

#### QUESTION 16

### How does the IMF function?

The IMF, like its twin institution, the World Bank, was founded in 1944 at Bretton Woods. Its aim was to stabilize the international finance system by regulating the flow of capital. In 2010, it had 186 member countries (the same as for the World Bank). The organization is similar to the World Bank: each country appoints a governor to represent it, usually the Minister of Finance or the governor of its central bank. The Board of Governors, the sovereign body of the IMF, meets once a year in October. It deliberates over important decisions such as the admission of new countries or the preparation of the budget.

For the daily administration of IMF missions, the Board of Governors delegates its powers to the Executive Board, composed of twenty-four members. Each of the following eight countries enjoys the privilege of appointing a director: United States, Japan, Germany, France, United Kingdom, Saudi Arabia, China, and Russia. The remaining sixteen are appointed by groups of countries that can differ slightly from the ones in the World Bank, and they can decide to elect a representative of a different nationality. It is noteworthy that France and the United Kingdom have succeeded in realizing the amazing feat of nominating the same representative on the Executive Board of both the IMF and the World Bank, which shows the proximity and complementarity of these institutions.

The third governing body is the International Monetary and Financial Committee (IMFC) which is composed of the twenty-four governors of

the countries on the Board of Governors. It meets twice a year (in spring and autumn), and in its consultative role, advises the IMF on the running of the international monetary system.

The Board of Governors elects a Managing Director for five years. The same tacit rule that exists in the World Bank reserves this post for a European. The French Michel Camdessus occupied the post from 1987 to 2000, and resigned following the Asian crisis. The role of the IMF, in helping creditors who had engaged in risky investments and in imposing economic measures that lead to the unemployment of more than twenty million people, had caused massive popular protests and destabilized several governments. The German Horst Köhler replaced Camdessus at the head of the organization, until his resignation in March 2004 to become president of the German Republic. He was succeeded by Rodrigo Rato, who was the Spanish finance minister in the conservative government of José Maria Aznar, until his electoral defeat in March 2005. Rato surprisingly resigned in June 2007, and has since worked for several giants of international banking. In November 2007, he was succeeded by the French liberal socialist Dominique Strauss-Kahn, former finance minister who received the backing of the conservative French president Nicolas Sarkozy.

In July 2008, the Managing Director managed a team of 2,596 higher officials from 146 countries, though mainly based in Washington. The “Number Two” of the IMF is always a representative of the United States, whose influence is significant. During the Asian crisis of 1997–98, Stanley Fischer, who held the post at the time, upstaged Michel Camdessus on several occasions, and this was one of the reasons for Camdessus’s resignation. In the Argentinean crisis of 2001–2002, Anne Krueger, a George W. Bush appointee, played a more active role than Horst Köhler. Since September 2006, this post has been held by John Lipsky, ex-chief economist of JPMorgan, one of the main U.S. commercial banks.

Since 1969, the IMF has its own accounting unit, which regulates its financial activities with its member states, called Special Drawing Rights (SDR). It was created at a time when the Bretton Woods system, based on fixed exchange rates, was wavering, so as to safeguard the credit reserve, namely gold and the dollar. But this did not prevent the Bretton Woods system from collapsing, following President Nixon’s decision to stop the

direct convertibility of the dollar to gold in 1971. With a floating rate, the SDR has effectively become another credit reserve. According to the IMF: "The SDR is neither a currency, nor a claim on the IMF. Rather, it is a possible claim on the freely usable currencies of IMF members." Originally equal to \$1, it is now reevaluated on a daily basis from a selection of strong currencies (dollar, yen, euro, and the pound sterling). On 12 April 2010, 1 SDR was worth about \$1.53.

