

Some Considerations regarding the International Monetary Fund's Reform

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Abstract

Large international organization with over 180 member countries, the International Monetary Fund (IMF) is the subject of many debates, appreciations and critics, both in the literature and in the daily newspapers. This effervescence of ideas quite often aims at the gap between the tasks declared by the IMF (to encourage global monetary cooperation, to ensure financial stability, to facilitate international trade, to promote employment and to support economic growth, and also to reduce poverty in the world) and the activities actually carried out. Moreover, in the current international context determined by the outbreak of the economic and financial crisis, dissatisfied with its own personal performance, the IMF seems to assume the risks of internal institutional reform. Thus, this article aims at capturing some of the aspects of the institutional reform of IMF, emphasizing the benefits/gains, but especially the minuses of such a reform.

Key words: *IMF, institutional reform, external loans, emerging countries*

JEL Classification: *F02, F33, F36, F53*

Introduction

Founded in July 1944 at Bretton Woods, New Hampshire, the International Monetary Fund has been designed to ensure international economic cooperation after the Second World War. In fact, IMF's goal has been to create a new international framework that could avoid the disastrous economic policies which have led to the '30 Great Depression. Its institutional evolution recorded accelerations and decelerations, determined both by the political will and the international context. Thus, in late 1945, the International Monetary Fund was set up effectively, and after another two years, it has become fully operational, France being the first European Union Member State which has requested a loan from IMF. Initially, the Fund supported mainly industrialized countries, only later it turned to developing countries or very poor countries by designing gradually financial instruments increasingly more appropriate for the needs of the member countries which request IMF loans.

Between 1945 and 1971, IMF conditioned the loan granting by the firm commitment of the applicant countries to peg their currencies to the dollar and in the case of the United States (U.S.) by the commitment of maintaining its currency's parity relative to gold. This system collapsed in 1971 due to the suspension of dollar's convertibility into gold and it was effectively abolished only in March 1973, when the major currencies began to float among them. In fact,

the strong currencies' floating prevented a possible re-entry into crisis due to the considerable increase in oil prices since the autumn of 1973. The international increase in fuel price has forced oil-importing countries to borrow from commercial banks in order to continue importing and to control inflation. This has led to a speculative increase in interest rates, the States becoming increasingly indebted to banks, appearing even the danger of loans default. In this context, in 1982, IMF intervened in Mexico, defusing the tension and calming the international markets in exchange of the implementation of painful economic reforms in this country. The situation repeated during 1990-2004, when, with the fall of the Berlin Wall in 1989, the former communist countries have begun the transition to the market economy, being assisted throughout this process, by IMF, both by technical consulting and by financial support. In 1997, the Asian crisis highlighted the fragility of the international macroeconomic stability, and in particular of the banking system; thus, the external financing's sudden stop determined the Fund to rethink its enthusiastic policy of capital account liberalization. In the last 5-6 years, the stronger financial integration of all countries in the world, which has led to an unprecedented economic effervescence, has been the most vulnerable channel of spreading the international economic and financial crisis, IMF being highly required to normalize the international situation through counselling, technical expertise, but especially by providing many financial resources. This has led again to the increase of IMF's importance, after a period of stagnation of its activity at the international level.

The emergence and the gradual consolidation of the European monetary pole could have provided more opportunities to stabilize the International Monetary System (IMS), but of course on the condition that it could have worked in a closer relationship with the American one. In this respect, some of the solutions applied in the European Union (EU) could have been extended worldwide, this meaning also changes in the international financial organizations framework and, in particular, in IMF's case. Thus, an important direction in order to support growth and economic stability aimed at efficient use of savings in the world, at developing less developed regions and at creating new jobs. But such measures, which have a rather European character, were apparently not enough agreed by the international bodies, having been in this respect, discussions on founding a European Monetary Fund, as a regional alternative to IMF. However, with the outburst of the global financial and economic crisis, both the institutional bodies of the European Union and the European Central Bank (ECB) called on IMF's ability to grant to the Member and Non-member States of the euro area the necessary funds for going beyond these difficult times.

