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Improve Living Standards in Poor Countries: Reform the International Monetary Fund

Ross P. Buckley*

The International Monetary Fund was primarily established to facilitate the management of a fixed exchange rate regime designed to promote global trade. It did this in the 1950s and 1960s. It was a good idea for its time. That time ended with the floating of exchange rates in the 1970s. Since then the Fund has become the economic policy director of countries in crisis, a role it is ill-suited to serve, and which it has fulfilled poorly. This essay reviews the Fund’s performance in managing the debt crisis of the 1980s, the East Asian crisis of the late 1990s, Argentina’s crisis early this decade and poverty in Africa generally. It then assesses the Fund’s capacity to reinvent itself and concludes the time has come for a far reaching and fundamental reform in the mission of the Fund – a reform to return it to its original mandate and remove it from setting economic policy for countries in crisis.

I. INTRODUCTION

The International Monetary Fund (the Fund) was founded, along with the World Bank, in 1945. In the words of its website, ‘It was established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment.’

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This is a reasonable summary. In the words of its constituent document, the Articles of Agreement of the Fund, the Fund was established to:

- “promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems”;

- “facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy”;

- “promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation”;

- “assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade”;

- “give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity”; and

- “in accordance with the above, shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members”. ²

But the website proceeds, ‘Since the IMF was established its purposes have remained unchanged but its operations – which involve surveillance, financial assistance, and technical assistance – have developed to meet the changing needs of its member countries in an evolving world economy.’

At best, this is spin, for the Fund’s actual purposes have changed. They changed in the 1970s when most developed countries moved from fixed, to floating, exchange rates and the core function of the Fund, the maintenance of exchange stability, was ceded by governments to the market. The Articles of Agreement were amended in 1976 to take this into account, with Article IV being changed to reflect the move away from the fixed exchange rate system. However, these amendments did not authorise the Fund to play the role that it began to play after the Debt Crisis of 1982 – the setting of domestic economic policies of nations in crisis. (In addition to the 1976 amendment, the only other significant amendment has been in 1969 to introduce special drawing rights.)

The Fund’s operations today do involve surveillance and financial and technical assistance, but these operations are primarily in the service of the prevention and management of developing country financial crises, not exchange stability.

The Fund performed a useful function throughout the 1950s and 1960s, which were periods of sustained growth in much of the world. But the Fund’s original purpose largely disappeared in the 1970’s, and so, by the end of the decade, it was an organisation with a much reduced mission. In the words of the former Chair of Citibank, Walter Wriston, ‘The IMF was created to iron out the bumps in a fixed exchange rate system and like any bureaucracy, when its mission … became irrelevant when rates started floating, it had to reinvent itself and began making interim loans in Latin America.’

II. THE DEBT CRISIS OF 1982

The debt crisis that engulfed Africa and Latin America in late 1982 gave the Fund a new lease of life – it reinvented itself as the manager of developing country crises.

The Fund quickly came to discharge a critical role in the management of the debt crisis in the 1980s: directing the debtor nations’ economic policies. Debtors needed new money, not least to service interest. Creditors, understandably, wanted some assurance

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4 *Id*

that the debtor’s economic policies that had contributed to the crisis had been changed. The commercial banks had firm views on the need for economic austerity by countries whose debt they were rescheduling. Yet considerations of national sovereignty made direct commercial bank involvement in the setting of local economic policies a political impossibility. The Fund was ideally placed, as an apparently independent international financial institution, to determine and monitor the economic policies, going forward, of the debtor nations.  

The Fund fashioned this role for itself by conditioning its loans upon domestic economic policy reform. Then the foreign commercial banks, in turn, conditioned their loans upon debtor nations securing the approval of the Fund for their economic policies. Thus was borne cross-conditionality – the practice by which foreign commercial banks would only extend new loans to debtor nations upon the new policies of those nations receiving the Fund’s stamp of approval.  

This practice ‘strengthened creditor solidarity and created close ties between the IMF and the commercial banks’. This entire process, and the policies it imposed on the debtor nations, became known as ‘structural adjustment’, a ‘stunningly bland name’ for policies with a stunningly high human cost.  

As early as 1983 the banks were describing the Fund’s role in these terms: ‘[A] fruitful co-operation is emerging between the commercial banks and the IMF ... without IMF persuasion of the borrowing countries to undertake needed adjustment and in the

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8 MacMillan, supra note 6, at 320.

9 See Green, supra note 6, at 11.


absence of Fund monitoring of the progress, the banks would be unwilling to advance sufficient additional credit.¹²

This utterly overstated the strength of the banks’ position. In 1983 the major banks would have advanced sufficient additional credit, irrespective of Fund involvement, as the consequence of not doing so was the debtors defaulting on their loans.¹³ The debtors simply had insufficient foreign exchange to service the debts.¹⁴ Some banks had insufficient capital to withstand the losses that would have to be taken onto their books should there be a generalised default. Advancing additional credit was simply a survival strategy for the major banks but, of course, their rhetoric never disclosed this.

