

Reform of the Bretton Woods Institutions: The IMF Might Not Live to See Its Anniversary

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The latest meeting of the ministers of finance and central bank governors of the G20 countries took place April 10-11, 2014 in Washington. A key issue was the reform of the International Monetary Fund (IMF).

The International Monetary Fund: A Long and Difficult Life

2014 marks 70 years since the Bretton-Woods Conference, at which the main parameters of the post-war world currency and financial system were defined and the decision to create the International Monetary Fund was made. The most important elements of this system were fixed exchange rates for the currencies of participant countries, the pegging of all currencies to gold (gold parity), and the free convertibility of dollars to gold by the U.S. Treasury for the monetary authorities of other countries. The Fund's main function was defined as extending credit to member countries if they have a deficit balance of payments and there is a danger that the currency's exchange rate could deviate from the established fixed rate and from gold parity.

The IMF survived a serious crisis in the 1970s when the Bretton-Woods system collapsed. It all began August 15, 1971, when U.S. President R. Nixon announced that the U.S. Treasury was terminating the convertibility of dollars to gold. The final dismantling of the system occurred at the Jamaica Conference in 1976, when amendments were made to the IMF Charter. From that time on, floating exchange rates were enacted and the pegging of the dollar and other currencies to gold was terminated.

Of course, it wasn't clear what the IMF was going to do in these new circumstances. After all, now it was no longer necessary to support payment balances using credit from the Fund. There were even proposals to close the Fund. However, in the 1980s the IMF found its niche. It became the main tool for implementing the so-called Washington Consensus - a set of principles for financial globalization and economic liberalization. The Fund began to extend credit in exchange for political and social concessions from the countries obtaining loans (privatization of state property, liberalization of capital movement, state nonintervention in the economy, etc.). Currently the IMF includes 188 countries, and 2500 people from 133 countries work there.

The Need to Reform the Fund

Over the course of many decades, the United States has had a «controlling interest» in the IMF. The number of votes each participant country has is determined by its share in the capital. 15% of the votes are needed to block any decision at Fund meetings. The number of votes held by the U.S. has always been substantially higher than this threshold figure. And

in order to push through the decisions it needed, the U.S. had no particular trouble in recruiting Great Britain and France, which after the war held the second and third largest shares in the Fund's capital, to its side. Periodically the shares of countries in the capital and their votes were adjusted in accordance with changes in the countries' positions in the world economy. Sometimes the decision was made to increase the Fund's capital, but such adjustments did not hinder the United States from maintaining a «controlling interest» and using the Fund as a tool of its global policy.

The test of the Fund's ability to resolve complex problems connected with maintaining the stability of the international currency system was the world financial crisis of 2007-2009. The Fund was not equal to the challenge, to put it mildly. First, the crisis revealed the insufficiency of the Fund's equity capital. Second, it was the countries of the periphery of world capitalism that were deprived of their fair share during the crisis; this was to a great degree because such countries did not have enough votes for the adoption of the decisions they needed. Since then, the largest of the countries which considered themselves «deprived» have begun to actively use the mechanism of G20 meetings in order to spur the process of IMF reform. The main movers of this process are the BRICS countries.

The G20 meeting in Seoul in 2010 played a special role. There an agreement was reached on the fourteenth and latest review of countries' quotas in the Fund's capital. But besides this, two strategic decisions were made: to develop a new, fairer formula for determining quotas; and to double the Fund's capital from 238.4 billion SDRs to 476.8 SDRs (Special Drawing Rights, a non-cash monetary unit issued by the IMF). It was expected that in 2012 the new quotas based on the 14th review would be put into effect, and by January 2014 the new formula would be developed. A 15th review of quotas based on the new formula was planned for January 2014.

As a result of the 14th quota review, over 6% of quotas were to be redistributed from developed countries to developing ones. If the 14th review is put into effect, China's quota will become the third largest among IMF member states, and Brazil, India, China and Russia will be among the fund's 10 largest stockholders.

The U.S. Blocks Reform of the Fund

Four years have passed since the adoption of the decision in Seoul, but the decisions remain purely on paper. The process is being blocked by the main «stockholder» in the IMF, the U.S. With a quota of 17.69% of SDRs and 16.75% of votes, which gives it veto power with regard to key decisions of the fund requiring an 85% majority of the votes, the U.S. has not yet ratified the quota review. Washington is worried that the IMF might get out from under its control in the near future. After all, the 15th quota review is just around the corner, and it is supposed to be based on a new formula which will most likely take the interests of the countries of the periphery of world capitalism into account more fully. The U.S., on the other hand, will have to contribute about 60 billion dollars to replenish the IMF's capital if it is ratified.

The previous meeting of G20 finance ministers and bank governors took place in Sydney in February 2014. By then it had become clear to everyone that the IMF has no money. Russian finance minister A. Siluanov said so publicly. At that time the following appeared on the site of the Russian Ministry of Finance: «...Currently the IMF has practically exhausted its own resources, and the fund's existing programs are essentially financed through General

Arrangements to Borrow». This means that the Fund extends credit not on the basis of its own capital, but on the basis of re-lending resources it receives from individual member countries. But such resources may be offered to the Fund on very specific conditions (say, to give loans to a specific country for specific purposes). And re-lending means that the interest on the loans for the end recipients will be substantially higher than that which the IMF charges when lending from its own capital. In Sydney the question of what kind of assistance the IMF can give to Ukraine was discussed. In the opinion of the majority of meeting participants – none. The most recent negotiations on the possibility of the International Monetary Fund offering a multibillion dollar loan to the current regime in Kiev were simply a charade. Both parties in the negotiations are nearly bankrupt.

