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THE IMF AND THE CHALLENGE OF GLOBAL GOVERNANCE

Faced with changes in the international monetary system, the IMF has enlarged its areas of competence and superimposed its means for action. In doing so, it has been juggling with two approaches to the governance of international monetary affairs. The first has liberal, free-market foundations, and is associated with mutual assistance mechanisms. The second is grounded in the principle of supranational monetary sovereignty. The recent financial crises, which attributed the to IMF the function of being an international lender-of-last-resort, have brought this debate to the fore once again. Were this function organised in a permanent fashion, then it would lead the Fund to taking on the role of a world central bank. This raises questions concerning the IMF's political legitimacy and how its representativeness could be improved*.

The International Monetary Fund is the institution through which the international community seeks to control monetary phenomena rather than be governed by them. The debates about its functions should not therefore be underestimated. In the wake of the crises at the end of the 20th century, the IMF has been called upon to reform itself. But the vast literature[1] on the new international financial architecture shows to what extent the positions put forward in official, academic and financial circles are contradictory. Since the first proposals for the creation of the Fund, there have been two opposing philosophies relating to the governance of international monetary affairs. The dominant approach has been to see the IMF as a mediator in mutual economic assistance between States, based on the principle of international insurance. The other approach comes to the fore during moments of crisis, and envisages the possibility of the Fund issuing a supranational fiduciary currency that provides final liquidity.

The responses to the major mutations of the international monetary system show how the Fund has navigated between these two positions. Contrasting them also throws light on the issues at stake in the present reforms.

The Metamorphoses of the IMF

Since the creation of the Fund in 1946, the community of Member States has assigned new missions to the IMF, in order to reply to the problems raised by the mutations of the international monetary system. These missions can be expressed as models of collective action, which have been superimposed over the course of time.

The initial model, forged for a system of stable parities, is that of a mutual assistance fund to deal with temporary, current account imbalances. The Fund acts as a cooperative credit association, providing international insurance between Member States.

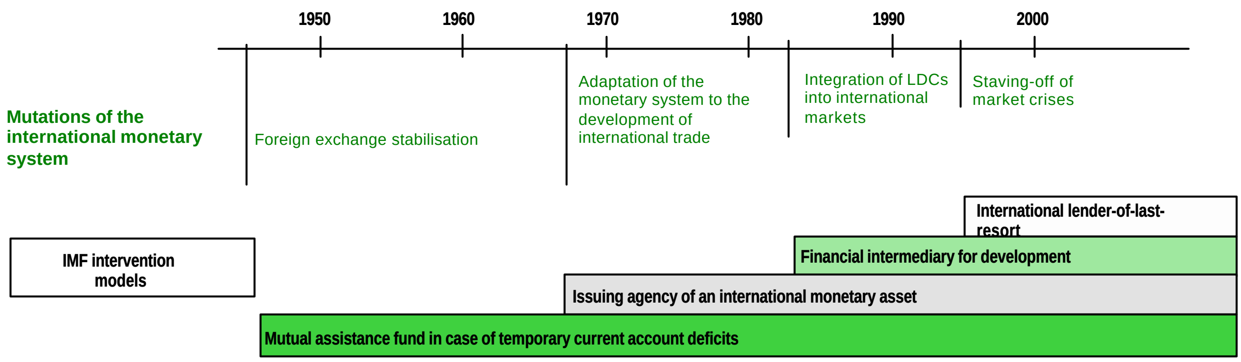
The creation of Special Drawing Rights (SDRs) corresponds to the mapping out of the second model, namely that of an agency issuing an ultimate reserve asset. The SDRs were to permit international liquidity to be adapted to the needs of the world economy, which the basic model, with the dollar as the only currency, could not do. But the failure of the project to reform the monetary system, and disagreements between the major powers led to SDRs being pushed to the sidelines. Nevertheless, this asset, which is a pure fiduciary currency with no debt counterpart, is a radical innovation, an embryo of international monetary sovereignty.

