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REFORMING THE INTERNATIONAL MONETARY FUND – WHY ITS LEGITIMACY IS AT STAKE

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ABSTRACT

The International Monetary Fund was designed to promote international monetary cooperation and foreign exchange stability, so as to facilitate international trade, high levels of employment and real income, and the development of the productive resources of all its members. However, the Fund's capacity to influence its key members' policies through its advice, and to give confidence to potential borrowers by offering opportune and meaningful financial assistance in case of trouble, has been seriously put into question. Its governance structure is inconsistent with its multilateral nature and is dysfunctional to its purposes. There is also an ideological bias in its policy advice that prevents the Fund from being responsive to citizens' concerns and challenges posed by globalization. The ongoing reform process is tinkering on the margins and if not redressed will fail to bring additional credibility and effectiveness to the Fund.

INTRODUCTION

The International Monetary Fund ('the Fund' or 'the IMF') serves its purposes by exercising surveillance on its members' economies, giving them policy advice and if necessary assisting those facing balance of payment (BoP) problems with short-term 'lending'.[1]

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[1] The Fund does not technically or legally 'lend' money to its members, although its financial support is normally described as such. The borrower 'purchases' reserve assets from the Fund with its own currency and the repayment is made by 'repurchasing' its currency from the Fund at a determined exchange rate. As this financial support from the Fund is not technically nor legally a loan, this could have relevance if the Fund's preferred creditor status is legally challenged (as it was) by other 'creditors' to a sovereign in arrears, claiming *pari-passu* treatment. For further understanding of the Fund's financing mechanism, please consult IMF General Department http://www.imf.org/external/pubs/ft/pam/pam45/pdf/chap2.pdf (visited 5 May 2007).

However, the Fund has lost its effectiveness. Its capacity to influence its key members' policies through its advice, and to 'give confidence'[2] to potential borrowers by offering opportune and meaningful financial assistance in case of trouble, has been seriously put into question. On the one hand, 'global imbalances'[3] indicate that the Fund has not been capable of persuading large members to follow its policy advice; whereas on the other hand, more and more emerging economies (precisely those that face higher capital volatility and that are therefore the Fund's potential borrowers), rather than relying on the Fund's 'multilateral insurance', prefer to self-insure by accumulating massive amounts of foreign reserves.[4] This is a costly option[5] which, among other causes, is explained by their lack of confidence in the capacity of the Fund to assist them financially. Moreover, many of these countries are also pooling their reserves in regional agreements[6] that may end side-lining the Fund.[7]

This is, in short, what we could categorize as the 'effectiveness deficit' of the Fund, which is in turn compounded and interlinked with a

[2] IMF, Article I (v) of the 'Articles of Agreement'.

[3] The US is running a current account deficit of approximately 6% of its national income (i.e. it spends far more than it saves). This requires a massive annual lending to the US, much of it coming from developing countries that run current account surpluses (i.e. save more than they spend) and who, rather than using these savings to invest in their own development, buy financial assets mostly valued in US dollars. This massive transfer of capital from the poor to the rich raises the fear of a correction that could, in turn, require raising US dollar interest rates and which could result in economic recession.

[4] Martin, Redrado et al, find that in the past ten years there has been 'an explosive growth at global level of international reserves' mainly driven by emerging economies and estimate the current level of reserves at 'a record (...) of 3.8 trillion dollars', Central Bank of Argentina, 'The Economic Policy of Foreign Reserve Accumulation: New International Evidence', Working Paper 2006/13 (September 2006), at 5.

[5] Setting aside reserves that normally give a very low return has a clear opportunity cost as savings could be better used to serve development needs. Joseph Stiglitz estimates the cost to developing countries is in excess of US$ 300 billion per year. Joseph Stiglitz, *Making Globalization Work*, (1st edn, New York: W.W. Norton & Company, Inc., 2006) 249.

[6] The most challenging for the Fund is the Chiang Main Initiative, which includes all ASEAN countries (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) plus China, Japan and Korea. It was launched in the aftermath of the Asian Crisis, and the volume of reserves accumulated by its most important members (2201 USD billions, circa) could enable them to turn it into an Asian Monetary Fund. Latin America also has a regional Fund, the FLAR (*Fondo Latino Americano de Reservas*); albeit so far much smaller and limited to a subset of Latin American countries (Bolivia, Colombia, Costa Rica, Ecuador, Peru and Venezuela). The appeal of these pooling arrangements appears to be related to governments' dissatisfaction with Fund lending decisions and the burden of conditionality.

[7] Mervin King, Governor of the Bank of England, argues that '[...] the growth of private capital flows *and the build-up of massive foreign exchange reserves by many Asian economies* have made redundant the idea that the primary function of the Fund is to be an international lender of last resort' (emphasis added). Mervin King, 'Reform of the International Monetary Fund' (speech delivered at the Indian Council for Research on International Economic Relations, New Delhi, 20 February 2006).

second deficit, one that has to do with failures in its governance structure, a 'legitimacy deficit'.

As I will argue, the Fund's governance structure, beyond considerations of fairness, is dysfunctional to the Fund's purposes of ensuring financial and monetary stability, by providing uncompromised policy advice and by offering short-term financing to countries facing BoP problems.

One of the key problems is 'quota' distribution among members. 'Quotas' to the Fund, namely contributions made by members, determine their capacity to participate in the Fund's decision-making process, and borrow from the Fund's resources. However, quotas are distributed according to an obscure method that gives wealthier members the right to contribute more capital to the Fund. This grants them more votes (and, therefore, more capacity to condition the Fund's policy advice) and, ironically, also more capacity to borrow from the Fund. As a consequence, advanced economies (i.e. those with no need to borrow from the Fund) have more access to its resources and virtually run the institution.

On the other hand, developing countries, i.e. potential borrowers, have little influence and relatively low (and expensive, as we will see) access to the Fund's resources. Not surprisingly, they feel sidelined from its decision-making process and have little or no ownership of the Fund policies (the legitimacy deficit).

