Stuffing New Wine into Old Bottles: The Troubling Case of the IMF[1]

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I. Introduction

Since the collapse of the Bretton Woods system in the mid-1970s the International Monetary Fund (IMF) and the World Bank, have helped the world avoid the horrors of a systemic collapse. However, when we look at the volatility in financial markets, the growing income inequality both within and between countries, the fact that nearly half the world's population lives on less than $2 per day and about 22% live on less than $1 per day, and hundreds of millions of people live without safe sources of running water, shelter, education or health care, it is clear that they are failing in their mandate to reduce poverty, promote and maintain high levels of employment and real income, a stable international monetary system, and shorten the duration and lessen the degree of payments disequilibria[3].

Unfortunately, they are failing us at a time when we badly need them to be functioning effectively. The increasingly integrated global financial system, with its apparently endemic volatility and uncertainties and unbalanced allocation of resources desperately needs some form of effective global governance.

In this paper I explore the reasons for the IMF's failure to adequately carry out its mandate. I argue that, while the suitability of the IMF's policies and the appropriate scope of its activities are certainly open to debate, an important and often under-emphasized cause of its unsatisfactory performance is its failure to adapt its structure and operating practices to its changing functions. In fact, without correcting this latter set of problems it will never be able to effectively perform its responsibilities.

My thesis is that since the collapse of the Bretton Woods system of relatively fixed exchange rates, the IMF has lost influence over its richest member states, particularly the G-7, and has steadily gained influence over its developing country member states. This process has resulted in the IMF slowly mutating from a monetary organization into a macro-economically

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3 *See generally*, THE WORLD BANK, WORLD DEVELOPMENT REPORT: ATTACKING POVERTY 2000-2001; INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK (Oct. 2000); THE WORLD BANK, GLOBAL DEVELOPMENT FINANCE (2000).

oriented development financing institution. These developments have important implications for the IMF's relations with its member states, the citizens of those member states and other international organizations. Unfortunately the IMF has not yet adequately acknowledged these implications. Consequently, the IMF is experiencing serious problems that are caused by the distortions that arise from it trying to squeeze its new functions and relations into its old structures. These problems are undermining its ability to function effectively. They are leading many in the developing world and in international civil society to view the IMF as an uncaring bully that is more responsive to the concerns of its richest member countries than to the real problems of the citizens of the countries in which it operates[4].

The paper also proposes a reform program for the IMF that is designed to adapt its existing structures to its new functions. The reforms will also make it more accountable, democratic and responsive to the challenges that its developing country member states face. Without these changes, the IMF will fail in its responsibility to ensure that the global financial system is able to contribute to the resolution of the serious problems of poverty and inequality that exist in the world today.

While this paper will focus on the IMF, the lessons drawn from this case study are applicable to other international economic organizations, like the World Bank, in which industrialized countries are perceived to have a disproportionate share of the power and developing countries, which are directly affected by the policies and actions of the organization, have very limited influence. It also has relevance for those international organizations, primarily the United Nations' other specialized agencies, which, because they are perceived by the richest countries as being too responsive to the concerns of developing countries, have lost power to the IMF and the World Bank over the past twenty years.

In order to establish this thesis, the paper is divided into a number of sections. The next section of this paper gives an overview of the IMF's structure and functions and will briefly describe the evolution in its operations since its creation. Section III describes 5 distortions that have arisen from the combination of the evolution in the IMF's functions and the inflexibility of its decision making structures. Section IV briefly reviews the problems that have resulted from these five distortions. Section V considers the possible responses to the current problematic situation of the IMF and concludes that the most desirable option is a substantial program of

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4 There is an extensive literature, from may different political perspectives on the problems with the IMF. *See*, for example, INTERNATIONAL MONETARY FUND, EXTERNAL EVALUATION OF IMF SURVEILLANCE (1999), at http://www.imf.org/external/pubs/ft/extev/surv/eval.pdf [hereinafter EVALUATION OF SURVEILLANCE]; EXTERNAL EVALUATION OF THE ESAF, Report by a Group of Independent Experts (June 1998), at http://www.imf.org/external/pubs/ft/extev/index.htm [hereinafter EXTERNAL EVALUATION ON ESAF]; Jeffrey D. Sachs, *The IMF and the Asian Flu*, THE AMERICAN PROSPECT, Mar.-Apr. 1998, at 16-21; Anna J. Schwartz, *Time to Terminate the ESF and the IMF*, FOREIGN POLICY Briefing No. 48, Washington, D.C.: Cato Institute (Aug. 26, 1998); Martin Feldstein, *Refocusing the IMF*, FOREIGN AFFAIRS 77(2), at 20-33 (1998); MELTZER COMMISSION, REPORT OF THE INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION (2000); J.M. Griesgraber and B. Gunther, THE WORLD'S MONETARY SYSTEM (1996); FIFTY YEARS IS ENOUGH: THE CASE AGAINST THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND, (Kevin Danaher, ed., 1994).

structural reform. It also contains a set of short-, medium and long- term proposals for reforming the IMF.

II. The Evolution in the IMF's Operations

At the Bretton Woods Conference in 1944, the 44 participating countries, agreed to surrender some of their monetary sovereignty to the IMF in exchange for the benefits of a rules-based monetary system[5]. The states agreed that the postwar international monetary system would be based on a fixed link between gold and the US dollar. Every other participating country would set the value of its currency, known as its "par value", in terms of the US dollar. The participants created the International Monetary Fund (IMF) to oversee the system. Its primary function was to ensure that members were following economic policies that were consistent with maintenance of the par value they had established for their currency. The countries also agreed that they would not let the value of their currency change, more than a specified amount, without the permission of the IMF. To encourage the participating countries to comply with these obligations and as part of the benefits of membership in the IMF, it was empowered to provide financial support to any member state that was experiencing balance of payments problems[6].

In order to perform its oversight functions, the IMF was required, pursuant to Article IV of its Articles of Agreement, to conduct an annual consultation with each of its member states. During these annual consultations, sometimes referred to as surveillance missions, the IMF focused its attention on those macroeconomic variables that influenced the ability of the country to maintain the par value of its currency. Thus, the primary focus of the IMF was on such macroeconomic variables as exchange rates, interest rates, inflation rates, the balance of payments, and growth in money supply and credit[7]. Given the nature of its interest, it made sense for the member states to stipulate in the IMF's Articles of Agreement, that the IMF should limit its interactions with its member states to the state's Central Bank and Ministry of Finance[8]. These were the two agencies in the member country that had jurisdiction over the variables of interest to the IMF.

The IMF's specialized international monetary mission also placed limits on the conditions it would attach to the financing it offered its member countries. These conditions were limited to such issues as the size of the currency devaluation, the required cut in the budget deficit, and the expected limits on the growth in money supply and credit. The fact that the conditions were focused on macroeconomic issues meant that the recipient state was free to choose the precise policy measures for meeting these conditions. During the period of the par value system many countries, including the United States, made use of the IMF's services[9].

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5 *See* Margaret Garritsen de Vries, THE IMF IN A CHANGING WORLD 1945-1985 14-20 (1986).
6 *See*, INTERNATIONAL MONETARY FUND, ARTICLES OF AGREEMENT art. I (1944) (stating purposes of IMF) [hereinafter IMF ARTICLES].
7 *See* Garritsen, *supra* note 5; ROBERT A. BLECKER, TAMING GLOBAL FINANCE 1-7 (1999); Daniel D. Bradlow, *The World Bank, the IMF, and Human Rights*, 6 TRANSNAT'L L. & CONTEMP. PROBS. 47, 68-69 (1996).
8 *See* IMF ARTICLES, *supra* note 6, at art. V, § 1.
9 *See* JOSEPH GOLD, LEGAL AND INSTITUTIONAL ASPECTS OF THE INT'L MONETARY SYSTEM: SELECTED ESSAYS II, at

Since the IMF was designed to be a monetary and not a development institution, it operated on the basis on uniform treatment for all member states. The justification for this was that all states were participants in the same monetary system and that the ability of each state to maintain its par value was influenced by the same variables and they were all vulnerable to the same types of balance of payments problems. Thus, the IMF offered each member state access to its financing facilities on the same terms and conditions. Similarly, the IMF's annual consultations with each member state covered essentially the same ground. The IMF concretized this uniformity of treatment by adopting a principle of uniformity as one of its key operating principles[10].

The IMF's original governance structure was designed on the assumption that in an international monetary system based on par values all countries could potentially run into balance of payments problems and need to make use of the IMF's financing facilities. Thus, even though the IMF's system of weighted voting meant that some countries had more influence in the IMF than others, they all had an interest in developing policies that were acceptable to states that actually used the IMF's services. Since even the most powerful states could one day need the IMF's support, they were unlikely to advocate policies that were unduly burdensome for member states[11]. They understood that the policies they supported in the IMF could one day directly affect their own citizens and they could be held accountable for them.

The governance structure was also build around the expectation that the IMF's Board of Executive Directors to exercise firm control over the IMF's management and staff. The Board would, thus, hold the staff and management were held accountable for their actions and decisions. During the period of the par value system, this expectation was realistic because the number of IMF programs was relatively small and the scope of the programs was limited to the key macro-economic variables relevant to the par value system.

