

E-ISSN: 2469-4339

Management and Economics Research Journal, Vol. 4, S1, 19–29, 2018

Special Issue: Is there a need for Reforms in IMF?

Reforms in International Monetary Fund (IMF): Challenges and the Road Ahead

Bhasin and Gupta

Reforms in International Monetary Fund (IMF): Challenges and the Road Ahead

Niti Bhasin*, Surbhi Gupta

Department of Commerce, Delhi School of Economics, University of Delhi, New Delhi, Delhi, India.

*Correspondence: nitisurydse@gmail.com

Received: Oct 5, 2017; Accepted: Oct 28, 2017

Abstract

A prosperous and stable world economy is in the self-interest of every nation. The International Monetary Fund (IMF), which is a worldwide institution that facilitates prosperity and stability, was founded in 1944 to restructure the world economy ruined by the Second World War and to design the postwar international monetary system. Since its inception, IMF has been playing an important role in the promotion of world trade and solving Balance of Payments (BOP) difficulties of its member countries, especially the developing ones. Despite its significant contribution, the IMF has been severely criticized by academics, politicians, and public interest groups on the grounds that it is dominated by the developed nations, and hence better serves the interest of the wealthy nations as opposed to the world's poor majority. Even after several reforms introduced over a period of 70 years to improve and strengthen the representation of the developing countries, there are four critical issues that are yet to be addressed: dominance, governance, loan conditionality, and quota system. In this context, this paper aims to study the reforms introduced by the IMF over the years, analyze the key areas where reforms are still needed in the light of existing criticisms directed at the IMF's functioning and governance, and suggest the direction of reforms to address the prevailing challenges faced by the IMF.

Keywords: IMF; Reforms; Surveillance; Governance; Quota.

1. INTRODUCTION

The First World War and the subsequent events like the Great Depression of the 1930s and the Second World War deteriorated the international monetary system with detrimental effects on international trade and investment. During the interwar period of 1914–1944, every economy in an effort to recover used predatory devaluation of their currencies as a means of gaining advantages in the world export market and increasing the price of imports. Trade restrictions were also imposed to eliminate the impact on domestic income, leading to lowering of world trade and increase in unemployment. So in the cycle of competitive devaluations, no country could win. In a nutshell, the interwar period was characterized by economic and political instability, bank failures, deteriorating world trade, currency issues, capital flights across borders, the abolition of the gold standard as the system of international payments, and the emergence of dollar as the dominant world currency by gradually replacing the British pound.

In an effort to restructure the world economy and to discuss and design the post-war international monetary system, in July 1944, representatives of 44 nations gathered at Bretton Woods, New Hampshire, USA. The Bretton Woods Conference resulted in the establishment of two multilateral institutions, namely International Monetary Fund (IMF) and International Bank for Reconstruction and Development, popularly known as the World Bank, on July 24, 1944. The founding members signed the Articles of Agreement (AOA) of the IMF, which constitutes the core of the Bretton Woods System. Under this system, each country established a par value in relation to the U.S. dollar, which was pegged to gold at \$35 per ounce, and then calculated the gold par value of the currency based on that selected dollar exchange rate. Dollar was the only currency to be convertible into gold. Each country was responsible for maintaining its exchange rate within -1% and $+1\%$ of the adopted par value. Countries were not allowed to use devaluation as a weapon of competitive trade policy or beggar-thy-neighbor policy. However, if a currency became too weak to defend, a devaluation up to 10% was allowed without any formal approval by the IMF.

The primary objectives of the IMF, on its inception, were to promote international monetary cooperation, exchange rate stability, and orderly exchange arrangements by avoiding competitive devaluations; to provide financial assistance to countries facing short-term balance of payments difficulties; to facilitate the balanced growth of international trade; and to foster sustainable economic growth with enhanced productive capacity and employment levels globally. It also committed its members to move as rapidly as possible to current account convertibility, although it allowed them to retain restrictions on international capital flows.

Keeping in mind the above objectives, on March 1, 1947, the IMF began its financial operations, and on May 8, 1947, France became the first country to borrow from it. After the demise of Bretton Woods System in the year 1973 and introduction of floating exchange rate system, the IMF members amended the IMF's Charter and accordingly its operations were reduced. The role of the IMF became more active as a manager or surveillant of overall macroeconomic policy of its member countries rather than just maintaining an oversight of the exchange rates. During the 1980s, after the outbreak of the international debt crisis, the IMF reemerged once again with a new mandate to prevent financial crisis among the emerging market countries, particularly the middle-income countries, which are vulnerable to massive capital outflows. The IMF took a lead role when Mexico in 1982 and Brazil in 1987 announced that they would no longer be able to service their debt obligations. Also at the time of East Asian crisis in 1997-1998, the IMF held its influential role in the international financial system and lent unprecedented amounts of money to Thailand, Indonesia, and Korea to stop the contagion effect of the crisis in other Asian countries and elsewhere (Head, 2003).

