IMF: Concerns, Dilemmas and Issues

The main concerns relating to the IMF's policies are relatable to intrusive conditionalities without due regard to the needs of and impact on the borrowers, with expanding scope of surveillance applied asymmetrically between borrowers or programme countries and others with no financial accountability except that of reputational risks. The response of the Fund has been to attune its policies to meet these concerns, emphasise aspects such as national ownership, leaving culture, transparency in its operation, independent evaluation and wider consultations. However, the basic limitations of resources, instruments and mandate in meeting the problems arising from volatile financial markets explain some of the persisting concerns. Three major issues are posed here for discussion to meet these concerns and improve the quality of resolving some of the tradeoffs and judgments involved. The first suggestion is to separate the surveillance function from lending, making the former somewhat independent of political processes as well as the weighted voting structure. The second suggestion is to remove the distortion in current voting strength by recognising intra-monetary union trade as not amounting to international trade since neither currency nor trade restrictions are in place and by accepting the Purchasing Power Parity basis of GDP computation. The third suggestion proposes that the Fund be given some authority to create limited but temporary liquidity under certain circumstances, to be "a lender of some resort".

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The paper starts in Section I with a brief mention of current realities leading to the conclusion that, as of now, reforms in the International Monetary Fund (IMF) are a pragmatic option and addresses in detail the concerns expressed in regard to the functioning of IMF. Section II focuses on the dilemmas that IMF itself faces which help delineating the tradeoffs in several of its policies in the current situation. Section III poses a few issues for debate, attempting to meet the concerns and improve the effective functioning of IMF. Section IV is essentially a summary of the major conclusions of the paper.

I
Current Realities and Concerns

For any study of IMF it is essential to assess what would appear to be distinctive current realities as compared to the traditional role and functioning of the IMF. These may be summarised as follows.

Firstly, the membership of the IMF has now become nearly universal. In 1945, when the IMF was established, only 29 countries signed the Articles of Agreement. Today, it has 184 members. The global character of the IMF's membership has broadened significantly, even after taking into account the increase in the number of countries in the United Nations system over this period.

Secondly, with the end of the cold war, there has been an increasing convergence in economic ideology. Though the role of state intervention is recognised in varying degrees, there is greater emphasis on the importance of competition and allowing market forces to operate with some stress on regulation. Major issues relate to the appropriate mix between state and market or public and private rather than ideological extremes of denying in totality either failures of market or of state or government.

Thirdly, there is a radical increase in the interdependence of countries with greater flows of goods, services, technology, capital and people across political boundaries. There is a debate as to the extent to which this is ideology-driven or technology-driven but economic interdependence is undeniable. In particular, cross border financial activity has increased as international investors seek out the best investment opportunities across the globe. Global gross capital flows spurred by improvements in information technology, communication and transportation, increased fourfold to $ 7.5 trillion between 1990 and 2000. Fourthly, such dominance of the financial markets has not been accompanied by strengthening of international capacity to regulate them, and the IMF is called upon to substitute for the lack of international regulation of financial markets. In particular, the foreign currency markets have expanded and multiplied disproportionate to the growth in the value of trade flows, but, not their regulation. Volatile capital flows combined with disruptive adjustments in currency values poses special challenges to the IMF with Article I (iii) of its Articles of Agreement mandating it to "promote exchange rate stability, to maintain orderly exchange arrangements and ...".

Fifthly, the type and character of the situations requiring IMF intervention have changed. From assisting countries rectify balance of payment imbalances which arose due to current account crises, i e, country specific issues, the IMF is now being called upon to assist countries facing capital account crises which may arise from loss of confidence and contagion and for reasons at times not solely or proximately related to changes in a country's fundamentals or shifts in policies. Indeed, the announcement of elections or even the platform of the candidates

contesting them seem to impart instability to financial and currency markets.

Sixthly, while in the initial years industrialised countries also utilised the lending facilities of IMF, more recently lending by IMF is mainly to developing and transition economies.

Seventhly, the concerns related to the functioning of the IMF are no longer confined to select academics or policy-makers in developing countries but extend to governments in developed countries, civil society and non-governmental organisations.

Eighthly, there has been a concerted debate among the leading policy-makers, starting with the discussions of the Willard Group and the G-33 in the late 1990s to seek a new financial architecture and on the scope for creating new international financial institutions.[1] The consensus appears to be to reform and reorient the existing institutions like the IMF rather than supplant them by creating new ones.

Broadly, the concerns about the functioning of the IMF can be categorised into three main streams, namely, concerns relating to the IMF's policies, to the IMF's governance and to the IMF's lending framework. While there is a degree of overlap among the above three categories, for convenience, this presentation examines the issues thrown up in each group separately. Initially, the broad parameters of the criticism levelled against the IMF are mentioned, followed by the stance the IMF has adopted in response to such criticism as well as ongoing work being undertaken in this regard. A pragmatic view of the concerns raised in the light of the IMF response, is then attempted.

Concerns Related to IMF's Policies

A number of concerns have been raised by a large variety of institutions and interests – parliaments, NGOs, think tanks, economists, trade unions, environmentalists – regarding the functioning of the IMF. Firstly, IMF is criticised for unreasonably and uniformly imposing the Washington Consensus on all member countries. Critics [most notably Stiglitz2002] charge that the IMF is obsessed with imposing fiscal discipline and it uses a 'one size fits all' approach in designing programmes for all countries which approach it for financial support. An often cited example is that the IMF uniformly insisted on fiscal contraction on all the Asian crises countries which approached it for support in 1997-98. More generally, it is argued that IMF tends to impose on all members the economic policies that are favoured by the dominant shareholders from time to time, often to the benefit of a few or privileged countries or people to the detriment of others. It is also argued that, in the recent past, IMF has been concerned with capital account crises and is designing packages of policies to protect the interests of financial markets, and the bailout of lenders, rather than aid the distressed countries. Furthermore, it is argued that IMF's bailout of countries in distress has resulted in moral hazard, encouraging less than prudent borrowing by some sovereigns and reckless lending by financial markets.

Secondly, IMF is also criticised for imposing intrusive conditionality in country programmes which it supports. To assure itself that the programmes agreed upon will be implemented, the IMF was said to have resorted to applying progressively more detailed and tightly defined prior actions (preconditions) as well as performance criteria (conditions) while adopting a more frequent monitoring regime in its effort to build in stronger incentives. Such conditionality, it is explained, has often resulted in becoming excessively intrusive – both in content as well as procedure and thus it often covers as part of conditionality areas which are not within its core competence. Further, though some of these measures may have helped to persuade governments to implement those conditions necessary to access the money, it is said that reforms have often been reversed once the programme ended, while other non-core conditions remained unimplemented. In these cases, member countries are constrained by the necessity to abide by IMF stipulations to engage in financially-driven tactical compliance and hence it is held that such actions are not sustainable in the long term since they are characterised by lack of ownership.

Thirdly, it is felt by some observers that the IMF keeps extending its agenda resulting in the phenomenon of mission creep and that the mandate of the IMF has expanded relentlessly since it was set up. It now covers an increasing number and variety of responsibilities and some analysts indicate that these have been essentially placed upon the institution by the majority shareholders by virtue of their dominant majority of voting power in the institution. Among the new mandates cited often in this regard are the intensified emphasis on financial surveillance, extensive work on the formulation and monitoring of Standards and Codes, growing involvement in anti money laundering measures and controlling the financing of terrorism, etc.

