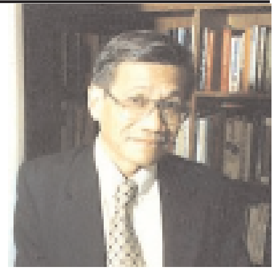
FPIF Column

The Crisis of Multilateralism



Walden Bello | September 13, 2006

Already buffeted by institutional crisis and policy conflicts, the International Monetary Fund (IMF) and the World Bank are heading into their fall meeting—scheduled to begin September 13 in Singapore—with yet one more problem. Desperate to win credibility among civil society groups, the Bank and the Fund had given official accreditation to representatives of four civil society organizations. The Singapore government had a different idea. It banned the groups "for security reasons." This commentator was among those specifically named and banned as a "security threat."

The two institutions have formally protested the government's action. But they are simply reaping the consequences of their decision to hold the fall meeting in the authoritarian island-state in order to avoid street protests like those that have attended WTO ministerial meetings. Angry at the banning of their colleagues, many civil society representatives are now asking the Bank and Fund to cancel the annual meeting, demanding that the two agencies be consistent with their declared support for practices of "good governance."

Controversial Reforms

Prior to the controversy over the banning of the NGO's, the IMF's Executive Board was trying to steer through two reforms intended to "safeguard and enhance the Fund's credibility." The first involved reallocating the voting power of IMF member countries according to the current size of their gross domestic product. This proposal was ostensibly intended to increase the voting power of a selected number of big developing countries—Korea, Turkey, China, and Mexico—while laying the ground for eventually expanding the decision-making power of other developing countries. The other initiative the IMF leadership was trying to get off the ground would give the Fund the new role of solving "global macroeconomic imbalances"—a euphemism for disciplining countries with large trade surpluses like China.

Both reforms are mired in controversy.

A bloc of about 50 developing countries objects to the proposed GDP-based formula. These countries see the move as dividing developing countries while producing only one real winner: the United States, which would increase its voting power under the new system. The second initiative has generated opposition for attempting to get the Fund to do Washington's dirty work of pressuring China to revalue its currency to reduce the massive U.S. trade deficit with Beijing.

These troubles are the latest in a string of crises to plague the two agencies, also known as the "Bretton Woods institutions" after the site of the July 1944 conference where they were founded. The Fund, in particular, is in a state of demoralization. "Ten years ago, the IMF was flying high, arrogant in its belief that it knew what was the best for developing countries," notes one civil society policy paper. "Today, it is an institution under siege,

hiding behind its four walls in Washington, DC, unable to mount an effective response to its growing numbers of critics."

The IMF's Stalingrad

The IMF's equivalent of Stalingrad—where the defeat of the German Sixth Army marked the turning point of World War II—was the Asian financial crisis, where it "lost its legitimacy and never recovered it," according to Dennis de Tray, a former IMF and World Bank official who is now vice president of the Washington-based Center for Global Development.

The Fund was blamed for pushing policies of capital account liberalization that made the Asian economies vulnerable to the volatile movements of speculative capital; assembling multibillion dollar rescue programs that rescued creditors at the expense of the debtors; imposing expenditure-cutting programs that merely worsened the downspin of the economy; and opposing the formation of an Asian Monetary Fund that could have provided the crisis countries with financial reserves to save their currencies from speculative attacks.

The Fund went from one financial disaster to another. The Russian financial collapse in 1998 was attributed to its policies, as was Argentina's economic unraveling in 2002.

Resistance was not long in coming. In the midst of the Asian financial crisis, Prime Minister Mohamad Mahathir of Malaysia broke with the IMF approach and imposed capital controls, saving the country from the worst effects of the crisis. Mahathir's defiance of the IMF was not lost on Thaksin Shinawatra, who ran for prime minister of Thailand on an anti-IMF platform and won. He went on to push for large government expenditures, which stimulated the consumer demand that brought Thailand out of recession. Nestor Kirchner completed the humbling of the IMF when, upon being elected president of Argentina in 2003, he declared that his government would pay its private creditors only 25 cents for every dollar owed. Enraged creditors told the IMF to discipline Kirchner. But with its reputation in tatters and its leverage eroded, the Fund backed off from confronting the Argentine president, who got away with the radical debt write-down.

By 2006, underscoring the crisis of legitimacy of the institution, the governor of the Bank of England described the IMF as having "lost its way."

From Crisis of Legitimacy to Budget Crisis

The crisis of legitimacy has had financial consequences. In 2003, the Thai government declared it had paid off most of its debt to the IMF and would soon be financially independent of the organization. Indonesia ended its loan agreement with the Fund in 2003 and recently announced its intention to repay its multibillion-dollar debt in two years. A number of other big borrowers in Asia, mindful of the devastating consequences of IMF-imposed policies, have refrained from new borrowings from the Fund. These include the Philippines, India, and China. Now, this trend has been reinforced by the move of Brazil and Argentina earlier this year to pay off all their debts to the Fund and declare financial sovereignty.

