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BODY:

The **International Monetary Fund** has displayed its awesome power in recent months in assuming the central role in the unfolding Asian financial crisis. Since July, the **IMF** has organized financial bailouts totaling more than \$ 100 billion of public funds in Indonesia, South Korea, and Thailand. Yet the **IMF** is almost unknown to the American people. Its vague public image -- carefully tended by the institution itself -- is something like the cartoon in a recent *Time* magazine profile: The **IMF**, garbed as Superman, sweeps low over the earth, extinguishing financial blazes. But a careful examination of the actual record shows that the **IMF**, loyal to financial orthodoxy and mindful of creditors to the neglect of debtor countries, often pours oil on the flames.

Consider the **IMF's** recent actions in Asia. Asia's current crisis has all the ingredients of a financial panic made in the private sector. Asian banks are large debtors to foreign banks, and a large part of the debt is very short-term. Despite sound "fundamentals" in Asia -- such as budget surpluses, high saving rates, low inflation, and export-oriented industries -- foreign creditors began to withdraw money from Asia last spring because of growing concerns about currency overvaluation, bank scandals, and weak real estate markets.

These concerns multiplied in midyear when Thailand devalued the baht. Suddenly, international banks became wary of extending new loans in Asia as the old loans fell due. The banks were becoming a bit worried about Asia's long-term prospects, which still looked rather good, but were much more worried about what the other investors were doing. Each investor understood that Thailand, Indonesia, and Korea would be pushed into outright default if enough creditors pulled the plug on new loans. In the end, each creditor started to rush for the doors precisely because the other creditors were doing the same thing.

In this kind of shaky situation, the role of public policy is to help the markets escape a self-fulfilling stampede. Six months ago, the appropriate steps for senior finance officials in the United States, Japan, and Europe would have been to try to slow the flight of the creditors. The major banks should have been brought together in mid-1997 to underscore their collective interest in avoiding a self-defeating panic (such discussions in fact began only at the end of December 1997, once the panic was already in full swing). At the same time, the key central banks led by the Federal Reserve might have extended some credit lines to their Asian counterparts, without great public fanfare and without adding to the market anxieties.

Instead, the IMF arrived in Thailand in July filled with ostentatious declarations that all was wrong and that fundamental and immediate surgery was needed. (Ironically, the ink was not even dry on the IMF's 1997 annual report, which gave Thailand and its neighbors high marks on economic management!) The IMF deepened the sense of panic not only because of its dire public pronouncements but also because its proposed medicine -- high interest rates, budget cuts, and immediate bank closures -- convinced the markets that Asia indeed was about to enter a severe contraction (as had happened earlier in Argentina, Bulgaria, and Mexico). Instead of dousing the fire, the IMF in effect screamed fire in the theater. The scene was repeated in Indonesia in November and Korea in December. By then, the panic had spread to virtually all of East Asia.

Even though the original fire could well have been contained, the ensuing panic has proved devastating. In Indonesia, Korea, and Thailand, stock and currency markets plummeted after the IMF entered the scene, and this despite the enormous bailout loans to these countries. Asia's own banks have stopped making loans in response to the IMF's insistence on closing "weak" banks. The local banks could read the warnings. They started to call in their own loans to build up cash reserves, since otherwise the IMF might insist on their own closure. In the end, the IMF programs could well cause Asia much more harm than benefit. Asian governments will borrow tens of billions of dollars to enable their banks to pay off foreign creditors, but the internal economies may well collapse. The Asian governments will get stuck with debts owed to the IMF and foreign governments, and the economies will contract sharply, while the foreign creditors will escape unscathed.

The IMF has provided a benchmark for judging its effectiveness in Asia. In the August program for Thailand, the IMF projected Thai growth of 3.5 percent for 1998. In the November Indonesia program, the IMF projected 1998 growth of 3 percent. And most recently in Korea, the IMF is targeting growth of 2.5 percent. These projections almost surely will fail just as the IMF's projections failed in Argentina, Bulgaria, and Mexico (more on this below). All three Asian countries are likely to suffer extreme contractions next year at the hands of the IMF's policy-induced credit crunch. Industrial production in Thailand was down 8 percent in November compared with a year earlier. A wave of bankruptcies is sweeping Korea, and a massive rise in unemployment seems set to hit all three of the economies. Most private forecasters are projecting outright declines in gross domestic product (GDP) next year, a sharp change indeed for economies that have grown at more than 6 percent per year for a decade or more. If history is a guide, the IMF will simply ignore its own faulty forecasts for the Asian program, rather than asking what went wrong.

WHAT IS THE IMF?

