

The Reform of the International Monetary Fund (IMF)

**A Provisional Appraisal
and Perspective on the
International Debate**

By Rainer Falk



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1. The Unfinished Agenda

This paper develops a perspective for the reform of the International Monetary Fund (IMF). It focuses explicitly on the renewal of its tasks and institutional structure. The intention here is not to join the chorus of left and right wing critics who are calling for a complete dismemberment of the Fund nor to argue that because the Fund has existed it ought to continue to exist. Rather, it is to examine possible strategies and show why ideas such as put forward by the prominent Meltzer Commission that the Fund should restrict its role to crisis manager in the emerging economies and pull its money out of the developing countries will not work.¹ The issue that is really at stake is the function that the Fund could take in the framework of a "new international financial architecture" and a reformed international development policy.

The dominant position of mainstream economics and politics in the debate on the new international financial architecture is characterised by major weaknesses. This concerns the extent and reach of the proposals and actual changes that have already taken place. The debate came to a head as a result of the financial crises in the second half of the 1990s: the Mexican Peso crisis of 1994-95, the Asian crisis of 1997-98, as well as the Latin American and Russian crises of 1998-99. It became quite clear that we were dealing with major functional disruptions of globalised financial markets; they were, without question, systemic in nature. Already at the time of the Mexican crisis, the then director of the Fund, Michael Camdessus, said that this was "the first major crisis of our new world of globalised financial markets."² However, in comparison to the visionary thinking of the founding fathers of the Bretton Woods system, the ensuing discussion about the crises was quite narrow.³ While the Bretton Woods generation were concerned with a "Grand Design" for the world economy, something that arose out of the depression of the 1930s and World War II, this generation are only concerned with tinkering with the details of the existing system. Even the idea of the necessity of a *new* international financial architecture is circumvented whenever possible; the main preoccupation being a "strengthening" of the existing financial system and not its renewal.⁴

At base these mainstream reform proposals refer to government policy and not to market failures,⁵ where the root causes of the increasing severity of the crisis in the international financial system actually lie.⁶ The emphasis has been on more "transparency" on the side of the governments in emerging economies, calling governments to provide timely and comprehensive information on domestic policy conditions and changes on financial markets.

Furthermore, the reform proposals concentrate on providing security for international investors, increasing the pressure on developing and emerging economies to introduce the type of banking systems and capital market regulation that we find in developed capitalist economies.

As far as the activities of the Fund are concerned, these discussions have led to the introduction of a new electronic information system on financial markets (the so-called SDDS) and to a building up of its "surveillance" activities for crisis prevention.⁷ These activities cannot, however, disguise the fact that there

¹ Cf. Report of the International Financial Institutions Advisory Commission (hereinafter: Meltzer Report), Washington D.C. 2000.

² Financial Times, 3.2.1995. Cf. Rainer Falk, *Neue Regeln für die Weltwirtschaft? Der IWF, die Mexiko-Krise und die Aussichten der "Global Governance"*, in: Blätter für deutsche und internationale Politik, Heft 4/1995, pp. 428-437.

³ Cf. Rainer Falk, *Von Bretton Woods zum "Kasino-Kapitalismus" und zurück? Zu Geschichte und Zukunft des internationalen Finanzsystems*, in: Jürgen H. Kreller/Jost H. Wagner (Hg.), *Europa vor globalen Herausforderungen. Beiträge des Trierer Kolloquium Zukunft, IfSF: Trier 2000*, pp. 73-92.

⁴ Cf. the title of the most recent policy position paper of the German Federal Ministry of Finance (BMF), *Stärkung der internationalen Finanzarchitektur* ("Strengthening the International Financial Architecture").

⁵ For a recent overview see, Horst Köhler, *Report of the Managing Director to the International Monetary and Financial Committee on the IMF in the Process of Change*, Washington D.C., April 25, 2001.

⁶ Cf. David Felix, *IMF: Case of a Dead Theory Walking*, in: Foreign Policy in Focus, No. 12/April 2000.

⁷ Other measures include, for example, strengthening the supervision of banks, combating money laundering, and the development of a code of conduct for financial markets. These activities have been undertaken by the Forum for Financial Market Stability, the Bank of International Settlements (BIS) and the OECD, which will not be dealt with in this paper.

is no functioning method of predicting and thus preventing crises. Furthermore it is worth mentioning that in the aftermath of the financial crises the Fund has extended its financing capacities (by doubling the General Agreement to Borrow and by creating two new credit facilities - see section 4 of this paper). But a convincing re-design of credit lines, particularly for the poorest of countries (see section 2 of this paper), is yet to come to the light of day.

In contrast to the market orthodoxy of the mainstream, this paper comes to what may at first appear to be a paradoxical conclusion: in a real process of reform, the Fund has to be both strengthened as well as weakened in its role depending on which *function* the Fund should serve in the future. Against that background, the following will deal with the particular functions of the Fund that a reform agenda must take into consideration:

- the social, legal, and disciplinary functions in the developing economies;
- the co-ordinating role and regulatory functions of the Fund in the world economy, particularly with regard to the globalised financial markets
- financing
- governance, particularly the decision-making processes inside the Fund.

The reform agenda that we wish to develop for a new IMF is concerned in particular with the following points: overcoming the traditional structural adjustment programmes (section 2); the regulative tasks of the Fund, especially international exchange rate policy (section 3); the future role of the Fund as crisis manager (section 4); and the democratisation of the Fund (section 5).

2. The Chameleon Nature of the IMF: Between Disciplinary Neo-liberalism and Poverty Alleviation

As already indicated, for most developing countries orderly relations with the Fund are a pro-condition for access to international capital markets. Since the introduction of the structural adjustment programmes (SAPs) in the early 1980s this "gate-keeper" function in fact works as an instrument of the Fund to secure global societal and economic order discipline. It gives the Fund a central role in what Stephen Gill calls "the new constitutionalism of disciplinary neo-liberalism"⁸. For this reason the programmes, which even spread to Eastern Europe in the 1990s, have been subject to heavy criticism. Often it has been shown empirically that the blanket and indiscriminate use of SAPs is responsible for the increasing poverty of people and the polarisation of incomes as well as environmental damage in the South. Even in terms of the SAPs own criteria – creation of the conditions for economic growth and credit worthiness – it is clear that they have been anything but a success. Some high ranking officials in the World Bank have come to the conclusion that the developing world's poor would have been better off if their governments had not heeded the advice and conditions that were tied to loans provided by the Bank and the Fund.⁹ The so-called "Washington Consensus", which was the basis of the neo-liberal SAPs, has started to crumble. Some, like the Bank's former chief economist, Joseph Stiglitz, have even emphasised the necessity of a "Post-Washington Consensus", although it is still unclear how this new consensus can emerge and what it will be.