During the early 2000s, the IMF faced another crisis of legitimacy and purpose owing to the declining demand for IMF loans due to the absence of large-scale financial crisis, increased availability from private international markets for middle-income emerging market countries, piling of large foreign exchange reserves by these economies, and growing dissatisfaction with the IMF's advice and loan conditionality. The IMF's financial woes were highlighted in May 2006 when its managing director Rogrigo de Rato appointed an expert group to advise him on how to develop alternative sources of income for the IMF (Helleiner and Momani, 2007). Later on, the global financial crisis of 2007-2009 posed a deep challenge for many IMF members, especially the Euro zone area, and for the Fund itself. The Fund called for a comprehensive plan for greater European financial and fiscal integration. The major bailouts by the IMF post-global financial crisis include the first Greek bailout in May 2010 that totaled €110 billion, to address the ballooning government debt, caused by continuing large public sector deficits; a €10 billion international bailout of Cyprus on March 25, 2013; at the end of March 2014, the IMF secured an \$18 billion bailout fund for the provisional government of Ukraine in the aftermath of the 2014 Ukrainian revolution.

Since its inception, the IMF has been playing an important role in the promotion of world trade and solving BOP difficulties of its member countries, especially the developing ones. A prosperous and stable world economy is in the self-interest of every nation—large and small, rich and poor, and the IMF is the worldwide institution that facilitates prosperity and stability. At present, 189 countries are members of the IMF, having 41 lending arrangements. The IMF is continuously working toward better financial sector regulation and supervision to ensure that the world does not return to the financial system that produced the crisis.

Although IMF has been persistently playing an important role in the promotion of world trade and investment, it has been severely criticized by academics, politicians, and public interest groups on the grounds that it is dominated by the developed nations and hence better serves the interest of the wealthy nations as opposed to the world's poor majority. Over the years, there have been many reforms relating to its governance, surveillance, and loan conditionality to improve and strengthen the representation of the developing countries. Even after several reforms introduced over a period of 70 years, IMF has been severely criticized by developing and least developing countries majorly on four critical issues relating to dominance, governance, loan conditionality, and quota system. In response of such allegations, the IMF is continuously striving to reform its activities and governance to ensure better growth and equity, particularly to ensure that the plight of poor and developing economies is recognized.

In this context, this paper aims to (i) study the reforms introduced by the IMF over the years, (ii) analyze the key areas where reforms are still needed in the light of existing criticism directed at the IMF's functioning and governance, and (iii) suggest how the reforms could take place to address the prevailing criticism/challenges directed at the IMF relating to dominance, governance, lending, and quota system. The paper is

divided into six sections. Section 2 presents an overview of the literature. Section 3 discusses in brief the organizational structure of the IMF comprising its internal governance mechanism, capitalization, voting system, and funding facilities of the IMF. Section 4 studies the major reforms introduced by the IMF over a period of 70 years since its inception in 1944. Section 5 proceeds to point out the major criticisms directed at the IMF and the areas where reforms are still needed. Finally, Section 6 concludes with suggestions to address the major issues/criticism directed at the IMF.

2. LITERATURE REVIEW

Head (2003) evaluated the key criticisms directed at the IMF, explaining their validity, which could form the basis for further reforms in the IMF. He suggested two types of initiatives: (i) structural reforms to make IMF more accountable for its operations and (ii) substantive reforms to strengthen the IMF's role in improving the national governments' competence to handle their economic challenges. Abouharb and Cingranelli (2009) examined the effects of four lending programs supervised by the IMF, namely Stand-by Arrangements, Extended Fund Facility, Structural Adjustment Facility (SAF), and Enhanced Structural Adjustment Facility (ESAF) on the governments' respect for the overall human rights' conditions in 131 developing countries between 1981 and 2003. They used two-stage Ordinary Least Squares (OLS) model and concluded that a longer period under an IMF program worsened the government's respect for economic, social, and human rights' conditions even after reforms in program lending of the late 1990s. Their findings support criticisms directed at the IMF that are common in the case study literature.