Financial liberalisation and flexible foreign exchange have completely emancipated the developed countries from Fund financing, whereas the oil shocks and the debt crisis of the 1980s have increased the official financing needs of the developing countries. Still labelled as a system of mutual assistance, the IMF has ***de facto*** evolved into being a financial intermediary for development and a mediator of contradictory interests between creditors and debtors. The former have assigned to it the role of supervising the structural adjustment of the latter. The Fund's

*This ***Lettre du CEPII*** draws on some key ideas developed by Michel Aglietta and Sandra Moatti in their book, ***Le FMI, De l'ordre monétaire aux désordres financiers***, Collection CPR, Paris 2000. See also, M. Aglietta, "The International Monetary Fund and the International Financial Architecture", ***CEPII Working Paper***, No 2000-08, May 2000.

1. For a summary of the most recent reports on IMF reform see J. Williamson, ***The Role of the IMF: A Guide to the Reports***, IIE, Washington DC, 2000.

Table - Mutations of the International Monetary System and Models of IMF Intervention



Structure of the monetary and financial system	Stable and adjustable parities, control of capital movements.	SDR as an international unit of account for defining parities.	Extension of flexible exchange, development of sovereign debt.	Generalisation of financial globalisation to countries
Nature of adjustments and the role of the Fund	Current account constraint. Tempory/fundamental disequilibria. Macroeconomic surveillance and conditionnality.	Adjustments imposed symmetrically on deficit and surplus countries. SDR reserves as an indicator of disequilibria.	Solvency problems of sovereign debt in the LDCs. Structural adjustment. Enhanced conditionality	Brutal capital account disequilibria due to financial market instability. Intervention aimed at restoring market confidence. Financial fragility as an indicator of disequilibria.
Liquidity regulation and the financial function of the Fund	Financial aid strictly limited by share-quotas.	SDRs as the major asset of international reserves.	Multiplication of credit facilities, increase of access limits, lengthening of repayment schedules	Emergency liquidity, and disconnected from share-quotas.
System governance	Intergovernmental agreement according to the principle of mutual insurance.	Enhanced supranationality: responsibility for issuing reserve assets.	Role of mediator between debtor countries and the various creditors (Members of the Paris Club, international banks)	IMF as a quasi lender-of-last-resort and coordinator of diverse public and private actors.

surveillance mechanisms have had to be increased, the field of conditionality enlarged, and its capacity to enter long term financial commitments adapted.

By encouraging countries to liberalise their markets, the IMF has had to extend conditionality to politically-sensitive issues, because these touch on State intervention in goods and labour markets. This liberalisation process has favoured the explosion of credit for the private sectors in these countries, free of any real prudential control. It was precisely such permissiveness that was justly criticised as having been the main ingredient of the Asian Crisis.

To stave off crises spreading from the private sector, which are strongly contagious due to manner in which they may turn round capital flows, the IMF was forced into emergency intervention of historically unprecedented levels. Within the framework of a new international financial architecture, the task now at hand is how to develop a new form of collective action: an international system which makes it possible to manage financial crises and in which the IMF may intervene as a lender-of-last-resort, and as a coordinator of the great variety of private and public actors.

Until now, the Fund has transformed itself through extension. It has accumulated areas of competence and superimposed means of action, without recognising that certain measures may be obsolete or that its models of action may be contradictory. From this point of view, the rationalisation of the Fund's credit facilities launched this year has been very timid (see box).

In seeking to ward off the splintering up of its functions by searching for uniform principles of action, the IMF has often been led to imposing similar procedures and conceptual frameworks in diversified situations. Its pragmatic evolutionism, which always creates and never destroys, means that the Fund risks being one step behind each new crisis. This danger was quite patent at the start of the Asian Crisis and led to strong criticisms of the Fund, which all pointed to the need to refocus its fields of intervention. For such refocusing to be compatible with the principle of universality, the Fund will have to extend its collaboration with other institutions. A key issue at stake in reforming the Fund thus hinges on delimiting its competencies and its place in managing the international system when in crisis.

