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HOW TO REFORM INTERNATIONAL MONETARY FUND?

1. INTERNATIONAL MONETARY FUND HAD SHORT HISTORY

The International Monetary Fund was conceived on July 22, 1944 during the United Nations Monetary and Financial Conference. The representatives of 45 governments met in the Mount Washington Hotel in the area of Bretton Woods, New Hampshire, United States, with the delegates to the conference agreeing on a framework for international economic cooperation. The IMF was formally organized on December 27, 1945, when the first 29 countries signed its Articles of Agreement. All members of the IMF are also International Bank for Reconstruction and Development (IBRD) members and vice versa. Its headquarters are in Washington, D.C. The organization's stated goals are:

- to promote international monetary cooperation and facilitate a balanced growth of international trade
- to promote exchange stability, to maintain exchange agreements among members, and to avoid competitive exchange depreciation
- to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade
- to make the general resources of the IMF temporarily available to member countries, under adequate safeguard, to correct maladjustments in their balance of payments.[1]

[1] International Monetary Fund. In: National Bank of Slovakia. Also aviable on the Internet: http://www.nbs.sk/en/about-the-bank/international-relations/international-monetary-fund

Countries contributed to a pool which could be borrowed from, on a temporary basis, by countries with payment imbalances. The IMF was vital when it was first created because it helped the world stabilize the economic system. The IMF works to improve the economies of its member countries. The IMF describes itself as "an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty."[2]

The IMF's influence in the global economy steadily increased as it accumulated more members. The number of IMF member countries has more than quadrupled from the 44 states involved in its establishment, reflecting in particular the attainment of political independence by many developing countries and more recently the dissolution in 1991 of the Soviet Union. The expansion of the IMF's membership, together with the changes in the world economy, has required the IMF to adapt in a variety of ways to continue serving its purposes effectively.

2. HOW DOES IT WORK?

The IMF gets its money from quota subscriptions paid by member states. The size of each quota is determined by how much each government can pay according to the size of its economy. The quota in turn determines the weight each country has within the IMF - and hence it's voting rights - as well as how much financing it can receive from the IMF.

Twenty-five percent of each country's quota is paid in the form of special drawing rights (SDRs), which are a claim on the freely usable currencies of IMF members. Before SDRs, the Bretton Woods system had been based on a fixed exchange rate, and it was feared that there would not be enough reserves to finance global economic growth. Therefore, in 1968, the IMF created the SDRs, which are a kind of international reserve asset. They were created to supplement the international reserves of the time, which were gold and the U.S. dollar. The SDR is not a currency; it is a unit of account by which member states can exchange with one another in order to settle international accounts. The SDR can also be used in exchange for other freely-traded currencies of IMF members. A country may do this when it has a deficit and needs more foreign currency to pay its international obligations. The SDR's value lies in the fact that member states commit to honor their obligations to use and accept SDRs. Each member country is assigned a certain amount of SDRs based on how much the country contributes to the Fund (which is based on the size of the country's economy). However, the need for SDRs lessened when major economies dropped the fixed exchange rate and opted for floating rates instead. The IMF does all of its accounting in SDRs, and commercial banks accept SDR denominated accounts. The value of the SDR is adjusted daily against a basket of currencies, which currently includes the U.S. dollar, the Japanese yen, the euro, and the British pound. The larger the country, the larger its contribution;

[2] International monetary fund. Also available on internet: <http://www.imf.org/external/about.htm>

thus the U.S. contributes about 18% of total quotas while the Seychelles Islands contribute a modest 0.004%. If called upon by the IMF, a country can pay the rest of its quota in its local currency. The IMF may also borrow funds, if necessary, under two separate agreements with member countries.[3]

3. FUNCTIONS OF THE IMF

The IMF has three principal functions and activities:

(1) Surveillance of financial and monetary conditions in its member countries and of the world economy,

(2) Financial assistance to help countries overcome major balance of payments problems,

(3) Technical assistance and advisory services to member countries.

3.1. Surveillance Oversight:

IMF members agree, as a condition of membership (Article IV), that they will “collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates.” In particular, they agree to pursue economic and financial policies that will produce orderly economic growth with reasonable price stability, to avoid erratic disruptions in the international monetary system, not to manipulate their exchange rates in order to attain unfair competitive advantage or shift economic burdens to other countries, and to follow exchange rate policies compatible with these commitments. Countries are required to provide the IMF with information and to consult with the IMF upon its request. The IMF staff generally meets each year with each member country for “Article IV consultations” regarding its current fiscal and monetary policies, the state of its economy, its exchange rate situation, and other relevant concerns. The IMF’s reports on its annual Article IV consultations with each country are presented to the IMF executive board along with the staff’s observations and recommendations about possible improvements in the country’s economic policies and practices.

