The International Monetary Fund at Eighty

What Next?

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Policy Brief

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The International Monetary Fund (IMF) was established in 1945, eighty years ago. The events that led to its creation – the Great Depression of the 1930s and World War II – have faded into distant memory and exert only the faintest influence on today's global economy. And yet, the IMF not only persists, it remains what US President Ronald Reagan called it four decades ago: "the linchpin of the international financial system." This achievement was not inevitable, and neither is its continuation.

What should happen now to enable the IMF to play an active and positive role in the coming years?

When the newly appointed governors of the IMF and the World Bank gathered for their inaugural meeting in 1946, John Maynard Keynes famously dubbed the two institutions the "Bretton Woods twins", after the New Hampshire location of the conference where they were conceived. In truth, however, the IMF was secondary to the World Bank. It was smaller, it was not expected to have a major role in the short-term recovery from the war, and it was secondary to the World Bank in financial strength. The US government decided that the World Bank would have to be headed by an American to be effective, and it left the selection of a Managing Director for the IMF to the rest of the membership. It was an inauspicious beginning.

For the first 25 years or so, the IMF oversaw the restoration of multilateral finance among its growing membership, and it experienced bouts when there were substantial demands for its loans. Its central role of supporting a system of fixed exchange rates ended in 1973, but it carried on with a renewed vigor to restore financial stability and help developing countries cope. What ultimately turned the IMF into a "linchpin" was the onset of a debt crisis in Latin America in 1982. The IMF responded decisively, and it quickly became the default manager of international financial crises. That role has grown and flourished ever since.

Effective crisis management required the IMF to become more deeply involved in policymaking, both in emerging market countries struggling to cope with the demands of global finance and in low-income countries burdened with unpayable debts. In the 1990s, the collapse of the Soviet Union brought a large wave of new members into the Fund and embedded the institution even more deeply in a wide range of domestic policy issues. These developments stretched the IMF's resources, both financial and human, and raised multiple controversies about its role. Was it staying within its mandate and its expertise? Was it acting effectively to solve problems? Was it improving or undermining national policymaking? By the millennium, the IMF was in an existential crisis.

For the past two decades, the IMF has addressed these problems by refining its interactions with its member countries. It adopted new guidelines for staff to follow in both its surveillance and its lending programs. These guidelines aimed to focus the Fund's policy prescriptions and advice more parsimoniously and more directly on the most critical issues. They also aimed to create an atmosphere of cooperation between the staff and country officials and avoid treating loan applicants as supplicants. At the same time, however, the Fund continued to take on new responsibilities, especially in its surveillance activities. This mixed record of streamlining within policy areas and expanding into newly relevant areas contributed to a reduced intensity of criticism from civil society organizations.

Also contributing to this decline in criticism was a sharp drop in demand for IMF loans in the early years of this century. Most emerging markets experienced several years of benign economic conditions and had no need to turn to the IMF for crisis management. Looking forward at the time, it appeared that newly developed regional entities would be able to handle most financing problems without reliance on the IMF. In response, the IMF embarked on a cost-cutting drive: it reduced its staff by approximately 500 personnel and adopted a new business model, which was less reliant on lending income, to cover its administrative budget.

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This lending lull turned out to be short-lived. The onset of the global financial crisis in 2008 quickly overwhelmed regional institutions, including those of the EU. To combat crises in Greece and several other European countries, the EU invited the IMF to join the European Commission and the European Central Bank in a "troika" arrangement. Suddenly, the IMF was back as a major creditor and a manager of international crises.

These developments have restored the IMF's linchpin role, but the future of global finance remains highly uncertain.

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The fragmentation of trade is just the most visible consequence of ruptures in global governance. The IMF, though universal, is tasked with taking sides in an effort to promote and preserve the rules-based system of which it is the linchpin. It is not clear whether this tension can be resolved so that the IMF's role can be sustained.

The most pervasive remaining criticism of the IMF concerns its governance. The agency was created in 1944 through the leadership of the two leading economies of the time: the US, which was the dominant rising power, and the UK, which had long been the center of global finance, but whose influence was by then rapidly fading. IMF lending was initially entirely in the form of US dollars, and, for three decades, the UK was the Fund's biggest borrower. The US rightly insisted on having the largest voting power and a veto over major financial decisions. Although the UK's role was mainly for historical reasons, it was awarded the second largest voting share, albeit much smaller than the US's share.

However, voting shares have evolved greatly over the 80 years since the original formulation. The IMF has held sixteen general quota reviews, many of which have shifted voting shares. Despite the natural reluctance of the old and fading powers to accept reductions in their influence, the Fund has taken incremental steps to increase voting shares for countries with the most rapidly growing economies. China , which had the third largest voting share in 1946, at 7% of the total, had only the eighth largest share when the People's Republic assumed China's seat in 1980. Today, it has the second largest share, with 6% of the total. The US is still the leading power in the world financial system, and its voting share reflects that. Its share is half of what it was at the outset, but it is still the only single country with a veto over major decisions. The EU also has a collective veto. Its 27 members have a total voting share half again as large as that of the US.