Moschella (2011) examined the factors that cause quick and deep changes in the IMF's surveillance policy soon after the global financial crisis of 2007-2009 despite the difficulties associated with the shift toward systematic surveillance. The IMF's surveillance policy was shifted from initial bilateral to multilateral surveillance post-global financial crisis, that is, from predominant one-country focus to detect the problems in domestic policies to a more systematic approach that requires the IMF to assess whether a country's domestic policies have a negative impact not only for its own financial stability but for the international financial stability as well. The author concluded that while the global financial crisis was an important catalyst, the causes that explain the rapid and substantive shift in the scope of surveillance are the incremental accumulation of knowledge and small transformation in policy instruments and organizational practices, especially lessons drawn from the 1994 Mexican crisis and the 1997–1998 Asian crisis.

Lavigne and Schembri (2009) assessed the potential impact of the IMF surveillance reforms introduced post-global financial crisis, namely the "2007 Decision on Bilateral Surveillance over Members' Policies" and the "Statement of Surveillance Priorities" (SSP). They concluded that these reforms if implemented properly have the potential to strengthen the effectiveness of surveillance by enhancing the IMF's ability to prevent crisis and maintain a stable international financial system. Also the surveillance reforms would be more effective if they were supported by changes to the surveillance review process and by governance reforms. Cottarelli (2005) pointed out that there exists potential trade-offs between legitimacy and efficiency, particularly for an international institution like IMF. Furthermore, designing appropriate governance structures for such institution is difficult, because steps to enhance the legitimacy of such an institution through constraints on its decision-making process may affect its operational efficiency. The paper has discussed the legitimacy-efficiency trade-offs with respect to three dimensions, namely Control of political power over the operational decisions of international "technocrats"; Transparency in the IMF decision making and Uniformity of treatment across countries. The paper underscored that the trade-offs are not absolute; however, they depend on the specific ways in which legitimacy is pursued—that is, on the specific constraints that are set. Strategic reforms should, thus, aim at improving the terms of the trade-off by exploring steps that are Pareto-improving in the dimensions of legitimacy and efficiency.

3. ORGANIZATIONAL STRUCTURE OF THE IMF

3.1. Internal Governance

At the top of the organization structure is the board of governors with whom the overall authority over the Fund's activities is vested. Each member country appoints one governor who is usually the finance minister

or the head of the central bank of the member country. The board of governors has delegated the power to an executive board, which is the Fund's major decision-making body and is responsible for the operations of the IMF. It has the power to discuss and decide on all aspects ranging from financial assistance programs to administration, surveillance, etc. The executive board comprises of 24 Executive Directors, out of which member countries having the largest IMF quota, such as the United States, the United Kingdom, China, Japan, Russia, Germany, and Saudi Arabia, appoint their own representative, and the remaining Executive Directors are elected by a group of countries that are grouped into multicountry constituencies, each of which has an executive director who casts the votes of all the countries in his or her constituency. The executive board, despite of the weighted voting system, makes its decisions largely on consensus among its members (Head, 2003). A third body, the International Monetary and Financial Committee (IMFC), was established much later to oversee the work of the Fund and make recommendations to the board of governors, the executive board, and the Fund's management.

3.2. Capitalization

The funding of the IMF comes from the members' subscriptions to the IMF capital. When a country joins the IMF, it has to deposit quota subscriptions measured in terms of Special Drawing Rights (SDRs). The quota is made up of two components: 25% of the quota is in the form of gold reserves, and the remaining 75% in the form of country's home currency. The size of the quota reflects the economic and financial importance of the member country relative to other members. A country's quota determines its borrowing power and voting power in Fund's two governing bodies namely its board of governors and its executive board. Currently USA has the largest quota in the IMF by virtue of its dominant economic power in the world (Table 1). Furthermore, the IMF is also empowered to borrow funds from the private markets.

3.3. Voting in IMF

A country's quota determines its voting power within the IMF. Voting in the IMF is based upon a "weighted voting system." Each member country has 250 votes plus an additional vote for each part of its quota equivalent to one lakh SDR (i.e., one vote per one lakh SDRs). The IMF uses a quota formula to help assess a member's relative position. The current formula is a weighted average of Gross Domestic Product (GDP) (50% weight), openness (30% weight), economic variability (15%), and international reserves (5%). This formula places most of the voting power in the hands of few powerful countries namely the United States, the United Kingdom, Japan, Germany, and France, which together control 40% of the total voting power in the IMF.

