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Global Governance and Reform of the International Monetary Fund: An Update

Jack Boorman

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Jack Boorman

Member of Advisory Board,
Emerging Markets Forum;

Former Counselor and Former Director of
Policy Development and Review Department,
International Monetary Fund (IMF)

The crisis that has unfolded in the past two years has already triggered significant changes in the governance of the global economic and financial system. The G20 has risen to new prominence by meeting for the first time at the Leaders level in November 2008 following the marked worsening of the crisis in September. The Leaders met again in April, 2009 after substantive work done by the Finance Ministers and working groups to propose measures to both deal with immediate responses to the crisis as well as to define reforms aimed at avoiding such crises in the future. As a result of this effort, and the work of many national and international agencies and institutions, major initiatives for economic and financial sector reform have been put forward.

The emergence of the G20 represents a welcome sea-change in the voice of emerging market countries, in particular, in the governance of the global economy. The crisis has also refocused attention on the role of the International Monetary Fund. The view that had taken hold in some quarters that the IMF would never again be a lender, other than to the poorer countries, has been dramatically proved wrong – or, at best, premature. Suggestions for change and reform in the institution have gained powerful new momentum, with concrete action already taken in a number of areas.

As is often the case, a major crisis has presented a new opportunity for genuine change and reform. It is now critical, especially for the emerging market countries whose place in the global economy has changed so fundamentally in the past several decades, to capitalize on that opportunity. It is important that this opportunity be grasped while the cost and pain of the crisis is still alive. Rapid, but still careful, reform is possible as many aspects of the reform needed in both the global governance system and in the IMF have been under discussion for years. Now is the time to further refine proposals and use the current momentum for change to bring about genuine reform before that opportunity recedes.

This note will recall the major elements of reform that were put forward in earlier papers by the author on both Global governance reform and reform of the IMF.[1] It will review the progress made on reform of the IMF over the past six months and will consider the elements that are common to the reform of the IMF and reform of the structure of global governance. Given the key role of the IMF in the global economic and financial system, the global governance structure and the governance of the IMF cannot be separated. The G20 has made reform of the IMF one of its priorities; a report commissioned by the managing director of the IMF on governance reform has been submitted and circulated widely within the international community;[2] and the IMFC, at its meeting in April, pushed the issues forward, including the following call in its communiqué:

"14. Also, broader reforms to ensure International Monetary and Financial Committee active participation in the Fund's strategic decision making process should be promptly considered. The Committee calls on the Executive Board to report on this issue, as well as the Report by the Eminent Persons Group, and the work done by other groups, on enhancing the IMF governance structure by the next Annual Meeting in October 2009."[3]

The feedstock for productive discussion and debate is well in place. Now is the time for action.

Change and Reform in the IMF

Two points are critical in thinking about reform of the International Monetary Fund:

1. The discussion cannot be just about reforming the institution;

[1] Jack Boorman:" Reform of the Global Financial System and the Role of the International Monetary Fund", Emerging Markets Forum, November, 2008; and "IMF Reform: Congruence with Global Governance Reform" in Global Governance Reform: Breaking the Stalemate, by Colin Bradford and Johannes Linn, Brookings Institution Press, 2007.

[2] Report of the Committee of Eminent Persons on IMF Governance Reform, March 24, 2009.

[3] Communiqué of the International Monetary and Financial Committee, April 25, 2009

- Yes, the institution – in its work, in its policy advice, and in its organization – failed in a number of its responsibilities in the lead up to the current crisis;

- But the contribution that the IMF can make to global economic and financial stability does not depend only on the way it is structured and organized, or on the capacities of its staff and management. Its effectiveness is dependent on its ongoing interactions with members – both individually and collectively, and that, in turn, depends on the attitude and behavior of members towards the institution.

- Surveillance – the foremost responsibility of the IMF – is a mutual responsibility of the institution and of the member countries.

- To the extent Fund surveillance did not deliver in the lead up to the crisis, some of the failure has to be laid at the doors of the member countries. The G20 recognized this and faults the (lack of) responsiveness of some members (a) in cooperating in the surveillance process and (b) in responding to the IMF's policy advice.

2. This leads to a second general point. None of this will change without fundamental reform of the governance structure and practices of the IMF. Such reform will not guarantee change, but it is a pre-requisite:

   - Member countries that feel excluded or without the voice and vote they should have in the institution won't take the interest in the institution needed to make it fully effective until those governance issues are addressed. These include a fundamental review of quotas and a reconsideration of the size, structure and responsibilities of the executive board.

   - And the institution will not be run the way it should be until other governance reforms are introduced – especially as regards the role and influence of the International Monetary and Financial Committee (IMFC), the independence of staff and management, and the accountability of all the organs of the institution – the staff, management and the executive board.

There are four major elements of a fundamental reform of the IMF. These include: the resources at the Fund's disposal; the facilities through which the Fund lends to member countries and the conditionality associated with that lending; the IMF's surveillance responsibilities; and its governance. Good progress has been made on some of the reform proposals in each of these areas; others will take some time to bring to fruition, especially in the realm of governance. This note will review progress in each of these areas and point to the changes that still need to be made.