Unlike democratic institutions, the IMF has been endowed with a mode of operation similar to that of a corporation. Any country that joins the IMF has to pay an entry fee which is a *pro rata* share. Thus the country becomes a shareholder in the IMF, since it contributes to its capital. This share is not freely chosen by the country but calculated according to its economic and geopolitical importance. Theoretically, 25 percent must be paid in SDR or one of the component strong currencies (or in gold, until 1978), and the remaining 75 percent in the country's local currency. This has given the IMF a large stock of gold (the third largest gold holder in March 2008 after the United States and Germany), as countries paid their IMF subscription in the precious metal. Furthermore, in 1970–71 South Africa, considered perfectly respectable by the IMF despite its continual violations of human rights under the Apartheid regime, sold it huge quantities of gold. At the end of March 2008, the IMF's gold reserves amounted to 103 million ounces (3,217 tons), with a market value of \$103 billion. Surprisingly, this amount appears on IMF accounts based on its 1970s valuation, that is, it is estimated at less than \$9 billion. This has allowed the IMF to play down its gold holdings, at least until this booty raised an internal debate, resolved in April 2008, as we will see later, to reduce a worrying deficit. Although these reserves do not enter into the IMF's loans, they confer upon the institution a stability and stature that are essential in the eyes of the players of international finance.

In February 2008, the IMF's total resources represented the equivalent of \$362 billion, of which \$95 billion were not to be used for loans (gold, weak currencies) and \$267 billion which were usable (mainly currencies of the Triad countries).<sup>75</sup> However, the outstanding credit of the IMF to the member states considerably decreased in the last few years and the IMF was desperately waiting for new borrowers to knock on its

IMF Outstanding Credit (in \$ billion)	
YEAR	AMOUNT
31 December 1998	94.0
31 December 1999	78.9
31 December 2000	64.2
31 December 2001	75.3
31 December 2002	95.8
31 December 2003	106.9
31 December 2004	96.5
31 December 2005	49.6
31 December 2006	20.5
31 December 2007	15.5
31 December 2008	33.1
31 December 2009	66.3
31 December 2010	70.2

Source: IMF. <http://www.imf.org/external/np/fin/tad/extcred1.aspx> (conversions from SDR to US\$ were made using the exchange rate prevailing at the end of each period).

doors. The economic and financial crisis that erupted in 2008 brought the IMF to the forefront again. Its lending capacity increased considerably and loans began a strong upward swing starting in 2008.

After the 2010 spring meeting of the IMF and the World Bank, the lending capacity of the IMF was tripled to \$750 billion. The main contributors were: Japan (\$100 billion); EU (\$178 billion); United States (\$100 billion); Brazil (\$10 billion); Russia (\$10 billion); China (\$50 billion); India (\$10 billion).<sup>76</sup> Its outstanding credit (see table below) amounted to \$33.1 billion at the end of 2008, \$66.3 billion at the end of 2009, and \$70.2 billion on 31 March 2010.

Unlike the World Bank, which borrows on the financial markets, it is member states' contributions that enable the IMF to build loan reserves, to countries with a temporary deficit. Such loans are conditional upon the signing of an agreement stipulating the measures the country must take in order to get the money. These are the notorious Structural Adjustment Programs. The money is released in instalments, after verification that the stipulated measures have indeed been implemented.