After the collapse of the par value system, which was formalized with the adoption of the Second Amendment to the IMF's Articles of Agreement in 1978, the IMF lost its well-defined monetary mission[12]. The Second Amendment gave each member state the right to choose its own exchange rate policy. This created a problem for the IMF. If the member state was not expected to maintain any particular value for its currency and could choose its own exchange rate

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647-650 (1984) [hereinafter GOLD II]; Bradlow, *supra* note 7.

10 *See* JOSEPH GOLD, LEGAL AND INSTITUTIONAL ASPECTS OF THE INT'L MONETARY SYSTEM: SELECTED ESSAYS I, at 469-519 (1979) [hereinafter GOLD I].

11 A good example of this point is that the IMF originally adopted the view that the standby arrangement is not a contract under the influence of the industrialized countries. These countries, who at the time were still using the financing facilities of the IMF, did not wish to be seen by their citizens or other countries as entering into a binding contract with the IMF. They also did not wish to be seen as breaching their obligations if they failed to effect the policies set out in the Letter of Intent that would form part of their standby arrangement with the IMF. *See* JOSEPH GOLD, INTERPRETATION: THE IMF AND INTERNATIONAL LAW 371 n.125 (1996).

12 *See* IMF ARTICLES OF AGREEMENT, amend. I (1978), at http://www.imf.org/external/pubs/ft/aa/index.htm; GOLD II, *supra* note 9, at 108-113.

policy, then what was the IMF supposed to be monitoring in its annual consultations with the country?

The amended Article IV provides only limited guidance. It requires each member state to "endeavour to direct its economic and financial policies toward...fostering orderly economic growth…" and to "seek to promote stability by fostering orderly underlying economic and financial conditions" and to "follow exchange rate policies compatible with the undertakings" of Article IV.[13] The lack of specificity of this language suggests, as in fact has become the case, that the IMF needs to look at any aspect of the member state's economic and financial policies that could affect its "orderly economic growth", its external balance of payments and the value of its currency. In other words, the Second Amendment resulted in the IMF dramatically expanding the scope of its Article IV consultations.[14]

It also has resulted in an expansion in the range of conditions that the IMF attaches to the financing it provides to member states. In fact, in some cases IMF financing arrangements can contain over 100 conditions covering such issues as privatization, reform of tax administration, adoption of new laws such as bankruptcy codes, and budgetary allocations for health and education, in addition to the more "traditional" macroeconomic conditions[15].

The Second Amendment had disparate impacts on different groups of IMF member states. The IMF lost its significance in the case of those countries, all of which were industrialized countries, that knew that they would not need to use or had no intention of using the IMF's services in the foreseeable future. On the other hand, if the country knew that it needed or may need the IMF's financial support, it necessarily had to pay careful attention to the views of the IMF and the advice it offered during the annual Article IV consultations. These views would inform the conditions that the IMF would attach to the financing it would offer the member state. Thus, an unintended effect of the Second Amendment was to create a, *de facto*, distinction between those countries that used or intended using IMF financing and those that did not.

In fact, since the Second Amendment, IMF member states can be classified into two groups. The first group, which can be called "IMF supplier states", consists of those countries which, because of their wealth, their access to alternate sources of funds and for political reasons, have no intention of using the IMF's services in the foreseeable future[16]. These countries do not

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13 *See* IMF ARTICLES, *supra* note 6, at art. IV, § 1 (adopted July 22, 1944, entered into force 1945, amended effective April 1, 1978).
14 *See* Gold I, *supra* note 10, at 573-4.
15 The IMF's financial arrangements with Russia and Indonesia contained over 100 conditions each. These conditions dealt with most of the issues cited in the text. In the case of the HIPC countries, the IMF requires them to follow participatory processes in developing their Poverty Reduction Strategy Papers and to allocate certain portions of their savings from debt reduction to primary health and education budgets. *For more information see IMF website* <www.imf.org>.
16 None of these countries have used the financial resources of the Fund since 1978. *See* DE VRIES, *supra* note 5, at 119 (noting that during 1972 to 1978, the IMF approved stand-by arrangements for Italy and the United Kingdom).

need to pay particular attention to the views of the IMF[17]. For these countries, the most important of which are the G-7 countries, the Second Amendment meant that they regained their monetary sovereignty from the IMF and escaped from its control. These countries, in fact, do not seem to pay much attention to the IMF's advice. For example, during the 1980s the IMF consistently and ineffectively called for the US to reduce its budget and trade deficits[18]. Similarly, its advice on such issues as interest rates and exchange rates in the G-7 countries do not appear to have had any real influence over the policies these countries adopt. Instead, these countries rely on their own judgements and the discussions that take place among themselves in making policies on these issues.

The second group, which consists of those member states that need or know they may need IMF financing in the foreseeable future can be called the "IMF consumer" countries. These states must pay careful attention to the views of the IMF because they will influence the conditions that the IMF will attach to the funds it provides the state. The IMF can also influence these countries' access to other sources of funds.

III. Institutional Implications of the Changing Role of the IMF: The Five Distortions

The IMF has attempted to fulfill its current expanded range of activities without making any significant changes in its decision-making structures or governance arrangements. It has also allowed its new role to develop without any serious public debate over the institutional and legal implications of this development. The result is that the IMF has "forced" its new broader functions into its existing decision-making structures and governance arrangements and its existing interpretation of its mandate. This has resulted in five distortions that are undermining the effectiveness of its operations and are increasing hostility to the IMF around the world.

These five distortions are:

a) Three legal issues;
b) The IMF's relations with the industrialized countries, in particular the G-7;
c) The IMF's relations with developing countries that utilize or expect to utilize its financial services;
d) The IMF's relations with the citizens of its member countries; and
e) The IMF's relations with other international organizations.

[17]Despite this the IMF continues to devote considerable amount of resources to its surveillance of these countries. *See* EVALUATION OF SURVEILLANCE, *supra* note 4.
18 *See e.g.*, INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK, from 1982-1986.

Each of these problem areas is discussed in more detail below.

A. Three Legal Issues

According to its Articles of Agreement, some of the IMF's primary purposes are[19]:

i) To "promote international monetary cooperation";
ii) "to facilitate the expansion and balanced growth of trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and the development of the productive resources of all members";
iii) to "assist in the establishment of a multilateral system of payments in respect of current transactions"; and
iv) to provide financial resources to member countries experiencing balance of payments difficulties so that they can overcome these difficulties without resorting to measures that are destructive of international or national prosperity.

As was explained above, the IMF, in implementing this mandate, developed the principle of uniformity. This principle results in the IMF granting all states equal access to its financing and other services without drawing any distinctions between its member states based on their wealth, size, level of development, or importance in the international monetary system. Thus, unlike the World Bank, the WTO or the United Nations, the IMF does not divide its membership into different categories based on their wealth or level of economic development. The uniformity principle has had the effect of protecting the richest countries from having to grant special treatment to developing countries in the use of the IMF's general resources. It has also offered developing countries some protection against being discriminated against by the richer member states[20].

The Articles of Agreement also require the IMF, when conducting its annual consultations with its member states and when designing the conditions it attaches to its funding, to pay due regard to social and political conditions in the country.[21] The IMF has historically interpreted this requirement as prohibiting it from being influenced by political (that is non-economic) considerations in its dealings with its member states.[22]

These two interpretations of its legal mandate pose a number of problems for the IMF. First, the principle of uniformity made sense when the IMF functioned purely as a monetary institution and all its member states, in fact, were utilizing its services. However, it does not make sense when its services are only being utilized by its developing country member states. An example of the problems that this creates is the Enhanced Structural Adjustment Facility, now

19 *See* IMF ARTICLES, *supra* note 6, at art. I.
20 A good example of how the uniformity principle worked in favor of developing countries is the original decision to allocate SDRs among all member states according to their quotas rather than to limit it to the richest countries. *See* GOLD I, *supra* note 10, at 469-470.
21 *See* IMF ARTICLES, *supra* note 6, at art. IV, § 3.
22 See Gold

renamed the Poverty Reduction and Growth Facility (PRGF). When the IMF decided that it needed to create a special facility exclusively for the poorest of its member states, it could not do so with its general resources but had to create a special fund for this purpose. Since this requires contributions from all member states, the PRGF has inevitably become politicized, subject to multiple demands and, as indicated by the external review of the Enhanced Structural Adjustment Facility, impaired in its functioning.[23] This suggests that the IMF would be better off if it could treat different categories of its member states differently in regard to all its services and resources. For example, it would enable the IMF to more easily design facilities that are only suitable for certain member states. It would also allow it to consider whether or not it needs to restructure some of its decision-making procedures to make them more responsive to the needs of its poorer and weaker member states.

Similarly, the IMF's interpretation of the requirement that it pay due regard to social and political conditions in its member countries may have made sense when the IMF's operations were limited to monetary issues. However, it is neither prudent nor principled for an organization that attaches conditions to its funding that relate to governance, corruption, budgetary allocations and privatization to pretend that it should not be influenced by social and political considerations. The only function that the current interpretation serves is to obscure what political considerations the IMF does view as relevant to its operations, what principles it applies in making these judgements and what process it follows in reaching these decisions. The lack of clarity on this issue also leaves undefined the outer limits of the IMF's specialized economic mandate[24].