Valences of the Role of the International Monetary Fund – Assessments, Critics and Aspects of the Institutional Reform

Paradoxically, in times of worldwide economic boom, IMF's role is not so clear, the Member States being able to repay the loans obtained from the Fund in the past more easily. Moreover, they don't need to seek advice and technical expertise from IMF, as it happens during financial crisis. This aspect raises a disturbing problem, which of course does not concern only IMF, but all the international financial bodies, namely: whether and how these international financial institutions are involved in creating or tolerating conflicting economic and financial situations which will give them, by the interventions required later, the very reason of being?

Of course, the importance of funding from an international institution doesn't only consist in the volume of the amount offered, but especially in the credibility that it is provided by such funding, which is attracting many foreign investors. This gives, even in less harmful economic periods, an increased importance, both to IMF and to the other international financial bodies. Therefore, in boom periods, IMF's role could be considered diminished, but not entirely lost. Maybe only the fight for supremacy in the international financing could be the motivation for an involvement, even a tacit one, in the emergence of global financial and economic crisis.

Given this context, it is not surprising why, in the recent years, the criticism against IMF has increased, existing even proposals to dissolve it. But at the same time with the criticism against the Fund, there have been gathered more and more practical proposals, some regarding the improvement of its activity.

Thus, there have been identified two asymmetries in the functioning of IMF, namely: the first concerns the lack of harmony between crisis prevention and crisis intervention and the second consists of the different treatment between lenders and borrowers. Critics say that lenders, rather than borrowers, have been assured that they will be saved in case of an emergency. Then, there are many reproaches against the Fund according to which, in most cases when IMF's intervention has been required, it failed to bring about the recovery of the payment capacity, the exchange rate stability and the balance of payments equilibrium.

Before presenting different views of the economic and political personalities in relation to IMF's reform, we consider that it should be reminded the following circumstances that should be taken into account in a fair judgment:

- The initiative to offer the IMF services to member countries in need does not belong to IMF, but on the other hand, it is worth mentioning, for example, the insurances of the Great Powers of the euro area that the countries with debt problems (like: Greece, Ireland, Portugal, Ireland and Italy) should seek international financial assistance. The international rating agencies operate in the same way, which under the threat of bad grades determine states with problems to seek help from IMF;
- IMF's resources are limited, and in that sense, at the end of 2011, it was discussed, at EU level, that Member States, each and everyone, should contribute to increase its resources. This increase in resources would aim at helping countries in difficulty from the euro area. However, this imposes an additional burden on the budgets of IMF's member countries, which is a pro-cyclical effect on the national public budgets already burdened in excess;
- IMF is not involving in the internal affairs of its member countries, but its constraints act strongly against the countries that have received loans from IMF. This often leads to increased default of the borrower by reducing or delaying the GDP growth, by the loss of many jobs, by restricting production capacity, by liquidating many companies, by the higher and higher tax burdens, by forced privatization of some companies or by the sale of strategic resources etc. For this reason, the request for a loan from IMF seems to be an "irrational" behaviour, to which many countries are forced at the international level to comply. One solution might be seeking an alternative to IMF loans or getting a combined loan between limited access to IMF's resources (without economic constrains!) and other funding sources;
- Any agreement with IMF can not be signed until IMF has sufficient assurance that the amounts granted to debtors will be used effectively, so that they can be recovered. Or, in many cases, exactly the inability or limited ability for repayment are the reasons to call for an IMF loan. The phenomenon is based on the inability of the state to declare default or bankruptcy, considering that in the end, regional or international solutions will be found so that a state should not enter in a default situation (see Greece), the concerned state receiving new loans. In this situation, of "repeated redemptions", those affected fall into a spiral of endless public debt, which will gradually lead to the loss of political, economic, financial and social autonomy and integrity and finally, of the territorial autonomy and integrity of that state;
- Based on a system of quotas or contributions, which reflect the size and relative strength of a country in the world, IMF is run basically by a group of shareholders consisting of a few

powerful countries (i.e. 8¹), each having its own director in the Executive Committee, the small countries, although much more numerous (i.e. 16), being unable to interfere in the elaboration and revision of IMF's rules and procedures.

Given the above mentioned, the solution offered by some economists (e.g. *Milton Friedman*²) to dissolve the Fund because it is an institution outrun by the events, was contradicted by the reality and therefore it has not been taken into account. However, it may seem unrealistic to support an overall change in the structure of IMF, considering this to be an ineffective updating of an outdated international structure. But as the international financial system's architecture is imperfect, asymmetric, but improvable, from it winning almost all its members, the solution for IMF could be making it more efficient.