⁸ Stephen Gill, *The constitution of global capitalism*, paper presented to a Panel: The Capitalist World, Past and Present at International Studies Association Annual Convention, Los Angeles 2000 (www.theglobalsite.ac.uk)

⁹ Cf. William Easterly, *The effect of IMF and World Bank programs on poverty*, World Bank, Washington D.C., October 31, 2000. Easterly has calculated that during the 1980s and 1990s the IMF and the World Bank provided 958 SAP loans to 36 very poor countries, i.e. around 10 or more per country. With barely an exception the average growth of these countries in both decades was zero: "Conditional lending did not cause the zero growth but it certainly failed to deliver "adjustment with growth". (*The failure of development*, in: Financial Times, 4.7.2001).

2.1 Difficult New Beginnings

Instead of drawing a clear line under the old policy and initiating a fresh start for the Fund we are actually observing a process that is slowing down change. The reasons are many, but this does not take away the fact that the outcome is at best contradictory. It seems to be a natural law that a big international bureaucracy like the Fund is itself seemingly incapable of structural adjustment. A serious break with the old ways of SAPs would easily reduce the Fund's staff of over 1000 to some 200.¹⁰ For the majority of the Fund's highly paid experts are occupied with the micro-management of countless SAPs: they would simply become superfluous if the SAPs were given up instead of being remodelled, and the responsibility for the formulation and elaboration of a new policy to tackle poverty is left to the developing countries themselves (keyword: "ownership"). But instead of looking for new jobs in the private sector, hundreds of international civil servants have simply found a new mission. The result is that the Fund is becoming, in the words of Angela Wood from the UK based Bretton Woods project, even more schizophrenic in its priorities and instruments.¹¹

One need not look far for evidence:

- a) *At first*, the Fund's new poverty orientation (e.g. the PRSP strategy that is within the framework of the HIPC initiative) was increasing conditionalities and cross-conditionalities linked to IMF loans.¹² Thus, in the last few years governance-related and social conditionality has been increased but without giving up the basic and traditional macro-economic conditionality. In a sense the Fund is now increasing its importance in an area that has proven the most problematic of its whole mission.

This development can be interpreted in two ways. On the one hand it seems that the Fund is now seriously concerned with the problem of poverty in the poor countries but thus runs into the trap of being seen as an omnipotent bureaucracy.¹³ On the other hand, it can be seen as a tendency of the Fund to expand its domain of activities – a trend that started in the 1970s. The upshot is that every crisis (often partially created by the Fund) leads to an expansion of the Fund and to a growth in its bureaucracy. Thus, the Fund creates the conditions for increasing its own power.¹⁴

- b) *Secondly*, the new concepts of the "Post-Washington Consensus" themselves contain substantial problems. The new catch phrases of the global development policy agenda are, for example, "pro poor growth", "social re-engineering", "good governance", "participatory implementation", and "more ownership". But all these have one aim: more and more rapid growth.¹⁵ Although it is laudable that there is now an attempt to integrate economic and social policy and the fight against poverty in a single concept, it will come to nothing unless there is the willingness to give up old premises and principles: "The hypothesis that growth can be accelerated by adding social policies to the standard macroeconomic policies designed to reduce inflation and fiscal deficits, and to the standard structural reforms designed to open economies to the rest of the world and promote privatisation and deregulation, is not very convincing. It is difficult to see how poverty reduction strategies will deliver accelerated growth, particularly as they are a new and untested policy mechanism."¹⁶

¹⁰ See, for example, the proposal of Walden Bello, *Jurassic Fund*, *ibid*.

¹¹ Angela Wood, *A Crisis Of Identity? Conflicting Roles For The IMF*, www.brettonwoodsproject.org.

¹² On average every SAP has had about 23 conditions.

¹³ Cf: Devesh Kapur/Richard Webb, *Governance-related Conditionalities of the International Financial Institutions*, G-24 Discussion Paper Series, Geneva, No. 6/August 2000.

¹⁴ This can be seen in the growth of special Fund facilities that have been created after the various crises. After the collapse of the first generation of SAPs the ESAF was created that was then renamed as the *Poverty Reduction and Growth Facility* as pressure was increasing for debt amnesty. Following the Asian crisis the Fund created the *Supplemental Reserve Facility*. See Bruce Rich, *Die Verpfändung der Erde. Die Weltbank, die ökologische Verarmung und die Entwicklungskrise*, Stuttgart 1998.

¹⁵ Cf. *World Development Report 2000/2001*, World Bank, Washington D.C. 2001. The main author, Ravi Kanbur resigned shortly before the report was finished in May 2000.

¹⁶ UNCTAD, LDC 2000 Report, p. XI/XII.

- c) Thirdly, there is as yet no appropriate solution to the conditionality problem. In fact, Horst Köhler, the director-general of the Fund, has stated that as the number of conditions increases, the aims of the conditions are ever more in conflict, which starts to overtax the recipient countries and thereby cancel out the effectiveness of the means altogether. However, the Review and Streamlining Process initiated in autumn 2000 has yet to bring clarity into the problem. Indeed, one can say that the present debate is too focused on the problems of implementation at the expense of discussion about the aims and substance of conditionality and SAPs.¹⁷

Although an attempt to simplify conditionality would be a welcome step it would be problematic if, at the end of the day, it only resulted in a shift in emphasis of partial conditions. For example, the simplification of tied loans can lead to an emphasis on conditions that relate to earlier phases ("prior actions") in which it is questioned whether the country is in fact now entitled to a Fund loan given in its past.¹⁸ Another tendency is that although the Fund may give up its role in micro-management in developing countries, this is transferred to the World Bank so that, in end effect, the recipient countries hardly face any reduction in conditionality: "Whilst it is important that conditionality is refocused on core areas it is an illusion that the IMF is cutting back its role and advice to core areas of expertise," concludes Angela Wood from Bretton Woods Project.¹⁹