A good example of the problems that can arise in this regard are human rights issues. There are occasions when the IMF will take human rights into account, for example in Indonesia in 1997. But there are also occasions in which it does not do so, for example in Mexico in 1994 or in Turkey in 2000. In all three of these cases the country was experiencing serious human rights problems. Furthermore, it is not clear that in Indonesia the human rights problems themselves were worse than in the other two cases or that they were causing more serious economic problems than in the other cases. However, since there are no clear principles that stipulate how the IMF should incorporate "political" issues like human rights into its calculations. Without such principles, the decisions of the IMF appear arbitrary or determined by the interests of its richer and more powerful member states. This inevitably undermines confidence in the fairness of the IMF.

A third legal problem for the IMF arises from the IMF's characterization of the legal nature of the standby arrangement through which it provides much of its financing to its member states. The standard documentation used in these transactions are a letter of intent, usually written by the government of the member state to the IMF, and the decision of the IMF's Executive Board. For many years the IMF has argued that this arrangement is *sui generis* and is not a legal contract[25]. Consequently, the IMF does not treat the arrangement as an international

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23 *See* EXTERNAL EVALUATION OF ESAF, *supra* note 4.
24 *See* Bradlow, *supra* note 7, at 66-70.
25 *See* GOLD I, *supra* note 10, at 52, 464-66.

agreement. This means that a member state that does not meet the performance criteria or other requirements of the standby arrangement will not incur any legal liability. Until recently, the IMF also relied, in part, on this characterization to avoid publicizing the member state's Letter of Intent[26].

The IMF's formalistic interpretation of the nature of this transaction had a certain utilitarian value when the IMF functioned as the manager of the par value system, and the conditions attached to the financing included a change in the par value of a currency. It is not, however, clear that the same considerations apply to its current development functions. In fact, the IMF seems to have recognized as much. In recent years, as part of its efforts to promote transparency, it has encouraged its member states to publish its Letter of Intent to the IMF[27]. Nevertheless, the IMF has not yet reviewed its decision regarding the nature of the transaction. The result is that the transactions are still not viewed by the IMF as contractual and, therefore, are still not considered as international agreements. This is problematic for two reasons. First, if the arrangements, like World Bank contracts, were classified as international agreements they would be registered with the United Nations and would become public documents[28]. Consequently, the IMF could require, rather than encourage, member states to publish these Letters of Intent. This would more effectively advance the IMF's goal of promoting transparency than the current arrangements.

Second, as IMF transactions become more complex and the IMF increases the number of conditions it attaches to its standby arrangements there is a greater need for these agreements to be subjected to predictable principles of interpretation. The reason is that, when dealing with conditionalities related to governance, for example, it is possible for disagreements to arise about what constitutes sufficient compliance with the conditions of the standby to justify allowing the country to obtain the next tranche of the funds. If these transactions were viewed as international agreements, they would be subject to public international law rules for interpreting international agreements[29]. Under the current IMF view that the transactions are *sui generis*, there are no obviously applicable rules of interpretation. Consequently, the transactions are amenable to *ad hoc* and arbitrary interpretation. This reduces our ability to hold either the member state or the IMF accountable for the execution and interpretation of these Arrangements.

B. Relations Between the IMF and The Industrial Countries

Since the adoption of the Second Amendment to the IMF Articles of Agreement in 1978, the industrial countries have relied on their own resources and the private financial markets to

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26 See *id.*
27 For the text of IMF agreements, see http://www.imf.org
28 *See* U.N. CHARTER art. 102 (1945).
29 These rules would include the Vienna Convention on International Agreements and the Vienna Convention on Agreements Between International Organizations and States (not yet entered into force). *Also See* GOLD I, *supra* note 10, at 446-447.

meet their financial needs. They have in effect concluded that the IMF is not a politically or economically feasible source of funds for them. The embarrassment of having to accept the conditions attached to IMF financing is viewed as politically unacceptable to these countries and financially too costly in terms of its impact on their future access to private financial markets.

The fact that these countries do not intend using the IMF's financing facilities has freed them from any need to defer to any advice the IMF may offer them in their annual consultations. This means that they are free to choose their own exchange rate system and manage (or mismanage) it as they choose. In other words, they have regained from the IMF the sovereignty that they surrendered to the IMF at the Bretton Woods Conference in 1944.

This does not, however, mean that they have regained full monetary sovereignty. The world's economy has become too integrated for that. Instead these countries, particularly the G-7, have, in effect, agreed to resolve all monetary and financial issues that may arise between them in an alternate set of international fora. These issues are now resolved through the G-7, the Organization of Economic Cooperation and Development (OECD), the Bank for International Settlement (BIS) and the Committee of Bank Regulators associated with it and the International Organization of Securities Commissions (IOSCO).

When these are not deemed adequate, the G-7 have been willing to create additional fora. For example, after the Asian financial crisis and the near bankruptcy of Long Term Capital Management, the G-7 became concerned about the regulatory framework for the international financial markets. These countries decided that they needed a mechanism through which they could coordinate national regulation of financial markets and financial institutions. Consequently, they created the Financial Stability Forum[30] in which the regulators of the banking, securities and insurance industries of major industrial countries and financial centers meet together with representatives of the IMF, the World Bank and the BIS to discuss regulatory issues of mutual concern. They also created the G-20[31], which consists of the G-7 plus some

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30 For information on the Financial Stability Forum, see http://www.fsforum.org ("The Financial Stability Forum (FSF) was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The *Forum* brings together . . . national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts."). The members of the FSF are: Australia, Canada, France, Germany, Hong Kong, Italy, Japan, Netherlands, Singapore, United Kingdom, and the United States.

31 For information on the G-20, see http://www.g20.org/indexe.html (describing the G-20 as an informal mechanism for dialogue among systemically important countries within the framework of the Bretton Woods institutional system). "The G-20 promotes discussion, and studies and reviews policy issues among industrialized countries and emerging markets with a view to promoting international financial stability." The members of the G-20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, and the United States.

Id.

other key industrial and emerging market countries. The purpose of this group is to ensure that the regulatory frameworks existing in all countries that participate in the international financial markets are consistent with the demands of the increasingly integrated international financial market.

Since the industrialized countries that participate in these fora have no need for the IMF's services, it is reasonable to question the purpose of having the IMF participate in the meetings of these fora. It would seem that the IMF's function is to ensure that those countries not invited to participate in these fora undertake the necessary economic and regulatory adjustments to enable them to participate in the international financial system being shaped by the richest and most powerful countries.

Similarly, the G-7 have continued to support the IMF because they find its influence over poor countries and middle income countries undergoing transformations or experiencing serious debt problems useful. In particular, they appreciate its ability to compel these countries to adopt stabilization and adjustment policies that the G-7 deem acceptable. They also support its role as the crisis manager in countries experiencing debt problems. In short, they value having an international organization that can focus on the problematic areas of the global financial system while they are free to shape that system to suit their own needs.

The wealth and independence of the industrialized countries, particularly the United States, Japan, Germany, Great Britain and France, also ensures that they are the dominant force within the decision making structures of the IMF. Their dominance is significantly enhanced by two developments that have occurred in the IMF since its formation in 1944. The first relates to the composition of the voting rights of each member state. Each state's vote consists of 250 basic votes plus 1 vote for each SDR 100,000 it contributes to the IMF's general resources. The basic vote is intended to reflect the general principle of the sovereign equality of states. The remaining portion of the vote is intended to reflect the size of the country and its importance in the world economy. Since the establishment of the IMF in 1946, the number of total votes in the IMF have been increased due to the IMF membership growing from 39 in 1946 to 182 today and the need to expand the total resources of the IMF. However, there has been no change in the basic vote. The result is that today the basic votes forms a significantly smaller portion of the total vote than was the case in 1946. In 1946 the basic votes accounted for 11.3% of the total vote. By 1982 they only accounted for 5.6%. Today the basic vote accounts for only 2.2% of the total vote. This means that the portion of the IMF's voting system that offered the smaller and weaker states some counterweight to the dominance of the richest and biggest countries in the IMF has been reduced in importance and the dominance of these richer and bigger countries has been enhanced[32].

The second development is that the number of IMF Executive Directors has grown more slowly than the number of IMF member states. The original 39 member states were represented by a 12 member board of directors. Today the 182 members are represented by a board of 24

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32 This information has been derived from IMF Annual Reports. *Also see* GOLD I, *supra* note 9, at 292-294.

members. Originally, only the 5 biggest shareholders had their own executive directors and the remaining 34 member states were represented by the other 7 directors. This meant that each of these 7 directors represented on average slightly less than 5 states. Today, of the 24 member Board, in addition to the 5 executive directors representing the five largest shareholders another 3 directors represent single countries. Thus, today 16 directors represent the remaining 174 member states. This means that each of these directors represents on average slightly less than 11 states. In fact, some executive directors, for example the two directors representing sub-Saharan Africa, represent considerably more than 11 states[33].

This change in the average size of the constituencies represented by the executive directors has an important impact on the power relations in the IMF's decision making process. It means that those states that have permanent representation on the Board have a distinct advantage in having their views heard in the Board and also in developing expertise in how to function effectively in the IMF. It is unlikely that a director who represents 10-11 states can advocate for the views of each of those states as effectively as a director who only represents one state. It is also unlikely that such a director can play the same active role in policy issues in the IMF as an executive director who represents only one state can play.

