Chapter – VII
Reforming the IMF: Issues and Challenges

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CHAPTER-VII

7.1 Introduction

This chapter deals with the study of the issues the IMF is still facing despite all the reform efforts taken so far. Although the Fund has made serious changes over the past few years, there is still a long way to reach a perfect IMF in the eyes of all its member countries. Plus, an attempt has been made to study the challenges the IMF might face in the road of future reforms. These issues and challenges should be addressed to go through successful reforms and make the Fund more efficient.

A descriptive methodology has been employed to study the issues and challenges of the Fund. The database for this chapter is secondary data taken from IMF website and all other papers done on the shortcomings of the IMF.

This chapter is organized into three sections. The issues and challenges regarding IMF lending and conditionality are discussed in detail in the first part. The issues and challenges regarding IMF governance are also studied in the second part. In the final section of this chapter issues and challenges of the IMF in the international monetary system have been explained. In the end, a case for further reform of the IMF is made.

7.2 Challenges and Issues of the IMF

Apart from the defects and anomalies proved through the hypotheses in the last chapter, from the beginning of the 2000s, the International Monetary fund has been criticized for many of its actions and its whole structure. The relationship of the Fund was said to be insufficient especially with respect to its developing country member states and its low income countries. The critics found many loopholes that the fund should have filled to become more legitimate and in order for the members to stay connected to the Fund.

Starting from the 2000s, and after the Asian crisis, the Fund has made significant efforts to bring changes to the structure of the Fund and other operations that take place in the Fund itself.
7.3 Lending: Issues and Challenges

Lending of the IMF is one of the most important aspects of the IMF operations. Over the years, the country members have relied on IMF resources to overcome their financial difficulties on different sources.

The lessons from the Asian crisis proved that the Fund has not only failed to help the countries to overcome their difficulties, but also have caused those member states to go deeper because of the strict structural reforms attached to its lending facilities. The reforms in lending started in 2002 with a simple review of guidelines in conditionality and have continued till date. The lending reforms of 2008 and 2010, and also the conditionality reforms of 2010 and 2013 have changed the whole lending framework of the IMF. The Fund has introduced new facilities to better satisfy the needs of its diverse membership. Plus, the conditions attached to its financing have been significantly streamlined to give the borrowing countries a better chance to overcome its difficulties with the resources given to them by the IMF.

Despite all the positive changes and the positive results the IMF have made during two decades, there are still many challenges in the IMF's lending framework that needs to be addressed.

7.3.1 Inadequacy of IMF Resources to Satisfy Future Financing Needs

The most important issue with respect to IMF lending is the question of the availability of IMF resources. The Fund makes resources available to its member states proportionate to their quotas. However, during the recent years, economic stability has been very fragile. Due to the severe interconnectedness of the countries all over the world, this instability can spread very fast across the countries. This will result in many countries in need of financial resources to overcome their difficulties. IMF, as a result may face a large group of countries in need of financial resources. The Fund's resources are clearly not enough to satisfy the needs of a very large group of countries. The recent European Sovereign debt crisis proves this point. Since the IMF did not have enough resources to cover all the needs of its members, the countries had to rely on other sources of Fund like the other regional institutions. Plus, the IMF accumulated additional reserves from more stable member countries like Japan.
On the other hand, with respect to its concessional facilities, the IMF’s concessional resources are supposed to satisfy the estimation need of its low income country members by the end of 2014. The main challenge with respect to this group of countries is after the 2014 since the financial resources dry up. Many propose the use of the gold sales profits for future concessional needs. This decision, if agreed by Executive directors should pass the 85% majority of votes and is very difficult to pass. So the challenge remains as to where the IMF can find additional resources to satisfy the needs of its member states, whether low income or not, in case of any future financing needs.

7.3.2 Lack of Diversity in IMF Facilities

When the IMF was established in 1944, most of its member countries were among the advanced economies. As a result, the Fund policies were directed towards the preferences of those advanced member countries. The facilities were also designed to help those countries tackle their respective problems. As the years went by, other country members were added to the Fund with their different economic backgrounds and their different needs. These countries made use of IMF facilities, but in many cases these facilities not only failed to help these countries but they also brought about more problems to those members. The reason for it was that those facilities were not designed based on these countries’ backgrounds and needs. The developing countries and the low income countries have complained to the IMF to design newer programs according to their needs.

The recent reforms have actually made significant progress in this area especially with respect to the low income countries. Many unused facilities like ESF-HAC were removed and other new facilities were brought about for this special group of countries. New facilities such as FCL or PCL were added to the non-concessional facilities. Other programs were also streamlined further to become more flexible for the developing country members to use.

