



UNIVERSITY
OF WOLLONGONG
AUSTRALIA

University of Wollongong
Research Online

Faculty of Law - Papers (Archive)

Faculty of Law, Humanities and the Arts

2011

IMF standby arrangement: its role in the resolution of crises in the 1990s.

Gabriel Garcia

University of Wollongong, ggarcia@uow.edu.au

Publication Details

G. Garcia, "IMF standby arrangement: its role in the resolution of crises in the 1990s." (Paper presented at the Ceremonies of Law Conference, Wollongong, University of Wollongong, Wollongong, 7-9 Dec 2011).

Research Online is the open access institutional repository for the University of Wollongong. For further information contact the UOW Library:
research-pubs@uow.edu.au

IMF standby arrangement: its role in the resolution of crises in the 1990s.

Abstract

This paper explores the role played by Stand-By Arrangements (SBAs) in the resolution of financial crises in the 1990s. It does so by examining these arrangements through a ceremony and ritual approach.

This presentation is divided in three parts. The first one reviews the legal nature of SBA as a form of international law. The second analyses SBAs using a ceremony and ritual approach; and the last part review the case of Venezuela.

Keywords

crises, resolution, role, 1990s, its, standby, arrangement, imf

Disciplines

Law

Publication Details

G. Garcia, "IMF standby arrangement: its role in the resolution of crises in the 1990s." (Paper presented at the Ceremonies of Law Conference, Wollongong, University of Wollongong, Wollongong, 7-9 Dec 2011).

IMF Standby Arrangement: its role in the resolution of crises in the 1990s

Gabriel Garcia

This paper explores the role played by Stand-By Arrangements (SBAs) in the resolution of financial crises in the 1990s. It does so by examining these arrangements through a ceremony and ritual approach.

This presentation is divided in three parts. The first one reviews the legal nature of SBA as a form of international law. The second analyses SBAs using a ceremony and ritual approach; and the last part review the case of Venezuela.

Nature of the IMF Standby Agreement

The 1990s was the decade of the promotion of the Washington Consensus in developing countries. It was argued that the adoption of a market economy was the best option to defeat underdevelopment and poverty. Financial crises that affected South America provided the propitious opportunity to put in practice neoliberal postulates promoted by IFIs including the IMF. Countries from Venezuela to Argentina turned to the Fund for technical and financial assistance. The IMF supported the market approach, using an instrument called “Standby Arrangement.” This instrument became the operative tool used by the IMF to implement the required changes while it represented the state’s written compromise to implement reforms to embrace a market economy.

When several countries agreed on the creation of the IMF in 1945, they adopted the Articles of Agreement. Among the issues regulated by this international treaty are the transactions between the IMF and its members for the purposes of providing financial assistance. According to Article V (2) (a) of the IMF Articles of Agreement

Except as otherwise provided in this Agreement, transactions on the account of the Fund shall be limited to transactions for the purposes of supplying a member, on the initiative of such member, with special drawing rights or the currencies of other members from the general resources of the Fund, which shall be held in the General

Resources Account, in exchange for the currency of the member desiring to make the purchase.

The first aspect that is worthy of notice is that a member in need initiates any process that can lead to IMF financial assistance. In this case, the government has to explain why it asks to enter into a transaction with the IMF. After that, the IMF reviews the member proposal and determines whether it is consistent with the IMF treaty. The second issue that is important to underline from Article V is that the financial assistance provided by the IMF is not in the form of an ordinary loan, although the Fund often uses this term to refer to its financial assistance. In this case, a member in need agrees with the Fund to purchase Special Drawing Rights (SDRs) or any other usable currency held by the institution in exchange for its own currency with the obligation to repurchase its official money later. Acquiring SDRs or usable currencies, a country is able to resolve its balance of payment problems.

The Articles of Agreement do not clearly state what legal form financial assistance should take. For this reason, the Executive Board developed a complex scheme to provide financial assistance and designed the Stand-By Arrangement framework. According to the Fund a SBA is

A decision by the IMF that gives a member the assurance that the institution stands ready to provide foreign exchange or SDRs in accordance with the terms of the decision during a specified period of time. An IMF arrangement—which is not a legal contract—is approved by the Executive Board in support of an economic program under which the member undertakes a set of policy actions to reduce economic imbalances and achieve sustainable growth.

According to this definition, a SBA contains the decision of the Executive Board that grants a member the right to purchase SDRs or usable currencies and a compromise by the state to adopt a set of policies requested by the IMF. A government includes these conditions in a letter of intent. This letter is addressed to the Executive Board and underlines the reforms that a country has agreed to implement. Although the Fund recognises that the letter of intent and the Executive Board decision are two halves of the same whole, the institution prefers to legally separate both components and categorically refuses the existence of a legal contract. But, **are really SBA non-legal documents?** I think that they aren't.