The influence of the industrialized countries on the IMF Executive Board is further enhanced by the fact that in all 6 cases in which an Executive Director represents both developing and industrialized countries, the Executive Director is always from an industrialized country[34]. The result is that of the 24 directors, 11 are from industrialized countries. Each of the G-7 countries always has a national of their country on the Executive Board, despite the fact that only 5 of the 7 countries have appointed Executive Directors. The net effect of this development is that on balance, the G-7 countries and the other industrialized countries have an even larger influence over the institution than their voting domination alone would suggest.

The numerical advantage of the industrialized countries on the Executive Board and the permanency of the G-7's representation is significant even though the Board always operates by consensus. The reason is that these countries, because of their permanent presence on the Board, are able to develop institutional memories and expertise in how to function in the IMF. This enhances their ability to negotiate effectively and to shape the issues and the decisions around which the consensus must form[35].

The result is that, *de facto*, the G-7 countries control the policy agenda in the IMF. However, because these countries are effectively independent of the IMF, they never have to live with the consequence of the policies that they make for the IMF's operations. This means that

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33 See, IMF SURVEY, Special Supplement, September 2000 (for list of Executive Directors and their constituencies); Ngaire Woods, "Governance in International Organizations: The Case for Reform in the Bretton Woods Institutions" in INTERNATIONAL FINANCIAL AND MONETARY ISSUES (UNDP, 1988)
34 See, IMF SURVEY, *supra,* note 33.
35 *See* Ngaire Woods, Ngaire Woods, "Governance in International Organizations: The Case for Reform in the Bretton Woods Institutions" , supra, note 33; Woods, Globalization and International Institutions, *in* THE POLITICAL ECONOMY OF GLOBALIZATION, *supra* note 31, at 208-209.

they can make policy that is only of limited interest to their own citizens. The policy is, of course, of immense interest to people in developing countries who have no ability to hold them accountable for their decisions or actions. This situation of decision makers having power with accountability to people who do not have to live with the consequences of their decisions but without accountability to those most affected by their decisions is a situation ripe with potential for abuse.

C. Relations Between the IMF and Its Consumer Member States

Since 1978 all the states which have utilized the financial services of the IMF are developing countries or the so-called transitional countries. For present purposes these countries can be divided into two groups. The first group consists of those countries that are classified as emerging markets and, under normal circumstances, have access to private financial markets. Many countries in this group need the IMF's support to satisfy private investors that they have adopted and are implementing good macroeconomic policies and that they are “suitable” for private investment. Thus even though this group of countries only needs IMF funding when they are unable to raise sufficient funds from private sources because of a debt or some other financial crisis, they are dependent on the IMF giving their economic policy performance a favorable review. This in turn is influenced by how they respond to the advice the IMF gives them in their annual consultations. Mexico, Argentina, Russia, and Thailand are examples of this group of countries.

The second group consists of those countries which because of their poverty or unstable political conditions are dependent on official sources of funds. This group, in addition to needing the IMF's financial support, depends on the IMF's approval of their policies because their other official funders tend to rely on the IMF's advice in making their funding decisions. Uganda, Malawi, Haiti, Laos are good examples of countries in the second group.

In addition to being a source of funds for all the consumer member states, the IMF has effectively become a gatekeeper who regulates access to other possible sources of external financing for these countries.

While there are significant differences both within and between the countries in these two groups of IMF consumer states, they all share a common characteristic. Although the challenges that these countries face have a macroeconomic dimension, the primary cause of their social and economic, including macroeconomic, problems lies in the governance of their societies. In particular their problems are caused by weaknesses in their institutional arrangements and technical capacities which limit their ability to effectively make and implement policy[36]. Although these structural issues are outside the scope of the IMF's specialized area of

36 *See*, for example, THE WORLD BANK, CAN AFRICA CLAIM THE 21ST CENTURY? (2000); THE WORLD BANK, WORLD DEVELOPMENT REPORT: THE STATE IN A CHANGING WORLD (1997).

competence it has attempted to address them[37]. This means that increasingly in both its policy advice and in the conditions that it attaches to its financing, the IMF is addressing non-monetary and non-macro-economic issues like bankruptcy laws, legal and judicial reform, allocations of public budgets, privatization, environmental issues, social safety nets, and banking reform. The specificity and micro nature of these requirements highlight the evolution of the IMF from a monetary institution to a development financing organization.

The broadening range of its interests and the increasing specificity of IMF advice during its annual surveillance missions and in the conditions it attaches to the funding it provides to these developing countries, is changing the nature of the relationship between the IMF and these countries[38]. It is turning the IMF into an important actor in the policy making process of its member countries. In the days of the par value system, the IMF limited its influence over national policy making by concentrating its advice and the conditions attached to its finance to specific macroeconomic variables. This imposed a restraint on the IMF's involvement in domestic policy making because it left the member state's government free to decide on the actual measures needed to achieve these macroeconomic targets. The increased range of issues the IMF considers and the specificity with which it addresses these issues means that the restraint has now been removed. The result is that the IMF has now become an active part of the policy making process of its developing country member states. Given the important influence it has over these countries' access to external financing, the IMF is often the decisive voice in these countries' policy-making processes.

The combination of the IMF's gate keeping functions and its *de facto* role in national policy-making further tips the balance of bargaining power in favor of the IMF in both the annual consultations and in the negotiations over the policy conditions to be attached to IMF financing. Moreover, given the dominance of the G-7 and the other industrialized countries in the IMF, there is a significant risk (that has often in fact been realized[39]) that these countries will use the IMF to impose their views of good political and economic policies on the developing countries. In fact, many people in developing countries already see the IMF more as a political organization that is biased in favor of the rich countries and their interests than as the technically specialized and politically neutral organization that it was intended to be.

The IMF's expanded role in its developing country member states has also changed the range of actors with whom it must directly interact in these states. Prior to 1978, the IMF could reasonably limit its direct interactions to the makers of monetary and macroeconomic policy in

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37 *See* Bradlow, *supra* note 7, at 66-72; , Devesh Kapur, *The IMF: A Cure or a Curse?*, FOREIGN POL'Y (June 1998) (hereinafter *The IMF*); Devesh Kapur and Richard Webb, *Governance Related Conditionalities of the International Financial Institutions*, G-24 Discussion Paper Series No.6 (2000); THE POLITICAL ECONOMY OF GLOBALIZATION, *supra* note 33**.**

38 *Id.*

39 *See* Kapur, *The IMF, supra* note 38, at 98 (quoting a supporter of the IMF in the U.S. Congress: the IMF "is in fact one of the best possible deals we could ever imagine: Its programs cost us nothing yet it provides enormous benefits for out economy and our foreign policy")

the member states, namely to the Central Banks and the Ministries of Finance[40]. Today, however, the IMF's operations directly affect many, if not all, government ministries and the lives of all those people who will be governed by the policies that the IMF helps make. This means that it is no longer feasible for the IMF to limit its interactions to the Central Bank or the Ministry of Finance. In fact, without directly interacting with a broader range of both governmental and non-governmental actors in the member states, the IMF is unlikely to obtain all the information it needs to play an effective policy making role. For example, it needs to consult with government ministries whose budgets and policies will be affected by the IMF's funding conditionalities. It also needs to consult with the legislators who must pass the laws that the IMF policies require. To be an effective and credible policy maker, the IMF also should hear the views of all those stakeholders who will be affected by the specific policy decisions it is influencing. These stakeholders have the ability to influence the success or failure of those policy decisions. To date, the IMF, utilizing informal procedures has consulted with some of these actors. However, it has not yet developed formal procedures for ensuring that all relevant stakeholders are consulted.

The principles of good governance that the IMF advocates require that all players in the policymaking process should be held accountable for their actions and decisions. To date, the IMF has not established any mechanism through which the citizens of these member countries or the governments of these countries can hold the IMF accountable for its actions in the policy making process. In other words, the changes in the IMF's functions have resulted in the IMF acquiring great power over, but being effectively unaccountable to its developing country member states or their citizens.

D. IMF Relations with the Citizens of its Member States

The creators of the IMF, like the creators of most international organizations, believed that it was not necessary for the IMF to have any direct interaction with non-state actors. This belief was premised on the sovereignty of its member states. It was also based on the belief that for the IMF to effectively perform its specialized monetary responsibilities it only needed to interact with each member state's Central Bank and Ministry of Finance. Restricting the IMF's interactions with its member states to these two institutions had the added benefit of reinforcing the limits on the extent to which the IMF could impinge onto the sovereignty of its member states.

The creators of the IMF also assumed that they had built sufficient accountability into the IMF by making sure that it would be accountable to its member states' governments through their representatives on the Board of Governors and the Executive Board. The creators also assumed that these representatives could be held accountable by their governments and, through elections, by their citizens. This indirect form of IMF accountability to non-state actors was deemed to be sufficient.

40 *See* IMF ARTICLES, *supra* note 6, at art. V, § 1.