3.4. Funding Facilities

The IMF extends its loan facilities through various loan instruments that are tailored to different types of balance of payments need (actual, prospective, or potential; short term or medium term) as well as the specific circumstances of its diverse membership. The IMF provides non-concessional loans through the instruments like Stand-by Arrangements (SBA), Extended Fund Facility (EFF), Supplementary Reserve Facility (SRF), and Contingent Credit Line (CCL). Apart from these facilities, low-income countries may borrow on concessional terms through facilities available under the Poverty Reduction and Growth Trust (PRGT). This facility replaced the earlier Enhanced Structural Adjustment Facility created in the year 1987. Concessional loans carry zero or low interest financing. The IMF never offers its funds in a single lump sum. Extensive drawings from the IMF require a country to agree to its imposed restrictions on its economic policies known as "IMF Conditionality." If the conditions are not met, the funds are withheld and gradual disbursements are contingent on the implementation and results of policies suggested by the IMF. Some of the conditions for structural adjustment can include austerity measures to cut down public expenditure, devaluation of currencies, liberalization of trade and investments, removing price controls and state subsidies, privatization, and improving governance among other measures.

4. SIGNIFICANT REFORMS IN IMF

Although the IMF has been persistently playing an important role in the promotion of world trade and investment, it has been severely criticized by academics, politicians, and public interest groups on the grounds

that it is dominated by the developed nations. In response to such allegations, the IMF is continuously striving to reform its activities and governance to ensure better growth and equity, particularly to ensure that the plight of poor and developing economies is recognized. Some of the reforms introduced in the IMF over the years have been described below.

4.1. Surveillance Reforms

When the IMF was created in 1944, its primary role was to stabilize the exchange rates. However, after the demise of the fixed exchange rate system in 1973, its role became that of the surveillance of overall macroeconomic policies of its member countries. Initially, the IMF's surveillance was bilateral in nature with primarily one country focus, assessing the implication of each country's policies for its own economic and financial stability. Any spill-over of these policies on other member economies was not considered. Also, financial sector issues were not properly incorporated in the surveillance reports. However, during early 1990s, increasing globalization, integration of world financial markets, and financial crisis prompted the IMF to expand the scope of its surveillance to include financial sector crisis (Moschella, 2011).

Over the years, the scope of IMF surveillance was broadened, and the annual reports prepared by the IMF staff covered many issues, including those having little direct relevance to the primary objective of the Fund, putting an enormous burden on the executive board. Furthermore, the global financial crisis of 2007–2009 mooted the discussion of further reforming the IMF surveillance to minimize the likelihood of future financial crisis. Hence, the post-global financial crisis, following reforms, was introduced in the Fund's surveillance mechanism:

1. The objective of surveillance was clearly defined as the maintenance of external stability, that is, to ensure that member country's current and capital account balances are not in extensive disequilibrium and are not vulnerable to capital flights or exchange rates. Countries should avoid such exchange rate policies that cause external instability.
2. There was a shift from bilateral to multilateral surveillance, which is a system approach involving analysis of the impact of domestic financial policies on the international spill-over effects. Multilateral surveillance aims at achieving the mutual adjustment of country's policies to ensure that exchange rate and macroeconomic policies result in national as well as international stability, avoiding any abrupt correction of disequilibrium that could impact the entire world economy.
3. Introduction of even-handed surveillance taking into consideration specific circumstances of a country.
4. Examination of countries on a common set of core macroeconomic policies favoring equal treatment.
5. Expansion of the surveillance focus beyond exchange rates to domestic macroeconomic and financial policies while limiting the scope of Fund's analysis to core policies related to external stability (Lavigne and Schembri, 2009).

4.2. Quota Reforms

A member country's quota size determines its borrowing and voting power in the IMF. Higher quota simply means more voting rights and borrowing permissions under the IMF. The "weighted average voting system" is designed in such a way that it places most of the voting power in the hands of few powerful countries namely the United States, the United Kingdom, France, Germany, and Japan. The United States itself has approximately 17% quota, which is higher than the cumulative of several developing countries. As a result, the interests of the developed countries are put above the needs of the world's poor majority. To ensure that the plight of developing countries is properly recognized, the IMF's board of governors conducts general quota reviews at regular intervals (usually every 5 years). Two main issues addressed in a general quota review are size of an overall increase and the distribution of the increase among the members. Any changes should be approved by 85% majority of the total voting power. Also, a member's quota cannot be changed without its consent.