The Asian story is hardly unique. In most of the developing world the IMF is not a figure that swoops in for a quick rescue. On the contrary, for perhaps half of the developing world outside of China and India, the IMF is an all-too-constant presence, almost a surrogate government in financial matters. Not unlike the days when the British Empire placed senior officials directly into the Egyptian and Ottoman finance ministries, the IMF is insinuated into the inner sanctums of nearly 75 developing-country governments around the world -- countries with a combined population of some 1.4 billion. These governments rarely move without consulting the IMF staff, and when they do, they risk their lifelines to capital markets, foreign aid, and international respectability. Newspaper headlines in these countries herald the comings and goings of IMF staff.

The IMF's power rests on three bases. Most importantly, the IMF is the instrument by which the U.S. Treasury intervenes in developing countries. When the United States took the initiative in bailing out Mexico in 1994 and Korea in 1997, it turned to the IMF as the institution that could provide the cover, the staff, and the bucks to do the job. Second, many developing countries genuinely welcome the chance to sign a "contract" with the world community, represented by the IMF, in which good economic policies are rewarded with emergency loans. Third, and much more dangerous, IMF power also flows from the institution's carefully constructed image of infallibility. The IMF gets its way in the developing world because to disagree publicly with the IMF is viewed in the international community as rejecting financial rectitude itself.

In dozens of cases each year in which developing-country governments manifestly do not agree with IMF prescriptions, they are terrified to murmur any opposition. To do so immediately brands the government as "lacking seriousness" in economic management. The new President elect of Korea spent the first day following his election

victory genuflecting to the IMF. Already the international financial press is judging Korea on whether or not it adheres to the IMF "medicine," without even asking whether the medicine is sensibly prescribed. From the point of view of the U.S. government, the IMF's aura of infallibility is obviously a convenient myth. Pesky developing countries are kept in line with little effort, and U.S. policymakers are confident that the IMF will do their bidding in any event. In fact, since the IMF has economic programs in some 75 countries, and since the U.S. Treasury carefully tracks a mere handful of these at any one time, the IMF staff is really running the show in most of the developing world with almost no supervision from the United States or anyone else. IMF autonomy is especially real in the poorest countries of the world, for which the Treasury and U.S. financial community have little time or interest.

No doubt the IMF is a convenient instrument of U.S. financial diplomacy in the high-profile cases. For a small amount of U.S. appropriations every few years, the United States gains effective control (shared to some extent with the European Union and Japan) over a large pool of money that can be lent to developing countries without congressional meddling. Since the IMF pools resources from all the member countries, the United States's own contribution is multiplied severalfold, and the U.S. influence inside the organization is all out of proportion to the U.S. contribution. Moreover, when the IMF loans money to governments, the loans are nearly risk free, since most governments recognize that their entire international standing rests on a timely repayment of those loans even if that means default to other creditors, extreme internal recession, or sales of valuable domestic assets.

The immense authority of a secretive international institution may be cozy for senior U.S. policymakers, but it can be deeply troubling for developing countries that live under IMF programs. The IMF claims that these fears are overblown: After all, its economic programs are voluntary -- the IMF cannot impose a program on an unwilling government. This voluntarism is a matter of semantics, however. When the most powerful governments of the world inform a poor developing country that it must agree with the IMF or else lose access to foreign aid, the goodwill of major governments, the chances for debt restructuring, and the confidence of private markets (which are encouraged by the G-7 to use IMF agreements as focal points for their own bargaining), the notion of voluntarism is a bit stretched.

The IMF also argues that it is a true international organization, jointly governed by developing and developed countries. True, the IMF is a voluntary association of member governments, now 182 in number. And true, it is governed by an executive board that represents the finance ministries of all of the member countries. But in fact, the executive board is largely a rubber-stamp institution of the U.S. Treasury and the major finance ministries of Europe and Japan, and the IMF senior staff itself. Voting is weighted by financial contribution (the so-called quota), so that the United States, the European Union, and Japan combined have a comfortable majority. Moreover, the quota allocations are set to preserve the voting clout of the developed countries. India and China have smaller votes than the Netherlands, for example, despite economies that are roughly four and ten times larger in purchasing-power terms (and populations, of course, that are more than 60 times larger). The board is also extremely weak in its operational oversight of the IMF staff: It almost never looks beyond IMF staff reports, and almost never seeks independent information or independent follow-up evaluations. Moreover, since IMF program documents are automatically confidential, the public has almost no ability to weigh in on IMF decisions.

AN IMF PRONE TO MISTAKES

The great power of a secretive international bureaucracy would be troubling enough to believers in limited government and public accountability. The problem is worse. The IMF's mask of infallibility hides a record of mediocrity punctuated by some truly costly blunders. Of course, these blunders almost never come to public light. When an internal IMF review criticized the IMF's role in Mexico in 1993 and 1994, it was quickly hushed up and never made public. In most cases, critical reviews are never put to paper. When anything goes wrong in an IMF-country program, it is easy enough to blame the government of that country for failing to abide by the (secret) words of wisdom of IMF staff.

