IMF AND INTERNATIONAL FINANCIAL ARCHITECTURE REFORM PROPOSALS

Duca Ioana

Titu Maiorescu University Bucharest, Faculty of Economic Sciences, ioana.duca@utm.ro,

Gherghina Rodica

Titu Maiorescu University Bucharest, Faculty of Economic Sciences, rodicagherghina@yahoo.com

During the past few decades, the radical changes that have occurred in the global economy – uncontrolled inflation rhythms, the growth in interest rates, the increase in foreign debts and in budget and current account deficits, financial crises – have led to the accumulation of a set of issues whose solution generates heated debates at international level and tensions among the global actors. Therefore, it is necessary to make a concerted effort at world level to rethink the International Financial Architecture, especially that of the International Monetary Fund (IMF), by adopting adequate legislative and institutional regulations.

Key words: International Financial Architecture, gradual reform, radical reform, the International Monetary Fund

1. Introduction

The current configuration of the international financial system was created before globalisation reached the size it has nowadays. In the past few years it has become obvious that the international mechanisms (the IMF, the World Bank, and the World Trade Organisation) need another „philosophy" and architecture in order for them to be valid in the new economic and political world order, their reform being imperative. In time, there were numerous critical opinions of the insufficiency, lack of action and weaknesses. Most of them targeted the International Monetary Fund. Actually, after the Jamaica Agreement, no substantial change has occurred as far as the principles guiding the activity of this organisation are concerned.

2. Criticism of the IMF activity and philosophy

The objections to the IMF and its activity can be classified into *exogenous criticism*, which is related to the technical-bureaucratic interaction of the IMF with the other institutional actors, and *endogenous criticism* which targets the political aspect of the decisions taken by the Fund and the activity performed by this institution (Toderean, O., 2002: 31).

Among the *exogenous criticisms* made in time, we can enumerate the following:

- The surveillance function is implemented asymmetrically. The IMF cannot influence the developed economies of the world, but it puts severe adjustment pressures on emerging countries. The latter are often forced to sign agreements with the IMF because such agreements are a „green light" for their entering international capital markets, which is an indirect guarantee for potential investors.
- The conditionalities included in the IMF programmes block development, diminish the economic potential and deepen social polarisation. In addition, they are imposed to countries that already have poor economic performances and that are faced with serious social problems.
- The IMF provides simplistic and universal „recipes", ignoring the peculiarities of each country's economic and social context, which require a different reform rhythm.
- The IMF often proves it lacks the pragmatic economic knowledge. Although initially the IMF was based on knowing the fact that markets often operate inadequately and concerted action at global level is necessary to ensure economic stability, nowadays, the initial Keynesian orientation was replaced in the 1980s by the *Washington Consensus*. It represents a different approach, with three pillars: fiscal austerity, privatisation and market liberalisation, namely the so-called „market fundamentalism" (Stiglitz, J. E., 2003). It generated *judgements* of the type *free markets operate more efficiently, and higher efficiency leads to the acceleration of*

economic growth. The IMF orthodoxy thus legitimated capital mobility and free trade, ignoring the role of the states in providing the necessary conditions for these to occur. As a result, many of the IMF policies through which early market liberalisation was induced by force generated not a better allocation of the resources, but a global instability, because the respective markets became vulnerable.

– The IMF programmes ignore the so-called „social contract", namely the principle which requires that the benefits and costs of the measures should be fairly allocated to social classes. In many cases, through the structural adjustment programmes – SAPs – the IMF imposed privatisation and liberalisation in a way and at a rhythm which generated very high costs for the countries which were not prepared to bear them, the IMF claiming that these costs were a part of the price that must be paid for progress.
– The lack of global financial supervision and coordination, determined by the lack of instruments necessary in limiting speculative movements (Pauly, L. W., 1994).
– The IMF is an untransparent institution, the decision-making process being opaque. We must mention, though, that after the Asian crisis, the communication process has improved visibly, the Fund's activities, missions, debates and decisions being brought to the attention of those who are interested by means of press releases, periodical reports and the permanent update of the web page.