If we look at the SBAs completed in the 1990s, they were complex documents that contained numerous conditions that required legal reforms to adopt the institutions necessary for the functioning of a market economy. In addition, SBAs contained other financial conditions in terms of payments, interest rate, etc. Furthermore, SBAs were backed by a strong institutional enforcement framework in case of default by the state member, including the power of the IMF to suspend a program, declare a member ineligible to use Fund's resources, suspend a member's voting rights or initiate procedures to expel a member from the IMF (Article XXVI, Section 2 (c)).

In spite of the existence of strong evidence that suggests SBAs are legal contract, the IMF sustains they are not. So, **what is the reason behind IMF's argument?**

CLICK

The answer may be found in the ritual role played by this instrument in the process of resolution of financial crisis as I suggest in the next part of my presentation.

SBAs: a ceremony and ritual analysis

Rai defines ceremony as 'an activity that is infused with ritual significance... while ritual means the prescribed order of performing ceremonial acts.' Rai affirms that while ceremony is distinguished by its hyper-visibility, rituals are more often seen as the performance of everyday routines. Rai adds that while ceremony is more exposed to the public, ritual standardises and simplifies actions, helping to mask mechanisms that facilitate the way how certain groups exercise dominance.

Applying this framework to the SBAs, I note that the campaign put in place by IFIs and the IMF in the 1990s to convince the rest of the world about the benefits of a market economy was quite visible and well-orchestrate. IFIs knew how to exercise pressure on developing countries to convince them to embrace in efforts to transform their economy. Likewise, they publically celebrated the acceptance of market liberal principles by developing countries, so, soon after a nation stamped its signature on a SBA, they were prised and welcomed to the international financial community. This was part of the ceremonial transition designed by the Fund.

In another level, perhaps a little bit more hidden from the media and the public, the non-legal character of SBAs facilitated the fast implementation of neo-liberal programs. Governments often completed these arrangements without congressional approval as it was required by several constitutions in South America. The non-legal character given to SBAs by the IMF reduced opportunities for an open discussion about alternative options. It also diminished the possibility of a debate about the content of SBAs which was controlled by the Fund.

The Letter of Intent supposedly prepared by the governments was indeed dictated by the Fund. It contained a set of conditions to be implemented by members in order to receive the financial assistance. It was argued that these conditions embodied the best financial practices accepted by the international community represented by the Fund. SBAs were standardised in a template that the IMF used for all countries disregarding of the type of crisis they suffered. It was little room for negotiations and similar agreements with minor changes were implemented by most South American countries.

Without a SBA, it was not possible to have the support of the international community. But **who were the members of the international community behind SBAs? Who were the IMF members who selected the best practices and policies to be adopted by developing countries?**

Buchanan and Pahuja argue that the meaning of international community has become the rhetorical vehicle by which legitimacy is sought for the nondemocratic decisions of international organisations. They explain that when the result of international law is non-consensual, in relation to some, international law's own assertion is that it embodies and is implementing the values of the international community. In that instance though, the boundaries of that community are themselves constituted by international law.

If we look at the IMF from Buchanan and Pahuja's perspective, the Articles of the Agreement are the law that legitimise the transactions made by the Fund. Based on this treaty, the Executive Board designed the way how financial assistance is granted. The Fund claims that the terms and conditions incorporated into SBAs reflect the values and principles of the international financial community. But, **is really this scheme the product of international consensus?**

187 countries are represented in the IMF, from powerful state such as the US and China to smaller countries like Fiji and Costa Rica. So, we could say that the organisation is truly international; however, the Fund has a governance/quota system that allocates the real decision-making process to a selected number of ‘advanced economies’, mainly the US, Japan and Europe that controlled about 60% of the voting power. Thus, decisions surrounded a SBA as well as its content was controlled by these nations that found in the Articles of the Agreement the legal support to create the SBA scheme.

In addition, there were formal and informal arrangements that provided opportunities for other members of the international community to influence IMF’s actions, namely private financial institutions. For instance, in the 1990s, SBAs often included bank friendly conditions (70% of arrangements). This is conditions that required a country to repay a private bank loan prior to access an IMF facility. Likewise, SBAs often required countries to liberalise financial and capital markets allowing the entry of transnational banks in domestic markets. This was commonly achieved through the privatisation of domestic banks, a policy highly promoted by the IMF.

Unpacking the IMF governance system and the ties between the institution and global private financial organisations helps to explain why a SBA was essential for this international community. It represents the submission of a country to the financial global order promoted by the Fund and aligned with the values and interests of private institutions. After a SBA was agreed, others IFIs, private banks and foreign investors were ready to support the trouble nation. On the contrary, if a country preferred to face a crisis without accepting a SBA, the country was marginalised from the international community. In the 1990s, few countries took the risks (e.g. Malaysia).

Borrowing Lukes’ analysis of rituals, we could say that the IMF built the SBA framework embracing Durkheim’s idea of ritual as a mechanism of inclusion, and try to integrate developing countries with the values of the international community. However, as I will discuss in the following part, the implementation of SBAs were accepted by government more for practical reasons rather than for conviction about the values integrated in the SBA.