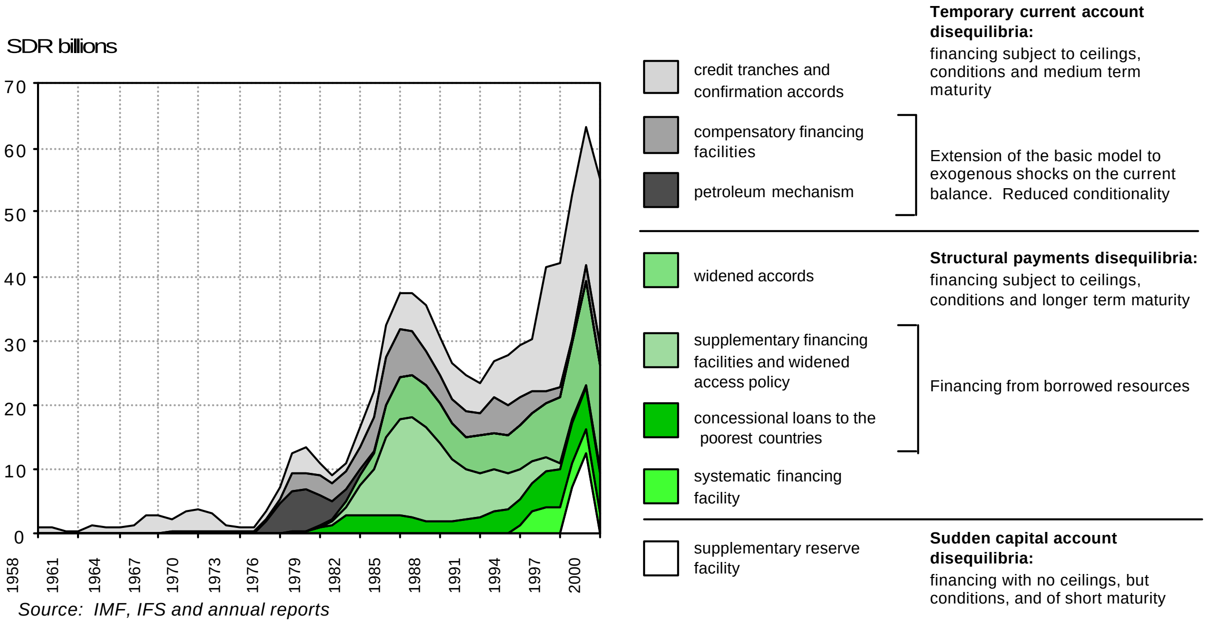
Pending Reforms

The IMF is the only institution which is preoccupied by the correct functioning of the world economy in the light of macroeconomic interdependencies. But globalisation has led such interdependencies to come under the

Box - The Successive Build-Up of IMF Credit Facilities

The graph illustrates the financial consequences of the extensive approach in superimposing models of collective action, whereby instruments and policies are accumulated. The mutual assistance model is geared to providing short term support. This is linked to the system of share-quotas, which finance such aid and determine its level, as well as the degree of conditionality attached to it. The basic model was altered after 1974, in the face of persistent, current payments deficits, to make it possible to commit aid on a long term basis. However, no instrument was designed to meet brutal disequilibria on the capital account, requiring massive capital injections and instantaneous liquidity. The Supplementary Reserve Facility, created during the Asian Crisis, offers a preliminary answer to this problem. Overall, two types of facilities, which correspond to the first and fourth models, will almost certainly continue to be largely used, one to absorb real, but reversible shocks to current balances, the other to stave off contagion that provokes disorder in the capital balances.

There is sharp controversy, however, concerning the enormous sums involved in structural credits, part of which are financed by the Fund borrowing from its members or from other makeshift sources. These facilities include structural adjustment support, aid to poor countries and support for the transition of ex-Soviet countries. The way such monies are distributed is highly obscure. This problem, linked to the excessive weight of long term finance which draws the IMF away from its first function (stability of the international monetary system), has brought issues into the public arena which go beyond the structure of financing.



Source: IMF, IFS and annual reports

overwhelming influence of the international financial markets. It is thus logical that a shift towards a crisis management model leads to a renewed concentration of surveillance of financial vulnerability criteria. This is an area in which the IMF should share its expertise with other institutions, especially the Forum for Financial Stability located in Basle, though this raises the problem of the division of labour in prudential matters. The Fund has also taken the initiative of taking up direct contacts with financial markets (by creating an in-house ***Capital Market Consultation Group***). The objective is ambitious and long term. By crossing lead indicators of financial tension and macroeconomic investigation under Article IV[2], it is possible to envisage linking the degree of weakness in financial systems to countries' economic policies, in order to detect whether certain policies (e.g. exchange rate policy) weaken financial tensions or not.

