Reforming the IMF

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What is the IMF?

Its foundation

- July **1944**:

  Representatives of 45 governments meeting in the town of Bretton Woods, New Hampshire, US, agreed on a framework for international economic cooperation.

  They believed that such a framework was necessary to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s.

What is the IMF?

Its foundation

- December **1945**:

  29 countries signed the Articles of Agreement.

  The International Monetary Fund (IMF, or “the Fund”) came into existence.

  The IMF's founders charged the new institution with overseeing the international monetary system to ensure exchange rate stability.

What is the IMF?

IMF vs. WB

- Both World Bank and IMF were estabilished in Bretton Woods, but they have different mandates.

- While the IMF's focus is chiefly on macroeconomic and financial sector issues, the World Bank is concerned mainly with longer-term development and poverty reduction.

IMF evolution

- **1950s-1960s**: Bretton Woods system. IMF controls fixed exchange rates and encourages member countries to eliminate exchange restrictions that hinder trade.

- **1971**: The United States suspend the convertibility of the dollar into gold, ending the par value system of fixed exchange rates.

- **mid 1970s**: revision of IMF Articles; oil-price shocks.

- **1980s**: the IMF becomes a global firefighter, dealing with international debt problems.

IMF evolution

- **1986-7**: IMF’s *Enhanced Structural Adjustment Facility* (ESAF) *is* established.

- **early 1990s**: IMF follows the economic transformation of former Soviet Union countries, then begins its work against global poverty.

- **1999**: the IMF replaces the *Enhanced Structural Adjustment Facility* with the *Poverty Reduction and Growth Facility* (PRGF).

IMF evolution

- **late 1990s - today**: financial crises erupt in Mexico, Southeast Asian countries, Brazil, Argentina, etc. The IMF becomes an instrument in the prevention and management of capital account crises.

- The IMF also increases its involvement in compliance with standards covering offshore financial centers and anti money laundering and terrorism.

Why such different faces?

The IMF is always reinventing itself.

Is it a pragmatic response by a respected institution to the changing needs of the financial world?

or

Is it nefarious mission creep, a bureaucratic effort to expand the institution's scope?

or

Is it a constant attempt to match its aspirations with its limited authority and instruments?

IMF identity crisis

- After the many financial crises of the 1990s, a consensus on the role of the Fund and the scope of its activities doesn’t exist today.
- The debate on its abolition or on its possible reforms is wide open.

IMF mandate

- Article I of the *Articles of Agreement* of the IMF does not contain a clear statement of the IMF's purpose relevant to the international financial system of the 21st century.

Article I

The purposes of the International Monetary Fund are:

- (i) **To promote international monetary cooperation** […]
- ii) **To facilitate the expansion and balanced growth of international trade** […]
- (iii) **To promote exchange stability** [..]
- (iv) **To assist in the establishment of a multilateral system of payments in respect of current transactions** […]
- (v) […] **providing them (the members) with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity**.
- (vi) **to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.**

Do we still need an international monetary institution?

- The world today is very different from that of the Bretton Woods era.
- The fixed exchange rate system has collapsed.
- Capital flows, especially private capital flows, are very large.
- Current account deficits do not necessarily indicate a disequilibrium; they can help to efficiently allocate capital throughout the world.
- So, should be abolish the IMF? (Schultz, Simon and Wriston, 1998; Schwartz, 1998)

We still need a IMF

- Article I does not explicitily mention financial stability as an objective, but capital account crises in recent decades have pointed to the importance of financial stability in order to achieve macroeconomic stability and growth.
- The growth of private financial markets is only relevant to a small fraction of the nonindustrial countries, and access of these countries to the markets is far from continuous.
- Domestic economic policies have become more stable. Their interaction has not.
- In a world with information problems and high-levered institutions, crises will still occur and threaten systemic stability.
- If properly administered, IMF loans can still help governments respond to sudden stops. IMF analysis can provide objective information, thus supporting compatible policies between countries.

