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Building new foundations: Reimagining the International Financial Architecture

Views and proposals from civil society

Reforming the international financial architecture: Addressing the IMF's social legitimacy crisis

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With contributions from

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This chapter critically examines the waning social legitimacy of the International Monetary Fund (IMF), focusing on its governance structure and role in the sovereign debt crisis. Despite growing calls for reform, the IMF has remained resistant to meaningful structural reforms, perpetuating an inequitable governance model dominated by a few wealthy nations. From the viewpoint that reforming the International Financial Architecture (IFA) also requires the reform of International Financial Institutions (IFIs), this imbalance marginalizes developing countries and undermines the IMF's credibility as a fair global financial institution.

The chapter also highlights how the IMF's continued reliance on austerity measures exacerbates economic hardships, particularly across several African countries that have recently defaulted or are currently experiencing debt distress, fuelling public scepticism and distrust. The IMF risks further erosion of its social legitimacy and continued irrelevance in global financial governance if it does not go beyond its minimalist approach to reforms.

Introduction

Kristalina Georgieva, Managing Director of the International Monetary Fund (IMF), and Rhoda Weeks-Brown, Director of IMF's Legal Department, wrote in 2023:

> "The [IMF] Fund's purposes and broad powers (together, the Fund's 'mandate') have not changed significantly over the past few decades. However, the substantive issues on which the IMF engages more systematically with its member countries in carrying out this mandate have evolved in important respects." [1]

To give some context to the above quote, Georgieva and Weeks-Brown admit that, while the conventional focus of the IMF is on monetary, fiscal, exchange rate and financial sector policies, along with closely related structural aspects, in recent years,

> "… the IMF's work has widened to cover a broader range of substantive topics, including governance and anti-corruption, climate change, fintech and the digitalisation of finance, inequality, social protection, and gender." [2]

According to them,

> "the IMF's work in these emerging areas with demonstrated criticality for the institution's macroeconomic and financial stability mandate is not an expansion of the IMF's mandate, but rather reflects continuing evolution in the economic understanding of what is critical for the achievement of that mandate." [3]

1 Georgieva/Weeks-Brown (2023), p. 17.

2 Ibid.

3 Ibid.

Indeed, the scope of the IMF's work has evolved beyond the conventional issues envisaged as 'macro-critical' within its original mandate as set out in its constitution. It is also true that the IMF's mandate has not changed significantly over the past few decades. The irony stems from this latter point because change is desperately needed within the IMF and the wider International Financial Architecture (IFA).[4] Admittedly, the evolution of the issues facing the global community requires international organizations to be agile and responsive to changing realities. However, Georgieva and Weeks-Brown's comments detract from the real issues and do not address the 'elephant in the room', which is the legitimacy crisis of the IMF and the wider IFA.

Conscious of the fact that much ink has flowed on these calls for reform, in this chapter we focus specifically on the waning social legitimacy of the IMF. In this context, we refer to the IMF's dwindling credibility with the audience and constituents it serves due to its reticence to acknowledge and engage with fundamental reforms to its structure. Our conceptualization of 'audience' and 'constituents' also goes beyond states and civil society organizations (CSOs), extending to voiceless ordinary citizens who bear the brunt of IMF policies. Focusing on the IMF's governance structure and its management in the sovereign debt crisis, we argue that the IMF's dogmatic insistence on maintaining the status quo not only undermines its legitimacy but also puts the future of the global financial system in jeopardy. Bradlow put this starkly, arguing that, unless the IMF and other IFIs address the fundamental structural issues, "they will never be able to fulfil their responsibilities effectively".[5]

The social legitimacy crisis of the IMF

Dellmuth and Tallberg define social legitimacy as the "acceptance of an institution within a given audience".[6] Dellmuth and Tallberg make an essential distinction between normative and sociological legitimacy. According to them, the former "refers to an institution's right to rule, based on its conformance to certain values and principles" and the latter "refers to the acceptance of an institution within a given audience".[7] Arguably, the IMF has retained the support of most states in the international system to regulate monetary policy. This normative legitimacy is derived almost entirely from its perceived efficacy and value as part of the IFA. Furthermore, given that the focus of CSO mobilization efforts has recently shifted to issues like Special Drawing Rights (SDRs) and fixing the debt architecture, one could also argue that the IMF has been adept at surviving critiques about its continued relevance as an institution.

