IMF and Monetary Reforms: Latin American and Caribbean Perspectives

Conference Report

The Centre for International Governance Innovation

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Up to now, the debate about International Monetary Fund (IMF) reform has been shaped largely by conversations among policy makers and scholars from countries of the Organisation for Economic Co-operation and Development (OECD). To remedy this imbalance, The Centre for International Governance Innovation (CIGI), in collaboration with the Initiative for Policy Dialogue, Columbia University, and New Rules for Global Finance Coalition sponsored a series of regional conferences in order to bring voices from emerging and developing countries to the IMF reform debate. Following previous meetings that have covered Asia, Central Asia, Africa, and the Middle East, this meeting in Washington, DC focused on Latin American and Caribbean perspectives to the IMF reform debate. The initiative brought together scholars and officials from central banks and governments throughout the region who have been or currently are involved in relations with the IMF. The objective of the meeting was to articulate the needs and priorities for future services from the Fund for these countries.

This workshop explored why the Latin American and Caribbean perspective is important for the future of the IMF. The Fund has played a considerable role in the political and economic life of many of the countries in the region throughout the last quarter century. IMF intervention has been associated with the provision of loans and economic restructuring in the 1970s and emergency financing in the aftermath of the several crises that have plagued the region beginning with the debt crisis in 1982, the Mexican or “tequila” crisis in 1994 and, ultimately, the Argentine crisis in 2001. For some of the smaller and most vulnerable countries, the Fund has recently been associated with the process of debt relief under the "Highly Indebted Poor Countries" (HIPC) initiative. In 2005, the Fund was allocating 80 percent of its loans in Latin America alone.

However, the importance of the Latin American and Caribbean perspective on the future of the IMF is significant given the decline it is currently experiencing. To date, the Fund's commitment in the region has fallen from more than US$50 billion to less than US$3 billion.

Several factors have created the conditions for this loss of influence. The high prices of the oil and commodity markets, the global demand for the most important Latin American exports, and regained macroeconomic stability have allowed several countries to replenish their foreign exchange reserves and "graduate" from the Fund's financial assistance. Today, there are only a few Latin American and Caribbean countries requesting financial assistance from the IMF given these developments.

Does this increasing lack of demand for loans indicate that the Fund has been successful in its interventions in the region? From the Fund's perspective, this is a sign that the region has internalized and benefited from its advice about macroeconomic policy and structural reforms. However, in the view of many Latin American countries, the diminished role of the Fund is more a sign of its ailing reputation in the region than of its success. The credibility of the Fund in these countries has certainly fallen in the last decades. The default by the Argentinean government in 2001 — for a decade the poster-child of the IMF — has led many government officials to openly question the effectiveness and legitimacy of its intervention.

Several Latin American countries have reacted to the financial crises of the last decade and mistrust in the IMF by bolstering their independence from the Fund. In December 2005, the Argentine and Brazilian governments

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— two of the largest borrowers — announced their intention to repay entirely their outstanding obligations to the Fund ahead of schedule (respectively US$9.6 billion and US$15.5 billion). Then Argentine President Nèstor Kirchner has described this highly symbolic act as a move toward "political sovereignty and economic independence." The declaration of independence by some Latin American leaders has also continued by taking more proactive forms. In 2007, Venezuela led Ecuador, Argentina, Brazil, Bolivia, and Paraguay announcing the creation of Banco del Sur (Bank of the South), a regional development bank. The Ecuadorean President Rafael Correa cited the "unacceptable conditions" demanded by the Washington-based international financial institutions as a key driver behind the creation of the new bank.

This increasing discontent with IMF policies in the region was a key point of discussion at the workshop. In sum, it was agreed that the perspectives of Latin American and Caribbean countries on the future of the Fund is particularly relevant for two reasons: first, because the IMF has been heavily and continuously involved in the region during the last quarter century. Second, because it is in this region that the IMF is experiencing its worse legitimacy crisis and the prospects for its future involvement are extremely uncertain.

Seeking to delineate a regional perspective on the way forward, the questions that framed the discussion included:

1. What does the Latin American and Caribbean region need from the IMF today?
2. How should the IMF be reformed in order to meet these needs?
3. What are the perspectives for regional monetary and financial frameworks, and what should be their relation with the IMF?

This report summarizes the consensus that emerged around these questions at the workshop in Washington. The second section will highlight the kind of role that the Fund should play in the region. The third section will discuss possible reforms in IMF governance structure, and the relation between the IMF and regional initiative in the monetary and financial realm.

Functional Issues

The role of the IMF in Latin America and the Caribbean

The severity of the legitimacy crisis experienced by the Fund in the region has led some commentators to question not only what its future role should be, but also whether the IMF still has any role to play in the region at all. The consensus at the meeting was that the region would benefit more if the IMF was reformed rather than abolished.

