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Governance of the global economic, financial, and monetary system

The G7 and G20, and the role of the International Monetary Fund

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Background Paper

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This chapter examines the role played by the G7 and G20 in overseeing the global economic, financial, and monetary system. The decisions and recommendations of those "leading country" groups are influenced by the views and analysis of a concert of agencies and institutions that play key roles in that system. Those groups are also dependent on those bodies to effectively operationalize and implement their decisions.[1] While important roles are played by all those agencies and institutions, the focus here is on the International Monetary Fund (IMF). The chapter will conclude with a set of recommendations to reform both the G20 and the IMF. Major reform is needed if the substantial changes in the global economy—including the continued shift in the relative economic and financial power of countries and the continuing evolution of global financial markets in the years up to 2050—are to be managed successfully. Those reforms must include changes in the representation of member countries - both in the G20 itself, as well as in some of the institutions that manage the system. Changes in the authority and powers of the relevant institutions, and changes in their modus operandi may also be needed. Only with significant - and continuing - change and reform will their critical roles in the global system be effective—especially in preventing and/or, if necessary, dealing with major economic and financial crises.

The issues

The global economic, monetary, and financial systems have changed dramatically in the past 50 years. Trade, technology, supply chains, and the globalization of finance have tied people and countries together across the globe as never before. These developments have brought enormous benefits to mankind. Not least, poverty in the world has been reduced at a pace and to a degree not seen in history.[2] Similarly, technological changes have produced great benefits, many of which already cover much of the world. At the same time, those great benefits have been accompanied by heightened risks in the economic and financial system and have linked the global financial world in a manner that transmits crises at a pace previously unimaginable.

Fortunately, the many institutions created in the wake of the Second World War have provided a structure to try to deal with the issues raised by global interdependence. There have been many successes in dealing with the new challenges. However, there have also been too many failures. Some of these failures resulted from a lack of information—and sufficient analysis—about developments in the global economy and their impact on financial markets and on individual countries. Among these, at the heart of the recent global crisis was a failure to understand, to measure, and to control global liquidity, and a failure to effectively regulate major banks and the increasingly problematic shadow banking systems. These failures, and others, can be attributed in large measure to weaknesses in the global governance structure and in the individual institutions that comprise that structure.

In the period to 2050, as has been the case throughout the past century, there will be further dramatic changes in the world that will challenge the management of national economies and of the global economic and financial system. The further evolution of that system cannot be predicted with any confidence. One can simply look back to the early 1960s and ask whether anyone foresaw the developments that would take place in the global economy over the subsequent 50 years. In the same way, the further evolution of the international monetary and financial system over the period to 2050 is, to a large extent, unknown. As a result, the optimal governance structure for 2050 cannot be defined. We are limited to examining how the current structure has evolved and how it has performed relative to the objectives sought for it. But even with only that limited basis, it is clear that there are elements of the current system in need of substantial change and reform now. It

1. See Annex 1 for a list of the relevant institutions relied on by the G20.
2. However, in the last few decades that progress has been accompanied by increasing inequality in income and wealth in much of the world. Decreasing inequality between countries has been accompanied by sharply increasing inequality within many countries.

The economic and financial governance structure of the world has too often failed.

is also clear that, beyond any reforms adopted in the near future, the governance structure - both at the global level as well as in individual institutions, will need to change continuously if the challenges that may be on the horizon are to be met successfully.

In truth, the economic and financial governance structure of the world has too often failed. That history reflects poorly on the self-appointed groups of countries that are relied upon to provide leadership to the global and regional economies and financial systems.[3] Similarly, the premier oversight institutions, including the IMF, while enjoying a quite positive record of major accomplishments, missed the onset of a number of regional and global economic and financial crises. The latest such failure in 2007/08 brought the world to the edge of another Great Depression. While forceful action prevented the worst, the cost to the global economy has been huge—and that cost continues to increase to this day. Thus, while there has been progress in developing a global governance structure, it has often been too slow to change, and the current structure continues to have too many blind spots. There is still a long way to go to bring about real change in global and institutional governance.

What is needed? First and foremost is the need to identify and repair the weaknesses in the current system and try to assure that it has the flexibility and responsiveness to change and innovate continuously as the economic, monetary and financial systems evolve. This will require an examination of the bodies that claim a dominant role in guiding the system, e.g., the G7 and G20, and the strengthening of the institutional infrastructure that manages it. And what role will the emerging market countries (EMCs) and developing countries play in that evolution? Will they be mostly observers, as has too often been the case to date? Or will they play a role commensurate with the growing importance of their economies in the global system? Flexibility and adaptability will be the keys to assure the needed evolution of the governance structure. The world in 2050—and the costs of crises that occur between now and then—will reflect the success or failure in this effort.

Perhaps a three stage approach should be considered. First, the reforms most evidently needed should be addressed immediately. Specific proposals will be made below that encompass some of those reforms. Second, a new Bretton Woods Conference should be convened as soon as the needed preparations for such an important undertaking can be completed. And lastly, the global community should be vigilant to make changes to the governance structures as the inevitable need for change becomes evident.

What Role Has Poor Governance Played in the Many Economic and Financial Crises of Recent Years?

The last 40 years have seen crisis after crisis across regions and, most recently, the worst global financial and economic crisis since the great depression. The analyses of the causes of those crises tend to focus mostly on the economic forces acting on the crisis countries, including commodity price cycles, the impact of the changing appetites of foreign investors for risk exposure in those countries, and other such factors. The errors of policy makers also receive attention. Less attention has been given to the impact of global governance structures or the performance of institutions within the crisis countries themselves. Box 1 catalogs a few relevant institutional features of some of those countries prior to the crises they faced.

This litany of country crises in Box 1 is just the tip of a very deep iceberg. Overall, in the forty years from 1970 to 2011 there were 147 systemic banking crises across the world, with many countries suffering multiple crises. The vast majority of those crises were associated with emerging market countries. However, more recently, in the wake

3. As just one example, it took major crises (in Asia in 1997/98 and in the United States and the global system in 2007/08) to have the G7 accept that the shifts in economic and financial power among countries warranted a faster pace of adjustment in the representation and voice of the emerging market and developing countries . Those crises also made clear how insufficient were the financial resources of the IMF to deal with such crises.

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Box 1: Recent economic and financial crises

The **Mexican** crisis in 1994/95 was triggered, if not caused, by the massive exposure to short-term dollar denominated sovereign debt in the form of *tesobonos*—the extent of which was mostly unknown due to a lack of transparency in government accounts. The build-up to the crisis was missed partly because of a lack of authority for the IMF to access the relevant information—such as developments in international reserves—needed to closely monitor and assess developments. These were institutional weaknesses.

The **Thai** crisis in 1997 was made much worse by the lack of transparency in the management of the country's international reserves and by the unwillingness of the authorities to accept the warnings from the IMF about the danger of not dealing substantively with the their underlying economic imbalances. In this case, the IMF saw the dangers emerging in the Thai economy, but lacked both the information to appreciate how fast the deterioration was occurring and the authority to do something about it.

The **Indonesian** crisis that same year could be attributed to a high degree to the failure of appropriate bank regulation in the country and the absence of information or controls over both the maturity and currency mismatches that developed in the corporate sector. Corruption in the financial and political systems was also a factor. This remains a primary governance issue in too many countries.

The **Korean** crisis was driven in large part by the extraordinary exposure of the banking system to short-term credit lines and the currency mismatches in bank books, which were the result, in large part, of the restrictions on longer-term foreign borrowing by the *Chaebols* and other Korean business enterprises. This was a failure of Korean policy, but also evidence of a weakness in IMF surveillance and its influence over the country's capital account regulations. The opening of the capital account to short-term flows while restricting long-term flows was a fundamental error.

The **Argentine** crises in 2001 and 2003 resulted, in large part, from the failure of the political system to understand the constraints imposed by the dollar peg—an institutional issue—and the threat posed by the macroeconomic policies of the authorities. Here, too, the power of IMF surveillance to alter the policy stance of a member country was repeatedly called into question

The 1998 **Russian** crisis reflected, inter alia, the undue reliance of the government on short-term credit and the absence of appropriate regulation of the banking system. But persistent fiscal problems, including increasingly evident problems in tax collection and the absence of action against tax delinquent enterprises, over time, shredded the confidence of markets. It also was hastened by serious information gaps that made impossible close monitoring of developments, including by nervous markets ready to exit at the first sign of problems.