IMF Structure

- IMF membership is 184 countries, only 7 less than the UN
- Employs approximately 2,716 people from 165 countries
- the Fund is owned by and responsible to its member countries

IMF Structure: Quotas

- Each member is assigned ‘quotas’ based on its standing in the world economy.
- Quotas in 2006 totaled $317 billion.
- Quotas determine a country’s maximum financial commitment to the IMF, and subsequently its voting power.
- They are denominated in Special Drawing Rights (SDRs), the IMF’s currency, which is made up of a basket of major national currencies.
- The IMF representation system is strikingly different from that of the UN General Assembly. Why?

IMF Structure

- The highest decision making body of the IMF is the Board of Directors, composed of a governor from each member country who meet once a year.
- The Board of Directors delegates much of its decision making to the Executive Board.

IMF Structure

- The Executive Board is composed of 24 Directors, appointed or elected by member countries or groups of countries, and the Managing Director (currently Rodrigo de Rato from Spain).
- Five of the directors are chosen by the countries with the highest quotas (United States, Japan, Germany, France, United Kingdom) and 19 are chosen by groups of countries, and vote to represent their constituent group.
- The Directors are based in Washington, DC and meet several times a week.

IMF Structure: Tools

- The IMF has three main tools at its disposal:
  - ***surveillance***
  - ***lending***
  - ***technical assistance***

  to create two main products:
  - ***policy advice***
  - ***financing***

IMF Structure: Tools

- **Surveillance**: the process of monitoring and consulting with member countries with regards to the national and international consequences of their economic and financial policies
- There are three types of surveillance: local (inside individual member countries), regional (such as the euro area) and multilateral (global and between countries).
- Multilateral surveillance is of increasing importance in a world of large global imbalances.

IMF Structure: Tools

- **Lending:** there are a number of different ways the Fund lends money to its members
  - Stand-by Arrangements (SBA) for short-term balance of payment problems
  - Extended Fund Facility (EFF) for longer-term balance of payment and structural problems
  - Supplemental Reserve Facility (SRF) larger amounts with shorter horizons for “capital account crises”
  - Compensatory Financing Facility (CFF) for temporary shortfalls in export earnings or increases in import costs
  - Poverty Reduction and Growth Facility (PRGF) long term low interest loans (similar to the WB’s International Development Association)

IMF Structure: Tools

- **Technical Assistance**: in areas of the Fund’s expertise, such as central banking, macroeconomic policy, tax policy, monetary policy, etc.
- normally free of charge and financed out of the Fund’s own resources, but sometimes financed by donations from member countries

IMF Structure: Products

- Surveillance, lending, and technical assistance are all geared toward providing:
  - **Policy advice**: recommendations to members about various macro and microeconomic policies
  - **Financing**: aiding with poverty reduction (PRGF) or dampening the ill effects of crises

What kind of reforms?

Reforms should involve:

- Surveillance
- Lending
- Governance
- Finances

Surveillance

IMF Reforms: Surveillance

- Relevant questions for Truman (2005) about the current state of IMF surveillance include:
  - What is the scope of IMF surveillance and what variables and policies should it cover?
  - Should the IMF more aggressively engage with countries on their exchange rate policies?
  - How can the IMF be made more effective in altering exchange rate and other policies?
  - Should the IMF have a larger role to play in policy coordination?
  - How can the IMF better perform its current role, or should it change?

IMF Reforms: Surveillance

- Policy coordination is an especially pertinent subtopic of surveillance in the current climate of large global imbalances, and is an area in which the Fund has had recent problems (China – US relations)
- Peretz (2005) and others believe this is because the Fund lacks leverage with countries that do not have to, and do not expect to have to, borrow from the IMF in the foreseeable future.
- There are additional (especially US) political problems.

Truman’s (2005) candidates for surveillance reform

- *Increased transparency:* Eichengreen (2004) suggests all IMF surveillance documents be released to the public
- *Increased candor:* more straightforward identification of the risks that member countries’ policies engender
- *Specific remedies:* specify the content and scope of structural adjustment that is recommended

Truman’s candidates for surveillance reforms (cont’d)

- *Issue ratings of member countries:* already proposed and rejected, but arguably beneficial if applied to all (especially industrial countries)
- *Develop scorecards:* frequent IMF staff assessment of member countries’ performance
- *Change the dominant paradigm:* shifting the way the IMF thinks about member surveillance

IMF Reforms: Surveillance

- Brown (2005) and Ubide (2005) have suggested that the surveillance function become fully independent of other IMF programs, creating separate subsidiaries that report to the same board.
- A more radical change would be splitting the Fund into two completely separate institutions, but this is a costly option.