Some proposals aim not only at a widespread IMF intervention in times of crisis, but also at preventing a crisis. In this respect, IMF has made some progress in the preventive area through introducing the Unexpected Credit Lines. These lines "reward" those countries that have "healthy" policies and provide them access to IMF lending before the onset of a crisis.

The structural reforms that have to be applied to IMF are supposed to be necessary not only to achieve a better balance between crisis prevention and crisis intervention, but also to achieve a better balance between the supply of "incentives" for countries applying "healthy" policies and the penalization of those who do not.

It should be noted that in 1994, on the occasion of the Jubilee of "Bretton Woods's institutions", the Commission for the future of "Bretton Woods's institutions" issued a report on the role of IMF and World Bank in the international monetary system and of the development process. The report indicated that IMF should focus more on core functions and play a more active role in the possible reform of the international monetary system. Generally, there are opinions that consider that by the merger between IMF and the World Bank, IMF's surveillance task of the international monetary system would be abolished and that IMF would remain only an institution for the third world.

Referring to the major global institutions, *Amarthya Sen* (Nobel Prize for economics in 1998) shows that it is very important to rethink their organization and the balance of powers inside them, because their architecture reflects to a large extent the concerns that dominated the world from the second day after the World War II. "They certainly completed their task by allowing the revival of trade and restoring growth. But, the world of that time was very different from what we know today. Therefore, the major international institutions - the World Bank, IMF, and WTO (World Trade Organization) - need to rethink their policies."³

Particularly interesting is the opinion of *Claude Smadja*, Director of the World Economic Forum who on the occasion of the Davos meeting (January 1999) said: "I am outraged by the errors of analysis and action of IMF [...]. They wanted the application of the American financial capitalism model in the global economy. This arrogance has painful consequences of which we do not even know yet."⁴

Generally, the problem of any creditor is the repayment by the debtor, without requiring the debtor what to do and how to do it until the repayment, or IMF conditions the access of any loan, including structural adjustment programs (SAPs), of the so called economic performances or imposes structural reforms through "austerity programs". This aspect is the main criticism of

¹ These are: USA, Japon, Germany, France, Great Britain, China, the Russian Federation and Saudi Arabia. Source: <http://www.imf.org/external/np/sec/memdir/eds.aspx>;

² Friedman, M., Friedman, R., *Liber să alegi, un punct de vedere personal*, Editura All, București, 1990

³ *Problemes économiques*, nr. 2734/31.X.2001, p. 27.

⁴ Belli, N., Globalizarea în gândirea economică contemporană, *Probleme economice*, nr. 45/2002, București, p. 12.

IMF's policy, being contrary to the declared goals of the institution. Between the adverse effects of IMF's policy implementation could be distinguished: the increase in taxes and the forced balancing of the budgets when economies are already weak; the generation of domestic anti-development policies which involve job cuts in the public sector, income reduction, deflation, poverty, currency devaluation, restriction of human freedoms and of rights to work, and a dangerous reduction of funding for key areas such as health, education, defense and security, but also the privatization of vital national strategic resources (e.g. the Argentinean crisis in 2001). An opponent of this type of restrictive policies of the Fund is *Joseph E. Stiglitz*, who in his book "*Globalization and Its Discontents*" (2002) criticized harshly the neoliberal policies of this international body. His accusations are mainly against the excessive monetary policies of IMF which include fiscal austerity, high interest rates, trade liberalization, liberalization of capital markets, and the solicitation for privatization of the state assets, thus considering that IMF has played an important role in the Asian crisis (1997-1999) and the Argentinean one (1982). In fact, Stiglitz mentions another criticism often brought to the Fund namely that it reflects "the interests and ideology of the Western financial community", which idealizes the virtues of market mechanisms and the effectiveness of the market-oriented policies.

Another criticism refers to the fact that IMF seems to be unable to identify correctly the causes of balance of payments' imbalances, considering that all disequilibria have internal sources. The oil crisis of 1973 is a good example, when IMF "ordered" to the countries with trade imbalances the same type of stabilization program as to the countries with oversized government spending. Also, although IMF argues that economic stability is a precursor of the democratization of a nation, many of the countries that have asked for loans and advice from IMF have experienced setbacks on democratization even after they have received such loans. At the same time, many reproaches addressed to IMF regard the lack of sufficient transparency concerning the institution's policies and funds. IMF (as the central banks) makes public the official reserves and their destination, but not all the funds of the institution are characterized by the same transparency.