The recent **Global** crisis revealed significant fault lines throughout the United States financial system and in the systems of other countries—failure of financial sector regulation, not just in the United States; the lack of transparency and regulation in the development of new financial instruments such as derivatives, credit default swaps, mortgage backed securities, and Special Investment Vehicles (SIVs) that allowed banks to hide risk off of their balance sheets; the failure to challenge the views of those who preached that nothing could be done by central banks to prevent asset bubbles; lax controls, or the weak implementation of controls; and criminality in the domestic mortgage market in the United States. There was also a failure of other governments, especially in Europe, to regulate the exposure of their banks and other financial institutions to the toxic asset-backed securities originating in the United States and to the unsustainable lending to real estate booms in a number of countries.

The **Greek** crisis reflected weak bank regulation; misreporting of fiscal and financial developments that made effective oversight and surveillance impossible; weak public institutions; incompetent management of Greek banks; and corruption. It also reflected a premature entry into the Eurozone—both a political and institutional failing.

The **Irish** crisis, as with the United States crisis, reflected fundamental problems in the regulatory institutions, hubris in the ineffectively supervised banking sector, and a bubble that had too many unthinking cheerleaders. The crisis was worsened by the route chosen to deal with the collapse of the banking system, i.e., the bailout of the banks by the government rather than at cost to banks in Europe and other private sector creditors that had carelessly lent into the Irish boom. This was doubly problematic as the regulators in other European countries failed to monitor the lending by their institutions into an enormous real estate bubble.

In the years from 2007 to 2011, of the 17 systemic banking crises, 12 were in advanced economies.

of the growing complexity and weak regulation of the global financial system, many of the crises have occurred in the advanced economies. In the years from 2007 to 2011, of the 17 systemic banking crises, 12 were in advanced economies. An additional eight crises occurred during that period that have been classified as "borderline."[4] Over the longer period, there were 218 currency crises and 66 sovereign debt crises—both often associated with banking crises.[5] This is an incredible commentary on both global economic and financial governance and regulation within individual countries.

Each of the countries listed in Box 1, as well as most of the other crisis countries, had underlying macroeconomic imbalances and other problems, including political issues, which helped bring on the crises and, in certain cases, to aggravate them. But in each case, the crisis was made worse—much worse in many instances, because of underlying governance and institutional weakness in their economic, fiscal, and financial systems.[6] History, and not just that of the last forty years, is littered with financial crises. And the cost to global development and growth, to countries' economies, and to individuals—such as those suffering long term unemployment, foreclosures on their homes, and repossessions in the United States during the recent crisis—has been enormous. How can this record be improved as the global economy and the financial and monetary systems march towards 2050? Surely better governance, more consistent, and robust, financial sector regulation within and across countries and markets is needed. But so too is better education and understanding for those using the financial system so that they are better informed about the risks they are taking on. And this must be matched by better ethics in the system and more serious punishment for those breaking the rules.[7]

The Continuing Shift in Global Economic Power

The following paragraphs briefly review the prospects for changes in the global economic and financial system most relevant to the challenges - and opportunities - in the global governance structure.

Growth Scenarios for the Advanced Economies

The IMF estimates that by 2019—eleven years after the collapse of Lehman Brothers—the recovery from the Great Recession will be broadly complete.[8] But GDP growth in the advanced economies is likely to slow from 2.7 percent during the period from 1985 to 2007, to 2 percent from 2019 to 2030, and 1.8 percent thereafter.[9] This will have an important influence on the global environment in which the emerging and developing countries find themselves.

Growth Scenarios for Emerging Market and Developing Economies

Developing countries will experience a similar slowdown, with GDP growth projected to slow from an average 4.6 percent in the period from 1985 to 2007 to 4.4 percent from 2019 to 2030, and 3.5 percent thereafter. This is driven primarily by emerging Asia, whose growth rate drops by over 3 percentage points over the period. Nevertheless, Asia will remain among the most rapidly growing regions. Elsewhere, the slowdowns are more moderate.[10]

4. See "Systemic Banking Crises Database— An Update", Luc Laeven and Fabian Valencia, IMF Working Paper, WP/12/163.

5. Currency crises are defined as a nominal depreciation of the currency vis a vis the US dollar of at least 30% and which is at least 10 percentage points higher than the rate of depreciation in the previous year.

6. One prominent observer puts it concisely: "International finance cannot be properly understood without reference to the global governance arrangements that shape the regulatory environment in which financial actors operate." Domenico Lombardi, "Stabilizing International Finance: Can the System be Saved?" by James M. Boughton, CIGI, September, 2014, Preface.

7. It is not enough for banks and others in the system to get away with not accepting guilt and only paying fines that, in the end, are paid by shareholders. There needs to be more robust punishment of individuals who break the rules and game the system.

8. However, the pace of financial globalization may be permanently affected by aspects of the regulatory response to the crisis, including through a lack of global consistency in regulatory reforms, and a tendency toward ring- fencing of bank subsidiaries by national supervisors (see IIF 2014) and Andrew Sheng: "Emerging Market Finance 2050, Finance for the Future—Funding growth, Inclusivity and Environment", 2015

9. About three quarters of this decline reflects the slowing growth of the labor force based on assumptions about population growth rates, and demographic factors including, most importantly, the aging of populations and other relevant projections.

10. In Sub-Saharan Africa, which is least advanced in the demographic transition, ---GDP growth is projected to rise sharply, making it the fastest

By 2050, developing countries are projected to account for 62 percent of global GDP, with the bulk of this increase due to emerging Asia.

While GDP growth in developing countries (including all EMCs and low-income countries) slows significantly, it nonetheless remains considerably higher than in advanced countries, resulting in a steady rise in their share of global GDP. By 2050, developing countries are projected to account for 62 percent of global GDP, with the bulk of this increase due to emerging Asia, whose share more than doubles from 20 percent to 43 percent of global GDP over the period. Overall, the result would be an increasingly multi-polar world, with the advanced countries and emerging Asia each accounting for about 40 percent of global GDP, the Western Hemisphere for 9 percent, and each of the other three developing country regions for four to five percent of global GDP.

Financial Linkage Scenarios

By 2050, the average size of financial markets in emerging market and developing countries is projected to rise from under 200 percent of GDP to well over 300 percent, with these countries' share of global financial markets more than doubling to 40 percent. Overall, therefore, the dominance of advanced countries would be significantly reduced, and emerging Asia alone would account for around one third of global financial markets by 2050, cementing its status as a central global financial player.

Overall, therefore, a reasonable baseline conclusion is that developing countries are likely to become more integrated into a global financial market still dominated by advanced countries, thus perhaps even more exposed than in the past to advanced country shocks transmitted through financial channels.[11] These scenarios suggest that financial instability in individual countries or in the global system could be even more destabilizing and more costly in terms of lost growth than crises witnessed in the past 30 years. The conclusion is, once again, that something must be done to improve global governance as well as governance and financial sector regulation in individual countries. Failure to do so holds the promise of continued instability in the global economic and financial system.

The Need to Adapt

As the share and importance of emerging and developing countries in the global economy grows, the need for, and gains from, multilateral policy cooperation will clearly rise. This implies that these countries should have a greater role—and, correspondingly, will have to accept greater responsibilities in global economic policymaking and governance. The challenges, including political, of adapting to these dramatic changes will be enormous. This adaptation will not be easy. Demographics across much of the world will present significant challenges. Technological change could be a major positive force, but it can also be disruptive and destabilizing. International politics are likely to continue to produce surprises, some of them potentially very disruptive. Economic and financial crises make regional and global political issues even more difficult to manage.

To deal with these issues, the institutions charged with managing the economic and financial systems in the global arena will need stronger governance than has been the case to date, and that always raises the question of sovereignty and other delicate issues. Those institutions will have to be flexible, but with authority to influence countries in the management of their economic and financial systems. In particular, this will involve the mandates, governance and operations of the IMF, the BIS, the FSB, the WTO and others.[12] This will, in turn, require that these institutions have clear and accepted mandates, clear rules of governance, strong support and involvement of all their members, appropriately inclusive memberships, and staff equal to the challenges they will face. They will also have to see themselves as integral and complimentary parts of a

growing region in the world by 2030.

11. This, of course, is a double-edged sword. Larger and more liquid financial markets, when well regulated and supervised, make it easier to absorb financial shocks, but can also increase vulnerability to shocks in third markets, since market participants are more easily able to sell assets to meet obligations elsewhere.

12. See Annex 1 for a list of organizations most deeply involved in advising on global economic, financial, and trade issues.