These beliefs about the relationship of the IMF to non-state actors are no longer valid. Given, as was shown above, that the IMF is now an active participant in the policy making processes of those member states that utilize its resources, it is no longer adequate for the IMF to limit its interactions to their Central Banks and the Ministries of Finance. For the IMF to be an effective actor in the policy making process it must consult with both other governmental agencies and non-governmental actors. This means that the IMF is now effectively entering into direct interactions with non-state actors and the policies it is helping to make are directly affecting these non-state actors.

If nothing else, the basic principles of good governance which the IMF advocates so eloquently to the governments of its member states should determine its conduct towards those directly affected by its policy-making activities. After all, there is no obvious reason why the IMF, when it "descends" into the national policy-making process should be less accountable to those people directly affected by its decisions than other actors in this process. This means that the IMF needs to offer the citizens of its developing countries a formal means for holding the IMF accountable for *its* actions in the national policy making process. It is no longer sufficient for the IMF to assume that it can rely on indirect forms of accountability to these non-state actors. To be sure there may be practical difficulties in designing an accountability mechanism that is suitable for an international organization and respectful of the member state's sovereignty. However, these problems have been dealt with in the case of the World Bank and there is no reason why they could not be overcome in the case of the IMF[41].

The IMF's lack of accountability is exacerbated by the fact that the IMF Executive Board does not provide much guidance on how the management should conduct itself in the national policy making process. Unlike the World Bank, the IMF does not have a publicly available operations manual that contains its operating rules and procedures. Such a manual would inform interested persons about how the IMF conducts its business and could be used by them to hold the IMF management accountable for its actions and decisions. The effect of the lack of such a document is to grant the IMF management and staff great discretion in its operations.

The developing countries and their citizens are unable to effectively limit the staff and management's discretion. While the Executive Board is the most appropriate body for controlling the management, as we have seen above, the consumer states are imperfectly represented on this body. Furthermore, it is unrealistic to assume the citizens of the consumer states can hold the IMF accountable through their representative on the Board of Governors. There are two reasons for this. The first is that this is not the appropriate body in which to challenge individual operational management decisions and the way in which these decisions were made or their effects. Second, even if this were possible, it is not realistic to assume that the state's IMF Governor will be willing to raise their complaints or those of its citizens in this way. This is particularly relevant in the case of IMF consumer states because of their governance problems.

41 The World Bank has established the Inspection Panel partly for this purpose. *See generally* Daniel D. Bradlow, *International Organizations and Private Complaints: The Case of the World Bank Inspection Panel*, 34 VA. J. INT'L L. 553 (1994); IBRAHIM F. I. SHIHATA, THE WORLD BANK INSPECTION PANEL: IN PRACTICE (2nd ed., 2000).

Almost by definition, this means that the mechanisms through which people can communicate their views to their own government, can participate in their own government's policy-making, and can hold their own government accountable for individual decisions are imperfect. It also means that often they will not have access to the information necessary to persuade the government to act on their behalf.

It is also unrealistic for the IMF to assume that the citizens of all its developing country member states can hold their governments accountable for the conduct of the state's relations with the IMF. As was discussed above, the primary problem in most developing countries is governance. This means, inter alia, that the mechanisms through which the people can communicate their views to the government are unlikely to function effectively and the people are unlikely to have access to the information needed to make an informed opinion about the government's conduct of its relation with the IMF. This means that, in fact, the ability of the people to hold their governments accountable for their dealings with the IMF is likely to be impaired or non-existent. It is also not realistic to assume that the electorate will always make its voting decision based only on the way in which the government managed its relations with the IMF.

There are other problems that arise because the IMF has no formal channels through which it can communicate with non-state actors in its member states. Under the current operating principles, the IMF, out of respect for the sovereignty of its member states, only communicates with non-state actors in a member state if it obtains the consent of the government to do so. In some cases governments do not agree to the IMF having unrestricted access to non-state actors. This means that in many cases the IMF does not actually meet with the full range of non-state actors in its member states. Consequently, it is at high risk of making policy decisions for the country on the basis of inadequate information about the likely reception that the policies will receive in the country and their chances of success.

The IMF's current approach to communications with non-state actors may have made sense before it assumed such an active role in the policy-making process of its member states. However it does not make sense given the expanded role that the IMF is playing in its developing country. This new role requires direct communication with non-state actors. The IMF's failure to establish formal communications mechanisms which are independent of the government has an adverse impact on the IMF's policies and its relations with the citizenry of these countries. They come to see the IMF as unapproachable and as an elitist, ideological institution that is uninterested in learning about the views of those who will be most affected by its policies.

Another dimension to the IMF's changing relationship with the citizens of its member countries is the impact of its changed activities on its relations with the citizens of its industrialized member countries. The citizens of these countries are not directly affected by the actions of the IMF. However, many of them, acting usually through NGOs, see themselves as being indirectly affected by the IMF's operations. They argue that it is their taxes that support the IMF and that, currently, these taxes are being spent to support policies and operating principles that they oppose. Consequently, these citizens have begun demanding changes in the operations of the IMF and have lobbied their governments to push for these changes in the IMF. The industrialized country NGOs have also used their access to their own governments and to the media in the industrial world to raise the concerns of their partners in the developing countries. These NGOs have had some success in influencing the IMF. For example, the involvement of the IMF in the environment, its activities in regard to corruption, military expenditure, debt relief, and poverty are all attributable, at least in part, to the campaigns of non-state actors in industrialized countries. Ironically, the influence of these NGOs in the IMF is attributable in part to the disproportionate influence and power of the industrialized countries in the IMF.

It can therefore, be seen that the IMF's increasing role in the policy making process in its developing country member states and its lack of accountability to those affected by this role is causing it to have tense relations with non-state actors in both its developing and developed member states. The failure of the IMF to address the causes of these tensions is leading many non-state actors to question the fairness of the IMF. The failure of the IMF to adequately address this perception is leading some of these non-state actors to even begin questioning the legitimacy of the IMF. The significance of these developments can be gauged from the impact non-state actors have had on the ability of the IMF to obtain funding from key member states, such as the United States[42] and from the demonstrations against the IMF at its 2000 Spring meeting in Washington and its annual meeting in Prague in fall 2000.

E. The IMF's Relations with Other International Organizations

The original conception of the creators of the specialized agencies of the United Nations system was that each agency would exercise its authority within the limited scope of its specialization and that the U.N. Economic and Social Council would be the forum in which their activities would be coordinated. Each specialized agency, in part to facilitate coordination, entered into a relationship agreement with the United Nations. This relationship agreement ostensibly clarified the fact that the specialized agency was subordinate to the United Nations and clarified how it would relate to the UN. The relationship agreement between the IMF and the UN[43] however amounts in effect to a declaration of independence. While it acknowledges that the IMF is a specialized agency of the UN, it relieves the IMF of any significant responsibilities to the UN and denies the UN any meaningful role in the affairs of the IMF.

The effective independence of the IMF from the UN has become a problem as the scope of the IMF's operations has expanded beyond its original monetary function. Now that the IMF is involved in such issues as law reform, poverty alleviation, labor issues, social welfare,

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42 *See*, for example, the complex range of conditions that were attached to the U.S. legislation authorizing the U.S. to participate in the most recent IMF quota increase. The legislation was only passed after intense debate and a great deal of lobbying. *See* Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, §§ 597(b), 602, 610 – 612, 112 Stat. 2681

43 *See* Agreement between the United Nations and the International Monetary Fund, entered into force 15 November 1947, 109 U.N.T.S. 340.

environment, and trade liberalization, its operations are encroaching into the jurisdiction of other specialized international organizations like the World Bank, the WTO, the ILO, WHO, and UNICEF.

IV. Problems Created by the Five Distortions

The five distortions discussed above are creating a number of problems for the IMF. The most significant of these problems are discussed below.

A. The Disconnect Between Power and Responsibility

As was discussed above, the industrialized countries, particularly the G-7, have accumulated great power in the IMF even though they are not interested in the services of the IMF for themselves. This enables them to make policy for the IMF without having to live with the consequences of the IMF's policies and actions. Consequently, most of their own constituents have little interest in the IMF or its policies and limited incentive to support their government's financial contributions to the IMF. The governments of these countries, therefore, are free to develop their policies for the IMF without paying appropriate attention to the concerns of the developing countries or to the situations in which these policies must be implemented. The most prominent example of this reality is the debates in the United States Congress about the IMF. In addition, this situation amplifies the voices of those NGOs who have an interest in the IMF and other international development issues. While many NGOs have utilized this situation to achieve a great deal of good, the reality is that they, like their governments, can influence the policy of the IMF without having to live with the consequences of their proposals.

One result of this situation, is that proposals that impose substantial burdens on already overloaded developing country governments or that make unrealistic assumptions about the access of these countries to private financing are able to receive serious consideration. For example, the U.S. government and the Congress seem to believe that developing countries in financial difficulty, even though a major cause of their problems are deficiencies in their governance arrangements, can implement complex adjustment programs in relatively short periods of time[44].