The Resources Available to the IMF

1. Staff Resources
   Downsizing the staff in 2008 was a major mistake. The managing director has recognized that, and has now reversed that process by announcing a program to increase the size of the staff. The downsizing was a mistake because it was done before the fundamental questions were asked and debated about the appropriate role for the Fund in the increasingly complex global economic and financial system. Those questions are being addressed only now and will have important implications both for the number of staff the Fund will need to carry out its responsibilities and the kind of skills and experience that those staff should have. In any event, considerable institutional memory, the skills needed for dealing effectively with member countries, and the deep commitment of many of the departing staff to the institution have already been lost.

2. Financial Resources
   There is almost universal agreement that the IMF has been seriously under- funded and that it was in no position to adequately respond to the needs of its members as the current crisis unfolded.[4] Fortunately, there are a variety of options available to increase the financial resources at the disposal of the IMF in addition to an increase in quotas. These include: bilateral borrowing; expansion of the New Arrangements to Borrow (NAB); market borrowing; and an allocation of SDRs to the membership.

The international community has moved relatively quickly to rectify the inadequacy of the IMF's capacity to assist its members with financial support:

i. New life has been given to the call for approval by members of the quota package submitted in April 2008; however, this is mostly symbolic as it will do little to increase the resources available to the Fund or to significantly change the distribution of voting power among the membership.

ii. It has been agreed that the fourteenth review of quotas should begin immediately, should provide a "substantial" increase to Fund resources, and should be concluded by January, 2011.

iii. It has also been agreed to increase immediate financing to the Fund from members by $250 billion. To this end, a loan from Japan has already been concluded for up to US$100 billion, and additional commitments have been made by Canada, members of the European Union, Norway, Switzerland, and the United States.

iv. This financing is to be subsequently incorporated into "…expanded and more flexible New Arrangements to Borrow (NAB), increased by up to US$500 billion".

v. A commitment has been made to consider market borrowing, and a step has been taken in this direction with the expression of intent by the Russian Federation to invest up to US$10 billion in notes that would be issued by the IMF.

vi. Additional resources are being sought to help support the Fund's concessional lending operations in the poorer countries. In this connection, consideration is being given to providing short-term and emergency financing to low income countries.

vii. Finally, the G20 and the IMFC have called for "rapid approval" of an allocation of SDRs equivalent toUS$250 billion; and a call has been made for rapid approval of the pending (for almost a decade) fourth amendment of the Articles of Agreement for a special onetime allocation of SDRs.

It would be useful to take the opportunities created by the current crisis to consider other mechanisms through which the Fund could provide support to those members with growing liquidity needs. One possibility that should be further explored is the post-allocation transfer of SDRs from countries with already strong reserve positions to members with the greatest need for liquidity support.

By any measure, this package would amount to a very significant increase in the Fund's resources to help support members needing assistance during the current crisis and in what may confront the global economy in the future. Only a wild-eyed optimist would have thought this was possible less than a year ago. The challenge now, of course, is to implement all of these ambitious commitments. Past experience suggests that this cannot be assumed!

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[4] The one year forward commitment capacity of the IMF at the beginning of the current crisis was less than $100 billion – insignificant in today's world. By way of example, that amount was less than what the U.S. Federal Reserve agreed to provide to just four countries – Mexico, Brazil, South Korea and Singapore – under the swap arrangements recently agreed with those countries.

The enlargement and expansion of the NAB could take some time as it requires agreement of the current NAB participants representing eighty-five percent of total credit arrangements. In addition, it will likely require legislative approval by some participants. Seeking these resources for the Fund through the NAB – as opposed to, say, additional bilateral loan arrangements such as that recently concluded with Japan may also have implications for the Fund's governance. (See below)

IMF Lending Facilities and Conditionality

Major Changes have also been made to the facilities through which the IMF makes its financial resources available to member countries. Most important, a new facility – the Flexible Credit Line (FCL) has been introduced, along with the High Access Precautionary Arrangement (HAPA). Together these facilities will permit:

- Precautionary commitments to members;
- A substantial increase in access limits; and
- A lengthening of maturities as compared to what was available under the Short Term Liquidity Facility (SLF) which has been discontinued.

FCL arrangements would be approved for countries meeting pre-set qualification criteria with access determined on a case-by-case basis. Disbursements under the FCL would not be phased or conditioned to policy understandings, as is the case under a traditional Fund-supported program. This flexible access is seen by the Fund as justified by the very strong policy track records of countries that would qualify for the FCL.

These changes have been part of a substantial streamlining of conditionality. This has been most appropriate for those countries that were following good economic and financial policies in the lead up to the current crisis – and continue to follow and strengthen such policies – but that have nonetheless been severely affected by the crisis. These are the countries that would be expected to request support under the FCL. This has required the acceptance by some of the previously reluctant creditor countries to recognize that this crisis requires greater risk-taking by the Fund. This is to be welcomed as it can be argued that in the Asian crisis of the late 1990's, for example, too many Fund programs were under –funded.