The first resolution to increase the overall quota size was adopted in the year 1958-1959, which resulted in 60.7% overall increase in the quota. Consequently, various quota reviews such as fourth quinquennial, fifth, sixth, seventh, eighth, ninth, and eleventh general quota review resulted in overall increase in quota to

30.7, 35.4, 33.6, 50.9, 47.5, 50, and 45%, respectively (Table 2). The distribution of quota and voting shares in the IMF is highly unbalanced and inappropriately reflects a nation's relative status in the world economy. In this context, in September 2006, the IMF countries promised that they would agree on a simpler and more transparent formula for rebalancing quotas and voting rights. In September 2006 in the IMF meeting held at Singapore, the voting share of the four emerging economies namely China, Korea, Mexico, and Turkey whose actual quotas were smaller than their economic weights saw an upward adjustment in their quotas and voting shares. However, India and Brazil who opposed the September 2006 changes did not get the first round upward adjustment. Also, even after many months of negotiations, the rebalancing formula proposed under the 2008 reforms was inadequate and far from being satisfactory. Formula did not achieve the stated goals of the 2006 Singapore resolution. However, on a positive side, the 2008 quota reforms strengthened the representation of the dynamic economies, many of them being emerging countries through an ad hoc increase for 54 member countries. The voice and participation of low-income countries through a near tripling of basic votes was also enhanced.

On the other hand, some developing countries were still under-represented and developed nations were overrepresented in the IMF even after their declining share in the world's GDP after the global financial crisis of 2007–2009. Due to this discontent with the IMF, the Brazil, Russia, India, China and South Africa (BRICS) nations established a new organization called the BRICS Bank to consolidate their position in the world as BRICS nations, which account for approximately one-fifth of the total world GDP. On December 15, 2010, the board of governors of the IMF completed the 14th General Review of Quotas which involved far reaching reforms of the IMF quotas and governance. These reforms became effective on January 26, 2016. These reforms resulted in an unprecedented 100% increase in the total IMF quotas; shifted more than 6% of quota shares from over-represented countries like the United States and European Union to under-represented member countries namely India, China, Brazil, and Russia; doubled the quotas from approximately SDR 238.5 billion to SDR 477 billion; preserved the quota and voting share of the poorest member countries; increased India's voting share from 2.44 to 2.75% and china's from 3.8 to 6%; voting share of Russia and Brazil was also increased. After the 14th General Review of Quotas, four BRICS countries are now among the top 10 shareholders in the IMF.

Furthermore, the 15th General Review of Quotas will provide an opportunity to assess the appropriate size and composition of the IMF's resources and to continue the process of governance reforms. Work on the new quota formula will also continue in the next 15th General Review of Quotas to be completed by 2019 spring meeting.

4.3. Loan Conditionality

Initially, when the IMF became operational, there was no conditionality attached to the loans. It was agreed by the executive board that several goals should be negotiated to secure the revolving character of the IMF resources and the borrowing country was free to decide which instrument it will follow to achieve those goals. Import substitution and export promotion to reduce current account deficit, few monetary and fiscal policies, and increase in international reserves were some of the few popular conditions in the beginning of Fund operations (Dreher, 2002). However, over the years, the IMF loan conditions became extensive especially after the Extended Fund Facility in 1974. The policies included in the programs were not preferred by the borrowing governments on the grounds that such extensive conditions were not commensurate to the small amounts of loan provided. Also, the developing countries alleged that the IMF conditions were not specific to a country's circumstances and developed countries received loans without conditionality. Although conditionality was formally introduced during the early 1970s, the era of 1970s was characterized by loose conditionality. At that time, partly as a consequence of the oil price shock, credit from private markets was abundantly available for developing countries at low interest rates without attached conditionality.

Faced with low demand for their resources, the IMF was willing to lend at low conditionality. However, as debt problems started to emerge in some Latin American countries, the flow of private money vanished. Now, for many developing countries, the only choice to get fresh money was to accept Fund and World Bank's conditionality. Consequently, faced with rising demand for their money, the IMF started to attach more conditions to their programs. As late as the 1970s, only 26% of the IMF loan disbursements involved substantial conditionality, but the Latin American debt crisis in the 1980s and the expansion of lending to Africa increased this figure to 66% by the end of the 1980s (Stone, 2008).

In 1986, with the introduction of its SAF, another kind of condition known as the structural benchmarks was established. Noncompliance with these benchmarks might lead to more stringent actions by the Fund's staff and could result to program interruptions. Since 1987, some other conditions that gained importance were privatization and liberalization in the trade systems as well as the financial sectors. Moreover, as a consequence of the Asian crisis, the IMF faced a rising demand for its money and governments were desperate enough to agree on virtually all kind of conditions to get the required international reserves. Again, they reacted with an increase in the number of conditions. In 1997, there were, on an average, 20 conditions included in programs with Asian countries, compared with an average of 16 conditions for all countries. Owing to such large number of conditions, it became increasingly difficult for borrowing countries to identify those conditions that were crucial for further Fund support, and it was criticized that that IMF programs were anti poor. The IMF was faulted for conditionality that sought to control too many policy variables, many of which extended beyond its traditional areas of competence. Also, it was criticized that conditionality did not help and may even worsened the economic prospects. Even though the Fund tried to consider this in more recent programs, it generally failed to establish pro poor measures under its conditionality. Over time, the IMF's conditions became more numerous and criticism of the authoritarian nature of conditionality increased. The IMF continues to be criticized for applying one-size-fits-all policy prescriptions without sensitivity to context, ignoring borrowers' domestic political constraints, and promoting the interests of major shareholding governments (or their elites) at the expense of borrowing countries' needs. Sympathetic insiders and the Fund itself have conceded that conditionality may, as a consequence of these shortcomings, have been superficially implemented, requiring a shift to greater "ownership" of reform by country authorities and "streamlining" of its content. (Stone, 2008).