Undoubtedly, all these initiatives represent essentially new areas for the IMF and in recent years, the IMF has further extended its activities into the areas of poverty alleviation, debt sustainability and HIPC, growth issues including governance and structural reforms. Some question whether the IMF – whose areas of core competence are related to macroeconomic stability, should expand its mandate to deal with poverty issues – a subject rightfully in the domain of the World Bank. Another complication that has been pointed out relates to the impact of such additional policies on member countries. Since there is lack of capacity in many developing and programme countries to effectively deal with these new issues, and in the attempt to provide them assistance, the IMF's Technical Assistance operations have expanded inexorably with the result that expenditures on Technical Assistance now rivals expenditures on surveillance.

Fourthly, the IMF according to many borrowers, is advocating policies which are not proven to be appropriate. An example cited is that the IMF had been a strong votary of capital account liberalisation, despite lack of clear evidence that this promotes economic growth in developing countries. In 1997, the IMF even considered modifying its Articles of Agreement to make orderly liberalisation of capital flows one of the objectives of the IMF, under the assumption that the financial sector needed to be completely liberalised in all member countries to create an environment conducive to growth.

In this regard, other examples cited of policy objectives which the IMF endorses overenthusiastically without concern for domestic country circumstances include flexible exchange rates and transparency including adherence to standards and codes. There are a variety of approaches to a flexible exchange rate. The IMF itself recognises five – the independent float, the managed float with no preannounced target , the crawling band, the crawling peg, the pegged rate within a horizontal band. These describe a range of flexible regimes and it is widely held that to be prescriptive of any regime without reference to country specific circumstances may not be desirable. Similarly, it is argued that while transparency of information can provide credibility and

accountability, excessive transparency can at times be counter productive, and in fact providing detailed information to the market may reduce information diversity, homogenise risk perceptions, and may even induce herding behaviour while impairing market liquidity.

The IMF response to these issues may be summarised as follows: Firstly, on the issue of excessive emphasis on fiscal consolidation, it has been pointed out that while the original programmes designed for Asian crises countries proposed small surpluses or deficits, these were based upon overly optimistic assumptions of growth. When it became apparent that these economies were entering deep recessions, the programmes were loosened to allow the automatic stabilisers to operate which resulted in substantial deficits. On the issue of imposition of some macroeconomic policies, IMF's position seems to be that it is essentially a result of technical analysis and subject to acceptance by the member concerned. On IMF's inclination to protect the interests of financial markets, its position appears to be that restoring confidence of international financial market is essential to resume financial flows to the countries affected by the crises and only reasonable policies in that direction are advocated.

Secondly, IMF conditionality, it is explained, has evolved as part of its mandate to provide 'temporary support available to members under adequate safeguards'. The IMF's conditionality is meant to provide the mandated safeguards such that successive tranches of financing are delivered only if key policies are on track. Conditionality is thus considered necessary to ensure that the programme country takes the steps that are necessary to improve its BoP position from the position which necessitated approaching the IMF in the first place. It is pointed out that the scope of IMF conditionality broadened in the 1980s when the IMF began to embrace more explicitly the objective of raising growth on a sustainable basis.

The IMF cites available evidence to demonstrate that it has now recognised that the conditionality expansion may undermine national ownership and after a detailed review, fresh guidelines have been issued streamlining and focusing the IMF's conditionality. These guidelines include shifting the presumption of coverage from one of comprehensiveness to one of parsimony thus ensuring that the conditionality proposed is essential to the IMF programme. Further, efforts are made to ensure a clear division of labour between the IMF and the World Bank as well as reduction in the use of structural conditionality including benchmarks.

Thirdly, the IMF transparently recognises now that international capital flows are highly sensitive to domestic macroeconomic policies as well as to the soundness of the banking system and other economic and political developments. It also accepts that markets are not always right, and that they can misjudge or over react and hence though the proposal to include orderly liberalisation of capital flows as one of the purposes of the IMF by amending the Articles of Agreement in 1997, the IMF was aiming to play a stronger role in guiding countries to promote policies and reforms aimed at liberalisation, helping countries find the pace of liberalisation that would be most appropriate to specific circumstances.

Finally, the IMF is clearly indicating that it is willing to learn and change. It is noted by the IMF that capital account convertibility by itself may not promote growth. A forthcoming IMF Occasional Paper recognises that financial liberalisation need not necessarily promote growth in developing countries and a threshold absorptive capacity defined by a viable macroeconomic framework as well as sound institutions and governance are necessary preconditions.[2]

Between the divergent viewpoints of the IMF and its critics on the policies of the IMF, lies a pragmatic middle ground. Firstly, on the IMF's response to the Asian crisis, while the IMF may have recognised earlier that financial liberalisation without a social safety net in place may result in hurting the poor, it started amending its programme design to allow for this only after the Asian crises. Over the past few years, the IMF has consciously fostered a learning culture through increased outreach with civil society groups, parliaments and faith based groups. Independent evaluation of its policies and programmes as well as their subsequent reassessment based on such evaluation also provide incentives to enhance the learning culture of the organisation. The recent IMF paper pointing out that financial liberalisation is not a sufficient condition for growth demonstrates that the IMF has now adopted a more nuanced approach to this important policy, though the IMF still feels that its role is crucial to provide increased benefits of globalisation to all member countries.

Secondly, the extension of the mandate of the IMF is merely a reflection of the sweeping changes in the international economic environment consequent to the increasing waves of globalisation since the early 1980s. Increased movement of goods, services, capital, technology and people across borders have resulted in world where member countries are increasingly interdependent on each other. In such situations perhaps there is no institution, at least not as yet, other than the IMF which can play a critical role in clarifying expectations of financial markets and mitigating volatilities of currencies.

Thirdly, there may be need to recognise and acknowledge limits of IMF in terms of resources, instruments and mandate, in managing the volatile financial markets and seeking to advise the countries concerned while recognising that the ultimate accountability for the policies rests with the governments concerned.

Fourthly, to the extent the international financial architecture, especially IMF, is less than adequate in providing satisfactory support to member countries, it will be essential that the governments concerned manage their economies appropriately. As Ghosh (2002) articulated very clearly while reviewing Joseph Stegliz's book, it is often the political class in every country and in particular the nature of governance in the developing countries themselves which take a country to IMF for support in the first place, and thus 'abject failure of governance' is a major culprit in this regard.

Fifthly, as Khatkhate (2002) points out, "It might surprise many that even the Fund has become fully aware of these challenges to the way it has been doing business".

Concerns Related to Governance of IMF

The following arguments are often made pointing to the 'democratic deficit' in the governance of the IMF. Firstly, the IMF is described as a plutocracy which is governed by the wealthy and is considered undemocratic because a large majority of the membership – the developing and transition countries who are in practice the borrowers of the IMF are minority shareholders. These developing countries, which form 85 per cent of the IMF membership have a voting power of 38 per cent. The majority vote of 62 per cent is held by the 24 industrial countries while

the US with 17 per cent of the voting share, exercises a veto power on all important matters considering that major decisions require a majority of 85 per cent.