That said, it will not be easy for the Fund to draw an appropriate line between those countries that should have access to low conditionality resources under the FCL and those whose policy record does not warrant such support. These latter countries should be asked to commit to policy adjustment under the Fund's more traditional conditionality guidelines and to more traditional phasing of access to Fund resources, not least to lessen the risk taken on by the IMF in these arrangements. There should also be concern that some of the problems that doomed the earlier Contingent Credit Lines (CCL), a facility that was created with great fanfare but was never used by its intended clients - the emerging market economies, have not been resolved with the establishment of the FCL. In particular, there are still unanswered questions – and risks – regarding the signaling effect to financial markets of withdrawing the FCL from a country that may not continue to adjust policies to the requirements of a possible further deterioration in the global environment or to a change in the domestic economic or political environment.

Surveillance

Clearly there is a need to better integrate financial sector analysis into the IMF's traditional macroeconomic analysis. There has been some progress on this front, but additional changes are needed:

- One of the core tools, Financial Sector Assessments (FSAPs), needs to be made mandatory. The U.S. refused to submit to an FSAP before the crisis that hit its financial system in 2007. It can never be determined whether conducting such an assessment may have changed the course of events. However, at a minimum, the refusal by the IMF's largest shareholder to submit its financial regulatory and supervisory system to examination under an FSAP provided the wrong signal to the rest of the membership regarding the role of the IMF in the surveillance and evaluation of members' financial systems.

- The focus of FSAPs needs to be expanded. It needs to be not just on whether the country has the needed legislation for regulation and supervision, and the needed institutions to carry out those responsibilities, but also on how they are enforcing standards and where the risk and vulnerabilities lie. Conducting FSAPs across the membership with this broadened focus and with the appropriate periodicity will require additional staff with the necessary talent and experience.

- Also, there is a need for better collaboration with the Financial Stability Forum (FSF) – now the Financial Stability Board (FSB). This collaboration must include better feedback from FSAPs, and from surveillance more generally, from the IMF to the standard-setters in the FSB. There are also important questions here about the FSB itself: which countries will be in its membership; and what its role and structure should be.

- There is also a need for better processes to look to the regional and global implications of vulnerabilities surfaced in the FSAP process. Hopefully, one result of increased collaboration between the IMF and the FSB will be to provide better indicators of systemic risks, to address data gaps, and to develop an acceptable – and publicly available - early-warning exercise;

- Beyond this, there needs to be better analysis by the IMF, in the context of its surveillance exercises, of capital account restrictions and capital account regimes. Consideration should again be given to an amendment to the Articles of Agreement to give the Fund jurisdiction over capital account restrictions similar to the jurisdiction it has over current account restrictions. The recent Report of the Eminent Persons Group points to this need.[5] In the event that the necessary support for such an amendment cannot be found, the IMF should, nevertheless, intensify its work in assessing countries' vulnerabilities as they open their capital accounts and advising on policies to help assure more orderly and less vulnerable paths to liberalization. The current crisis, and the vulnerabilities that the crisis has made evident in countries such as Iceland, Hungary, Latvia, and others, has demonstrated all too well the need for better analysis and advice in this critical area. The one hundred or so member countries that will be opening their economies more widely over the next decades should not be doomed to repeat the mistakes that so many of today's emerging market economies have made in opening their economies. Bringing the wisdom – and the failures – of other members' experiences in areas such as this is one of the key contributions the IMF can make to greater financial stability in individual countries and in the global system.

One change that would positively influence all of this work would be a move to greater independence of the staff and management in voicing its views on both the policies of individual member countries

5 The Report of the Eminent Persons Group to the managing director recommends: "The expansion of the Fund's surveillance mandate beyond exchange rates to provide appropriate coverage of macroeconomic policies, prudential issues and financial spillovers. The capital account would fall within the mandate".

– including the largest member countries, and the prospects for systemic countries and the global economy. For example, The World Economic Outlook (WEO), a flagship publication of the IMF, is labeled a "staff document"; greater independence on the part of the staff would assure that the document fully reflects the staff's views and is not unduly influenced by the countries subject to those views.

Governance Reform – The Global Structure and the IMF

There remains a dire need for governance reform involving the Fund at two levels:

1. At the global level, both in terms of member countries' voice and influence in all fora whose decisions or guidance affect the IMF, and as regards the global bodies in which policy makers at the most senior level must engage to confront systemic risks that threaten the global economy. In the lead up to the current crisis, all the traditional fora – the G7/8, the G20, and the IMFC – failed to address effectively the systemic risk posed by the developing global imbalances that were a key contributing factor to the crisis. The IMF and others warned of that risk, but the community lacked – and still lacks – a forum in which the relevant policy makers can actively engage and constructively collaborate to counter such risks.

2. At the institutional level, especially as regards the voice and vote of members in the decisions and the operation of the IMF. These include matters such as the selection process for the managing director (and deputy managing directors), the processes for defining responsibilities at all levels in the institution, and for holding all players in the institution accountable. The managing director must hold staff accountable; the executive board must actively hold the managing director accountable; and the IMFC or Board of Governors must hold the executive board accountable. At all these levels, but particularly the latter two, new procedures are needed to assure effective accountability.