The inadequate implementation of the Fund's promise to simplify conditionality is in no way restricted to the poorest countries. Even the Fund's recent Bail-Out-Programmes for Turkey and Argentina indicate that there is no real break with the past. These programmes include a spectrum of conditions that affect the economic, social, and development policies of these countries, such as privatisation and deregulation of the economy and reform of the agricultural sector, the social security and pension system, and industrial, competition, and trade policy.²⁰

- d) *Fourthly*, the debate about "ownership", which is closely related to the problems of conditionality, is not without snares either. "The laudable attempt to increase domestic ownership of reform programmes may easily be undermined through low domestic policy capacities, and a narrow view of acceptable programmes within the development process."²¹ What if, however, the results of ownership do not turn out to be that which the creditor countries have expected? This can happen if for industrial nations the concept of ownership appears to be one in which a country simply has to accept the Fund's reform programme as its own.²² One can conclude that the Fund's proposals actually have nothing to do with a strengthening of ownership and national bargaining power. The proposals are much rather evidence of the fact that both Bretton Woods institutions are redefining and re-organising their tasks and activities. This does not mean that the economic policy decisions will be handed back to the debtor nations.²³ In fact this is the real criterion to see if there really has been a change in the Fund's loan policy.

2.2 Renewed Roll-back?

Since the start of the Bush administration there have been increasingly obvious signs that a move to a new orientation of SAPs will be scuppered if Washington has its way. We can see this in the person of Paul O'Neill, the new US secretary of finance, who has re-invented economics. In O'Neill's view, the financial crises of the recent past were due to an "absence" of capitalist structures (and not due to "too much capitalism") – a diagnosis that the *Financial Times* declared quite correctly to be "First World

¹⁷ Cf. Barbara Unmüßig, *Konditionalitäten und Ownership*, DSE/IMF-Tagung, Berlin, 11./12.6.2001.

¹⁸ The Meltzer Commission had suggested this idea.

¹⁹ Angela Wood, *Carrots and Sticks: a quick fix for IMF conditionality*, April 2001, www.brettonwoodsproject.org.

²⁰ Cf. UNCTAD, TDR 2001.

²¹ UNCTAD, LDC 2000 Report, p. XII.

²² See BMF, *Stärkung der internationalen Finanzarchitektur. Überlegungen zur Reform des IWF und der Finanzmärkte*, Berlin, 1 March 2001.

²³ Barbara Unmüßig, *Konditionalitäten und Ownership*, *ibid.*

Fundamentalism".²⁴ Observers have now started to speak of a major disagreement between O'Neill and the Fund's director-general, Horst Köhler.²⁵ While in an interview with Köhler at the 2001 IMF and World Bank spring meetings, Köhler warned that the Fund's clients should "not be overstretched by too many reforms at one time," and that the Fund should in future avoid the impression of being "only an instrument of its main shareholders," O'Neill in contrast declared: "First Reform, then Credit". That is, the position of the US Treasury is that recipients of IMF credits are to be made even more "accountable".

Where this journey is going will be determined by the personnel policy of the new US administration. In the person of Anne Krueger the US have proposed a hard-line believer in the Washington Consensus as the successor to Stanley Fisher for the position of deputy director-general of the Fund. Krueger established her career in the circle of Reaganites in the 1980s and has already held the position of chief economist at the World Bank. She was very much instrumental in the "Roll back" in the North-South conflict. In having the likes of Kenneth Rogoff as the Fund's chief economist and Timothy Geithner as the Fund's political director, it does not look as if there will be a very strong will to reform in the Fund.²⁶ Rather, we should expect a resurgence of the traditional role of the Fund as the North's instrument of control over the South.²⁷

However the exact opposite is needed as the first and elementary step towards a real reform of the Fund. The Fund has to disarm itself in terms of economic policy and give up its role as a disciplinary mechanism in the interests of the main creditor nations.²⁸

3. The Amputated IMF: Stabilisation and Regulation?

3.1 Hot and Cold in Currency Policy

Although the idea has been that the Fund should reduce itself to its original tasks and concentrate on its "core business", a move in this direction is not readily detectable. Given that we are living in "an age of financial instability" (Martin Wolf)²⁹ it is highly ironic that the Fund's original mandate to work towards securing currency stability (it is the International *Monetary* Fund, remember!) today is heavily neglected. The breakdown of the Bretton Woods Agreement in the early 1970s moved the Fund from being a guardian of a fixed exchange rate system to that of a consultant: offering currency policy advice in the context of its country based surveillance. Especially in that regard, the Fund's role had become extremely contradictory and problematic.

As the currency crises have piled up since the 1970s, hopes that floating exchange rates would create more stable currencies have had to be dispelled. The establishment of appropriate exchange rates, the harmonisation of balances of payment, and overcoming imbalances between surplus and deficit countries have yet to occur.

With regard to the "emerging economies" the Fund has swivelled 180 degrees in its exchange rate policy within a very short period. Up to the 1997-98 Asian crisis the Fund's policy was to recommend fixed exchange rates on the basis of "soft pegs", as this was considered a way of protecting the interests of international capital investors. After the crisis policy has completely changed: the Fund now recommends

²⁴ *Financial Times*, 17.2.2001.

²⁵ Jörg Goldberg, *IMF und Weltbank unter Bush*, in: *Blätter für deutsche und internationale Politik*, Heft 6/2001, p. 661.

²⁶ Cf. *Financial Times*, 8.6.2001; *Luxemburger Wort*, 11.6.2001.

²⁷ Cf. John Gershman, *The Resurgence of the Washington Consensus*, in: *Foreign Policy In Focus*, Global Affairs Commentary, www.fpiif.org

²⁸ The paper has been written before September 11, 2001. In the aftermath of the terrorist attacks it could come to another shift of the conditionality debate: If it becomes the main criteria in international politics to be inside or outside the "anti-terrorist camp" that could have an important impact on IMF and World Bank lending policies, too; the importance of economic orthodoxies would decrease and supporting all kinds of "friends" like in the cold war would increase dramatically.