Secondly, it is pointed out that all major decisions of the IMF are often settled in advance and outside of IMF's governing structure, at G-7 meetings – starting from the first meeting in Rambouillet (1975) which agreed upon the proposals for international monetary reform to the recent ones which agreed upon the debt reduction to HIPC countries.

Thirdly, it is well widely perceived that the major shareholders influence the IMF's lending policies to further their own interests. IMF and Bank lending to the Democratic Republic of Congo (formerly Zaire) in the early 1980s is often cited as an example when both these institutions continued to lend to the country despite indications that the money was not being appropriately used. The Independent Evaluation Office of the IMF in its report on the prolonged use of IMF Resources (2002) has pointed to the need for the IMF to respond appropriately to the "appearance of undue political intervention in the IMF's decision-making to grant a country resources".

Fourthly, the top five shareholders in the IMF (the US, Japan, Germany, France and UK) appoint their Executive Directors to the IMF, as compared to the other 19 Executive Directors who are elected to fixed two year terms. These appointed Executive Directors serve entirely at the pleasure of their respective Governments, and are liable for dismissal at any time. Such a provision, it is argued, implies greater sense of continuous accountability of the five Directors to their respective authorities rather than to the interests of the IMF as a whole and in some ways weakens corporate governance in the IMF.

Fifthly, the procedure for appointment of IMF Management appears to favour the industrialised countries, which in the view of some observers, further accentuates the IMF's bias against the developing countries. The post of the Managing Director of the IMF is, in practice, earmarked for a European national. A similar unwritten rule ensures that the post of the First Deputy Managing Director of the IMF goes to a US national.

Since the governance issues are structural, it is difficult for IMF to have a stance on the issue. Recognising that its operations are based upon the provisions of the Articles of Agreement – which are impossible to amend without the support of the major shareholders, in particular the veto holder, the IMF's response highlights the opportunities available to developing countries to work within the system.

Firstly, the IMF Executive Board operates mostly by consensus by seeking to establish common ground amongst members in settling policy. As far as possible, unanimity is sought for all Board decisions, with Executive Directors adopting a spirit of compromise. In such an environment, it has been held that the voting strength does not have as great a relevance as the intensity of the arguments made by the Executive Directors, the technical expertise backing them and the persuasiveness and diplomacy displayed by them.

Secondly, while it is true that developed countries can exercise veto power in the formulation of IMF policy, it is explained that such opportunities are available to and have been exploited by the developing countries also. With 37 per cent of the vote, they can effectively block any major policy proposal (which requires either an 85 per cent or a 70 per cent majority). The developing countries successfully did so in 2000 when they resisted the G-7 proposal for increase of charges. Such occasions are considered to be not very frequent, mainly because the developing countries may not act in concert on the IMF's Executive Board, in view of their diversity and systems of representation. Further, it is explained that the G-7 countries do not necessarily work in unison all the time and in fact the US, western Europe and Japan frequently differ on major issues of policy and management, with each exhibiting often different regional links.

Thirdly, it is pointed out that the IMF is essentially a monetary institution and its governance must be consistent with the contributing capacity of its members. It is argued that only with such a provision will creditor countries be willing to support the IMF through their quota contribution – they should have a say in the deployment of the IMF's funds, since it is essentially their money. In addition, demonstration of such a role for creditor countries, it is urged, is essential to enable the IMF to maintain its credibility with markets. Further, from a purely financing angle it is held that even if the quota of developing countries were to be increased, some of them may be unable to contribute the required amount of such increases in hard currency to the general resources of the IMF.

Fourthly, there is evidence of some progress in the procedures for selection of senior functionaries in the IMF. After the prolonged exercise of selection of the present Managing Director of the IMF in 2000, a joint working group was established in the IMF/World Bank to put forward procedural guidelines for the selection of these Chief Executives in the future. The group recommended that as a first step, Executive Directors could decide on the required qualifications of the candidates and establish an advisory group which would review applicants and submit a short list to the Board. The Board would then select the candidate.

Finally, by enhancing the transparency of IMF policy and country documentation as well as by the establishment of the Independent Evaluation Office, the IMF holds that it is now recognising its accountability to global stakeholders, such as civil society, faith groups, parliamentarians, etc, and not merely to member countries.

A balanced viewpoint on the issue of IMF governance must recognise the realities governing a monetary institution owned by governments, who find it hard to be above what are considered to be national or political interests. However, changes to reflect new global economic realities ought to demand attention.

Firstly, while it is true that the IMF operates broadly by consensus, this is not the case for significant issues where there is a sharp difference of opinion. In such cases, the decision of a minority of the Executive Board – which has the majority voting power holds sway. While unanimity remains the objective, in view of the diverse membership and differing interests, the achievement of a 'large majority' is seen as adequate for many decisions.

Secondly, one possible way to achieve a higher voting profile for the developing countries could be through possible reduction in the aggregate voting and quota shares of some of the developed countries, whose economic strength is inconsistent with their voting power. Presently Belgium (with a GNI of $ 252 billion and voting strength of 2.15 per cent) and the Netherlands (GNI of 400 billion and voting strength of 2.41 per cent) have a larger voting power than India (GNI of $ 471 billion and voting strength of 1.95 per cent). Such anomalies reflect the advantage small countries with large trade enjoy under the present formulas. In the past, the sizeable weights attached to foreign trade and official foreign reserves served these European economies well when regional integration had not yet proceeded far and they needed large quotas given the very open nature of their economies. With

the progress of the EU, today most of these countries have one currency, one exchange rate and one regional balance of payments. In view of these recent developments, it is possible to aver that the voting power of the 15 European Union countries need not be as high as 29.9 per cent and could be moderated to accommodate the aspirations of the developing countries.

Thirdly, a large number of developing countries (like China, India, Saudi Arabia, Malaysia) have acquired substantial foreign exchange reserves. This gives credibility to their demand for increased quota which they can back up with increased contributions to the IMF.

Fourthly, the present practice of sharing of the top posts in the World Bank and the IMF between US and Europe and Japan being 'allotted ' the office of the President of the Asian Development Bank seem to warrant a review and a mere change in process of selection may be less than adequate.

Fifthly, while progress has been made in the transparency of IMF documentation – this has not extended to the working of the Boards. It can be argued that Executive Board members should be willing to have their stance and voting positions on various issues, become public knowledge as the decisions made by them affect the welfare of the people across the world. To impart greater transparency, agenda, transcripts, summaries and minutes of the IMF Board could also be published after a lag of a shorter period, than the present five-year period.

Sixthly, the emphasis on consensus adopted by the Board could dilute the stance of individual Board members, whose positions are unclear behind the 'mass of consensus' generated in the Board. To some extent, it can be argued that this diffuses their accountability.

Finally, the resources available to the IMF for lending are not tapped from the market, but are made accessible from the capital contributions of those member countries which have strong currencies. Of the 184 countries which are members of the IMF, only the currencies of 44 members are strong enough to be usable internationally. The quota contributions of other 140 members of the Fund, which form about 30 per cent of the IMF's total quota contribution of SDR 212 billion are essentially not usable. In such circumstances, the 44 creditor countries whose quota contributions are used for the IMF's lending operations, seek to have a larger say in the disposition of credit and in putting in place adequate safeguards in the lending process. Thus, even with a rebalancing of voting power, creditor countries may tend to have a greater weight in the IMF.[3]

Concerns Related to IMF's Financing Framework

Concerns relating to the IMF's financing framework are not widely appreciated, in spite of their relevance. This is because partly it is considered internal and partly because of the complex nature of the IMF's financing mechanism and the terminology used. A loan is a 'purchase', repayment is 'repurchase', interest payment is 'charge' and repayment is based upon two different schedules – a recommendatory 'expectations schedule' and a mandatory 'obligations schedule.' In this regard four main concerns have been expressed regarding the IMF's financing framework.