On Global governance, there is an important issue regarding the relationship between the G20 and the IMFC. The G20 has now met twice at the Leaders level to help deal with the global crisis. That has given new prominence and new force to the pronouncements of the G20 finance ministers. The political force given to many of the reform issues elaborated above by the meetings of the G20 must be recognized and is to be welcomed. However, a few points about the G20 need to be kept in mind:

- It is not the governing body of the Fund;
- It is not universal;
- It is arbitrary in its membership; and
- It has no constituency structure to bring all the other 165 countries that are members of the IMF into its deliberations.[6]

It can be argued that the G-20 can play a useful role because of the sheer economic and financial power of its members and, at the summit level, because it can provide political impetus to important initiatives. This has been well demonstrated over the past year. That is the practical reality and, to that extent, it is a significant improvement over the G7/8. However, the G20, and other global agenda-setting bodies such as the G7/8, should place the responsibility for carrying out specific reforms regarding the IMF where it belongs – with the IMFC, and should see the IMFC as the key forum for the coordination of economic and financial policy to reduce systemic risk.

[6] See the annex to this paper for an excerpt from an earlier paper by the author in which a set of principles are suggested that should guide the formation and operations of global governance structures.

But there is also an issue with the IMFC itself:

- It is advisory and is not a decision making body;
- In times of major, and controversial, decisions taken by the IMF, it has sometimes been invisible, leaving the management of the Fund almost alone to take the heat for those decisions;
- It has not always been involved in deciding the strategic direction of the Fund in a manner appropriate to a governing body;
- It has not been seen as the primary forum for the coordination of policies to reduce systemic risk and global vulnerabilities; and
- It has not actively assessed the performance of either the management of the Fund or of the executive board as best governance practices suggest it should.

Many of these short-comings of the IMFC could be remedied through the creation of the Council that was anticipated in the Articles of Agreement but never activated. The original Interim Committee established in 1973 was called “Interim” because it was expected to be replaced by the Council. The Interim Committee was renamed the International Monetary and Financial Committee in 1999, but the change fell far short of the changes that would be made through the creation of the Council. In particular, the Council would have decision making powers, as called for in the Articles of Agreement. It would also add incentive for greater involvement of all members, not least because Councilors could split their vote, something that is not possible in the executive board under the Articles of Agreement.

Creation of the Council could also help resolve an emerging issue with the G20, i.e., where does the decision-making power reside regarding IMF powers and responsibilities. Like the executive board, the Council would have a constituency structure which would create a mechanism for all counties – not just the G7/8 or the G20 – to have a voice in the decisions that affect them. It would, thus, be universal and would have a legitimacy that is not present in the current global governance structure.

Neither the Interim Committee nor the IMFC succeeded in creating the atmosphere required to engage the most senior national policy makers in the kind of discussions needed to address systemic risks. This would not change automatically with the establishment of the Council. That would require other changes in the size and structure of the Executive Board – which would be mirrored in the Council, and in the division of decision-making and consultative responsibilities between the Council and the executive board. Nevertheless, the establishment of the Council would provide the opportunity to create the kind of body in which the most senior policy makers could address the issues thus far neglected in the bodies that have been in place to date.

Particularly difficult issues would have to be confronted in considering how the emerging G20 – or other global agenda-setting bodies – could, over time, be married into the Council. This issue would not necessarily affect the G20 Leaders group. However, the Council should replace the G20 finance ministers group for all matters that are raised for discussion that directly affect the IMF and for ongoing assessment of systemic risks and vulnerabilities and the policy changes needed to address such risks to the global economy. In both roles, the council would be supported by the analytic and policy capacity that exists in the IMF, i.e., it would have a permanent secretariat.[7]

[7] One change that could be made immediately that would help empower the IMFC, and ultimately the Council, would be to put the power to appoint the Secretary to the Executive Board – and to the IMFC, in the hands of the board. The role now played by the secretary for management could be filled by the creation of a new staff position, probably in the office of the managing director.

At the institutional level, there is an obvious need to fundamentally realign the voting power within the IMF to reflect today's realities in the global economic and financial system. Such change would

be needed to provide the maximum legitimacy to the IMFC or, better, to the Council. As noted, there also needs to be a substantive review of the size and structure of the executive board. As elaborated elsewhere, Europe holds the key to both these reforms.

Fortunately, there is now agreement to press forward with the next review of quotas and complete it by January 2011. That presents a real opportunity to bring about genuine governance reform in the Fund. However, this will be a difficult exercise as there are trade-offs in the issues involving country quotas and the size and structure of the executive board. This may require some kind of "grand bargain" wherein all of the matters are dealt with at the same time so as to have room for compromise that will be needed to bring these reforms to a successful – and appropriate - conclusion.

One aside here. The enlargement and the expansion of the New Arrangements to borrow will bring welcome additional financing to the IMF. However, the availability of those resources should not be allowed to influence the size of the quota increase to be decided in the forthcoming review. The IMFC communiqué in April noted that "…the IMF is, and shall remain, a quota-based institution". The "substantial" resources that are agreed as needed by the Fund should come from quotas. That means a tripling, at least, of current quotas. This is critical as it is only through a very substantial increase in quotas that the needed changes in the voice and vote of members can be brought about. The enlargement of the NAB, and the availability of resources that will come with that enlargement, must not be allowed to get in the way of this most fundamental element of the reform of the IMF.