These two 'deficits' are interlinked in a vicious circle as ultimately '[t]he Fund's credibility depends on its perceived legitimacy as an international organization representative of its members and [its] effectiveness suffers if countries of growing economic importance are not adequately represented'.[8]

In this article, I will focus on the Fund's 'legitimacy deficit' and suggest possible solutions that could help recover the Fund's credibility as a truly multilateral institution.[9]

I. THE EGALITARIAN FOSSIL

In every decision-making process there is tension between formal power and real power. Whereas formal power normally reflects, in some way or another, the egalitarian paradigm, real power reflects the fact that actual equality is only an idealization but hardly ever a reality in itself. Citizens are all equal in rights and obligations but do not have equal skills, assets or opportunities.

In other international organizations, such as the World Trade Organization (WTO), this tension is somehow resolved by using consensus to make decisions. All countries are deemed to be equal and, theoretically, any one of

[8] Rodrigo de Rato y Figaredo, Managing Director of the IMF, Remarks at the Banco de Mexico, Mexico city, 'The IMF's Medium-Term Strategy: Meeting the needs of emerging market members' (23 March 2006).

[9] Joseph Stiglitz prefers to categorize this as a 'democratic deficit' that has contributed to the Fund's 'lack of legitimacy, which has undermined [its] efficacy'. Above, n 5, at 19.

them could block consensus if strongly determined. However, countries with small markets can only actually do it if they join together in significant numbers. Consensus may be disappointingly slow but arguably it is a good compromise between a paradigm (every country is equal in rights and obligations) and a reality (only big markets count for trade concessions).

The Fund's decision-making process gives prominence (almost absolute prominence) to 'real power' and even this – the calculation of 'real power' – is obscure and deficient. The egalitarian paradigm found some place in the original design of the Fund when 'basic votes' were distributed to all members regardless of their quotas.[10] In 1944, basic votes represented 11.3% of the aggregate voting power. Now they only represent 2.1%. Why? Because quotas have expanded significantly over the decades in the context of general and ad hoc quota increases (e.g. due to the addition of new members)[11], but basic votes remained unchanged.[12]

In sum, at the Fund, the egalitarian paradigm is no more than a fossil; votes are distributed according to quotas and quotas are meant to reflect wealth. G7 countries[13] alone have 41.72% of votes[14] and advanced economies (28 countries which represent somewhat less than 14% of world population[15]) hold over 61% of the voting power both at the Fund and at the World Bank. Not surprisingly, decisions are made quite expeditiously (*vis-à-vis* a consensual decision-making process).

Ironically, the Fund is keen to say that its decisions are mostly taken by consensus. This is because the Executive Board rarely votes; however, not voting and taking the trouble to build up consensus are quite different things. In lieu of taking a formal vote, the Chair of the Executive Board, either the Managing Director or one of his deputies, is responsible for identifying the 'sense of the meeting', which in plain language is to ascertain whether there would be a qualified majority of votes if there were to be a vote on the issue under consideration.

Putting it in a nutshell, members buy their votes and rich countries run the Fund. Ruthless as it may sound; what is wrong with this? The Fund is borrowing money from the rich and lending it to the poor. Is it not then just

[10] Article XII, Section 5(a) of the Articles of Agreement states: 'Each member shall have two-hundred fifty votes plus one additional vote for each part of its quota equivalent to one hundred thousand special drawing rights'. This article was never amended.

[11] Quotas were increased approximately 37-fold.

[12] The basic votes for original members represent 0.5% of current total aggregate voting power. The 2.1 percent figure includes basic votes allocated to members that were incorporated after 1944.

[13] Canada, France, Germany, Italy, Japan, United Kingdom and the United States.

[14] This does not include the aggregate voting power of the constituencies led by Canada and Italy.

[15] USA, Japan, Germany, UK, France, Italy, Canada, Netherlands, Belgium, Switzerland, Australia, Spain, Sweden, Austria, Norway, Denmark, Finland, New Zealand, Portugal, Singapore, Ireland, Greece, Luxembourg, Iceland, San Marino, Israel, Korea and Cyprus (ordered according to voting power).

logical that the rich should have a major saying in determining when, where and how to lend it? The answer is not as simple as it may appear.

II. VOTES FOR MONEY: IS THIS A GOOD IDEA?

Perhaps before answering this question I should clarify that potential borrowers cannot chose to integrate more capital into the Fund. Countries are allotted with certain quotas and cannot unilaterally decide to integrate more money into the Fund in order to be able to count on a larger access to financing in case of need.

I turn now to the question of whether it makes sense to let the wealthy run the Fund. The short answer is 'no', and I will offer five reasons why.

First, because even if it made sense to allocate quotas exclusively according to relative wealth, this would be shortly outdated without a mechanism to revise and adjust quotas to changes in relative weight in the global economy. There is no such mechanism and as a consequence 'it is not even today's dollars that count'.[16]

The Fund's quotas are calculated in an obscure way using five formulas that are almost impossible for the average person to understand, including policy makers.[17] They are far from reflecting the relative economic importance of members in the world economy, let alone their potential need to borrow.[18] A few examples may help to illustrate this; the Netherlands's quota is only 36% smaller than China's; India's is smaller than Belgium's; Switzerland's quota is bigger than Brazil's and Austria's is bigger than Nigeria's. Moreover, when quotas were allotted to original members they were not established to reflect relative weight in the global economy but predetermined political objectives.[19] The same thing happened for acceding members.[20]

[16] Joseph Stiglitz, above, n 5, at 12.

[17] The quotas are calculated using five different formulas. The original Bretton Woods formula was supplemented with four additional formulas and the calculated quota of a member is the higher of the Bretton Woods calculation and the average of the lowest two of the remaining four calculations. All formulas use four variables: GDP at current market prices, Reserves [foreign exchange, special drawing rights (SDRs) and gold], Openness (of current account) and Variability (of current receipts).

[18] Abbas Mirakhor and Zaidi Iqbal, walk us along the labyrinth of how quotas are calculated and what variables are used; see IMF, 'Rethinking the Governance of the International Monetary Fund', IMF, Working Paper, WP/06/273 (December 2006).