However, the social legitimacy of the IMF is a more nebulous concept than its normative legitimacy. This is because social legitimacy is not premised on the mandate from states, derived from the IMF's efficacy as a technocratic institution focused on maintaining macro-economic stability or even predicated on the delegitimization efforts from CSO mobilization. Instead, the social legitimacy of the IMF is predicated on public perceptions (i. e., opinions by ordinary citizens) about it and the extent to which its activities are deemed embedded within the wider social fabric of society.[8] Barnett and Finnemore support this position, arguing that the "legitimacy of most modern public organisations depends on whether their procedures are viewed as proper and correct and whether they are reasonably successful at pursuing goals consistent with the values of the broader community".[9]

The attempts by global governance institutions such as the IMF to avoid scrutiny and accountability on the premise that their mandates related to issues are highly technical and are best left in the hands of an elite cadre of qualified experts no longer hold. In the 1990s, the IMF faced sustained criticism for its austerity-focused measures. However, it weathered the

4 Gathii (2023).

5 Bradlow (2000), p. 152.

6 Dellmuth/Tallberg (2015), p. 454.

7 Ibid.

8 Abdelal/Ruggie (2009).

9 Barnett/Finnemore (2004), p. 166.

storm and succeeded in blunting the delegitimization efforts of CSOs and avoiding public scrutiny for some time. However, the increasing visibility and impact of the IMF's decisions on everyday lives, especially in the immediate aftermath of the COVID-19 pandemic, have lifted the veil and rendered such justifications obsolete. The IMF's influence on ordinary citizens, particularly through the implementation of austerity measures – its preferred strategy for ensuring debt sustainability in countries in the Global South – has made the IMF a focal point of discussions. It is within this context that the IMF has gone on the charm offensive with the rhetoric expressed in the article published by Georgieva and Weeks-Brown. The attempt to justify the expanding mandate of the IMF on the so-called emerging issues without addressing the broader systemic and structural issues indicates an organization that is not yet open to change and would rather defend and justify its continued relevance.

The IMF may be doing important work in the areas mentioned above; however, this must not detract from the fact that there is widespread discontent with the current system, and for good reason. Bradlow commented along these lines in 2000, arguing that the primary cause of the unsatisfactory performance of IFIs such as the IMF "is their failure to adapt their structure and operating practices to their changing functions".[10] In effect, the problem is not necessarily about its expanding scope or functions but about the lack of corresponding changes to its governance structure to match its functions. By ignoring these agitations for systemic change, the majority shareholders of the IMF, such as the USA, are taking for granted the fact that "the social legitimacy of an International Organisation says little about the actual rightness or goodness of the organisation; [rather] it refers exclusively to the public's acceptance of and support for that organisation".[11] This underscores the urgent need for the IMF to evolve its governance structures to align with its expanded roles, ensuring greater accountability and legitimacy in the eyes of the global public.

As it stands, the view from the ground and stakeholders across different constituencies does not match the picture that the IMF seeks to portray with the aforementioned publication. The system is broken and needs fundamental reforms. United Nations Secretary-General António Guterres was categorical about this fact, stating that the International Financial Architecture is "outdated, dysfunctional and unfair".[12] This is a viewpoint that has been repeatedly made by several leaders in the Global South, including President Nana Akufo-Addo of Ghana, who argued that the current global financial system is "skewed significantly against developing and emerging economies" and in favour of rich countries,[13] and President William Ruto of Kenya, who has made calls for the "democratisation of global governance and a re-imagined multilateralism that is inclusive".[14] Mia Mottley, the Prime Minister of Barbados, has repeatedly made similar remarks calling for a "new internationalism" that is truly inclusive and reflective of the current global realities.[15] To be clear, these are not just unfair criticisms of the IMF and other IFIs. Two examples are discussed in the subsequent sections of this chapter to illustrate this point.[16]

