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Research Report

The IMF's Principal Tasks - Guidelines for a Reform Programme

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The IMF's Principal Tasks - Guidelines for a Reform Programme

With the international monetary system dominated by the USA, by the European Monetary Union and Japan, all important decisions on monetary policy will continue to be taken within the G 7 framework. For the foreseeable future the IMF will have to content itself with a role that is essentially geared to ensuring the monetary stabilization of the developing and newly industrializing countries, and especially of the emerging economies. The emphasis here is on four areas of responsibility:

- *Monetary forum: Regardless of the special role played by the G 7, the IMF should be developed into the world's main monetary forum. Only if the newly industrializing and developing countries are appropriately involved in the reform of the international financial architecture can the IMF live up to its claim to universality. In these circumstances, the establishment in the autumn of 1999 of the G 20, in which the leading industrialized and newly industrializing countries are represented, counteracts the planned upgrading of the IMF's International Monetary and Financial Committee.*
- *Economic and monetary advice for its members countries will continue to be one of the IMF's principal tasks in the future. It is the most important contribution the IMF makes to crisis prevention. The IMF should be given the mandate of an "enlarged information policy", enabling it in specific cases to inform the public about critical developments in a country or even to issue a warning if it becomes clear that the government concerned is unwilling to take action against serious undesirable developments in its own country. Greater discipline over a country's economic policy might then be maintained through the markets.*
- *The financing facilities are the IMF's most important instrument in the management of financial and monetary crises. However, they form an extremely complex, bureaucratic system of arrangements, which has also lost its inner logic with the passage of time. Apart from the existing credit facilities and a new crisis facility that covers all kinds of crisis, all the facilities should be completely abandoned. The same applies to the Poverty Reduction and Growth Facility. The scope of the credit facilities should be increased accordingly, and terms of maturity should be determined flexibly to suit the nature and magnitude of the balance-of-payments problems.*
- *The IMF should expand its service functions, some of which it is already performing. They include the preparation of statistics, analyses and assessments, technical cooperation with developing countries and countries in transition and mediation, as in relations between creditors and debtor countries at the time of debt crises.*

The IMF as the main monetary forum

With the collapse of the system of fixed exchange rates in the early 1970s the IMF forfeited its central monetary role. Nothing has since happened to change this loss of importance. The present international monetary system is dominated by three currencies, the dollar, the euro and the yen. There is no sign that the American, European and Japanese central banks, or the governments behind the three currencies, intend to abandon their dominant position in the international monetary system to the IMF. In the future the IMF will have to content itself with continuing to play a monetary role that essentially concerns the financial and monetary problems of the developing countries and countries in transition. This, however, contrasts with the IMF's ambition, officially endorsed by the industrialized countries, to be not only an institution operating throughout the world but also the institutional focus of the international monetary system.

No one can seriously question the dominant monetary role of the USA, EMU and Japan. How they use their power is, however, a different matter. The frequent instances in the past of the G 7 discussing and, de facto,

deciding on the reform of the IMF and the international financial architecture, leaving it to the press to inform the IMF and its other members, can only be described as inappropriate. It helps to reinforce the impression among the developing countries and countries in transition that the IMF is an instrument used by the western industrialized countries for economic and monetary operations "out of area". It is therefore essential that the discussions on monetary policy be moved back to the IMF if it is to retain its credibility. The renaming of the Interim Committee, on which developing and industrialized countries are represented and which is now known as the International Monetary and Financial Committee, should be accompanied by an actual upgrading of this body. The establishment in the autumn of 1999 of the G 20, in which the leading industrialized countries and the emerging economies consider aspects of the international financial architecture, is an extremely questionable development because it helps to weaken the IMF's role.

Economic and monetary advice

Economic and monetary advice for its member countries has been one of the IMF's most important tasks for years and is primarily aimed at preventing crises. It is also the most difficult task, because it not only entails the risk of erroneous assessment but also requires a high degree of sensitivity in dealings with national decision-makers.