As an economic advisor to many developing-country governments, I have had a rare opportunity to witness IMF operations at close range. Let me mention a few cases.

In 1985, Bolivia faced a 24,000 percent hyperinflation, a 30 percent drop in living standards, and a catastrophic

rise in poverty, reflecting a generation of mismanagement by dictatorships, over-indebtedness, and the collapse of tin exports. When a new democratically elected government came into office in 1985 and bravely carried out a dramatic stabilization program, the IMF nearly torpedoed the government's successful efforts by demanding a resumption of payments on a mountain of bad debts inherited from past military governments. Luckily, Bolivia fought this one -- in this case it had almost nothing to lose. The United States backed the Bolivians, in part as a reward for Bolivia's economic reforms and its cooperation with U.S. antidrug policy. As a result, Bolivia pioneered debt relief two years before it became official IMF policy. And though the IMF had initially opposed the whole approach, Bolivia's success was later trumpeted as an IMF success story.

In 1989, postcommunist Poland desperately needed a fund to stabilize the exchange rate. A stabilization fund is a pool of money that allows the central bank to intervene in currency markets to prevent damaging speculative swings in its exchange rate. The idea of a stabilization fund was a novelty; the IMF didn't warm up to the idea until six years later when such funds finally became part of IMF policies. The IMF mission to Poland dismissed the idea of a stabilization fund. Fortunately, the Poles were able to lobby the United States directly (thank goodness for Chicago voters), the zloty stabilization fund was established without the IMF's initiative, and Poland succeeded in breaking the hyperinflation. Again, Poland's success was later championed as an IMF success story.

In 1992, Estonia wanted to break out of the disastrous hyperinflation that gripped the 15 successor states of the Soviet Union. The IMF's brief was both ludicrous and explicit: Try to keep all of the successor states joined in a common ruble currency, which would be managed from 15 capitals, with 15 coordinated IMF programs. The vision was preposterous: Any introductory economics student would have figured out that with 15 independent central banks all issuing credit in a shared currency, the outcome would be continuing hyperinflation. The Estonians told the IMF that they would introduce their own currency with or without the IMF support. The IMF relented in Estonia, and the Estonians became the first stable post-Soviet economy. Not only was Estonia paraded as an IMF success story, but the hapless other 14 successor states -- which experienced a full year more of hyperinflation under the IMF's flawed policy -- were castigated by the fund for their errant ways.

In Bulgaria in 1996, the IMF praised the government for its continuing reforms, and signed a new agreement with the Bulgarian government for a one-year loan. The program forecast a zero growth rate in 1996 and 2.5 percent for 1997. The IMF recognized that there was a budding banking crisis but neither the IMF nor the Bulgarian government really knew how to handle it. In a ham-handed way, the IMF and the government decided to take "tough" action, including the announcement of sudden bank closures. Depositors panicked; the rest of the banks collapsed, and the flight from the currency produced a hyperinflation. Defying IMF predictions, in 1996 GDP collapsed by 10.9 percent (in fact, this represents a staggering fall of around 20 percent in the second half of 1996). Of course, the IMF blamed the entire mishap on the government. Ironically, the IMF has entered Asia with the same ill-prepared calls for immediate bank closures.

Bulgaria is one of three recent IMF cases that resemble the Asian financial crisis. The other two are Mexico and Argentina in 1995. These second two IMF interventions are often viewed as great IMF success stories, but a closer look is disquieting. In Mexico in 1994, as in East Asia in 1997, foreign creditors turned abruptly from euphoria to flight. The outflow of funds started moderately in April 1994; it became a stampede in December 1994, following the devaluation of the Mexican peso. Like Asia, Mexico was basically a solvent, creditworthy country hit by a panicked withdrawal of foreign funds. And like today's crisis countries in Asia, Mexico had so much short-term debt that the sudden withdrawal of confidence threatened to push Mexico into default.

The United States and the IMF led a bailout operation in early 1995. The IMF was assigned the task of designing the "macroeconomic framework" -- the set of monetary, interest rate, exchange rate, and fiscal policy targets -- to accompany the bailout loan to Mexico. The IMF didn't really understand the Mexican crisis, and treated it incorrectly as a typical case of a profligate government rather than crisis in the private capital markets. The IMF called for a lot of monetary and fiscal stringency that unnecessarily added to the contractionary effects of the creditor panic. In setting up the program, the IMF forecast a Mexican growth rate of 1.5 percent in 1995. The actual outcome was -6.1 percent. This whopping prediction error of 7.6 percentage points within the year was never explained, and apparently did not lead the IMF to reconsider its strategy in Mexico or in similar countries.