IMF Reforms: Exchange Rate Policy

- Goldstein (2005) suggests that the IMF should more aggressively pursue countries that engage in currency manipulation and pile up international reserves.
- There is lots of internal debate about appropriate IMF exchange rate policy, mostly because it is a confusing macroeconomic issue.

IMF Reforms: Financial Sector and Capital Accounts Policy

- Part of IMF surveillance is the Financial Sector Assessment Program (FSAP), a joint IMF and World Bank program that is aimed at increasing the soundness of financial systems in member countries.
- A current problem is that the Reports on Observance of Standards and Codes (ROSCs) are only made public at the country's discretion.
- Another problem is that the US has not had an FSAP, and Japan successfully resisted one until 2002.

Miscellaneous problems within the IMF’s surveillance sector and areas for possible reform

- The culture and work of the IMF is dominated by macroeconomists with little or no training in financial sector issues
- Internal institutional payoffs are not associated with effective assessment of specific financial sector issues, rather glamorous reports
- Individual country surveillance of financial sectors is not well integrated with other aspects of surveillance
- The IMF needs to solidify its position with respect to capital account liberalization

Lending

Table 3: Distribution of Members with IMF Credit Outstanding—1975 -2005 (Percent)[a]

Category of Country	1975	1980	1985	1990	1995	2000	2005[b]
Industrial	**11**	**10**	**2**	**0**	**0**	**0**	**0**
Emerging Market[c]	**13**	**9**	**18**	**16**	**11**	**11**	**7**
Western Hemisphere	4	1	6	7	5	4	4
Asia	6	5	8	6	2	4	2
Other	4	3	4	3	4	2	1
Other Developing	**17**	**20**	**20**	**22**	**30**	**22**	**20**
PRGF-Eligible[d]	**58**	**61**	**60**	**62**	**59**	**67**	**73**
Africa	34	39	37	41	37	40	44
Other	25	23	23	21	22	28	29
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Memo:							
Total number of countries with credit outstanding	53	80	87	86	98	91	85
Countries with credit outstanding as a percent of total members	42	57	58	56	55	50	46

Table 4: Distribution of IMF Credit Outstanding—1975-2005 (Percent) [a]

A. By Category of Country

	1975	1980	1985	1990	1995	2000	2005 [b]
Industrial	48	12	2	0	0	0	0
Emerging Markets ●	27	35	60	60	63	70	76
Others Developing	7	16	13	11	15	9	10
PRGF-Eligible ●	19	37	24	29	22	18	14
Total	100	100	100	100	100	100	100

● with India (even if is PRGF-elegible)

● (2005) Afghanistan, Albania, Armenia, Azerbaijan, Bangladesh, Benin, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Dominica, Ethiopia, The Gambia, Georgia, Ghana, Grenada, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Kenya, Kyrgyz Republic, Lao People's Dem. Rep., Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Moldova, Mongolia, Mozambique, Myanmar, Nepal, Nicaragua, Niger,Nigeria, Pakistan, Papua New Guinea, Rwanda, Samoa,nSao Tome & Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sri Lanka, St. Lucia, St. Vincent & the Grenadines., Sudan, Tajikistan, Tanzania, Togo, Uganda, Uzbekistan, Vietnam

Countries borrowing from the Fund, 1970 to present

Category of Countries	**Borrowers (139)**	**Nonborrowers (45)**	**Percent of Borrowers (76%)**
Industrial (24)	(9)	(15)	38%
Emerging (22)	(21)	(1)	95%
Other Developing (61)	(39)	(22)	64%
PRGF-Eligible (77)	(70)	(7)	91%

Today about 150 countries are potential borrowers.

Have they taken enough steps to self-insure against the possible need to borrow? Will they face financial crises?