IMF and governance

The IMF's governance structure is a primary factor in its waning social legitimacy, as its decision-making power remains concentrated among a few wealthy nations, marginalizing the voices and interests of developing countries. A closer look at the IMF's composition and power dynamics shows that the IMF is the lynchpin of the global debt and financial architecture. Given its prominent status, it is unfair that it has retained an inequitable governance structure. To put

10 Bradlow, (2000), p. 152.

11 Dellmuth/Tallberg (2015), supra note 8 at p. 454.

12 https://press.un.org/en/2023/sgsm21855.doc.htm

13 https://gadebate.un.org/en/77/ghana

14 https://www.standardmedia.co.ke/national/article/2001456275

15 https://www.kofiannanfoundation.org/news/kofi-annan-lecture-2022-mia-mottley/

16 See Dieter (2006), p. 343.

this in context, with the IMF's governance system based on weighted voting, the USA, which has 16.5 percent of the voting share, has an effective veto over any fundamental reforms of the system because 85 percent of the total voting power is required for any change in the voting structure.[17] This means that the US Treasury disproportionately influences IMF matters, particularly its role in the sovereign debt crisis. This is not only unsatisfactory but also exemplifies the uneven and undemocratic voting system based on quotas weighted by economic criteria and capital contributions, which favour a few wealthy countries over the vast majority of the world's countries. What is more evident from this dynamic is that the world's poorest economies have no power at the IMF, especially when the votes of the permanent members of the Paris Club are combined with the weighted shares of the USA.[18] The subordination of indebted countries is further enshrined in the design of the global debt and financial architecture through the requirement that the approval of Paris Club members must be sought at the start of any sovereign debt renegotiation.

Furthermore, Africa's 55 countries remain under-represented in the IMF's governance structures, with a meagre 7.2 percent of voting rights.[19] The IMF's addition of a third seat on the Executive Board for African countries illustrates a minimal approach to reforms that fails to inspire confidence in stakeholders regarding fundamental reforms. As the African Sovereign Debt Justice Network (AfSDJN) has argued, adding a new Executive Director is not enough to provide Africa with fair representation.[20] Currently, several wealthy countries each have a single Executive Director representing their interests on the Executive Board. According to the AfSDJN, this is "… an absurdity that shows that more is needed in terms of quota reform than an additional Executive Director".[21]
It is clear that African economies stand to be disadvantaged by a quota adjustment based primarily on economic weight. Even though the IMF pledges to 'protect' the quota of low-income countries, this is insufficient to increase the influence of African countries in the operations and policies of the IMF. The AfSDJN, therefore, posits that the enhancement of the IMF quotas of low-income countries to amplify their voice in its decision-making regardless of their economic weight is the more meaningful option.

To regain its social legitimacy, the IMF must undertake substantial reforms in its governance structures to reflect a more equitable distribution of power and to include the diverse perspectives of all member countries.

The IMF and the sovereign debt crisis

Another important point made by Dellmuth and Tallberg is that "the social legitimacy of an International Organisation [is not] necessarily based on a single logic but may be shaped by multiple sources that make citizens more or less supportive of an organisation".[22] In the context of the IMF, multiple sources of contention have fuelled public distrust of the system. The most apparent factors include the link between the IMF's regulation of global fiscal policy and the sovereign debt crisis. Based on the inequality in the voting structure, the critical argument is that the IMF system is perceived to be undemocratic due to the closed nature of the system, which does not accommodate a broad range of voices in its decision-making process. There is a strong correlation between this negative perception of the IMF and the declining effectiveness of the system in recent years. For example, the challenges experienced in the recent debt restructuring processes, especially the IMF's inability to get private creditors to the negotiating table, speaks to its declining credibility as the best forum for addressing the global debt crisis.

17 Ibid.

18 Ibid.

19 Gathii (2023), supra note 4.

20 African Sovereign Debt Justice Network (2023).

21 Ibid.

22 Dellmuth/Tallberg (2015), supra note 8 at p. 455.

While these regulatory International Financial Institutions (IFIs) have undergone historic proportions of stress in addressing these challenges, they are failing the test, as illustrated by today's debt crisis, particularly in the Global South. The IMF-hosted Global Sovereign Debt Roundtable (GSDR), an initiative aimed at building a greater common understanding among key stakeholders (creditors and debtors) involved in debt restructurings, is a welcome gesture. However, it is imperative to highlight that there have been several debt roundtables in the past, and creditor-centric discussions have dominated these.