Firstly, at the margin, the burden of additional IMF expenditures is borne almost entirely by the borrowers in the General Resources Account (GRA) of the IMF.[4] The IMF operates its financial structure in a 'bottoms up' approach. It is based upon the requirement that a certain amount of net income must be generated after meeting all its expenses.[5] It adjusts the rate of charge to meet this requirement so that after accounting for all its commitments, the projected net income for a particular year is generated.[6]

Whenever the administrative expenses are increased in the IMF, the total expenditures would correspondingly rise. As the projected net income is not reduced, the projected gross income will have to rise and thus the rate of charge will also have to rise. Effectively, whenever the IMF expands its mandate to new areas which justify additional administrative expenditures, this will be borne mainly by the GRA borrowing countries.[7]

Secondly, the income generating structure of the IMF is complex. The accounting procedures of the IMF allow for two sources of income – general income and other income. General income is derived from borrowers who pay charges on their borrowings, as well as service charges, commitment fees and special charges. The IMF's other income, which is also derived from borrowers, comprises surcharges levied on purchases under the SRF, CCL, the credit tranches and the EFF.[8] These surcharges are levied as a disincentive for large and prolonged borrowing rather than for the purposes of deriving income. However, the IMF's other income – SDR 650 million derived from surcharges is six times its regular income – SDR 108 million from charges. Further the surcharge income stream is separated from the regular income stream, though both are eventually credited to the Fund's reserves. If other income is merged with the general income account, there is considerable scope for reducing the rate of charge and thus giving relief to GRA borrowing countries.[9]

Thirdly, the process of accumulation of reserves in the IMF may be seen as not necessarily in the best interests of the borrowing countries. The Board – with its creditor country majority feels that the level of reserves needs to be substantially enhanced from the present $ 4.3 billion. The entire burden of providing these reserves is placed on the GRA borrowing countries – who are required to finance them through charges and surcharges levied.

Fourthly, member countries which are in a neutral position do not bear any part of the IMF's expenditure burden. Since the IMF essentially recovers its costs from borrowers and (to some extent) creditors, those member countries which are in a neutral position, i e, who are neither creditors to or borrowers from the IMF do not pay any charges to the IMF at all.

The justification advanced by the IMF on the issue of charges paid by GRA borrowing countries is mainly related to the cost of the alternate financial sources available to such countries. Firstly, the cost of the IMF's support to the borrowing country ignores the opportunity cost – the cost that the borrowing country would have paid in the international market if it had been able to tap it for a loan. Borrowing countries usually approach the IMF when outside credit dries up, and no agency is willing to provide them further financing, and those that are, will charge very high rates. The IMF is thus not levying a high rate of charge even when all the surcharges are taken into account. Secondly, from procedural point of view, it is explained that income for surcharge on purchases are excluded from the calculation of regular net income because such income could significantly distort the rate of charge in any given year. More importantly, including the income from surcharges in the determination of the rate of charge would defeat the purpose for which these surcharges were established, i e, to set a higher rate of charge which would act as a disincentive to large and prolonged use of IMF credit.

Thirdly, reserves need to be built up based upon the level of credit outstanding, and the only way to accumulate reserves is through appropriation from income – whether it is net income or other income. Therefore necessarily, charges recovered from borrowers have to finance such reserve accretion. Finally, the financing framework of the IMF is constructed based strictly on the Articles of Agreement and there is no intention to be iniquitous to borrowing countries.

Laying out a clear position on the issue of the IMF's financing framework is a complicated exercise, but the following narration is intended to lay out the broad parameters for further discussion. While it may be true that the IMF's rate of charge is reasonable when compared to alternate means of financing available to a country in crisis, this does not, by itself, provide justification for the IMF laying the burden of all its expenditures on GRA borrowing countries. The IMF's administrative expenditure is incurred on account of four broad categories of its activities (a) multilateral and bilateral surveillance, (b) Use of IMF Resources (c) Technical Assistance and (d) Research. The expenditure relating to use of IMF resources, i e, providing financial support to borrowing countries forms only about 35 per cent of the total budget. The balance 65 per cent of the IMF's budget goes towards activities which benefit all members (assuming technical assistance is a global public good). Thus ideally, all members should bear the burden of IMF activities not directly related to the IMF's lending programme. It would be reasonable to assume that in addition to their share of expenses incurred on account of IMF's 'public good' activities, borrowing members should bear the additional burden of the expenses related to the use of IMF resources, i e, lending related costs. At present the borrowing members pay not only the lending related costs of the IMF but also all the other charges of the IMF related to activities which benefit the other members also. One way in which the position of the borrowing countries could be made more equitable, is through the application of a two part rate of charge by the IMF – a general rate of charge to be paid by all member countries which would be earmarked for expenses related to the 'public good' character of the IMF and an additional lending rate of charge which would be paid only by borrowing countries and would be appropriated towards the expenses relating to the use of Fund resources. Such an approach will additionally resolve the issue of neutral position members not bearing any burden of the IMF's expenses.

An issue related to the Fund's net income projections (and hence the rate of charge which will be applied to borrowing members) is the desired level of reserves in the IMF and at what pace these reserves should be accumulated. As has been mentioned earlier, a higher rate of reserves and thus a higher rate of accumulation will demand the projection of a higher net income which in turn will require a higher rate of charge. While it may be difficult to agree on objective criteria for determining the ideal level of reserves, this issue could be examined against the background of the six categories of risks against which reserves provisions are routinely made in the banking sector. Three categories of these risks, namely, credit risk, liquidity risk and legal risk have been effectively managed through the design of the IMF's financing framework as well as obligations enshrined in the IMF Articles of Agreement.[10]

The level of reserves to be accumulated by the Fund may then need to be influenced by perceptions of the remaining risks. These risks could include market risks, operational risks and reputational risks. It is against these risks that the IMF would seek to insulate itself through the accumulation of reserves. In this regard the following points need to be considered: (a) As on April 30, 2002, the IMF held 103.440 million fine ounces of gold valued at SDR 25.1 billion (approx US $ 35 billion).[11] However, in its balance sheet, this gold is valued at only SDR 5.8 billion – 23 per cent of the market value. Thus gold reserves are undervalued to the extent of about SDR 20 billion – which is about four times the present level of precautionary balances of the IMF.[12] This cushion of underestimated gold reserves provides additional strength to the IMF's balance sheet and it is desirable that this is explicitly recognised while debating the optimum level of reserves the IMF should aim for. (b) Presently, net income of the IMF is derived as a percentage of general reserves. Usually, the net income figure is based upon a requirement that reserves increase by 5 per cent. Under such a dispensation of pro rata contributions – as reserve levels increase, the absolute amount of accretions to reserves also may increases, instead of moderating. This may not be a wholly appropriate approach to strengthening reserves, specially as such increase is entirely funded by GRA borrowing countries. Thus the pace of accumulation of reserves need not rise as reserves themselves rise – an argument for slowing down the pace of accumulation of reserves as reserve levels rise needs to be examined. It is also debatable whether, as the IMF argues, the surcharge remains an effective disincentive to large and prolonged use of IMF credit. Clubbing the surcharge income with regular income will make this annual IMF flow exercise more transparent, and allow for the IMF's reserves to be buttressed from a single income stream rather than two. While such a move will slow the present pace of accumulation of reserves, it will also underline the need for the membership as a whole to bear the burden of financing reserve accumulation instead of the GRA borrowing countries alone.