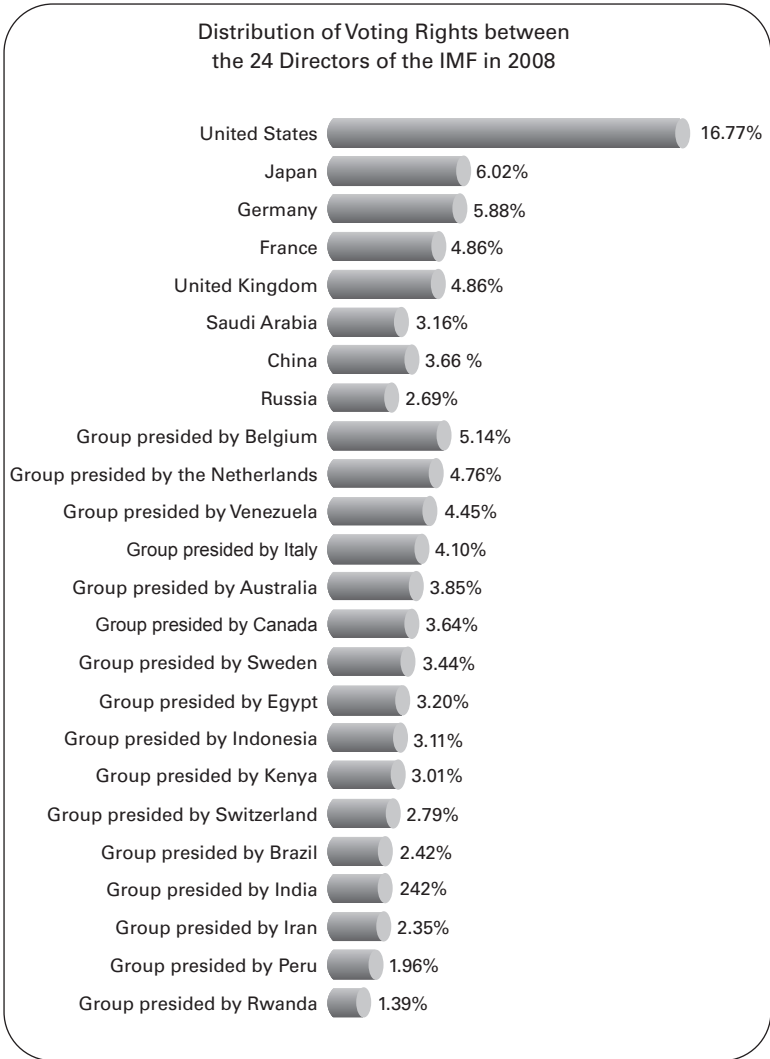
As a rule of thumb, a country in difficulty may undertake yearly borrowings of up to 100 percent of its share value from the IMF and up to a maximum of 300 percent in total, except in the case of emergencies. These are short-term loans that the country is expected to repay as soon as its financial situation improves. The greater the share value, the greater the amount that can be borrowed.

The interest rates on funding granted by the IMF to member states can be calculated from the SDR's interest rate (valued at 0.26 percent on 12 April 2010). At the time, the interest rate at which stranded countries could borrow from the IMF was 1.27 percent. At the same time, the IMF was remunerating rich countries for the sums they loaned it at a rate of 0.25 percent.<sup>77</sup> The difference allows the IMF to finance its day-to-day running costs.

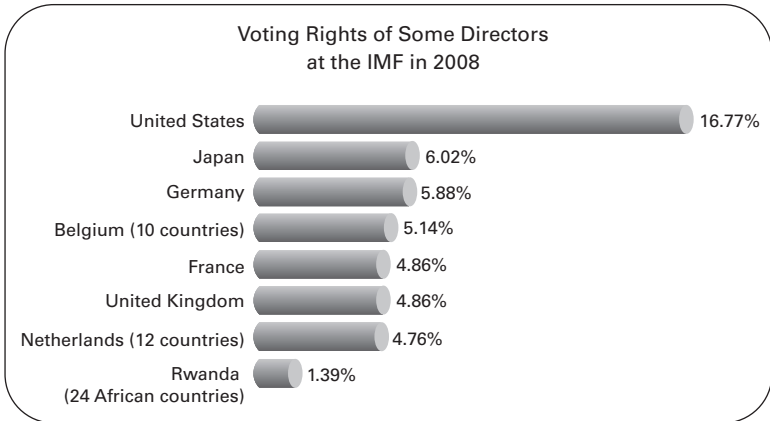
As in the World Bank, a country's share determines its number of votes in the IMF, which corresponds to 250 votes plus one vote per 100,000 SDRs portion of the share. That's how IMF's Executive Board allocates a prominent place to the United States (over 16 percent of voting rights), followed by Japan, Germany, the group led by Belgium, then France and the United Kingdom. By way of comparison, the group led by Rwanda, including twenty-four Sub-Saharan African countries (French- and Portuguese-speaking) and representing 225 million people, has only 1.39 percent of voting rights.

Such blatant inequalities have been the cause of much anger among developing countries, which are demanding a review of voting rights. In 2006, the increasingly precarious position of the IMF led the managing director to propose a reform. Instead of a thorough reform of a shaky organization, it was decided that a revamp in multiple stages and over several years would take place. The first phase concerned only four developing countries, close to the United States and big buyers of U.S. Treasury bonds: China, South Korea, Mexico, and Turkey. The chosen ones have had to make do with a few tenths of percentages more on their respective allocations, not adequate to loosen the stranglehold of the big powers, but just enough to massage the ego of the leaders of these countries, which the United States and Wall Street consider strategically important. Dominique Strauss Kahn has made democratization of the IMF his main warhorse. The next phase of this project is moving at pedestrian speed, but one thing remains certain: the division of powers at the IMF is a subterfuge, and it will remain so.

