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# The need to reform the IMF

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**The recurring episode of financial downturns since the breakdown of the Bretton Woods system has clearly shown that the IMF and the International Monetary System lack mechanisms for crises prevention.**

The absence of rules and procedures to effectively control inherently unstable international financial markets and capital flows along with the "lack of multilateral discipline over misguided monetary, financial and exchange rate policies in systemically important countries despite their disproportionately large adverse international spill-overs" shows the IMF's incapability of effectively dealing with the crises.

To make matters worse, policymakers around the globe are engaged in curing the disease — by facilitating those who are at the origin of problems — instead of taking preventive measures and making institutional changes that will stop another outbreak.

*The Fund needs to regain its focus of preventing market and policy failures*

The most significant is its ineffective surveillance of global economic developments and policies. The IMFs' inability to predict and prevent oncoming crises lies in its blind faith in the self-adjustment capability and efficiency of free markets.

Asset price inflation that results from speculative investment and lending poses a serious threat to economic stability and growth, the IMF remains negligent.

Instead of diagnosing and correcting the main cause of the problem, the Fund maintains its obsession with budget deficits and inflation and downplays the real problems.

The inability of the IMF to prevent crises has resulted in shifting its role from crises prevention to crises lending and management.

During stable time periods, such as 2003-08, drawing upon the IMF almost came to a halt.

The emergency lending is meant to provide a 'breathing space' to countries facing liquidity crises, allowing them time to adjust and recover, but more often than not it has failed to prevent their economic downturn and caused more damage than good.

Take the example of the Greek Crises: Greece's debt is now at J270bn — a staggering 179pc of its GDP. Many IMF officials are of the view that the Fund overextended itself in Greece since the country has been borrowing more to payback existing debt.

Because of the pro-cyclical policy conditionality, the impact of the crises has increased manifold in response to new austerity measures and the social and political upheaval in the country is worsening.

Another problem is that the IMF does not have leverage over their macroeconomic policies because of non- borrower countries.

Moreover, the quotas which determine the contribution of members to the Fund, their drawing and voting rights, are determined by a politicised exercise which tends to give majority power to a few dominant members, especially the United States whose quota remained unchanged i.e. 16.73pc despite recent reforms.



The US's share dwarfs all other member countries' and grants it a veto power. It is quite ironic that the US used this veto to prevent the changes in voting shares which were agreed upon by all other members in 2010. Majority of the countries don't have much of a say in decision making.

A study of 41 countries with IMF arrangements during the 2009 global recession concluded that 31 of these arrangements included pro-cyclical monetary or fiscal policy, or in some cases both. These are the policies which post-war planners sought to avoid in countries facing balance of payment crises.

Little attention is paid to the extractive policies and institutions of major industrialised countries which in turn may trigger an international financial crisis.

Standards and codes have been designed primarily to discipline debtor developing countries on the presumption that the cause of crises rests primarily with policy and institutional weaknesses in these countries.

It has been proposed that surveillance must be treated independently from decisions about programme lending and must be carried out by authorities operating independently of their governments.

This could address problems regarding the quality, effectiveness and even-handedness of surveillance. Such a step needs to be supplemented by reforms of governance for effective implementation.

The problems of governance, hegemony of few members and lack of uniformity of treatment across members, cannot be resolved as long as the Fund's resources depend on the discretion of a small number of its shareholders.

The IMF should be transformed into a truly multilateral institution with equal obligations and rights for all members.

SDR is a reasonable source of funding and must be promoted as a global form of payment. The case for creating SDRs to provide funding for the IMF for current account financing is much stronger than the case for using them to back up financial bailout operations advocated by some observers.

Also the Fund needs to regain its focus on the core objective of preventing market and policy failures. However if such failures cannot be avoided it is better to involve both private creditors and investors in crisis management and lending directed to facilitate expansion of employment and income rather than large scale lending to bail them out.

This is needed to strengthen the capacity of the IMF in crisis prevention.

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