Globalisation has thus led to a cleavage within the developing world, between emerging countries and poor countries excluded from capital markets. It may be admitted that specifically long term financing is not pertinent to the relations between the Fund and emerging or transition countries. Nevertheless, the problem of poverty reduction still stands out[3]. The universal vocation of the Fund may justify its participation in this area. But, the principal responsibility in this field belongs to the World Bank, which may promote forms of dialogue with countries that are more adapted to their needs than the ***dirigisme*** which the IMF has displayed in its conduct of structural adjustment finance.

From the perspective of ring-fencing systemic risk, the accumulated experience of developed countries' financial systems demonstrates that effective measures to manage crises include three dimensions: i) that of a lender-of-last-resort to prevent liquidity crises, ii) the means of involving the private sector in the ordered resolution of credit crises, and iii) that public supervisors have the authority to enforce the application of early, corrective

2. Article of the Revised Statutes drafted at the Jamaica Accords (1976), which institutes annual surveillance of exchange rate regimes and economic policies of Member States.
3. The approach of the programme tends to privilege the quality of growth rather than just quantity; the appropriation of programmes by civil society rather than just by elites, and lastly the provision of fundamental public services and not just the development of markets.

measures, to ensure the respect for agreements to share losses, and the power to manage restructuring. Each of these elements raises problems when financial crises are international.

The IMF intervened as the lender-of-last-resort in the Asian Crisis. But, major difficulties exist in organising this function on a permanent basis. The idea of pre-qualifying a certain number of virtuous countries as eligible to receive emergency support in the face of a liquidity crisis lies behind the recent Contingent Credit Lines, created in 1999. Yet no State has so far volunteered to subscribe to this scheme. More seriously, restraining the authority of the Fund to support only virtuous countries, as put forward in the Meltzer report [4], breaches the IMF's principle of universality and global responsibility. Furthermore, last-resort assistance mobilises resources whose volume cannot be determined in advance. Yet, the IMF has limited resources, that are little elastic: hence the idea of financing intervention to tackle a major crisis by issuing SDRs ***ex nihilo***. A move in this direction would mean promoting the SDR via the lender-of-last-resort function, which is a central bank activity. This involves shifting the Fund away from the mutual assistance model towards the second model, namely that of an issuing agency. For this reason, there is much reticence about pursuing such a policy.

Involving private creditors is necessary to avoid losses being collectivised internationally through the massive commitment of public funds. But the implementation of such a measure runs up against private sector resistance and the hostility of the American authorities towards systematic rules. But, if the involvement of the private sector cannot be ensured through codified ***a priori*** obligations covering all cases, nor can it be achieved only a voluntary basis alone. While the consortia formed by some large banks accepting to maintain their credit lines in times of emergency may stave off crises in certain situations, it will not be sufficient when other types of creditors predominate or when debt rescheduling is not sufficient to re-establish a situation which is externally sustainable. Freezing service payments on debt may then be a necessary evil, first in order to limit moral hazard, and second to reduce the cost of restructuring programmes. The link between payments freezes, the evaluation of losses and restructuring implies negotiations in which the public supervisor of the debtor country plays a key role, especially when declaring a moratorium. Without any international bankruptcy law, the IMF is the only institution with the authority to guarantee the validity of the moratorium with respect to the international financial community.

For the present, these reforms are marking time, because the Fund does not have the legitimacy of an international agency of governance in the management of monetary and financial affairs. Strategic decisions are taken by the G7 under American leadership, without this ***status quo*** being contested by emerging countries. The enhancement of the Fund's authority can only occur if it becomes more representative, along three lines at least: a redistribution of power to reflect the rising political weight of the emerging economies; a redefinition of the voting constituencies to take into account regional monetary arrangements; and lastly, in conformity with its statutes, the creation of an operational directorate within the IMF enjoying real political authority.

The constitution of a prudential mechanism at an international level rekindles the debate over having a political authority capable of imposing effective measures of prevention and able to manage crises. It also sharpens the diverging positions based on a free-market view of multilateralism, associated with international insurance mechanisms, and the principle of supranational monetary sovereignty.

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4. F. Meltzer ***et al.***, ***International Financial Institutions Advisory Commission Report***, US Congress, Washington DC, 2000.

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