The fundamental governance issue is the conflict between financial considerations for effective control and oversight and the political or moral considerations for fairness and democracy. The IMF is a financial institution with assets that are contributed voluntarily by countries. It makes loans to member countries that choose to submit themselves to its conditions. Those facts necessitate a voting structure that is controlled primarily by creditor countries, but in which every member has a share commensurate with its role in the world economy. Any other system would undermine the institution, but finding the right balance between the interests of creditors and debtors is a delicate and continuing political process.

The other prominent governance issue for the IMF is the selection of its leadership team, especially the Managing Director, who has always been from Europe. Non-Europeans have occasionally tried to break the pattern, without success. Although European leadership has been mostly successful, it has led to problems. It is hard to avoid the impression that the post of Managing Director is awarded based on patronage rather than meritocracy. When the IMF was called upon in 2009 to help manage financial crises across much of Europe, a widespread perception arose that Europe was being treated much more favorably than developing countries, simply because Europe was running the IMF.

The current system appears to have an open process for selecting the Managing Director, but the structure of the IMF makes it very difficult to break the habit as the EU and the US together control 42% of the voting power. If they agree on a candidate and include just a few close allies, no opposing candidacy can be viable. No matter how effective individual Managing Directors are, it is indefensible to argue that one bloc of countries should continually oversee the work of an institution with such a deep and broad influence over the global financial system. Realistically, however, the only way forward will be for political leaders in Europe to agree to stand aside.

While the IMF and its major creditors are implementing reforms to further strengthen the Fund's contribution to financial stability and prosperity, the institution can only do so much within the current system of global governance. An effort to obtain more fundamental improvements must start with a recognition of the broader systemic weaknesses. As is widely acknowledged, the UN Security Council is barely functional and needs to be restructured. At the next level down, the UN Economic and Social Committee (ECOSOC), the International Monetary and Financial Committee (IMFC), and the Development Committee are all bound by a formal rigidity, which limits their effectiveness. All of the IMF's partner institutions – such as, the World Bank, regional development banks, the World Trade Organization, the Bank for International Settlements, and the Financial Stability Board – carry out their own mandates within their own silos. The connections that could bind these agencies together into a coherent system are virtually nonexistent.

The success of the Bretton Woods conference in the middle of World War II provided valuable lessons on how to move forward in the middle of current divisions.

As the Bretton Woods conference was being planned, the world was split into three blocs: the Grand Alliance, the Axis, and neutral nations. The Bretton Woods conference was essentially a gathering of the Grand Alliance. Its long-term goal was to establish a system of international trade and finance that would encompass as many of the world's countries as possible. At that time, however, universality was no more than an aspiration. Membership in the IMF and World Bank was limited to the 44 countries that had been invited to the conference, but the charters specified that all other countries could join whenever they were ready to accept the terms of the agreements. By the mid-1990s, half a century after its founding, the IMF had become a universal institution, with only a small number of countries (Cuba, North Korea, and a handful of small states) remaining outside.

At present, something close to a global three-way split has returned. Russia, China, and several smaller countries dispute the value of the Western-led system, with its rules that were designed by a coalition led by the US and Western Europe during and after World War II. The EU, Japan, South Korea, Australia, New Zealand, a number of smaller countries, and (until recently) the US support and defend the rules-based system. Much of the Global South struggles to cooperate with both of these blocs. Reconciling these diverse views and interests to reestablish an effective global system of trade and finance is not realistic at this time.

The first lesson from Bretton Woods is that the only way to progress from a dysfunctional system towards the restoration of global cooperation is for a group of large allied countries to take the lead. Reform from within can only be partial and incremental because it is never in the interests of declining powers to cede control. In 1944, the effort succeeded because the old system based on monetary gold had been destroyed by the First World War, and the League of Nations and various ad hoc assemblies had failed to rebuild it. With no effective system of governance left, the allies had no choice but to start again. The current task is no less urgent, but it is even more challenging. The UN-led structure is in place and resistant to change, but it lacks coherence and is much less effective than it needs to be.

A second lesson is that successful reform requires a clear goal and a clear path toward it. The goal today is simple: to restore global cooperation within a rules-based system, in which all countries have the opportunity to participate, commensurate to their status in the modern world economy. As Antònio Gutteres, the Secretary General of the UN, alarmingly stated at the 2024 summit meeting of the General Assembly: "We are here to bring multilateralism back from the brink." The challenge, then, is how to devise a strategy to overcome the current state of distrust and autarky.

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The prevailing strategy at the moment is to try to reform and update existing institutions from within so that the 80-year-old system can be preserved and made more effective. In 2024, the UN General Assembly responded to Gutteres' call by adopting the document *UN Pact for the Future*. The pact commits its supporters to make the UN system both more democratic and more effective through reforms to the Security Council, ECOSOC, and other agencies. As for the IMF, it welcomes the ongoing efforts to strengthen the governance role of developing countries. The underpinning assumption, though, is that the existing architecture is appropriate and only needs to be tweaked.

A more fundamental restructuring of global financial governance appears unrealistic as long as the entrenched interests of major countries prevail, but the limited range of reforms currently underway seems to have little prospect of restoring global cooperation or of bringing "multilateralism back from the brink." At Bretton Woods, a handful of committed officials from a small number of countries were able to create a new and largely successful system because the old regimes had already collapsed. If globalism is to have a future *without* an intervening collapse of the magnitude of the Great Depression and World War II, the overarching lesson from Bretton Woods is that a new generation of responsible leaders will have to emerge with bold and practical plans.