What first needs to be clarified, then, is how intensive the IMF's advice should be and when it should be given. The consultations under Article IV of the IMF's Articles of Agreement take place normally once a year. They are not binding on the member country concerned. In other words, members may take the IMF's advice, but they are not forced to. In many cases they do not. Thus before the outbreak of the financial crisis in Asia such countries as Thailand, Malaysia and Indonesia were so blinded by their own success that they turned a deaf ear to any warning of undesirable structural developments. For larger countries, such as India, China and Brazil, independence from the IMF is mainly a question of national prestige. Other countries fail to see the need for structural adjustments or do not have the strength to undertake them.

A far more intensive form of advice and analysis of economic and monetary problems is possible only when the member country wants to take advantage of Fund resources. The dialogue on economic policy then gives way to conditionality. The various credit tranches are disbursed only if the member country satisfies the agreed economic conditions. As this normally requires the country to make major and highly unpopular adjustments, governments understandably put off using Fund resources as long as they can. As a general rule, the impact of the IMF's conditionality therefore comes very late, often too late.

Given these difficulties, it would be wise to equip the IMF with an instrument that is stronger than Article IV consultations and can be used before Fund resources are taken and conditionality begins. Such an instrument might, in certain cases, be an *enlarged information policy* designed to maintain greater discipline over a country's economic policy through the markets.

Since the collapse of the socialist planned economies the developing countries too have adopted the market economy as the model for their economic policies. Some are now well integrated into the world economy. Countries which have gained access to the international financial markets are becoming increasingly dependent on the assessment of their creditworthiness by foreign investors and banks. The IMF should therefore be given a mandate to inform or even warn markets specifically of critical developments in a member country if it becomes clear that the government concerned is unwilling to take action against serious undesirable developments in its own country. Maintaining discipline over government economic policies through the markets is already a more effective way of influencing national economic policies than the conditions imposed by the IMF. The policy of conditionality it has pursued and increasingly refined over the years is still geared to a development model in which governments are the leading actors in the development process and the national and international markets are not

recognized as having the power to keep discipline over government policy.

In one respect the debate on the reform of the IMF seems to have resulted in a consensus: in the future the IMF should concentrate on its member countries' macro policies and withdraw from development aid, this being the World Bank's business. On closer examination, however, it becomes clear that the two terms *macro policy* and *development aid* fall well short of addressing the real problems. The strict separation of these two areas would be acceptable only if development cooperation was confined to the financing of individual investment projects. In fact, development cooperation is far more than this. The IMF's "development aid" in particular is meant to bring about structural changes so as to make markets and institutions more efficient and improve conditions for a more effective macro policy. The IMF stabilization programmes are essentially macro-oriented.

It should not be forgotten in the current debate that the failure of many IMF programmes in the 1960s and 1970s was due not least to the IMF's belief that no more than monetary and macro policy needed to be addressed in developing countries. "Do not in any circumstances get involved in a country's internal affairs," was the watchword at that time. It was a painful experience for the monetary policy specialists working at the IMF to realize that, unless the structural problems underlying monetary and macro policies are considered, current accounts in deficit cannot be put back on a sound footing. The IMF therefore broadened its monetary approach not in pursuit of an ambitious policy of increasing its authority but in order to cater for the structural circumstances of underdeveloped economies.

A question that arises for the IMF time and again is how broad and how deep its analyses and conditions should be and at what juncture the division of labour with the World Bank begins. This division of labour cannot be deduced from a theory: in an intensive consultative process with the World Bank it must be determined pragmatically which institution is to perform which tasks and what practical form their cooperation is to take. How this can be achieved is evident, for example, from the agreement reached by the IMF and World Bank on cooperation in the financial sector.

Financial aid and crisis management

Recurrent balance-of-payments problems and financial crises in the developing countries and countries in transition have made financial aid and crisis management ongoing tasks for the IMF. In the final analysis, the aim is to maintain or to restore monetary stability in these countries in order both to ensure their sustained economic and social development and to prevent monetary instability from spilling over into the global financial system. The latter applies in particular to economic and financial crises in the emerging economies, which have now gained so much economic weight that they are capable of threatening the financial and monetary stability of the OECD world.