Three months after the Mexico shock, Argentina felt the tidal wave of investor panic. Once again, the IMF was

thrust into a case of banking crisis made in the private sector rather than the government sector. Once again, the IMF resorted to its tried-and-true tactics: budget cuts, interest rate increases, a credit squeeze. And once again, the IMF left a benchmark for judging its own work. As of April 1995, the IMF projected Argentine GDP growth of 2 percent to 3 percent in 1995. The actual outcome was -4.6 percent, again a miss of around 7 percent of GDP within the very year of the program.

The list of questionable judgments can be extended into many other areas. Just to name a few:

* The IMF rejected the idea of debt relief for seven years after the outbreak of the developing-country debt crisis in 1982. Official IMF policy insisted that no relief was needed. When the U.S. Treasury finally shifted position in April 1989, the IMF suddenly swung around. There was, apparently, no follow-up review of why the decision on debt relief had been so long delayed, and at what cost.

* While many high-profile countries have received debt relief after 1989, many of the poorest of the poor have continued to languish. The recent IMF-World Bank initiative on debt relief for Highly Indebted Poor Countries (HIPC) was long delayed, and is exceedingly limited in scope and lacking in urgency.

* The IMF has missed the boat in the former Soviet Union, failing to help countries to institute separate national currencies until after they had been ravaged by hyperinflation, and generally failing to address the linkages between corruption, disastrous tax systems, poor public management, and ongoing macroeconomic turmoil.

* The IMF rejected stabilization funds for Russia and other transition economies when they could have been useful. It finally adopted the policy of supporting such funds in 1995. Again, there was no external review of past decisions.

AN ACCOUNTABLE IMF

It is high time that we take the IMF seriously -- seriously enough to hold it accountable for its actions, its failed forecasts, and the details of the "advice" that it imposes on the developing world. The IMF will be with us for the foreseeable future. The name of the game is reform, not elimination of the institution. Public bureaucracies need to be tamed by transparency, disclosure, oversight, and where possible, competition. Before Congress delivers more money to the institution, the IMF should be held accountable to the same standards of good governance that it sanctimoniously preaches for others.

First, all IMF program documents should be made public, and thereby open to public debate and critical scrutiny. Even with \$ 100 billion of taxpayers' money on the line, the programs in Asia were not made public by the IMF (in fact, Korea made the main loan agreement public a couple of weeks after signing, while the Thailand and Indonesia documents remain confidential). In some cases, a delay of a few weeks or even months might be understandable, when market-sensitive information must be withheld. The current system of a 30-year embargo of program documents is preposterous. In addition, the IMF archives should be opened so that scholars and market participants can better understand what the IMF has done and failed to do in the past. What really happened in Russia, Mexico, and Argentina? How did the IMF decide on its strategy for the developing-country debt crises?

Second, the executive board should start doing its job of overseeing the staff, rather than simply rubber-stamping the staff's programs. A properly functioning executive board, perhaps with voting weights adjusted to reflect economic realities, would realize that there is more information, informed opinion, and ideas around than are found within the fund itself. With issues as complex and challenging as the debt crisis, postcommunist market transition, the Asian currency crisis, or the failures of economic growth in Africa, the executive board should take the lead in canvassing outside opinion and testing the IMF staff's recommendations and approaches. The executive board should also take the minimal step of formalizing a process of external review and evaluation of past programs. The World Bank introduced external evaluations as a result of strong pressures from environmental groups aghast at the environmental mismanagement of World Bank projects. By many accounts, the process has added integrity and discipline to World Bank programs.

Finally, and most importantly, it is time to end the IMF's artificial monopoly on policymaking in the developing

world. The IMF complains frequently that member governments don't feel proper "ownership" of the programs that they sign with the IMF, and therefore that these governments fail to implement them adequately. The subtext is clear: "Ownership" is simply a buzzword meaning happier compliance with the directives from Washington. It is time for real ownership in the developing world. This will come when programs are designed by member governments, with the help rather than the command of the IMF, thereby making it far more likely that programs will be tailored to the specific and complex circumstances of the particular countries. Some of the favorite nostrums of the IMF and the U.S. government -- such as insisting that countries open their capital markets to global markets even before adequate banking supervision is in place -- will fall by the wayside as the realities of local circumstances are brought to the fore. Better advice from the start will save us the headaches -- and the tens of billions of dollars -- that expensive bailout operations cost.

As democracies gain strength in Latin America, Africa, postcommunist Europe, and developing Asia, we should expect and rejoice in the moral authority and political legitimacy of elected leaders to chart the economic course for their nations. The G-7 and the IMF itself should give these new democracies the space to act. The IMF's advice might prove useful -- even welcome -- if it becomes part of a true collaboration between rich and poor nations in search of common global goals.

GRAPHIC: Illustration, no caption

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