The GSDR has been criticized for its continued exclusion of debtor countries, resulting in less positive impact on Africa's economies.[23] Despite the GSDR being designed to provide a platform for stakeholders to work together on the current shortcomings in debt restructuring processes, most African countries, including Zambia and Ghana, still face debt restructuring challenges. Furthermore, there has not been any positive impact on the debt sustainability challenges, making a case for reforming the Debt Sustainability Framework.

As a tool, the Debt Sustainability Assessment (DSA) should be reformed by de-emphasizing its commitment to austerity. Austerity measures are overwhelmingly associated with the need to guarantee debt service levels through a reallocation of budgetary resources otherwise allocated to public investment and services, education, healthcare and social security, typically by means of fiscal adjustment and regressive taxation. This de-emphasis would be possible through the incorporation of a human rights perspective. Currently, the DSA framework is legally and macroeconomically biased towards conducting assessments that underestimate sovereign insolvency problems. For the AfSDJN, a debt sustainability framework that does not appropriately account for sovereign insolvency problems effectively legitimizes unsustainable debt service – much to the detriment of citizens.

The G20 Common Framework, presented as the ultimate solution, has proven to be one of the many minimalist reforms to the global debt architecture favoured by the IMF. The G20's Common Framework approach to help countries seeking debt treatment has clearly failed to give Zambia, Ghana, Chad and Ethiopia the resolution these countries so badly need. Zambia has been stuck in debt restructuring negotiations for over three years and is facing the worst drought in over four decades. Having defaulted two years ago, Ghana has had to complete three major debt restructuring operations comprising domestic debt restructuring, external bilateral debt restructuring and commercial bondholders' debt restructuring. In Ethiopia's case, the process of seeking debt resolution has stretched over three years without resolution. Meanwhile, Chad became the first country to reach a Debt Treatment Agreement with official and private creditors under the G20 Common Framework, including Glencore.[24]

The IMF's role in the ongoing three restructuring processes has been very apparent, with its influence noted through its Extended Credit Facility, whose tranche-based disbursement is typically hinged on a country's ability to make progress with official and private creditors. This is a trend that the IMF has maintained over the years, with analysts flagging this as far back as 1998. Robert Barro wrote a revealing piece titled "The IMF Doesn't Put Out Fires, It Starts Them" in 1998, criticizing the IMF for encouraging bad economic policies by rewarding failure with bailouts, which increase moral hazard and financial crises.[25] Today, as a case in point, Kenya is on the brink of chaos.[26] It is critical to situate the 2024 Kenyan unrest in a context that considers both endogenous and exogenous variables. At the heart of this problem is a complex interaction of domestic challenges, such

23 https://afrodad.org/sites/default/files/statements/Reaction-to-the-Press-Released-by-IMFWB-on-the-Global-Sovereign-Debt-Roundtable-Meeting.pdf

24 https://www.afronomicslaw.org/category/african-sovereign-debt-justice-network-afsdjn/sixty-second-sovereign-debt-news-update-chad

25 Barro (1998).

26 https://www.afronomicslaw.org/index.php/category/analysis/alternatives-kenyas-austerity-and-militarized-response-genz-revolution

as government corruption and inefficient resource allocation, mixed with the frequently contested role of external actors – most notably the IMF. In 2021, Kenya agreed to a debt reduction deal with the IMF, obtaining US$ 2.34 billion in exchange for strict economic reforms.[27] These reforms, known as 'austerity measures', have sparked outrage, with critics claiming that they disproportionately burden the most vulnerable members of society while exacerbating pre-existing imbalances.

