IMF mandate needs fundamental rethink

Bretton Woods Project Briefing

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Overview

The IMF launched a review of its mandate in January, with two background papers and a narrow public consultation period ending 15 May 2010. The decades old development crisis and the recent financial crisis have both shown that the international financial architecture is failing to deliver equity, sustainability, and justice. This paper is the Bretton Woods Project's contribution to that debate. It argues that the IMF needs to fundamentally rethink its role, and return closer to its original purpose, focussing on three key areas: reform of the international monetary system; surveillance over the policies of systemically important countries; and providing rapid access, conditionality-free finance to countries facing crisis.

The last such IMF mandate review, launched by then managing director Rodrigo de Rato in 2005, resulted in little change apart from the failed multilateral consultation process on global imbalances. Hopefully this one will be different. It was therefore disappointing to note that the Fund's background papers seem to suggest a lack of ambition, for example by repeatedly stressing how difficult it would be to do anything that would require changes to the IMF's articles of agreement. The flaws in the global financial architecture in general, and the IMF in particular, are too great for anything but a fundamental and rigorous review.

Part of the IMF's problem is that none of the potential Fund role changes can be considered outside the lenses of legitimacy and governance. The IMF will continue to suffer from mistrust especially from Southern countries as long as the US maintains a veto and Europeans maintain overrepresentation on the board and in quota shares. Fundamental governance reform (the planned reforms for this year fall far short of this) must go hand-in-hand with mandate reform. As set out in our common European civil society position[1], previously discussed with European executive directors and governments, we believe this should include: double majority decision making based on countries, quota formula reform to reflect a democratic element, board reform to ensure European consolidation and more accountability, open and merit-based selection of all senior management, and dramatically improved participation and transparency.

Surveillance and crisis prevention

The Fund must become more even-handed in its surveillance, and focus on improving and adding teeth to its multilateral surveillance of systemically important countries. Developing countries have long complained that the IMF has no ability to make non-borrowing rich countries consider the external impact of their domestic policies, but frequently rebukes developing country borrowers over domestic political choices. This was borne out in the recent Independent Evaluation Office report on the IMF's relations with members[2].

One clear potential value-addition of an international institution such as the IMF is to look at the policies of systemically important countries and the impacts they have on other countries – the so-called spillovers. An IMF with democratised, more accountable governance could become the venue for discussion of economic policies and their spillovers, as part of the IMF's mandate to ensure economic stability and prosperity. Systemically important countries must be willing to negotiate, where necessary, changes to their economic policies that are damaging other countries, and the IMF must be empowered in this area to enforce negotiated and agreed solutions. Enforcement

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[1] See 53 organisations, "European CSO open statement on governance reform of the IMF", 17 July 2006, http://www.brettonwoodsproject.org/art-539161.

[2] See IEO, *IMF Interactions with Member Countries*, January 2010, http://www.ieo-imf.org/eval/complete/eval_01202010.html.

mechanisms would need to be designed, but the evidence from the evolution of the WTO is that this is possible. The focus on spillovers should take the IMF away from surveillance that is narrowly bilateral and concerned mainly with domestic stability. If this requires an amendment to the articles, then that should be supported, but other administrative means could be used to achieve the same result.

Secondly, the issue of capital controls is fundamentally important. The staff position note which argued that capital controls should be a part of country toolkits to combat destabilising capital flows is a start.[3] However it carries no political weight as a staff opinion and does not go far enough: any perception of capital controls as a temporary, short-term quick-fix solution to deal with volatile capital flows is unlikely to succeed. Rather capital controls should be seen as one of the policy instruments in the hands of governments to pursue independent economic policy making, growth and financial stability. As at the founding of the IMF, capital controls should be available to all members, and the IMF should be stand ready to help countries design smart controls that are more than just temporary band-aids.

The issue of financial sector surveillance is crucially important, but a democratically reformed IMF should play a tightly defined role. It is clear that developing countries have been negatively impacted by the regulatory failures in the developed world. We have argued for an international regulatory body that would put justice, equity, sustainability, policy space (not liberalisation and deregulation) and developing country interests at its heart, but recognise that this may be a distance away.[4] The Financial Stability Board has been created to address some of the severe gaps in financial regulation and supervision at the international level. However, the FSB has a serious deficit in its governance and transparency, with most countries excluded from membership, and woeful participation by most of those affected by its discussions, and it does not appear to be pursuing adequate regulation of the entire financial system.

It is clearly not sensible for the IMF to take on a financial regulatory and supervisory role. However a democratised IMF should greatly improve its treatment of the financial sector in its multilateral surveillance of systemically important countries and institutions.

Crisis resolution and IMF facilities

A democratically reformed IMF should focus on providing rapid, adequate, conditionality-free emergency finance to countries in trouble, rather than continuing to attach counter-productive conditionality. We argued before and during the crisis that countries needed much larger levels of resources but only if they come without conditionality. The IMF has a short-term liquidity role to play, but has unnecessarily constrained access to its resources – especially when the crisis shows that economic shocks which they did not create, damage developing countries and their economic prospects.

The rapid, low-conditionality Flexible Credit Line (FCL)[5] is proving to be popular with the small number of countries able to access it – with Mexico, Poland and Colombia renewing or potentially planning to do so. We support greatly expanding access to the FCL, which would mean much more flexible ex-ante qualification criteria.

