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An Analysis of Competing IMF Reform Proposals

In the wake of several major crises, in which it played a highly controversial role, the IMF has recently come under heavy fire from various quarters. A number of proposals for reform have been put forward, of which the report of the Meltzer Commission has attracted particularly widespread attention. The authors analyze this and some competing reform proposals using the "trilemma of economic integration", which the US Treasury Secretary, Lawrence Summers, suggested as a common framework for investigation.

The International Monetary Fund (IMF) is probably the most often criticized international organization. Surprisingly, this fact has not harmed the IMF much but has rather demonstrated its importance in the international arena. The criticism has been ineffective mainly because the arguments and the demands for reform have represented opposite views and therefore also suggested changes in opposite directions. This fact could be interpreted by the IMF and its supporters as a sign that the Fund's policy followed a middle-of-the-road path, indicating a balanced approach and characterizing the Fund's critics as being radical.

This quite comfortable situation has become more critical as a result of the recently published report of the "International Financial Institutions Advisory Commission" (IFIAC). This commission, headed by Allan Meltzer, was charged by the US congress with analyzing the effectiveness of the international financial institutions, such as the IMF, the World Bank, etc., and to provide a proposal for reform. The result has been a shock for the IMF. The analysis comes to the conclusion: "While the IMF can point to some successes, it has presided over, and fostered, a crisis-prone system". The consequence of this analysis must be a drastic change in the international financial system and in the role of the IMF. The recommendations come close to making the IMF an ineffective institution, still existing, still compiling data and giving advice, but unable to force anything on anybody and largely unable to extend any credit. The IMF would no longer be what it has been since the late 1940s.

Although even more radical proposals have been made in the past, the recommendation of the IFIAC is very influential as it is supported by the parliament of the largest IMF-shareholder. Before we examine this proposal and other competing approaches in more detail, it is useful to establish a common framework for investigation. Lawrence Summers, the present US Treasury Secretary, has made a suggestion in this respect, the "trilemma of economic integration". In the next section, we first explain this framework. We then characterize the IMF using the criteria of this framework. Finally, we analyze three competing reform proposals with a special focus on their contribution towards the international integration trilemma. We conclude with remarks about the IMF's present path of reform.

The Trilemma of Economic Integration

One of the by now traditional analytical tools of the theory of international economic policy is the "impossible trinity". This concept states that the international monetary order is influenced by the pursuit of three goals, of which only two can be reached simultaneously in a satisfactory manner. Thus, policy makers have to decide which two goals they prefer. This largely determines the resulting international monetary system:

4. For a longer exposition and application to the present discussion see Michael Frenkel, Lukas Menkhoff: Stabile Weltfinanzen? Die Debatte um eine neue internationale Finanzarchitektur, Berlin 2000.
If countries prefer stable exchange rates and national monetary autonomy, they will restrict international capital flows and thus create an order like the Bretton Woods system.

If countries prefer free capital flows and national monetary autonomy, they cannot fully realize the goal of stable exchange rates, which describes the present system.

If countries prefer stable exchange rates and free capital flows they have to give up national monetary autonomy, an order which was by and large realized under the classical Gold standard.

The concept of the impossible trinity is designed to analyze competing goals for the international monetary order but does not cover the broader aspects of international integration. For this latter purpose, Summers proposed a kind of enlarged and thus more abstract impossible trinity which he calls the "economic integration trilemma". It obviously also consists of three competing goals and deals with international economic policy (see Figure 1).

Figure 1
Goals of the "Economic Integration Trilemma"

![Diagram of Goals]

Proper public economic management

Greater international economic integration

National sovereignty

Figure 2
Positions towards "Solutions" of the Integration Trilemma

![Diagram of Positions]

Internationalist utopians

Modern protectionists

Traditional conservatives

The “translation” of the three goals of an international monetary order into international economic integration is as follows: the specialized goal of monetary autonomy is advanced into “national sovereignty”. The goal of stable exchange rates is transformed into the broader idea of “proper public economic management” (in short “public management”). Summers associates with this objective the creation of institutions and the implementation of regulations that aim at reducing or eliminating market failure and market imperfections. In this sense, arguments in favor of foreign exchange market interventions are based on the expectation that a positive externality results for the real sector of the economy. Finally, the corresponding goal of free capital flows is “greater international economic integration” (in short “international integration”). It stresses the aspect that economic integration generally encompasses more than just the integration of capital markets.

Summers suggests that the three goals of the integration trilemma involve similar trade-offs to the goals of the impossible trinity. For example, if a country pursues greater international integration and appropriate public policies, which also focus on a more global environment, independent national goals cannot be reached.

Policies of International Integration

The logic of the integration trilemma leads – in analogy to the analysis of the impossible trinity – to three "policy solutions" which reflect clear preferences regarding the three competing goals. These solutions largely show the approach of their protagonists towards international economic integration and are thus labelled according to their respective characteristics, i.e. “traditional conservatives”, “modern protectionists” and “internationalist utopians”.

We will briefly elaborate on these positions and later examine their impact on the possible role of the IMF (see also Figure 2):

Traditional conservatives typically stress the importance of free markets and sovereign governments. As this position is often accompanied by strong beliefs in the efficiency of markets and by deep mistrust of the motives and capabilities of state agencies, the necessary negligence of the third goal of the integration trilemma, i.e. public management, is not seen as a major loss.

Modern protectionists prefer a different solution to the trilemma, which is indicated by the name given to their approach.

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* See Lawrence H. Summers, op. cit., pp. 10 f.