[19] This was explicitly recognized in his memories by Raymond Mikesell, the economist from the US Treasury to whom Mr White (then Secretary of the Treasury) instructed to prepare a formula that would give the US a quota twice as big as that of the UK, a bit more than twice that of the USSR, and more than a bit more than twice that of China. See Mikesell R., 'The Bretton Woods Debates: a Memoir', Essays in International Finance, Department of Economics, Princeton University Intl Economics, N.192 (March 1994).

[20] Germany and Japan were allotted closely similar quotas despite that Japan's economy was much bigger.

Second, the Fund has a regulatory capacity as its money comes together with conditionality. When the Fund lends money, it ties this financial support to conditions that, more often than not, have effects on income distribution for the borrower's population.[21] When a country gets into financial trouble it may call on the Fund; the Fund then evaluates its needs and 'negotiates' (actually lays down) a set of conditions[22] (purportedly) meant to help the country regain access to voluntary private financing, which ultimately ensures that the Fund will be repaid. These conditions go from macroeconomic objectives (e.g. limiting the size of the fiscal deficit or setting a target for reserves) to structural reforms (e.g. requiring changes to taxes, tariffs and the privatization of state-owned enterprises or reforms in labour rights). In the 80s, as the Fund stopped lending to industrial countries, structural conditionality stepped up[23] and with it the fear that requiring financial support from the Fund comes at the cost of accepting intrusive conditions 'possibly motivated by the ideology of powerful members or their need to secure a political or competitive advantage'.[24]

In democracies, citizens have a legitimate expectation to participate in decisions that have direct consequences on their incomes and assets. But at the Fund, their only voice is that of the Executive Director who supposedly represents their interests. However, if you happen to be a citizen living in a developing country 'your' Executive Director (beyond not having been elected and not being accountable), normally has very little capacity to influence decisions at the Board. Naturally, conditionality is normally perceived as sympathetic to the interests in the borrowing country's economy of those Fund members with bigger quotas and, not surprisingly, there is a high degree of resistance to comply with conditionality.[25] As Joseph Stiglitz accurately notes, conditionality undermines confidence in democracy and breeds radical political opposition as '[t]he electorate sees its government

[21] Joseph P. Joyce, 'The adoption, implementation of IMF programs: A review of the issues and evidence', Wellesley College, Department of Economics (December 2003), at 12, '[...] Fund programs [have] important distributional effects that depend on a country's pre-income situation, with negative consequences for countries in the worst circumstances'.

[22] Theoretically, it is the authorities' responsibility to lead the process of designing a program and therefore choose which conditionality should be included in it (see IMF, 'Operational Guidance on the 2002 Conditionality Guidelines'; revised 9 January 2006 - SM/06/14). Unfortunately, things are quite the opposite, as the Fund uses its financial leverage to virtually impose the conditions to which the financial support is contingent [see Ariel Buira, 'An Analysis of IMF Conditionality', Challenges to the World Bank and IMF, Buira (ed.) for the G24 Research Program (Washington: Anthem Press, 2003)].

[23] At the peak of abusive use of financial leverage, Indonesia had to accept 140 conditions in its program with the Fund in 1998.

[24] Raghuram Rajan, Economic Counselor and Director of Research at the Fund, 'The IMF in A Changing World', keynote address at the International Conference on Global Asset Allocation at the Arison School of business in Israel (17 May 2006).

[25] Joseph P. Joyce quotes studies that indicate that only 47% of the programs were successfully complied with, Above, n 21, at 7.

bending before foreigners or giving into international institutions that it believes to be run by the United States'.[26]

Conditionality is included in the 'Letters of Intent'[27] signed by finance ministers of borrowing countries. Beyond requiring action from the executive branch of the government, it frequently requires the approval of legislation by a certain date[28] and sometimes even rulings by courts![29] It is no wonder then why the Fund is so unpopular and why self-insurance (despite its economic cost) makes so much political sense.

Third, members are legally obliged to collaborate with the Fund (and other members) 'to assure orderly exchange arrangements and to promote a stable system of exchange rates'.[30] Consequently the Fund, as part of its regulatory capacity, exercises surveillance on members' economies, monitoring compliance with obligations contained in the Articles of Agreement and provides them with policy advice.

This oversight function came into being in 1978 when the present Article IV of the IMF's Articles of Agreement was adopted. The Fund's initial 'surveillance' responsibility was rather simple, limited to safeguard the Bretton Woods system of fixed exchange rates. When this system collapsed, the Fund had to find 'new means [...] to insure against the risk that countries might run their policies in blind pursuit of their own short-term interests'[31], disregarding the effects this could have on global welfare. The Fund was then entrusted with its more complex and discretional current surveillance function but, alas, the additional discretion needed to discharge its regulatory function did not entail any adjustment to its governance structure. Indeed, the distribution of votes remained linked to the logic of its 'lending function' (the more contributions to the multilateral pooling of reserves, the more capacity to condition its decision-making process).

As a consequence, 'creditor' countries, namely those whose domestic policies can potentially have more damaging consequences on its neighbours, are those with greater capacity to condition the Fund's oversight function

[26] Above, n 6, at 12.

[27] Governments have to sign 'Letters of Intent' before borrowing from the Fund. Ironically, when the Board reviews compliance with the conditionality there included, the government's 'intent' is read as commitment to deliver.

[28] Joseph P. Joyce quotes studies that, not surprisingly, indicate that '[d]emocracies with fractionalized legislatures perform poorly in IMF programs and are more likely to be sanctioned'. Above, n 21, *at* 10.

[29] In its latest program with Argentina, the Fund wanted the Supreme Court to stop '*amparos*' against banks (legal actions of depositors requesting banks to return their assets in US dollars). The government refused to accept this condition. For further information, Hector Torres, '*Argentina and the IMF: Learning Lessons from our Experience*', Initiative for Policy Dialogue, Columbia University, New York (December 2005) (visited 5 May 2007)

[30] Article IV, Section 1 of the 'Articles of Agreement'.