II
Current Dilemmas

Like most organisations involved in public policy, IMF also faces dilemmas or tradeoffs in many areas of decision-making and judgments are often called for, though they are within well-defined rules, procedures and precedents. Judgments are indeed a collective responsibility of the organisation but they do remain significant for both management and the Board in policy as well as implementation. Some of them are illustrated here.

Has Adjustment Become Disproportionate to the Needs of Financing?

A country facing a BoP problem has the choice of financing through running down its reserves or by international borrowing, when such gap is judged to be transitory. If the imbalance is of a persisting nature and becomes difficult to deal with, a combination of financing and adjustment is required. In a difficult situation, normally the credit and capital markets shut their door and the country may need to approach the IMF for meeting the financing gap. Hence, there is a tradeoff between financing and adjustment. IMF, through its quantitative performance criteria on various macro indicators and also structural conditionalities, aims to lay a sustainable path for adjustment for the country. In the earlier periods, IMF programmes were short and adjustments were minimal. In the era of capital market liberalisation and

floating and volatile exchange rates, the financing needs of crisis afflicted countries have become rather large, and reuse of IMF resources has got prolonged, expanding the role of adjustment. Countries, however, may find it difficult if the adjustment is severe and the path is not smooth, particularly when costs of adjustment becomes politically unacceptable.

The IMF financing now is concentrated in a few countries with large exposures. It is increasingly perceived that the financial needs of adjustment have become larger and the IMF, with access limits in place and with limited resources, encourages member countries in such a direction. Given that firstly, the act of a country approaching the Fund for support often generates an 'undesirable' domestic political message; secondly, compliance with Fund conditionality consequent to a programme may have deep and lasting impact on the domestic polity, and finally the emphasis on adjustment referred to earlier, there is a tendency for countries to shy away in early stages of BoP difficulties from turning to the IMF. In brief, the dilemmas relate to the stage at which the country should approach the Fund for support, what should be the level of adjustement the country is prepared to undertake, how much is needed from the IMF as a minimum for managing the crisis-situation, how much support the IMF will provide in this environment, how does one assess both upside and downside risks of alternative paths of adjustments given the countries' own priorities for adjustment as well as the perceptions of the financial markets on acceptance parameters of adjustment. Further, while each country is 'unique', there is also understandable expectation of uniformity of treatment of the member countries.

What Kind of Signal Can the IMF Give?

IMF has access to country data/information and its surveillance report when published could send signals to markets. In this regard, one question is that while making assessments of country's compliance with various standards and codes, whether the IMF should adopt a score-card approach of classifying economies. While nuances of IMF analysis by itself can be read by markets and the markets could form judgments based on information/data disclosure, IMF turning into a 'rating agency' may lead to 'credibility' problems, particularly because IMF itself is a 'lender' in the international market. In signalling the stance of IMF, there is also a problem for IMF of assessing the ways of creating or restoring market-confidence in the near term which may not necessarily coincide with what appears to be a prudent medium-term policy or consistent with social goals of a country.

How Far is IMF Accountable to Its Programmes?

While the IMF expects ownership and commitment from member countries, it is debatable whether the IMF is sharing the ownership with countries having IMF programmes. Many a time there could be divergence of views regarding policy prescriptions and implementation between the authorities and the IMF. The fact remains that whether the failure of programme is due to faulty implementation by authorities or due to faulty programme design, the burden of cost is entirely borne by the member country. While in non-programme countries, following IMF's policy advice remains generally voluntary, in programme countries, there is an element of compulsion. Thus, for any failure of programme due to its programme design, the IMF is in many ways accountable and in fact faces at least a reputation risk. A combination of the prevalence of judgments on the path of adjustment and uncertain accountability poses complex dilemmas to both member concerned and the IMF.

More Conditionality or Less Conditionality?

The larger the component of adjustment, greater are the conditionalities. Over years, the scope of conditionalities has expanded beyond the traditional monetary, fiscal and exchange rate related areas to structural measures in labour and product markets, trade, legal reforms, public sector management, etc. The IMF has adopted modified conditionality guidelines to make them relatively parsimonious and to improve country ownership and commitment to policies. Larger number of conditionalities reduce the incentive for countries to approach the IMF and dilute the ownership, because of difficulties in getting political acceptance. It has been argued that conditionalities must be parsimonious and founded on IMF's core areas of responsibilities like macroeconomic parameters and structural conditionalities should be limited to interrelated areas. The IMF's trilemma is to ensure the 'revolving nature of IMF resources', while simultaneously convincing the financial markets about overall soundness of policies prescribed and making the conditionality acceptable to the programme-country. In this complex scene, there is also a view that conditionalities are less than uniform due to political economy considerations among the membership.

Candour and Transparency versus Market Sensitivity

While strengthening surveillance, one of the arguments is that the IMF should show candour in its reporting and bring out vulnerabilities in more clear terms. Similarly, by advocating transparency in monetary, financial and fiscal policies, as part of promotion of international financial standards and codes, IMF has been advocating transparency and disclosure of information and data, including details for instance of possible bailing out of institutions. While transparency is welcome on the part of both the IMF and the member countries, the main issue is 'what' type of information/data could be disclosed and 'when' such information/data are to be made public. Markets in the integrated and globalised world generally overreact to new information and any panic created by adverse information can prove to be damaging due to self-fulfilling expectations. Therefore, prudent public policy both at domestic and international levels would require caution in transparency policy so as not to create panics or knee-jerk reactions in the market. There is no denying the fact, however, that the IMF should exhibit candour and transparency, as part of its internal monitoring and review mechanisms. There should be a careful tradeoff between internal transparency and external transparency.

Coordination with World Bank and other International Institutions

With participation of both IMF and the Bank in resolving crises in recent periods and the enhanced role of the IMF in developmental and structural issues, coordination between the IMF and the Bank has assumed a critical role. While arrangements exist for clear demarcation of responsibilities, based on the institutions' areas of core competence, there are several overlapping areas. For instance, in the area of public expenditure management,

IMF's prescription of 'primary surplus' budgets, as part of performance criteria, may clash with Bank's developmental objective of budgetary expenditures. In the case of trade-related matters, the multilateral objective consistent with WTO framework may, at times, clash with IMF's views on the basis of BoP considerations. On such issues, the IMF could face a dilemma of 'how far' and 'to what extent', the coverage and scope of conditionalities, as also surveillance, should extend.

III
Issues for Discussion

On the assumption that some reform of IMF is a desirable and feasible objective towards improving the international financial architecture, three issues are posed for discussion viz. Should IMF's surveillance be independent of its lending? How to minimise the democratic deficit in the functioning of the IMF? And can the IMF be a lender of some if not the last resort?