However, looking at the history of the use of these facilities, one can observe that these facilities are also not being used by these countries. Plus, the lessons from the recent global financial crisis and the Euro zone crisis show that the IMF has not been very helpful to offer the trouble country members an efficient program to smooth their recovery path further. Although this cannot be completely blamed on the
IMF, the Fund should think of new facilities in case of future similar financial needs. The challenge remains for the IMF to design new programs most importantly for the developing countries with more flexible conditions to encourage them to use IMF financial resources instead of accumulating huge piles of reserves to self-insure themselves against future threats. With respect to high debt countries, IMF has a lot to work on. The size of the programs offered to these countries should be studied very carefully to help these countries overcome their problems and at the same time the conditions should be designed in a way not to interfere with the recovery plans of the countries but also in a way to guarantee the safety of IMF resources considering the problems these countries are in.

7.3.3 Scope of Structural Reforms Relating to Conditionality

The low income member countries do not have the freedom other members have to choose their source of financing. As a result, they always turn to the IMF for help. Despite the very tough conditions (especially structural reforms) the IMF sets for these countries in the past, these countries had to stay with the IMF due to their high financing needs. The recent reforms of IMF conditionality have improved a lot during the past ten years with respect to these country members. The interest rates on all concessional facilities carry a zero interest rate until the end of 2014. Plus, the reformed lending framework has streamlined its conditions for these countries to help them make better use of IMF facilities and achieve their goals more efficiently. The streamlined conditions and better policy measures set by the Fund have improved the economic conditions of these countries compared to the last 3 decades.

However, this is not the end of the line for the IMF with respect to this group of countries. IMF has to decide how to raise further concessional resources to satisfy these countries in the future. Whether to carry on with the zero interest rate or not is also another issue the IMF has to decide on. The low income member countries have very different economic backgrounds from other IMF members. As a result, the Fund should decide on better programs with more focused conditions to help these countries more efficiently. The better programs the IMF designs according to these countries' needs and backgrounds, the better implementation by these countries and as a result the better achievement of the Millennium Development Goals the IMF and the World Bank have planned by the end of 2015. A challenge for the IMF is the
conditions the Fund sets for this group. The scope of the structural reforms and other conditions the IMF sets for these programs can directly affect the success of these programs and these countries' economic position in the world.

7.3.4 Moral Hazard Issues

IMF conditionality was reformed to focus on those macroeconomic conditions that are critical for the implementation of policy measures. As part of the reforms, the IMF focused more on the pre-qualification process of assessing the countries to see if they are eligible for IMF resources. If the countries qualify for the IMF programs based on the pre-qualifications set by the Fund, the resources are available to the country on a more front-loaded basis. This was also done to encourage the member countries to come to the Fund sooner before it is too late to solve their problems instead of spending so much time on structural reforms. Upon approval, the troubled country received a larger tranche of its agreed resources to start its programs. This is a positive step. But at the same time, there is always the issue of moral hazard. The Fund resources are gathered by the contributions of all its member countries. Therefore, the Fund is responsible towards its member countries as to how it uses the resources. The objective of the conditionality was to make sure that these resources are guaranteed and the Fund can get them back on time. However, with the recent reforms and a more front-loaded IMF program design, the challenge remains as to how safe guard these resources. If the IMF is very leisure towards the release of these resources and the conditions attached to its financing is very loose, the borrowing countries will not either care much about returning the resources on time. As a result, the IMF should design its programs in a way that the conditions are more streamlined and more flexible, but not to the degree to lose its control over the power to take back its financial resources from the borrowing countries.