In an increasingly interconnected and globalized world, the Fund still provides several valuable functions that cannot be provided equally effectively by other public institutions or Wall Street firms. Especially for the smaller and more open economies, the IMF can help strengthen institutional and technical capacities through the process of consultation and technical assistance. In particular, IMF advice should focus not on the details of government expenditures, but on issues such as managing their debt overhang and exchange rates, achieving better ratings and decreasing the risk-premium on sovereign debt, managing capital inflows and their foreign exchange reserves. However, IMF involvement in the region varies greatly according to the trust in which it is held. Widespread skepticism remains about the extent to which Latin American and Caribbean countries should let the IMF dictate how to reform their economies.

Since most Latin American countries have now graduated from IMF financial assistance, reforming the lending facilities is not a currently pressing issue. However, the current positive outlook for Latin American countries remains in part cyclical. It is possible that a shock generated in the international capital markets could negatively affect the stability of the region. The creation of some form of international safety net, such as an emergency credit line, therefore remains a priority. For many countries in the region this is seen as the purpose of the institution in the present context. This facility should be able to provide rapid liquidity when a country is hit by a crisis of confidence in the international markets, while conditionalities should be confined to issues of macroeconomic and financial stability.

During periods of financial stress, the IMF should support countries in responding to shocks through rapid liquidity provision. At the same time, during periods of relative financial stability when its lending is not required, IMF should recommend policies aimed at avoiding recurrent patterns of overconfidence and reckless lending, which preclude the emergence of bubbles and financial crises. In both cases, counter-cyclicality, providing stability during times of crisis should be the principle guiding different IMF activities, such as oversight of macroeconomic policies, technical assistance, and regulatory initiatives.

The Global Responsibilities of the Fund

The IMF was created in 1944 as an institution with a global reach. Since the breakdown of the Bretton Woods system, it has narrowed its range of action, focusing mainly on those emerging and developing countries that were borrowing from the Fund. As the Fund has become more detached from global issues, developing countries have lost a channel to be heard on key issues, such as macroeconomic coordination and multilateral surveillance.

The relevance of coordination and surveillance for Latin American and Caribbean countries is highlighted by two current developments. In the area of macro-economic coordination, the constant depreciation of the US dollar has hurt many Latin American and Caribbean countries, which rely heavily on their exports to the American market. Despite their concerns, the IMF has not been influential in constraining the macroeconomic policies driving the decline of the American currency.

In the area of multilateral surveillance, the Fund was one important actor in responding to the financial crisis of the 1990s, which had been generated in emerging economies (Mexico, East Asia). By contrast, the IMF has played only a marginal role in the reaction to the current market turmoil originated in the US markets since it was centered on the private sector and its lending was not required. While at the international level, the lessons from the crisis are debated in bodies such as the Basel Committee and the Financial Stability Forum, and intergovernmental fora such as the G7, these are restricted membership forums, without any direct representation from Latin American and Caribbean countries. Since the Fund remains the only institution with a quasi-universal membership, some commentators have suggested it should play a coordination role between different international financial institutions, also in the context of the current crisis.

However, the idea of handing more power over the oversight and regulation of financial markets to the IMF would probably not be met with support of most Latin American and Caribbean countries. These countries then face a considerable dilemma. On the one hand, the region is exposed to the Fund's lack of instruments to coordinate exchange rate management between the major currencies, and to tame the volatility in financial markets. From their perspective, the Fund should exercise its responsibilities vis-à-vis industrial countries with the same intensity as it has traditionally done vis-à-vis developing and emerging countries.

Latin American and Caribbean countries are deeply skeptical of any initiative granting the Fund greater instruments to interfere in their own economies. From their perspective, the Fund remains an institution overly influenced by the Northern industrialized countries, supporting the kind of market liberalization that had been opposed by policy makers in the region. An example of this dilemma is the attempt to establish a "Sovereign Debt Restructuring Mechanism," suggested by the former IMF Deputy Managing Director Anne Krueger in 2001, which ultimately failed also because of opposition from countries such as Mexico and Brazil.

Governance Reforms/Representation Issues

Representation

Given the current ambiguity on the most appropriate role of the IMF in the region, what is the way forward? Consensus emerged at the workshop that the decline in the role played by the Fund in the region and its lack of credibility in the eyes of Latin American policy makers cannot be addressed without first addressing the imbalances in its governance.

It was agreed that the current reform of the quota distribution to make the IMF more representative of the current economic reality is certainly a step in the right direction, yet more is required to restore its credibility and legitimacy in the region. The excessive influence of industrial countries on the Fund derives not only from their over-representation in the Executive Board, but also their predominance in the staff. From the perspective of the Latin American and Caribbean countries, a reform of the IMF would start from encouraging a greater heterogeneity of views internal to the Fund, as well as in the geographical origins in the staff hiring and in the selection of the Managing Director.

Regional initiatives

The incapacity of the IMF to address these shortcomings in both the output-side (the policies recommended in the region) and the input-side (its governance structure) has evoked a call for a renewed emphasis on the establishment of regional initiatives that could either complement or replace the role the Fund plays in Latin America and the Caribbean.