We think that even if countries are self-insuring (reserves, ...), crises may still occur. Thus, the IMF still has a role as a lender.

Reforms involve

1. IMF as an international lender
2. IMF as a lender for good performers
3. IMF support without lending
4. IMF as a lender for developing countries

1. IMF exchange-rate & lending policies

- IMF support of fixed exchange rate with massive high-interest-rate loans is blamed for leading countries to unsustainable debt and subsequent financial crises. Is this the case of Russia, Brazil and Argentina? Did Malaysia do better because of resistance?

- Or is government high spending the source of troubles? Is the IMF too weak in its approach?

  “It’s time to get radical. Argentina must temporarily surrender its sovereignity on all financial issues. A foreign agent […] has to run the country with a tight grip” (R. Caballero and R. Dornbusch, MIT)

The IMF as an international lender

Debate revolves around:

- Limit on access to IMF resources:

  illiquidity vs. insolvency: should IMF prevent what? moral hazard?
- Private sector involvement in financing
- IMF’s role in debt restructuring

IMF coordination role: another label for multilateral surveillance

- The financial system does not have a natural replacement to play a coordinating role. Collective action clauses in sovereign bond contracts governed by international law are not a substitute where a large proportion of the debt does not take that form. (Argentine case, Anna Gelpern 2005).
- The IMF, as a collective institution, has to address this market failure by playing a coordinating role. Roubini and Setser (2004),
- Inevitably it will have a “political dimension”, which is not surprising since one of the parties is a government and because of the necessarily political foundations of the IMF (Tarullo 2005).

2. IMF lending programs for good performers

- Establishment in the IMF of a facility to help emerging market economies with strong economic policies and large sovereign debt ratios to achieve sustainable growth, work down their debt ratios and protect them from financial crises unrelated to their current economic policies. (Enhanced Monitoring Facility, B. Eichengreen)

Problems:

- What is a “good performance” for a country?
- In which context access to the facility should be activated?
- Should lending be limited to countries qualified by meeting a set of conditions?
- What if the country policy worsens? What are the implications of turning off a positive signal once it has turned on? Would it lead to a crisis?

3. IMF support without lending

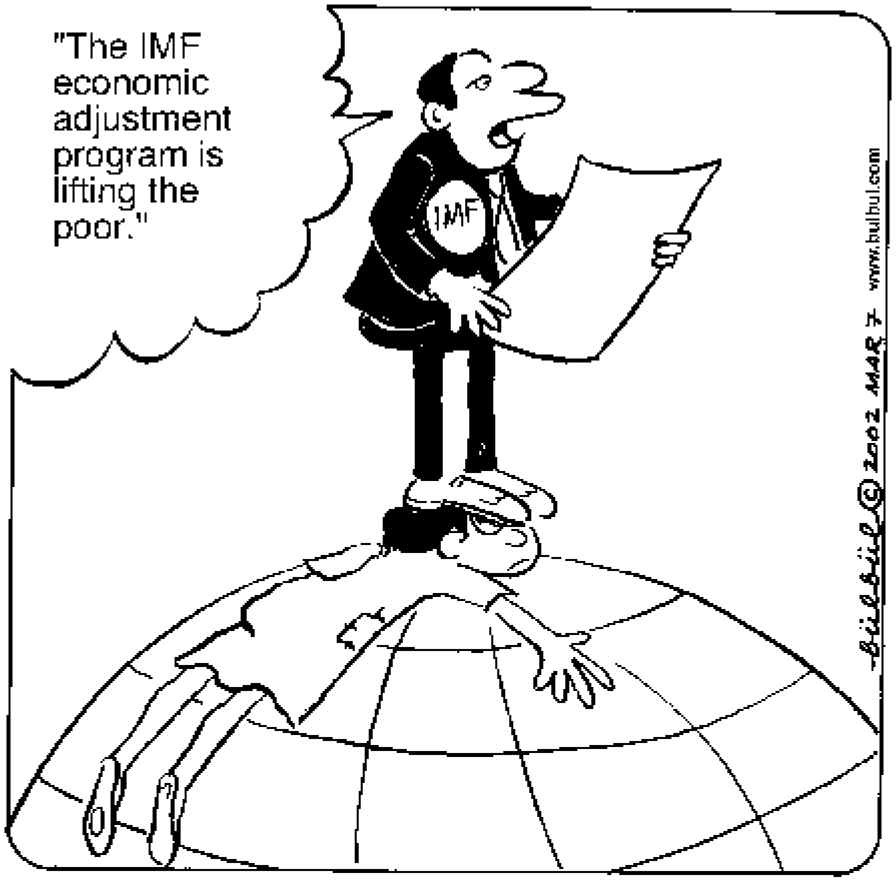
- Actually, there often are precautionary SBA or EFF lending arrangements, without real loans, just to provide confident signals to the private sector. Plus, the IMF has staff monitored programs that involve no resources.