As regards the supervision of the financial and banking system, there are necessary some prudential rules which should apply to all financial and banking system's players, not only at national and European level but also at the international level.

Also, there have been discussions about the need to strengthen the character and political force of the decision bodies of IMF and also to raise the shares of the Member States.

In the current context of crisis, the most recent criticism concerning IMF regards the delay of its actions, IMF tending rather to react to the crisis than to prevent it. This justifies the implementation of institutional reforms. Thus, in 2006, "The medium term strategy of the International Monetary Fund" has been approved by the member countries and it aimed at strengthening the role of developing countries in the decision-making process of the institution, but also at focusing stronger on the basic mandate of IMF: economic surveillance and the assistance of member countries in order to adopt macroeconomic policies to support global growth and to reduce poverty.

In 2007, the IMF's Executive Board has adopted a Decision on Bilateral Surveillance, replacing a measure valid for over 30 years, concerning the way IMF should analyze the economic results of a country.

In 2009, the Director of the IMF from that moment, asked the Member States for the increase of the resources placed at the Fund's disposal. Thus, it was aimed to consider IMF as a credible financier in extreme situations of the world economy. Brazil, India, China and Russia (BRIC) have requested an increase of 7% of the share of developing countries, compared to 5% as proposed by the U.S.

Also during this year, under the pretext of the financial crisis, when the problems generated by

it were wide spread and the states were strongly interested in change, G30 (a group of political leaders, economists and important bankers) required a deep reform of IMF. This group proposed the establishment of a new board of directors of IMF after the G20 model, the faster use of flexible credit lines, which can be received at need by the emerging countries, the improvement of IMF's ability to provide resources in order to alleviate possible future crises. G30 supported the rapid change of IMF's governance style so that to reflect the changing balance of powers in the world economy. G30 did not require the IMF to act as a global central bank, as it has repeatedly been suggested by some politicians from some emerging countries. China strongly urged for the reorganization of the IMF management, as it wants to play a greater role in leading this international financial institution.

Also, in 2010 the International Monetary Fund's reform increased the importance of emerging markets and of developing economies, offering 6 percent of its quotas to these countries, thus providing more decision-taking power to BRIC countries (Brazil, Russia, India and China). At the end of 2010, the Governors Board of the International Monetary Fund approved the doubling of the total IMF's contributions from 238.4 billion SDR to 476.8 billion SDR⁵. This has been the 14th general review of quotas and it has had as target the increase of representativeness of emerging countries and the protection of poor states. As everyone knows, the decision making process inside IMF reflects the position of each member country in the global economy, through the quotas that reflect the political and financial commitment toward IMF, unlike the United Nations which give each country the right to one vote. Thus, we can say that IMF's reform should take into account a better distribution of decisional power in order to represent the interests of all its members and not just the interests of the "strong" countries and the new emerging economies.

As it concerns the European Union, it could be the most influential party in the international financial institutions such as IMF and the World Bank, due to a high percentage of votes in the Boards of Directors of both organizations, but the power of EU is potential because it rarely acts as a unified structure or as a political bloc. This reflects also the high discrepancy of forces of the EU countries concerning their representativeness in the two international bodies, making it extremely difficult to accept and to promote common positions and strategies. However, in order to increase the effectiveness of the IMF's activity, the European Union's function, also as a whole, through its institutions (the European Commission, the European Union Council, the European Parliament, the European Central Bank, etc.) and partly, through the member countries, should be at least more distinct because of its responsibilities within these bodies, particularly the IMF.

In 2011, IMF has set its institutional reform among its priorities, in the context that tensions were noticeable in the increase of global imbalances, in the capital flows and the exchange rates volatility, and also in the accrual of huge financial reserves.

With the purpose to materialize the importance of the BRIC economies in the world economy, and particularly of China, the General Director of the International Monetary Fund, Christine Lagarde, appointed in May 2012 the Chinese economist Lin Jianhai as Secretary of the Fund, in the conditions that in July 2011, another Chinese economist, Zhu Min, has been appointed as deputy General Director of IMF, becoming the first representative of China which took a major leadership position with the Fund.