The provision of financial aid from the IMF facilities presupposes the conclusion of a stabilization agreement in

which the member country concerned undertakes to carry out economic reforms. As the IMF has endeavoured to meet its members' financial needs as far as possible, this instrument has, with the passage of time, become an extremely complex, bureaucratic system of arrangements, which has now, moreover, lost its inner logic. Furthermore, it is not without a degree of arbitrariness in that the amount of financial aid provided depends on the nature and magnitude of the balance-of-payments disequilibria, a term which does, however, leave plenty of room for interpretation. A reform of the system of facilities with a view to achieving greater transparency and administrative simplification is therefore overdue.

In principle, all the facilities except the ordinary reserve and credit facilities should be completely abandoned. The lending capacity of the remaining facilities should then be increased accordingly. In addition, a single facility catering for all kinds of disaster should be established. The terms of maturity of IMF credits should be handled flexibly, and they should also permit longer commitments so that appropriate account may be taken of the different causes of balance-of-payments deficits.

Financial crisis in Asia: payments of aid initiated by the IMF (in US \$ bn)				
Country	IMF	World Bank/ADB	Bilateral donors	Total
Indonesia	11.2	10.0	21.1	42.3
South Korea	20.9	14.0	23.3	58.2
Thailand	4.0	2.7	10.5	17.2
Total	36.1	26.7	54.9	117.7
Source: IMF, Annual Report, 1998				

The call for IMF lending to be restricted to pure liquidity aid, as advocated, for example, by the Meltzer Commission, a group of experts formed by the US Congress to draw up proposals for the reform of the international financial institutions, ignores the realities of the developing countries and countries in transition. In the past too, the IMF made short-term loans only in a few exceptional cases. Its standard conditions provide for terms of maturity of 3 to 5 years, which in common parlance is medium-term. Here again, it should also be remembered that the IMF introduced facilities with long terms of maturity in the 1980s and 1990s in response to the almost unanimous criticism that its short-term financial aid amounted to a policy of "overkill". The annual meeting of the IMF and World Bank in Berlin in 1988 should be recalled in this context: mass protests, partly militant in nature, almost resulted in a state of emergency being declared. The pendulum of public opinion on the maturity of IMF aid now seems to have swung in the other direction. But what was realized in the 1980s remains valid today: not all kinds of balance-of-payments deficits in developing countries and countries in transition can be overcome in the short or medium term, and not all developing countries and countries in transition are able to overcome balance-of-payments problems at the same speed.

The objection that the simplification of the IMF's

facilities would deprive it in certain cases of the means to meet a member's financial needs is easily refuted. It has never been the IMF's task to finance current account deficits. The emphasis has always been on the catalytic function of IMF aid. The conclusion of a stabilization agreement is meant to send the message to the donor countries and international capital markets that the country in payment difficulties has initiated fundamental adjustments to its economic policy and that it can again be granted credits within the defined limits.

This simplification would also solve the problem of the *Poverty Reduction and Growth Facility*, the former Structural Adjustment Facility, which occupies a special position among all the various facilities and has long been under fire from all sides. Given its conditions and refinancing, it can only be classified as development aid. The conditions governing access are also borrowed from development cooperation: the requirement for taking advantage of this facility is not a balance-of-payments problem but a low per capita income. The aims of this facility are, however, often misunderstood, although the IMF itself is to blame for this. Former Managing Director Camdessus's frequent comment that the IMF too was now primarily concerned with reducing poverty gave the impression that the frontiers with development cooperation had been removed. That a good economic and monetary policy also helps to reduce poverty is usually overlooked or not associated with the concept of poverty alleviation.