7.3.5 Involvement of the IMF in Developmental Issues

Another challenge of the IMF in the lending and conditionality framework is with respect to the World Bank. After the collapse of the Bretton Woods system, the IMF lost its mission in the international monetary system. The IMF was established to protect the fixed exchange rate system which no longer existed. The 1972 review of guidelines of the articles of Agreement was very vague and did not clearly specify how the Fund should function in a floating exchange rate system. The guidelines
mentioned that the Fund should act in all areas to promote global stability. This as a result expanded the IMF’s responsibilities in many areas which were not involved before. The Fund started taking parts in many developmental issues regarding its member countries. Plus, the ongoing changes in the global economy and the diverse membership of the IMF pushed the Fund to contribute in areas where the Fund was not involved before. The involvement of the Fund in new areas such as poverty reduction or education, health or other developmental issues or even pushing the member countries towards a faster liberalization process could be clearly seen in its structural conditions set by the Fund attached to its programs. Many of these responsibilities especially with respect to the low income countries were among the main responsibilities of the World Bank. In many cases, these two institutions' involvements were overlapping since the IMF had gone beyond the areas of its expertise. Today, these conditions are a major part of IMF conditions whereas the Fund has not enough expertise or even enough resources to push the borrowing countries to achieve those objectives. The Fund’s resources as per the Articles of agreement are designed for other monetary problems such as the balance of payments problems. The challenge now is whether the IMF should leave these areas to the World Bank or other international institutions and focus on its initial defined areas of expertise or whether to continue being involved in these areas. Any decision regarding this will directly affect the design of IMF programs. Since the Fund does not have enough expertise and resources to focus on these areas, and focusing in these areas may cause the Fund to stray from its original objectives, there should be a clear discussion to leave this area to the World Bank or at least bring down its involvement to the minimum.

7.3.6 Program Design Issues and IMF’s Diverse Membership

Another issue the IMF should take into consideration is the fact that the Fund has a very diverse membership with very different economic backgrounds. Thus, the design of a program for a borrowing country is very important. The Fund should design each program very carefully and should consider the circumstances of each country before approving the programs. Unfortunately, the IMF facilities are very limited compared to the diverse membership of the Fund. The IMF has taken the "one-fits-all" policy for its members with respect to its programs and has offered the same program to countries with very different circumstances and backgrounds.
Although the Fund cannot design one program for each country that approaches the fund for financial resources, there is still scope for further improvement in program design. The recent conditionality reforms have focused on streamlining the conditions and making them more flexible based on the circumstances of each country. However, by the low rate of approach of the countries after the reforms, it can be said that the countries are still not satisfied with the approach the Fund is taking towards designing its conditions. One way to improve this is to improve the expertise of the staff. If the IMF understands the circumstances of each country better, they can design a better program based on their strengths and this will lead to better program implementation.

Therefore, the most important challenge of the IMF in the future is the design of its programs. It is important for the IMF to gather sufficient expertise in each area whether low-income or developing or even advanced to understand better the circumstances of each member country that applies for Fund resources. The Fund should take use of this expertise to design a program that suits the troubled country best and sets the conditions according to the country's strengths and future goals. For the high debt countries, the IMF should choose programs that minimize the harms that come to the citizens of the borrowing country since due to high debts the country should go through high spending and wage cuts. The Fund should take that into consideration while designing the programs and focus on overcoming the debt sooner and bring about stability to the country. Conditions should focus on creating productivity, higher exports and higher employment to increase the country's revenue on its own and overcome the debt. With respect to the developing countries, the Fund should work a lot to gain the confidence of those countries and to design programs to encourage them to come to the Fund and use IMF resources instead of turning to other private sources of finance or accumulating their own reserves. With low income countries, the IMF's challenge is to guarantee the consistent existence of concessional financing since these finances will drop after the 2014 and also to design programs according to their circumstances. The Fund should continue to make the use of contingent financing available to all its members since it reassures the member countries that there is a safe source of finance available to them in case of future threats.
7.3.7 IMF’S Role as a Lender of Last Resort

Overall, the question remains whether the IMF should pay the role of the lender of last resort in the international monetary system or not. There are many cases for and against this case. The recent global financial crises and the euro zone crisis showed that even the advanced economy members of the IMF may also be in need of IMF finances, unlike the last two decades where most of the borrowing countries were among the developing and low income countries. Therefore, there is an increasing number of member states in need of finances. But, the IMF is incapable of providing for all their needs because its resources are very limited compared to the global needs. Plus, it should be mentioned that there is always a moral hazard risk and since the IMF is responsible to the resources the member states have contributed to the Fund, it cannot freely give away its resources if it becomes the lender of last resort. The countries should only rely on the IMF if they pass the Fund's strict pre qualification criteria. These criteria should be used to make sure that the borrowing countries are capable of getting back on their feet and returning the borrowed money from the IMF. Even if they pass the criteria by the IMF, all the access limits should be respected except in cases of special circumstances. The IMF should make it clear that the troubled countries can turn to the Fund for resources but the degree to which they can borrow from the Fund and their borrowing arrangements are all based on the commitments they make to the Fund.

