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The G20 and Sustainable IMF Reform

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Will the G20 agree to the reforms needed to make the IMF an effective part of international financial governance? The prospects are grim because it would require difficult political compromises or amendments to the IMF's Articles of Agreement. Yet reforms are needed to address the IMF's coordination with other international institutions, the scope of the financial regulatory regime, and its representative legitimacy. This column some initial steps the G20 might take.

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The prospects of the London G20 meeting agreeing on the reforms needed for the IMF to operate effectively in the evolving international financial governance arrangements are uncertain at best. Some of these reforms require either difficult political compromises or amendments to the IMF's Articles of Agreement. It is therefore more realistic to hope that the G20 will launch a multi-stage reform process that is responsive to the key problems in the current governance arrangements and is based on a long-term vision of the IMF's role in international financial governance.

The three major problems in the international financial architecture

The three key problems are coordination, scope, and legitimacy.

Coordination

Global financial governance currently involves a multiplicity of formally uncoordinated organisations and mechanisms. These include separate international bodies for banking regulators, capital markets, and insurance companies, the Financial Stability Forum, which coordinates regulators in a select group of countries but has no global mandate, the IMF, which plays some role in overseeing some financial issues in some member states, the World Bank, which helps member states improve their financial systems, the WTO, which deals with issues relating to establishment of financial institutions, and the G7 and G20, whose efficacy is unclear (Alexander, Dhumale and Eatwell 2006).

Lacking an effective coordination mechanism, the international community resorts to ad hoc crisis-driven measures. For example, the IMF, in response to previous financial crises in its key member states, has assumed a role in the oversight of capital markets and national financial systems, even though it was designed as an international monetary institution. This approach is problematic from a legal and global governance perspective, raising concerns about the scope of the IMF's mandate and its relations with its member states.

Scope

The scope of current financial regulatory regimes is deficient in two ways. First, they do not cover all relevant products and participants. They also do not incorporate all significant issues, for example climate change, even though many financial institutions recognise it as a source of financial risk[1] and the climate change negotiations could result in significant new financial flows to developing countries.

Legitimacy

There are three aspects to the legitimacy problem. First is representation. This involves, in relation to the IMF, both ensuring that member states receive a vote that is commensurate with their role in global economic affairs (Rueda-Sabater, Ramachandran, Kraft 2009), and that those states that actually consume IMF services have a meaningful voice in its decision-making bodies. A related issue is the asymmetry in the IMF's relations with its members – the most powerful states in fact, but not in law, are less subject to its jurisdiction than weak states.

IMF member states have already agreed on limited adjustments in the voting power of some members. Unfortunately, reaching this agreement was hard and may have consumed much of the available political will for dealing with this topic – despite the rhetoric to the contrary.

The second aspect of the legitimacy problem is the scope of institutional authority. The IMF's legal mandate has not changed since its creation, even though the range of its operations has. For example, it now deals with financial governance issues that involve it more deeply in the internal affairs of its member states than its creators envisaged. Consequently, the IMF's mandate needs updating to ensure consistency with its evolving role.

Third is accountability. As the IMF's mission grows, it needs to be appropriately accountable to those member states and their citizens that are directly affected by its operations but have limited say in its governance. In addition, as its operations become more complex, it needs enhanced management and staff accountability to the Board.

The G20 London meeting and IMF reform

An IMF capable of assuming its envisaged governance roles needs a clear mandate, meaningful participation by all members, transparent operational policies and procedures, and effective accountability mechanisms. There are a number of actions that the G20 may take in London to promote this goal.

The first is a significant increase in IMF financing through expansion of the New Agreement to Borrow (NAB). However, this action, whether or not it is based on the ambitious US proposal, will both mitigate and exacerbate the IMF's legitimacy problems. The increase in NAB membership will give some IMF member states additional say in IMF operations. However, merely increasing the IMF's resources and authority will exacerbate its accountability and scope problems. The IMF can offset this problem by adopting transparent operational policies and procedures and authorising an enhanced role for the Independent Evaluation Office (IEO) in assessing their use.

Additional actions will be needed to plug the gap in development financing. One option is for countries that have established IMF trust funds to agree to expand their uses. At the same time, they should require improved transparency and accountability in the IMF's management of these trusts. Another option is a new issue of special drawing rights. While this idea is attractive, the required approval process is slow and unpredictable.

A second likely action is agreement on merit-based selection of the IMF Managing Director. The significance of this change should not be overstated because there are many ways for powerful countries to ensure that “their” candidate (regardless of nationality) is appointed.

Another issue that may receive attention is the representativeness and role of the IMF Board. Making the Board more democratic depends on European countries surrendering some Board seats. Despite their calls for greater fairness in IMF voting and representation, European countries are unlikely to accept this change without some compensation. Thus, absent some “grand bargain” it is unlikely that the political will to reform either the Board or IMF voting exists.

This issue should be considered in conjunction with the proposal to create the “Council” to replace the IFMC. This Council, anticipated in Schedule D of the IMF Articles, would have the same composition and voting arrangements as the Board. Consequently, it would not resolve the IMF’s representational problems and would merely replace an advisory body with a decision-making body.

The debate over the Board’s role is whether or not it should surrender its operational responsibilities and concentrate on strategic issues. This reformed Board could meet less frequently and its Directors need not be based in Washington. This would result in the management and staff having greater operational responsibilities, thereby underscoring the internal accountability problem at the IMF. This could be addressed by both improving the IMF’s operational policies and procedures and expanding the responsibilities of the Independent Evaluation Office.

The London meeting can initiate but not conclude consideration of reforms in the IMF’s oversight, coordination, enforcement and advisory functions. The IMF already performs versions of these functions in its consumer member states but not in its richer member states. Without addressing this asymmetry, the IMF will not have the credibility to be a fair coordinator of international financial governance arrangements.

In addition, the IMF cannot effectively perform these functions unless it has the legal authority to address the full scope of international financial governance issues. This requires amending its Articles because some issues are outside its current mandate. Given that amending the Articles involves the same ratification process as approving a new treaty, might the international community be better served by creating a new institution that better reflects current geopolitical realities and international financial needs than to reform an organisation that has serious legitimacy and legacy problems?

Conclusion

The world needs the IMF. But, it also needs an organisation that does not have the scope, function, and legitimacy problems that plague the IMF. While resolving these issues is a long-term process, the G20 can begin by increasing the IMF's resources, enhancing its accountability to all its internal and external stakeholders, and making its operational policies and procedures more transparent.

Footnote

1 See, for example, www.equator-principles.com

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