A further problem that gives rise to heated debate is the relationship between the IMF and official donors on the one hand and the private creditors on the other. In the 1990s the ratio of public to private financing in the developing countries shifted sharply in favour of the private sector. Financial crises and balance-of-payments problems will therefore largely affect private rather than public creditors in the future. The IMF must react to these structural changes. The answer certainly cannot be to go on increasing the IMF's financial capacity and to demand even more from the official donors. The international commercial banks are unlikely ever again to be helped out so generously with public funds as they were in the Asian financial crisis. Bailing out private creditors on this scale creates counterproductive incentive structures, i.e. incentives to the banks to continue lending money to the developing countries without a more careful assessment of the risks involved (moral hazard).

Long-term net capital flows to developing countries (in US \$ bn)				
	1985	1990	1995	1999
Official capital flows	36.0	55.9	53.9	52.0
Private capital flows	31.6	43.5	203.3	238.8
– Direct investments	10.9	24.1	105.0	192.0
– Private credits	20.6	15.7	62.2	19.2
– Portfolio in-	0.1	3.7	36.1	27.6

vestments				
Source: DRS and OECD				

The IMF's service functions

The term "service" covers a range of activities, only some of which have so far been undertaken by the IMF with any vigour. The IMF should systematically expand these services and regard them as a separate, new area of responsibility. They include the preparation and publication of *statistics*. With interdependence in the world economy growing, the demands on statistics in terms of topicality, breakdown and international comparability have risen sharply in recent years. If these demands are to be met, there will need to be even closer cooperation between the IMF and its members in the future. There are serious deficiencies in the recording of international capital market flows. The information on offshore centres is inadequate. The IMF's announcement that it intends to strengthen its staff considerably by recruiting additional capital market experts indicates that it is determined to perform this function more actively than hitherto.

A second service comprises *analyses and assessments*. It is a task that the IMF has performed no more than sporadically, i.e. on request, in the past. Analyses for world economic summits and the appraisal of a member country's economic situation for the Paris Club are the best known examples. The IMF should be more active in providing these services in the future. The member countries might, for example, ask the IMF for an assessment of their own economic situation because they hope the publication of the findings will lead to a positive reaction from the international capital markets. The Meltzer Commission has even gone so far as to propose that the economic policies of all member countries should undergo constant rating to give the international financial markets a sounder basis on which to take their decisions.

Technical cooperation is another IMF service. Given the considerable need for advice on monetary policy and the willingness of UNDP and bilateral donors to make financial resources available to the IMF for this purpose, this activity has meanwhile become a permanent fixture. Nor should there be any fundamental objections to an expansion of technical assistance now that crisis prevention has a far higher priority than crisis management.

The last of the IMF's service functions to be mentioned here is *mediation*. This would be particularly appropriate at the outbreak of financial crises, when the earliest possible arrangement between the private creditors and the debtor country is essential. The creditors usually comprise hundreds of banks, and it would be too late if they left it until after the crisis had begun before they tried to reach agreement with the debtor country. As speed is of the essence in a crisis, the course must be set in advance. In other words, it must be specified when the credit agreement is concluded what the consequences will be in the event of the debtor's insolvency. All past experience indicates, however, that the banks deny the debtor country the right to determine on its own the time at which

insolvency sets in. Hence the need to introduce a third, objective party. This can only be the IMF, first, because it has the best information for the assessment of a country's solvency and second, because it can be assumed to be an impartial mediator.

There are many indications that the IMF's future position in the international monetary system will no longer be determined primarily by its own financial capacity or the total volume of the aid packages it is able to mobilise in a crisis. There will continue to be financial crises in which IMF funds are required, but not in the same way as during the last financial crisis. Of greater importance will be the functions and skills that accrue to the IMF from its broad information base, its expertise, its function as an adviser and its participation in decisions on monetary policy. Only by consistently expanding these functions is it likely in the foreseeable future to emerge from the shadows of the three great players in the monetary field, the USA, the EMU and Japan. At the same time, if the IMF is to live up to its claim to universality, it will have to make a far greater effort in the future to integrate the newly industrializing countries and the other developing countries and countries in transition than it has made in the past.

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