There appears to be general acceptance that it is appropriate and helpful for some group of major economies to provide a forum for the discussion of what are seen to be primarily economic, monetary, and financial issues.

cohesive and cooperative global institutional system. Perhaps most importantly, those institutions - and especially the IMF, which has treaty-based obligations to oversee the adherence of its members to policies that promote global growth and financial stability, as well as relevant international standards and codes of conduct - must be equipped to enforce discipline so as to keep the global system in reasonable balance.[13] This is something that has too often been ineffective under the current institutional structure.

These prospects call for a robust examination of the current global governance structure. This is a massive agenda, and much of it beyond the scope of this chapter. Most attention will be given here to the role and function of the groups of leading countries that have taken responsibility for global economic and financial governance—the G7 and the G20—and the role of the IMF. However, the role to be played by other organizations, such as the BIS, FSB, WTO, and others needs to be kept in mind.

The "G" Question

There appears to be general acceptance that it is appropriate and helpful for some group of major economies to provide a forum for the discussion of what are seen to be primarily economic, monetary, and financial issues. This role was filled in the 1970s, by the G5 (United States, Germany, Japan, the United Kingdom and France). Italy and Canada were added to form the G7 in 1987 and Russia later joined to form the G8.[14] In 1999, a much larger group, the G20, was formed bringing in large emerging market countries.[15]

The G7

As the October 2014 World Economic Outlook of the IMF shows, the total GDP of the current G7 is now eclipsed by that of the seven largest emerging market countries in purchasing power parity (Brazil, Russia, India, China, Indonesia, Mexico, and Turkey).[16] That obviously should not be the sole criteria for forming a global group like the G7. However, the implications of this dramatic change over the past two decades is worth some thought.

The size and importance of countries in the global economy will continue to change and groupings such as the G7 should be capable of changing their membership to reflect new realities. Proposals have been made recently to reconfigure the G7 to include a few of the largest emerging market countries. Clearly Brazil, India, and Russia (after resolution of the current tensions with the West) could be candidates. Perhaps the United Kingdom, Canada, and/or Italy could withdraw, or the group could be slightly enlarged. Were the European countries to combine into one or two seats in the International Monetary and Financial Committee (IMFC) and the Executive Board in the IMF, that would suggest other possibilities for a reconfiguration of the G7. Whatever the membership, some small grouping of the relevant countries should be preserved. A small group provides a familiarity, a capacity for quick response and action, and a flexibility not possible for larger groups such as the G20.

The G20

The G20 was formed in 1999 in the wake of the Asian Crisis as a forum of finance ministers and central bank governors. The Group met for the first time at the leaders' level in November 2008 to deal with the global financial crisis. Since then the Leaders have met nine times. At the Leaders' Summit in Pittsburgh in September 2009, the

13. More specifically, one of the Purposes of the IMF is "to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of productive resources of all members as primary objectives of economic policy." Article I (ii) of the Articles of Agreement accepted by all member countries.

14. Russia was expelled from the Group in the wake of the annex of Crimea and the incursion of Russian forces into Eastern Ukraine.

15. Prior to the formation of these groups, the group of countries that had agreed to participate in the General Arrangements to Borrow (GAB) formed the G10. The GAB was established in 1962, when the governments of eight International Monetary Fund (IMF) members—Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom, and the United States—and the central banks of two others, Germany and Sweden, agreed to make resources available to the IMF for drawings by participants, and, under certain circumstances, for drawings by nonparticipants. The GAB was strengthened in 1964 by the association of the eleventh member, Switzerland.

16. IMF, World Economic Outlook, October, 2014

The problem with both the membership and the G20's self-proclaimed status as "the premier forum" reflects the absence of a firm set of principles underlying its establishment and its relationship to international institutions.

G20 described itself "as the premier forum for its members' international economic cooperation and decision-making."[17] The membership of the G20 comprises 19 countries plus the European Union. Finance ministers and central bank governors of G20 countries meet regularly during the year to discuss ways to strengthen the global economy, reform international financial institutions, improve financial regulation, and implement the key economic reforms that are needed in each member economy. Over the years, the G20 has expanded its focus to cover environmental and other issues.

Is this G7 plus G20 combination effective? Is it the appropriate structure to guide the global economic, monetary and financial systems? Needless to say, views differ on these critical questions.

Critics have cited a number of characteristics of these groups that lead them to question both their legitimacy and effectiveness. But what are the principles that should guide the formation and work of such groups of "major" countries, and do either the G7 or the G20 accord with those principles? The focus here will be on the G20—although most of the issues and questions raised relate to both groups.

Of the many issues that need to be considered regarding the G20, three are critical:

- The problematic origin of the group
- Its membership
- Its relationship to the IMF and other institutions that are significantly affected by decisions taken by the G20

These issues are all intertwined.

When the G20 was inaugurated in 1999, it had a membership determined somewhat arbitrarily — and to a large extent by the United States Treasury. That membership has not changed and includes countries whose presence in such a forum is, at best, questionable. Some of them surely cannot be held up as models of the kind of economic and financial policies one would like to see other countries emulate.[18]

This problem with both the membership and the G20's self-proclaimed status as "the premier forum" reflects the absence of a firm set of principles underlying its establishment and its relationship to international institutions. What should be the guiding principles?

Three such principles would seem particularly important: universality, legitimacy, and subsidiarity (Box 2).[19]

How does the G20 stack up against these principles? In terms of the number of countries that participate actively in the G20, the Group comes nowhere near to being universal. The countries included may represent about two-thirds of the world's population, around 85 percent of global GDP, and three quarters of global trade, but 173 countries are excluded from the main table. How can this problem be resolved? The G20 itself is working to be more inclusive as indicated in the G20 statement in Box 3 which is taken from the G20 home page.

But this practice hardly seems to be an effective resolution of the problem. A very different solution would be for the G20 to reform itself by structuring the group as a constituency system. There are multiple regional forums through which a constituency system could be built to provide broad representation of the views of all countries. But it is not at all clear that the current panoply of regional fora build in a coherent fashion to a system that would facilitate effective representation within a group such as the G20. In fact, the multiplicity of such fora 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

17. Some might interpret this statement as duplicating the role of the IMF which in Article I (i) is "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems. The International Monetary and Financial Committee (IMFC) of the IMF meets at the level of finance ministers and central bank governors to consider, inter alia, actions to be taken by the IMF and its members to carry out the Fund's mandate .

18. The members of the G20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union.

19. These principles, among others, are discussed in greater detail in "IMF Reform: Congruence with Global Governance Reform," Jack Boorman, Brookings Institution, 2006.

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positions taken in regional and other forums can effectively percolate up to the predominant forum. 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 a real voice and influence at the top.

A constituency system that provides a voice for those now excluded would go some way to providing a sense of inclusion. A constituency system could also help foster processes that would help respect the subsidiarity principle. Issues best left to more specialized agencies or organizations could be dealt with at the level of the bodies representing the various constituencies.

In addition to these changes to the G20, there would be great value in establishing a set of guidelines to determine appropriate membership in the group—whether individual

Box 2: Guiding principles for the G20

1. 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 open to active participation by all countries. There are important roles for regional and other less than universal institutions and country groupings. But in a globalized world, there should be mechanisms to allow forums that are more local and regional to have a voice in the universal or global forums. The subsidiarity principle also argues for such a structure.

2. Legitimacy

Under the principle of legitimacy, the 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.

Perhaps the dictionary can be helpful in defining "fairness," inter alia, as "achieving a proper balance of conflicting interests." In the end, both the members of a group and the rest of the global community of nations 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.

3. 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 and best tailored to their circumstances, 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.

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 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 issues taken to too great a level of detail or specificity at the top risks wasting time and effort, but also cause problems in the implementing institutions and resentment among countries that were excluded from the top-level deliberations.[1]

1. As but one example, 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 G7 finance ministers' communiques 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 G7 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.

Some have argued that the G20, while useful, particularly when the global economy confronts a crisis, is too large and unwieldy to be effective outside times of crisis.

countries in their own right, or countries that lead constituencies comprising a number of other countries. Some criteria could be quantitative, such as size of the economy, population, involvement in international trade and global finance, and other such measures. Another criterion, as suggested above, might involve the status of members in the regional or other fora that could constitute the constituency system. A final criteria could be the performance of a country's economy and financial sector, reflecting the policies responsible for that successful performance.

