New Resources for an Unreformed IMF?

Massive crises can be excellent news, as the present US Crisis proves, which resulted from deregulating and liberalising the financial sector. Although much larger, it is a crisis like other neoliberal crises earlier in Chile, Mexcio, East Asia or the Savings & Loan Crisis in the USA. Those policies the IMF forced on or recommended to Southern Countries (SCs) were carried to their logical extreme. Deregulation went as far as to encourage practices such as "liar" or "NINJA" (No Income No Job or Assets) loans that can only be explained by the fact that securitised debt was quickly sold on and regulatory checks were not applied. Lenders were off the hook after cashing

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their fees.

The basis of the crash was again the Robichek (now rather Greenspan) doctrine: markets know best and should not be "overregulated". The government should not interfere as it can only make things worse. Historically one of the first cases, Chile's military dictatorship provided an ideal precondition to implement neoliberal ideas, producing the first neoliberal financial crash. State enterprises were privatised, public expenditure was reduced and the economy opened up. As the market knows best banking supervision was cut down, as in the US recently. Moral backing came from the Bretton Woods Institutions, especially from the IMF. The IMF's Director of the Western Hemisphere, E. Walter Robichek, assured Latin Americans that exchange and other risks would presumably be taken into account as private firms can be expected to be careful. Private borrowers (as opposed to governments) were very unlikely to overborrow, even with official guarantees. Briefly, private, voluntary transactions were the private sector's own business and presumably Pareto optimal. This view is sometimes called the Robichek doctrine. The "Chilean miracle" turned into a catastrophe in 1982, GDP fell by over 14%. The government was forced to socialise private losses, another parallel to the present US Crisis.

These international crises had positive effects on the IMF. The perpetrator was called in to save its victim; the alcoholic was put in charge to guard the bar. Recently, though, richer SCs had become able to free themselves from the IMF's grip. Early repayments to the Fund started to threaten its existence. On the brink of bankruptcy due to early repayments and a corresponding shrinking of its outstanding claims from SDR 70 billion (2002) to some SDR 15.5 billion (end 2006) as well as income shortfalls projected to surpass 40% during 2008-10 (Torres 2007, p.9), this Crisis saved the IMF once again, also making it more powerful. After the demise of Bretton Woods, the IMF should have been dissolved. The Southern debt crisis of the early 1980s saved it, allowing the IMF to usurp the task of "debt manager" after having egged SCs on to borrow. Again, an international debt crisis the IMF had helped come about saved it in 2008.

Iceland broke the ice. On 24th October, 2008 an IMF package totalling $2.1 billion was announced under the Fund's fast-track emergency financing mechanism. A Stand-By Arrangement for Hungary was approved in November. The G20 decided to increase the IMF's role and financial base substantially. This neoliberal crisis has again put the neoliberal Fund back into business. In March 2009, the IMF "overhauled" its lending structure, also establishing a Flexible Credit Line (FCL). When the first country, Mexico, availed herself of the FCL, IMF First Deputy Managing Director John Lipsky spoke of "a historic occasion", "the largest financial arrangement in the Fund's history", and "the consolidation of a major step in the process of reforming the IMF and making its lending framework more relevant to member countries' needs." (IMF Survey online, April 17th, 2009). The IMF in particular was saved by the Crisis triggered by those neoliberal policies it recommends. Money is rolling in from the leading economies. Apparently due to criticism of her surpluses meanwhile even called one main reason of the US Crisis, China signalled her intention to invest up to US$50 billion in notes issued by the Fund in June 2009.

The worst result, though, is that the IMF was granted more power without any meaningful reform, and may now continue as before. Reform proposals abound, especially with the IMF they have become some kind of cottage industry. It is all the more surprising that the most urgent problem has practically eschewed attention: making the IMF obey its own statutes and the principles it preaches - applying good governance and the Rule of Law to itself. "Reform" is limited to a few basis points of voting being shifted between regions, one tangible though economically irrelevant

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outcome. It might be quite nice if China has a few votes more than Belgium instead of a few votes less, but this will hardly change things fundamentally.