[31] IMF, The Framework for IMF Surveillance: Enhancing the Effectiveness of Surveillance in a Globalized World, background document prepared by Fund Staff for a 'Dialogue with High-Level Officials', Santiago de Chile (11 December 2006).

(despite their lip-service to the 'independence' of staff). In any event, if the staff's criticism ever gets too candid, they can always use the Board to water-down the public communiqués that normally follow the Fund's Article IV consultations.

Beyond this, members that issue currencies of international reserve or those that have accumulated massive amounts of them (e.g. China), feel insulated from the Fund's criticism, normally politely worded, conveniently encrypted or reduced to its minimal possible expression.[32] Developing countries do not have this advantage, as the Fund's seal of approval counts in volatile economies. If the Fund gives a low mark to a developing country's government, this would normally entail more basic points of interest payments when borrowing from the markets, which in turn means either more taxes or less money for the government to distribute, or most likely both.[33] In short, the governance structure pushes the Fund to exercise pressure where it can and not where it should.

The fourth reason why it makes very little sense to allot higher quotas, and, therefore, higher access to the Fund resources to wealthy countries is that they do not need to borrow from the Fund. Advanced economies are able to borrow on their own currency and with little or no premium for default or exchange risk. The last instances where the Fund had to provide financial support to a developed country were in 1977 (to Italy and the UK), and in 1978 (to Spain).

However, as quotas are used to calculate access to Fund resources (and of course also votes), the result is that those countries that are less likely to need the Fund's support are those with more access to its credit (and more capacity to shape conditionality imposed on others to their national interests), whereas the potential borrowers see their access limited to a percentage of their meagre quotas.

This forces developing countries in need of financial support to apply for 'exceptional' access, namely to borrow beyond the established annual limit of 100% of quota or beyond a cumulative limit of 300% of their quota.[34]

[32] There was only one paragraph, out of 54, addressing the Common Agricultural Policy in the 2005 report on the EU economy.

[33] At this point, it is worth making a digression. In delivering a positive or a negative signalling with its seal of approval, the Fund's responsibility goes beyond markets. As countries are obliged to provide information to the Fund and hold regular consultations with its staff, the Fund has an informational advantage. Naturally, common citizens give credibility to its approval or disapproval seal. This was evident during the 90s in Argentina when the country was 'touted as a model for other developing countries to follow' (Paul Blustein, *And the Money Kept Rolling In (and Out)*, Public Affairs, New York, 2005), 147. Common citizens in Argentina, guided by their past experience and conventional wisdom mistrusted the sustainability of the fixed peg of the Argentinean Peso to the US dollar. However, the repeated and enthusiastic support given by the Fund to the government of former President Menem (unfortunately) did not go unnoticed when voters had to decide on whether his economic policies were sustainable.

[34] Net of scheduled 'repurchases' – reimbursements of credit.

Naturally, exceptional access comes at 'exceptional' costs, both financial[35] and political.[36]

Needless to say, as 'normal access' (under 300% of meagre quotas) usually falls short of what is needed to help a country overcome the consequences of a balance of payments crisis, exceptional access is anything but usual business.[37] Indeed, total new resource commitments by the Fund during 2003–04 (arguably the last period in which the Fund had to provide meaningful assistance to members in balance of payments crisis) amounted to approximately SDR 19.6 billion; of these SDR 15.7 billion was committed in arrangements involving exceptional access.[38]

Last but not least, the Fund lives mostly on borrowing countries. As there are less and less borrowers[39], the Fund's financial situation has worsened and it is currently running a deficit close to 17% of its administrative expenses.[40] Ironically, the Fund has preferred to draw from its reserves rather than living up to the draconian budget adjustments that it has so often 'recommended' to its borrowers.

[35] There is a surcharge of 200 basis points for borrowing over 300% of quota. The cost of borrowing over 300% of quota (first trimester of 2007) is of 7.38% in SDR. Repayment is normally expected within 2.25 to 4 years (the bulk of the IMF lending is provided under short-term 'Stand-By' Arrangements). This can be compared with the cost of borrowing in private capital markets (Uruguay issued a bond in November 2006 at a cost of 7.525% in US dollars and with a 30 years maturity period and, of course, with no 'conditionality' attached).

[36] A country requesting exceptional access has to comply with four criteria: (i) it has to be undergoing 'balance of payments pressures on the capital account, resulting in a need for Fund financing that cannot be met within the limits'; (ii) it has to have a 'high probability that debt will remain sustainable established on the basis of a rigorous and systematic analysis'; (iii) it has to have 'good prospects . . . to regain access to private capital markets within the time Fund resources would be outstanding and (iv) it has to implement a '*strong adjustment program* . . . [with] a reasonably strong prospect of success, *including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment*' (emphasis added). On top of this, before entering in negotiations with a Member requesting exceptional access, the Fund's management has to consult the Board, giving the Executive Directors representing the main creditors the opportunity to set 'prior actions' that the potential borrower should undertake. IMF 'Review of Access Policy in the Credit Tranches, the Extended Fund Facility and the Poverty Reduction and Growth Facility and Exceptional Access Policy' (14 March 2005) Box 1, Summary of Access Policies.

[37] In 1995, Mexico had to request borrowing 688% of its quota. In 1997, Thailand had to request borrowing 505% of its quota; Indonesia 490% of its quota (augmented in 1998 to 557%); Korea 1938% of its quota. In 1998, Russia borrowed over 350% of its quota; Brazil 600% (augmented by 2002 to 752%). In 1999, Turkey requested to borrow 300% of its quota and this had to be augmented in 2001 to 1560% of its quota. By 2001, Argentina had to request to borrow 800% of its quota and in 2002, Uruguay had to request to borrow equivalent to 694% of its quota. Ibid, Table 10.

[38] Ibid, para 21.

[39] The Fund's outstanding credit peaked at 70 billion SDR in 2002 and by the end of 2006 it had fallen to approximately 15.5 million SDR.