Should Surveillance Become Independent?

In crises prevention, one of the major steps taken by the IMF is towards strengthening its surveillance mechanism – of multilateral, bilateral and regional levels, through Article IV consultations, FSAP and its periodical assessments of standards and codes under ROSC. It may be recalled that after the collapse of the Bretton Woods system, and the integration of capital markets, surveillance over members' policies has been the focal point of international cooperation. Laying utmost importance to surveillance function, UK Chancellor of the Exchequer Gordon Brown said recently that the strategy is to make the IMF as credible and independent from political influence in its surveillance of economies as an independent central bank should be in the operation of domestic monetary policy. The effort of surveillance is to detect problems at an early stage, influence members' policies appropriately and help strengthen crisis prevention. Ed Balls, Chief Economic Advisor to UK Treasury has, in a recent speech at the Institute for International Economics, made out a case for independent IMF surveillance. According to him, a surveillance should reflect the following features: authoritative, commanding international respect; comprehensive, covering all issues relevant to economic stability; focused, highlighting most important risks and vulnerabilities; influential, reflecting alignment of country problems with policy recommendations; and accountable, to retain the necessary influence and legitimacy.

There is an inherent conflict between effective surveillance and prolonged use of IMF resources by a member. Working to reach an agreement on a programme and to restore confidence, many a time result in adverse incentives to become overoptimistic in the surveillance of risks. Secondly, doubts are raised that in respect of non-programme countries, whether surveillance is even across the membership or is biased towards low income and developing countries. This has become a structural issue. Even peer pressures at times may turn into peer protection. On this basis, Ed Balls, drawing on the British model of central bank independence, has argued that as in the case of central bank's autonomy in monetary policy, the IMF surveillance can be made operationally independent, devoid of potential influence from a single or a small group of member countries. One way of improving surveillance is to provide the IMF with a 'fresh pair of eyes' in key countries with active programmes. But, as a matter of long-term solution, Ed Balls has suggested that the surveillance and lending functions be made separate.

One thought that could be thrown up for discussion now is whether the IMF in addition to the present arrangements, can have a separate Board of Surveillance elected/nominated by the present Board of Governors. This Board could consist of Central Bank Governors (represented on rotational basis) or could be a sub-committee of the Executive Board. This Board, which would be fully responsible for the surveillance functions of the IMF, would have members with equal voting power. This distinctive feature of members of the proposed Board of Surveillance having equal voting powers, without any weightage for quotas, would enhance the credibility of its working. This proposal could make the surveillance process somewhat independent of political influence inasmuch as most central banks are less politically oriented and are more tuned to financial markets. This would also be consistent with the view that regulation and supervision should be separate from financing functions within economies and that central banks should be independent of governments. It must be recognised that under the proposed arrangements IMF in its role as a lender will continue to closely monitor the programme, as any responsible lender would.

An additional advantage of this suggestion is that it directly addresses one of the concerns articulated earlier relating to the Fund's financing framework. This is the issue of equitably distributing among all the member countries the Fund's expenses incurred on account of its activities relating to its public good nature – surveillance, research, etc. Presently borrowing countries pay for all the Fund's administrative expenses even though only about 35 per cent of it is attributable to the Fund's lending functions. All member countries must bear the cost of providing surveillance and other public good functions of the Fund and this can be effectively achieved if the above suggestion to formally separate the surveillance function is considered.

Minimising the Democratic Deficit

Improving IMF governance and thus reducing the 'democratic deficit' in its functioning needs to be approached through structural reforms aimed at redistribution of the voting power amongst member countries. Of the total membership of 184 countries, 24 industrial countries hold 62 per cent of the vote. The 160 developing and transition countries, which form 85 per cent of membership have a voting power of only 38 per cent. Major decisions in the Fund require an 85 per cent or a 70 per cent majority – which can be blocked by the US alone or the G-7 working in concert.[13]

This situation is accentuated by the fact that the spectrum of countries borrowing from the IMF has narrowed since the 1980s. It now includes only the developing and transition countries. Prior to this, even the developed countries used to borrow from the IMF. For example, the UK borrowed about $ 9 billion between 1947 and 2000 and is ranked as the sixth largest borrower from the IMF during this period.[14] Even the US made a reserve tranche drawing in 1978. With the developed countries no longer borrowing from the IMF, the IMF has lost some of its credit union characteristics and there is a tendency for the creditors' viewpoint to dominate in IMF decision-making. Members like India, Mexico, South Korea, Poland who were borrowers, and are now lenders do reflect the credit union character of the IMF, but such instances are not many. Most of the borrowers are developing countries

who have never been lenders while a very few of the lenders have been borrowers since the past two decades. This often creates a sharp discontinuity between the viewpoint of these two groups on the functioning of the IMF.

A further issue is the problem of removing distortions in the present distribution of voting power. For example, as mentioned earlier, countries with lower GDPs have higher voting powers merely because of its high trade. Such anomalies reflect the advantage small countries with large trade enjoy under the present quota formulas. The present quotas are not representative of the size of the economies of members, their ability to contribute and their relative importance in world trade and financial markets. The present formulas under which quotas are calculated thus need to be revised keeping in mind the sweeping global changes which have occurred since they were first adopted in 1945.

Voting power is decided based upon quotas of member countries. Quotas are arrived at based upon a set of five formulas. Five parameters are used in the present quota formulas – GDP at current market prices; Reserves; Current Payments; Current Receipts and Variability of Current Receipts. It is useful to focus attention on two of these as most relevant variables for designing quota formulas. The objective is that the formulas truly reflect the member's position in the world economy as well as the member's ability to contribute to IMF resources. The suggestions listed below relating to the use of PPP based GDP as well as the treatment of intra-monetary union trade, will result in a significant redistribution of voting power in the Executive Board while retaining the veto power of the US (without which stipulation, any proposal has little chance of success).

Presently, market exchange rates are used in converting GDP expressed in national currency to SDRs in the quota formulas. This obscures the relative strength of the economy at the global level for the purpose of international comparison. GDP converted at PPP rates will better reflect the real value of total output produced by a country. Global trade fluctuations have an asymmetric impact if compared at market exchange rates, as the consequent undervaluation of the output of developing countries is much greater compared to that of the developed countries. Two arguments are used against the use of PPP based GDP. First that this may not always correctly indicate a country's ability to contribute to IMF resources and second that accurate data for all countries are not readily available. The first objection overlooks the position that a large number of developing countries are now in a position to supply liquidity needs to the IMF as they have reasonably steady currencies, large reserves and a comfortable balance of payments position. For a few, which may have some difficulty, we can explore alternative ways for meeting this requirement, as done in the past. A quota increase will thus not create a significant barrier to contribution by such countries. Issues of data quality and availability can be resolved through a determined effort to replace estimates by actual price surveys. By providing technical assistance, countries can be motivated to support price surveys and suitable transitional arrangements can be worked out in the interregnum. Data problems relating to price comparison are not significantly different from the problems associated with measurement of variability of current receipts and net capital outflows; which variables are already being used in the quota computations.