With such a system, it is clear that the Triad countries easily manage to get the majority of voting rights and are thus in the driving seat at the IMF. Their power is utterly disproportionate if compared to that of the developing countries, whose voting rights are ridiculously small in relation to the size of the populations they represent.



As in the World Bank, the 85 percent threshold allows the United States to rule the IMF. Indeed, this majority of 85 percent is required for all important decisions over the future of the IMF, such as the allocation and the annulment of SDR, the increase or decrease in the number of elected directors, decisions affecting certain operations or transactions

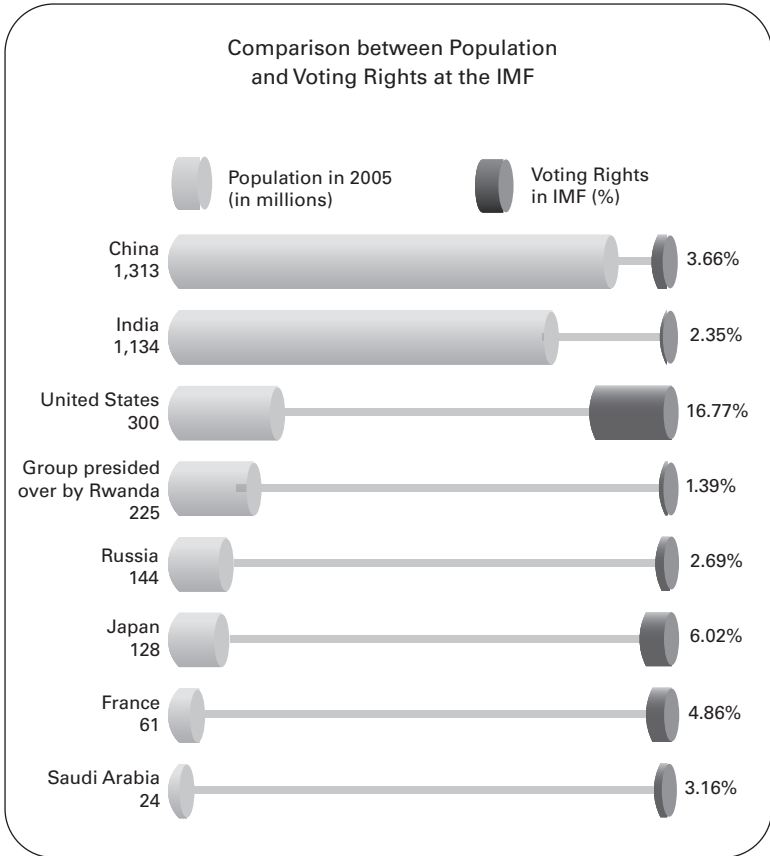


Source: IMF

concerning gold, evaluation of SDR, the modification of shares, the temporary suspension of certain measures or various operations and transactions with SDR, and others. As in the World Bank, the United States is the only country with more than 15 percent of voting rights, which automatically gives it a blocking minority for any far-reaching change in the IMF. Initially, this threshold was 80 percent, but with the increase in independent countries, the United States saw the erosion of its voting rights. The United States only agreed to hold less than 20 percent of the votes if the threshold was raised to 85 percent.

The missions of the IMF are carefully defined in its statutes:

- (i) To promote international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems.
- (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.<sup>78</sup>
- (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.