[40] The Fund's projected income shortfall for FY2007 is equivalent to approximately 17% of its Net Administrative Budget (not counting depreciation for capital assets and IT equipment) and projections for the period 2008–10 bring the red up to 41%!

There are proposals under consideration which would allow the Fund to live from an investment account that could be fed by selling part of its gold reserves and members' quotas[41]; however, their approval will require a qualified majority at the Board that so far has been elusive and its implementation would require amendments to the Articles of Agreement (which should be approved by parliaments). So the reality is that for the time being, and possibly for still a quite long period, the Fund's income will continue to come from the differential between its borrowing cost and what it charges for its financial support (the 'rate of charge'[42]). In short, it is taxpayers from borrowing countries (i.e. poor countries) who are called to shoulder most of the expenses of an institution in which salaries are annually indexed and benefits are first class, but does not give them much of a say in its decisions (taxation without representation). I find this pathetic.

As Woods and Lombardi correctly note, 'the costs of most of the "public goods" functions undertaken by the IMF fall mostly on the shoulders of borrowing members'[43] and a breakdown of costs of financing the Fund's 'administrative expenses and precautionary balances shows that, in the period from 1980 to 2000, borrowers have raised their relative contribution from 28 to 71 percent [whereas] creditors have decreased their contributions from 72 to 29 percent'.[44]

In sum, and beyond fairness considerations[45], it does not seem functional for the Fund's purposes that the rich should have the right to integrate bigger quotas and, therefore, have greater access to the Fund's financing and the privilege of running the institution by themselves.

III. THE 'STRATEGIC' REFORM: MORE NOISE THAN NUTS

In implicit recognition that the Fund either changes or fades away into irrelevance[46], Mr Rodrigo de Rato launched a 'strategic' reform that delivered

[41] Final Report of the 'Committee to Study Sustainable Long-Term Financing of the IMF', chaired by Andrew Crockett (31 January 2007) http://www.imf.org/external/np/oth/2007/013107.pdf (visited 5 May 2007).

[42] In December 2006, the margin for calculating the rate of charge is of 108 basis points over the SDR (Special Drawing Rights) interest rate.

[43] Ngaire Woods and Domenico Lombardi, 'Uneven patterns of governance: how developing countries are represented in the IMF', 499; Review of International Political Economy 13:3 August 2006: 480–515. Global Economic Governance Programme, University College, Oxford, UK.

[44] Ibid, at 498.

[45] For more on fairness see, Abbas Mirakhor and Iqbal Zaidi, who assess the IMF's governance structure using John Rawls' concept of justice. Above, n 18.

[46] The International Monetary and Financial Committee of the Board of Governors of the IMF candidly acknowledged that the effectiveness and credibility of the Fund needed to be 'safeguarded and its governance further enhanced, emphasizing the importance of fair voice and representation for all members'. IMF, Communiqué of the International Monetary and Financial Committee issued in Washington, D.C. (22 April 2006) http://www.imf.org/external/np/cm/2006/042206.htm (visited 20 May 2007).

a first result on 'quotas and voice' at its 2006 Annual Meetings in Singapore. On that occasion, the Governors of the Fund adopted the decision to grant four countries, namely China, Korea, Turkey and Mexico, the right to modestly increase their quotas (an overall 1.8% increase in the capital of the Fund).[47] These countries appeared to be the most underrepresented using the current (flawed) quota calculation method, so arguably the start has not been bright and many developing countries voted against the reform[48] or supported it only after strong lobbying from the Fund's management.[49]

As for basic votes, it was decided to 'at a minimum' double them and thereby, the 'existing voting share of low-income countries (LICs) as a group' [50] should be protected. The actual amount of increase in basic votes is yet to be decided since in Singapore it was agreed that the amount of increase in basic votes will be defined together with a second round of quota increases, no later than by the Annual Meetings of 2008. The actual implementation of both the increase in basic votes and the aforementioned second round of quota increases will, however, take some time.

Indeed, increasing basic votes will require an amendment to the Articles of Agreement of the Fund[51] and a second stage of more meaningful quota increases will only come after the adoption of a new quota formula. The Fund's Executive Board is requested to 'reach agreement on a new quota formula'[52] no later than by the 2008 Spring Meeting of the IMFC. Then, by the Annual Meetings of 2008 (normally taking place in the northern hemisphere's fall) the Board of Governors should consider new quota increases for those members who appear as underrepresented. However, this will not be the end of the saga, since the aforementioned 'at a minimum' doubling of basic votes requires an amendment of Article XII, Section 5(a) of the Fund's Articles of Agreement and the foreseen next increase in quotas shall not become effective until the basic votes amendment enters into force. In sum, parliaments will have the last word and, most probably, the US Congress.[53]

The reservations that several developing countries had with the decision approved in Singapore were two-fold. First, the reform foreshadowed in that

[47] Resolution No. 61-5 on 'Quota and Voice Reform in the International Monetary Fund', adopted at the Sixty-First Annual Meeting, September 2006, Singapore.

[48] Argentina, Bolivia, Brazil, Chile, Colombia, Comoros, Dominican Republic, Ecuador, Egypt, Haiti, India, Iran, Maldives, Oman, Panama, Paraguay, Peru, Qatar, Sri Lanka, Trinidad and Tobago, Uruguay, Venezuela and Yemen.

[49] This was confirmed to the author by several colleagues that found that, against their own advice, their governors had been lobbied to vote in favor of the Resolution.

[50] Above, n 49, para 4.

[51] Above, n 12.

[52] Above, n 49, para 3.

[53] Such an amendment of the Fund's Articles of Agreement can only enter into force for all of its members if it is accepted by three-fifths of the Fund's members having 85% of the total voting power. As the US holds more than 15% of the total voting power, this means that ultimately the US Congress holds the key of the reform initiated at Singapore.