Such regional initiatives in the financial and monetary realm are not novel in the region. For instance, a noteworthy example presented in the workshop is the Latin American Reserve Fund. This is a regional financial institution formed by seven Latin American countries in the Andean subregion, which assists countries in correcting payments imbalances, and in coordinating their monetary, exchange-rate, and financial policies. The scope of this initiative is circumscribed, but it provides an example of how a regional institution could be more agile and flexible than the IMF, without replacing its important role in a time of crisis.

The positive macroeconomic outlook in the region at the moment, and the abundant liquidity possessed by countries like by Venezuela, creates favorable conditions for the establishment of similar initiatives at a broader scale. To some extent, the proposed Banco del Sur (Bank of the South) could represent an embryonic version of a “Latin American” Fund. Although this institution is developing into a regional development bank, countries like Venezuela would like to see it take on the role of a regional stabilization fund, directly competing with the IMF.

The creation of any credible regional initiative depends on the capacity of its creators to address various challenges, such as defining the kind of conditionalities attached to its lending, the mission of the new institution (whether it be long-term development financing or short-term stabilization), and, above all, determining its relationship with the IMF and the multilateral system. It is not clear at this time to what extent it is in the interest of Latin American and Caribbean countries to break free completely from the strictures of the Fund. A common view holds that any regional mechanism should not come as an alternative to the Fund, but rather as a complement to its traditional role. Regional institutions are not always sufficient to mobilize the capital to address contagion in the international financial markets that have global implications.

On the other hand, the IMF should support the emergence of regional initiatives, recognizing the positive effects of empowering individual countries in defining what adjustment is required, and relying more explicitly on a peer-review mechanisms. The IMF could help Latin American and Caribbean countries to develop regional bond markets, which are crucial to strengthen the macroeconomic stability in the region.

Conclusion

The discussion in Washington highlighted how despite the unpopularity of the IMF in the region, Latin American and Caribbean countries would still benefit most if the institution was reformed. It is clear that Latin American and Caribbean countries are now at a crossroads. On the one hand, the region needs the Fund to promote macroeconomic and financial stability. However, given the flaws in the Fund's governance and representation and in the policies it has pursued in the region, these countries are wary of granting greater responsibilities and power to interfere in their own economies.

The workshop participants advocated for the IMF to take a new approach in the region. The following summarizes their findings, and offers some policy recommendations to address the current questions of legitimacy so the IMF can meet the long-term goal of stability in the international financial system.

Policy Recommendations

- Within Latin American and Caribbean countries, the IMF still has an important role to play in promoting cooperation and helping countries strengthen their institutional and technical capacities.
- Although the region is not currently borrowing substantially from the Fund, traditional lending facilities must be strengthened. The Fund should develop wider and rapid emergency lending facilities to contrast the possibility of contagion in the international markets.
- The Fund should exercise its responsibilities vis-à-vis industrial countries with the same strength as it has traditionally done vis-à-vis developing and emerging countries, addressing the volatility of the major currencies and macroeconomic imbalances, and overseeing more effectively Northern financial markets.

- The Fund should perform its responsibilities not only during periods of crisis but also during periods of booms. In order to avoid the recurrent patterns of reckless lending, bubbles and financial crises, counter-cyclicality should be the principle guiding different IMF activities, such as oversight of macroeconomic policies, technical assistance, and regulatory initiatives.
- In order to address the legitimacy crisis of the Fund, its governance should be improved. The current reform of the weighted votes is a step in the right direction, but further measures should be taken, encouraging a greater heterogeneity of views and of geographical origins in the staff hiring and in the selection of the Managing Director.
- The establishment of regional mechanisms in the monetary and financial realm would improve several shortcomings of the Fund's involvement in Latin America and the Caribbean. However, regional mechanisms should come not as an alternative to the Fund, but rather as a complement.

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CIGI's work is organized into six broad issue areas: shifting global power; environment and resources; health and social governance; trade and finance; international law, institutions and diplomacy; and global and human security. Research is spearheaded by CIGI's distinguished fellows who comprise leading economists and political scientists with rich international experience and policy expertise.

CIGI has also developed IGLOO™ (International Governance Leaders and Organizations Online). IGLOO is an online network that facilitates knowledge exchange between individuals and organizations studying, working or advising on global issues. Thousands of researchers, practitioners, educators and students use IGLOO to connect, share and exchange knowledge regardless of social, political and geographical boundaries.

CIGI was founded in 2002 by Jim Balsillie, co-CEO of RIM (Research In Motion), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario. CIGI gratefully acknowledges the contribution of the Government of Canada to its endowment Fund.

Le CIGI a été fondé en 2002 par Jim Balsillie, co-chef de la direction de RIM (Research In Motion). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario. Le CIGI exprime sa reconnaissance envers le gouvern-ment du Canada pour sa contribution à son Fonds de dotation.

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