²⁹ *The age of financial instability*, *Financial Times*, 13.6.2001.

either fully floating exchange rates or fully fixed exchange rates in the form of *currency boards*, "hard pegs", or dollarisation.³⁰ But here there are two problems: these policies dramatically reduce the exchange rate autonomy of national economic policy;³¹ and neither fully floating nor fixed exchange rates will establish the appropriate exchange rates and prevent future currency crises. "Whichever option is chosen, it will not be able to ensure appropriate alignment and stability of exchange rates in developing countries as long as major reserve currencies themselves are so unstable and misaligned, and international capital flows are volatile and beyond the control of recipient countries... Briefly put, there is no satisfactory unilateral solution to exchange rate instability and misalignments in emerging markets, particularly under free capital movements."³²

3.2 The IMF and the "Free" Flow of Capital

In a certain sense the exchange rate instability is only the flip-side of the instability of international capital flows. The role that the Fund has played in the liberalisation of capital markets since the collapse of the Bretton Woods Agreement does not reflect its abstinence in exchange rate policy. Although the *Articles of Agreement* of the Fund explicitly included the option for national capital controls as a way of regulating international movements of capital (Art. VI. Para. 3), the Fund has actually, since the 1980s, emphasised the lifting of national restrictions on capital flows within the framework of its country surveillance programme. In fact, up until the Asian crisis there were attempts by the Fund to change its statutes so that it would have a mandate for the implementation of liberalisation of the capital markets, i.e. the removal of capital controls ("capital account liberalisation").

It has since been recognised that the Fund's policy of furthering capital market liberalisation was a factor (if not the main one) in the world-wide increase in financial crises. The Fund's recognition of this fact can be seen in that it now issues warnings to developing countries to "orderly" liberalise their capital markets. Governments should sequence reforms appropriately and ensure that at every step there is appropriate regulation of the internal financial markets. Although the Fund's aim to alter its mandate has not been scrapped in the light of these developments, it has been shelved until further notice.³³

3.3 Currency Stabilisation as Task of the IMF

One of the main reasons why the mainstream debate about the international financial architecture has not seriously considered the Fund's role in currency stabilisation within the debate about the international financial architecture can be put down to politics (or the lack of political will on the part of the most important members of the Fund). It is not simply that there is as yet no promising alternative to the *laissez-faire* policy.³⁴ However, a greater role for the Fund in a global currency policy would imply that the major industrial nations use the IMF to co-ordinate their own economic policy. This is something these countries have never intended to do and is why they founded their own club in 1975, the so-called Group of 7 (G-7).

Although the mainstream has dismissed the idea of exchange rate target zones for the three major currencies (Dollar, Yen, and Euro) to be watched over by a multilateral agency, the idea does keep

³⁰ Even the much discussed Meltzer Report makes no exception. It recommends "that countries avoid pegged or adjustable rates. The IMF should use its policy consultations to recommend either firmly fixed rates (currency board or dollarization) or fluctuating rates" (Report of the International Financial Institutions Advisory Commission, Washington D.C. 2000, p. 8).

³¹ See Elmar Altvater, *Neue Wege in die Abhängigkeit: Paradoxie der Dollarisierung*, W&E 06/2001.

³² UNCTAD, *Trade and Development Report 2001*, p. 67.

³³ Even the Federal Ministry of Finance still considers it a medium-term goal to give the Fund the mandate for liberalizing capital markets. See BMF, 10.

³⁴ The current international exchange-rate system with freely floating currencies has been called by David Felix, a US economist, a "Non-System" or "Pseudo-System", because it is characterized by the absence of policy arrangements. David Felix, *Reform der globalen Finanzarchitektur: Bretton Woods Light oder: Die nächsten Schritte*, W&E, Sonderdienst Nr. 7/1999.

raising its head.³⁵ In its *Trade and Development Report 2001*, the UNCTAD secretariat has argued that a global arrangement for a stable currency system would have positive effects on growth and employment; however, it would demand the political will of the main shareholders of the IMF to intervene in a co-ordinating manner into markets to defend the system. By stabilising the currency markets with the passage of time the necessity for intervention would gradually disappear. The Fund would be the most natural choice to manage this task.³⁶ But the rider is, of course, and the authors of the UNCTAD report recognise this, that the most important industrial nations would be willing to co-ordinate intervention into the market.

The concept of currency target zones exists in various forms and degrees. In Germany, the idea was mooted by the former finance minister, Oskar Lafontaine; a "soft" version has been developed by Wolfgang Filc during his time at the BMF with his idea of a "managed exchange-rate flexibility".³⁷ At the other extreme is the vision of a "World Monetary Authority",³⁸ something that would require a much higher level of policy convergence and economic integration than currency zoning. It must be said, however, that these types of arrangements are highly unlikely to emerge in the foreseeable future given the present attitudes of the leading industrial nations.

3.4 Is Regionalisation an Alternative?

Against this backdrop, the idea of target zones among major currencies is increasingly discussed in combination with the possibility of currency arrangements at a regional level. This itself has implications for the Fund: it would include the regionalisation of IMF functions. In this regard, the experience of the European Monetary Union after the collapse of the Bretton Woods System and the debate after the Asian crisis are all important to take into account.

After Japan's proposal for an Asian Monetary Fund following the outbreak of the Asian crisis has been rejected by the US government and the IMF leadership – it was felt that this would infringe upon the power monopoly of the Fund in international crisis management – more modest forms of regional currency arrangements for Asia have come up for serious discussion. At the same time in other regions, e.g. Latin America, interest is also growing as regionalisation is seen as an alternative to dollarisation. But again, it must be said that forming a economic and monetary union is a long-term process – as the European Economic and Currency Union has shown to be the case.³⁹

Furthermore, for regional currency groupings in the South it is of great importance whether the grouping includes a "Lender of Last Resort", i.e. whether a "hard" currency anchor is available. In Asia, the yen provides this role. In the absence of such a currency, the alternatives are only "dollarisation" or "euroisation" or fixing the local exchange rates based upon the special drawing rights of the Fund. Being as the value of the special drawing rights is determined by a "currency basket", such a model would still imply dependence but in a "diversified" form".