The IMF's prescription for Kenya, as with many developing countries seeking its aid, has focused on fiscal consolidation, which is frequently carried out through a combination of tax increases, subsidy cuts and public spending cuts. While the IMF warned the Kenyan government in January 2024 of the possibility of protests if the Finance Bill 2024 was passed, it urged President William Ruto's government to remain committed to changes under its programme, citing a revenue shortage. The IMF had assessed the risk of the protests as 'medium', an assessment that resulted in the loss of 39 lives. The IMF has temporarily delayed its board approval of fresh funding following the withdrawal of the Bill while it "closely monitors the situation".[28] It can be argued that, while the IMF did not necessarily write Kenya's Finance Bill, it certainly exerted influence over it. This is one of the many fires started by the IMF, and one it does not seem to be putting out any time soon.

For the IMF to restore its social legitimacy, it must shift from creditor-centric policies and instead prioritize inclusive, sustainable debt solutions that acknowledge the social and economic realities of debtor nations, ultimately fostering trust and support from the global community.

Conclusion

The persistent legitimacy crisis faced by the IMF is a direct consequence of its resistance to meaningful reform and adherence to outdated governance structures, which fail to meet modern demands for transparency, accountability and inclusivity. Ironically, the two examples that we focus on in this chapter were highlighted as far back as 2006 by Heribert Dieter, who argued that the IMF governance structure was in need of reform to address the imbalance where Organisation for Economic Co-operation and Development (OECD) countries dominate policy decisions affecting developing nations.

Heribert also argued that the IMF's outdated lending policies fail to provide a robust safety net for financial crises, prompting countries to seek alternative financial governance measures.[29] Almost two decades later, nothing meaningful has been done to resolve these systemic issues. This enduring lack of meaningful reform underscores the persistence of outdated practices, allowing institutions like the IMF to wield disproportionate power over debtor nations. The prevailing norms, regulations and mechanisms grant institutions such as the IMF the structural authority to hold debtor countries hostage, thereby perpetuating and enabling the distorted international financial system established back in 1944 to continue unabated.

What is even more worrisome is that, throughout its 80-year existence, the IMF's multiple 'restructuring' efforts have largely been cosmetic in nature, as the core paradigm has not changed significantly. Gathii warns, "The IMF and private creditors want minimalist reforms to the global financial system that are just enough to contain the pressure for more radical reform while they reap massive profits. Such minimalist reforms serve to kick the can down the road – they do not challenge the unequal governance of the IMF that is based on the assumption that the current international financial system is here to stay."[30]

27 https://www.imf.org/en/News/Articles/2021/04/02/pr2198-kenya-imf-executive-board-approves-us-billion-ecf-and-eff-arrangements

28 https://www.businessdailyafrica.com/bd/economy/imf-may-delay-approval-of-fresh-funding-to-kenya-4683254

29 Dieter (2006), p. 343.

30 Gathii (2023), p. xii.

Gathii's concerns are corroborated by Shim's study, which finds that investors react favourably if a borrowing government is credibly committed to implementing essential IMF conditionality.[31]

As was the case with the IMF's advice to Kenya over the Finance Bill 2024, Shim's study highlights how the opinions and perceptions among investors continue to have primacy in the interactions between the IMF and governments of borrowing nations. This further entrenches the perception that the IMF's conditional lending practices are primarily designed to serve the interests of private creditors by maintaining just enough reform to ensure debt repayment and economic stability, rather than addressing deeper systemic issues.

The 2005 argument of Rodrigo Rato, a former Managing Director of the IMF, that "change is held back by politics" epitomises the entrenched interests that are not ready to see the status quo change.[32] If that is the case, then plausible reform of the global debt architecture can only take place in an environment that is not monopolized by the IMF or those who stand to gain from the skewed operations of the IMF. Perhaps a more responsive and conducive environment would be under the umbrella of the United Nations, wherein a multilateral legal framework would provide for a new comprehensive, fair and effective sovereign debt restructuring mechanism that would be binding on all creditors, including commercial creditors.

In conclusion, unless the IMF embraces comprehensive reforms that address its structural imbalances and enhance its responsiveness to global challenges, it risks further erosion of its social legitimacy and continued irrelevance in the evolving landscape of international financial governance.

31 Shim (2022), pp. 2151–2152.

32 Ibid, p. 344.

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