Regarding the endogenous criticisms, the most frequent are:

– The voting system based on participation quotas is undemocratic.
– The IMF is a facade for American interests (Allais, M., 1993), contributing to the consolidation of the USA position and often serving this country's interests. Instead of being a cooperative-type institution, it changed into a super-state decision-making organism, in which the key position is held by the USA. Moreover, the IMF was not limited to its initial purpose – to strengthen global stability, but it started supporting the elitist financial community interests – many of its employees originating from banks or Wall Street (Stiglitz, J. E., 2003).
– Any form of civil society participation are excluded (the IMF does not work with NGOs).
– The process of selecting the IMF employees, especially the managers, is untrasparent, the criteria not being public.
– There are no mechanisms through which the institution can be held responsible for the negative effects or failures of the policies that were implemented.

3. IMF reform proposals

Regarding the role the International Monetary Fund should play in an international-globalised financial system configuration there is a consensus in terms of the opinions that were expressed: a reform, a new legitimacy are necessary. The IMF should become a support for the new international financial architecture. At this point, though, the advanced solutions are divergent and many of them are questionable. We can group the IMF reform proposals in two large categories:

Gradual or incremental reform proposals

They do not affect the fundamental principles in the IMF Statute. Among them we can mention:

a) The reform of the conditionality principle, in terms of an increased flexibility. Certain authors (Stiglitz, J. E., 2003) claim it must be reconsidered, replaced with the one of *selectivity* (which means that the countries which can support the respective measures will benefit from finances). On the other hand, it is necessary to approach the programmes on the long term, not on the short term as before and to grant more decision-making freedom to the benefiting countries (Leandro, J. E., Schafer, H., Frontini, G., 1999: 285-299).
b) The reform of the voting system, probably according to the UNO system – *one country – one vote*. Yet, these measures would diminish considerably the influence of most OECD countries. A proposal that is more likely to be implemented is that made by R. Gerster, which consists in increasing the minimum number of votes for each country up to 5000, instead o

250 as it has been the case so far, to which the votes assigned according to participation quotas should later be added (Gerster, R., 1993: 121-136). Recently, the IMF has announced that in April 2008, a general increase of 10% in the votes is possible, accompanied by at least a 100% increase in the basic votes. The expansion of the votes using the new formula would benefit emerging countries, allowing them to have an increased power in the organisation.

c) The implementation of an NGO collaboration pilot programme, which will improve the IMF relationship with the civil society (Scholte, J. A., 1998: 42-45).

Radical reform proposals

These deeply alter the principles and procedures underlying the IMF actions. Many of the proposals are, yet, arguable and hardly feasible, involving a change in the essence of the paradigm which supports the activity of this organism. In addition, a radical reform does not necessarily guarantee radical consequences, because there are numerous factors influencing this process. Among the noteworthy proposals, there are:

a) taking into account alternative solutions to the economic problems of the countries which request the Fund's support and assistance, in order to ensure a fair, participative and sustainable development. The selection of the reform package should be made on the basis of an IMF-assisted country partnership, not by unilaterally imposing certain conditions.

b) identifying new sources of financing for the IMF activity. Proposals envisage either levying a Tobin-type tax, or reducing the military expenditures of each state and reallocating the respective amounts or a kind of tax on the balance of trade surplus for the countries that record such a surplus.