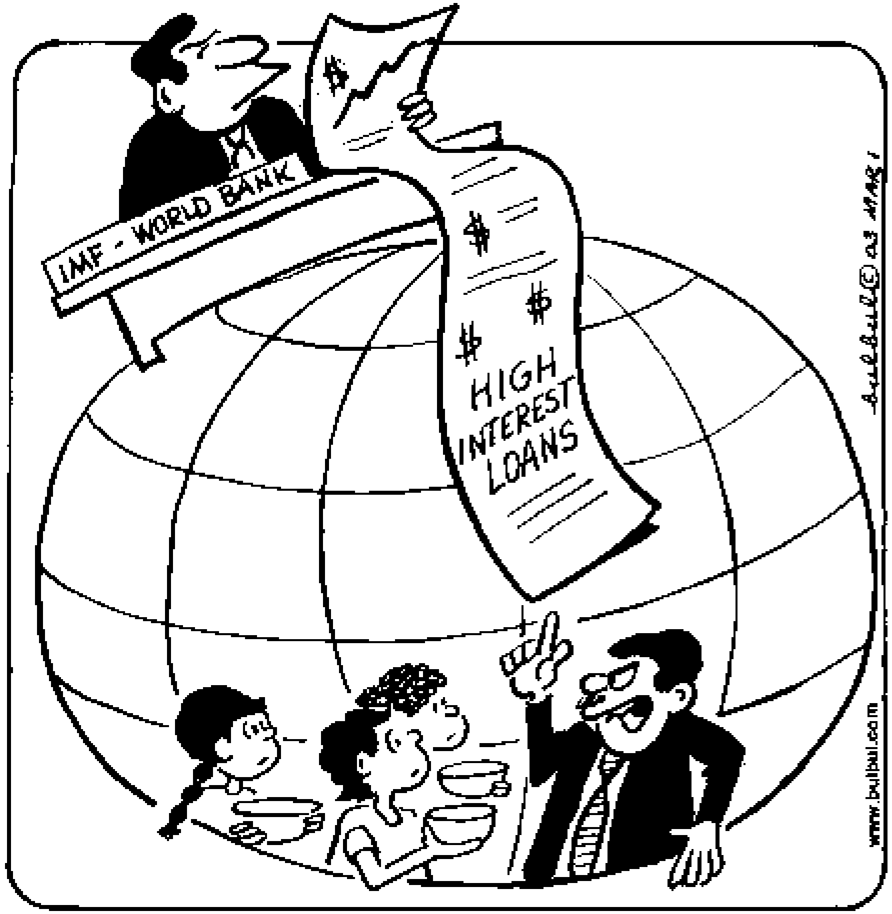
Problems:

- Wouldn't the IMF become another useless rating agency?
- How many countries should be involved? Voluntary?
- What about a facility to help members cope with positive external shocks (such as a surge in the price of a commodity that represents a large share of its export earnings), to assist the country to avoid the "Dutch Disease"?

4. IMF lending programs for poor countries

We have supplied you with all the infrastructure to pay us off the debt which we have invested in your development, you see..?





"His needs take precedent over your needs for food, housing, health care, and education."


LOANS
FROM:
THE
IMF
Exxon

IMF: a trojan horse?

- Sharpest criticisms involve IMF loan policy for poor countries. The words “structural adjustment” had become a catch-all phrase for the pain inflicted on the poor in developing countries by faceless austere bureaucrats in Washington.

