

## FPIF Commentary

# Fixing the IMF



EMAIL A FRIEND



FEEDBACK

Daniel Bradlow | March 30, 2009

Editor: Emily Schwartz Greco

Foreign Policy In Focus

<http://www.fpif.org/>

**The leaders of the G20 will meet on April 2 in London. One item on their agenda will be to consider enhancing the International Monetary Fund's role in international financial governance. This can only be successfully achieved if the IMF undergoes substantial reforms that require either difficult political compromises or amendments to the Fund's [Articles of Agreement](#), the formal international treaty that created the IMF and that has only been amended three times since the organization's inception in 1946.**

Consequently, it's more realistic for the G20, a grouping of states that includes, in addition to the seven industrial states that belong to the G7, China, India, Indonesia, Mexico, Brazil, Argentina, Russia, Saudi Arabia, Australia, South Korea, Turkey, Italy and South Africa (the only African country), to use the London meeting to launch a multi-stage reform process that addresses the key problems plaguing the key institutions responsible for international financial governance and that is based on a long-term vision of a reformed IMF.

The three biggest problems in the international financial governance are coordination, scope, and legitimacy.

## Coordination

Global financial governance currently involves a multiplicity of formally uncoordinated organizations and mechanisms. These include separate international bodies for banking regulators, capital markets, and insurance companies; the Financial Stability Forum (which coordinates regulators in a select group of countries but has no global mandate); the IMF, which plays some role in overseeing some financial issues in some member states; the World Bank, which helps member states modernize their financial systems; the WTO, which deals with issues relating to establishment of financial institutions; regional organizations, and the G8 and G20, whose efficacy is unclear.

This arrangement is inefficient and results in an incoherent system, in which each key actor is motivated to assert jurisdiction that is broader than its actual mandate. For example the IMF, in response to previous financial crises and its key member states, has assumed a role in the oversight of capital markets and national financial systems, even though it was designed as an international monetary and macroeconomic institution and doesn't have full authority to deal with international capital movements. This approach raises concerns about the scope of the IMF's legal mandate, its relations with its member states, and its appropriate role in global governance.

## Scope

The scope of current financial regulatory regimes is deficient in two ways. First, they don't cover all relevant products, participants, and markets. They also don't incorporate significant issues such as climate change, even though many financial institutions recognize it as a source of financial risk and climate change negotiations could result in significant new financial flows to developing countries. They also don't focus on the social implications of the incentives created by financial regulations. For example, they don't consider whether financial regulations create stronger incentives for financial institutions to promote the poor's access to financial services or serve the interests of the rich and powerful. The subprime mortgage crisis suggests that financial regulations that fail to address this issue may create perverse incentives.



## Legitimacy

There are three aspects to the legitimacy problem. First is representation. The IMF needs to ensure that its member states' votes are commensurate with their role in global economic affairs, and that those states that actually use its services have a meaningful voice in its governance. A related issue is the asymmetry in the IMF's relations with its members — the most powerful states in fact, but not in law, are less subject to its jurisdiction than weak states.

It's important to acknowledge that the IMF member states, after difficult negotiations, have already agreed to small increases in the votes of a small group of particularly under-represented member states and an increase in basic votes that will marginally benefit the poorest states. Unfortunately, these efforts, which aren't yet fully implemented, may have consumed much of the available political will for dealing with this topic — despite the [rhetoric](#) to the contrary. In this regard, it's important to keep in mind that any meaningful representational changes will require legislative approval in some member states, which is a slow and unpredictable process.

Second is the scope of institutional authority. The IMF's legal mandate hasn't changed since its creation, even though the range of its operations has expanded so that it's now more deeply in the internal affairs of its member states than its creators envisaged. Consequently, its Articles of Agreement need to be updated to ensure consistency between its legal powers and the roles it actually plays, or is expected to play, in the evolving system of international financial governance. Third is accountability. As the IMF's mission grows, it needs to be accountable to those member states and their citizens that are directly affected by its operations but have limited say in its governance. In addition, as its operations become more complex, it will need to create effective means for the Board to exercise effective oversight of the management and staff.

## Reform Agenda

For the IMF to be capable of assuming its envisaged roles international financial governance, it must have a clear mandate, meaningful participation by all stakeholders in its governance, transparent operational policies and procedures, and an effective accountability mechanism. The participants in the London Summit can take a number of steps that will move the IMF closer to this goal.

The first is a significant increase in IMF resources aimed at enabling the Fund to provide more financing to both middle- and low-income countries. The European Union and the IMF itself have called for a doubling of IMF resources, while the United States has called for a tripling of the resources. In fact, already the Japanese have pledged an additional \$100 billion and the European countries an additional \$50 billion, making it likely that the G20 will result in at least a doubling of IMF resources, through a series of bilateral and multilateral lending arrangements.

This action will both mitigate and exacerbate the IMF's legitimacy problems. On the one hand, those IMF member states that provide substantial new financing to the IMF through bilateral or multilateral borrowing arrangements will gain some additional voice in its operations. On the other, by increasing the IMF's involvement in those states that receive its funding, it risks exacerbating its accountability and scope problems. Hence, the G20 should link this new financing to a requirement that the IMF adopt transparent operational policies and procedures and an enhanced accountability role for its Independent Evaluation Office (IEO).