³⁵ For an overview of this discussion, see Michael Frenkel/Lukas Menkhoff, *Stabile Weltfinanzen? Die Debatte um eine neue internationale Finanzarchitektur*, Springer: Berlin, 2000, pp.52 ff; Jörg Hufschmid, *Politische Ökonomie der Finanzmärkte*, VSA: Hamburg 1999, pp.196 ff.

³⁶ Cf. UNCTAD, TDR 2001, pp. 65ff and p.109 ff.

³⁷ Cf. Wolfgang Filc, *Mehr Wirtschaftswachstum durch gestaltete Finanzmärkte. Nationaler Verhaltenskodex und internationale Kooperation*, Internationale Politik und Gesellschaft, 1/1998, pp. 22-38. Recently, in sketching out a reform scenario for the IMF and the World Bank, Jörg Hufschmid proposed that the IMF concentrates on exchange rate management and prevention of currency crises, see Jörg Hufschmid, *Demokratisierung, Stabilisierung und Entwicklung. Ein Reformszenario für IWF und Weltbank*, Blätter für deutsche und internationale Politik, Heft 11/2000, pp. 1345-1354.

³⁸ Cf. John Eatwell/Lance Taylor, *Towards an Effective Regulation of International Capital Markets*, Internationale Politik und Gesellschaft, 3/1999, pp. 279-286.

³⁹ For a history of the difficulties of monetary policy in Europe, see Barry Eichengreen, *Vom Goldstandard zum Euro. Die Geschichte des internationalen Währungssystems*, Berlin 2000, pp. 183 ff.

Although the initiatives in Southeast Asia have been limited, they do actually provide the most concrete point of departure for the development of further considerations. There is now an agreement among Southeast Asian nations to pool their currency reserves in the event of future speculative attacks on their currencies (so-called currency swaps). From this, a slightly more ambitious model could be considered, and that would come into being in three phases. In the first phase regional liquidity funds could be created that would make the countries more independent of the IMF in the event of a crisis. In a second phase regional currency zones could come into being. And in the third phase regional economic and monetary union would come on to the agenda.⁴⁰

An interesting proposal in this regard was recently put forward by the Nobel laureate in economics Robert Mundell at a conference at the Asian Development Bank. According to Mundell, Asia needs a common currency. A first step towards this goal would be the introduction of a "parallel" currency alongside the existing ones. In order to strengthen the position of the Asian countries in the Fund, Mundell also suggested that these countries create an IMF caucus and push for an Asian director-general of the Fund. Parallel to this, Mundell also suggested that a "ASEAN-plus-three" (ASEAN, Japan, China, and South Korea) should be established in order to push for far reaching reforms of the international exchange rate system. ASEAN-plus-three should also establish a committee to examine the possibility of a common Asian currency and begin a regular and joint surveillance of the necessary convergence processes. At the end of this process, an Asian Monetary Fund would come into being that would be modelled along the lines of the original *Articles of Agreement* of the Fund.⁴¹

4. The Fund as Crisis Manager

So long as the possibility of financial crises is given, there needs to be an international mechanism to pull the strings together and get a crisis under control. This implies the need for both additional and emergency financing during a crisis as well as having the institutional mechanisms for overcoming the crisis. In both these areas the Fund has played an out-standing role both as de facto lender of last resort and in regulating creditor-debtor relationships.

4.1 Financing and Providing Liquidity

The founders' vision of the Bretton Woods Agreement was originally one in which the Fund would be responsible for lubricating the wheels of the world economy by guaranteeing the liquidity of the international financial system. This task has now largely been reduced to the provision of emergency financing; and the extent of this is itself very much determined by the willingness of the members of the Fund to provide the necessary financial means. Here, however, we must take care to distinguish between guaranteeing liquidity, something that usually occurs automatically in a crisis situation, and the usual practice of emergency credit.⁴² Although the Fund in principle has a right – by use of special drawing rights – to provide liquidity, it has traditionally been very hesitant to do this, although the Asian crisis forced an increase in the number and the volume of emergency or "bail-out packages".

Actually, the Fund has access to a whole spectrum of credit facilities for which it can provide emergency credit, which in many cases are regionally adapted. That is, there are categories of credit to take into

⁴⁰ Cf. Heribert Dieter, *Monetary Regionalism: Regional Integration without Financial Crisis*, CSGR Working Paper, No. 52, University of Warwick, May 2000.

⁴¹ See, Robert Mundell, *Poverty, Growth, and the International Monetary System*, Keynote Address held at the Asian Development Bank, 5-9 February 2001.

⁴² For this distinction, see Gerald Karl Helleiner, *Markets, Politics and Globalization: Can the Global Economy be Civilized?*, 10th Raúl Prebisch Lecture, Geneva, 12 December 2000.

account not only the specific needs of groups of countries but also the bargaining power of these countries and their groupings. In general we can make the following distinctions:⁴³

- Firstly, instruments for bridging balance of payments deficits that have occurred either as a result of policy mistakes or exogenous shocks (e.g. falling terms of trade or sudden increases in interest rates in the industrialised nations), such as the *Stand-By-Arrangements* (SBA), the *Extended Fund Facility* (EFF) and the *Compensatory Financing Facility* (CFF), are at the Fund's disposition. In principle all members of the Fund are entitled to make use of these instruments.⁴⁴
- Secondly, since the Mexican peso crisis specific credit lines have been successively created in order to deal with the so-called "crises of the 21st century" (Camdessus). In the main, these concern the volatility of capital flows combined with gaps in regulatory arrangements in national and the international financial systems. These instruments include (alongside the "New Arrangement to Borrow" which came into being at the end of 1998) the *Supplemental Reserve Facility* (SRF) – out of which most "bail outs" are financed – and the *Contingent Credit Line* (CCL), which was created due to the Brazilian crisis early in 1999, but as yet to be used.
- Thirdly, there are specific credit lines for the poorest developing countries as they have lower interest rates and longer loan periods. These include the traditional *Enhanced Structural Adjustment Facility* (ESAF), recently renamed as the *Poverty Reduction and Growth Facility* (PRGF).