Open violations of its statutes have caused substantial damage to SCs, and increased IMF-income. IMF-flops have created IMF-jobs. This paper argues that any "reform" remains meaningless as long as the IMF is allowed to continue to breach its own statutes and to inflict heavy damages on its Southern members and clients with impunity, financial and institutional gain.

Capital Controls - A Membership Right

Although the IMF's Articles of Agreement clearly stipulate the right to capital controls, even explicitly restricting the use of Fund resources to finance speculative outflows, the IMF has made its Southern members resist from exercising their membership right and financed such outflows. It foisted high interest rates and keeping capital accounts open onto members in distress, at great costs to them and violating its own statutes.

Art. VI(3) establishes the right of members to "exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions". Art. XXX(d) defines these as "not for the purpose of transferring capital", including "Payments of *moderate* (emph. KR) amount of amortization of loans or for depreciation of direct investments", or "*moderate* remittances for family living expenses". Although this definition is somewhat opaque, even restricting flows such as amorisations is a member's right.

Not only has any member the right to control capital flows, but the IMF is not allowed to finance outflows as it did in Asia 1997-8. Pursuant to Art. VI(1)(a), a

> "member may not use the Fund's general resources to meet a large and sustained outflow of capital except as provided in Section 2 of this Article [this refers exclusively to reserve tranche purchases] and the Fund may request a member to exercise controls to prevent such use of the general resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the general resources of the Fund."

By financing large and sustained outflows in East Asia and in other countries, the IMF clearly and openly violated its own Articles of Agreement, inflicting considerable damage on its member countries. Although the IMF may but is not obliged to request controls and declare members ineligible, its statutes clearly show that it is not supposed to press for liberalisation of capital movements in the way it actually did. Clearly, Asian countries had not only the right to control capital outflows in 1997, as the IMF had to admit when Malaysia courageously exercised it (Raffer and Singer 2001, p.157), the Fund's forcing members to finance large and sustained outflows by speculators is definitely a violation of the IMF's own constitution. Routinely, short term speculators have been bailed out in breach of the Fund's statutes.

The intentions of its statutes are clear. Rather than forcing or even encouraging members to keep capital accounts open, the Fund is meant to request controls from members not imposing such controls as appropriate themselves It may even sanction them. However, when it comes to protecting the rights of developing members, legal regulations and obligations are apparently insignificant. Art. VI(1)(b)(ii) allows members to meet outflows "out of a member's own resources, but members undertake that such capital movements will be in accordance with the purposes of the Fund." Members are even encouraged not to finance large and sustained outflows. Current transactions can be restricted with the Fund's approval.

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In plain English, members have always had the right to stop amortisations. In 1997-8 there was no obligation to finance outflows fully, nor is there an economic need to keep extremely high reserves against capital account crises, as several Asian countries do now to shield against having to call in the IMF again. They do so at great costs. Exercising their statutory rights would be cheaper and not expose them to the blame of contributing to "global imbalances", thus being "responsible" for the present US-made crisis.

Falsely Claiming Preferred Creditor Status

Although the status of preferred creditor is alien to the statutes of the IMF, the impression has quite successfully been created over decades that its claims are entitled to preferential treatment. This perception is completely unfounded and at odds with the truth, both regarding the IMF and multilateral development banks. In fact, IFIs have undone their founders' intention, reversing it into its opposite. De facto preference of the IMF and other multilaterals has made debt reductions more difficult as other, bona fide creditors must accept larger haircuts.

The IMF knows that it enjoys no legal or contractual preferred creditor status, as can be read on its very own homepage (Boughton 2001, p.820). When problems with SCs unable to service their debts to the IMF in time could no longer be ignored around 1988, it was tried to find arguments in favour of preference. But the fact that the IMF has no legal or contractual status as a preferred creditor could not be denied. Supporting their institution's drive for undue preference, its "Executive Directors stressed the ... need ... in practice ... to treat the Fund as a preferred creditor." In September 1988, the Interim Committee endorsed this position and "urged all members, *within the limits of their laws*, to treat the Fund as a preferred creditor." (ibid, p.821, emphasis added) The qualification "*within the limits of their laws*" shows that even this IMF-organ could not bring itself to demand unconditional preference for the Fund from its own members. The Committee accepted that national laws may forbid such treatment. In contrast to the impression the IMF tries to create, there is no legal hindrance to treating it like any other creditor. Therefore, the IMF's SDRM-proposal attempted to obtain de jure preferred status for IFIs in an extremely self-serving way.