4.4. Special Drawing Rights Reform

SDR is an artificial international reserve, which was created by the IMF in 1970 to partially alleviate the pressure on the dollar as the central reserve currency. SDR, which is a basket currency, comprising of major individual currencies was allotted to the members of the IMF who could then use it for transactions among themselves or with the IMF. Initially, the SDR was designed to be the weighted average of those 16 currencies whose share in the world exports were more than 1% and the percentage share of each currency in the SDR was about the same as the country's share in the world exports. In 1981, the SDR was greatly simplified to comprise only five major currencies, namely the U.S. dollar, German mark, Japanese yen, British pound, and France franc. Later, the SDR comprised four major currencies, namely the U.S. dollar, euro, British pound, and Japanese yen. However, effective October 1, 2016, the IMF added the Chinese renminbi (RMB) to the basket of currencies that make up the Special Drawing Right, or SDR. Renminbi joins the U.S. dollar, euro, yen, and British pound in the SDR basket. This change represents the important milestone for IMF, SDR, and China.

5. CRITICAL EVALUATION OF THE IMF

The IMF has been in existence for more than seven decades and over the years there have been many reforms relating to its governance, surveillance, and loan conditionality to improve and strengthen the representation of the developing countries. Even after several reforms introduced over a period of 70 years, the IMF has been severely criticized by academics, politicians, and public interest groups on several grounds. Some of the criticisms directed at the IMF, which need immediate resolution are presented in the following:

- (i) The IMF continues to be criticized for applying "one-size-fits-all approach" to macroeconomic policy prescriptions, ignoring the borrowing countries' political and economic constraints at the expense of their needs (Stone, 2008). The conditionality measures of the IMF attached to the loans hamper the sovereignty of the borrowing countries. It is also alleged that the tight macroeconomic policies imposed by the IMF not only fail to cure but also make their economies sicker. Such policies also create distributional inequalities and ignore the social aspects of a country's well-being. For example, in South Korea, the government had been running a budget surplus for years (it was 4% of South Korea's GDP in 1994-1996) and inflation was low at about 5%. It had

the second strongest financial position among the Organisation for Economic Co-operation and Development (OECD) countries. Despite this, the IMF insisted on applying the same policies that it applies to countries suffering from high inflation during the 1997 crisis. As a result, the IMF sparked a recession by raising the interest rates, which led to more bankruptcies and unemployment.

