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Reforming the IMF—too late and too little

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The spring meeting of the International Monetary Fund (IMF) and the World Bank group in Washington concluded last week. Gone are the days when these meetings received high media visibility, particularly in India. Have the organisations become increasingly irrelevant even as the world has become more interdependent?

The World Bank still remains the most credible response of the international community to fighting poverty and improving life quality. In somewhat more mature emerging markets like India it facilitates long-term infrastructure financing. It also supports social-sector investments in health and education. Given recent improvements in Sub-Saharan Africa, registering a 5 per cent growth for the third consecutive year, enhanced financing coupled with improved governance hold the promise to turn Africa's fortune.

What about the IMF? Drafted in Savannah, Georgia, 60 years ago, it is the principal instrument to facilitate expansion and balanced growth of international trade, to promote exchange stability, and to provide temporary resources to correct maladjustment without measures destructive of national and international prosperity. However, over the years, it has not adapted to the changing global configuration.

For many decades after its inception, the IMF was seen not only as a guardian of the international monetary system but also as a ''Lender of Last Resort''. India herself resorted to successive borrowings to support its external account and meet debt obligations. However, with many emerging markets, particularly in Asia, accumulating large foreign exchange reserves, contingent borrowing from the Fund to meet external liabilities has become increasingly irrelevant. Besides, the integration of financial markets and the easing of exchange restrictions with large capital flows make the meagre resources of the Fund hopelessly inadequate to mitigate any fundamental disequilibrium in the balance of payments.

The Fund has now increasingly resorted to being a facilitator in clubbing and putting together resources of multiple agencies to meet any large financing needs, contingent on recipients accepting conditionalities which can restore market confidence.

Thus, what is its relevance now? Most importantly, enhanced surveillance. Spotting vulnerabilities and acting as an early warning system are important obligations designed to be discharged through what is traditionally known as the Article IV Consultations of the Fund, which all member countries have voluntarily accepted. Nonetheless, the somewhat narrow focus of these consultations on macro-economic variables, particularly the external sector, instead of balance-sheet linkages which have dramatically altered our risks has handicapped their usefulness. As Mervyn King, the Governor of the Bank of England, speaking at ICRIER early this year on 'The Reform of the IMF', said, ''any answer to the question of what role the IMF should now play must recognise these balance-sheet linkages. The size and composition of balance sheets are crucial for determining how shocks are transmitted across national borders. And surprises about economic policies and news about the economic fundamentals can, by generating changes for desired balance-sheet positions, have large impacts on capital and expenditure flows''.

The IMF at its recent meeting focused on some of these issues following the Global Imbalances Conference and also considered them in the Managing Director's report on the medium-term strategy. Three issues appear crucial. First, the orderly medium-term resolution of global imbalances which must entail shared obligations. It is well known that the key factors are the large and prolonged current account deficit of the United States, its low savings rate coupled with huge surpluses accumulated by several Asian countries particularly Japan and China, along with exchange rate inflexibility in many countries. This phenomena has continued for long. Apart from exhortations, the IMF has been unable to influence their policy matrix.

Given the limited room for manoeuvre which the USA presently has, with little appetite to enhance tax revenues and with its committed liabilities on health, social security and a large defence expenditure, fiscal consolidation is scarcely round the corner. Persuasion of Asian countries to augment domestic consumption and permit exchange rates to appreciate has met with limited success. The MD's proposal to review these issues at the time of the annual meeting in Singapore, including the outcome of the new multilateral consultations, offers scope for greater engagement without necessarily holding much hope for tangible outcomes. A cynical view could be that the writ of the IMF is respected by the poor but ignored by the rich. Its prescriptions on macro-economic stability are liable to the same charges.

Second, there are other issues beyond improved surveillance, namely increase in quota to reflect the important changes in the weight and role of countries to give a fair voice and representation to all members. Consensus on this too has been elusive and hopefully the MD's concrete proposals at the annual meeting can take the dialogue further.

Third, the procedures and working of the IMF, particularly the Executive Board's attempt to micro-manage the working of the Fund, the need for increased autonomy to the Secretariat and the relationship between management and technocracy are other areas of reform which received scant notice.

If all this has meant an increased politicisation of the IMF, then the warning of John Maynard Keynes, one of the founder fathers of the Bretton Woods institutions, that ''it would be best for the twins to fall into an eternal slumber, never be woken or heard of action in the courts or markets of mankind'' may well have come true.

In popular perception, the IMF has been preaching reforms to all developing countries and urging them to take timely decisions, notwithstanding transitional pain, but has been less than even-handed in addressing policy challenges elsewhere. What is worse it has neglected to reform its own outmoded processes and procedures, accountability patterns, and to alter the approach and focus of surveillance reports to meet contemporary needs. What is now being proposed (or postponed) for the Singapore meeting may be too little and too late.

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