7.4 Governance: Issues and Challenges

IMF governance issues have always been a major part of criticism and reform proposals. Due to its unfair distribution of quotas and voting power in the governance structure, IMF was seen as an illegitimate institution especially by the developing countries. The Fund failed to entail the global changes of power into its governance and change its structure accordingly. The recent IMF governance reforms have tried to make significant changes in the whole governance framework of the Fund. The reforms of 2008-2009 tried to make slight changes in the quotas of some the developing countries and improve the voting system. The next round of governance reforms in 2010 were made as an effort to continue to bring about further changes to make the IMF fairer and evenly distributed.
7.4.1 Pending Governance Reforms

The most important issue in the governance of the IMF is the pending reforms that have been stalled since 2010. The reforms of 2010 tried to bring more quota shares to the developing countries and some other advanced economies according to their strength in the global economy. This process happens by shifting over 6% of the quota shares from the advanced economies including the US and some other European countries to the developing countries. As a result of these changes, China and India will be among the top ten strongest economies in the world. However, all these reforms have not come into effect since in order to become effective there is a need for 85% of the voting from the member countries. Since these changes will reduce the voting power of many advanced economies, these countries are unwilling to give up their power and pass it to the developing member states of the IMF. As a result, all the governance reforms from the 2010 onwards are on hold. All other reforms approved by the Executive Directors of the IMF after 2010 are also on hold since they all come into effect conditional to the passing of 2010 reforms. So the challenge here is for the IMF to make the pending governance reforms of 2010 onwards effective by any means possible. Any further governance and structural change in the IMF is conditioned on the approval of these reforms.

7.4.2 Veto Power of the United States Issues

Not only the above reforms are affected by the 85% majority of the votes, but also all other important decisions in the Fund will need to be approved by 85% of the total votes of the IMF. A very important issue in this area is the United States. The United States currently holds about 16.75 percent of the total votes. With the country holding this very high share in the total voting power, one can say that all the IMF’s important decisions and operations which need an 85% approval rate lie in the hands of the United States. This is a very complicated issue. No matter how difficult the decision is and how much all other country members push for a policy or reform, in the end all are decided by the United States. The US congress decides on all the important decisions of the Fund. This issue has been a very important part of the criticism by many IMF members. There have been numerous numbers of IMF proposals to change this. Many countries have called for the changes in the total quotas of the United States and reducing it to a level so that the percentage of its total
votes drops to below 15%. Many countries believe that until this is done, IMF is not a legitimate institution since the United States is actually running the operations of the Fund by holding onto its high voting power. However, for this to become effective, the United States should be willing to leave its power which is very ambitious. The challenge for the IMF is to think of other ways to make the United States give up its veto power in the Fund to make the whole voting system fairer.

7.4.3 Unfair Representation of IMF Chairs

The next challenge still existing in the IMF governance is with respect to its chairs in the Fund. Currently, out of the total 24 chairs of the Executive Directors of the Fund, 8 are representing single countries. The remaining 16 are representing the rest of the countries which account for 180 member countries. Each of these constituencies represents about 4 to 22 countries. Each constituency is directed by one of the countries in that group and will represent the preferences of the whole group. Many of the member countries in these constituencies have argued that due to large number of countries in these constituencies they are at times being ignored or their voices are not being heard in the executive Directors’ decisions. Many countries tried to push to increase the number of the chairs of the executive Directors. However, in the recent reform efforts, the Fund decided that the number of the Executive Directors should remain at 24. Since the IMF’s major decisions are discussed and made in the meetings of the Executive Directors, having a chair or at least a proper voice among the chairs is very critical for each member state. This unfair and inefficient representation of the chairs of the Fund is still not acceptable by many members especially the developing countries. These countries believe that the European countries are clearly over represented in the chairs of the Fund and as a result of that many decisions are oriented towards their preferences. They call for further reforms and ask that the chairs should be more fairly represented to give other countries higher voice. The low income countries are also very disappointed in the representation of the chairs. Their situation is way worse than that of the developing country members. The challenge for the IMF is to make changes effective in the representation of the Fund chairs whether by taking some chairs from over represented European countries or by adding extra chairs to balance the voting power of the under-represented countries.
7.4.4 Underutilisation of the Expertise of Developing and Low Income Countries in IMF Governance

Over the past two decades, the developing and even low income countries have made significant progress in exploring expertise with respect to their own region or even the global economy. As per the Articles of Agreement of the IMF, the Fund Managing Director should be a European. Plus, as mentioned above the majority of the chairs are also occupied by the advanced economies including the United States and the European countries. As a result, the IMF is relying on the expertise of this group of countries which account for the majority of the decisions. The issue here is that the IMF is not making use of the expertise that the developing and low income countries have developed in the recent years. If the Fund makes use of their expertise in their research or even in the design of their programs, this can lead to higher success in the implementation of the IMF programs since the programs are designed better based on the strengths and circumstances of the borrowing countries. This does not have to end there. Over the past two decades, there have been many significant economists capable of running the IMF. The convention that the IMF should be managed only by a European should be dropped and a fair voting system should be designed by the IMF so that other volunteers from other parts of the world can have a chance to run the IMF. How this process is handled and how the framework is designed to give a better chance to others is a challenge the IMF should address in the coming years.