The calculated quota is linearly related to certain trade based parameters. The sum of current payments and receipts is a parameter in three of the five quota formulas while the variability of current receipts is a parameter in the other two. These do not appear to be appropriate measures for use in quota calculations for a number of reasons. Firstly, current receipts, are recorded on gross value, which unduly biases this variable in favour of countries largely engaged in processing imports for re-export. Secondly, such a problem is accentuated in countries, which are part of a currency union where the trade turnover measure would substantially overstate the financing requirements. The Articles of Agreement mandate the IMF to support adjustment of temporary disequilibria in the balance of payments. This clearly refers to payments in external currency. Consequently, trade within a currency area, say the EMU should be excluded from the computation of quotas. It has been argued that monetary union cannot be treated as a single economic unit like a country, as the IMF deals with states and not other entities. However, equally, trade within such a union, which may neither precipitate a BOP disequilibrium nor impact on an external financing need, should not be included for the purpose of quota calculations. Thirdly, it may not be possible to measure such trade flows accurately. Thus, all intra currency union trade flows should be removed from consideration for quota calculations, as this is a major factor contributing to the present distortion in quota distribution.

Is IMF a Lender of Last or Some Resort?

There is increasingly a general acceptance of the argument that IMF should in effect be a lender of the last resort, meaning that it should be authorised and able to inject additional international liquidity in the event of a credit crunch and this could be achieved through creation and selective allocation of SDRs. This could provide confidence to the international financial system, as the central banks in domestic financial markets provide some confidence to overcome liquidity shortages and payment crises. Even in the case of central banks, however, there is a tension between whether the problem of contagion is on account of liquidity crisis or a solvency crisis. If solvency is the major issue, liquidity provision on assured terms would lead to 'moral hazard' problems as in the case of 'bailing out' of financial institutions by central banks.

Liquidity provision may be needed not necessarily at the time of crisis. It may be required earlier, well before the BoP problem turns into a crisis. Here, the argument is that the IMF should provide precautionary financing through appropriate mechanisms so that the liquidity crunch is avoided. As many countries resort to IMF lending, mainly as last resort, the efforts of the IMF, to be a lender of first resort has not worked in practice. The failure of CCL demonstrates this, with no country participating, for a variety of reasons mainly stemming from the fear of adverse market signalling that such financing might create.

In identifying IMF as the lender of last resort, there are certain factors which need to be kept in view. Creation of liquidity, even on short term basis, should not conflict with the 'borrowings' that can be undertaken in the international markets. In principle, a liquidity creator should not be a borrower. Secondly, the liquidity creation by a central bank is guaranteed by a sovereign in domestic financial system. As regards the IMF it does not strictly speaking borrow in the international private markets. NAB/GAB borrowing agreements are concluded with sovereign countries and not private suppliers. Further the IMF's liquidity instrument – the creation of SDR – is implicitly guaranteed by all member countries.

However, the central banks create liquidity not only to resolve crises, but also to smoothen market functioning. It can justifiably argued that the IMF's liquidity creation ability should be in situations when (a) countries in financial crisis require support, and (b) when the IMF has run out of its own resources as well as the available funds under the arrangements to borrow. To this extent, the IMF should remain a conditional liquidity creator.

In other words, IMF can remain only as a quasi lender of the last resort or as Bimal Jalan puts it, "IMF is a lender of some sort". To enhance the resources available, India, therefore, argued for issuance of SDR by IMF to itself for use in contingencies subject to a pre-determined cumulative limit and other appropriate safeguards. Such a mechanism would enable creation of 'temporary liquidity' which would be exhumed when it is repurchased by the borrowing country.

It must be recognised that the IMF's effectiveness would be enhanced even as a conditional limited liquidity creator irrespective of whether this facility is actually operated or not. The fact of availability itself could enhance the IMF's capacity to influence markets. Coupled with the ongoing work on the SDRM as well as progress in Collection Action Process, this initiative would strengthen the IMF's effort towards crisis resolution.

Finally, this proposal to make IMF a 'lender of some sort' as described by Jalan, with authority to create limited liquidity temporarily perhaps with severe constraints is also suggested for further discussion.

IV
Conclusions

The Fund was created "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems" against the background of the 'lose-lose' policies adopted by countries during the inter-war years. The expansion and balanced growth of international trade was considered fundamental to this objective which was sought to be achieved by promoting a fixed exchange rate system. The IMF had the characteristics of a cooperative credit union but with unequal rights and obligations to members where members faced with temporary balance of payments could access resources from other members while any fundamental disequilibrium which necessitated policy changes, and to the extent they warranted alteration of the fixed exchange rates could do so with the consent of the IMF. Creation of liquidity through SDRs, introduction of mandatory consultations or surveillance, establishment of new windows for assistance to members, and more recent changes in policies or procedures were IMF's responses to emerging global situations such as the abandonment of fixed exchange rates, oil shocks, transformation of centrally planned economies, debt-crises, increasing levels of contagion particularly relatable to volatile capital flows, and severe resentment in many fora on the IMF's role and functioning in several respects.

The current realities are characterised by practically universal membership of countries in the Fund, elimination of ideological extremes relating to role of markets, radical increase in interdependence of countries especially in financial markets; and widespread criticism of its functioning. The IMF is seldom lending to industrial countries; the scale of financing, urgency of Fund's response and the signalling impact of its stance have all increased while the link between economic fundamentals and domestic policies of developing countries is becoming increasingly difficult to comprehend. Efforts to design new institutional mechanisms to replace or supplement IMF to meet the new challenges have not borne fruit. In brief, while the new realities reflected by the technological developments and ideological orientation, do appear to warrant new global institutions or radical changes in existing ones the search for such changes has not yielded results. Hence the importance of appreciating the concerns related to working of IMF and exploring areas for some improvements.

Main concerns relating to IMF's policies are relatable to intrusive conditionalities without due regard to the needs of and impact on the borrowers, with expanding scope of surveillance applied asymmetrically between borrowers or programme countries and others with no financial accountability except that of reputational risks. The response of the Fund has been to attune its policies to meet these concerns, emphasise aspects such as national ownership, leaving culture, transparency in its operation, independent evaluation and wider consultations. However, the basic limitations of resources, instruments and mandate in meeting the problems arising from volatile financial markets explain some of the persisting concerns.

There is also concern at democratic deficit in the governance of the Fund, primarily attributable to structural aspects of distribution of voting strength and membership of the Board. The persistence of structural issues is explained as partly on account of reluctance of existing controlling interests to accept changes and partly on account of the demands on financial resources as well as financial markets' perception. Some processes or procedures are sought to be implemented to reduce the impact of such structural issues on actual functioning. There is, however, some scope for acceptable changes in structures, and representation by capturing the developments especially in Europe and Asia, to bring about a better balance without undermining the requirements held to be important for a monetary institution.

Another area concerns the inequity of the Fund's financing framework, in that a disproportionate part of burden of financing of the Fund's activities is borne by borrowers since the cost of surveillance activities which are essentially global public goods are not shared by the membership equitably.

There are several dilemmas or tradeoffs or judgments involved in the functioning of the IMF which could help appreciate the validity of some of the concerns expressed. These relate to the financing needs of a borrower vis-à-vis the extent and path of adjustments; the problems in signalling stance of the Fund faithfully but with due regard to market sentiments as well as members' sensitivities; the accountability of the IMF vis-à-vis the safety of its resources; the breadth vis-à-vis the depth of conditionality appropriate to each country, given the expectation of uniform treatment of members, transparency and candour – internal vis-à-vis external; and its jurisdiction in relation to other international institutions in view of increasing interdependencies in the policies.