The focus of the Fund reform programs was to permit the debtors to generate sufficient foreign exchange resources to stay current on their debts.¹⁵ The policies imposed to achieve that goal typically included:

- reductions in the budget deficit to limit inflation, and the need for foreign borrowing,
- limits on domestic credit expansion to control inflation,
- exchange rate devaluations to discourage imports and encourage exports, and

¹² The cooperation of debtors with the IMF was indeed fruitful, for the banks: CARLOS MARICHAL, A CENTURY OF DEBT CRISES IN LATIN AMERICA 235 (Princeton University Press, 1989). Adherence to IMF austerity programs permitted continued servicing of the debt so that by the end of the decade, the banks were in a much stronger state than in 1983 and the debtor nations in a worse state.

¹³ Between 1982 and year-end 1988 the nine largest US commercial banks nearly doubled their capital from $29 billion in 1982 to $55.8 billion in 1988 with the result that the ratio of the exposure of these nine banks to Latin America to their capital decreased from 176.5% to 83.6% over the same period. See Atsushi Masuda, Mexico’s Debt Reduction Agreement and the New Debt Strategy, 11(1) EXIM REVIEW 26, 36-7 (July 1991). In 1983 and 1984 they were certainly in no position to stop advancing fresh funds to Latin American debtors, for their capital was less than their exposure to the region.

¹⁴ Id.

• generally a much reduced role for government and a much increased role for
markets.  

Other structural adjustment policies imposed on debtors, at times, included (i) higher income and sales taxes, (ii) higher charges for state-produced goods and services such as electricity and water, (iii) privatisation of state-owned companies, (iv) deregulation of the labour market, and (v) reform of tariffs and import quota regimes. These policies have been criticised for their adverse effect on economic growth and their devastating effect upon the living standard of the local people, particularly the poor.

Another explicit aim, and effect, of the Fund’s policies was to reduce protectionism in the Latin American countries. The Washington consensus was that economic growth is promoted through bilateral tariff cuts and reductions in import restrictions. Once again, this policy flies in the face of the experience of OECD countries. Britain in the nineteenth century, and the United States in the twentieth century, promoted free-trade ‘because they were the most efficient producers of the highest value-added goods. They did not become so through free trade; they protected themselves for decades in order to achieve that end.’

John Kenneth Galbraith wrote of this nineteenth century protectionism in these terms:

For Britain, the industrially most advanced of countries, free trade was of obvious advantage, and like laissez-faire, it acquired a strong theological aura. In Germany and the United States, on the other hand, economic interest was better served by tariffs. Accordingly, the most respected

17 Green, supra note 6, at 45-46; and Hannon & Hudgins, supra note 14 at 4-5.
18 Hannon & Hudgins, supra note 14.
19 Bello, supra note 9; George, supra note 9; Green, supra note 6, at 90-111 and 130-138 (Green entitled his chapter on the IMF and the World Bank, ‘Poverty Brokers’, at 32 et seq); and Wade Mansell, Legal Aspects of International Debt, 18(4) J. L. & SOCIETY 381, 388-90 (1991).
economists in those countries ... spoke vigorously for protection for their national ‘infant industries’ ... from the products of the British colossus.\textsuperscript{21}

Free trade and laissez-faire economics do indeed attract a theological aura; as do the economic theories of the Fund.\textsuperscript{22} Ultimately, like all matters religious, one embraces the theology of the Fund by a leap of faith, not logical reasoning. The consequences of this theology since 1982 was literally a matter of life or death for millions of people.

The Fund policy prescriptions for Africa and Latin America meant that the 1980s were a lost decade. A decade in which net capital flows from these nations were northbound. A decade in which infrastructure crumbled. A decade, in Sub-Saharan Africa, in which life expectancy at the decade’s end was shorter than at the beginning.\textsuperscript{23} In short, as Hal Scott has put so simply, ‘there is little evidence that IMF conditions, usually requiring contractionary fiscal and monetary policies, have worked.’\textsuperscript{24}

In the early years of the debt crisis the Fund severely underestimated its magnitude\textsuperscript{25} and the Fund’s policies did little to alleviate the crisis. The debt crisis was eventually relieved for the banks by the Brady Restructurings of the early 1990s in which the loans were converted into tradable bonds, with security for the repayment of principal and 12 to 18 months of interest repayments, and upon which some debt relief was granted. The Brady process did less for the debtor nations than for the banks but brought some modest relief and encouraged genuinely new capital inflows into the region.\textsuperscript{26} Of particular importance in terms of the contribution of the Fund, is that the Brady Plan was devised initially in Sao Paulo and Mexico City and given the imprimatur and support of the U.S. Treasury.\textsuperscript{27} The fingerprints of the Fund were nowhere to be found on the only

\begin{itemize}
\item \textsuperscript{21} JOHN K. GALBRAITH, THE CULTURE OF CONTENTMENT 46 (Houghton Mifflin, 1992).
\item \textsuperscript{22} George, \textit{supra} note 9.
\item \textsuperscript{23} EDUARD R. BOS (ed), DISEASE AND MORTALITY IN SUB-SAHARAN AFRICA 12 (2nd Ed, The World Bank, 2006).
\item \textsuperscript{24} Hal S. Scott, \textit{A Bankruptcy Procedure for Sovereign Debtors?}, 37 INT’L LAW. 103, 115 (2003).
\item \textsuperscript{26} Ross P. Buckley, \textit{Turning Loans into Bonds: Lessons for East Asia from the Latin American Brady Plan}, 1(1) J. RESTRUCTURING FIN. 185-200 (2004).
\item \textsuperscript{27} Id.
\end{itemize}
creative measure brought to bear on the worst international economic crisis since World War II.