7.4.5 Preserving the Share of Low Income Countries after the Reforms

Another issue to consider in the IMF governance that the Fund should take into consideration is the share of the low income countries. For the countries to vote on IMF decisions each country is given a total number of basic votes which is equal for all the members plus an additional percentage based on their total contribution of quotas. The basic votes account for a very low share in the total voting process. So, the main share is the quotas of the member countries. The recent reforms of the IMF have tried to make these quotas more adapted to the countries’ relative power in the IMF. The problem here is that some of the low income countries will actually lose a further share of their voting power after the reforms are effective. As a result, the Fund should always try to think of alternatives to preserve the voting power of the
low income countries and make sure that their voice is not lost in the reform process. The recent effort to triple the number of the basic votes from 250 to 750 was a good step to preserve the share of the low income countries. However, of the governance reforms of 2010 become effective, and there is a quota increase, these countries will lose some of their voting power again. As a result, the challenge for the Fund is to think of other ways to make sure that the voice of these countries is not lost in the process.

7.4.6 IMF’s Voting System Issues

An important issue to consider in the governance of the IMF is the whole voting system that the Fund has employed. Countries getting to vote based on their quotas may seem to be unfair by many countries with lower shares of quotas. One may question whether this voting system is outdated or not and whether a better system can be used to make the IMF decisions better reflect the preference of all its members. During the last few years, many developing countries have proposed that the shares of each country be proportionate to the contributions they make to the IMF. According to the existing convention, each member state is required by the IMF to make a certain amount of contribution to the Fund based on its relative power in the global economy. However, many countries have argues that they are capable of contributing more to the Fund if it leads to giving them more power over the decisions of the Fund. This is very important issue that the Fund should consider since it affects the overall decisions and operations of the Fund. The proposal is certainly a valid and useful one since by contributing more to the Fund, the IMF can have additional resources and hence be engaged in more programs. Another proposal is to change the voting process and give each country one vote as it is done in UN. This will certainly ignore the relative power of each country in the global economy, but in turn gives all the countries an equal voice and power. It is up to the IMF to decide whether to continue using the same voting system or not. The clear thing is that many countries are not satisfied with this system and are challenging the IMF to use different method so that their votes are better heard in the decisions the Fund makes in the future.
7.4.7 Quota Formula and Its Variables Issues

Since the share of each country in voting and other important aspects of IMF operation are based on the quotas each country is assigned to, a very important challenge of the IMF is to adopt the best quota formula that gives each member country its fair share in the IMF. Currently, the current quota formula is a weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent). For this purpose, GDP is measured through a blend of GDP—based on market exchange rates (weight of 60 percent)—and on PPP exchange rates (40 percent). The formula also includes a compression factor that reduces the dispersion in calculated quota shares across members.

Any change in any of the variables in the quota formula gives different shares of quotas to each country. The IMF reviews the quota formula every five years and decides on the variables in the formula and their respective weights. This is a very important decision since it affects the countries contributing and borrowing power directly. Therefore, every five years, the IMF is challenged with choosing the best quota formula. This formula should represent the member countries fairly according to their relative weight in the global economy. Plus, in the review the IMF has to decide whether to add on newer variables or to remove any extra variable in the formula. Any change in the quota formula needs an 85% of the total votes of the IMF which can be again affected by the veto power of the United States.

7.5 Challenges and Issues of the IMF in the International Monetary System

IMF as the major agent in the international monetary system to maintain the global economic stability is always under close consideration to make sure that it is doing its responsibilities right. To ensure this, the Funds is practicing its surveillance responsibility by reviewing the policies of the member countries and warning them of any risks that come along with their policies, whether domestic or global.