As importantly, there should be provisions elaborated to facilitate rotation in the membership. Perhaps those in the G7, possibly reconstituted as suggested above, would be permanent members. The other positions should be set for fixed terms allowing new members to come into the group. This would also help deal with the fact that the larger emerging and developing economies are growing at very different rates. If there were a constituency system, perhaps the constituencies themselves could rotate the leaders they wish to represent them in the G20. If done on a staggered basis so that only a few of those positions changed each year, that should help assure a high degree of continuity. For example, if twelve of the 20 chairs were rotating, four-year terms would permit three new members to join each year. Also, if the European Union retains a chair, perhaps some of the chairs of European countries could be vacated.

Some have argued that the G20, while useful, particularly when the global economy confronts a crisis, is too large and unwieldy to be effective outside times of crisis. One proposal, suggested above, is to keep the G20 roughly at the size it is, but establish a smaller, but more inclusive group to replace the current G7. One such proposal would see the G7 replaced by a "G7+" consisting of Brazil, China, the Euro Area, India, Japan, Russia, the United Kingdom, and the United States. Such a group, it is argued, should be preferred to the current G7, including in dealing with key global monetary issues.[20] This proposal warrants discussion, but it would have serious implications for the membership in the G20. If there is to be a change in the G20, the composition of both Groups needs to be considered at the same time. Not least, if some of the current members in the G7 were to be excluded in the creation of a small but different group, they might be more willing to accept that change if their positions in the G20 were seen as secure.

20. "The Twenty-First Century Needs a Better G20 and a New G7+," Jim O'Neill and Alessio Terzi, Bruegel Policy Contribution, Issue 2014/13, November 2014.

Box 3: G20 guest countries

"Each year the G20 President invites guest countries to attend the Leaders' Summit to participate in member discussions about the agenda.

Inviting guests gives non-members an opportunity to bring their views to G20 meetings. The selection of guests reflects the G20's commitment to ensuring all regions of the world are represented, and in consulting with countries beyond the G20 membership so as to understand fully their economic challenges, how they experience changes in the global economy and how G20 decisions affect them. Each year, the G20's guests include Spain (a permanent invitee); the chair of ASEAN; two African countries (the chair of the African Union and a representative of the New Partnership for Africa's Development [NEPAD]); and a country or countries invited by the Presidency—usually from its own region. From the first leader-level meeting of the G20 in 2008, guests have included Benin, Brunei, Cambodia, Chile, Colombia, Equatorial Guinea, Ethiopia, Kazakhstan, Malawi, the Netherlands, Spain, Switzerland, Thailand, the United Arab Emirates, and Vietnam.

In 2015 Turkey decided to invite Azerbaijan together with Malaysia, as the 2015 chair of ASEAN, Senegal, representing NEPAD, Singapore, Spain and Zimbabwe, as the 2015 chair of the African Union."

Source: G20 website "About G20"

The crisis, the Fund's reaction to the crisis, and its involvement with the G20 have significantly changed the way in which the IMF attempts to fulfill its mandate.

This entire process would be more rapidly advanced if the members of the euro area were to occupy a single chair in the governing bodies of the IMF – the executive board and the International Monetary and Financial Committee (IMFC). This would have the added advantage of reducing the size of those bodies. It would also facilitate the an alignment of the memberships of the G20 and the IMFC.

In short, the G20 needs a place for the largest economies and those with globally significant financial systems. But it should have a flexible set of rules to assure a rotating membership in the remaining chairs. A more fluid, rotating membership would help bring new ideas and new perspectives into the group's discussions. Finally, rather than individual countries as members, the G20 could consider the possibility for each member to be responsible for bringing the views of other countries to the Group through a constituency system. This would bring the group closer to meeting the goal of universality. One option for structuring such a constituency system would be for the membership of the G20 and that of the International Monetary and Financial Committee (IMFC) of the IMF to mirror each other. A significant virtue of having the same membership in the two groups would be to eliminate the duplication of meetings that now takes place – at both the Ministerial level and subordinate levels(See below for a concrete proposal.)

Global Governance and the International Monetary Fund

The G20 relies on the active engagement of several international organizations to provide advice on G20 priorities and to help members identify policy gaps where actions will have the most impact (see Annex 1). Representatives of those organizations are invited to relevant G20 meetings, including meetings of Sherpas, finance deputies, and working groups. The influence of those organizations and their impact on actions taken by the G20 is difficult to determine. The influence of the G20 on those organizations, however, is clear. That influence has been evident to all in the actions taken by the G20 in the wake of the global financial and economic crisis. None of those organizations has been affected more than the IMF.

What has been the impact of that influence on the IMF? There are several issues.

- How has the focus and work of the IMF changed?
- How has the governance of the IMF been affected? And, more generally, and importantly,
- In light of the lessons learned from the global crisis, what are the issues that the IMF needs to deal with to carry out its mandate to help assure economic and financial stability in the world?

Each of these issues will be discussed in turn.

How has the Focus and Work of the IMF Changed in the Wake of the Global Crisis?

The crisis, the Fund's reaction to the crisis, and its involvement with the G20 have significantly changed the way in which the IMF attempts to fulfill its mandate. In its first meeting at the leaders' level in Washington DC in November 2008, the G20 was focused primarily on organizing a coordinated reaction to the crisis. The most important element of the group's response was to commit to a substantial fiscal stimulus program and to call for strong actions by monetary policy-making institutions, in an effort to reverse the sharp decline in economic activity that had already become evident. It also stressed the important role of the IMF in responding to the crisis; welcomed a new short-term liquidity facility created by the Fund; urged further review of its instruments and facilities to ensure flexibility; and called on the IMF to take a leading role in drawing lessons from the crisis. The Fund was also asked to "conduct rigorous and evenhanded surveillance reviews of all countries...giving greater attention to financial sectors", and better integrating the results of Financial Sector Assessment Programs (FSAPs) so that "macro-financial policy advice would be strengthened."[21] The G20 also called for better collaboration with the Financial Stability Forum (later the Financial Stability Board, FSB) in order

21. G20 Summit Statement November 2008.

The recent global crisis has made it clear that we live in a world where financial developments overwhelm the mere monetary and current exchange developments

to provide early warnings of macroeconomic and financial risks and actions to address them. All of this amounts to a call for a broadening of the IMF mandate in the financial sphere—the need for which had been evident for many years, and first called for by Michel Camdessus, the former managing Director of the IMF, after the Mexican crisis in 1994/95. As he has said more recently, "the recent global crisis has made it clear that we live in a world where financial developments overwhelm the mere monetary and current exchange developments."[22]

The G20 also ventured into governance issues by calling for comprehensive reforms of both the IMF and the World Bank. As noted above, that declaration was a precursor to a much more ambitious and detailed agenda set down in subsequent leaders' meetings.

The declarations of the leaders at subsequent meeting are outlined in Box 4.

Several years of working with the IMF and others to design and implement policies to deal with the crisis and to address the governance issues surrounding the IMF culminated in the G20 Leaders' Declaration and an Action Plan issued at the conclusion of the Summit in Seoul, Korea in November, 2010. The main elements of that declaration affecting the IMF and the International Monetary System more generally included the following commitments:

- To enhance the Mutual Assessment Process and to pursue policies conducive to reducing excessive imbalances and maintaining current account balances at sustainable levels. The IMF was asked, as part of the MAP exercise, to develop indicative guidelines composed of a range of indicators that would serve as a mechanism to facilitate timely identification of large imbalances that require preventive and corrective actions
- To modernize the IMF to better reflect the changes in the global economy through greater representation of dynamic emerging market and developing countries by shifting over 6% of total quotas to those countries
- To double total quotas, with a corresponding rollback of the NAB by the time of the Annual Meetings in 2012
- To conclude a comprehensive review of the IMF quota formula by January 2013 and to complete the next general review of quotas by January 2014
- To support selective changes in the composition of the executive board of the IMF through a reduction by two of the chairs occupied by advanced European countries and provision of a second alternate executive director for all multi-country constituencies
- To support a move to an all elected executive board
- To work to reform the IMF's mission and mandate, including a strengthening of surveillance.

The IMF has responded to these calls from the G20. Unfortunately, more than four years later, many of these intentions that were most critical to a change in the governance of the IMF have not yet been implemented. [23]

What then has been the result of all this activity by the G20? Certainly much of this agenda is positive and contributed to preventing the financial crisis from bringing on another great depression. However, it can be argued that the way in which decisions were taken in the G20 has damaged and weakened some of those institutions and organizations charged by international treaties with responsibility for critical economic and financial decision making—most importantly, the IMFC and the Board of Governors of the IMF.