Access to Information:

The information in these reports about their economic conditions, performance and policies is the property of the countries concerned and may not be disclosed without their consent. In recent years, however, the IMF has successfully persuaded most countries to allow publication of their Article IV consultation reports, loan documents, and other information about their economic policies and conditions. The IMF makes these available to the public on its country information page. Most countries now also publish on their IMF country page considerable information (often the verbatim text of their letters of understanding with the IMF) concerning the stabilization programs they plan to

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[3] An Introduction To The International Monetary Fund. In Investopedia. Also available on internet: <http://www.investopedia.com/terms/i/imf.asp>

pursue in connection with an IMF loan. These are generally the product of close discussions between IMF staff and country officials. The IMF executive board will not normally approve a loan unless the condition embodied in these plans is acceptable to it. The IMF executive board must approve the disbursements at each stage of these loan programs. Its published remarks often give the reader considerable insight into the borrower's performance and its degree of compliance with loan "conditionality."

Crisis Prevention

Some analysts are concerned that IMF surveillance is not sufficient in preventing financial crises. In a recent report, the U.S. General Accounting Office (GAO) asserted that the IMF's surveillance mechanisms, including the Fund's biannual World Economic Reports (WEOs) and its Early Warning Systems (EWS) have not performed well in predicting crises. In a reply to the report, First Deputy Managing Director Anne Kreuger noted that it is difficult for the IMF to publicly predict crises. If the Fund publicly reported a country's economic weaknesses, this alone might precipitate the very economic crises everybody wishes to avoid. Some argue that the IMF should formally separate its surveillance activities from its lending operations in an attempt to get around this problem.[4] It is difficult to see how this would solve the problem, however, since its surveillance functions are generally the means by which the IMF gets inside information about economic conditions in member countries. The IMF would violate its rules if it released information of this sort without a country's consent and it would likely make the acquisition of accurate information about economic conditions in member countries more difficult in the future. Moreover, if a fire wall were erected between the two functions, the IMF staff responsible for its loan program would not have ready access to the information derived from surveillance as conditions became more serious in a prospective borrower country.

3.2 Financial Assistance

When its member countries experience balance of payments (BOP) difficulties, either through capital account or current account crises, the IMF can make loans designed to help them stabilize their international payments situation and adopt policy changes sufficient to reverse their situation and overcome their problems. In some cases, the IMF makes short-term loans to help prevent countries' economies from spiraling into financial crisis and to facilitate renewed inflows of private sector capital. Many financial crises in developing countries in recent years were the result of a lack of confidence by the international financial markets and the "sudden stop" or reversal of capital inflows to developing countries which often occurs at the outset of a crisis. In other cases, the IMF makes loans to help countries deal with BOP crises but the loan repayment period is longer and the conditionality includes. The IMF is

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[4] Balls Edward.Preventing Financial Crises: The Case for Independent IMF Surveillance, at the Institute for International Economics, Washington, DC, March 6, 2003.

required by its Articles to ensure that countries' use of its resources will be temporary and that loans will be repaid. To insure this end, as well as to guarantee oft-needed economic reforms, the Fund splits the disbursement of its loans into tranches and requires that specified economic conditions must be met for the continued disbursement of IMF funds. The IMF has redesigned its conditionality guidelines to better tailor its lending arrangements to the specific financial needs of each recipient country.5 The IMF's area departments, which interact with borrower countries and prepare loan agreements, may well have a different perspective on this question than do the IMF's functional departments which must approve a prospective loan agreement before it goes to the executive board. On one hand, the IMF wants to tailor its loan programs to the particular situation in the borrower country. On the other hand, the IMF also needs to have a consistent approach and policies which are equally applicable in all parts of the world. Officially, the amount a country is able to borrow from the IMF is related to the country's quota, its ownership and contribution share in the IMF. In most instances, countries may borrow several multiples of their quota in response to particular circumstances. The conditionality and performance standards attached to a loan become more rigorous and demanding as its size (relative to the borrower's quota) increases. In many cases, deemed exceptional by the IMF executive board at the time, countries have received loans from the IMF which are much larger than the normal guidelines would allow.