⁵ Tempea, O., Mediafax, *Romania pays for the crisis. The participation to IMF will increase by almost 900 million euro*, November, 8th 2011.

Conclusions

In the new global context, we can notice that the institutional reform of IMF reflects a change of world political and economic polarity, the organization focusing on providing more power to the countries holding financial and energy resources: the BRIC countries.

The question arises, taking into account all these aspects, whether IMF, through the financial mechanisms and instruments at its disposal, could have managed better the international crises? Could IMF have avoided the Mexican crisis (1995) or the South-East Asian crisis (1997) or the Russian crisis (1998)?

The experience of the financial crisis from 1997 proves, according to IMF critics, that IMF has not always answered successfully to the problems that it had been required to solve. In other words, IMF has become an institution, which deals with the problems of capital importing countries. IMF is an institution that requires the compliance of the condition according to which the revenue growth should exceed the increase in expenditure in the case of capital importing countries. But what IMF has recommended has proved that the measures imposed by IMF to the capital importing countries made them unable to export enough to be able to increase the level of revenues over that of the expenditures. Then, some economists have begun to suspect IMF of some irregularities or of an unworkable or even malicious decision transmission mechanism. In general, we can say that IMF's targets are not quite clear: on the one hand, the financial assistance granted to the countries in need of funding comes with a number of conditions that are not beneficial for them, leading to lower economic growth, loss of jobs, freezing of wages and pensions, increase of public debt, etc., and on the other hand, the purpose of the funding is to increase economic and financial stability of that country, contrary to the conditions imposed.

Before the outbreak of the international financial crisis in 2007, many experts have focused on the problem of redefining the role of IMF, they have asked questions about and have tried to clarify the following issues: if IMF has had the necessary resources and if it has done the right thing to do for the welfare of the countries who have asked IMF for help. Moreover, noting that both IMF and other international financial entities detected neither the signs of a global economic and financial crisis nor the size of the "disaster", as well as the lack of signals of alert for the previous crises, we might wonder whether this institution will still be necessary in the future. At the same time, IMF has not conceived a mechanism for counterbalancing the pro-cyclical effects of its funds invested in the countries that have asked it for loans, these effects aggravating the crisis and prolonging the period of "recovery" of the economies in question.

In our opinion, as a country becomes more financially independent, showing improved economic competitiveness and productivity, and she becomes less internationally indebted (including from IMF), she is more likely to survive in any crisis periods.

The countries which have resorted to IMF loans (Hungary, Romania, Serbia, Latvia), in order to ensure investors that they would promote adequate macroeconomic policies, have had to lay off staff of the public administrations, to diminish dramatically wages and pensions or to freeze them, to implement painful reforms without long-term perspective, but also to block funds for business development. These measures aimed at achieving the deficit targets imposed by IMF and other international financial institutions and not at solving some temporary problems, brought about exclusively by the crisis and / or permanent problems, of structural nature, of the countries that have asked for loans from IMF.

Considering the International Monetary Fund as one of the main international financial institutions responsible with the globalization process, for a well-functioning of the global financial system, it should improve its policies in favour of developing countries.

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Unele considerente asupra reformării Fondului Monetar Internațional

Rezumat

Organizație internațională amplă, cu peste 180 de țări membre, Fondul Monetar Internațional (FMI) este subiectul unor numeroase dezbateri, aprecieri și critici, atât în literatura de specialitate, cât și în presa cotidiană. Această efervescență de idei nu de puține ori vizează discrepanța între atribuțiile declarate ale FMI, acelea de încurajare a cooperării monetare globale, de asigurare a stabilității financiare, de facilitare a comerțului internațional, de promovare a ocupării forței de muncă și de susținere a creșterii economice, precum și de reducere a sărăciei în lume, și cele realizate efectiv. Mai mult, în actualul context internațional determinat de declanșarea crizei economice și financiare globale, nemulțumit de performanțele personale, Fondul Monetar Internațional pare a-și asuma riscurile unei reforme instituționale interne. Astfel, prezentul articol își propune să surprindă unele dintre aspectele reformei instituționale a Fondului Monetar Internațional, punctând asupra plusurilor, dar mai ales a minusurilor unui asemenea demers.