B. The IMF's Lack of Accountability

The IMF still operates on the erroneous assumption that its existing channels of accountability are sufficient. The IMF structure provides for two channels of accountability: the IMF's Board of Executive Directors, and the Board of Governors. The Board of Executive Directors are not an adequate channel of accountability to those member states most affected by the IMF's actions for three reasons. The first is that, as we have seen, most consumer member states are only indirectly represented on it. In fact, the link between each consumer member state and the Executive Director who represents it on the Executive Board has weakened as the

44 *See*, for example, Omnibus Consolidated and Emergency Supplemental Appropriations Act, *supra*, note 42.

number of countries each Executive Director represents has grown. Second, the Executive Directors from the key supplier member states dominate the Board.

The third reason is that IMF programs have become too numerous and complex for the Executive Directors to be able to exercise firm oversight over the staff. The Executive Directors representing the consumer states do not have sufficient staff or time in the day to adequately understand all the programs in which the IMF is involved. Nor do they have the capacity to play an active role in making operational policy for the IMF and in dealing with the numerous organizational issues that the Board of any organization as complex as the IMF must address. The result is IMF staff and management are making decisions about IMF programs and are interpreting IMF policies without any substantive accountability to IMF consumer member states. For example, it is the management and staff who design the conditions attached to IMF financing for a country and who make the decision that the country has sufficiently complied with the multiple conditions attached to IMF financing to warrant asking the Board to release the next tranche of IMF funding.

The Board of Governors is also not a sufficient channel of operational accountability even though each member state is represented on it. The Board, which only meets once a year, is the highest body in the organization and is not the appropriate body to deal with the operational issues that may arise in the relationship between the IMF and a consumer member state. Furthermore, even if the Governor from a consumer member state were willing to raise an operational issue in the Board of Governors, it is unlikely that they would have adequate knowledge of the impact of the IMF's policies and program in his/her country on its citizens. The reason for this is that these countries suffer from governance problems which mean that they are unlikely to have adequate channels of information about these impacts.

The problems in the existing channels of accountability have three important operational implications for the IMF. The first is that the IMF staff and management are effectively operating without any accountability. However, if the IMF staff are making policy in the member states, there is no obvious reason why they should be less accountable to those affected by the policies than the other participants in the policy-making process. In fact, it undermines the IMF staff and management's credibility when they advocate accountability as an aspect of good governance in its member states but do not apply the principle to themselves.

The second is that the IMF does not provide much guidance to the staff on how they should perform their responsibilities when they act in this policy-making capacity. For example, it does not clarify to whom they owe their primary responsibility, what obligations they owe to those affected by the policies, what factors they should consider in making decisions in this process etc. The lack of such guidance results in each staff member or mission team exercising great discretion in their policy-making activities in each member country. It also makes it hard to hold the staff accountable. In this regard it is important to note that, unlike the World Bank, the IMF does not have an operational manual that contains the detailed operational policies and procedures that its staff should follow in the conduct of their duties.

Third, the IMF is performing its policy-making functions without establishing any formal mechanisms through which those non-state actors most affected by its actions can communicate directly with the IMF. In fact, the IMF is not unaware of this problem and it often engages in informal communications with these affected parties[45]. However, this means that the IMF, in consultation with the government of the member state, is choosing with which non state actors it communicates and is setting the terms for this communication. A more formal procedure for communication with these non-state actors -- such as a requirement that all IMF missions hold a public hearing in the country they are visiting or an explicitly recognized right to make written submissions -- would ensure that many more interested non-state actors have a meaningful opportunity to communicate with the IMF. The IMF's failure to establish such procedures contradicts the principles of participation and the need for transparent governance procedures that it advocates to its member states. It also suggests that the IMF is often making policy without having access to all the relevant information.

Another aspect of the IMF's lack of accountability is its continued adherence to the principle of uniformity[46]. While it is important that international organizations treat all similarly situated member states equally, it is also important that it treat all member states fairly. Given the difference in the nature of the IMF's relations with the industrialized and developing countries it is no longer adequate to contend that since all states participate in the same international monetary system they all should receive uniform treatment. In reality, as discussed above, some IMF consumer states do not have access to the financial markets that the G-7 utilize. Furthermore, very few, if any, of the IMF consumer states are able to have any substantial input into the workings of the international monetary and financial systems or influence in its governance arrangements and institutions. This suggests that the uniformity principle has become a means of justifying unfair treatment for the developing countries. For example, it precludes the IMF from offering certain groups of member states disproportionately favorable access to its general resources or special considerations in its decision-making procedures.

C. The IMF and Other International Organizations

The expansion of the IMF's scope of operations has resulted in the IMF encroaching into the areas of responsibility of other specialized agencies. For example, the IMF is beginning to deal with budgetary allocations for health and education[47] but without involving the WHO or UNESCO in these activities. While in some cases the IMF may attempt to have communications with these organizations, there is no formal agreement designed to ensure regular communications at the staff level. The only specialized agency with which the IMF has a formal

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45 *See* for example, EVALUATION OF SURVEILLANCE, *supra* note 4; EXTERNAL EVALUATION OF ESAF, *supra* note 4.
46 *See* GOLD I, *supra* note 10.
47 *See* INTERNATIONAL MONETARY FUND, *Progress Report on the Heavily Indebted Poor Countries (HIPC) Initiative and Poverty Reduction Strategy Papers (PSRP) Program and Work Priorities in 2001*, at http://www.imf.org/external/np/hipc/2001/020601.htm.

arrangement is the World Bank[48]. The result of this situation is that the IMF is making policies and taking action in these new areas without necessarily having the technical expertise to do so and without adequate consultation with the appropriate specialized agency[49]. It may hire consultants to work on these issues, but it does not have in-house the expertise to evaluate the work of the consultants. This situation will continue until it either hires people with the necessary technical skills or establishes some sort of cooperative arrangement with the relevant specialized agencies. This creates a significant risk that the IMF will have inadequate policies in these areas or that it will assign a lower priority to these issues than may be appropriate in particular situations.

The UN specialized agencies' implicit acquiescence in the IMF usurping parts of their responsibilities also has adverse consequences for the functioning of the UN system as a whole. It is resulting in a concentration of power in organizations like the IMF and the World Bank. This exacerbates the IMF's tendency to maintain that it has the "correct" answer for the major development challenges that its member states face. The inability of other specialized agencies to effectively challenge the IMF's position increases the risk of the IMF giving wrong policy advice. Furthermore, the developing countries, because of the IMF's gate keeping functions, have no real choice but to follow the advice of the IMF.

D. Interpretation of Articles of Agreement

The IMF has not fully recognized that the expanding scope of its activities is calling into question its interpretation of its own Articles of Agreement. In particular, it raises questions about the limits on its permissible scope of activities and about the IMF's claim to be a "non-political" body. The IMF has failed to define the limits of its mandate or to stipulate a principled basis on which it determines what issues it is willing to address and which issues are outside its mandate because of their inherently political or non-economic nature. This failure makes it hard for outsiders to understand why the IMF is willing to address certain issues, for example human rights in Indonesia, but not other issues, for example human rights in Mexico in 1994 or Turkey. It also subjects the IMF to the charge that it is acting in an arbitrary and capricious fashion in interpreting its articles.

V. A Proposed Solution to the Problems Caused By the Five Distortions

There are three basic approaches that could be taken to resolving the problems with the IMF. The first is to conclude that the IMF is irredeemably flawed and should be abolished. The second is to conclude that the IMF is a necessary organization in today's integrated global

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48 *See* Jacques Polak, *The World Bank and the IMF: A Changing Relationship*, *in* THE WORLD BANK: ITS FIRST HALF CENTURY II 473 (1997).

49 *See generally* Daniel D. Bradlow & Claudio Grossman, *Limited Mandates and Intertwined Problems: A New Challenge for the World Bank and the IMF*, 17 HUM. RTS. Q. 411 (1995).

economy but that the policies that it advocates are flawed and must be changed. Implicit in this view is the belief that if the IMF changed its policies the distortions identified in this paper would loose their significance. The third approach builds on the second approach and argues that changes in the IMF's policies alone, while necessary, are not sufficient to ensure that the IMF will effectively fulfill its responsibilities in the world. It argues that policy reform is unlikely to be sustainable unless the IMF first undergoes substantial structural reform.

i) Approach 1: The IMF Should Be Abolished

There are two different groups who advocate this approach. The first argues that the market is the most efficient and best means for allocating resources and that all state interventions into the market merely impair its functions[50]. Consequently, they oppose all state sponsored interventions in the functioning of the market. From their perspective the operations of the IMF are merely a form of state intervention and are *per* se suspect. This group further argues that their only effect is to create a moral hazard problem. The IMF is accused of doing so by leading both investors and governments to believe that they can engage in excessively risky economic activities because the IMF will bail them out if they fail.

The second group are the opponents of the current power relations in the world. They contend that international organizations are merely a reflection of these power relations and that they will always be used by the rich and powerful nations to keep poorer and weaker developing countries in "their place". These groups also argue that developing countries would be better off if they followed more independent policies that did not rely so heavily on international organizations that are controlled by the G-7[51].

While the political perspectives of these two groups are clearly very different, they both believe that the IMF as currently constituted, is irredeemably flawed. Consequently, they agree that the IMF should be abolished. These groups can draw support for their position from the mutation of the IMF from a monetary organization into a development financing one. They can argue that the IMF's record as a development financing organization is not impressive, citing the controversial record of the IMF's involvement in Russia and in the countries that have used the IMF's Enhanced Structural Adjustment Facility as evidence[52].