Decisions on IMF quotas, on representation in the executive board, on SDR allocations, and other critical issues have been decided in the G20 and effectively dictated to

22. Michel Camdessus, Speech sponsored by the Triffin International Foundation and Giovanni Agnelli Foundation, Turin, Italy, 26 November2014.

23. The reform measures agreed by the G20 - and subsequently endorsed by the IMFC, were included in a package of measures that included the proposed quota increase. As such, that requires that members holding at least 85% of the voting power in the IMF approve the package. But the United States, which holds over 16 percent of votes in the Fund - and thus whose approval is required to pass the package, has to date failed to secure the needed Congressional approval. See below.

Leaders recommitted to governance changes in the IMF by agreeing to a shift in the IMF quota share to dynamic emerging market and developing countries of at least five percent and to protect the voting shares of the poorest countries in the IMF.

Box 4: Recent IMF declarations

At the London meeting in April 2009, the leaders agreed, inter alia, to the following:

- "An increase in resources available to the IMF through immediate financing from members of $250 billion - subsequently incorporated into an expanded and more flexible New Arrangements to Borrow, increased by up to $500 billion; and to consider market borrowing if necessary;
- To support a general SDR allocation of $250 billion;
- To reform the mandates, scope and governance of the International Financial Institutions;
- To reflect changes in the world economy and the new challenges of globalization...and that emerging and developing economies...have greater voice and representation;
- To assure that this is accompanied by action to increase the credibility and accountability of the institutions through better strategic oversight and decision making;
- To complete the next review of quotas—the fourteenth—by January 2011; and
- To call on the IMF to complete sales of IMF gold."

At the next meeting in Pittsburgh in September, 2009, the leaders recommitted to governance changes in the IMF by agreeing to a shift in the IMF quota share to dynamic emerging market and developing countries of at least five percent and to protect the voting shares of the poorest countries in the IMF. This meeting saw a formalization of some of the work the IMF was doing in response to requests from the G20 for ongoing analysis of the impact of the crisis and the needed policy response. The Group launched a "Framework for Strong, Sustainable, and Balanced Growth." The members committed themselves "to develop a process whereby we set out our objectives, put forward policies to achieve these objectives, and together assess our progress." The IMF was asked to help by providing analysis of how the member's respective national or regional policy frameworks fit together. Finance ministers were charged with setting out medium-term policy frameworks and assessing the "collective implications" of those national frameworks. The IMF was asked " to assist...in this process of mutual assessment by developing a forward looking analysis of whether policies pursued by individual G20 countries are collectively consistent with more sustainable and balanced trajectories for the global economy, and to report regularly to both the G20 and the International Monetary and Financial Committee (IMFC), building on the IMF's existing bilateral and multilateral surveillance analysis."

At the next Leaders' Summit in Toronto in June 2010, the Group reported that members had completed the first stage of their Mutual Assessment Process (MAP) and concluded that "we can do much better." This was, in part, a reflection of the work done by both the IMF and the World Bank that suggested a more ambitious path of reforms over the medium term. The Leaders committed themselves to following through with fiscal stimulus but defined that more concisely as "growth-friendly fiscal consolidation." This was a reflection of the forecasts coming from the IMF and others that the global economy was strengthening and that attention needed to be directed to limiting further increases in government debt in those countries that had run larger deficits in response to the initial impact of the crisis on economic activity across much of the world. That forecast turned out to be overly optimistic and probably slowed the incipient recovery that was underway.[1]

1. See "IMF Response to the Financial and Economic Crisis', Independent Evaluation Office of the IMF, 2014.

the rest of the membership of the IMF. The latest round of such decisions have led to serious frustration among members of the IMF not included in the G20 who see this process as an infringement on the decision-making bodies in the IMF.[24] That tendency, together with the slow pace at

24. This is put clearly by James Boughton, the former historian of the IMF: "The replacement of the G7 by the G20 as the main external force on the IMF…was fundamentally different from the earlier evolution of these ad hoc self-appointed groups... Previously, whichever group was in the lead would develop a policy position and present it as a proposal, for instance to the IMF. Other groups, most notably the Group of Twenty Four developing countries (G24) would usually develop their own counter-proposals and the executive board of the IMF…would hash out a consensus decision on how to move forward. Although the large advanced economies always had the upper hand, they could not generally force a decision without going through the additional process of negotiation within the established institution. That has now ended."

The initiatives put forward by the G20 to "reform the IMF's mission and mandate" would go some way in modernizing the institution and making it more attuned to the realities of the global economic and financial system.

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 IMF.[25]

What Should be Done?

Proposals on many of these issues were made in the Report of the Palais Royal Initiative in February 2011, a group of which Michel Camdessus, a former Managing Director of the IMF was Chair.[26] The essence of the suggestion is to reconfigure the G20 as the apex of a constituency system. As suggested above, this would help bring the Group closer to a principal of universality. The suggestion would effectively merge the G20 at the level of Finance Ministers and Central Bank Governors with the Governing bodies of the IMF. As proposed in the Palais Royal Report:

"The system of governance would be based on a three-level integrated architecture, comprised of:

1. The Heads of Government or State, meeting sparingly (e.g., once a year) except in times of crisis;
2. The Finance Ministers and Central Bank Governors, taking strategic decisions related to the functioning of the international monetary system in the framework of a "Council" as envisaged in the Fund's Articles of Agreement. This Council could be activated to take over and merge the functions of the IMFC and the G20 ministers and governors, as far as the latter's role in the global economic, monetary, and financial domains is concerned. This would require an amendment to ensure a representation of Central Banks in the Council, as is the case in the current G20 structure; and
3. Executive Directors overseeing the work of the IMF and its managing director."

As the memberships of the G20, on the one hand, and those in the IMFC and Executive Board of the IMF are not now the same, there would need to be some change in the G20 membership and/or those in the governing bodies of the IMF. The process might be facilitated by reopening the membership of the G20, as suggested earlier. It would also be facilitated by the change suggested in the section on the G20, i.e., to reduce the size of the IMFC by having the members of the Eurozone to combine into a single chair in the IMF. With additional changes, this would permit an alignment of the membership of the G20 and the representation in the IMFC and the executive board of the IMF. This would also provide an occasion to review some of the other governance issues confronting the IMF, in particular: the voting majority required for particularly important decisions in the IMF, including quota decisions, which could be reduced from 85 percent to 70-75 percent. Similarly, the double majorities required for some other decisions could be extended, thus ensuring that decisions affecting key aspects of the institution command the support of the majority of members. The G20 and the IMF would both benefit significantly from such a structure. These changes may be strongly opposed by some. But such proposals should be kept on the table and actively debated, perhaps as part of the agenda for the next review of quotas and voting rights in the IMF.

Other Reforms of the IMF

The initiatives put forward by the G20 to "reform the IMF's mission and mandate" would go some way in modernizing the institution and making it more attuned to the realities of the global economic and financial system. But those changes should also make it easier for the Fund to keep up with changes in the global system. At times in the past, the IMF fell behind important changes in the global

25. A broader reflection of this fragmentation of multilateralism can be seen in the weakening of the World Trade Organization (WTO) and the increasing focus on negotiations of regional trade arrangements such as the Trans Pacific Partnership and the Trans-Atlantic Trade and Investment Pact. It is also seen in the plan to create a BRICS bank and in the initiative by China and others to create an Asian Infrastructure Investment Bank. The responses to these initiatives by some of the advanced economies of the West risks a further weakening of the global institutions that are key to effective global governance.

26. Reform of the International Monetary System: The Palais Royal Initiative, Edited by Jack Boorman and Andre Icard, Sage Publications, 2011. See Section I: The Report of the Palais Royal Initiative—Reform of the International Monetary System: A Cooperative Approach for the 21st Century

In the wake of the recent global crisis, and the IMF's failure—like virtually everyone else—to see the crisis coming, significant changes have been made to the way in which the Fund conducts surveillance.

economy. This is true regarding the pace of change in trade and in the global capital markets; the changing landscape of economic and financial power between the more advanced economies and the emerging market countries; the limited options for countries wanting to hold larger stocks of international reserves; and in other areas. In some areas, such as the Fund's efforts to promote the adoption of a Sovereign Debt Reduction Mechanism (SDRM), its efforts at least helped push others to adopt other ways of dealing with sovereign debt problems, including the use of collective action clauses (CACs) in sovereign bond contracts. These alternative mechanisms, however, have left the global financial system without a sufficiently robust and comprehensive system for dealing with the inevitable future sovereign debt crises.