7.5.1 Issues Relating to Articles of Agreement

After the break down of the Bretton Woods system, the IMF lost its role in the international monetary system for a while. The Fund was established with clear guidelines to ensure the stability of the fixed exchange rate system. After the break
down of the par value system in 1971, the Fund faced an identity crisis since no more clear guideline was given in its Articles of agreement as to how to manage the floating exchange rate system. The review of its Articles of Agreement in 1972 also gave no clear guidelines and actually expanded the responsibilities of the IMF since the Fund was now responsible to exercise its power in any area necessary to make sure the stability of the monetary system was there. This problem could be easily seen in the surveillance areas of the IMF and its conditions attached to its financing. Although the recent reforms have tried to give the IMF clear guidelines as to where and to what scope they should exercise their power, the Articles of Agreement of the IMF is still very much vague in its directions. The basis for the Articles of Agreement was based on a monetary system with fixed exchange rates and not a floating one. Till date, many of its guidelines are outdated and in many other areas where the Fund is engaged there is no clear direction given. This leads to the involvement of the IMF beyond its areas of expertise with many of its countries. As long as the IMF continues with these unclear guidelines, there is little hope for the IMF to perform its best in the international monetary system and be the legitimate institution in the eyes of its member countries. The challenge for the IMF is to adapt a new Articles of Agreement or at least a reformed Agreement acceptable by the member countries that also gives the Fund better help on how to perform. Since the slightest change in the Articles of Agreement of the IMF needs an 85% approval rate by the members, this will not be an easy process to accomplish.

7.5.2 Surveillance Challenges

IMF uses its surveillance power by reviewing the policies of the member countries take over the years and warns them of the risks that their policies may bring about to the stability of the international monetary system. If the policies are risky at domestic or at the global level, the IMF can help the countries make the necessary adjustments to remove the identified risks. The challenge the IMF faces here is that the surveillance of the IMF for the member countries are not mandatory. It means that no matter how risky the policies of the countries are, the countries are not mandated to change their policies. The IMF has no authority to make the member countries change or adjust their policies until they ask the IMF for help. As a result, this can lead to formation of a series of policies especially from the advanced economies that are in their own interest without considering the effects those policies have on other
countries in their region or around the world. In the recent years, the members have tried to give the IMF more authority to affect the risky policies of some member countries but not much has been achieved. No matter how much expertise the IMF has in identifying the problems and risks, the countries are free to choose IMF directions or not. Surveillance of the IMF therefore, is very weak at the moment. The Fund has made some slight changes in this area to make encourage the member countries apply for the surveillance and review of their policies by the Fund. To make it more encouraging, the Fund can now give the members free consultations over their policies or even in the case of identified risks, the IMF offers the countries earlier financial resources to avoid larger problems. In 2011, Japan was among the member countries which applied for the surveillance of the IMF over its policies and has made the report public for other country members to encourage more surveillance.

7.5.3 Orientation of IMF Surveillance

Another challenge in the surveillance of the IMF is that even if the countries apply for bilateral IMF surveillance, due to the uneven structural governance of the IMF and its over representation of the advanced economies in the chairs of the Fund, the policy directions and the reviews given by the IMF may be oriented more or less towards the preferences of those advanced economies. The advanced economies will have the authority to advice and in many cases make the member countries change the direction of their policies if those policies affect their own interest in any way. So, the surveillance of the IMF will not be completely partial until the IMF governance is changed to give all the member countries their fair share in the Fund.

7.5.4 IMF and Early Warning System Issues

Lessons from the recent crisis have also identified that the IMF surveillance has been very weak in identifying the risks to the global economy in early stages. This may be due to different factors. The lack of IMF expertise or even its engagement in other not necessary areas may cause the Fund to ignore signs of risks to the stability in earlier stages. Once they are ignored, they may lead to higher levels of risks and as a result higher needs for IMF financing and technical support and a longer time to bring back the stability to the monetary system. Thus, the IMF surveillance is still challenged with low expertise and low warning system. If the IMF wants to stay the leading agent in the international monetary system and for the member countries to
rely more on the Fund, it should be more proactive in detecting and taking actions before it leads to higher risks and endangers the stability of the system.

7.5.5 IMF’S Limited Relationship with Other Stakeholders

For the IMF surveillance to become more proactive than today, the IMF should interact with other stakeholders in the country except the finance ministers. At the moment, the countries are represented by their finance ministers or at most by the head of their central banks. The relation of the Fund with each country is therefore limited to their interactions with each other. In case of an approach by a member country in trouble, the understanding of the depth of that problem the country is facing is also limited to the information given by the finance ministers’ and central bank’s research. As a result, the actions taken may not be sufficient since the IMF as not understood the true nature of the problem. Better surveillance and further actions from the IMF can be achieved if the IMF engages ore with other stakeholders. Other stakeholders may include the private creditors, the citizens or even other labour unions. The perspective of the problem given by each of these stakeholders will give the IMF a better understanding of the problem and as a result a better risk detection and finally a better solution to overcome the problem. The recent reforms have tried to make the IMF surveillance better, but not much has been done in this area. Another surveillance review of the IMF is expected by the end of 2014. Consistency and focus of the IMF’s policy advice and the even-handedness of IMF surveillance across its membership is still very weak and should be addressed in the future reviews.