Three major issues are posed for discussion to meet to some extent these concerns and improve the quality of resolving some of the tradeoffs and judgments involved. The first suggestion is to separate the surveillance function from lending, making the former somewhat independent of political processes as well as weighted voting structure. The second suggestion is to remove the distortion in current voting strength by recognising intra-

monetary union trade as not amounting to international trade since neither currency nor trade restrictions are in place and by accepting the Purchasing Power Parity basis of GDP computation. The third suggestion proposes that the Fund be given some authority to create limited but temporary liquidity, under certain circumstances to be, as Bimal Jalan put it, "a lender of some resort". As may be observed, the three suggestions should be treated as a package to make some incremental changes to the structural aspects while persisting with the eminently sensible changes in the current policies and procedures of the IMF. EPW

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Notes

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1 In the wake of the east Asian crisis, the establishment on a temporary basis of the Group of 22 (referred to also as the "Willard Group") was announced by president Clinton and the other leaders of APEC countries at their meeting in Vancouver in November 1997. Its purpose was to promote consultation and cooperation among key industrial and emerging market countries on issues pertaining to the stability of the international financial system and effective functioning of global capital markets. The Group of 22 comprised finance ministers and central bank governors from the G-7 industrial countries and 15 other countries (Argentina, Australia, Brazil, China, Hong Kong SAR, India, Indonesia, Korea, Malaysia, Mexico, Poland, Russia, Singapore, South Africa, and Thailand). In early 1999, it was enlarged into a Group of 33 to include Belgium, Chile, Côte d'Ivoire, Egypt, Morocco, the Netherlands, Saudi Arabia, Spain, Sweden, Switzerland and Turkey. The first meeting of G-33 was hosted by Germany in Bonn on March 11, 1999. This too was an ad hoc group which was succeeded by the present G-20 in November 1999.

2 Prasad and Rogoff (2003).

3 These 44 countries are members of the IMF's of the Financial Transaction Plan (FTP). Membership in the FTP indicates a strong external position which warrants having that country's currency being used in IMF transactions – i e, that country's quota contribution is usable for supply to borrowing countries and it becomes a creditor country. A number of developing countries like China, India, Malaysia, Mexico, Saudi Arabia are members of the FTP in the IMF.

4 The GRA is the principal channel through which non-concessionary support (i e, all programme facilities excluding the concessional Poverty Reduction and Growth Facility (PRGF) is extended to member countries. The rate of interest paid by borrowing countries to the IMF on their credit outstanding is derived from and is linked to the basic rate of charge. Other arrangements include the borrowing arrangements the Fund has in place (the General Arrangements to Borrow and the New Arrangements to Borrow) which can yield in times of stress an aggregate amount of $ 34 billion from creditor countries. The above argument essentially applies to the NAB/GAB also as the cost of borrowing is completely recoverable from the IMF budget and hence its borrowing members.

5 This target net income which is credited to the Fund's reserves is determined as a percentage of the existing stock of Fund's reserves. This percentage has varied from 1.7 per cent to 5 per cent over the years.

6 The total expenses of the IMF during a year comprise of (a) the remuneration the IMF pays to creditor countries (FTP members) whose currency contributions as part of quotas are used in lending transactions, (b) the administrative budget of the IMF. The targeted gross income of the IMF is then computed as the sum of (a) the remuneration to creditors (b) the administrative expenses of the IMF and (c) the targeted net income. From this targeted gross income figure, the IMF derives the basic rate of charge to be imposed on borrowing countries after assuming a certain level of borrowing. The rate of charge is further enhanced to provide for non-payment of charges by certain countries – so that such an eventuality does not affect the IMF's net income. This is done through a mechanism called burden sharing where the rate of remuneration paid to creditors is also correspondingly reduced so that the burden of arrears to the Fund is shared equally between creditors and debtors. If the actual level of borrowing is greater than or less than the targeted borrowing, the net income target will be correspondingly affected. To adjust for this, any excess in achieving the net income target is refunded to the borrowers through a retroactive reduction in the rate of charge; any shortfall in the net income from target is recovered from the net income in the succeeding year.

7 A distinction is made between GRA borrowers and concessional (PRGF) borrowers as the latter group pay concessional rates not linked to the rate of charge.

8 These surcharges which vary from 100-500 basis points are levied based upon the volume of credit availed by a member country as a percentage of its quota. These surcharges are designed to discourage large use of IMF resources. The SRF, CCL surcharges increase with the time elapsed since the first purchase, which sharpens the incentive for repayment ahead of the obligation schedule.

9 It has been estimated that the relative burden on IMF members of financing the IMF's administrative expenses, precautionary balances and imputed credit costs (the last for the non-remunerated portion of the reserve tranche) has shifted from 28 per cent on the debtors and 72 per cent on the creditors in 1982 to 75 per cent on the debtors and 25 per cent on the creditors in 2002. Thus over the past two decades, the burden of IMF expenditures has shifted significantly to the debtors. For every additional dollar expenditure the IMF undertakes, effectively the borrowing countries presently pay about 75 per cent.

10 The three risks are managed in the following fashion. (a) The IMF has preferred creditor status in the international debt market and thus its claims have priority over those of all other creditors. This exceptional feature places the IMF above all other creditors. A country can rarely operate in the markets as long as it has overdues to these institutions and thus, the earliest creditors a country will repay are the IMF and World Bank. Thus, this framework effectively insulates the Fund from credit risk – the risk of non-payment by the borrower. (b) The commitments made by a member country by accepting the Fund's Articles of Agreement effectively manage the legal risk – the risk that the lending contracts will be unenforceable (c) The liquidity risk – the risk that non-payment by borrowers will affect the lenders liquidity is met through the burden sharing mechanism. This mechanism ensures against arrears from members (either in the form of overdue purchases or charges) do not affect the Fund's income dynamics, with this burden being placed equally upon the creditors and the borrowing countries.

11 Item 5 on page 163 of the IMF's Annual Report for 2002.

12 As per the IMF's General Department Balance Sheet as on April 30, 2002, the general reserves are SDR 3640.445 million and the balance in the Special Contingency Account is SDR 1307.019 million, giving a total of nearly SDR 5 billion in precautionary balances.

13 Nearly all the 13 categories of decisions to be made by the Board of Governors (which are not delegated to the Executive Board) require 85 per cent of the total voting power for approval. These include decisions relating to adjustment of quotas, allocation or cancellation of SDRs, creation of the Council, size of the Executive Board. There are about 40 categories of decisions which can be taken by the Executive Board, which require special voting majorities. Sixteen categories of decisions require 85 per cent majority (these include change in obligatory periods of repurchase, basis for calculation of reserve tranche positions, valuation of SDRs, sale of gold, BoP assistance from Special Disbursement Account (SDA) while the others require 70 per cent majority (these include – determination of rates of charge, increase in percentage of quota for remuneration, determination of SDR interest rate, suspension or reinstatement of voting rights). Thus major decisions in the IMF can be blocked with a 15.1 per cent voting strength while other significant decisions with a 30.1 per cent voting strength.

14 The countries ahead of UK are Mexico, Korea, Russia, Brazil and Argentina. India stands seventh in this list.

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