Source: World Bank; UNDP, *Global Human Development Report, 2007*

- (iv) To assist in the establishment of a multilateral system of payments with respect to current transactions between members and in the elimination of foreign exchange restrictions that hamper the growth of world trade.
- (v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

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Voting Rights in the IMF, 1945–2000 (in percent)

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COUNTRY	1945	1981	2000
Industrialized Countries :	67.5	60.0	63.7
United States	32.0	20.0	17.7
Japan	–	4.0	6.3
Germany	–	5.1	6.2
France	5.9	4.6	5.1
United Kingdom	15.3	7.0	5.1
Oil Producing Countries:	1.4	9.3	7.0
Saudi Arabia	–	3.5	3.3
DC:	31.1	30.7	29.3
Russia	–	–	2.8
China	7.2	3.0	2.2
India	5.0	2.8	2.0
Brazil	2.0	1.6	1.4

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Source: Yves Tavernier, *French National Assembly Finance Commission Report on the Activities and Control of the IMF and the World Bank, 2000*

- (vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

In reality, the IMF's policies contradict its statutes. Contrary to the second point, the IMF does not give priority to full employment, whether in the highly industrialized countries or in the developing countries. The IMF, under the influence of the U.S. Treasury and with the support of the other highly industrialized countries of the North, has taken the initiative to become a major actor that has greatly influenced the political and economic orientations of its member states. To achieve this, it was not unwilling to act beyond its rights.

The IMF has thus favored the complete liberalization of capital flows. This freedom of capital is one of the major causes of the financial crises that have violently hit the developing countries. The removal of all restrictions on capital flows promotes speculation and contradicts what is stipulated in Section 3 of Article 6 of the statutes of the IMF, titled “Control of Capital Transfers,” which states: “Members may exercise such controls as are necessary to regulate international capital movements.” Blinded by its neoliberal will, the IMF management tried in April 1997 to change this part of the statutes to give a legal framework to its deregulatory activities. This project failed due to bad timing: the meeting held in Hong Kong and the South Asian crisis was just starting. The opposition of the governments of some developing countries buried the project. Consequently, the continued abolition of all controls on capital flows enacted by the IMF constituted a clear violation of the spirit of the institution’s statutes.

The IMF sees the end of the Asian recession as proof that its policies are right. That is stupid. All recessions come to an end. All the IMF managed to do was to make the Asian recession deeper, longer and more painful.

—JOSEPH STIGLITZ, in *The New Republic*, April 2000

Surveillance, financial aid, and technical assistance are the IMF’s three areas of intervention. Yet clearly, when one takes stock of the situation, it verges on total failure. The annual consultations with member countries and the recommendations of its experts did not enable the IMF to foresee nor avoid any of the major crises after 1994. Some critics maintain that its policies even worsened the crises.

The G7 governments, particularly the United States, use the IMF as a vehicle to achieve their political ends. Numerous studies of the effects of IMF lending have failed to find any significant link between IMF involvement and increases in wealth or income. IMF-assisted bailouts of creditors in recent crises have had especially harmful and harsh effects on developing countries. People who have worked hard to struggle out of poverty have seen their achievements destroyed, their wealth and savings lost, and their small businesses bankrupted.

Workers lost their jobs, often without any safety net to cushion the loss. Domestic and foreign owners of real assets suffered large losses, while foreign creditor banks were protected. These banks received compensation for bearing risk, in the form of high interest rates, but did not have to bear the full (and at times any) losses associated with high-risk lending. The assistance that helped foreign bankers also protected politically influential domestic debtors, encouraged large borrowing and extraordinary ratios of debt to equity.

—INTERNATIONAL FINANCIAL INSTITUTION  
ADVISORY COMMISSION (US Congress),  
known as the Meltzer Commission, 2000

At the beginning of the twenty-first century, the IMF was in bad shape. Its managing directors had resigned before the end of their term, as soon as a less risky job had become available. The challenges to its authority kept growing, both from global justice movements and many governments of developing countries. All its major borrowers had paid their debts or stopped asking for its help. This was not without consequence on the finances of the IMF, as an early reimbursement implies a major shortfall. That is why in April 2008 the Executive Board approved the sale of 403 tons of gold, for a value of \$11 billion. The investment of this transfer allowed the IMF to refill its coffers.

During the 1970s, following Nixon's decision to effectively end the Bretton Woods agreements by suspending the convertibility of the dollar into gold, the IMF was profoundly destabilized and only recovered thanks to the debt crisis that hit the countries of the South in the 1980s. In a different context, the international crisis of 2007 has again given the IMF a prominent role.