7.5.6 Reserve Accumulation Issues

Due to lack of confidence of many of the developing country members of the IMF and some other low income countries, they have started to accumulate reserves as a mean to self-insure themselves against the future threats that might threaten their economy. This process is very dangerous to the stability of the international monetary system. Countries with large reserves facing short term problems will try to delay their adjustments in their exchange rates by fixing their problems using their accumulated reserve. This ignored problem can turn into riskier problems in the future and can spread very fast to other countries and threaten the whole monetary system. All of these are a result of the lack of useful reserves for the member countries in case of future threats. IMF financial resources have failed to be satisfactory to these
countries since they have either very tough conditions along with them or there have not been enough resources to satisfy their needs on time. The challenge for the IMF is to think of alternatives to first of all increase their financial resources to match the needs of all the members in need of financial aid. Second of all, the future IMF programs should be designed in a way to be as front loaded as possible and entail minimum conditions possible to encourage the member countries come to the Fund for future financing needs instead of accumulating their own reserves. This has not been successfully done till today especially for the developing countries.

On July 2014, the BRICS nations established a new Fund worth $100 billion in order to safeguard themselves against future crisis. The rationale for the establishment of this institute was the disappointment of these countries in the IMF and the World Bank and their programs. The institute has offered to provide up to $3.2 billion per year in loans with less conditions compared to the IMF. The institute will be managed by India for 6 years and further contributions will be added next year. The same happened in 2011 when the finance ministry of Economy and Finance of the African Union proposed to establish an African Monetary Fund. IMF will be challenged by other competitions trying to attract the member countries go to them for financial aid instead of the IMF. In order for the IMF to remain a major force in the international monetary system, it has to change and evolve dynamically and bring more constructive reforms to its operations and its structure to stay legitimate and trustful in the eyes of the member countries. Otherwise, the Fund loses its power and is easily substituted by other international or regional institutions offering better services to the countries. IMF should try instead to collaborate with these institutions and take charge of the situation. Responsibilities or some regional research on particular issues can be delegated to these institutions by the IMF to get better results and get a more stable monetary system.

7.6 Case for Further Reforms of the IMF

Despite all the reform efforts the Fund has made since the beginning of the 2000s, the IMF is still pretty much the target of great criticism especially from its developing and low-income member countries.

The International Monetary Fund as the major agent to guarantee the stability of the International Monetary System is far from perfect in many aspects of its
operations. If the Fund stays like this, it will lose its legitimacy especially in the eyes of its developing and low-income member countries. Since the recent reforms have not at all been satisfactory for these members, many of them have tried other alternatives such as choosing other monetary funds, establishing new monetary funds of their own or even accumulating high levels of reserves which is in its way the origin of more serious instability in the international monetary system.

As proved by the hypotheses, the governance of the IMF is the major cause of the dissatisfaction and unfair share of power in the Fund. The governance reforms of the IMF have made very little attempt at addressing the criticisms from the member countries. The reforms in the governance structure of the Fund should involve all aspects of the governance of the IMF. Most importantly, as proved in the hypothesis 2 and 3 of this chapter, the unfair representation of the members in the quotas and votes of the IMF has affected most aspects of the Fund operations since these operations are based on the quotas and voting power assigned the members. This has been mentioned in the issues and challenges relating to the governance of the IMF. Secondly, the process of choosing the Management of the IMF is pretty outdated and the underutilisation of the expertise of the developing and low-income countries is also another factor hurting the legitimacy of the IMF. It is important to note that the governance reforms of the Fund should be at the centre of attention in the reforms of the IMF since as mentioned earlier all other operational aspects of the IMF are affected by the governance structure of the Fund. Unless the future reforms of the IMF result in correcting the underrepresentation of the developing and low-income country members of the IMF, and these countries receive their fair share of voting power in the Fund, the IMF is not considered a legitimate institution in the eyes of these member countries.