III. THE EAST ASIAN CRISIS OF 1997

In mid-to-late 1997 a succession of East Asian countries ran out of foreign exchange reserves with which to defend the value of their currencies in the markets. The currencies of Thailand, Indonesia, Malaysia, and finally Korea, collapsed and foreign capital fled from the region.

Asia’s was a fundamentally different crisis from the debt crisis of 1982 or Mexico’s peso crisis of 1994-95 in that the great majority of the troublesome indebtedness was of the private, not the public or quasi-public sector and it was not a crisis of over-consumption. The Latin American nations had been borrowing, in part, to fund general government budgets. The East Asian governments had not been similarly seduced. Their fiscal policies were prudent. In the words of Laurence Meyer, a member of the Board of Governors of the U.S. Federal Reserve System, ‘By conventional standards, the monetary and fiscal policies of the developing Asian economies prior to the crisis were largely disciplined and appropriate. … consumer price inflation … was relatively subdued [and] fiscal policy also appears to have been disciplined.’

Furthermore, Asia’s crisis occurred within ‘a benign international environment with low interest rates and solid growth in output and exports’.

Asia’s crisis was primarily a crisis of inadequate local prudential regulation and inadequate confidence in the region by global capital. It was a contractionary crisis in which the largest problems were that the exodus of global capital and loss of confidence in the region meant a steep decline in economic activity.

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29 World Bank, 1 GLOBAL DEVELOPMENT FINANCE 4, 30 (1998)
30 With the exception of Indonesia which was overly indebted and experienced a more traditional debt crisis. For more on the Asian crisis, see Ross P. Buckley, An Oft-Ignored Perspective on the Asian Economic Crisis: The Role of Creditors and Investors, (2000) BANKING AND FIN. L. REV. 431-54 (2000).
Notwithstanding all of these differences, the Fund ventured into Asia dispensing the policy prescriptions it believed had worked in Latin America in the 1980s and Mexico in 1995 – prescriptions of budgetary tightening and austerity. Austerity is always bad policy for a contractionary crisis. It is utterly ineffective in encouraging contracting economies to expand.

At the time the Nobel laureate, Joseph Stiglitz, was the Chief Economist of the World Bank and he spoke out repeatedly to highlight the fundamental error in the Fund’s response to the Asian crisis.31 The vast gulf separating Stiglitz’s views from those of the Fund can be seen in two quotations. Stiglitz said, economic pain ‘should contribute to strengthening the economy, not exacerbating economic downturns.’ Michael Mussa, the Fund's economic counsellor, responded that, ‘Those who argue that monetary policy should have been eased rather than tightened in those economies are smoking something that is not entirely legal.’32

Joe Stiglitz was proven right by later events, but when it mattered the most, the Fund disagreed with him.

Subsequently the Reserve Bank of Australia approached the U.S. Treasury to deliver essentially the same message: the fiscal policies of the Asian economies had been in the main conservative and prudent. This was a contractionary crisis, a crisis of confidence, and expansion was needed to stimulate these economies, not the higher interest rates and budget tightening being prescribed by the Fund.

The U.S. Treasury took the message on board and managed to persuade the Fund its diagnosis of the crisis was quite wrong. So about 15 months after the onset of the crisis, the Fund began to acquiesce to requests by national governments for more expansionary policy settings.33

While the Fund eventually came around, the crisis was deepened by its initial misdiagnosis and considerable, otherwise avoidable, human suffering was the result. Furthermore, the Fund only altered its views to the extent of easing the austerity it had imposed. In the meantime, Malaysia had adopted more successful strategies that remain outside the Fund’s kitbag of policy options.

IV. MALAYSIA’S EXIT FROM THE ASIAN CRISIS

Malaysia refused IMF funding and advice in late 1997 and 1998 and chose to chart its own way out of the Asian crisis. The policies Malaysia eventually settled upon were in sharp contrast to the Fund’s. Malaysia imposed capital outflow controls to keep foreign capital within the country, and pegged the ringgit to the U.S. dollar. With these policies in place, Malaysia was able to ease monetary policy and pursue expansionary fiscal policies, without being hampered by concerns about the impact on the exchange rate of capital outflows.

Suddenly Malaysia had created as close to a controlled laboratory experiment as one ever gets in economics. Thailand and Korea were seeking to exit the Asian Crisis using the Fund’s policies, while Malaysia was charting an utterly different course. (I leave Indonesia out of the analysis as its high debt levels means the nature of its problems were quite different and proved to be of much longer duration).

All three economies recovered from the crisis, but Malaysia’s recovery was more rapid, and its poor were harmed far less by its recovery policies than were the poor in countries following the Fund’s approach. In the words of Kaplan and Rodrik, ‘compared to IMF programs, we find that the Malaysian policies provided faster

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36 Buckley & Fitzgerald, supra note 33.
economic recovery... smaller declines in employment and real wages, and more rapid turn around in the stock market.\(^\text{37}\)

Yet the Fund’s mistakes in East Asia, so clearly highlighted by Malaysia’s taking the road less travelled, paled in comparison to its more egregious errors in Argentina.