The IMF has several loan programs:[5]

For the **Poverty Reduction and Growth Facility (PRGF)**, borrowers are charged an interest rate of 0.5% and loans are repayable over a period of between 5 գ and 10 years. Loans are based on a Poverty Reduction Strategy Paper, which is supposed to be prepared by the borrower country in cooperation with civil society and its development partners, in particular the World Bank. In practice, the World Bank has a major role in preparing these papers. IMF non-concessional loans carry an interest rate ("rate of charge") which is based on the IMF's SDR interest rate. The SDR rate is calculated weekly based on a weighted average for short-term debt in money markets in the United States, United Kingdom, Japan and the Euro zone. There is a markup, depending on the status of the country, and in some cases there is also an interest rate premium ("surcharge.") In March 2004, the rate was 1.61%, about double the reference rate for rate for dollar-based loans but only about one-third the rate for loans in pound sterling.

Stand-By Arrangements (SBA) are the IMF's standard loan program and its most commonly used facility. Designed to address short-term BOP problems, these are lines of credit which may be used as needed during a specific period of time (generally 12 to 18 months). Repayment is expected within 2¼ to 4 years after each disbursement is made. Surcharges are applied to loans which represent high multiples of the borrower country's quota.

[5] Martin A. Weiss. New IMF Conditionality Guidelines CRS Report to Congres, November 19, 2002. Also available on internet: http://www.policyarchive.org/handle/10207/bitstreams/3666.pdf

The **Extended Fund Facility (EFF)** was created in 1975 to help countries address long-term BOP problems which required major restructuring of their economies. Credit is generally kept available for a longer period (3 years) and repayment is expected within 4½ to 7 years of disbursement. Surcharges also apply.

The **Supplemental Reserve Facility (SRF)** was created in 1997 to provide short-term financing on a large scale. The IMF used this facility to fund the large loans it made to emerging market economies during the international financial crises of the 1990s. Countries are expected to repay within 2 to 2½ years of disbursement. SRF loans carry a substantial surcharge of 3- to-5%.

The **Compensatory Financing Facility (CFF)** was created in the 1960s to help countries experiencing a sudden loss of export income or a sudden rise in imported cereal prices due to fluctuating world prices. SBA repayment terms apply. Its purpose was adjusted several times, most recently in 2000. The IMF executive board recommended in 2004 that the CFF - unused in recent years - might be terminated.

All facilities of the IMF aim to create sustainable development within a country and try to create policies that will be accepted by the local populations. However, the IMF is not an aid agency, so all loans are given on the condition that the country implement the SAPs and make it a priority to pay back what it has borrowed. Currently, all countries that are under IMF programs are developing, transitional and emerging market countries (countries that have faced financial crisis).

3.3. Technical Assistance

The IMF helps countries to administer their economic and financial affairs. This service is provided to any membership country that asks for assistance, and is typically provided to low- and middle-income countries. Through the use of technical assistance, the IMF can perform useful surveillance and lending to help the country avoid economic pitfalls which creates sustainable economic growth. Technical assistance helps countries strengthen their economic policy, tax policy, monetary policy, exchange rate system and financial system stability.[6]

4. CRITICISM

Over time, the IMF has been subject to a range of criticisms, generally focused on the conditions of its loans. The IMF has also been criticized for its lack of accountability and willingness to lend to country's with bad human rights record.

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[6] An Introduction To The International Monetary Fund (IMF). In investopedia. Also available on Internet http://www.investopedia.com/articles/economics/09/international-monetary-fund-imf.sp#ixzz1fDrG6Kns>

Many Criticisms of IMF include:[7]

4.1. Conditions of Loans

On giving loans to countries, the IMF makes the loan conditional on the implementation of certain economic policies. These policies tend to involve:

- Reducing government borrowing - Higher taxes and lower spending
- Higher interest rates to stabilise the currency.
- Allow failing firms to go bankrupt.
- Structural adjustment. Privatisation, deregulation, reducing corruption and bureaucracy.

The problem is that these policies of structural adjustment and macro economic intervention make the situation worse. Critics contend that IMF policy prescriptions provide uniform remedies that are not adequately tailored to each country's unique circumstances. These standard, austere loan conditions reduce economic growth and deepen and prolong financial crises, creating severe hardships for the poorest people in borrowing countries and strengthening local opposition to the IMF.