All of these issues are now on the table. It will take great effort, and good judgment, to bring them to a successful conclusion. The voice – and the strategy – of the emerging market countries will be critical to the outcome of the discussions and debates that will have to take place to find the necessary "Grand Bargain".

ANNEX

The following is an excerpt from a paper published by the Brookings Institution in 2007:
IMF Reform:
Congruence with Global
Governance Reform, by Jack Boorman
In Global Governance Reform:
Breaking the Stalemate by
Colin Bradford and Johannes Linn

There is, of course, another layer of issues that involve IMF governing bodies besides the executive board, including the IMFC, the twenty-four member ministerial body that represents the same constituencies as those represented on the executive board, and the board of governors, the body comprising ministers from each of the IMF's 184 member countries and the body from which the powers of the other governing bodies derive. While those two bodies have direct and formal responsibility for running the IMF, reflections on the governance of the fund must go well beyond the role played by those bodies. Because of the way that the global economic and financial system has been organized in the official sector, the IMF's formal governance structure is only one element of the much broader structure involving the agenda-setting and guiding bodies of the international economic and financial community. Those bodies include the G-7/8, the G-20, the G-24, the G-77, and others and the structures surrounding each of them: the deputies and the various technical working groups, below the ministerial level, and the summits or meetings of leaders, above the ministerial level. The IMF's formal governance structure has evolved through a somewhat ad hoc and not fundamentally democratic process and not necessarily according to any well-established and widely agreed-on set of principles. But suppose that the international community was starting over and had a blank slate with respect to that structure. What kind of system might it try to create? Here, let me echo a pessimistic note sounded some months ago by Martin Wolf in talking about the IMF. He recalls the oft-repeated phrase—at least by the fund's supporters—that if the IMF did not exist, it would have to be created. But in today's environment, he says, that would not happen. "We would not reinvent the Fund, not because it is useless," he said, "but because today's world lacks the courage and vision to create powerful multilateral institutions." Indeed, today's world is one in which nations, or at least some of the major nations, seem unwilling to cede any of their sovereignty to international organizations.

Principles for Governance Reform

That difficult, but hopefully temporary, reality notwithstanding, is it possible to come up with a set of principles to guide the development of better governance structures—both of the IMF itself and its visible and formal governing bodies and of the broader agenda-setting and guiding bodies of the international economic and financial system, that is, the "Gs"? Some such principles are implicit, or even explicit, in the writings of others on the subject. But can a reasonably inclusive list of such principles be enumerated? This chapter attempts to create such a list and then asks how the current system stacks up against those principles, giving some concrete examples of what might be considered its failures or shortcomings. The chapter also suggests some actions that could be taken to make the system more faithful to those principles. The suggested principles, which may tend to intersect and overlap, include the following:

— universality
— legitimacy, or what might be considered simple fairness
— subsidiarity
— efficiency
— accountability.

Universality

In a globalized world, the actions of one country—indeed, of individuals in one country—can affect every other country and the individuals therein, whether the actions involve economic activity, the environment, water use, public health, or a host of other areas. In such a world, every country should have some voice in global forums, both political and economic. That by no means implies that all forums must be global, open to participation by all countries. There is an important role for regional and other less-than universal institutions and country groupings. But in a globalized world, there should be mechanisms to allow the forums that are more local to have a voice in the universal or global forums. The subsidiarity principle also argues for such a structure.

How does the IMF, charged in article I of its Articles of Agreement with promoting international monetary cooperation and financial stability, measure up under the principle of universality? Since the fall of the Soviet Union, the Fund has come very close to achieving universal membership. But there is a difficult issue here. While virtually all countries belong to the IMF, the voice and vote of member countries vary widely. Similarly, the relationship of members to the institution and to each other is different from what was envisioned under the fund's original credit union–like character. Those relationships have changed dramatically with the expansion of the membership and with the growth of the private capital markets and the differential access of member countries to those markets.

In the original conception and with the original membership, it was anticipated that the financial resources of the IMF would revolve, or circulate, among the members—each country at times being a creditor and at other times a debtor. For some time now, however, the membership has tended to fragment into two groups of countries—some that are almost permanent creditors, and others that are either frequent or even permanent debtors. Thus, what was closer to a community of peers has become much less so. As an aside, the forecasts of some observers that this state of affairs will change as the Fund finds fewer debtors and ceases to be much of a lender should not be taken too seriously. Mervyn King, for example, in a widely reported speech in New Delhi in February 2006, said that "the growth of private capital flows and the build-up of massive foreign exchange reserves by many Asian economies have made redundant the idea that the primary function of the Fund is to be an international lender of last resort." Others have expressed similar views. I agree with the view that the IMF's primary role should not be that of lender; it should be surveillance. And that role is clearly recognized in the second amendment to the fund's Articles of Agreement. But announcing the death of financial crises, or the end of a financing role for the fund in such crises, may be premature—not least because of the conditions that it can request of a borrowing country. The current benign economic and financial environment will not last and will be seen to have been a temporary lull in fund lending activity, as has often been the case in the past. The IMF will continue to have an important role to play as a lender in the inevitable future crises.