Low-income countries (LICs) clearly need liquidity in times of crisis, just as middle-income countries do. The provision of some special drawing rights (SDRs) to LICs in 2009 was a step in the

[3] See Bretton Woods Project, "IMF changing its mantra? Capital control, not inflation", *Bretton Woods Update* No.70, March/April 2010, http://www.brettonwoodsproject.org/art-566106.
[4] See Bretton Woods Project, "Memorandum by the Bretton Woods Project for the UK Treasury Committee", 30 April 2009, http://www.brettonwoodsproject.org/art-564526.
[5] See Bretton Woods Project, "IMF bigger but not much nicer", *Bretton Woods Update* No.65, March/April 2009, http://www.brettonwoodsproject.org/art-564205.

right direction[6] (though most of the allocation went to developed countries), and more steps need to be taken on this (see below). However LICs also need an FCL-like facility, something we called for at the time the FCL was created and again when LIC facilities were revamped last year. Short-term, un-conditional and high-access finance is very important in dealing with economic shocks. This could be accomplished through greatly expanding the size and availability of the Rapid Credit Facility. Alternatively and preferably, in order to retain similarity between concessional and non-concessional facilities, a new concessional FCL should be created.

Other innovative ways of providing conditionality-free, rapid access finance or support to countries facing crisis should be urgently considered, such as guaranteeing new debt issuances of governments as proposed in the IMF staff paper for the mandate review.

This should not be construed as arguing for the IMF to play a larger role in LICs. As we have argued in the past the IMF is not a development finance institutions and should stop acting like one. With a new focus at the IMF on economic spillovers and the monetary system (see below), the IMF needs to shed some of the roles that are not squarely part of its mandate. That would mean an end to medium- to long-term finance, aid signalling and other problematic aspects of the IMF's involvement in LICs.[7] These ideas are well supported across the spectrum from many parts of the US government, to NGOs and academics, to the Malan experts committee[8] and most recently Supachai Panitchpakdi, former Thai deputy prime minister and current secretary general of UNCTAD.

International monetary system reform

The international monetary framework which emerged after the collapse of the Bretton Woods system in the 1970s has proved volatile, damaging and prone to crises. It is time for a fundamental redesign and the introduction of a global reserve currency, to help stabilise international exchange rates, smooth commodity prices, promote international economic cooperation, and prevent future financial crises.[9] Many developing countries will continue to attempt to run surpluses and stockpile reserves until there are resolutions to the stigma and conditionality problem associated with emergency support and a fix to the global monetary system.

There are two main requirements: a global reserve currency not based on the dollar, and a system of managing exchange rates to deal with systemic imbalances. On the former, with radical improvements in IMF governance, the special drawing right (SDR) could serve as the cornerstone of a new monetary system. It will need reforms, but they are not technically unfeasible, they only require political will. SDRs issuance should become regular, automatic, and not strictly along the lines of the IMF quota formula, with the ability for larger counter-cyclical issuance at times of need. SDRs should be commercialised (e.g. trade invoicing, commodity pricing) and become more broadly used, something the IMF can encourage through a number of measures to improving settlement, trade and use of SDRs.

Second, along with capital control techniques, the international monetary system must ensure that the burdens of adjustment to imbalances fall equally between surplus and deficit countries. As the Greek crisis has shown, asymmetric adjustment is problematic. One way to achieve this would be to go back to some of the ideas proposed by John Maynard Keynes in the run up to the original Bretton Woods conference – an international currency union. Adapting these proposals to the modern context

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[6] ibid

[7] See Bretton Woods Project, Christian Aid and Save the Children, *Reforming the role of the IMF in low-income countries: Questioning the IMF's current involvement*, February 2008, http://www.brettonwoodsproject.org/doc/wbimfroles/IMF_LICS_feb08.pdf.

[8] See Final report of the external review committee on Bank-Fund collaboration, February 2007, http://www.imf.org/external/np/pp/eng/2007/022307.pdf.

[9] See Chowla, Peter, Barbara Sennholz and Jesse Griffiths, "At issue: Dollars, devaluations and depressions: how the international monetary system create crises", Bretton Woods Project, September 2009, http://www.brettonwoodsproject.org/art-565403.

will be necessary, but not impossible, UNCTAD has already started work on elaborating the use of a constant real exchange rate rule.[10]

Conclusion – balance needed

The world needs an international financial and monetary system that enhances equity, sustainability and justice; not one that detracts from it. The IMF and its shareholders have a key opportunity at this time – with the financial crisis fresh in our memories and the dawn of a new global geopolitical arrangement. The IMF, if it is to be useful, must radically change. That means reducing its power and roles in some areas while enhancing them in others. It is time for:

- Fundamental and comprehensive governance reform of the IMF;
- A refocusing of the institution on three goals: reform of the international monetary system; surveillance over the policies of systemically important countries; and providing rapid access, conditionality-free finance to countries facing crisis:
    - Ensuring the IMF has traction over the policies of systemically important countries that have spillover effects, with special emphasis on the impacts on the poorest and most vulnerable countries;
    - Ensuring the stability of a new monetary system based on SDRs (or some other new reserve asset) and an international currency union.
    - Creating a set of crisis resolution facilities with sufficient resources and no conditionality and ending the IMF's continuing pursuit of development finance (recurrent and long-term lending, as opposed to short-term balance of payment crisis support) and other roles outside its mandate and area of expertise

[10] See for example, UNCTAD, "Global monetary chaos: Systemic failures need bold multilateral responses", Policy Brief No. 12, UNCTAD/PRESS/PB/2010/2, 19 March 2010, http://www.unctad.org/Templates/Download.asp?docid=12898&lang=1&intItemID=4566.