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Before the Second Amendment, the IMF's Articles of Agreement "contained a provision suggesting that others would have preference on the Fund" (Martha 1990, p.825). The author refers to Schedule B, paragraph three on the calculation of monetary reserves on which repurchase obligations were based. It seems logical that the exclusion of holdings "transferred or set aside for repayments of loans during the subsequent year" was done "to give preference in repayment to lenders other than the Fund." He argues that the intention of deleting this calculation and with it Schedule B, paragraph three from the statutes by the Second Amendment "was not to repudiate the underlying thought that it was beneficial to encourage bank lending by giving banks and others a preference in repayment" (ibid., p.814). Unfortunately, this initial intent was blurred when conditionality was introduced, rather than making the IMF financially accountable as indicated by economic reason, and legally and ethically proper.

One has to concur with Martha (1990, p.814) that the IMF's statute contains "a presumption against a preferred creditor status", and that "general international law contains no compulsory standard of conduct requiring the preferential treatment of any external creditor, including the Fund" (ibid., p.825). However the IMF has no explicit statutory obligation to grant debt relief, which can again be explained by its initial role as a helper without conditionality. Important multilateral development banks violate their own constitutions by not giving members in default relief as stipulated. Preference as interpreted by the multilaterals and the Paris Club creditor cartel and forced onto the South includes absolute exemption of multilateral claims. This is done in open breach of their own statutes by multilateral development banks whose statutes foresee appropriate relief mechanisms explicitly (cf. Raffer 2008; fc, Chapter 13). These membership rights are just denied to SCs.

Forced by external auditors, the IMF started to provide for non-payment by building up loan loss provisions. This means that borrowers have paid for the eventuality of default. Nevertheless they have continuously been refused the relief they had already financed with the "argument" that the Fund were preferred and could not survive losses. It has charged its clients for the event of default, but also claims it cannot use these reserves for the very purpose they were established for. This is like an insurance company charging necessary fees but refusing to cover damages once they occur. Unlike the Fund no insurance company could get away with such behaviour, not even if the client were from the South. Legal double standards may exist, but not everywhere.

Paying for Unlawfully Inflicted Damage

While statutes of other IFIs contain mechanisms of legal redress – most clearly so in the cases of the IBRD and IDA - the IMF clearly differs. Art. IX(3) of its Articles of Agreement grants it total immunity "except to the extent that it expressly waives its immunity for the purpose of any proceedings or by the terms of any contract". Obviously, this is explained by the fact that initially the Fund was to help member countries to overcome short-term dollar/gold-parity problems by unconditional short-term drawings (=loans). It would be difficult to perceive any need for legal procedures and redress in the case of an emergency helper unconditionally giving money, except cases such as money paid to dictators fully knowing that large parts would routinely be embezzled (as did the IBRD in Suharto's Indonesia). Probably such eventuality made the IMF's founders insert this waiver to provide for proper legal dispute settlement. When conditionality became enshrined in the IMF's statutes in 1969, the appropriate change regarding immunity was not made for whichever reason, although its founders would doubtlessly have stipulated the possibility of legal redress as they did with the IBRD if they had approved conditional drawing. Arguably, this was the first step to establish legal double standards globally. Nevertheless, the IMF may not only submit to arbitration or courts, but contractual clauses stipulating this remain expressly allowed. Nothing in its statutes prevents the Fund from applying civilised legal standards. On the contrary, the existence of this waiver seems an encouragement to do so if and when appropriate.