Thus, while the IMF is very close to being an all-inclusive organization, there is a question as to whether a genuine "commonality of interests" exists among its members. On one level, the answer certainly is yes. All countries have an interest in the primary mandate of the IMF—that is, to promote global economic and financial stability. But that commonality sometimes fades on issues specific to the policies and operations of the fund, such as access to its resources, the kind of conditions attached thereto, and other matters on which the creditors and the debtors sometimes part company in rather fundamental ways.

Even on something as basic as the IMF's primary responsibility—that is, surveillance of member country policies—the distinctions among members have an impact. The fund's influence over the policies of individual member countries is sometimes criticized as asymmetric: the IMF exercises more power and influence over the policies of member countries that periodically seek financing directly from the fund or from creditors or donors who maybe influenced by the fund's views on those countries' policies; it exercises less influence over the policies of major creditor members, essentially the industrial countries.

That critique has merit, and the IMF managing director's strategic review offers some suggestions with regard to it. Through the creation of new mechanisms of multilateral surveillance, the impact of surveillance—not least surveillance of the major shareholder countries—could be strengthened. In addition, through efforts to increase the voice and vote of those members that are currently seen to be underrepresented—some of whom are, or recently have been, borrowers—a better balance of power may be struck between creditor and debtor members.

The IMFC has endorsed a new framework for multilateral surveillance and has asked for concrete proposals to improve the distribution of quotas. What will come of this is unclear. John Snow, at the IMFC, supported the proposed multilateral consultations but with the caveat that "they are small, informal, and take place at senior management levels." That view is probably realistic, but if they are only that, can they, at the same time, satisfy the objective of universality? It is hoped that effective modalities for multilateral consultations will be designed and some of them will succeed, helping to preserve both the universality of the institution and its substance—that is, the commonality of interests of its members.

Going beyond the formal structure of IMF governance to the broader structure of the global governance system through which countries also influence the fund, the picture is even more complicated. The G-7 and even the G-20 are hardly universal, although the latter comes much closer to something like the ideal than the former. And, of course, there are fundamental questions about the legitimacy and effectiveness of these groups. Moreover, although there are multiple regional forums, it is not clear that they build in a coherent fashion to a system that facilitates effective representation within the G-7 or the G-20 groupings. In fact, the multiplicity of such forums may well be one of the factors limiting their impact. What is needed are more effective vehicles through which the views put forward and the positions taken in regional and other forums can effectively percolate up to the predominant forums—today, the G-7/8. The international community needs to think in terms of what might be called a "ladder of representation" that can ensure that a channel exists whereby the views of the many can find some voice at the top. That takes us to the next principle.

Legitimacy

Under the principle of legitimacy, some concept of "fairness" in representation should be included. To a certain extent, any definition of "fairness" is and must be a matter of perception because there are no hard and universally accepted criteria to determine whether something is legitimate and fair. The dictionary is of little help here! Webster defines "legitimacy" as "accordant with law or with established legal forms and requirements" and as "conforming to recognized principles or accepted rules and standards." But the first of these is a bit circular: who establishes the "legal forms and requirements" and how are they established? Neither of the suggested meanings is operationally very meaningful. Carlo Cottarelli, in an interesting IMF working paper, says that "legitimacy means that its [an official organization's] actions must be seen as expressing an accepted source of power delegated to it by sovereign countries." But there are problems with the absence of specific rules governing how that power is delegated. What or who is it that grants the right to representation and determines the nature and extent of that representation? Is it military power? Economic might? Population size? There is, quite obviously, no agreement in today's world on the answer to that question.

Perhaps the dictionary is more helpful in defining "fairness," inter alia, as "achieving a proper balance of conflicting interests." In the end, the members of a group—for example, the members of the IMF—must feel that they are fairly represented; that is, that they are represented in a way that helps achieve a reasonable balance of their conflicting interests. But does that feeling exist when, at the global governance level, as Leo Van Houtven, the former secretary of the IMF, puts it, "the major industrial countries, the G-7 . . . have exhibited a growing tendency in recent years to act as a self-appointed steering group or 'Directoire' of the IMF." That tendency, together with the slow pace at which the IMF has adjusted the representation of members as their place in the world economy has changed, has had a harmful effect on the tradition of consensus building and therefore on members' sense of fairness and of ownership in the fund.

The governing structure of the IMF should provide legitimacy, and it should be seen as legitimate by its members as well as by people outside the institution. Perhaps the question can be put as follows: what governance features of an organization make sovereign countries find it acceptable to work with the organization and give up some of their sovereign power in doing so—and make that ceding of sovereignty acceptable to their populations? Suppose the IMF is put to that test. Representation in the IMF is determined primarily by the quota granted to a member country, and quotas are based on a formulaic effort to measure the role of the country in the global economic and financial system. The basic variables included in the formulas are GDP (at market exchange rates); openness (as measured by current receipts and payments); variability (meaning vulnerability to balance-of-payment shocks); and holdings of international reserves.