- For example, in the Asian crisis of 1997, many countries such as Indonesia, Malaysia and Thailand were required by IMF to pursue tight monetary policy (higher interest rates) and tight fiscal policy to reduce the budget deficit and strengthen exchange rates. However, these policies caused a minor slowdown to turn into a serious recession with mass unemployment.
- In 2001, Argentina was forced into a similar policy of fiscal restraint. This led to a decline in investment in public services which arguably damaged the economy.

4.2. Exchange Rate Reforms.

When the IMF intervened in Kenya in the 1990s, they made the Central bank remove controls over flows of capital. The consensus was that this decision made it easier for corrupt politicians to transfer money out of the economy (known as the Goldman scandal). Critics argue this is another example of how the IMF failed to understand the dynamics of the country that they were dealing with - insisting on blanket reforms.

The economist Joseph Stiglitz has criticised the more monetarist approach of the IMF in recent years. He argues it is failing to take the best policy to improve the welfare of developing countries saying the IMF "was not participating in a conspiracy, but it was reflecting the interests and ideology of the Western financial community."

4.3. Devaluations

The IMF is often criticized for allowing inflationary devaluations.

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[7] International Monetary Fund. In Encyclopedia Britannica Inc., 2011.. Also available on Internet: <http://www.britannica.com/EBchecked/topic/291108/International-Monetary-Fund-IMF/224475/Criticism-and-debate>

4.4. Neo Liberal Criticisms

There is also criticism of neo liberal policies such as privatization. Arguably these free market policies were not always suitable for the situation of the country. For example, privatization can create lead to the creation of private monopolies who exploit consumers.

4.5. Free Market Criticisms of IMF

As well as being criticised for implementing 'free market reforms' Other critise the IMF for being too interventionist. Believers in free markets argue that it is better to let capital markets operate without attempts at intervention. They argue attempts to influence exchange rates only make things worse - it is better to allow currencies to reach their market level.

- There is also a criticism that bailout countries with large debt creates moral hazard. Because of the possibility of getting bailed out it encourages people to borrow more.

4.6. Lack of Transparency and involvement

The IMF have been criticised for imposing policy with little or no consultation with affected countries.

Jeffrey Sachs, the head of the Harvard Institute for International Development said:

"In Korea the IMF insisted that all presidential candidates immediately "endorse" an agreement which they had no part in drafting or negotiating, and no time to understand. The situation is out of hand...It defies logic to believe the small group of 1,000 economists on 19th Street in Washington should dictate the economic conditions of life to 75 developing countries with around 1.4 billion people".[8]

4.7. Supporting Military dictatorships.

The IMF have been criticised for supporting military dictatorships in Brazil and Argentina, such as Castello Branco in 1960s received IMF funds denied to other countries.

5. CONCLUSION: REFORMING THE IMF

5.1. Level of Fund lending

It should to intend to increase the likely level of lending by the Fund during the crisis. This also involves two types of changes: changing the principles which prompt Fund lending, and increasing the sums available to be lent. Likewise proposals for reforming the principles underlying Fund lending tend to come in two forms. The well-conceived ones are directed at discriminating between countries that wish to borrow as a defensive mechanism because of

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[8] Mike Moffatt: *Recession? Depression? What's the Difference?* In Economist, available on internet: http://economics.about.com/cs/businesscycles/a/depressions.htm

events elsewhere, and those that are obliged to go to the Fund because of their own policy inadequacies. There should be, but is not, ample scope for countries to borrow of their own volition when their shortage of foreign exchange happens through no fault of their own. Reform should therefore concentrate on enabling countries that have to go to the Fund through no fault of their own to borrow large sums without all the complications and degradations of conditionality. The Fund has already created a Short-Term Liquidity Facility to provide quick-disbursing finance to countries with “strong policies” suffering a liquidity shortage because of contagion in the financial markets. This is useful, but it can at best help a limited number of countries.[9]

5.2. IMF institutional reform

Edwin Truman has neatly summarized the first of the changes as involving chairs and shares. “Chairs” refer to seats on the Executive Board, and “shares” to the percentage of total quotas that determines voting power in the Fund. At present both reflect the world of the 1940s, being dominated numerically by the Europeans, although only one country -- the US, obviously -- has veto power.

A real reform would give the European Union a single Director, with the same voting power as the US, neither of whom would be able to veto changes. This would permit a major increase in both chairs and shares for the Asian countries, which are almost all egregiously under-represented in view of the rapid growth of the region over the past half century. And it would still leave enough slack in the system to allow a reduction in the size of the Executive Board, the already-agreed increase in the size of basic votes (which benefits the small countries), and quota increases elsewhere in the exceptional cases that merit them by virtue of their past economic growth.