These groups can also contend that if the IMF has no monetary role left to perform, why do we need two international organizations offering development financing services? They can

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50 *See*, for example, MELTZER COMMISSION, *supra* note 4; George Schultz et al., *Who Needs the IMF?*, WALL ST. J., at A22, Feb. 3, 1998.

51 *See, for example,* FIFTY YEARS IS ENOUGH*, supra, note* 4.

52 *See* EXTERNAL EVALUATION, *supra* note 4; EXTERNAL EVALUATIONS ON ESAF, *supra* note 4; Kapur, *supra* note 37; THE POLITICAL ECONOMY OF GLOBALIZATION, *supra* note 31; *The IMF: Doctor, Savior – Or Wastrel?*, BUS. WEEK, Dec. 28, 1998, 12 (criticizing the IMF for "throw[ing] $22 billion at an economic basket case like Russia . . . after billions had disappeared in that black hole before"). The article also discusses the IMF's involvement in Mexico in 1995. *Id.*

cite the fact that the World Bank exists to fund development and that there is already a great degree of overlap between the functions of the two organizations. Consequently, it would be more efficient to either merge the two organizations or shut down the IMF and let the Bank assume those development financing activities that only the IMF currently performs[53].

These critics can also point out that the industrialized countries, who as we saw above control the IMF, do not have any intention of allowing the IMF to become an effective manager of the international monetary system. In support of this position, they can offer the fact that when serious financial or monetary issues arise in the global economy, the rich countries have not turned to the IMF. Instead they have turned to the G-7, the BIS or the OECD. In addition, they have been willing to create new fora, such as the Financial Stability Forum or the G-20, whenever they see a missing element in their ability to control the international monetary and financial system. The only role they assign the IMF in these arrangements is essentially the developmental one of ensuring that the developing countries will be "structurally adjusted" to fit into the financial system that the industrialized countries are shaping.

While these arguments raise important issues and have persuasive power, they are ultimately unrealistic. The increasingly integrated global financial system needs international organizations which have the specialized mandate to help those countries that are either, *de facto*, not full participants in the global financial system because of their extreme poverty or that are experiencing difficulties in becoming a full participant in the global system. Even if the sovereignty of many of these states in fact is illusory, it is not politically or economically feasible for the richest and most powerful states to directly control them or to directly force all of them to adjust to their economic and political requirements. The industrialized states have also conclusively demonstrated that they are not willing and may not have the capacity to help these countries address the complex development challenges that they face. Furthermore, it is unrealistic to expect that private financial markets will be willing to fund important primary health and education projects in very poor or unstable countries on financially feasible terms. It is also unrealistic (and even of questionable desirability) to count on private investors to provide sufficient balance of payments support to governments facing serious monetary or debt crises. Consequently, there is an absolute need for international organizations that can fund development in the poorest countries, and work with emerging markets to help them gain secure and adequate access to the financial resources available from the international capital markets. There is also a need for international financial organizations that can provide a forum where the developed and the developing countries can communicate about issues of mutual concern relating to the global financial system.

This means that while it may be possible to abolish the IMF, it is not possible to eliminate the need for an organization like the IMF. It therefore is irresponsible to suggest abolishing the IMF, unless one can be confident that it is politically possible to create an alternate organization

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53 This position has been advocated by people other than those who are implacable foes of the IMF. *See*, for example, Raymond Mikesell, *Proposals for Changing the Functions of the International Monetary Fund*, Jerome Levy Economics Institute, Bard College, Working Paper No. 150 (1995).

that will effectively and equitably perform its legitimate monetary and macroeconomic functions. It is clear that the political conditions for creating new international organizations do not exist and are unlikely to exist in the near future. Consequently, the only option is to reform the ones that currently exist.

ii) Alternative 2: Change the Policies of the IMF

Those supporting this position accept that conditions have changed and that the IMF must change to fit the new conditions. They however believe that what must change is the substance of the IMF's policies and its *modus operandi*. Those who advocate for this position can be divided into two sub-groups. The first sub-group's argument with the IMF is over the expanding range of its operations. They contend that the IMF was established as a specialized organization with a mandate to focus on macroeconomic issues and that the IMF should not let its scope of operations expand beyond this set of issues[54]. In their eyes any conditions relating to issues such as governance, legal reform, or regulatory issues that the IMF attaches to its financing are illegitimate. These issues either fall within the mandate of the World Bank or within the sovereign prerogatives of the member state. This group therefore argues for a reduction in the scope of the IMF operations and a return to its original focus on macroeconomic issues.

The second sub-group's fight with the IMF is not so much over the scope of its operations but over the content of its policies. This sub-group argues that the IMF is insensitive to the impact of its policies on the poor, the environment, and human rights. Consequently, this group advocates for the IMF to adopt new policies that are more pro-poor, pro-environment and pro-human rights[55].

Those who criticize the IMF's policies for being insensitive to the poor and the environment share a problem with the IMF. They can also be criticized for not recognizing any clear limits on the permissible scope of IMF operations. The logical endpoint of their suggestions, and of the current IMF expansion, is that it will be the preeminent international organization with *de facto* authority over all issues related to economic and social policy and with great influence over such issues as human rights, environment and political process. As was suggested above, this great accumulation of power without any obvious checks or balances on its power is troubling and contrary to the principles of good governance.

Some members of this sub-group focus more on the economic content of the IMF's policies and the conditions that it attaches to its financial support than on its social and environmental impacts. For example, they argues that the IMF offers bad policy advice on such

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54 *See*, for example, Feldstein, *supra* note 4; Robert S. Browne, *Rethinking the IMF on Its Fiftieth Anniversary*, *in* THE WORLD'S MONETARY SYSTEM 1 (Jo Marie Griesgraber & Bernhard G. Gunter eds., 1996).

55 *See*, *See*, for example, FIFTY YEARS IS ENOUGH: THE CASE AGAINST THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND (Kevin Danaher ed., 1994); BLECKER, *supra* note 7; Omnibus Consolidated and Emergency Supplemental Appropriations Act § 610(a); FRIENDS OF THE EARTH, THE IMF: SELLING THE ENVIRONMENT SHORT (2000), at http://www.foe.org/imf/index.html

issues as exchange rate policies including exchange controls, capital controls, and budget deficits. Consequently, they call on the IMF to change the assumptions and economic model it uses in developing its policies towards its developing country member states and challenge the specific policy measures contained in individual agreements between the IMF and its member states[56].

This second approach is more realistic than the "abolish the IMF" approach. Its call for more critical assessment of IMF policies and the scope of IMF operations is important and needs to be heeded if the IMF's performance is to begin improving. In fact, any coherent approach to reforming and improving the IMF must include this as at least one element of the reform agenda. However, this "reform the policies" approach is ultimately inadequate. It is addressing the symptom rather than the real cause. The policies of the IMF arise from the power relations within the organization and from its policy and decision-making structure. Without changing these structural features, the IMF will always adopt policies that are heavily biased towards the interests of its industrialized member states and that are insufficiently responsive to the needs of its consumer member states. Thus, policy changes that leave the basic structural features of the IMF intact will ultimately fail to achieve their intended results.

iii) Alternative 3: Reform the IMF[57]

The third approach argues for a comprehensive reform program for the IMF which has as its primary focus correcting the structural problems with the IMF. This approach accepts the necessity for an inter-governmental financial institution like the IMF but contends that it must be structured and must function according to the same principles of good governance -- transparency, participation and accountability -- that the IMF advocates should apply at the national and sub-national level. This means that the IMF must be reformed so that its basic structures and operating policies and principles are transparent. In addition, those who are most directly affected by its policies and actions must be able to participate in the IMF's policy making processes and must be able to hold its decision makers accountable for their decisions and the actions based on those decision. It also means that there should be appropriate checks and balances on the power of the IMF. The proponents of this approach argue that if the structural problems with the IMF are corrected, the organization will be more responsive to the needs of its consumer member states and their citizens. This in turn should result in the IMF adopting more acceptable policies.

The appeal of this reform option is further strengthened by the reality of international power relations and the inherent difficulties of making changes at the international level. This reality leads to the conclusion that before we reject the existing international organizations we need to be confident that we have exhausted all feasible possibilities for reforming them. In the case of the IMF, very little effort has been made to reform it. Consequently it is relatively easy to

56 See Blecker, *supra*, note 7 at 39-53.
57 For an interesting overview of reform initiatives in the IMF, see Angela Wood, *Structural Adjustment for the IMF* (2001), at www.brettonwoodsproject.org.

identify a program of reform that has the potential to correct the problems identified in this paper.

Given the complexity of the nature of the relations between international organizations and their member states and the current hostility to international organizations in such key countries as the United States, it is likely that carrying out the structural reforms being advocated in this paper will be a long term project. However, it is possible to divide this reform program into short-, medium- and long-term proposals. The distinction between these categories is not only based on how possible it is to achieve these proposals but also on the basis of who must act to implement the reform proposal. Thus, short-term items are those which only require action by the IMF staff and Executive Board acting on their own authority. Medium term items are those that are more politically difficult and will require the participation of the Governors of the IMF. The third category are those items that will require amendment to the Articles of Agreement or at least will require the agreement of each of the member states, including the agreement of their legislatures. It should be noted that the IMF has begun to implement at least some aspects of the proposed reform agenda.