But many observers think that the current formulas need to be revisited, not least because they question the legitimacy of the representative structure that results from the formulas. Suggestions include changing the weight or the measurement of some of the variables already included or perhaps including new variables. For example, some suggest using a purchasing power parity (PPP) measure of GDP; others, including Michel Camdessus, a former IMF managing director, would include population. But this important issue remains unresolved, and even if the concepts of legitimacy and fairness cannot be given precise operational meaning, it is perfectly clear that some of the current quotas in the fund are perceived by many as illegitimate or unfair. The basis for that perception is easy to see. A great deal of material is available on the anomalies of current quotas. By way of example, the aggregate quota of the twelve Eurozone countries is 23.3 percent of total quotas; for the twenty-five countries in the European Union (EU 25) together, is 32.2 percent of total quotas. The share for the United States is 17.4 percent. Neither the EU nor the Eurozone constitutes a country in the same sense that the United States does, but as monetary policy, trade policy, and other financial and economic authority is transferred to Brussels and to Frankfurt from the member states, the more similar the two entities begin to look. If one thinks of what the U.S. quota would be if trade among the fifty states were included in the U.S. measure of current payments and receipts, it certainly raises questions about the inclusion of intercountry trade in the quota calculations for Europe. As another example, if one looks at the quotas of some of the larger emerging market countries—such as China, Korea, Mexico, Turkey, and others—large discrepancies are seen when comparing their quotas with those of other countries, including many in Europe, that have a much smaller role in the world economy. Korea, for example, with three times the output of Denmark, has a smaller quota in the IMF. Beyond the issue of quotas is, of course, the matter of voice within the fund. To a great extent, that is a function of representation on the executive board. But again, there are some questionable realities. Of the EU 25 countries, three appoint their own executive director; other EU 25 countries are represented in no fewer than six additional multicountry constituencies, generally holding the position of executive director. These realities are important because if changes are to occur in quota shares, there will have to be some reduction in European shares; similarly, if representation on the executive board is to change or the size of the board is to decrease, it is difficult to see how such changes can come about without a reduction in the number of executive directors appointed or elected by the European countries. The voices of the countries most affected by the IMF's policies also need to be reconsidered in making any changes. That could be dealt with both by changing the number of basic votes that each country is granted—moving the fund back to something closer to the original conception of the purpose of basic votes—and by looking at the capacity of countries to represent themselves effectively.

Subsidiarity

There is a well-accepted view in the theory of social organizations that functions that subordinate organizations perform effectively belong more properly to them than to a dominant central organization.

That is, in some ways, a "voice" issue, in that one leaves specific policies and decisions to those most affected by them but within a broad framework established by the more dominant or global organization. Leaving issues to those likely to have the greatest expertise would also generally support the principle of subsidiarity.

This principle also helps to limit the agenda of the more global organization or authority, hopefully producing greater efficiency. Basically, the subsidiarity principle says that issues ought to be settled as close to the ground as possible, but within an overall framework agreed on at the more global level. This is not an easy matter to resolve. In the political realm in the United States, for example, it involves the issue of states' rights and the uneasy balance maintained between power at the federal level to set overarching policies and power at the state and local levels to implement policies**.**

When thinking about optimal arrangements at the global level, one should ask whether there has been a tendency to pull issues unnecessarily— and perhaps at times counterproductively—to the top, to ministers or even to summits, rather than dealing with them in the relevant lower-level institutions. Surely guidance from the top is necessary and can be helpful, not least of all in order to know what is acceptable at the political level. But if issues are taken to too great a level of detail or specificity at the top, that can not only waste time and effort but also cause problems in the implementing institutions and resentment among members that were excluded from the top-level deliberations. A case can be made that this was a problem in some of the discussions regarding the reform of the international financial architecture in the aftermath of the financial crises of the 1990s. Some may remember the extraordinarily detailed annexes to the G-7 finance ministers' communiqués of that era. More recently, this issue arose in the formulation of the multilateral debt reduction initiative (MDRI) to grant 100 percent debt relief to some of the world's poorest countries. In that case, the initial proposals formulated by the G-7 deputies and agreed to by the ministers and leaders ran afoul of the IMF's Articles of Agreement, under which all members are bound, and the proposals had to be reformulated in the institutions. Greater involvement and attention at a subordinate level and within the relevant institutions—primarily the IMF and the World Bank in the case of the MDRI—could have avoided that outcome.

Efficiency

Cottarelli has examined the trade-offs between efficiency and governance in the IMF. Among other things, he points to the implications that the search for efficiency can have in an organization like the fund for the distribution of power between the "political pole," that is, the shareholders, and the "technocratic pole," that is, management and staff. Greater delegation generally enhances efficiency, but it can have significant implications for the way in which the various parties exert their influence. Of course, ultimate responsibility for the way that the IMF is run and for the decisions that it takes rests with the sovereign governments that are its members. I will come back to this point.

The more practical efficiency issues involving the fund that are currently on the table include the size and organization of the executive board and, by implication, the size of the IMFC. At the global level, these questions involve the size and composition of the global agenda-setting and guiding bodies— the "Gs." Let me say something only about the executive board. A couple of things need careful consideration.

First is the size of the board. There is fairly broad agreement that it is too large to operate efficiently—perhaps even effectively. Second is the seniority of directors within their own governments. There is quite a mix among directors in that regard, but generally speaking, it would be better if the level of seniority was raised; doing so might also help increase the independence of directors. That proposal adds a complication, however, in that such a change may be possible only if the board is made nonresident, with more-senior officials coming to Washington only periodically, perhaps monthly, to provide the oversight required and to consider the major policy, country-related, and administrative decisions that need to be taken.