c) transforming the IMF into a *lender of last resort*, which will stabilise financial markets, regulate the international liquidity levels, regulate the financial institutions' operation, but also act as crises manager as before, refunding the financial-banking institutions through guaranteed loans, with interest rates above the market level (Fisher, S., 1999: 85-104; Calomiris, C., 1998). The premise is that, because a central bank, regardless of how many reserves it may have, cannot financially support measures to fight crises under the conditions in which the capital account is open, this function can only be performed at a supranational level. The proposal is seen by its supporters in the spirit of the original plan designed by J. M. Keynes in 1944 at Bretton-Woods, regarding the International Clearing Union. But it is highly criticised by other authors, being considered unrealistic in the context in which the IMF is not a bank and should not be one (Coyle, D., 2005: 84), therefore it cannot create liquidities. B. Eichengreen considers that such a direction that the IMF activity would take could encourage financial actors to become involved in risky operations even more, namely they could increase *moral hazard*, despite the surveillance measures and the prudence requirements (Eichengreen, B., 2002: 99). Even under the conditions of introducing systems to guarantee commitments and assess risks, banks will still be tempted to become involved in crediting less secure projects. Certain economists recommend that, when crises occur, the function of international lender of last resort should be performed by the Central banks' Club and by the Bank of International Settlement, not by the IMF (Aglietta M., De Boissieu C., 1999).

d) Another proposal belongs to J. Sachs and it was promoted intensely after the crisis in Argentina by the former deputy managing director of the International Monetary Fund - Anne Kruger. It aims at transforming it into an *International Bankruptcy Court (*Krueger, A. O., 2002; Sachs, J., 1995). The new system would be designed following the model of the mechanisms in the USA (chapters 9 and 11 in the American law on bankruptcy), the International Monetary Fund having a bankruptcy trials supervision and administration role. The solution is not feasible for at least three reasons: firstly, because it is difficult to define what *a country's bankruptcy* would mean, and secondly the country-company parallel is faulty – a country's main objective is not profit, but social welfare, and thirdly the responsibility for the failure of macroeconomic policies in a country is associated with a group of economic actors, one cannot identify only one culprit. In addition, political agreement at international level for such an institution, whether it is about transforming the IMF or about a new one, is difficult to be reached in the near future.

e) The dissolution of the IMF and revision of Keynes's initial plan regarding the International Clearing Union, which will administer international reserves and operate with a unit of account called International Money Clearing Unit (Davidson, P., 2004: 591-605). Post-Keynesians consider that the existence of such an organism would clearly diminish the panic on the international capital markets.

f) The dissolution of the IMF, the World Bank and the Bank of International Settlement and their replacement with a single financial authority - *World Financial Authority.* This radical proposal was also made by post-Keynesan economists – J. Eatwell and L. Taylor (Eatwell J., Taylor L, 1998).

4. Final remarks

Although they can be criticised, the reform proposals previously enumerated provide a support in terms of ideas which can improved in time, leading to solutions with actual chances for implementation, but only with an adequate political support.

The need to reform the international financial architecture is acknowledged at all ideological levels, as being a priority, the initiatives and debates in this respect being numerous. In our opinion, a few measures are necessary and can be implemented gradually, in order to ensure their effectiveness. We should not overlook, though, the fact that all these endeavours aim at moving targets, given the dynamic and versatile international economic and financial environment:

- To improve the quality and relevance of the assistance provided by the IMF and also by the World Bank by means of operating major changes in the visions of these institutions. This means that both the World Bank and especially the IMF must become open, flexible and participative institutions which are not only the mirror of the distribution of power at international level.
- To reposition the IMF in the equation of the responsibilities shared by IMF and the governments of the countries benefiting from financial assistance.
- To increase the transparency of the IMF and World Bank operations, namely to implement *good governance principles* in the activity of these institutions.
- To improve the set of conditionalities (a first step was made in 2000 by adopting a new guide in this respect – *Interim Guide on Streamlining Conditionality*) and to increase the IMF responsibility for the implemented measures. The programmes will have to reach a viable compromise between the adjustment component and the economic growth one. In addition, we consider that it would be advisable to reduce the system of conditionalities to relevant aspects in the case of a financial crisis or to aspects that fall into the IMF expertise.
- To improve the intervention systems in the case of financial crisis, by means of ensuring the necessary mechanisms and resources. After the events in Asia in 1997 the Supplemental Reserve Facility (SRF) was introduced for interventions in case of market confidence crises and the Contingent Credit Lines (CCL) in 1999 aimed at counteracting the contagion effects. The introduction is being debated of a new liquidity instrument and the characteristics it should exhibit, meant for the countries that have access to international capital markets and which implement firm economic policies.
- To use an Independent Assessment Office in the case of the IMF activity.
- To encourage he participation of all countries in establishing the IMF and World Bank Agenda by reforming the voting system. The distribution of votes should be established according to the relative position of that country in the world economy, but the emerging countries' right to an opinion should be strengthened. This reform could be made taking into account, for example, each country's actual GDP per capita, which would increase the participation quota of Asian countries. At the annual meeting in 2006, the IMF members agreed upon an ad-hoc increase in votes for China, South Korea, Mexico and Turkey. In the future, a new formula should be established for the participation quota and a second increase should occur for a wider range of countries.

- To create a new process for the selection of an IMF Board of Directors, according to professional performance, not nationality criteria.
- To develop an *information highway* role for this institution, which would strengthen collective confidence.

References:

1. Aglietta M., De Boissieu C. - *Le prêteur international en dernier ressort*, în Bergsten F., Davanne O., Jacquet P., Artus P., Debonneuil M., Aglietta M. et De Boissieu C. - *Architecture financière internationale*, Rapport du Conseil d.Analyse Economique, Paris, La Documentation Française, 1999
2. Allais, M. – *Le perversion monetaires*, Le Figaro, 23 Juin 1993
3. Calomiris, C. - *Blueprints for a New Global Financial Architecture*, Mimeo Columbia Business School, 1998
4. Coyle, D. – Guvernarea economiei mondiale: mit şi realitate pe piețele financiare, Bucureşti, Editura Antet, ediția a doua, 2005
5. Eatwell J., Taylor L. - *International Capital Markets and the Future of Economic Policy*, Center for Economic Policy Analysis Working Paper, New School for Economic Policy, August 1998
6. Eichengreen, B. – *Financial Crises and what to do about them*, Oxford University Press, 2002
7. Fisher, S. - On the Need for an International Lender of Last Resort, *The Journal of Economic Perspectives*, Vol. 13, No. 4, Autumn, 1999
8. Gerster, R. - Proposals for Voting Reform within the International Monetary Fund, Journal of World Trade, vol. 27, 1993
9. GFGI Working Group on institutional reform in global financial governance, Annual Meeting, 2002
10. Krueger, A. O. - A New Approach to Sovereign Debt Restructuring, IMF, April 2002
11. Leandro, J. E., Schafer, H., Frontini, G. - *Towards A More Effective Conditionalitey: An Operational Framework,* World Development 27 (2), 1999
12. Mishkin, F. S. - The International Lender of Last Resort: What are the Issues? Horst Siebert, ed. The World's New Financial Landscape: Challenges for Economic Policy, Springer-Verlag: Berlin, 2001
13. Pauly, L. W., - *Promoting a Global Economy: The Normative Role of the International Monetary Fund,* in R. Stubbs şi G. R. D. Underhill (Editori), Political Economy and the Changing Global Order. Toronto: McClelland & Stewart, Inc., 1994
14. Sachs, J. - *Do We Need an International Lender of Last Resort?* Essays in International Finance, Princeton University International Finance Section, January 1995
15. Scholte, J. A. - *The IMF Meets Civil Society,* Finance and Development, 35, No 3, 1998
16. Stiglitz, J. - *Globalizarea speranțe şi deziluzii*, Ed. Economică, Bucureşti, 2003
17. Toderean, O. – *Reforma organizațiilor internaționale*, Cluj Napoca, Presa Universitară Clujeană, 2002
18. Woods, N. - Making the IMF and the World Bank more accountable, International Affairs 77.1, 2001