- The IMF’s severe policy conditions for lending (privatization, free labor market, land-law reforms, ..) are blamed for destroying developing countries’ economies without the consideration of local conditions.

  Is this the case of Ecuador, Tanzania and others?

- In partial response to the criticism of excess of policy conditions, the IMF created a new lending program in 1999, the PRGF; in 2002 the IMF adopted revised conditionality guidelines that emphasize country ownership of policies and parsimony in conditions (IMF 2005h). Some reforms have been implemented, answering critics.

IMF support for low-income countries

- Over the past 30 years there has been a progressive shift in the IMF from balance-of-payments lending to longer-term, structural adjustment lending, which accelerated in the late 1980s (ESAF).
- The failure of ESAF led to the PRGF where, in principle, the borrowing country has more ownership.
- The transformation of the nature of IMF lending to low-income countries into structural lending has meant that the Fund and the Bank have been called upon to collaborate more intensively, with mixed results.

- Should the IMF continue to lend to these members? Should the IMF's involvement in PRGF lending be terminated?
- If IMF participation in PRGF lending is terminated, what type of lending arrangements for low-income countries, if any, should take its place?

Governance

IMF Reforms: Governance

- The IMF is established by an international agreement embedded in the legal systems of each member.
- Recent changes in the global economic architecture (rise of China, emerging-markets) have created the need for a broad review of the system of IMF governance.

IMF Reforms: Governance

- There are four main issues under the broad heading of IMF governance reforms:
  - **Member quotas**
  - **Choice of management and staff**
  - **Chairs and reform of the Executive Board**
  - **Direction of the IMF**

IMF Reforms: Quotas and Voting

- The relative sizes of member quotas is very important to IMF governance; the US currently has approximately 18% of the total votes, so it has the power to veto measures that require an 85% majority to pass.
- Abdullah (2005) discusses the Asian emerging-market economies feelings that their recent quota growth has lagged behind their actual economic growth, and how this leads to a lack of the Fund’s legitimacy in the region.

IMF Reforms: Quotas and Voting

- Quota calculation is a sticky issue.
- Factors that are traditionally taken into account in quota calculation are:
  - GDP at current market prices
  - official international reserves
  - current payments and receipts
  - the variability of current receipts
- Calculated quotas often differ from the actual quotas that the Fund chooses to account for differences not picked up in the formulas.

IMF Reforms: Quotas and Voting

- Some suggestions for reform of quota calculation (from Truman) include:
  - Calculating quotas with only a simple formula using GDP and a composite of the variability of current receipts and net long-term capital flow
  - Replacing GDP at current market prices with GDP on a PPP basis
  - Introducing population into the GDP considerations
  - Changing the number of basic votes per country
  - The establishment of a constituent EU voting area block that would act as a counterbalance to the US veto power

IMF Reforms: Quotas and Voting

- A recent IMF decision (*Quota and Voice Reform in the IMF,* September 2006*)* has already begun acting on some of these reforms.
- Its stated purpose was to:
  - make significant progress in realigning quota shares with economic weight in the global economy and to make quota and voting shares in the Fund more responsive to changes in global economic realities in the future, and
  - to enhance participation and voice for low-income countries, whose weight in the global economy may be small, but for which the Fund plays an important advisory and financing role.

IMF Reforms: Quotas and Voting

- Specifically, the proposal includes:
  - Modest initial ad hoc quota increases for China, Korea, Mexico, and Turkey
  - stated intention to begin discussion about new quota formulas
  - a second round of ad hoc quota increases at a later date that would include more countries
  - a proposed increase (of at least double) in the basic votes of all members, and the future tying of basic votes to the total amount of quotas, so they stay current
  - possible strengthening of the two African chairs on the Executive Board
  - an increase in the transparency of the selection of the Managing Director

IMF Reforms: Choice of Management and Staff

- Existing convention is that the IMF Managing Director is proposed by the EU and the World Bank President is proposed by the US.
- This causes some problems, obviously.
- Reform up until now has been limited; an internal review in 2001 recommended small changes, including increased transparency, but this has had little obvious effect on the subsequent selection process.