- (ii) The second criticism directed at the IMF is that its bailouts create a problem of moral hazard. Moral hazard arises when people behave recklessly, because they know that they will be saved if things go wrong. The IMF conditionality requires the borrowing countries to deregulate their financial markets. Such deregulations have resulted in massive cross border flow of capital investments thereby providing an opportunity for speculation. The Mexican peso crisis of 1995 was partly the result of such policies. When the bubble popped, the IMF stepped in to bail out. The IMF's bailouts provide a signal to the governments engaging in poor economic management that their bad performance will not be penalized because the IMF would come to their rescue. It also encourages investors to continue making risky-speculative bets, thereby encouraging instability of the national economies.
- (iii) The IMF has been criticized on the ground that it lacks any real mechanism for accountability. The IMF works with a selected staff to make policies and design loan packages without the deep knowledge of the borrowing country. The institution has resisted calls for public scrutiny and independent evaluation. To address the issue of accountability and conduct objective and independent assessment of the issues relevant to the IMF, it introduced Independent Evaluation Office (IEO) in July 2001. Although IEO has already undertaken several evaluation projects indicating IMF's willingness to provide increased public accountability, yet IEO falls short of being an external organ. IEO is an internal organ of the IMF as the director of the IEO is appointed by the IMF's executive board and may be dismissed at any time by the executive board. Also other IEO officers are hired as per the terms and conditions of the Board (Head, 2003).
- (iv) Critics argue that the IMF is a closed, nontransparent organization that operates behind the veil of secrecy. Although IMF responded to this criticism in the past by undertaking impressive projects to provide more information on its operations such as publishing information on the use of its resources, reports on IMF programs, and posting information on its website about each member's financial position in the form of quarterly financial statements. However, further improvements in the IMF are still desirable.
- (v) One of the major criticisms directed at the IMF is that it better serves the interests of wealthy countries as opposed to the world's poor majority. Controlled by a handful of rich nations, the IMF is an unaccountable autocracy in which the people most affected by its operations have no or very little chance to participate (Head, 2003). Unlike a democratic system wherein each member country would have an equal vote, rich countries dominate decision making in the IMF. This is reflected in its weighted voting system where powerful countries have more voting power because they pay more into the quota system. Although the 14th General Quota Review of the IMF has increased the voting share of four developing economies namely India, China, Russia, and Brazil placing them among the top 10 IMF shareholders; however, the current formula to determine the relative position of an economy in the world is flawed and overrepresent several developed nations despite their declining share in the world's GDP especially after the global financial crisis of 2007–2009. Hence, there is an urgent need for a simpler and more transparent formula for rebalancing quotas and voting rights to truly reflect the relative position of an economy in the world. Also it is impossible to make any reforms in the current quota system as more than 85% of the total votes are required to make it happen. With approximately 16.66% of voting power with the United States, it is impossible to reform quota without the consent of the United States.
- (vi) Since its inception, the European members and the United States have conspired to allow Europe to nominate the head of the IMF. Throughout the history of the Fund, its managing director has been a European. Also, the IMF board is over-represented by the European chairs who play a major role in selecting 10 of the 24 executive directors. These arrangements are obsolete and should be replaced quickly. One of the most important ways to enhance the Fund's legitimacy would be to adopt a modern, open, and transparent procedure of selecting the Managing Director to include candidates selected on merit basis without citizenship restrictions.

- (vii) Few other criticisms directed at the IMF are extension of its operations into areas in which it has no real authority such as microeconomic and structural issues (like corporate governance, political governance, etc.) and asymmetry in following the loan conditionality as the rich member nations are under no pressure to follow the conditionality attached to loans provided by the IMF as opposed to the poor and developed nations.

6. RECOMMENDATIONS AND CONCLUSION

In the light of the above criticisms directed at the IMF, urgent reforms are needed on four critical issues relating to the governance, loan conditionality, quota system, and dominance. Based on the analysis of the prevailing criticism, following are the proposals or suggestions to address the same for further reforming the IMF:

- Among those advocating IMF reforms today, the top priority should be given to address its governance structure particularly the reallocation of quotas (and thus votes) as well as the composition of chairs at the IMF's executive board. Governance structure should be such that it encourages participatory democracy and ensures that every member has a voice and its vote truly reflects its weight in the world economy. This will reinforce the faith of member countries in the functioning of the IMF.
- There should be voluntarily rebalancing of quotas within the existing total, from overweight countries to the most underweight emerging markets. Although the 14th General Quota Review of the IMF has increased the voting share of four developing economies, namely India, China, Russia, and Brazil, by placing them among the top 10 IMF shareholders, the current formula to determine the relative position of an economy in the world is flawed and overrepresent several developed nations despite their declining share in the world's GDP especially after the global financial crisis of 2007–2009. Hence, there is an urgent need for a simpler and more transparent formula for rebalancing quotas and voting rights to truly reflect the relative position of an economy in the world. Basic votes should also be increased to restore the degree of equality among the members. The formula could include shares in world population as an additional variable or more weight could be given in the formula to (Purchasing Power Parity) PPP-GDP with less weight to cross-border trade. Also the variables in the formula for the variability of international transactions and for cross-border trade could be redefined and measured more appropriately.
- The composition of the executive board should be adequately representative of current economic and political conditions in the world. The present distribution of seats in the executive board in favor of Europe may have reflected relative economic and political weight in the early years of the Fund's history, but today there is a clear economic shift away from Europe to emerging market economies that puts Europe's pre-eminence at the board into doubt. As proposed by Edwin Truman, consolidation of the European Union or perhaps just the euro zone into one seat would help to increase the relative voice of the emerging and developing member countries.
- The board of governors could revise the structure of the Independent Evaluation Office to make it more independent of the IMF's executive board.
- Most of the Fund's managing directors have been effective leaders of the institution. But equally effective leaders could come from other countries, including some of the emerging-market countries. A modern, open, and more transparent procedure should be followed for selecting the Managing Director to include candidates selected on merit basis without citizenship restrictions. Guidelines adopted for the selection of MD should be properly published. Kahler recommends "a process of restrained competition" where (1) minimum qualifications are agreed upon, (2) search committees establish a qualified long-list of possible candidates, and (3) national governments narrow down the long-list to a veto-proof nomination short-list. The entire process of selecting the MD should be democratized but clearly the hesitation of the United States and the European political capitals to forgo their "privileges" remains.
- The IMF's financial involvement in low-income countries has been less than expected. Hence, it should expand its lending facilities in relation to least developing economies. Peter Evans and