A. Short-Term Reform Agenda: Those Actions That the Managing Director and Board of Directors Acting on Their Own Authority Can Take

These actions can be divided into the following 5 categories:

1) **Actions to Make the IMF More Responsive to Its Developing Country Member States**:

a) Allow the member state's governor to the IMF or his/her representative to participate in any discussion in the Executive Board on the member state. This would include discussions about the staff report following the annual IMF surveillance mission to the country and about any proposed IMF program and financing for the country[58]. It should be noted that this reform is roughly analogous to the situation in the United Nations Security Council[59]. In this case, states who are not members of the Council but have a direct interest in the matter being considered by the Council can ask for permission to address the Council and participate in the Security Council discussions but not its vote. For many countries the issues being discussed about the country in the IMF Executive Board can be as momentous as those that can arise in the U.N. Security Council.
b) Give more resources to the Executive Directors representing IMF consumer countries so that they can more effectively represent their constituents[60].

58 *See* JOSE DE GREGORIO ET AL., AN INDEPENDENT AND ACCOUNTABLE IMF: GENEVA REPORTS ON THE WORLD ECONOMY (1999).
59 *See, eg.*, FREDERIC L. KIRGIS, JR., INTERNATIONAL ORGANIZATIONS IN THEIR LEGAL SETTING (2nd ed. 1993).
60 The IMF has begun to provide some more resources to the African Executive Directors.

c) Establish formal procedures for how the IMF will consult with non-state actors during its Article IV consultations with its member countries and when developing a program for any member state that wishes to use its financing facilities. This procedure should create a meaningful opportunity for non-state actors to submit information and express their views to the IMF.
d) Establish a formal mechanism through which non-state actors as well as civil servants who feel that they cannot safely or freely participate in any meetings that the IMF might hold with non-state actors can communicate with the IMF. This mechanism should enable such actors to make written submissions to the IMF. It would also provide a mechanism for communication with non-state actors in those states in which the government will not allow the IMF to meet with non-state actors.
e) Establish an IMF-NGO Liaison Committee in which a group of NGO representatives, elected on a regional basis, can meet on a regular basis with senior IMF staff to discuss issues of concern to NGOs and other non-state actors around the world[61].
f) The IMF should adopt a policy of publicly releasing drafts of all official reports and policies, redacted to remove all market sensitive information, and submitting them to public comment before the final reports or policies are adopted. The IMF has improved its information disclosure policy but it usually only releases final reports and policies[62].
g) An external review panel should evaluate the policies of the IMF to assess their impacts on poverty and the environment. This panel should also be charged with making recommendations on how the IMF, acting consistently with its mandate (see below) could improve its policies so that their potential to have a positive effect on poverty and the environment is maximized.

The soon to be established IMF Evaluation Office should perform this role[63].

2) **Actions to Make the IMF More Accountable:**

a) Establish a permanent and independent evaluation unit in the IMF. The IMF, in fact, is in the process of establishing such a unit[64].
b) Establish an ombudsman at the IMF who has the power to receive and investigate complaints from any person, organization, or state, that feels that the IMF has not been acting in conformity with its mandate. This official should have the power to publish an annual report that discusses the investigations he/she has conducted and to make recommendations to the Board of Directors on how to reform the functioning of the IMF[65].

61 The World Bank has had such a committee for a number of year.
62 For the IMF information disclosure policy, see <http://www.imf.org>. The IMF set an important precedent for releasing drafts of policies and procedures when it published its draft decision on establishing an independent evaluation office before the decision was taken by the Board to do so. Ultimately the Board decided to establish such an office and it is in the process of doing so.
63 *See* INTERNATIONAL MONETARY FUND, *Making the IMF's Independent Evaluation Office Operational* (Aug. 2000), at http://www.imf.org/external/np/eval/evo/2000/Eng/evo.htm.
64 *Id.*
65 See, Daniel Bradlow, "An Ombudsman for the IMF", Letter to WASHINGTON POST, September 24, 1999.

3) **Actions to Better Coordinate the IMF's Activities with Other International Organizations**
a) Establish an expert panel to review the IMF's relations with other international organizations and to make recommendations on how the IMF, acting in conformity with its limited mandate (see below), can most effectively coordinate its activities with these organizations.

4) **Actions to Better Match IMF Skills to the Tasks it Performs**:
a) Change the skill mix in the IMF to make it more suitable to the functions the IMF defines as within its mandate (see below). This will mean hiring more people with social science other than economics, expertise. This action will be less necessary if the IMF has better coordinated relations with other international organizations.

5) **Legal Actions**:
a) The Board of Directors, after a notice and comment period, should issue a decision defining the scope of the IMF's mandate.
b) The Board of Directors should abandon the principle of uniformity and should explicitly categorize countries according to their wealth and level of economic development.

B. Medium Term Actions: Those Actions That Require the Approval of the Board Of Governors

1) **Actions to Make the IMF More Responsive to its Developing Country Member States:**
a) The IMF should increase the number of alternate directors that can assist each director in more effectively representing the members of his/her constituency. Since this will lead to a more unwieldy board, the IMF may need to give thought to delegating more responsibility to Board committees.

c) The IMF should consider moving from its current practice of making decisions on the basis of consensus to making decisions on a basis that better reveals the preferences of those who will be most affected by the decisions. One possibility would be for the IMF to require separate votes by those Executive Directors who represent developing countries and those who represent industrialized countries. Any decision would only be adopted if it commanded a majority of both groups.

2) **Actions to Make the IMF More Accountable**:

a) The IMF should develop detailed operating principles and procedures. These policies and procedures should be made public. This publication would be analogous to the World Bank's operating manual[66]. This publication would detail the responsibilities of the IMF staff and the procedures that they should follow in each situation. The publication of this information would enable those people affected by the IMF's actions to understand how IMF policy is made and whether the IMF has acted in conformity with its own rules and procedures in all cases. It would also facilitate efforts by these people to hold the IMF staff accountable for their actions.

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66 *See*, www.worldbank.org.

3) **Actions to Improve the IMF's Relations with other International Organizations**:

a) Establish formal and more extensive links between the IMF and other relevant international organizations (eg. WTO, WB, UNICEF, WHO, ILO, etc.) at both the senior management and staff levels. These links should include regular meetings, staff exchanges, regular exchanges of information and reports and other publications, participation in joint missions to countries and formal agreements on the division of labor and responsibility between these organizations. It should also include a means for resolving any disputes that may arise between the parties.

b) The IMF should renegotiate its Relationship Agreement with the UN. The objective of this exercise would be to clarify the IMF's responsibilities to the UN and to enhance the ability of the UN to ensure the IMF fully respects the jurisdiction of other specialized agencies.

c) The IMF should establish an independent review commission, with members drawn from the institutions, the member states and non-state actors, to consider the optimal division of responsibilities between the IMF and the World Bank. One option that the commission should consider is defining their responsibilities not according to function but according to the level of wealth of the country and the type of financing sources on which it relies. Under this proposal the IMF would deal only with the problems of emerging markets that have access to private markets. The World Bank would have deal exclusively with countries that are dependent on official sources of funds. The issues of primary concern to industrialized countries would be addressed in other fora. The IMF and World Bank would only participate in these fora to the extent necessary to understand how the issues being discussed would affect their areas of responsibility.

C. Long Term Actions: Those Actions That Require Ratification By the Member States

1) **Actions to Make the IMF More Responsive to Its Developing Country Member States**:

a) Amend the Articles of Agreement to increase the basic votes to at least its original proportion in the total votes at the IMF.

b) Amend the Articles of Agreement to introduce a qualified voting procedure that ensures that in votes on policy issues, those countries that use the resources of the IMF vote separately from the industrial countries and the policy measure must obtain the support of a majority of both groups.

2) **Actions to Alter the Structure and Functions of the IMF to Recognize the Changing Responsibility of the IMF**:

a) Implement the findings of the independent review commission that investigated the division of responsibilities between the IMF and the World Bank.

VII. Conclusion

The IMF is suffering from serious structural distortions that have slowly developed since the Second Amendment to the Articles of Agreement. These problems create a substantial barrier to the effective functioning by the IMF. They can only be corrected through a broad ranging reform program that will overhaul the structure and operating principles of the IMF. Without undertaking this reform program, it is unclear if the IMF will ever be able to effectively make any useful contributions to solving the complex problems of poverty, inequality and inadequate governance which plague developing countries today.

Unfortunately the problems that exist in the IMF are only the most extreme version of a problem that exists in all international organizations. All those organizations that have great economic power in the developing world -- the World Bank, the regional development banks and the WTO -- share, although it may be in less extreme forms, the same problems. Those UN specialized agencies that lack adequate resources, influence and power-- such as UNESCO, FAO, UNICEF, WHO -- often suffer from the reverse problem. They lack influence and power because they are deemed to be too sensitive to developing countries. The result is that industrialized countries loose interest in them. If international organizations are to perform the global governance functions that were envisaged for them and if they are to play an effective role in dealing with the complex problems that exist in the developing countries and the extreme inequalities of power and wealth that exist between developing and developed countries, they will need to undergo their own reform programs, that will be complimentary to the one this paper proposes for the IMF.