This spectrum of different instruments actually spans the recent discussion about the financing task and function of the Fund. For instance, whereas on the one hand the Meltzer Commission recommended that the Fund roll-back emergency financing in order to reduce the "moral hazard" to private creditors, on the other NGOs have been particularly critical of the ESAF and PRGF programmes because the Fund lacks the expertise in long-term development financing.⁴⁵

Both lines of argument do not really take into account the basic rationale that bridging finance by the Fund in the event of a crisis must follow: overcoming a crisis will become even more expensive should the Fund roll-back its financing role; the real costs then will simply have to be borne by others. And further, it is wrong to believe that rescue packages are only for bailing out the creditors. Whether this is the case or not depends upon how the creditor-debtor relation is managed (see section 4.3). Finally, financing must be quickly made available in the event of a financial crisis if it should have anti-cyclical effects.

We find a similar case with regard to qualification for ESAF/PRGF programmes as instruments of development financing: it is not the term or the interest rate of the loan that is decisive, but rather the misuse of IMF resources for implementing the neo-liberal agenda in the poorest of poor countries. As has already been demonstrated elsewhere, ESAF programmes have been conceived only against the backdrop of the failure of the orthodox policy of structural adjustment; that is, as an incremental instrument for the implementation of the aims of this policy. The positive effects on stability and the intended return to growth and development have, as I have already said, been rather limited.⁴⁶ In other words, instead of redesigning credit lines as a means for short-term economic stabilisation, a re-naming

⁴³ Cf. Stephany Griffith-Jones/José Antonio Ocampo, *Facing the Volatility and Concentration of Capital Flows*, in: Jan Joost Teunissen (ed.), *Reforming the International Financial System. Crisis Prevention and Response*, FONDAD: The Hague 2000, p. 50.

⁴⁴ For a discussion of how these instruments work, see Hans-Joachim Jarchow/Peter Rühmann, *Monetäre Außenwirtschaft, II. Internationale Währungspolitik*, Göttingen (3. Aufl.) 1993, pp. 122ff.

⁴⁵ In Germany, for example, the Deutsche Bundesbank has taken a similar position but aimed at blocking attempts to roll-back the traditional policy of conditionality. See, Deutsche Bundesbank, *Die Rolle des Internationalen Währungsfonds in einem veränderten weltwirtschaftlichen Umfeld*, in: Monatsbericht, September 2000, pp. 15ff.

⁴⁶ Cf. Rainer Falk, *Der IWF und die Armen. Zur Kritik der Strukturanpassungspolitik des IWF am Beispiel der ESAF*, WEED-Arbeitspapier, Bonn, Nr. 1/1998.

(of ESAF into PGRF) was celebrated under the slogan of poverty reduction, thus providing the Fund with a new "development" mandate.

In the last instance this dilemma is due to interests and conceptual notions of the most important members of the Fund – those who at the end of the day provide the lions share of the financing. Progress could only be made if the main lenders agreed to reduce conditionality to a number of key areas. It obviously makes no sense to provide international credit without any strings attached; but it would seem thinkable that it could be restricted to interest rates and methods of repayment as well as major and systematic violations of human rights.

One of the ways to increase the Fund's independence from the economic policy preferences of its major shareholders would be to strengthen the automatic financing mechanism within the Fund. In times of financial turbulence the Fund ought to be able to provide extra SDRs. By affecting world wide liquidity, this would give the Fund a role in managing anti-cyclical processes. That is, SDRs would take on a new importance in the world financial system, something that the developing countries have always been arguing for.⁴⁷

Finally, it is worth noting an idea that has been passing around in recent years: that there is a way to make space for the Fund in development finance, known as the "link" proposal. The idea relates explicitly to the use of the SDR mechanism as a means of activating supplementary finances for development purposes.⁴⁸ In this context one could even consider using a reformed Fund as the means for the introduction of an international capital transactions tax ("Tobin tax").

However, it has to be said that there is no necessary connection between the use of the fund for raising new development finances and the embedding of particular financial sources in the Fund. Where particular financing functions are to be located is, in general, a matter of fundamental political decisions. Given the experience of the Bretton Woods institutions this question seems even more fundamental than 10 or 20 years ago. Why not, as Jeffery Sachs recently suggested, leave the World Bank to deal with the private sector and leave the financing of sensible development programmes and projects to a new development fund or development agency that could be established by the United Nations. This is something that the developing countries have been repeatedly trying to get.⁴⁹ Although this appears quite novel it is really an idea of the past: the Fund as a Bank and the Bank as a Fund. Obviously, such proposals have no realistic chance during the high tide of neo-liberal fundamentalism. A real change is only possible once the Washington Consensus is a thing of the past. One place where such an idea could be discussed is in the preparations for the UN World Conference "Financing for Development".

4.2 Protect the Debtors against the IMF!

As has been indicated above, the question of regulating creditor-debtor relationships is, in crisis situations, to be held apart from the question of the Fund's role as a financier. In the context of finding a realistic reform perspective for the Fund, it is of utmost importance for the Fund to overcome its one-sided role that has emerged since the debt crises of the 1980s: furthering the interests of the creditor nations. In this regard, UNCTAD has recently proposed a major change to the Fund's *Articles of Agreement*; that there should be measures (including legal ones) that will protect debtor nations from debt-servicing arrangements that clearly favour creditors. For "without a statutory protection of debtors, negotiations with creditors for restructuring loans cannot be expected to result in equitable burden sharing. Indeed, in recent examples of negotiated settlements the creditors have not borne the

⁴⁷ Cf. Griffith-Jones/Ocampo, *ibid.*, pp. 48ff. It has been correctly pointed out again and again that the financial means of the Fund and indicators such as world-wide output or trade have gone largely in the direction of the Fund's capability for intervention.

⁴⁸ In this regard, see Hans-Joachim Jarchow/Peter Rühmann, *Monetäre Außenwirtschaft*, *ibid.* pp. 181 ff.

⁴⁹ Jeffrey Sachs, *Keine Bank, sondern eine Weltentwicklungsagentur!* (translated from the *Financial Times*), W&E 09/2000.

consequences of the risk they have taken; rather they have forced the developing country governments to assume responsibility for private debt and accept a simple maturity extension at penalty rates.⁵⁰

In order to manage and oversee "orderly debt workouts", UNCTAD has also proposed the establishment of an independent arbitration procedure.⁵¹ Another much discussed proposal is the establishment of an international bankruptcy procedure following the Chapter 9 of the US Bankruptcy Code.⁵² Again, decisive for this mechanism is that it is an independent international procedure and should not be part of the Fund because of its tendency to act on behalf of the creditors during a crisis – something that is not going to change in the foreseeable future.