Martha Finnemore note that the combined vote of all of the 80 low-income countries that qualify for the Fund's Poverty and Growth Reduction Facility is roughly 10% whereas G10 industrialized countries have 52%. Enhancing the developing members' voice in the IMF decision making will translate into better suited IMF loan conditionality that emphasizes long-term economic growth.

- The IMF should play a more active role in information dissemination. The IMF should provide timely and uncensored information on countries' financial health. It should rank countries' financial systems, and use modern risk management techniques to evaluate the degree of fragility of different economies (Edwards, 1998)
- The IMF should not expand its surveillance into areas in which it has no real authority such as micro-economic and structural issues (like corporate governance and political governance). The IMF surveillance activities should respect the domestic social and political policies of members. IMF should be more ambitious in its surveillance of exchange rate policies of its members.
- IMF staff should be trained in political economy as well apart from being trained as macroeconomists.
- Other suggestions include encouraging transparency, openness, accountability; promoting trade liberalization and free markets; and combating corruption and nepotism.

References

- Abouharb MR, Cingranelli DL. 2009. IMF programs and human rights, 1981-2003. *The Review of International Organizations* 4(1): 47.
- Cottarelli MC. 2005. Efficiency and legitimacy: trade-offs in IMF governance. Working Paper, International Monetary Fund.
- Dreher A. 2002. The development and implementation of IMF and World Bank conditionality. Available at: SSRN: <https://ssrn.com/abstract=333960> or <http://dx.doi.org/10.2139/ssrn.333960>
- Edwards S. 1998. Abolish the IMF. *Financial Times*.
- Head JW. 2003. Seven deadly sins: an assessment of criticisms directed at the International Monetary Fund. *University of Kansas Law Review* 52(1): 521-582.
- Helleiner E, Momani B. 2007. Slipping into obscurity? Crisis and reform at the IMF. Available at: <http://ssrn.com/abstract=964915>
- Lavigne R, Schembri L. 2009. Strengthening IMF surveillance: an assessment of recent reforms. Discussion Paper, Bank of Canada. Available at: <https://www.econstor.eu/handle/10419/66936>
- Moschella M. 2011. Lagged learning and the response to equilibrium shock: the global financial crisis and IMF surveillance. *Journal of Public Policy* 31(2): 121-141.
- Stone RW. 2008. The scope of IMF conditionality. *International Organization* 62(4): 589-620.

Citation: Bhasin N, Gupta S. 2018. Reforms in International Monetary Fund (IMF): Challenges and the road ahead. *Management and Economics Research Journal* 4: 19-29.

APPENDIX

Table 1. Quota and Voting Shares of Top 10 IMF Members.

Rank	Member country	Quota: Million SDRs	Quota (% of total)	No. of votes	% of total votes
1	The United States of America	82,994.2	17.46	831,407	16.52
2	Japan	30,820.5	6.48	309,670	6.15
3	China	30,482.9	6.41	306,294	6.09
4	Germany	26,634.4	5.60	267,809	5.32
5	France	20,155.1	4.24	203,016	4.03
6	The United Kingdom	20,155.1	4.24	203,016	4.03
7	Italy	15,070.0	3.17	152,165	3.02
8	India	13,114.4	2.76	132,609	2.64
9	Russia	12,903.7	2.71	130,502	2.59
10	Brazil	11,042.0	2.32	111,885	2.22

Source: IMF members' quotas and voting power, www.imf.org

Table 2. General Quota Review of the IMF.

Quota review	Resolution adopted	% Increase in overall quota
First Quinquennial	No increase proposed	–
Second Quinquennial	No increase proposed	–
1958/59	February and April 1959	60.7
Third Quinquennial	No increase proposed	–
Fourth Quinquennial	March 1965	30.7
Fifth General	February 1970	35.4
Sixth General	March 1976	33.6
Seventh General	December 1978	50.9
Eighth General	March 1983	47.5
Ninth General	June 1990	50.0
Tenth General	No increase proposed	–
Eleventh General	January 1998	45.0
Twelfth General	No increase proposed	–
Thirteenth General	No increase proposed	–
Fourteenth General	December 2010	100

Source: IMF quotas factsheet, www.imf.org