Changes in IMF governance need to go beyond the question of chairs and shares, key as this is. They need also to involve adoption of a formal mechanism for appointing the Managing Director when the situation becomes vacant, with the mechanism aiming to appoint the best person for the job in the world rather than giving it to the person nominated by the West European country that regards it as its turn to have the job. And there was great merit in many of the suggestions for reforming IMF governance -- like replacing the International Monetary and Finance Committee by a Council, and directing its Executive Board to focus on strategic rather than tactical issues -- advanced last year by the Fund’s Independent Evaluation Office.[10]

5.3. Structural reform

The basic problem with the IMF model was that the latest financial crisis had its origin in the private sector, not in the government overspending. Banks and private investors lent too much money under too little supervision to fast-growing developing countries, then pulled the money out in panic. Political criticism has mounted about the effectiveness of IMF intervention, which in

[9] John Williamson: Reforming the IMF, 2009, In voxeu. Also aviable on internet: <http://www.voxeu.org/article/reforming-imf>

[10] ibidem

many cases failed to stabilise their currencies or restore the country's economic well-being. Right-wing critics, especially in the US Congress, argue that the IMF has should not be bailing out mistakes made by the private sector, and should let the market take its course in setting exchange rates. And the IMF itself has begun reforming both the way it operates and the conditions it imposes. It has pledged to become more open in the way it operates, publishing the agreements it makes with countries about their economic performance (so-called Letters of Intent) and its own evaluations. It wants to encourage more openness among developing country governments, with common standards of regulation and disclosure, which might give private sector investors more warning of potential problems.

Many economist believe that the IMF should fundamentally rethink its role in forcing governments to open markets. They believe that countries should be allowed to introduce short-term capital controls in order to limit the flow of speculative investments - such as happened in Chile and Malaysia. And they believe that the high interest rates the IMF has imposed as a condition of aid damaged the crisis-torn Asian economies even further. Surprisingly, perhaps, chief economist Joseph Stiglitz of the World Bank, the IMF's sister institution, shares some of these views. Mr Stiglitz has criticised the macro-economic policies of the IMF for pushing up interest rates in the midst of the financial panic, for example in Thailand, saying that it produced the worst of both worlds, with "workers who are going to be put out of jobs" paying the price of austerity. He says more emphasis should have been placed on strengthening institutions, like banking regulation, both in Asia and Russia.[11]

5.4. Change intervention principles

IMF should scale down its role and ambitions. Many economists argued that[12], IMF should be wary of big financial rescue packages and should intervene only if the crisis had serious implications for the world financial system. They also say the IMF should do more advance lending to countries that are taking the right steps to reduce financial vulnerability. The series of financial crises in the last two years stretched the IMF to its financial and political limits. A return to a limited agenda may be just what the organization itself would now prefer.[13]

[11] Business: The Economy Reforming the IMF. In BBC. Also available on internet <http://news.bbc.co.uk/2/hi/business/454301.stm>
[12] For example Fed chairman Paul Volker and hedge fund manager George Soros
[13] ibidem

ՌԻՉԱՐԴ ԴՅՈՒՐԵՉ
Բրատիսլավայի տնտեսագիտական համալսարանի մագիստրոս

Ինչպե՞ս վերակառուցել Արժույթի միջազգային հիմնադրամը.- Արժույթի միջազգային հիմնադրամը կարևոր դերակատարություն ունի ամբողջ աշխարհում: Սույն հոդվածի հիմնական շեշտադրումը ԱՄՀ գործունեության թերությունների մատնանշումն է (աջակցություն ռազմական բռնակալությանը, թափանցիկության և ներգրավվածության պակաս, ազատ շուկայի, նորազատական սկզբունքների քննադատություն, արժեզրկում) և լուծումների առաջարկումը: Սահմանվել են հիմնական ուղղություններ, որոնք կնպաստեն ԱՄՀ բարեփոխումներին:

РИЧАРД ДЮРЕЧ
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Как перестроить Международный валютный фонд (МВФ)?- Международный валютный фонд (МВФ) играет очень значительную роль во всем мире. Главной целью этой статьи является указание на недостатки в функционировании Международного валютного фонда (поддерживающего военную диктатуру, нехватку прозрачности и причастности, критических замечаний свободного рынка, неолиберальных критических замечаний) и предложить определенные способы их устранения. Определены главные области, в которых было бы уместно внести реформы МВФ.