Decision may result in more, not less, quotas and voting power for the most advanced economies. The discussion of a new quota formula had not yet started when the aforementioned Decision was adopted, but GDP[54] and 'openness'[55] were already put as the two variables that should bear more weight. This was a bad start, as including reference to other variables which better capture likeliness to borrow would have presented a more promising reform for the majority of developing countries.[56] However, front-running GDP and openness is made even worse by the insistence of the most advanced economies in using market exchange rates to calculate GDP (rather than Purchasing Power Parity[57]) and that of EU members of factoring their intra-Euro trade as part of their 'openness' to the world.[58]

Admittedly, the US manifested that it was only looking forward to restoring the voting power that it had before the implementation of the aforementioned token quota increase approved in Singapore.[59] The Europeans did not join the US in its pledge, but decided to put forward an alternative proposal, that of using a 'compression factor'[60] to reduce the disparities between large and small economies to which a new formula could lead. The Japanese have neither joined the US in its pledge of self-restriction, nor the Europeans in their proposal to mend the problem by compressing the disparities; far from that, they have made it clear that they are not ready to forego any increase in quotas/voting power to which they could result entitled with a new quota formula.

Naturally, a reform on quotas and voice that would further deteriorate the already minority position that developing economies hold in the Fund's aggregate voting, would be clearly at odds with the objective of giving additional legitimacy to the Fund and reinforcing multilateralism.

But there is a second and perhaps more powerful reason behind the square opposition or the very reluctant support of many developing countries to the Singapore Decision. The drafting of that Decision creates a very high risk

[54] Gross Domestic Product.

[55] The sum of total receipts of current account.

[56] Ariel Buira shows how combining GDP calculated at Purchasing Power Parity with volatility of movements in commodity prices and capital movements would increase developing countries' participation in aggregate voting. 'The Bretton Woods Institutions: Governance without Legitimacy?' table 4, in: *Reforming the Governance of the IMF and the World Bank*, G-24 research program, (Anthem Press, Washington: 2005), 23.

[57] It should be noted that measured at market exchange rates, developing economies' share of global output is roughly 26% [in 2005] whereas measured at PPP, it is over 50%. The Economist (21 January 2006), 69.

[58] Trade within a same currency unit could not bring BoP problems and, therefore, no need for Fund financial support.

[59] The US has also hinted that it may be ready to accept a 'blended' measurement of GDP, however, giving PPP a very small weight.

[60] The end result of a linear formula which, on its own, would increase the quotas and votes for large economies would be multiplied by a negative number (the 'compression factor') so as to partially smooth-out the resulting disparities. This would be to the benefit of most developing countries and small European countries as well.

that, even if advanced economies were not to increase their current share in quotas and votes, the end result of the reform could allow for the increase of the quotas of a handful of successful emerging economies at the expense of middle-income developing countries. As the increase in quotas for the most dynamic emerging markets could not come at the expense of advanced economies because they have the voting power necessary to prevent it, and it could neither come at the expense of LICs, to which the Singapore Decision guarantees no further erosion in their quota share, it would necessarily come at the expense of middle-income developing countries. The irony is that whereas emerging markets such as China or Korea or some ASEAN countries, seem to be 'graduating' from potential use of Fund support (thanks to their persistent current account surpluses), middle-income countries remain to be Fund potential borrowers. Thus, it would be self-defeating for the Fund to reduce their quotas' relative weight. Indeed, this would encourage this large group of countries to step up their policies of self-insurance, shoot for depressed exchange rates that allow them to accumulate more reserves, and build up new (or reinforce existing) regional reserve pooling arrangements.[61]

I am not, of course, against prudential policies, or against the pooling of reserves amongst neighbours, but I am wary of a world that resorts to bilateralism or regionalism as an alternative to inefficient and unreliable multilateral institutions.

IV. FAT CATS COME FIRST

The questioning of the Fund's legitimacy goes way beyond the quota issue and its consequences on its decision making process. The independence and objectivity of its policy advice and conditionality are also questionable and doubts are raised on the 'difficulty [of Fund officials in] resisting the temptation to lavish praise on countries that are implementing orthodox economic policies'.[62]

The Fund is basically an organization designed to foster monetary and financial stability; it is, therefore, natural that it is keener to give priority to financial interests over the overall interests of society. However, governments have to take care of a multiplicity of interests, financial amongst them. It is not uncommon to perceive that financial interests are disguised behind the Fund's policy advice and conditionality, for instance, by giving a *de facto* preferred creditor status to financial liabilities.

Governments have a variety of liabilities to attend to and any unbiased observer would agree that, unless otherwise determined, public liabilities are to be honoured *pari pasu*, namely, regardless of who holds the claim.

[61] We are already seeing some of this in South America with the '*Banco del Sur*' initiative.
[62] Paul Blustein, Above, n 33, at 212.

Alas, the Fund does not seem to agree. When it comes to financial liabilities no budgetary effort has to be spared and the 'sanctity of contracts' has to be respected at any rate.[63] But if claim-holders are pensioners or public employees, then public liabilities are recategorized as 'budgetary rigidities' that need to be removed.[64]

Unfortunately, the Fund does not limit its advice and conditionality to financial issues. In exercising surveillance over national economies and in 'proposing' conditionality before lending, it covers a variety of policies such as trade, fiscal and labour. Promoting coherence between the different international agencies and UN bodies seems to be a very sensible thing to do. Therefore, it would only be reasonable for the Fund to consult with the International Labour Organization (ILO) before putting forward advice on labour policies, an area in which it has no particular expertise. Alas, the Fund feels appropriate to give policy advice on labour without consulting the ILO. I have personally requested repeatedly – and so far hopelessly – that reports on national economies put forward for the consideration of the Executive Board should include the opinion of the ILO every time they touch on labour policies.

Asking these two organizations to consult each other on topics that overlap is elementary good governance as ultimately it is tax-payers who shoulder the cost of running both the ILO and the Fund. This was, precisely, one of the key recommendations included in the report of the World Commission on the Social Dimension of Globalization[65]; to increase coherence between the Fund, the World Bank, the WTO, the ILO and other relevant UN bodies.

