a re-interpretation of Article VIII, Section 2(b) of the IMF Articles. The chances of such options being implemented are minimal and it would be fruitless to argue for any standstill to be authorised by the IMF. Much better would be some mechanism for the debtor country itself to declare a temporary standstill, and to choose how extensive to make the standstill, while it is negotiating with the IMF for financial support.[1]

Another option for an orderly debt work-out would be the arranging of debt rollovers, as illustrated by the recent Korean case, and the possibility of providing 'financing-in-place', as is the case when the IMF is prepared to 'lend into payments arrears'. The criteria for such lending must be carefully defined; thus, the IMF must assure itself that the debtor country is negotiating in good faith with its creditors at the same time as it ensures that recalcitrant creditors do not hold up the provision of IMF assistance.

It is the framework for such negotiations that constitutes the final step in the debt work-out process. The role of the IMF in this process is a delicate one, especially if it is a creditor of the debtor country and enjoys a 'preferred creditor' status. Even otherwise, it is important to preserve the principle that the IMF is not a party to the negotiations between the country and its creditors. 'The IMF should play the role of facilitator – and not an arbiter – for an agreement between countries . . . and [their] private commercial creditors.'[2]

Surveillance issues: A number of issues are in contention in this area. One of the more easily resolved is whether IMF surveillance should be exercised on a selective basis (as proposed, for instance, by the Meltzer Commission, which would exempt OECD members) or be universal. Given the cardinal importance of the principle of the uniformity of treatment of members enshrined in the Fund's Articles of Agreement, such an opting-out provision would not be acceptable on equity grounds alone.

Another question relates to the content of surveillance, for example whether it should be restricted to the core competence of the IMF – macro-economic policy and management. There has been a widespread

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[1]John Williamson has proposed that the IMF 'certify that the debtor is negotiating to restructure its debts in good faith as a condition for receiving interim finance, and that it gets a final agreement only after the debts have been successfully restructured'. Paper commissioned by the Commonwealth Secretariat, 'The Role of the IMF: A Guide to the Reports', May 2000. Mimeo.

[2]Speech of the President of the Central Reserve Bank of Peru, Dr. German Suarez, inaugurating the 12th Technical Group Meeting of the G-24. Lima, March 2000.

feeling among IMF critics that 'mission creep' on the part of the IMF has tended to enlarge the coverage of the surveillance exercise to the detriment of its operational focus, and that the IMF has moved into areas where it has no particular comparative advantage. On the other hand, it has been argued that 'effective, credible policy implementation hinges on the broader issues of sound economic institutions, structural reforms and the implementation of international standards'.[1] A practical argument for extending the scope of surveillance, and one which appeals to developing countries, is that because the obligation to accept the Fund's oversight applies to the entire membership, it is the only international institution that has the credibility within the financial community to serve as the lead agency for monitoring diverse areas of activity in both developed and developing countries.

Yet another issue in the surveillance area is its primary purpose. Should it be the primary means of transferring 'cutting-edge' knowledge of best practices, including the application of international standards of transparency and codes of good fiscal and monetary policies and procedures? Or should it be the main instrument of crisis prevention? While there need be no hard-and-fast choices here, there is a question to which the answer depends on who is the addressee for this function. In recent times, much emphasis has been placed on responsibility for crisis prevention and critics have argued that IMF surveillance either failed to detect the vulnerabilities in particular countries or failed to provide early warning on their likely onset. A great deal of emphasis on transparency and disclosure has been justified on the grounds that the focus of surveillance should shift from 'collecting and sharing information within the club of nations . . . to promoting the collection and dissemination of information for markets and investors.'[2] The issue goes to the *raison d'être* of a public intergovernmental institution. Whom does the IMF serve – its member governments or the private financial services industry which is mainly located in a few industrial countries? As a co-operative of governments, the IMF cannot be expected to issue public warnings that are likely to become self-fulfilling prophecies. Nor should insistence on IMF transparency be pushed to the point where it begins to affect the trust of governments in the confidentiality of their exchanges with the institution in the course of exercising the surveillance function. While the dissemination of information to markets can be justified, developing countries tend to resist pushing the IMF into the role of a super-rating agency for the benefit of private market participants.

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[1]ODC Report, op. cit., fn 2, supra.

[2]Op. cit., fn 4, Summers.

IMF conditionality: This issue has always been a contentious one and acrimony over it intensified after IMF interventions in the East Asian countries[1] and the subsequent crises in Russia and Brazil. The main charge made by the critics is that by insisting on fiscal austerity, high interest rates and exchange rate depreciations in East Asia, and by initially supporting fixed exchange rates in Russia and Brazil and then changing course, the IMF prescriptions made a bad situation much worse. There is no question that operating in an environment of unparalleled crisis and with data either incomplete or inaccurate, the IMF staff were forced to take major decisions under enormous time and data constraints. That mistakes were made is true; the IMF did reverse course, but a good deal of damage would have been done in the interregnum. This is a risk that all policy-makers face, whether in the private or public sector, when decisions have to be made in an atmosphere of crisis and with profound uncertainties about the outcome.[2] With the V-shaped recovery under way in most of the Asian countries and in Brazil, the criticism has abated somewhat.

A quite different approach has gained some currency. The Meltzer Commission, for instance, has argued that the IMF be precluded from conditioning its support to member countries on the achievement of economic reforms, other than reforms required to meet pre-qualification conditions. Even the Commission, however, would require the IMF to establish 'a proper fiscal requirement to assure that IMF resources would not be used to sustain irresponsible budget policies'. As this paper has argued, there are always contending factions within governments and IMF conditions, including 'prior conditions', are frequently used by those advocating reform policies as a means of overcoming resistance from other parts of the official apparatus. Developing country representatives on the IMF Executive Board have, by and large, accepted IMF conditionality as a fact of life, although there has been much resistance to some of the newer conditions that have been applied under the rubric of 'governance conditionality'.[3]

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[1]The most acrid critique was launched by Joseph Stiglitz, former World Bank Chief Economist, in an article in *New Republic*, 17 April 17 2000.

[2]Robert Rubin, a former US Treasury Secretary, has pointed out that in public life, 'critics . . . always punish risk-taking if it is unsuccessful – no matter how sound the decision may have been – and that all too often deters sensible risk taking in the public sector. . . . Too often, public servants are held to a standard of being error-free – a standard that those that suffer from the frailty of being human beings can only meet by doing nothing'. Remarks made at the World Affairs Institute Award Dinner, Washington DC, 26 April 2000.

[3]For a good analysis of this subject, see Devesh Kapur and Richard Webb. 'Governance-Related Conditionalities of the IFIs'. Paper presented to the XII Technical Group Meeting of the Intergovernmental Group of 24. Lima, Peru, March 2000. Mimeo.

Capital liberalisation: This issue has tended to recede somewhat from the peak of interest in it reached at the annual meetings of the institution in Hong Kong in 1997 when recommendations were made for investing the IMF with statutory authority to promote capital liberalisation. A number of studies conducted subsequently, both inside and outside the IMF, have adopted a position that is far less ideological; support for open capital accounts has been qualified with references to liberalisation being gradual, prudent and orderly. Developing countries would prefer a Fund position where the possibility of maintaining capital controls as a regular instrument of national policy is recognised, rather than their being regarded merely as a temporary device to deal with emergency situations in countries with poor financial regulation. This is particularly necessary to deal with the issue of the choice of exchange regimes in a world of freer capital movements. Developing countries are being pushed to choose between 'corner' solutions. They might prefer intermediate regimes supported by capital controls, whether of a market-oriented character (as in Chile in the past) or of an administrative nature.