As it has been seen over the last few years after the Global Financial Crisis, the IMF is again considered a reliable source the countries can turn to in case of their emergency financial needs. Therefore, the loans the IMF offers to its member countries are once again very interesting not only in the eyes of the low-income member countries but also for the developing and even the advanced members of the Fund. However, as proved in hypothesis 1 of this chapter, the Loans of the IMF regardless of being concessional or non-concessional are also being offered unfairly to the members of the Fund. The advanced economy members of the Fund holding
large shares of quotas can receive loan shares way larger than the share of the developing and low-income member countries. This problem is once again a reflection of the deficiencies of the governance of the IMF and is affecting the lending framework of the Fund. The wave of reforms for IMF should address this unfair allocation of loans to the member countries. Plus, the conditionality framework of the IMF should be streamlined more and the conditions should focus more on the core areas of IMF expertise. Although the recent reform efforts to streamline the conditionality of the IMF especially for the low-income member countries have proved to be very successful as seen in chapter 3, there should be dynamic study of the structure of the conditionality of the IMF with each country member. The IMF should focus on designing programs that are strictly based on the circumstances and strengths of that borrowing country and the conditions should also be based on those factors. A more streamlined conditionality framework where the country ownership is higher leads to a more successful implementation of the conditions set by the Fund.

As discussed in the issues and challenges relating the lending aspect of the Fund, the scope of the structural reforms of the programs should be limited. All conditionality under an IMF-supported program must be macro-critical—that is, either critical to the achievement of macroeconomic program goals or necessary for the implementation of specific provisions under the IMF’s Articles of Agreement. The reforms of the Articles of Agreement of the IMF should also define how much the involvement of the Fund in the developmental issues of the low-income member countries should be. Once again, the lending and conditionality reforms of the IMF start with addressing the deficiencies of IMF governance. The increasing number of the financial and banking crisis over the last two decades proves the instability of the international monetary system is still intact and the countries in the international monetary system will definitely be in need of future financing from the IMF and other sources of finance. Successful reforms of the IMF give the Fund a better hand at managing the borrowing countries and restoring the stability of the monetary system.

Through successful reforms of the IMF in governance and as a result of that in the lending and conditionality structure of the Fund, the IMF will be in a better cooperation with its member countries and other regional and international monetary funds to help the members bring back stability to their country once again. A better relationship of the Fund with its member countries will result in better surveillance of
the IMF. However, the reforms of the Fund should focus on reforms to strengthen the surveillance power of the Fund in the international monetary system. The reforms to strengthen the Fund should mainly focus on finding new ways to give the IMF more power over the policies of the advanced economy members since their decisions affect the entire international monetary system. New instruments should be designed to encourage the member countries trust the Fund and turn to the Fund to study their monetary and financial policies and help them correct or change the harmful policies they are employing.

The future reforms of the IMF should be multi-dimensional to encompass all aspects of the Fund operations starting from the governance of the IMF to its lending and conditionality and its surveillance. The reforms should give the developing and low-income member countries a better chance of being heard in the decision making process of the IMF. This may result in changing or amending the Articles of Agreement of the Fund.

Until the IMF faces these issues and challenges, the legitimacy of the Fund is at stake and member countries will consider other alternatives to substitute the Fund. Moreover, the issues will not end here. The Fund should be in a constant process of reform and change to be a dynamic monetary institution adapting to the ongoing changes in the global economy. The IMF as a monetary institution responsible to bring economic stability should be as independent as possible from politics and should only act as a neutral agent focusing only on maintaining the stability of the international monetary system. Acting according to the preferences of the advanced economies, as has been done in many cases since the establishment of the Fund, lead to criticism from many member states ad should be addressed. This and all other issues and challenges the Fund faces cannot be solved without significant changes and reforms in the governance structure of the IMF. A monetary fund with fair representation of all its member states, and a fair voting system is a legitimate institution with certainly better program success.
Conclusion

Although the Fund has made great progress in its reform efforts from the early 2000s, these reforms can be accounted as just a beginning. The Fund is still in a serious danger of losing its legitimacy especially among its developing and low-income member countries.

As explained in this chapter, the future reform package of the IMF faces serious challenges it has to address. The future reform package of the IMF should encompass all aspects of its operations. The issues with respect to the Fund’s governance, lending, conditionality and surveillance of the Fund should be solved in order to restore the position of the Fund in the international monetary system and be considered reliable in the system once again.

Most importantly, the issues and challenges in the governance structure of the Fund are adversely affecting other aspects of IMF operations. The focus should be to address the governance issues as soon as possible. If solved, many other aspects of the Fund operations will be solved as a result of better governance in the Fund.