V. THE ARGENTINE CRISIS

To put Argentina’s collapse in 2001 into perspective, we need to go back a decade. In 1991 Argentina was emerging from the aftermath of the Debt Crisis and fresh capital was flowing into the country. The years from 1991 to 1998 were prosperous. Argentina’s economy performed strongly. GDP per capita increased 44% in the eight years.\(^\text{38}\) Inflation was completely under control.\(^\text{39}\)

Finally it seemed Argentina’s time had come. It has always had a strong base for an economy: high literacy rates, the best educational system in Latin America and rich natural resources.\(^\text{40}\) Now Argentina significantly improved its banking system, more than doubled its exports, privatised a broad range of industries, experienced significant growth in oil and mineral production and achieved record levels of agricultural and industrial

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\(^{38}\) Miguel Kiguel, \textit{Structural Reforms in Argentina: Success or Failure?}, 44(2) \textit{Comparative Economic Studies} 83, 84 (Summer 2002); percentage calculated from Figure 1. There was a brief hiatus in the growth during 1995 in response to the Tequila effect: the contagion from Mexico’s crisis in late 1994 and early 1995: at 94-95.

\(^{39}\) Id.

\(^{40}\) Sophie Arie, \textit{Rich Argentina Tastes Hunger}, \textit{The Observer}, 19 May, 2002. In the 1930s, on the back of strong beef and grain exports, per capita income in Argentina was on a par with that in France.
Argentina in the 1990s was a darling of the Fund and global financial markets. It was toasted as ‘the best case of responsible leadership in the developing world’. Nonetheless at the end of 1998 Argentina entered a severe recession. The timing was dictated in part by external factors, in particular the 1997 Asian economic crisis and the August 1998 Russian crisis which together severely limited capital flows to emerging markets economies. Argentina accordingly had very limited access to new capital to finance budget deficits and service its debt. However, as with the Debt Crisis of 1982, external factors influenced the timing of the crisis, but were not its cause. The causes were excessive borrowing to support general government expenditure, the peg of the peso to the U.S. dollar, and Argentina’s widespread and apparently endemic corruption.

The recession was magnified by massive levels of capital flight, so much so that the government had to impose harsh caps on withdrawals from bank accounts, and eventually, had to close the banks. Still the crisis deepened in late 2001 when the Fund refused to extend further credit to the nation, believing its economic programs to be unsustainable. As commercial lenders followed this lead, Argentina was denied access to capital and defaulted on its external debt of some US$132 billion.

In the year from March 2001 to March 2002, total domestic Argentine financial assets shrunk from US$126.8 billion to US$41.5 billion, according to Business Monitor

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41 Kiguel, supra note 37, at 100-01. This is not to suggest that many of the privatisations were not deeply problematic. It is always a profound challenge to realise appropriate prices for the privatisation of major businesses and assets in emerging markets nations for the range of potential purchasers is not wide and because of the risk of very favourable prices for well-connected purchasers. The scrupulous and rigorous public accountability procedures that would mitigate against the latter risk are rarely present. There is much to suggest that many of the privatisations of the 1990s in Argentina were at a deep undervalue.


43 Kiguel, supra note 37.


Nonetheless, Argentina was exceptionally resolute in its negotiations with its external creditors and refused to accept conventional levels of debt relief. President Kirchner maintained his refusal to service the debt from the ‘suffering and hunger of the people’. He had good grounds: Argentina’s poverty rate, 27% in 1999, had doubled by 2003 to 54.7%; per capita GDP, US$7,800 in 1999, had fallen by more than half by 2004 to $3,800; and debt that represented 47.4% of GDP in 1999, was 140% of GDP in 2004.

In the words of an article in *The Financial Times*, ‘Argentina gambled, and the gamble paid off’. In March, 2005 76% of Argentina’s creditors accepted its offer to exchange its debt for bonds at the unprecedented discount of some 66% on a net present value basis.

Argentina emerged from its default on the most advantageous terms ever secured by a middle-income country in a debt restructuring.

The Fund emerged from Argentina’s collapse with its credibility in tatters. Never before had a country that had so faithfully followed the Fund’s policies collapsed so severely. Never before had the Fund’s image been so badly damaged by a sovereign default.

In addition to these very public and profound policy errors of the Fund, there are more subtle practices and policy stances that, over decades, have severely damaged debtor nations in general and the poor in such nations in particular. Together these practices and policies fall under the rubric of the socialisation of private sector debt.
VI. THE SOCIALISATION OF PRIVATE SECTOR DEBT

One of the depressingly consistent themes of the aftermath of each of the three financial crises that have been considered here is the way that the common people of the debtor nations have in the end repaid substantial portions of the debt incurred by private corporations – a consequence which the Fund either engineered or to which it acquiesced.

After the debt crisis broke in 1982 the creditors persuaded each nation to represent all debtors within its borders in the rescheduling negotiations and to do so by bringing all the debts of those debtors under its sovereign guarantee. The first step was necessary. The second was not.

Bringing all debts under the sovereign guarantee improved the security of the creditors – particularly of the creditors who had made most of the loans to private sector corporations – and these just happened to be the major lenders who were sitting on the creditor steering committees and orchestrating the process. Bringing corporate debts under the sovereign guarantee also represented an utterly unjustifiable charge on the common people of these countries – these loans have been serviced by decades of higher taxes and lower social services.