5. Global Governance and the Future of the IMF

As this discussion has shown, even in a changed world economic environment a reformed Fund has an important role to play. But here we must recognise that a reform of the Fund's agenda presupposes a reform of its governance structure also. One cannot go without the other, for it is ultimately a matter of legitimacy. For even if, in the light of the increasing number of crises, the industrialised nations found an agreement among each other for a "re-regulation of the world economy"⁵³ by having a much more regulated global financial system with a renewed Fund at the centre, this would most probably have more to do with the interests of the rich nations rather than overcoming the imbalance between debtors and creditors.⁵⁴

As long as there is no significant progress in overcoming the structural asymmetry in the international financial system between creditor and debtor nations as well as that between surplus and deficit nations, it will be necessary for developing countries to find ways to secure latitude for sovereignty over their own affairs. This is of particular importance for a developing country's investment policy or its right to implement capital flows controls in order to defend itself against speculative attacks on its currency.⁵⁵ The situation has been pointedly expressed by the G-77 in their opposition to the unquestioned and unrepresentative acceptance of the new financial regulations with their slogan "No Harmonisation without Representation!" Actually this also depicts the problem with the policy of conditionality: the developing countries are extremely sensitive to each and every undermining of their sovereignty so long as they have no real say in the relevant decision-making processes in the international financial institutions.⁵⁶

The systematic inequality of power in the Fund is generally consolidated in member's voting rights in that the industrial nations have a secure majority and that for most questions the USA is a blocking minority. With a voting weight of 17.5%, the USA can block all motions that are of central importance. This means that, for matters such as a change in the majority quota, which requires a majority of 85% by weight, the USA can very much act alone; a single member has excessive power.⁵⁷ Reforming the voting system is

⁵⁰ UNCTAD, TDR 2001, *ibid.* p. 69.

⁵¹ Cf. UNCTAD, TDR 2001, *ibid.* pp. 68ff and pp. 132ff.

⁵² Cf. Kunibert Raffer, *Ein internationales Insolvenzverfahren? Wirtschaftlich notwendig und gut für die Armen?*, W&E 06/1995.

⁵³ Cf. "Re-Regulierung der Weltwirtschaft": Prokla. Zeitschrift für kritische Sozialwissenschaft, Heft 118/Nr. 1/März 2000.

⁵⁴ Even a consensual decision-making procedure does not exclude the possibility that an organization will have an informal balance of power. The World Trade Organization is a case in point.

⁵⁵ Cf. Yilmaz Akyüz, *The Debate on the International Financial Architecture: Reforming the Reformers*, UNCTAD Discussion Papers, No. 148/April 2000.

⁵⁶ Cf. Kapur/Webb, *ibid.* p. 18.

⁵⁷ Cf. Aziz Ali Mohammed, *The Future Role of the IMF: A Developing Country Point of View*, Jan Joost Teunissen (ed.), *Reforming the International Financial System*, *ibid.* p. 208.

clearly one of the most important and difficult tasks on the whole of the reform agenda for the Fund; for this means breaking up the asymmetric power structure itself.⁵⁸

Against this background, a more appropriate and democratic governance structure of the Fund would consist of at least three elements:

- The embedding of the Fund in a democratic UN-system. This position has been pushed for a number of years by the *South Centre*.⁵⁹
- A democratic re-allocation of voting weights in the Fund with the aim to increase the negotiating power of the developing countries (G77).⁶⁰
- An increased participation of civil society in the decision-making structures of the Fund (something that has been strongly emphasised by NGOs in the debate about reform of the Fund).⁶¹

In view of the dominant power relations and also for pragmatic reasons, efforts should be made to strengthen the ties between the Fund and the UN, as well as to increase transparency, accountability, and participation (by civil society) in the Fund itself. Although the Bretton Woods institutions have for decades maintained a sort of unilateral declaration of independence from the UN (although they are formally part of the UN system), the debates surrounding the policy of SAPs following the World Social Summit have set in motion some modest changes. We now see regular meetings between senior management of the Fund and the World Bank and the UN Secretary General as well as the introduction of the annual UN Economic and Social Council (ECOSOC) Report. Another significant development would be the publication of important documents (e.g. "Letters of Intent", programme evaluations, the report over the Capital-4-Consultations), something that the NGOs have been pushing for (although this would require consent of the affected parties) as part of the creation of a regular consultation mechanism.

Saying this, however, there are limits to the positive consequences that flow from changes in procedures. Firstly, while it is desirable to place a duty on the Bretton Woods institutions to report to the UN, this is of limited value if it means – as it has in the recent past – a way of furthering the ideology of markets, privatisation, and deregulation.⁶² For the power of social movements and NGOs against the institutions of the governance of the global economy requires in final analysis a change in the political and social paradigm.

In absence of this paradigmatic change introducing NGOs into the structure could have the adverse consequences of strengthening the old ways as the Fund coopts NGOs in order to further its aims.⁶³

⁵⁸ As the tug-of-war over the election of Michel Camdessus' successor as director-general of the Fund has shown, it is not only the developing countries that are affected by this asymmetric power, but also the European countries who have never been able to act as a bloc in the Fund. The German minister of finance, Hans Eichel, has suggested that Germany and France are represented as a single entity. A genuine European bloc would make it easier for coalitions with developing countries and therefore change the power relations in the Fund.

⁵⁹ Cf. South Centre, *For a Strong and Democratic United Nations: A South Perspective on UN Reform*, Geneva 1996, pp. 175 ff.

⁶⁰ Cf. Roy Culpeter, *Global Financial Reform: How? Why? When?*, North South Institute, Ottawa 2000.

⁶¹ Cf. Angela Wood, *Structural Adjustment for the IMF. Options for Reforming the IMF's Governance Structures*, Bretton Woods Reform Project: London, January 2001

⁶² Cf. Tanja Brühl et. al. (Hg.), *Die Privatisierung der Weltpolitik. Entstaatlichung und Kommerzialisierung im Globalisierungsprozeß*, EINE WELT Texte der Stiftung Entwicklung und Frieden, Bonn 2001.

⁶³ For a description of the interaction between social movements, NGOs, and multi-lateral economic institutions, see Robert O'Brien et. al., *Contesting Global Governance. Multilateral Economic Institutions and Global Social Movements*, Cambridge 2000.