What is, in effect, a boycott by its biggest borrowers is translating into a budget crisis for the IMF. Over the last two decades the IMF's operations have been increasingly funded from the loan repayments of its developing country clients rather than from the contributions of wealthy Northern governments. The burden of sustaining the institution has shifted to the borrowers. The upshot of these developments is that payments of charges and

interests, according to Fund projections, will be cut by more than half, from $3.19 billion in 2005 to $1.39 billion in 2006 and again by half, to $635 million in 2009. These reductions have created what Ngaire Woods, an Oxford University specialist on the Fund, describes as "a huge squeeze on the budget of the organization."

Role Crisis

The erosion of the Fund's role as a disciplinarian of debt-ridden countries and an enforcer of structural adjustment has been accompanied by a futile search to find a new role.

The Group of Seven tried to make the Fund a central piece of a new "global financial architecture" by putting it in charge of a "contingency credit line" to which countries about to enter a financial crisis would have access if they fulfilled IMF-approved macroeconomic conditions. But the prospect of a government seeking access to a credit line that could trigger the very financial panic that it sought to avert doomed the project.

Another proposal envisioned an IMF-managed "Sovereign Debt Restructuring Mechanism"—an international version of a Chapter 11 bankruptcy mechanism that would provide countries protection from creditors while they came out with a restructuring plan. But when South countries objected that the mechanism was too weak and the United States opposed the proposal for fear it would curtail the freedom of operations of U.S. banks, this new prospect also collapsed.

The role of righting "global macroeconomic imbalances" assigned to the Fund during the spring meetings of the IMF leadership earlier this year is part of this increasingly desperate effort by the G 7 governments to find a task for an international economic bureaucracy that had become obsolete and irrelevant.

Hiding the World Bank's Crisis

While it does not have the aura of controversy and failure that surrounds the IMF, the World Bank is also in crisis, say informed observers. A budget crisis is also overtaking the Bank, according to Ngaire Woods. Income from borrowers' fees and charges dropped from US$8.1 billion in 2001 to US$4.4 billion in 2004, while income from the Bank's investments fell from US$1.5 billion in 2001 to US$304 million in 2004. China, Indonesia, Mexico, Brazil, and many of the more advanced developing countries are going elsewhere for their loans.

The budgetary crisis is, however, only one aspect of overall crisis of the institution. The policy prescriptions offered by Bank economists are increasingly seen as irrelevant to the problems faced by developing countries, says de Tray, who served as the IMF's resident officer in Hanoi and the World Bank's representative in Jakarta. The problem, he says, lies in the emphasis at the Bank's research department on producing "cutting edge" technical economic work geared to the western academic world rather than coming out with knowledge to support practical policy prescriptions. The Bank is currently staffed by some 10,000 professionals, most of them economists, and de Tray claims that "there is nothing wrong at the World Bank that a 40% staff reduction would not fix."

American University Professor Robin Broad, an expert on the Bank, claims that the Bank is, in fact, in more of a crisis than the IMF but that this is less visible to the public. "The IMF's response has been to withdraw behind its four walls, thus reinforcing the public perception of its being besieged," she notes. "The Bank's response, however, has been to engage the world to hide its mounting crisis."

Broad identifies three elements in the Bank's offensive. "First, it goes out and tells donors that it is the institution best positioned to do lending to end poverty, for the environment, for addressing HIV-AIDS, you name it…when in fact its record proves that it's not. Second, it has the world's largest 'development' research department—funded to the tune of about $50 million—whose *raison d'etre* is to produce research to back up predetermined conclusions. Third, it has this huge external affairs department, with a budget of some $30 million—a PR unit that feeds these so-called objective research findings to the press and fosters the image of an all-knowing Bank." But, she concludes, "This can't last. Inside the Bank, they know they're in crisis and are scrambling. And sooner or later, if we do our work, the truth will come out."

Multilateralism in Disarray

The crisis of the Bretton Woods institutions must be seen as part of the same phenomenon that has overtaken the World Trade Organization, whose latest round of trade liberalization negotiations fell apart in July. Noting that "trade liberalization has stalled, aid is less coherent than it should be, and the next financial conflagration will be managed by an injured fireman," the *Washington Post*'s Sebastian Mallaby contends that "the great powers of today are simply not interested in creating a resilient multilateral system."

What is troubling for people like Mallaby, however, offers an opportunity for those who have long regarded the current multilateral system of global economic governance as mainly concerned with ensuring the hegemony of the developed countries, particularly the United States. Proposals for alternative institutions for global finance have been circulating for some time. The current crisis may be the break in the system that will make governments, especially those in the South, willing to seriously consider the alternatives.

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