This is not to say that the IMF has not responded well to the challenges it has confronted. It certainly did in dealing with the breakup of the Soviet Union, in dealing with crises in the emerging market countries starting with Mexico in 1994, in responding to the massive changes occurring in the developing country members of the Fund in the 1990s, and in many other instances. But the governance, the policy instruments and facilities, and the funding mechanisms of the IMF have at times lagged behind global realities and were only changed in crises situations.

What needs to change? Four issues deserve urgent attention:

- The conduct of surveillance over member countries polices
- The voice and vote issue
- The financial resources available to the Fund and, related to that, its role in overseeing capital account restrictions and liberalization of capital accounts in member countries; and
- The role of the SDR

These issues were addressed in the Report of the Palais Royal Group from which this section will draw.[27]

Surveillance Over Member Country Policies

Each member country of the IMF, in signing the Articles of Agreement, accepts to:

- "Endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
- Seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;
- Avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and
- Follow exchange policies compatible with the undertakings under this Section."[28]

The Fund typically analyses the appropriateness of each member country's economic and financial policies for achieving orderly economic growth, and assesses the consequences of these policies for other countries and for the global economy. In the wake of the recent global crisis, and the IMF's failure—like virtually everyone else—to see the crisis coming, significant changes have been made to the way in which the Fund conducts surveillance. In response to requests from the G20 (enumerated above), and responding to the conclusions in its own review and an assessment by the Independent Evaluation Office of the Fund (IEO),[29] the conduct and focus of both surveillance of individual countries and of the global economic and financial system have undergone significant change. The major changes are listed in Box 5.[30]

27. Palais Royal Initiative – Reform of the International Monetary System: A Cooperative Approach for the 21st Century, February 8, 2011. The report and the background papers reviewed by the group can be found in "Reform of the International Monetary System: The Palais Royal Initiative" edited by Jack T. Boorman and Andre Icard, Sage Publications, 2011.
28. Articles of Agreement on the IMF, Article IV.
29. Independent Evaluation Office of the IMF, "IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004—07", 2011.
30. See IMF Triennial Surveillance Review—Overview Paper, SM/14/227, July 30, 2014. See also "Report on Interviews for the 2014 Triennial Surveil-

It is no secret that the Fund's influence is vastly greater in the context of advising countries that are actively borrowing from the IMF.

Box 5: Modifications to the conduct of IMF surveillance in the wake of the Global Crisis

- The introduction of vulnerability exercises for advanced economies in 2009 and for low income countries in 2011; these exercises had earlier been done only for emerging market countries
- The launching of Early Warning Exercises (EWE) jointly with the Financial Stability Board
- The provision, though technical assistance, of detailed assessments and policy recommendations for the G20 Mutual Assessment Process (MAP)[1]
- The revamping of the Financial Sector Assessments Program (FSAP), including mandatory minimum five-year FSAPs for the top 25 systemic financial center countries; this was extended to 29 countries in 2013
- The introduction of Risk Assessment Matrices
- The preparation of annual Spillover Reports on the "systemic " economies
- The introduction of a Global Risk Assessment Matrix
- The launching of a pilot External Sector Report and the introduction of a new External Balance Assessment methodology
- Adoption by the executive Board of a new integrated surveillance decision;
- The development of a framework for and staff guidance on Macro-Prudential Policy
- The creation of the Fiscal Monitor and strengthening and sharpening of the focus of the World Economic Outlook (WEO) and the Global Financial Stability Report (GFSR)
- A modification of the IMF's views on the liberalization and management of capital flows (in 2012)

1. The MAP process has reportedly been replaced by the G20 growth strategy process. This process has moved the G20 away from IMF monitoring of specific macro targets. Instead, the focus is on the G20's adherence to the implementation of structural reforms—with peer review of the content of those structural reforms a more country led process. The IMF is also no longer involved in writing the G20 Accountability Assessments. The indicative guidelines process for global imbalances remains, and it reflects the work done in the IMF's External Sector Report.

Continued action along these lines is reflected in the Managing Director's Action Plan for Strengthening Surveillance which followed the 2014 Triennial Surveillance Review. The Plan includes actions to revive and adapt balance sheet analysis, fully embed macro-financial analysis in surveillance, and lay the groundwork for stronger and more focused structural policy advice. All of this remains work in progress and an assessment of the success or failure of these initiatives lies well beyond the scope of this chapter.[31] Nevertheless, these efforts and new products signify the intent of the Fund to take measures necessary to improve the analytic basis of IMF surveillance and the means by which its conclusions are communicated to members. This exercise is key to helping assure that the IMF is up to the primary task assigned to it in the Articles of Agreement.

However, there is a dimension of IMF surveillance that needs further, and urgent, attention. This involves the extent to which the Fund's analysis and policy conclusions actually impact the behavior of member countries. It is no secret that the Fund's influence is vastly greater in the context of advising countries that are actively borrowing from the IMF. The conditionality associated with these financing arrangements is the vehicle to assure this influence. But there are no such vehicles, aside from the power of persuasion in the executive board or the IMFC, or the impact of the Fund's public statements about a countries policies and prospects, in the Fund's dealings with countries not in financial arrangements, and especially with the more advanced and larger economies.

There have been many suggestions to increase the influence of Fund surveillance on these countries. Most of these involve the specification of some kind of benchmarks,

lance Review (Multilateral and Bilateral Surveillance Issues), Jack Boorman and Teresa Ter-Minassian, TSR Background Papers.

31. Some assessment can be found in the following reports: The Triennial Surveillance Review (TSR), International Monetary Fund, September 2014; External Report on Interviews with Stakeholders, Evidence Base for the TSR, Jack Boorman and Teresa Ter-Minassian, September 2014; Staff Review of IMF Surveillance products, Evidence Base for the TSR, September 2014; and various reports of the Independent Evaluation Office of the IMF.

The IMF should adopt norms for member policies in support of surveillance over each country's or group of countries' compliance with the obligations under the Articles.

norms, or other quantitative indicators for assessing the extent of a country's adherence to appropriate polices. As noted earlier, the G20, at the Seoul Summit in 2010, asked the IMF as part of the MAP exercise to develop "... indicative guidelines composed of a range of indicators that would serve as a mechanism to facilitate timely identification of large imbalances that require preventive and corrective actions."

The Palais Royal Initiative also made specific suggestions on this issue after concluding that "surveillance over countries' economic and financial policies is inadequate. Not only must surveillance be improved, but it needs to be broadened to problems of global dimension, including developments in global liquidity[32] and macro-prudential issues. In broadening the scope of its surveillance in these areas, the IMF should cooperate, as appropriate, with other relevant multilateral institutions (e.g. the FSB, the BIS and the OECD)."

Six suggestions were made in the Palais Royal Report to strengthen Fund surveillance:

1. "Article IV of the IMF Articles of Agreement (needs to be) amended to reflect this strengthened commitment and to ensure that firm surveillance applies not only to exchange rate policies but to all economic and financial policies relevant for both domestic and global macro-financial stability. In the same spirit, Article VI should be amended to provide the IMF with the mandate and responsibilities it needs to effectively monitor and assess capital movements and restrictions on such movements imposed by member countries.

The first of these suggestions has been implemented with the adoption of a new Surveillance Decision by the executive board aimed at modernizing the legal framework for surveillance.[33] However, there has been no movement in recent years to amend Article VI.

2. The IMF should adopt norms for member policies in support of surveillance over each country's or group of countries' compliance with the obligations under the Articles. The development of such norms should draw on the advice and experience of all IMF members and other available expertise. The norms might cover, for example: current account deficit or surplus; real effective exchange rates; measures to deal with capital inflows and outflows; changes in relative size and composition of reserve assets; inflation rates; fiscal deficits; and government debt ratios. Norms might also be established with respect to financial sector soundness and the effectiveness of banking supervision. Norms should be established in such a way that they function as alarm signals, with appropriate thresholds defined for each of them whenever possible.
3. Persistent breach of a norm would trigger a consultation and, if needed, remedial action. The purpose of the consultation would be to ascertain the underlying causes and potential consequences of the deviation from the norm, both for the country itself and for the good functioning of the international monetary system. The assessment would have to look at all relevant factors, including economic policies in the country concerned and in other countries. The country's specific structural features and its present economic circumstances would also be taken into account. If the assessment concludes that a persistent deviation from the "norm" is not justified by any relevant specific circumstances and is a source of serious disturbance for the good functioning of the international monetary system, it should be followed by policy recommendations.
4. Oversight of compliance with IMF obligations should be more transparent than is currently IMF practice in order to increase the accountability of

32. See Annex 2 for a conceptual note from the BIS on global liquidity.
33. See IMF, Integrated Surveillance Decision, September 30, 2013.