Reform of voting weights in the IMF

(Weights determined by economic potential, population, and Human Development Index each carrying a weight of one third in the calculation of the voting weight)

Rank	Country or Group	Voting weight in %	
		Before	After
1	USA	17.8	11.2
2	China	2.3	8.7
3	India	2.1	6.4
4	Japan	5.5	6.5
5	Germany	5.5	3.2
6	France	5.0	2.2
7	Brazil	1.5	2.2
8	UK	5.0	2.2
9	Italy	3.1	2.0
10	Indonesia	1.0	1.7
	G7	44.8	28.0
	G24 (minus Iran)	12.1	19.0
	G77	28.4	52.0

Source: Jörg Hufschmid, *Demokratisierung, Stabilisierung und Entwicklung. Ein Reformszenario für IMF und Weltbank*, Blätter für deutsche und internationale Politik, Heft 11/2000.

Given that the Fund is an intergovernmental organisation in which the member states' governments ultimately determine policy choices, the question of bargaining power is clearly of great importance. A special problem of the Fund is that it is structurally split between creditors and debtors because the industrial nations are no longer reliant on it.⁶⁴ This has created the untenable situation in which the bloc of creditor nations can impose conditions on debtors that they themselves would never have to tolerate. This asymmetry can only be corrected if the most important decision structures are more equitable and balanced.

As Hufschmid has shown in his calculations, a democratisation of the voting weights in the Fund needs to be based neither on a one-country-one-vote principle as in the UN nor on the economic power of the country as is currently the case, but must take into account the population of the country, its economic potential, and its Human

Development Index in order to make substantial changes to the voting power in the Fund.⁶⁵ As the figures in the table show, by weighting each of these factors equally in the calculation of the voting weights means that no country alone can be a blocking minority. In total the position of the developing countries is greatly improved. What is to be avoided is that one group is dominant. It is obvious that creditors will not accept this if debtors form a majority bloc against them.⁶⁶

6. Summary: A Blueprint for Reform

Many of the ideas presented in this paper are not considered realisable in the short-term. They are part of more comprehensive long-term considerations.

All in all, the argument in this paper is that what is needed is nothing more and nothing less than turning the IMF upside down, that is, its policy has to change substantially; its institutional structure has to change; and its role in regulating the world's financial system has to be reconsidered. Although many of the proposals that have been outlined here may be quite unrealistic in the short-run, what is important is to start work on a "Blueprint for Reform". Only in this way can we start to structure the debates about the future of the Fund.

⁶⁴ The last industrial nation to rely on the Fund was in 1976.

⁶⁵ Cf. Hufschmid, *Demokratisierung, Stabilisierung und Entwicklung*, ibid.

⁶⁶ For similar proposals see, UNDP, *Human Development Report 1999*, New York-Oxford 1999; José de Gregorio/Barry Eichengreen/Charles Wyplosz, *An Independent and Accountable IMF*, Genfer Reports zur Weltwirtschaft, Nr. 1, Center for Economic Policy Research, Geneva 1999; Robert Blecker, *Taming Global Finance*, Economic Policy Institute, Washington D.C. 1999. Such proposals are not entirely unrealistic; the Montreal Fund (for greenhouse gas reduction) and the Rio-originating Global Environmental Facility (GEF) both operate on a mixed governance model excluding mutualmajorisations.

The Fund could be a council where its members could co-ordinate their economic policy and offer short-term and disinterested financial support in the event of balance of payments difficulties and thereby providing a stable and monitored global exchange rate as well as the instruments and financial resources for development. The reality is, however, quite different.

The main theme of this paper was the question, which functions of the Fund should be strengthened and which should be weakened? That is, I have sketched the criteria for reform, not the details of the final product:

(1) The Fund should give up its role as an instrument of societal and political **disciplinary neo-liberalism**. Even if asymmetric power relations in the real world can never quite be avoided, the era of monopoly thinking as represented by the Washington consensus is a thing of the past. What we need is an opening for more competition for different paths of societal development, i.e. more space to manoeuvre for societal choices.

(2) Given the winding back, the **optimisation of the coordinating and regulating function for the world economy** gains more significance. The idea is in no way to make the Fund an omnipotent world economic bureaucracy but rather that it is placed to oversee a currency policy that is regionally organised and can provide the appropriate regulatory support. That is, the Fund should fill the increasing need for an international regulatory body.

(3) As far as the **financing function** is concerned, this paper has argued for a reorganisation of the system of international development financing. This requires a new focus on the financing function of the Fund. The essential idea is that the Fund should focus on strengthening its fundraising function but hand the distribution to another body.

(4) None of these changes will work unless there is simultaneous democratisation of the Fund's own **governance structure** (as well as other international financial institutions).

As far as the core of the Fund's activities are concerned, this paper has argued for the following:

(1) Currency policy. From being an instrument of the interests of creditors, the Fund must in the long-term become an instrument of currency stabilisation working in the interest of all member states. This requires a new international exchange rate system, including target zones for the major currencies, so as to protect members against speculative attacks and currency volatility. In the medium run one could think of regional currency systems as a means of stabilising financial markets.

(2) Credit conditionality. The Fund's political influence over the countries of the South has to come to an end if it is to act as an impartial crisis manager. It should offer immediate and generous bridging finance in the event of a crisis. The first and most important precondition for this is a real reduction and simplification of conditionality. The conditions should be clear and restricted, e.g. repayment schedules, levels of interest rates, and basic human rights.

(3) Providing liquidity. The implementation of development programmes does not belong to the tasks of the Fund and should be left to other agencies. The Fund should concentrate on providing automatic financing – be it by SDRs or the introduction of a Tobin tax or any other innovative instrument that is being discussed in the run up to the UN conference "Financing for Development".

(4) Democratisation. The one-sided domination by a minority of member states (the industrialised nations) in the Fund over the majority (developing nations) must come to an end by replacing the current voting rules. In this regard, the Fund should look to the governance structures of other institutions on how to solve the imbalance of decision-making power (e.g. that in the Montreal Protocol for regulating climate control, or the governance model of GEF). Both, a power monopoly of the North as well as "automatic" majorities of the South have to be avoided.