[63] In 2002–03, Argentina arguably lived through its deepest social and economic crisis. More than half of its population was suddenly sent below the poverty line, social unrest was rampant and the country was in political chaos. In that socially volatile context, the transitional government gave fiscal priority to its 'social debt' (rather than to its financial debt). The influential Fund's driven 'Capital Markets Consultative Group' disagreed: 'The rule of law need[s] to be firmly established and the sanctity of contracts honored [in Argentina]', otherwise it viewed a 'risk of "wider" contagion of weakening policies to other countries in the region and elsewhere'. Report from management on the seventh meeting of the Capital Markets Consultative Group, 8 September 2003 http://www.imf.org/external/np/cmcg/2003/eng/091803.HTM (visited 5 May 2007).

[64] For example 'To reduce budget rigidities, it would be crucial to control the growth of the wage bill, including through a renewed effort at civil service reform [...] It would also be essential to substantially reduce [...] government contributions to pensions'. Ecuador, 2005 Article IV Consultation-Staff Report, para. 17 www.imf.org/external/pubs/cat/longres.cfm?sk=19009.0 (visited 5 May 2007). 'The pattern of [public] health spending reflects [...] budget rigidities' Republic of Slovenia (July 2006), IMF Country Report No. 06/250, para. 21 www.imf.org/external/pubs/cat/longres.cfm?sk=19422.0 (visited 5 May 2007).

[65] The report was issued on February 2004. The Commission was created by the ILO. It was co-chaired by H.E. Ms Tarja Halonen, President of the Republic of Finland and H.E. Mr Benjamin Mkapa, President of the United Republic of Tanzania. Commissioners included former Prime Minister of Italy Guliano Amato, Former President of Uruguay, Julio M Sanguinetti and Nobel Prize Winner Joseph Stiglitz. http://www.ilo.org/public/english/fair-globalization/report/index.htm (visited 5 May 2007).

Labour policies are crucial to avoid globalization deepening social inequities among countries and also within countries themselves. The asymmetry of mobility between capital and labour puts the latter in a bargaining disadvantage which is compounded by the lack of enforcement of Core Labour Standards (CLS).[66] Needless to say, the approaches that the ILO and the Fund take to labour matters are quite different. Whereas the ILO has made it a priority to promote respect for CLS, at the Fund, labour regulations are mostly perceived as obstacles to hiring and firing workers and its policy advice normally includes additional 'flexibility', code word that at the Fund translates as further reducing labour rights[67] (and, therefore, not respecting contractual terms which, in this case, seem to have a lesser 'sanctity' status than financial contracts).

It is well documented that globalization, together with technological innovation, are pushing 'labour's share of GDP [down] to historic lows, while profits are soaring'.[68] Labour's participation in national income is at its lowest level for decades.[69] This preoccupying deepening of inequality appears to be correlated with the reduction in labour protection and the decrease in the bargaining power of unions; which is compounded by capital mobility, a key feature of globalization.[70] Political consequences are quite obvious and the protectionist sentiment is on the rise.[71] This should concern the Fund, as one of its purposes is 'to facilitate the expansion and balanced growth of international trade'.[72]

Unfortunately, an ideological bias prevents the Fund from taking a more balanced approach to labour matters. For instance, it has

[66] 'Core Labour Standards' are internationally agreed fundamental human rights recognized for all workers, irrespective of whether they toil in developed or developing countries. They are defined by the ILO conventions that cover freedom of association and the right to collective bargaining (ILO Conventions 87 and 98); the elimination of discrimination in respect of employment and occupation (ILO conventions 100 and 111); the elimination of all forms of forced or compulsory labour (ILO conventions 29 and 105); the elimination of all forms of forced or compulsory labour (ILO Conventions 29 and 105); and the effective abolition of child labour (ILO Conventions 138 and 182).

[67] Joseph P. Joyce quotes studies that indicate 'that labor's share of income is lower in countries with IMF programs'. Above, n 5, at 12.

[68] 'Rich Man, Poor Man', The Economist, 20 January 2007, 15.

[69] 'A Survey of the World Economy, The New Titans', The Economist, 16 September 2006, 6.

[70] Guscina, Anastasia, 'Effects of Globalization on Labor's Share in National Income', IMF Working Paper, WP/06/294, December 2006; in researching on the reasons that made labour's share of national income in industrial countries steadily decline in recent decades, finds that 'by making capital more mobile, globalization may have decreased the bargaining power of the less mobile factor – labor' (ibid, at 5). Moreover, she also finds what should be pretty obvious for the Fund, that 'a higher degree of employment protection benefits labor more than capital, resulting in higher compensation and labor share' (13).

[71] According to the Financial Times (12 January 2007), 3, 'Wages gap "undermines support for free trade"') Tim Geithner, the president of the Federal Reserve Bank of New York, stated that sustaining support for further global integration 'may be the most important economic challenge of our time' and warned that rising inequality and economic insecurity (of workers) was undermining support for open markets.

[72] IMF, Articles of Agreement, Article I, (ii).

consistently opposed minimum wage settings, disregarding the social and political benefits that such a floor of protection for low-skilled workers could have.[73] Just to illustrate the point, it is worth referring to Germany's economy, where unemployment 'has dropped sharply in the last two years', 'business confidence remains close to a 15-year high' and '[d]eclining real wages and a modest upswing in productivity have together produced a sustained drop in unit labour costs'.[74] Despite this 'good news', consumer confidence (which depends on household's perception of their future income) 'failed to take off convincingly'[75] and the EU enlargement is bringing uneasiness on the consequences that the immigration of workers ready to work for lower wages could bring. This should not surprise us since consumer confidence and openness to immigrants are clearly related to job stability and wages. The government was, therefore, considering the introduction of 'minimum wages to "protect" against competition from immigrants from low-wage countries (and to limit potential fiscal costs of wage subsidies)'.[76] The Fund staff was quick to categorize this as a 'serious policy error'[77], without taking the trouble to consider whether the government, by introducing minimum wages, was aiming at making it easier for German workers to assimilate legal immigrants who would otherwise be pushing salaries down and nationalist sentiments up. Introducing minimum wages may come at a cost, but in assessing its convenience, the Fund should take a more balanced and less dogmatic approach.