Fifteen years later in Asia the nature of the crisis was quite different, but the resolution of it was the same – the poor in the debtor countries were shafted – this time by a process engineered by the Fund. The Fund organized bailouts of Indonesia, Thailand and Korea. While described as Fund bailouts of the countries, they were in fact long-term loans made on condition they be used to repay creditors. These loans thus became debts of the nation and the bailouts were of the creditors, not the debtor nations at all. It took

50 Buckley, supra note 44, at 43.
four years before bailouts were generally understood to be ‘a welfare system for Wall Street’ as the funds flowed directly through to creditors.

To make matters worse the creditors with debts due typically held short-term bonds – and short-term debt is particularly destabilising for developing countries. So the Fund bailouts encouraged precisely the type of debt that a stable system would discourage.

The idea was that the nations would again take responsibility for the indebtedness of corporations incorporated in the nation, use the loans obtained in the bailout to pay off the foreign creditors, and later recover the debts from the corporate debtors. On average, the Indonesian government recovered some 28% of the value of the loans it incurred on behalf of the banking sector. The other 72% became a charge on the Indonesian people. And these are large sums of money. The amount of the Fund bailout now represents some 29% of the total sovereign indebtedness of Indonesia.

After Argentina’s economic implosion, the international financial community, with the assistance of a compliant Argentine government and the Fund, found two ways to socialise private indebtedness. The first is the familiar Fund bailout, in this case a massive US$40 billion loan to Argentina in late 2000, that was required to be used to repay a mix of public and corporate debt. The second was a new way to achieve an old end: having the people repay corporate debts. This technique was known as ‘pesofication’.

In the words of a senior G-7 official, quoted in Charlotte Denny, *IMF Sheds No Tears for Argentina*, THE GUARDIAN, Apr. 29, 2002.


Under pesofication, dollar-denominated bank loans and deposits were redenominated in pesos. Banks were required to convert their assets (such as loans) into pesos at a one-for-one rate and their liabilities (such as deposits) into pesos at a rate of 1.4 to 1. This generated huge losses for the banks for which the government sought to compensate them by a massive issue of government bonds of necessarily doubtful value.\textsuperscript{57}

Thus the circle was completed in the usual way in such crises – the ultimate burden fell on the public purse. In the words of Pedro Pou, President of the Central Bank of Argentina until mid-2001, ‘The government has transferred about 40\% of private debt to workers … We are experiencing a mega-redistribution of wealth and income unprecedented in the history of the capitalist world.’\textsuperscript{58}

To require the common people to repay private corporate debts, through increased taxes and reduced government services, is simply immoral. It is a massive interference with the market system that the Fund professes to support. In each of these crises, the market, through the mechanism of bankruptcy, would have allocated the costs of the poor lending and borrowing decisions upon the lenders and borrowers. The Fund, either as architect, or complicit partner, in each case allocated the costs of these poor credit decisions to parties who had nothing to do with them: the common people of the debtor nations.\textsuperscript{59}

Given the failures of the Fund are manifold, whether the Fund should be allowed to continue depends upon whether it can reform itself sufficiently to become a positive force in the development of poor nations. In short, does the Fund have a track record of listening and responding constructively to criticism from within and without?

\textsuperscript{57} Andres Gaudin, \textit{Thirteen Days that Shook Argentina – and Now What?}, 35 NACLA REPORT ON THE AMERICAS 6 (March/April, 2002); and \textit{Latin Banks: Eyes on Brazil}, 8(18) EMERGING MARKETS MONITOR, Aug. 19, 2002, at 12.

\textsuperscript{58} As cited in Gaudin, \textit{supra} note 56.

VII. THE FUND’S RESPONSIVENESS TO CRITICISM

Criticism of the Fund’s policy prescriptions have been sustained, fierce and unrelenting from the left ever since the early-to-mid 1980s, principally for the impact of its policies on the poor and because the Fund is seen, by the left, to be the handmaiden of the G-7 nations in implementing their policies and those of their banking sectors. More recently, for the past 15 years or so, commentators from the right have joined battle criticising the Fund for having lost its mission, purpose and relevance. Commentators from both sides of politics and from developed and developing nations have argued for the Fund’s fundamental reconceptualisation or closure.60

The Fund has done much to appear to respond to these criticisms. In 1999 it replaced the economic policies which it had been imposing upon developing nations in crisis, the so-called Structural Adjustment Policies (SAPs), with Poverty Reduction Strategy Papers. PRSPs were to be a new tool for poverty reduction, debt relief, and access to funding from donors.

According to the Fund, ‘PRSPs are prepared by the member countries through a participatory process involving domestic stakeholders as well as external development partners, including the World Bank and the International Monetary Fund.’61 PRSPs outline the economic, social, and structural programs to be used to


reduce poverty.\textsuperscript{62} Instead of focusing on macroeconomic stability and growth like SAPs, PRSPs, as their name suggests, were to put poverty reduction at the core of the nation’s economic policies.

