THE IMF AND ITS CRITICS

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How the future role of the IMF should be modified has been the subject of a slew of recent reports. I discuss the main criticisms, the proposals for reform, and the response of IMF management and staff to its critics

Criticisms of the IMF

Some of the main criticisms of IMF performance follow.

- Mission creep. The IMF began its existence in 1947 with two tasks: to monitor member countries adherence to pegged but adjustable exchange rates and to provide temporary loans to resolve balance of payments problems. It has since expanded the scope of its loans by introducing six different facilities that cater to different subsets of countries.

It created a Trust Fund in the 1970s to make low-interest loans to poor countries, and also provided them with (i) traditional stand-by loans, which allows a country to draw on the Fund on a specified schedule under certain conditions. In the 1980s, both types of loans were refinanced from a newly established Structural Adjustment Facility at low interest. In the 1990s this facility was expanded as the Enhanced Structural Adjustment Facility, and renamed in 1999 as the Poverty Reduction and Growth Facility (ii).

In addition, the Compensatory and Contingency Financing Facility (iii), introduced in the 1960s, makes low-conditionality loans to countries with a temporary shortfall in exports, or an increase in cereal or interest costs.

The Extended Fund Facility(iv), introduced in 1975, makes longer-term loans to countries with a structural payments problem.

The Supplementary Reserve Facility (v). a high interest facility, and the Contingent Credit Line (vi), to pre-qualify countries, were introduced in 1998.

- The principle of conditionality in lending. The efficacy of conditionality has aroused skepticism, even as its practice has expanded. The number of conditions has proliferated over time. Some are performance criteria, which specify targets for fiscal deficits and the current account. The content of conditions may include other desired economic policy actions. If the borrower has not fulfilled the conditions that it agreed to implement, it may be denied the next installment of its drawing on the Fund, although that does not necessarily happen. A recent report highlights the absurd extent to which the IMF has imposed conditions on a borrower. Indonesia was asked to implement 140 conditions to be eligible for the loan it obtained in 1997. Multiple conditions that are unenforceable and that the client country with the best will in the world –though often absent – cannot comply with make the IMF a laughing stock.
- Lending in non-crisis situations. The IMF has encouraged the piling up of indebtedness in some countries and the extension of IMF credit year after year in others.
- A laggard in preventing financial crises. It has failed to spot the warning signals of trouble in emerging market countries: the condition of banks, the amount and composition of capital inflows, and the foreign debts of the private and public sectors – the areas most susceptible to financial crises.
- Lending in financial crises. Extending large loans to countries to restore market confidence creates moral hazard.

Proposed Reforms

The proposed reforms address the criticisms.

- Limiting the scope for IMF activities would curtail mission creep. The consensus is that the IMF should not be involved in financing the structural transformation of individual member countries and should not be in the business of alleviating poverty. The World Bank should be assigned these responsibilities. The IMF instead should concentrate on the provision of limited financial assistance to countries experiencing temporary illiquidity.
- Eliminating conditionality and substituting market interest rates for low-cost loans is one reform proposal.
- The record of persistent borrowing by some countries and high indebtedness by others underscores the need for reform of these practices. Low-interest loans as a form of aid to these countries does not do these countries a favor. Now a program to forgive the debtors is taking shape. A $90 billion global debt relief plan, of which the U.S. share is $435 million, is intended to reduce the debt burden of 41 poor nations in Africa and Latin America. Many of the debts were incurred by corrupt governments. The borrowers would have been better off had they not incurred the debt or had it been obtainable only at a commercial interest rate It is uncertain how much of outstanding debt will be relieved by the program, and questionable why donor nations are expected to foot the bill. The World Bank, the IMF, and the regional banks have adequate loan-loss provisions to cover all their bad loans. However, the IMF, rather than use its loan-loss account, proposes to revalue some of its gold reserves to obtain $570 million as an accounting gimmick to contribute to relieving poor nations' debt. It remains to be seen whether debt relief will reduce poor nations future acquisition of unsustainable debt and reform international lenders' propensity to lend too freely.
- Preventing financial crises is a reform with the highest priority for the IMF. It maintains staff as residents in the countries that are its clients, They should be alert to signs of deterioration

in key institutions and macro economic conditions. The information the staff collects should be evaluated at the highest levels and acted upon to forestall a financial collapse.

- The size of the rescue packages assembled to respond to the financial crises of the 1990s has become an issue because it has created precedents and expectations. Private and public borrowers alike and foreign investors rely on bailouts to rescue them when loans are nonperforming and domestic currencies depreciate. Reform requires limits on rescue packages and willingness to allow borrowers and investors to bear losses.

IMF Management and Staff Response to the Critics

Political support for the IMF and the World Bank appears to be declining. The international financial institutions are beset by critics on the left who disrupted their meetings in Washington in April and in Prague in September, by critics in the Executive Branch and the Congress, and by the nongovernmental institutions that commissioned critiques of their lending practices. Leaders of the IFIs have expressed conciliatory responses.

Horst Koehler, who became Managing Director of the IMF in May, has responded to the protesters, who assert that the IFIs hurt the poor in the countries they are supposed to be helping, by allying himself with the governments and charities of developing countries and distancing himself from the advanced countries that provide most of the IFIs financing. Koehler has also embraced the demands of critics that the IMF reduce the number of conditions it imposes on borrowers. He has named a panel of outside experts to review the advice that the IMF gives governments to improve the operations of their financial sectors and capital markets and to report to its board by year end.

The Executive Directors of the Fund, after initially vetoing the proposal, agreed in September to charge higher interest rates and limit the duration of many loans, and to eliminate four loan facilities. The Fund, however, will continue to extend medium-term loans and in special cases long-term loans. Contrary to the views of critics, it will not yield its antipoverty program to the World Bank. And the Fund intends to retain its role as the source of large emergency loans to rescue governments should a global financial crisis erupt in case private capital markets dry up.

Whether promised IMF changes will appease its chief Congressional critic, Senator Phil Gramm, should soon become evident. A bill in Congress that authorizes the commitment of U.S. funds to debt forgiveness contains the recommendations of the International Financial Institution Advisory Commission for far-reaching changes in the IFIs.