By not availing itself of this option when and where appropriate, the IMF has knowingly created a system incompatible with the very idea of the market economy, good governance, or the Rule of Law. As members are always forced to repay fully, also when avoidable damages are inflicted by gravest negligence or even wilfully by the Fund, more damage created by it leads necessarily to larger involvement of the IMF as a "trouble shooter". Its flops create more IMF-jobs, and increase its importance. This is an intolerable moral hazard situation, unless one agrees to double standards based on nationality. The only exception of the generally accepted principle that someone inflicting damage unlawfully must compensate their victims is unfortunately development co-operation, the last sphere where damage can still be inflicted with impunity and even financial and "reputational" gain. If normal accountability standards applied to Southern debtors there would in all likelihood be no multilateral debt problem.

The IMF may advise (or force, as skeptics may formulate) SCs to implement programmes that it had "known to be counterproductive ... or that had proved to be 'ineffective and unsustainable everywhere they had been tried'41". (IMF 2004, p.91). Footnote 41 further clarifies that the IMF was fully aware of proven ineffectiveness and unsustainability: "As expressed by FAD [the IMF's Fiscal Affairs Department] at the time" (ibid., p.55).This does not result in damage compensation but in increased earnings and more control over the client. A quick and efficient solution would in comparison have reduced earnings. The difference may be illustrated by Stiglitz's (2000) famous story "of one unfortunate incident when team members copied large parts of the text for one country's report and transferred them wholesale to another", leaving the initial name in some places. Any private consultant would be liable to pay damage compensation. In most countries penal consequences would not be unlikely.

Evaluating the Fund's role in Argentina, its own internal controllers found many cases of grave negligence

Evaluating the Fund's role in Argentina, its own internal controllers found many cases of grave negligence, if not worse (IMF 2004). In addition to applying policies fully aware that these were counterproductive, Argentina's programme did not "address the now clear overvaluation of the exchange rate". Another "critical error" (ibid., p.46) in 2001 was, that there was no sufficiently clear understanding what to do should the approach fail. The Board supported "a program that Directors viewed as deeply flawed" (ibid., p.50). The "September 2001 augmentation suffered from a number of weaknesses in program design, which were evident at the time. If the debt were indeed unsustainable, as by then well recognized by IMF staff, the program offered no solution to that problem" (ibid., pp.54f). In a footnote the IEO corroborates this last point by quoting a "memorandum to management dated July 26th, 2001", stating that IMF "staff estimates that a haircut of between 15 and 40 percent is required". Instead, new loans were granted to Argentina. The IMF not only "failed to use the best analytical tools" (ibid, p.66), but "[a]vailable analytical tools were not used to explore potential vulnerabilities in sufficient depth" (ibid., p.67). It goes without saying that the IMF was as usual unduly "optimistic" in its forecasts, as the report documents. This is just a small selection from a limited part of the period evaluated in one country. May this suffice to show that, if the IMF were a consultancy firm and Argentina its client, the plaintiff's lawyers would have a feast. But the IMF is not a consultant and Argentina had to pay for programmes that (as the IMF did know, according to its own documents) contributed to her ruin. The IMF got more interest income from Argentina than it would have got if it had refrained from such strategies. One cannot but concur with the Statement of the Argentine Governor: "Recognising errors is, however, just the first step in a healthy self-criticism exercise. The second step is bearing responsibility for failures, namely sharing the burden of redressing their consequences" (ibid., Annex) as allowed by the IMF's statutes. Equal treatment of all creditors in the case of a country's incapability to pay fully would be a first yet important step to provide incentives for good institutional governance and for applying due care. Furthermore, arbitration and courts could be used to provide decent legal relief (see Raffer 2004; fc). The IMF's statutes authorise it to behave properly by waiving its immunity in such scandalous cases.

Conclusion

More voice and representation of the South within the IMF is necessary and fair. But all present reform proposals will go nowhere unless one forces the IMF to obey its own statutes. A seven percent shift of voting in the IMF is doubtlessly a well justified demand, but making the IMF obey its statutory obligations even if and when these safeguard rights of SCs is much more important. Obeying one's own statutes is the cornerstone of the Rule of Law and good governance – without enforcing this self-evident necessity any other reform will remain fairly useless. One may flout one version of one's statute as well as any other if allowed to do so. IER

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