Once approved, the PRSP forms the basis for future funding.\textsuperscript{63} Potential recipients of debt relief under the Heavily Indebted Poor Country (HIPC) Initiative and the Fund’s Poverty Reduction and Growth Facility (PRGF) are required to produce a PRSP to be eligible.\textsuperscript{64}

However, the change from SAPs to PRSPs was more an effort to rescue the Fund from its crisis of legitimacy\textsuperscript{65} than to respond to the needs of the poor in poor countries.\textsuperscript{66} If programs were truly national creatures, tailored to each individual nations’ needs, one would expect some PRSPs to exhibit strategies that differ from the standard policy prescriptions of the past. But this is not the case – the PRSPs of virtually all countries are strikingly similar. The macroeconomic policies under PRSPs have essentially been a continuation of the policies under SAPs\textsuperscript{67} and PRSPs don’t contemplate alternative approaches to poverty reduction such as resource redistribution.\textsuperscript{68}

In short, there has been a marked gap between Fund rhetoric and policies.\textsuperscript{69}

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{62} Frances Steward and Michael Wang, \textit{Do PRSPs Empower Poor Countries and Disempower the World Band, or is it the Other Way Round?} 4 (QEH, Working Paper Number 108 Oct. 2003).
\item \textsuperscript{63} Diana Sanchez & Katherine Cash, \textit{Reducing Poverty or Repeating Mistakes? A Civil Society Critique of Poverty Reduction Strategy Papers} 13 (Church of Sweden Aid, Diakonia, Save the Children Sweden and the Swedish Jubilee Network, Dec. 2003).
\item \textsuperscript{64} Steward & Wang, supra note 61, at 5.
\item \textsuperscript{65} George Dor, \textit{G8, Tony Blair’s Commission for Africa and Debt, GLOBAL POL’Y F.}, 7 Jul., 2005, at 1
\item \textsuperscript{66} Dr. Ebrahim M. Samba, \textit{African Healthcare Systems: What Went Wrong}, HEALTHCARE NEWS, 8 Dec., 2004, at 3.
\item \textsuperscript{67} Ricardo Gottschalk, \textit{The Macroeconomic Policy Content of the PRSPs: How Much Pro-Growth, How much Pro-Poor?} 3 (The Institute of Development Studies, University of Sussex, Feb. 2004).
\item \textsuperscript{68} Steward & Wang, supra note 61, at 19.
\item \textsuperscript{69} In the context of aid to Africa, this gap was noted by the Independent Evaluation Office of the IMF in \textit{Independent Evaluation Office of the IMF, The IMF and Aid to Sub-Saharan Africa}. 7
\end{enumerate}
\end{footnotesize}
The entire shift from Structural Adjustment to Poverty Reduction Strategy Papers was designed to blunt the criticisms but it failed because it was mere window dressing, the operative ideology of the Fund, and hence its policy prescriptions, had not changed. The clearest example of this is to be found in the Fund’s policies in Africa.

VIII. THE IMPACT ON POVERTY OF FUND’S POLICIES IN AFRICA

In 2000, Michel Camdessus, the Fund’s Managing Director said:

[T]he greatest concern of our time is poverty … it is the ultimate systemic threat facing humanity. … If the poor are left hopeless, poverty will undermine the fabric of our societies through confrontation, violence, and civil disorder. We cannot afford to ignore poverty, wherever it exists, whether in the advanced countries, emerging economies, or the least developed nations. But it is in the poorest countries that extreme poverty can no longer be tolerated; it is our duty to work together to relieve suffering.

The Fund has its own internal evaluation division, the Independent Evaluation Office, and in March, 2007, the IEO released an Evaluation Report, The IMF and Aid to Sub-Saharan Africa.

The Report concluded that there were differences of views among the Executive Board of the Fund about the Fund’s role and policies in poor countries, and that ‘lacking clarity on what they should do on the mobilization of aid, … and the application of poverty and social impact analysis, Fund staff tended to focus on macroeconomic stability, in line with the institution’s core mandate and their deeply ingrained professional culture.’

In other words, some seven years after the Managing Director’s speech cited above, seven years after the replacement of Structural Adjustment Programs with Poverty


70 Ross P. Buckley, IMF Policies and Health in Sub-Saharan Africa, in GLOBAL HEALTH GOVERNANCE: CRISIS AND CHALLENGES (Adrian Kay & Owain Williams (eds), 2008).

71 Michel Camdessus, Address at the Tenth U.N. Conference on Trade and Development (Feb. 13, 2000).

72 Independent Evaluation Office of the IMF, supra note 68.

73 Quotation is from the Foreward by Thomas A. Bernes, Director, IEO, id at vii.
Reduction Strategy Papers, seven years after the establishment of the Poverty Reduction and Growth Facility, Fund staff were unclear on the priority to be give to poverty reduction and how to achieve it, and so sought to attain that which they knew how to attain, macroeconomic stability. In the first year or two of the introduction of new priorities and programs this would be understandable though regrettable. After seven years this is ridiculous. For an institution that is the subject of unremitting criticism for the impact of its programs and policies on poverty, and which has been maintaining steadfastly in all its press releases and public pronouncements since 2000 that poverty reduction is its highest priority, to still be trying to bed down new initiatives and priorities on poverty reduction over seven years after their introduction is utterly unacceptable. In most corporate or government settings, one would expect such non-performance to result in the sacking of senior staff.