The vote of member countries in the IMF is determined essentially by quota, but the power to influence the institution comes from a variety of sources.

those engaged in the surveillance process. For example, relevant documents, other than those dealing with highly sensitive issues, and records of IMF Board discussions should promptly be released to the public and in full.

5. The IMF should develop positive incentives for countries to remain in full compliance with the requirements of the strengthened surveillance system. And,
6. Strong consideration should be given to including in the surveillance framework the possibility for the IMF to impose appropriate graduated remedial actions if a country has persistently violated one or more obligations.[34]

These suggestions deserve greater attention than they have thus far received. While the last suggestion may be beyond the capacity of a cooperative organization to enforce, the other suggestions involve only a reasonable, but significant, strengthening of current policies. In a world where policy spillovers from one country, especially a large one, can have serious implications for other countries, there should be a mutuality of interest in supporting a surveillance system with the features outlined above. Something along the lines of these proposals is needed to help enforce the surveillance mandate of the IMF if the path to 2050 is not to see a repetition of the kind of crises experienced over the past 40 years.

Voice and Vote

The vote of member countries in the IMF is determined essentially by quota, but the power to influence the institution comes from a variety of sources. These include the quality and experience of the executive director, his or her seniority in the home country and, for members leading a constituency, the respect commanded by the director among members of that constituency. In the past several years there have been some changes in the structure of the executive board that could affect the relative influence of executive directors. For example, Belgium, which long held the director's chair for the constituency, and Luxembourg moved into the Netherlands constituency. At the same time, a new constituency emerged comprising Central and Eastern European countries, chaired by Turkey, which replaced Austria in that position. In addition, larger constituencies can now appoint two Alternate Executive Directors easing staffing constraints in those offices.

Other changes are awaiting the final approval of an increase in quotas and of a Board Reform Amendment adopted in 2010. That will occur only if the United States Congress consents to the proposed amendment and the quota increase. That is the only block to final approval. Unfortunately, the most recent opportunity to do that failed when the spending bill for FY 2015 was passed in the US House of Representatives without the necessary provision on that matter. Unfortunately, as of June, 2015, there were no plans to introduce that legislation.[35] Surely this experience supports the proposals of the Palais Royal Initiative to reduce the current 85% majority required for important decisions in the IMF to 70 - 75 percent, thereby removing the veto power of the United States. Consideration should also be given to broadening the use of double majorities in the decision making processes in the IMF.[36]

34. See also work by Ted Truman on this issue in Edwin M. Truman, "Strengthening IMF Surveillance: A Comprehensive Proposal", Peterson Institute for International Finance, Policy Brief 10 - 29, December 2010.

35. Ted Truman of the Peterson Institute for International Economics has proposed a "Plan B." As reported in the Financial Times (12/13/2014), his Plan B would have the IMF abandon the 2010 agreement and negotiate a new version with a lower threshold for ratification. The US Treasury Secretary could agree to that and the reform could take place with the support of the rest of the membership of the IMF. However, this would involve a permanent loss in US voting power. The threat of such action by the rest of the membership might force the US Congress to act to preserve its veto. Mr. Truman subsequently elaborated additional possible ways of deal with the refusal of the U.S. Congress to approve the quota increase. See "What next for the IMF?", Policy Brief, Peterson Institute for International Economics, January 2015.
Thus far Mr. Truman's proposals have not been acted upon and the United States Congress still refuses to join the international consensus. As a result, the emerging market countries and others grow increasingly frustrated with the way in which the IMF is governed, weakening both the authority and credibility of the institution - as well as the authority and credibility of the United States.

36. See "Bridging the democratic deficit: Double majority decision making in the IMF", by Peter Chowla, Jeffrey Oatham, Claire Wren

The informal agreement between the United States and Europe that the Managing Director of the IMF will be a European and the President of the World Bank will be from the U.S. must be abandoned.

The 2010 agreements were part of the discussions on the fourteenth review of quotas. A draft report on the fifteenth review of quotas was due to be submitted to the Board of Governors of the Fund by the end January 2015, which was the deadline for the completion of the review. That document was to include a proposal on the size of the Fund, i.e., the aggregate size of quotas, as well as a change in the formula which serves as a guide in determining each country's quota. The goal of this exercise is to continue the process of adjusting quota shares to reflect the economic and financial shifts in the global economy. That realignment is expected to result in increases in the quota shares of dynamic economies and thereby a likely increase in the share of emerging market and developing countries as a whole. Steps are also expected to protect the voice and representation of the poorest members.

This realignment process has been underway for many years now. However, progress has been slow, to the frustration of many fast growing and increasingly globally integrated emerging market countries. Even with approval of the 2010 reforms - still not in prospect, the process would be far from complete as the European countries as a group are likely to remain significantly over-represented relative to their share in global GDP and other determining metrics. This is an example of something that must change if the global governance structure is to become more flexible and adaptable to changes in the global economic and financial system. It does neither the institution nor the global system any good to deny the proper place to countries in a fast changing world. One result of all of this is the creation of institutions such as the New Development Bank and the Asian Infrastructure Investment Bank. There, too, the failure of the United States to be supportive of these initiatives has further weakened the position of the IMF and further encouraged the search by the emerging market and developing countries to seek regional and other alternatives to respected, experienced - and universal - global institutions.[37]

Two additional issues in the governance of the IMF need to be addressed. First, the informal agreement between the United States and Europe that the Managing Director of the IMF will be a European and the President of the World Bank will be from the U.S. must be abandoned. The best candidates must be sought from across the membership. Some efforts have been made in the past decade to broaden the search for the heads of these institutions but, to date, they have come to naught. The related practice of reserving some Deputy Managing Director positions for certain nationalities must also be reconsidered. The second issue concerns the executive board. The traditional practice of electing as Dean of the Board the longest serving executive director should be changed. The position of Dean should be open to all executive directors or to all those with some minimum specified time on the Board. A fixed term should also apply to the position, perhaps with the possibility of re-election.

Financial Resources of the IMF

The basic source of IMF resources to lend to member countries is quotas. The quotas of countries with strong balance of payments positions can be drawn upon to make loans to countries facing balance of payments difficulties. However, the demand for these resources is both highly variable and unpredictable. Borrowings by member countries in the years immediately preceding the global crisis were at a historic low. A few years into the crisis, including the Eurozone crisis that began in 2010, commitments to member countries with financing arrangements with the Fund reached historic highs. The quota resources available to the Fund proved inadequate to satisfy requests from member countries, forcing a scramble to secure additional funding through loans from individual, mostly large, member countries. The Fund fell into this trap, in part, because most of its lending in the previous three

37. In a similar way, the role and authority of the World Trade Organization is being undermined by the fractioning of the global trading system by as a result of the increasing preference for regional trade arrangements such as the Trans-Pacific Partnership (TPP) now under negotiation.

If the IMF is to play its proper role over the decades to 2050, it must increase its quota resources substantially.

decades had been to emerging market countries and not to advanced countries; because the scope of the crisis that hit the global economy was anticipated by virtually no one; and because the explosion of the private capital markets had convinced some that those markets were sufficient to deal with the resource needs of countries in difficulty. This last proposition was fundamentally flawed. In total, the IMF had to go outside the quota system and borrow more than $440 billion from 35 countries.

If the IMF is to play its proper role over the decades to 2050, it must increase its quota resources substantially. Notwithstanding changes to the global financial system in the wake of the crisis, there will be future crises, including some involving both the advanced economies and current emerging economies that will join the ranks of those advanced economies. The IMF needs at all times to be prepared for such events. The mistakes made in the mid-2000s, including the downsizing of the staff, were the equivalent of closing the fire house when the number of fires temporarily declines.

The current agreement to double quotas to SDR 477 billion (about US $700 billion at end 2014 exchange rates) is a step in the right direction. However, it does not solve the long-standing problem with the quota review process that has allowed total Fund quotas to decline relative to appropriate measures of the global economic and financial realities. When the Fund was first created, quotas were equivalent to about 20 percent of the value of world trade. Since then, they have declined almost continuously and are currently only about five percent of world trade. Even more important, when the Fund was founded, global capital flows were small and mostly governed by capital and other controls. Since the 1970's, global capital flows have exploded, and most balance of payments crises are driven by problems in countries capital accounts. Even with the increase in regional support mechanisms such as the Chiang Mai Initiative, the European Stability Mechanism and others, there will be periods when the IMF must be in a position to provide substantial financial support to its members. These facts suggest that as the global financial system marches on to 2050: the IMF's quotas should be much larger than they will be even after the currently pending agreement is implemented. As there is likely to be resistance to rapidly increasing quota resources to appropriate levels, the need to rely on borrowed resources in times of major regional or global crises will likely continue, a better structure should be devised to guide such borrowing.