Admittedly, the Fund is making some progress. Albeit timidly, it is progressively taking the good practice of consulting with civil society representatives, including trade unions, before presenting Article IV reports to the Board. However, I do not recall ever having read a report in which the Fund touches on labour matters and recommends members to respect core labour standards and other ILO conventions ratified by the country or, perhaps even more evident, to duly enforce their own labour legislation!

Our concern goes beyond questioning the fairness of the Fund's advice. I also believe that its pro-profits advice may not be functional to the purpose of preserving global economic stability, let alone political stability. If productivity grows at the expense of labour retribution, it will eventually

[73] Just to cite a few of the latest examples; in 2006 it opposed increase in Chile's minimum wages (IMF, 'Chile-Staff Report for the 2006 Article IV consultation', SM/06/245) and 'high' minimum wages in France (IMF, 'France- Staff Report for the 2006 Article IV consultation', SM/06/329) and the 'excessively rigid' collective wage bargaining system in Spain (IMF, 'Spain-Staff Report for the 2006 Article IV consultation'SM/06/174). It also opposed the introduction of minimum wages in Germany, as we will see next.

[74] 'Beggar Thy Neighbour', The Economist 27 January 2007, 73.

[75] Ibid.

[76] IMF, 'Germany – Staff Report for the 2006 Article IV Consultation' (13 November 2006), SM/06/370, para 16.

[77] Ibid, para 17.

affect consumer confidence, and this is particularly dysfunctional at a time the world needs to rely less on US consumers' spending. We should be doing more to integrate into the market those who currently feel sidelined from the benefits of globalization. Needless to say, most of these would-be-consumers are living in countries that are currently running huge current account surpluses.

V. CONCLUSION

The Fund has two well-differentiated roles. First, a regulatory role, which comes from its capacity to design conditionality, exercise surveillance on the economy of its members and oversee compliance with members' obligation to collaborate with the Fund to assure 'orderly exchange arrangements and to promote a stable system of exchange rates'.[78]

Second, a lending role, which comes from its capacity to serve as a multilateral pool of reserves meant to 'give confidence to members by making the general resources of the Fund temporarily available'[79], so as to help them correct their BOP problems while promoting 'high levels of employment and real income'[80] and 'without resorting to measures destructive of national or international prosperity'.[81]

The current governance structure of the Fund, beyond being inconsistent with its multilateral nature, is dysfunctional to both these roles. A promoter of international monetary and financial stability requires the capacity to perform and put forward uncompromised arms-length assessments of the economies of its members and blow the whistle (loud and clear) when domestic policies are systemically disruptive. The fact that its decision-making process is dominated by its largest and most powerful members, precisely those whose domestic policies have systemic implications, attempts against the independence of the Fund's assessment and its capacity to police compliance with its obligations. This handicap is compounded by the fact that two of its members, the US[82] and the EU[83], can veto its most important decisions.[84]

As regards its 'lending role', it makes very little sense that those countries that will not need to borrow have the right to integrate higher quotas, and, therefore, have more access to Fund resources (and weight in its decisions). Not surprisingly, potential borrowers are keen to accumulate reserves and design regional pooling agreements.

[78] IMF, Articles of Agreement, Article IV, Section 1, General obligations of members.
[79] Article I, (v), Purposes. Above, n 2
[80] Article I, (ii), Ibid.
[81] Ibid.
[82] The US holds 16.83% of the votes.
[83] The European Union countries act individually, but coordinately. As Woods and Lombardi note the EU countries form a coalition with a Brussels permanent Sub-committee on the IMF. Ibid. Together they hold 32.18% of the votes.
[84] The most important decisions require a qualified majority of 85% of votes.

The reform process launched in Singapore in September 2006 is not likely to help the Fund, neither recover credibility nor improve efficiency. At the Board, we are just tinkering with the variables used in the current flawed quota formula and preparing ourselves to horse-trade on the weight that should be given to those that better accommodate narrow national interests. At most, it will result in giving some more votes to a few successful emerging economies, already weaned off the Fund's financial support, at the expense of other less successful developing countries that remain to be potential borrowers. This will not bring additional effectiveness or credibility to the Fund.

Other international organizations (e.g. the EU Council, the Council of the Global Environment Facility, the International Seabed Authority and the African Development Bank) have also been confronted with the need to find a compromise between regulatory capacities that call for an even distribution of votes among members with the need to accommodate the reality of members with very unequal economic weight. They have resolved the dilemma by establishing a double majority system in which an economically-weighted majority is complemented by a one-country one-vote majority. This combines the recognition for differences in relative economic weight with the equality of rights and obligations for all members. The Fund is much more than a club of creditors; a double majority system could help bring both additional sense of ownership for its policies and effectiveness.

The redressing of its ideological bias will require more than 'just' reaching agreement on a fairer and more functional distribution of votes and quotas (and access to its financial resources). It will require making the Fund more accountable and responsive to citizens' concerns, as its policy advice and conditionality has direct implications on their income. We should start by recognizing that policies recommended or 'conditioned' (i.e imposed) in Fund programs are not technically neutral but imply trade-offs in terms of social justice and should, therefore, be subject to democratic accountability. As Joseph Stiglitz rightly points out, '[n]o economic issue affects people more than the macroeconomic performance of the economy. Increasing the unemployment rate makes workers worse off, but the resulting lower inflation makes bondholders happy. Balancing these interests is a quintessentially political activity'.[85] There is no way to depoliticize these decisions and those involved in taking them, namely those that have the privilege of sitting at the Fund's Executive Board, should be accountable to Congresses.[86]

[85] Above, n 17, at 279.

[86] Ngaire Woods, and Domenico Lombardi, ibid, find it astonishing that there are virtually no mechanisms to hold accountable elected Directors (those representing 'constituencies' of countries that gather to have a seat at the Board). The situation for appointed Directors (those appointed by countries that enjoy their own seat at the Board, i.e. US, Japan, Germany, France, the UK, China, Russia and Saudi Arabia) is somewhat different, as in some cases (e.g. the US) their appointment has to be approved by the legislature.