The Report also found that the Fund’s policies have accommodated increased aid ‘in countries whose recent policies have lead to high stocks of reserves and low inflation’, but ‘in other countries additional aid was programmed to be saved to increase reserves or to retire domestic debt’.74 Yet virtually no sub-Saharan African countries have strong foreign exchange reserves and low inflation rates. So extra aid was routinely being channelled by the Fund into foreign exchange reserves or into the repayment of debt in most poor African countries. This is a perfect illustration of the damage that overly restrictive policy settings on inflation rates can do in developing countries. The obsession with the macro-economic profile of the country denies much needed resources to the poor. Such an approach has two flaws:

1. It diverts extra aid away from healthcare, education or other social welfare expenditures, and

2. It risks being a ‘self-fulfilling prophecy’ as diverting aid flows into reserves and debt reduction is likely to dissuade donors from giving more aid.75

Most donors want to give aid to directly assist suffering people, not to improve the macroeconomic profile of the nation in which they live.

74 IEO Report, id, at 32.
This profound inability to implement its own priorities and policies, gives rise to the question of whether the Fund can reform itself?

When Malaysia was charting its own course out of the Asian crisis and imposing capital outflow controls, the Executive Director of the Fund, Michel Camdessus was Malaysia’s sternest critic. In speech after speech around the world he admonished Malaysia in terms such as: ‘investor confidence has been damaged by the capital controls, and some official sources of external finance have dried up. Neither source is likely to recover until the overall stance of policies is modified.’

The extraordinary feature of this episode is not that Michel Camdessus was wrong, there has been nothing unusual about that at all in Fund’s performance in the past 25 years. The extraordinary and laudable feature is that as quickly as 12 months after the Fund’s Managing Director was delivering withering attacks on Malaysia’s use of capital controls, members of the Fund’s staff felt able to write a balanced and generally positive assessment of Malaysia’s use of capital controls and to conclude that ‘preliminary evidence suggests that the controls have been effective in realizing their intended objective of reducing the ringgit’s internationalization and helping to contain capital outflows …’.

Furthermore, in the Fund’s review of Malaysia’s policies between 1997 and 2000 other staff members wrote that: ‘Market assessment turned more positive, however, as it became clear that Malaysia’s macroeconomic policies were not out of line, that the undervalued pegged exchange rate was contributing to the rapid recovery of exports and output, and that financial sector reforms were being vigorously pursued.’

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And in yet another publication, the staff noted that the ‘successful experience of the 1998 controls so far is largely due to the appropriate macroeconomic policy mix that prevailed at that time’\textsuperscript{79} and that the controls were effective because they ‘were wide ranging, effectively implemented, and generally supported by the business community’\textsuperscript{80}

So the Fund, through the work of its research department, has a proven capacity to be self-critical, a fundamental requirement for an organisation’s ability to learn from experience, change and adapt. The Fund enhanced this capacity in 2001 by establishing the Independent Evaluation Office (IEO), the report of which into Aid in Africa has already been considered. The IEO states that it is ‘fully independent from the Management of the Fund and operates at arm’s length from the Board of Executive Directors, representing the 185 member countries of the IMF.’\textsuperscript{81} In its own words:

The IEO’s overarching mission is to improve the Fund's effectiveness by:

- Enhancing the learning culture of the Fund and enabling it to better absorb lessons for improvements in its future work.
- Helping build the Fund’s external credibility by undertaking objective evaluations in a transparent manner.
- Providing independent feedback to the Executive Board in its governance and oversight responsibilities over the Fund.
- Promoting greater understanding of the work of the Fund.\textsuperscript{82}

Since its inception, the IEO has issued 25 Evaluation Reports.\textsuperscript{83} Each has been an extensive, detailed, reasoned document, some more forthright and direct than others, but most tending to be relatively clear and critical in their findings.

\textsuperscript{79} Id., at 6.
\textsuperscript{80} International Monetary Fund, \textit{Malaysia: Selected Issues}, supra note 77, at 18.
For example, the Summary of Major Findings, Lessons and Recommendations of the Report on the Evaluation of Poverty Reduction Strategy Papers and the Poverty Reduction Growth Facility, July 6, 2004, states, inter alia, that:

- most PRSPs fall short of providing a strategic road map for policymaking, especially in the area of macroeconomic and related structural policies,
- on balance, joint staff assessments do not perform adequately the many tasks expected of them, and
- success in embedding the PGRF in the overall strategy for growth and poverty reduction has been limited in most cases – partly reflecting shortcomings in the strategies themselves.

These are not the words of bureaucrats seeking to be coy or to obfuscate. These are honest assessments of the Fund’s policies and achievements. The Fund is able to accommodate within its research staff, and its Internal Evaluation Office, officers who are sharply critical of its policies and performance, and yet somehow not modify its policies substantively in response to such criticisms. These honest and frank assessments have had almost no impact on altering the policies and culture of the Fund.

IX. THE GLOBAL FINANCIAL CRISIS OF 2009

Yet, again, in 2009, another crisis rescued the Fund.

When the Funds’ mission had evaporated in the late 1970s and early 1980s it was rescued by seizing a new role in the resolution of the debt crisis of 1982.

By 2007-2008 the Fund’s credibility was again at historic lows. Its critics were strident and were from both sides of U.S. politics, as well as from most developing

countries. Argentina’s economic implosion, following the Fund’s misdiagnosis of Asia’s crisis, had left its reputation in tatters. Then along came the Global Financial Crisis (GFC). This crisis meant the G-20 needed an organisation through which it could channel most of its US$1.1 trillion funding package, a bill the Fund fitted. And so, today, the credibility of the Fund has been somewhat restored by having a new role, and its staffing levels are again climbing.