Venezuela

Since the 1920s, oil has played a decisive factor in the policy-making process in Venezuela where it represents 70% of the country's GDP. Venezuela was in a deep recession when Carlos Andrés Pérez assumed the presidency in February 1989. Soon, Pérez announced that his administration had signed a Letter of Intent with the IMF containing a neo-liberal program coined "The Great Turn-around" with the aims of ending years of inward-looking economic policies and modernising the economy. There was no debate about whether or not the SBA was the best option for Venezuela. The Great Turn-around was sold to the people as the only option the country had to recover the economy.

The reform included hasty financial liberalisation, increasing prices of goods and services provided by governmental companies and a vast privatisation program. The implementation of the program had positive effects in global markets and for example, the government was able to place new offers of bonds in international markets. Domestically, the story was different. People rioted in the streets, producing chaos and death. The introduction of the program had other tangible impacts on society including high inflation (81%), unemployment rate (9.2%) and a decline in real salaries of 11%. As a consequence of the implementation of the Great Turn-around, Pérez lost political support, even that of his own party, and this caused uncertainty, ultimately leading to two failed military coups in 1992. In May 1993, Pérez was impeached on allegations of corruption and he was found guilty by the Supreme Court.

The same year, a banking crisis exploded. The management of the crisis was in the hands of a new president, Caldera who used two programs to manage financial problems. The first program was known as "My Letter of Intent to the Venezuelan People". The title of this program was a criticism against the letter of intent agreed with the Fund by his predecessor. After Chávez's coup was defeated by the forces loyal to the government, Caldera gave a speech in the congress and justified the rebels' actions on the grounds that "the IMF policies that had left Venezuelans so poor and in such miserable conditions were a sacrifice that no one had the right to demand in the name of democracy". Using a similar platform, during his electoral campaign, Caldera promised not to apply neo-liberalism and his first program was in accord with this pledge.

Due to the failure of the first program, Caldera's administration tried a different approach, using the IMF's methods. The change in policy approach came due to the need of filling the huge fiscal deficit and the unavailability of external financial sources which were reluctant to provide fresh funds to Venezuela before any commitment to the IMF to apply market reforms was made. The government claimed that the new program agreed with the IMF was a social plan that seeks to promote economic recovery as an instrument for achieving social development.

In reality, Agenda Venezuela had the same objectives common to other IMF programs, including the previous Great Turn-around. It seems that the argument about the social emphasis of the Agenda Venezuela was more a political explanation of why Caldera decided to apply an orthodox program sponsored by the IMF. The Stand-By Arrangement was signed by the minister of finance and the president of the central bank with limited participation by the congress. The IMF's position of considering SBA a non-legal contract facilitated the subscription of the agreement by the Venezuelan authorities without congressional approval.

The lack of a strong government commitment to Agenda Venezuela was revealed two months after the completion of the agreement with the IMF when oil prices recovered. With the rise in oil prices, the government was less willing to take further political risks and its will to implement the program faded. Ultimately, the government foresaw a better income from oil exports and suspended the application of Agenda Venezuela, demonstrating that they were not really committed to the program or any of its objectives, not even to the social goals which, months earlier, had been defended as capable of improving the well-being of the Venezuelan people. The revival in oil prices was short-lived and soon Caldera's administration was again facing similar economic problems due to the decline in oil income. Caldera finished his mandate in February 1999 and left the country still in a deep recession and socially divided a scenario that facilitated the electoral victory of Chavez.

Conclusion

To sum up, in the 1990s, SBAs were used to spread neo-liberalism and the establishment of market economies in developing countries. SBAs as a ceremony and ritual, created the perception that practices and policies contained into those documents were discussed and accepted by the international financial community. In spite of the intent of SBAs to integrate

developing nations in the global community, sharing a similar set of values and principles, they produced a sense of exclusion as the case of Venezuela suggests. This exacerbated social conflicts, producing changes that still affect South America and the rest of the world.

Dissatisfaction with the IMF made developing countries to react creating new mechanisms to break with this organisation or at least to diminish its influence and for example, they accumulated more international reserves to face future crises, fully paid their debts with the IMF and what it is more important, countries created new regional forums where they could discuss, design and implement their own best practices; so we now talk about the Chiang Mai Initiative Multilateralisation (CMIM) by ASEAN +3 (People's Republic of China, Japan, and the Republic of Korea) and *Banco del Sur* in South America. Time will tell us whether a new ceremony and ritual is emerging from the implementation of these mechanisms that integrate in a better way the principles and values seek by developing nations.

Meanwhile, it is now Europe that calls for financial assistance from emerging economies such as China and Brazil; however, it is not clear whether these nations will provide assistance and if so, it is no clear whether they will have a say in the design of rescue packages for European countries. The IMF has made few changes due to the new crisis and for example, symbolically increase the participation of emerging economies in the IMF governance; however, this participation is still irrelevant in the decision making process of the institution. Time will tell us whether a new ceremony and ritual is emerging from the current financial crisis.