IMF Reforms: Choice of Management and Staff

- Miles Kahler (2001) proposed that the convention be explicitly abandoned and criteria developed to choose a candidate from a comprehensive list with the help of the ministers from the member countries, as well as introducing a two-term limit and an internal review process.

IMF Reforms: Choice of Management and Staff

- Concerns have also arisen over the general selection of the IMF staff.
  - There is a general view that economist technocrats dominate the Fund and its activities.
  - Also, it has historically difficult finding large quantities of qualified workers from places outside the US and the EU.
  - Finally, there is a constant worry over the role that political influence may play in staffing the Fund.
- There are no easy solutions to these problems.

IMF Reforms: Chairs and Reform of the Executive Board

- Several authors (Peretz 2005, Rajan 2005) favor a nonresident Executive Board, with the officials meeting regularly but less often than the current board.
- Gregorio et al (1999) advocates an Executive Board independent of the member countries.
- Woods and Lombardi (2005) favor increased transparency in the form of immediate publication of the Directors' votes and evaluations of their performance.

IMF Reforms: Chairs and Reform of the Executive Board

- There are several proposals for the redistribution of member country representation on the Executive Board.
- Many believe that the EU is over-represented on the Board, and many others believe that the Board itself is too large.
- Mimicking the quota argument, some believe that the emerging-market economies are under-represented.
- Kenen et al (2004) suggest giving the EU only two chairs, one for the euro countries, one for the rest.

IMF Reforms: Direction of the IMF

- Neither the Board of Directors, the Executive Board, nor the IMFC (group of 24 Directors that meet twice a year) actually own the responsibility of steering the direction of the IMF.
- The current de facto leadership of the Fund is the G-7, but Mervyn King (2005) suggests that several other countries (China, India, Brazil, Mexico, South Africa) be considered for addition into this little club.

Finances

IMF shaky financial ground

- IMF is facing a shortfall of about $105 million this fiscal year (ending April 30, 2007), a deficit which is projected to explode to $185 million in 2008 and $244 million by 2009.
- Many formerly cash-strapped Third World countries are experiencing enough prosperity to make early repayment of loans (Indonesia, Serbia, Uruguay and Ecuador), thereby cutting down on the interest income the IMF relies upon to cover operating expenses.
- The drop-off in lending means the IMF will face a $400 million hole in its $1 billion annual administrative budget by 2010 unless it cuts spending or raises new revenue.

IMF long-term finance model

- The actual IMF finance model is based on a single source of income: the intermediation margin between the rate at which the Fund lends and the rate at which it remunerates creditors.
- This method is volatile, it reacts to up/downturn of global economy, and it is not reliable.

A new proposal

Andrew Crockett, chair of the Eminent Person Committee, suggest a new model for the IMF (2007):

- Regarding its role as financial institution, i.e. intermediation and lending to countries, the intermediation margin is sufficient to cover the costs.
- Regarding its role as provider of “public goods” (surveillance, statistics, ..), no levy should be imposed to countries (impartiality problem). The Fund should sell a part of its gold reserves (400 metric tons = 6.6 billion dollars) and use the money to create an endowment, that would thus provide a stable income.
- The Fund should invest its activities in capital markets in a more profitable way, and it should release some of the quota resources to invest them also.
- Regarding its provision of technical assistance, the Fund should review the incentives to best target it, making sure low-income countries can receive and benefit it.

Concluding Remarks

- We still need an IMF in today’s global economic environment.
- Multilateral surveillance is an increasingly important role that the IMF needs to focus on in the coming years.
- Crises are not obsolete, and the Fund should still be available in case of their occurrence.

Concluding Remarks

- However, it lacks legitimacy in Asia and Latin America. Impending quota and Executive Board reform, as well as increased transparency may help this, but it might not be enough.
- There are financing problems, but these hopefully are being worked out.
- Past poverty-reduction lending programs may have caused more problems than they have fixed; shifting international focus on poverty reduction to the World Bank is a good idea.
- Reforms must occur soon or else the Fund will become more and more obsolete in a changing global economy.