The G-20’s principal response to the GFC was a US$1.1 trillion dollar funding package. US$100 billion was in additional concessional financing for poor nations. US$250 billion was to support trade finance, financing for which had been severely limited by the GFC. Another US$250 billion was an increase in Special Drawing Rights, the Fund quasi-reserve-capital. And the final US$500 billion was the additional credit facility.

Special Drawing Rights (SDRs) are based on a basket of four currencies, the U.S. Dollar, Pound Sterling, Euro and Yen, and are the ways nations make their contributions to the Fund. They are an excellent source of funding for poorer nations and the increase in them is a laudable response to the GFC. However, SDRs can only be drawn down in proportion to a nation’s quota. Accordingly, nearly two-thirds of the increase in SDRs is available to OECD nations, leaving US$100 billion to developing countries, within which only US$19 billion is available for low-income nations.  

The principal destination of the $500 billion credit facility is intended initially to be the Eastern European nations, and ultimately the repayment of their loans to the German banks. So, once again, the Fund has been captured and is being used to further the ends of the powerful nations at the expense and cost of the people of the debtor nations, the revenue of which will have to service these loans for up to 30 years.

But at least, I hear you say, in the midst of the GFC the Fund must surely have adapted its market fundamentalist policies? Well, just as it did a decade ago, the rhetoric

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has certainly shifted. Dominique Strauss-Kahn, the managing director, now speaks repeatedly of the need for counter-cyclical national fiscal policies.\(^8^7\) And precisely as a decade ago, there is a yawning chasm between rhetoric and policy. The Fund has recommended fiscal stimulus in Mozambique and Tanzania, only two of the 78 lower-income countries. Whereas it has required as a condition of its loans to Hungary and Latvia that they cut public sector salaries by 8 to 15\% to bring their fiscal deficits to 3.8\% of GDP by 2010, later revised to 4.6\% of GDP by 2009, in the case of Hungary and 3\% of GDP by 2012 in the case of Latvia.\(^8^8\) And the Fund imposed less severe but nonetheless contractionary policies on six other countries in 2009. Where else can these economies go, in the midst of a GFC, but down a contractionary plug hole?

X. CONCLUSION

Why, and how, could the Fund staff have been unsure throughout the last decade of the priority to be afforded to poverty reduction in Africa when poverty reduction was at the centre of the Fund’s policies and rhetoric? Why did the staff revert to structural adjustment because it was what they knew best? Why is an organisation unable to learn and adapt when its staff have sufficient intellectual freedom to adopt positions in direct opposition to those recently taken by their Managing Director and its internal evaluation


office regularly critiques its performance in honest, unflattering terms? In short, how can this organisation be so unable to reform itself?

The reason is that the Fund is a fundamentalist organisation. At core it is no different, really, from a fundamentalist church of any faith. Officers who subscribe to its dogma are promoted, those that question the prevailing faith are not. This explains why in Africa the Fund could promote the privatisation of healthcare provision, and impose salary caps upon expenditure by government on healthcare, because the Fund officers involved really believe that the private sector will deliver better healthcare than the public sector – this is notwithstanding that all the evidence indicates that privatisation of healthcare in poor countries results in good, albeit expensive, care for middle class urban residents, and virtually no care for the urban poor and for people in rural or remote communities. This explains why the Fund could divert foreign aid designated for healthcare or education in Africa into foreign exchange reserves or debt reduction, because the officers involved genuinely believed that an improved macroeconomic profile would mean more to the poor, in the medium term, than healthcare or education for their kids. This explains why the Fund could agree with Argentina maintaining the rigid peg of the peso to the dollar when there was no way the Argentine economy could remain as competitive as that of the U.S. over time, because the officers genuinely believed inflation was the number one enemy to be fought.

As Walter Wriston, the former Chair of Citibank, has put it, ‘If [the IMF] weren’t around, countries would be better off’ because once the Fund got into the business of advising governments on policy it ‘created more trouble than it cured.’

A rigid, blinkered market fundamentalism explains many Fund policies that viewed in any other light are ridiculous. And fundamentalist organisations are tremendously difficult, if not impossible, to reform.

The only viable answer is to remove the Fund from the role it is not authorised, or qualified, to perform, that of economic policy director for countries in crisis, and return it to the role it was originally designed to fulfil: the facilitation by short-term loans and

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89 See Wriston, supra note 4.
technical advice of the management of fixed exchange rates, for the countries that still seek to manage fixed exchange rate regimes. This is a major reduction in mission for the Fund, and will, in time, result in the organisation shrinking considerably.

The Fund’s performance establishes it cannot reform itself so as to perform competently its current, expanded role. If an institution is required to dictate policy to nations in crisis, it needs to be a new one, staffed with different people, with different skill sets and culture. No one would give a central banker the job of turning around a failing company. The skills required to turn around poorly performing economies are utterly different from those typically held by central bankers and PhD graduates in macro-economics, the two most common backgrounds of Fund staffers. The Fund is the wrong organisation to set economic policy for nations in crisis and it should be removed from this role. If an international financial institution is required to play this role, a new one, with the right skills set, attitudes and culture needs to be established. This change would limit the Fund to data collection, technical surveillance and advice giving roles.

It is time for the Fund’s mission creep to stop and to return the Fund to its roots, to what is left today of the job it was originally designed to do, and which it managed to do well; and to stop it doing a job it has done poorly, to the cost of millions of people in poor countries.