Second is a matter of process. A practice has developed in the board whereby executive directors may submit a written statement on an agenda item ahead of a meeting. That was initiated primarily as a means of shortening meetings by setting down some of the more routine elements of an agenda item that an executive director wanted to include in the minutes and as a means of establishing positions, to the extent possible, ahead of the meeting. Most directors now submit such statements for most board meetings involving policy issues. It seems, however, that the possible gain in efficiency is now severely outweighed by the cost in terms of dialogue, discussion, and the search for consensus—something critical to the operation of the IMF. The room for maneuver of most executive directors may be reduced once positions are set down in black and white, especially if those positions have been vetted and agreed to by capitals. Board meetings must be an opportunity to learn something new, to see things from different perspectives, and, as a result, at times to modify positions. Current practice seems to operate against that.

Accountability

In any organization, accountability needs to be clear. But where and with whom does accountability lie in the IMF? And where does it lie within the agenda-setting bodies at the global level?

Given the way that the IMF is supposed to be managed, accountability should, in the first instance, rest with the managing director. But under the Articles of Agreement, the managing director is to carry out the business of the fund "subject to the general control of the Executive Board." However, it is at least worth asking whether the board has developed practices and procedures that allow it to exercise oversight and control effectively and to the extent required—but without micromanaging in a way that makes it more difficult to hold management and senior staff accountable for their decisions. On the highest level, it is of course the sovereign governments of the member countries that bear ultimate responsibility for the IMF and its decisions. But are they seen as accountable? There was a telling statement in a speech by Michel Camdessus to the Council on Foreign Relations in February 2000, around the time of his departure from the IMF. Speaking on this issue, he said: "The problem is not that we are not accountable, but that we are not seen to be accountable, and that some member governments from time to time find it convenient not to express their public support for actions they have supported in the Executive Board."I believe that his remark was a candid expression of the frustration that he felt with the fact that some governments seemed publicly to be second-guessing or even distancing themselves from some of the controversial operations of the fund, especially in Russia and in some of the Asian crisis countries. He went on to say that "it is . . . important to insure that the IMF is seen far more visibly to have legitimate political support of our shareholders." To that end, he proposed transforming the IMF's advisory ministerial committee (today's IMFC) into a decision-making council for the major strategic operations facing the fund. As he said, "This would simply, in the eyes of the public, place responsibility squarely where it already exists." He expanded the proposal in a speech in September 2005, saying that "the Council . . . would be the ideal place to discuss the policies needed to address global systemic issues with a global membership, and thus to take the place also of the G10, G20 and other Gs." He seemed to imply that he would retain the G-7.

Thus far Camdessus has not persuaded the community to create the council. He did succeed in transforming the Interim Committee into the current IMFC in September 1999, a significant step toward creating a permanent body. However, the IMFC is still only an "advisory" and not a decision making body. More recently, Peter Kenen has taken up the proposal to form a council, but in the context of a broader set of changes to the executive board and to the voting power of participants in the council and in the executive board. These ideas deserve a full debate in the context of the principles elaborated above.

The issue of accountability, as evident in Camdessus's recent reiteration of his proposal to create a decision-making council, cannot be discussed without bringing in the role played by the Gs, especially the G-7/8 and the G-20 and, perhaps to a lesser extent, the G-10, whose role has faded in the last years. It is in those forums that many issues are deliberated and debated and positions determined. Those issues may then be brought into the IMF, but only after a certain level of agreement has been reached among the participants in the forums. It should be clear that good ideas should be accepted from any source and any forum. But two issues within the current system call for reflection. The first is the balance that must be struck, under the principle of universality, between raising and formulating ideas in the G-1, G-3, G-7, or elsewhere and the need—indeed requirement, if real meaning is to be given to the participation and involvement of others—for consultation with the rest of the community in deciding the final outcome of a debate or in taking decisions on an issue. It weakens members' sense of ownership and challenges the concepts of universality and legitimacy when the G-7, for example, brings an idea into the IMF that has been too finely tuned and cannot be subject to genuine debate and modification. In the end, such a practice also blurs the issue of accountability: does it lie with the universal membership of the fund or with the smaller groups? Such has been the case on a number of important policy issues and in a number of critical country operations. The second issue involves the breach of the subsidiarity principle that occurs when the G-7 or another forum takes an issue that the community may be disposed to support to a level of detail and specificity that precludes genuine discussion, debate, and consensus building or makes them very difficult. Sometimes that seems to occur because concessions must be made to find agreement within the G-7, but the balance then struck makes later modification in the IMF and elsewhere much more difficult. This issue involves a difficult trade-off. But the objective should be to frame issues in the smaller groups in more general terms, sufficient to secure the political agreement needed to move them forward, and then to bring those issues into the IMF or other relevant institutions in a manner that permits genuine debate and reformulation and, it is hoped, wider consensus on—and ownership of—the outcome. Formulating the specifics of an issue closer to the ground within the affected institution will almost always result in better and more widely owned and accepted policies.

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The Watergate Office Building, 2600 Virginia Avenue, N.W., Suite 201
Washington, DC 20037, USA Tel: (1) 202 393 6663 Fax: (1) 202 393 6556

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