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Ready for a Role Change?

Stung by criticism that its bailout policy hasn't worked, the IMF mulls reforms that stress crisis prevention, not just rescue

By Mac Margolis and Richard Ernsberger Jr.

If you think your job is thankless, try working at the International Monetary Fund. Not so long ago the IMF was the pin-striped fireman of global finance, dashing from one national conflagration to the next, and mostly praised for its work.

Nowadays "the Fund" is just another word for "angry," which describes the mood of many government officials and ordinary citizens when they hear that the sober-minded Washington economists are around. South Americans are heaping scorn on the organization; last week Argentine Finance Minister Roberto Lavagna partially blamed the IMF for his country's economic collapse, accusing it of "blindness" for not spotting the policy missteps of the mid 1990s that by the end of the decade had helped push Argentina to the brink of economic collapse. The Fund isn't very popular with the home crowd either: 650 anti-globalization demonstrators were arrested in D.C. last week as the annual IMF-World Bank meeting commenced.

One expects the bandanna-and-Birkenstock set to shout at the beast of global capitalism. But lately prominent bankers, analysts and Ivy League luminaries have all taken turns flaying the Fund—for "losing" Russia, for making wrongheaded policy prescriptions in Asia after its 1997 economic crisis, for pushing market fundamentalism on poor countries that lack the institutions to handle it, for doing too much, for doing too little. Ian Vasquez, a senior economist at the conservative Cato Institute, calls the Fund's traditional economic bailouts a "disaster." Nobel Prize-winning economist Joseph Stiglitz, the former senior economist for the World Bank, devoted an entire book ("Globalization and Its Discontents") to bashing the Fund. "The Fund has done something no one else could. They've united the left and the right, the developed and developing countries against it," he told NEWSWEEK.

Some of the criticism is grossly exaggerated. With the global economy sputtering and U.S. stock market in tatters, everybody is feeling some pain. And yet even the staunchest Fund loyalists agree that the business of righting the world economy has gone wrong—especially in Latin America, where, after a decade of IMF-prescribed belt-tightening and market-friendly reforms, nation after nation is still choking on debt. Uruguay's banks are threatening to crumble. Brazil's by-the-book fiscal discipline has won plaudits, but that country remains a shaky bet in capital markets and, in August, needed a historic $30 billion loan from the Fund to keep the real from sinking. The International Institute of Finance, which represents 322 institutional investors, projects net foreign-capital flows to Latin America this year of $123 billion, the lowest level since 1992. And it's not only Latin America that is hurting. According to an IMF report, 44 client-nations are chronic borrowers—that is, they've never managed to pull themselves off the world's indigent list. **"The IMF hasn't had a victory in a long time," says Alex Kazan, Latin American analyst for the G7 Group, a private consulting firm in Washington. "There really is a sense that they are becoming impotent."**

The Fund argues that its basic policies—fiscal restraint, low inflation through tight monetary policy—are as sound as ever. But it's clearly been stung by the criticism, so much so that the organization has lately embarked on a process of self-examination. Last week the Fund even issued a few cryptic mea culpas. A report from an internal-review panel admitted that some economic-rescue programs were "deficient in design." The Fund also blamed itself for "excessive optimism" at times, for caving in occasionally to "political considerations" and for "insufficient adaptability in response to shocks or deviations."

IMF Managing Director Horst Kohler, in a speech last month, was not giving much ground. He said the big problem in Latin America was too little reform, not too much. But he made clear that "the latest experience in [that region] should make us humble about our performance." And he emphasized that the organization had embarked on a reform agenda. What will it include? "First," he said, "we must do more to improve the IMF's capacities for crisis prevention." That is a signal shift—one that could turn the organization into more of a surveillance rather than emergency-relief operation. To do that, Kohler said, the Fund must help member countries put "shock absorbers" in place to cope with risks—more flexible exchange-rate regimes, better debt management and "more effective social safety nets." He also stressed that economic gurus needed to start "thinking creatively about ways to deal with the excessive volatility of international flows." Latin America, in particular, has been repeatedly crippled by investors who grab their money and run at the first inkling of a problem.

The Fund also aims to be more "selective" with its lending, Kohler said. That, too, would be a big change. Alberto Bernal, an analyst with the Wall Street consultancy IDEAglobal, contends that, in the future, it will be harder for developing countries to receive major IMF loans unless they can prove there's a "unified political front" backing the reforms the IMF recommends. "In the past it was enough for, say, the president of Ecuador to say he believed in market reforms, whereas the country's Congress might be 99 percent against them. One person cannot make the difference. For the IMF, that can no longer be an option."

The biggest issue raging in Washington now is what to do when nations go broke. Anne Krueger, the IMF's deputy director, has proposed that the Fund become a sort of international bankruptcy court. Under this concept, the IMF would halt the obligations of a troubled debtor, winning time for the country to pay back its loans under terms negotiated by an international committee. Creditors would grant the relief, and the Fund would referee the process. Not everyone is keen on the idea; private investors fear it will encourage profligate nations to renege on loans.

What it all adds up to, say some analysts, is a less interventionist IMF. The United States has long held the view that it could solve the world's economic woes through massive bailouts. "That view is no longer appreciated," says Bernal, "especially after the collapse of Russia and Argentina." Indeed, U.S. Treasury Secretary Paul O'Neill and other Bush administration officials have opposed the idea of massive bailouts. The Fund is already showing some flexibility. Since the Asian crisis, it has dropped its rigid and uniform demand for tight money (through higher interest rates). That's still the basic pursuit, but the Fund now vows to mold monetary policy on a case-by-case basis. The IMF, now 57 years old, is not going to alter its course too dramatically, or too fast. And it shouldn't. Kohler suggested as much when he noted, in his speech, that the Fund would need more funding from its members. In this business, money raised is money loaned. Isn't that where we started?