Increased IMF resources from commitments made at the London Summit won't fully compensate for the steep reduction in capital flows to developing countries expected this year. Consequently, there are three other funding proposals for expanding IMF resources that should be considered because they have the potential for advancing an IMF reform agenda. First, those countries that have funded IMF trust funds should revise the trust arrangements to allow for more flexible use of these funds provided that the IMF adopts more transparent and socially accountable operating policies and procedures. Second, as was advocated by the Governor of the Central Bank of China, George Soros, and a number of leading commentators, the IMF member states should consider a new issue of Special Drawing Rights (SDRs), a form of money created by the IMF to increase global liquidity. Although the process for approving this measure is slow and unpredictable, it would result in an increase in global liquidity, and if, as advocated by many of its proponents, it's linked to voluntary SDR contributions from rich to poor countries, could be a significant source of flexible funding for poor countries. Third, the IMF could sell a portion of its substantial gold holdings and use some of these proceeds to support its poorer member states. Given that the original value of these holdings was \$42 per ounce and that the price of gold is now over \$900 per ounce, this action could generate substantial new resources for the IMF — albeit at the expense of gold-exporting countries.

*Related Coverage of  
U.S. Agencies*

[Neocons 1, Obama 0](#)  
Mar 16, 2009

[Secrecy and Foreign  
Policy](#)  
Dec 8, 2006

[World Movement for  
Democracy—Made in  
the USA](#)  
Jul 29, 2005

*Related Coverage of  
Financial Flows*

[Multilateral Money](#)  
Aug 25, 2009

[Keynes: A Man for this  
Season?](#)  
Jul 8, 2009

[Obama: Sweep Away a  
Free Trade Relic](#)  
Feb 9, 2009

*Related Coverage of  
Human Rights Issues*

[Book Review: 'The  
Slave Next Door'](#)  
May 18, 2009

[John McCain and the  
International  
Republican Institute](#)  
Jun 27, 2008

[Sharp Attack  
Unwarranted](#)  
Jun 27, 2008

Second, they should commit to a merit-based [selection process](#) for the leaders of all international financial institutions. While breaking the European and U.S. control over these positions would enhance IMF credibility, the significance of this change shouldn't be overstated. There are many ways for powerful countries to ensure that "their" candidate (regardless of nationality) is appointed.

Another issue that may receive attention at the London Summit is the representativeness and role of the IMF's board. Making the board more democratic depends on European countries surrendering some Board seats. Despite their calls for greater fairness in IMF voting and representation, European countries are unlikely to accept this change without some compensation. Thus, absent some "grand bargain" it is unlikely that the political will to reform either the Board or IMF voting exists. This, in turn, could complicate negotiations to increase IMF resources because it is hard to see why key under-represented countries would be willing to contribute additional resources to the IMF or to be fully engaged in it unless they are given greater influence in the organization. Merely agreeing to address this issue in the next round of quota reviews is unlikely to be sufficient, given the limited results and difficulty of the last effort at changing IMF member state votes.

The second aspect of this issue is the function of the IMF's executive board. The debate over the board's role relates to whether or not it should surrender its operational responsibilities and concentrate on strategic issues. A "strategic" board could meet less often and its members (known as "executive directors") need not be based in Washington. This would result in the management and staff having greater operational responsibilities, thereby underscoring the internal accountability problem at the IMF. This can be addressed by both improving the IMF's operational policies and procedures and expanding the responsibilities of the Independent Evaluation Office.

A third reform issue that the London meeting can initiate relates to the future functions of the IMF in international financial architecture. There are many who want the IMF to be the "apex" institution in international financial governance. In this capacity, it will act as the overall coordinator of the mechanisms and institutions of international financial governance. The Fund already performs versions of these functions in its consumer member states, but not in its richer member states. Without addressing this asymmetry problem, the IMF won't have the credibility to be a fair coordinator of international financial governance arrangements.

In addition, the Fund can't effectively perform these functions unless its Articles of Agreement are amended to give it the legal authority to address the full scope of international financial governance issues. For example, the IMF currently lacks the legal power to oversee the regulation of its member states' capital flows, or the establishment of foreign financial institutions. Granting it such authority therefore will require amending the Articles. Given that amending the Articles of Agreement involves the same ratification process as approving a new treaty, it's reasonable to ask if it is more worthwhile for the international community to amend the IMF's Articles of Agreement and retain all the IMF's current legitimacy baggage, or to create a new institution that is free from its legitimacy and legacy burdens and is more clearly reflective of current international financial governance needs.

## Conclusion

The world needs an organization like the IMF. But, it also needs an IMF that doesn't have the Fund's current scope, function, and legitimacy problems. While fully resolving these issues is a long-term process, the G20 can begin the necessary process by simultaneously increasing the IMF's resources, enhancing its accountability to all its internal and external stakeholders, and by making its operational policies and procedures more transparent.

*Daniel D. Bradlow is the SARCHI Professor of International Development Law and African Economic Relations at the University of Pretoria and a professor of law and director of the International Legal Studies Program at American University's Washington College of Law. He is also a [Foreign Policy In Focus](#) contributor.*

Subscribe to  
**[World Beat](#)**

FPIF's weekly ezine



Back to FPIF Homepage

Published by Foreign Policy In Focus (FPIF), a project of the Institute for Policy Studies (IPS, online at <http://www.ips-dc.org/>). Copyright © 2009, Institute for Policy Studies.

**Recommended citation:**

Daniel Bradlow, "Fixing the IMF," (Washington, DC: Foreign Policy In Focus, March 30, 2009).

**Web location:**

<http://fpif.org/fpiftxt/6002>

**Production Information:**

**Author(s):** Daniel Bradlow

**Editor(s):** Emily Schwartz Greco

**Production:** Jen Doak

**Latest Comments & Conversation Area**

*Editor's Note:* FPIF.org editors read and approve each comment. Comments are checked for content only; spelling and grammar errors are not corrected and comments that include vulgar language or libelous content are rejected.

You may add a new comment here. **It will not appear on this page until it has been approved** by the moderator.

Your Name:

Comment:

Contact FPIF's [webmaster](#) with inquiries regarding the functionality of this website.

Copyright © 2009, Institute for Policy Studies.