In Sydney the G20 finance ministers spent a lot of time trying to convince the U.S. to resolve the issue of ratifying the 2010 decisions. The communiqué from the meeting stated: «Our highest priority remains ratifying the 2010 reforms, and we urge the US to do so before our next meeting in April». Alas, these urgings were not heeded by Washington.

The IMF Is Doomed. What Now?

Through their inaction on the issue of reforming the IMF, the United States first and foremost is discrediting itself. And second, the Fund. Third, the G20. The Fund's reputation is plummeting especially fast considering that in recent years China has been giving «third world» countries loans similar in size to those offered by the IMF and the IBRD. But Beijing, unlike the IMF, does not set political conditions in the spirit of the Washington Consensus.

According to the Rand Corporation, in 2001 the total volume of aid promised by China to foreign partners equaled 1.7 billion dollars. A decade later this figure had reached 190 billion dollars. The total volume of aid promised over 10 years was around 800 billion dollars, and the aid given was over 70 billion. The difference is explained by the fact that preparations for the projects in which the Chinese participate take an average of six years. Among recipient regions, Latin America occupies first place, followed by Africa, the Middle East, South Asia and Eastern Europe. The largest aid recipient is Pakistan (89 billion dollars). Among the purposes for which money is allocated, extraction and processing of natural resources predominate (42 percent), followed by infrastructure projects (40 percent) and humanitarian aid (18 percent). All assistance is divided into concessional loans, interest-free loans and direct non-refundable grants. The first category is provided by state banks, while the other two go directly through the budget of the PRC. The overwhelming majority of recipients of Chinese assistance are unable to obtain loans on the open market. However, the average interest rate on concessional loans is only 2.3% per annum, which is significantly lower than on the IMF's stabilization loans.

If the decisions of the G20 and the IMF have not been being implemented for four years, that is a serious blow to the reputation of these international organizations. Incidentally, this is not the first time that the U.S. has blocked the reform of the Fund. A glaring example is the decision on the 13th quota review, made by the Fund in 2001. The U.S. dragged out its ratification until 2009; only at the very height of the financial crisis did Congress confirm it. The majority of Western European countries, although they ratified the 2010 review, were secretly pleased by Washington's inaction, as the enactment of the 14th review would have resulted in a decrease in their share of votes.

Many American congressmen believe that they have more important matters than returning to the issue of reforming the IMF. If one is to believe their statements, the next time this

issue will be heard in Congress will only be in November 2014. However, many IMF member countries are running out of patience. Especially China, which has provided its own funds many times to the Fund on the basis of General Arrangements to Borrow. There are not that many options for getting out of the dead end.

Some believe that a kind of revolution could soon occur in the IMF: a decision on reforming the fund will have to be made without U.S. participation... But formally the Fund's charter in the form it has had since the Jamaica Conference in 1976 will not permit this. Such a revolution will in fact mean not a reformation of the IMF, but the creation of a new organization with a new charter on its foundation – and without the U.S.

There is one more possible option. It is already fairly well worked out and has every chance of success. This is the Currency Pool (Currency Reserves Pool) and the Development Bank of the BRICS countries. The main decision to create these organizations was made at the meeting of BRICS countries on the eve of the G20 summit in St. Petersburg in September 2013. The BRICS Currency Pool and Development Bank will have capitalization of 100 billion dollars each. Operation is planned to start in 2015. Currently such questions as the schedule of capital formation, the shares (quotas) of individual countries, and the location of the headquarters of both organizations are being decided. These international organizations of the BRICS countries could become crystallization points which attract other countries to themselves. Who knows: maybe in time they could become financial organization which could replace the International Monetary Fund and the World Bank.

As we can see, in both options for getting out of the current dead end, the International Monetary Fund has no place in the new world financial order.

Financial G20 Members Decisive

Part of the communiqué published after the meeting of the G20 finance ministers in Washington April 10-11, 2014 was devoted to reform of the IMF. «We are deeply disappointed with the continued delay in progressing the IMF quota and governance reforms agreed to in 2010», states the document. «We reaffirm the importance of the IMF as a quota based institution. The implementation of the 2010 reforms remains our highest priority and we urge the US to ratify these reforms at the earliest opportunity», the statement reads. «If the 2010 reforms are not ratified by year-end, we will call on the IMF to build on its existing work and develop options for next steps and we will work with the IMFC (the International Monetary and Financial Committee, a structure within the International Monetary Fund – V. K.) to schedule a discussion of these options», the G20 document emphasizes.

Behind the scenes, Russian Minister of Finance A. Siluanov commented on the decisions of the financial summit in Washington as follows: «It was decided that if this year amendments in the IMF Charter are not ratified, then at the end of this year other alternative mechanisms will be proposed which would take into account the increased share of emerging markets in the world economy». He recalled that today the IMF operates on the principles of using borrowed funds, where the opinions of countries which have increased their share in the world economy are not fully taken into account. «Other measures for taking countries' interests into account in questions of the fund's policy will be proposed», he concluded. By all appearances, the reform of the IMF could be a «quiet revolution».

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