A complementary proposal to increasing IMF quotas is to better organize the way in which financing is provided to countries in distress.[38] At present, there is a multitude of facilities through which individual countries, regional financing arrangements, and central banks can help cover the emergency financing needs of such countries. But the system is highly fragmented and has only limited mechanisms through which to coordinate the provision of such financing and the conditions under which the financing is provided. In essence, the proposal would link the provision of financing to distressed counties to the Flexible Credit line (FCL) of the IMF. That FCL facility is described by the IMF as "...designed to meet the demand for crisis-prevention and crisis-mitigation lending for countries with very strong policy frameworks and track records in economic performance."[39] It is intended to provide confidence to markets - and financing to the subject countries in time of heightened risks. One of the important features of the FCL is the clarity of the qualifications a country must meet to be approved for the FCL. It also has the benefit of flexible and rapid access to IMF resources if the need to use them arises.

The new Proposal would link the provision of financing to distressed countries by regional financing arrangements, by central banks through swap lines, and others to the FCL. This would not solve the problems of providing systemic liquidity in a crisis, nor the needs of countries that do not qualify for the FCL. But it could help bring greater

38. See: The Global Liquidity Safety Net: Institutional Cooperation on Precautionary Facilities and Central Bank Swaps, C. Randall Henning, CIGI, The Global Liquidity Safety Net, 2014.
39. See: IMF Fact Sheet on the Flexible Credit Line.

To bring greater stability more generally to capital markets, the IMF needs to have a greater role in monitoring and assessing the policies that affect a country's capital account.

order to the fragmented system that now exists to help in the provision of liquidity to FCL qualifying countries.

Capital Account Issues, Sovereign Debt and the IMF

To bring greater stability more generally to capital markets, the IMF needs to have a greater role in monitoring and assessing the policies that affect a country's capital account. Box 6 reviews the history of the earlier attempt to modernize the role of the IMF in fostering more orderly liberalization of capital controls.

Without a broader mandate in the Articles of Agreement, the IMF has been hampered in trying to effectively advise countries on liberalization of their capital accounts and has failed in a number of cases to prevent countries from liberalizing in ways that increased their risks to capital account crises (for example, Korea in 1997). There are many emerging market countries that have as yet not fully opened their capital markets, and there are many developing countries that have barely started that process. Appropriate capital account liberalization can be a spur to growth. The IMF is the right institution to assist countries in that process and to advise on the proper macroeconomic and regulatory response to deal with tensions and crises stemming from disruptions to capital flows. Its role—and the needed amendment of the Articles of Agreement to provide the authority to fulfill that role—is an issue to which the international community should give formal consideration. The executive board of the IMF, with advice from other institutions with expertise in these matters—such as the OECD, the FSB, the BIS and others—should take up this challenge. A smooth path to 2050 is not assured without giving the needed attention to this important issue.

There is a related, and important, issue that warrants mention here. Many countries, with both open capital accounts and more restrictive regimes, have suffered sovereign debt crises. Opening the capital account can expose a country to greater risk of excessive borrowing - not just by the private sector, but by the sovereign, by state enterprises and by other entities that may benefit from government guarantees on their debt. There has been substantial progress in the past decade in modifying the terms of government borrowing in the issuance of sovereign bonds on the international capital markets. Most important has been the inclusion of collective action clauses (CACs) in those bonds. These clauses attempt to lay out a set of procedures for negotiating debt relief from bond holders in the event of severe strains on a country's ability to service its debts.

The most recent modifications to these clauses in new bond issues break new ground. In particular, the new clauses help deal with one of the major weaknesses earlier clauses. With many different bond issues outstanding from a given country - with different CACs, or no CACs at all, different maturities, issued under different national legal systems, and other complications, it was extremely difficult to find agreement among the many creditors on terms that would provide the needed debt relief to the country in a timely manner.

There has been progress in addressing these issues and the most recent modifications to the model CACs helps address, among other things, the problem of aggregation. Aggregation is the problem of finding a solution in the face of the very different terms and conditions contained in individual bond issues. Effectively, agreement had to be found separately with the holders of bonds in each of the individual issues and it was possible for a minority of creditors to block an agreement on any one issue. Without going into any detail, it is clear that the new CACs hold the promise of securing agreement among the many bond creditors more likely than before. These new model clauses have been endorsed by the IMF, the G20, the International Institute of Finance, and others.

However, there remain limits to what can be accomplished through the use of the latest model CACs. In particular, even if these new clauses were included in all new sovereign bond issues, they would not cover already outstanding sovereign bonds. It will be years—perhaps decades, before all sovereign bond issues include these

There has been substantial progress in the past decade in modifying the terms of government borrowing in the issuance of sovereign bonds on the international capital markets.

Box 6: IMF history in fostering more orderly liberalization of capital controls

Article VI of the Fund's Articles of Agreement which defines the Fund's role regarding capital account issues states in Section 1(a):

> *"A member may not use the Fund's general resources to meet a large or sustained outflow of capital...and the Fund may request a member to exercise controls to prevent such use of the general resources of the Fund."*

This language reflects the world of the 1940s when most capital flows were subject to strict and wide ranging regulations in virtually all countries. This certainly is a strange read in a world in which most advanced and emerging market countries have generally open capital markets and most crises for which Fund financing is requested involve capital, not current, account crises.[1]

As far back as 1997 an effort was made to better define the role of the IMF in this domain. The governing body of the IMF—at that time, the Interim Committee—at its meeting in Hong Kong asked the Fund "to complete [its] work on an Amendment of the Articles of Agreement that would make the liberalization of capital movements one of the purposes of the Fund and extend, as needed, the Fund's jurisdiction through the establishment of carefully defined and consistently applied obligations regarding the liberalization of such movements." In April 1998, draft provisional language was agreed by the executive board of the IMF to modify the purposes of the Fund as stated in Article I (ii) and (iv) as follows:

(ii) To facilitate the expansion and balanced growth of international trade in goods and services and an efficient allocation of capital, and to contribute thereby to the promotion and maintenance of high levels of employment and real income.

(iv) To assist in the establishment of a multilateral system of payments in respect of current and capital transactions between members, in the orderly liberalization of international capital movements and in the elimination of foreign exchange restrictions which hamper world trade and investment.

However the further the discussions progressed, the more opposition there was to change. The major concern and opposition came from the emerging market countries that feared these amendments would give authority to the IMF to force liberalization on countries that felt they were not ready for it. This view was widespread, and the Fund was heavily criticized by those holding it. However, an evaluation by the Independent Evaluation Office in 2005 challenged this view in its conclusions:

> *"During the 1990s, the IMF clearly encouraged capital account liberalization, but the evaluation suggests that, in all the countries that liberalized the capital account, partially or almost fully, the process was for the most part driven by the country authorities' own economic and political agendas. In none of the program cases examined did the IMF require capital account liberalization as formal conditionality (which is understood to mean prior actions, performance criteria, or structural benchmarks), although aspects of it were often included in the authorities' overall policy package presented to the IMF. This is consistent with the interpretation of the Articles of Agreement, which states that the IMF, as a condition for the use of its resources, cannot require a member to remove controls on capital movements."*[2]

1. In fact, the IMF did lend to the United Kingdom in the wake of the Suez Crisis in 1956 in response to a capital outflow. As put by Jim Boughton, "what the United Kingdom faced in 1956 was almost purely a speculative attack against a backdrop of reasonably sound economic policies. That is, it was a financial and not an economic crisis, and its primary effect was on the capital account of the balance of payments." See James M. Boughton, Northwest of Suez: The 1956 Crisis and the IMF, IMF Staff Papers, Volume 48, No. 3, January, 2002.

2. Report on the Evaluation of the IMF's Approach to Capital Account Liberalization, IMF Independent Evaluation Office, April 20, 2005.

new CACs. Moreover, bond indebtedness is only one form through which governments borrow. There is trade credit, other forms of borrowing from banks, and many other forms of government indebtedness, and the outstanding debt in these forms can be very large. It is also the case that many sovereigns guarantee the debt of state enterprises and other entities and such debt is not covered by

Many have argued that only a statutory mechanism, modeled after domestic bankruptcy law, can deal with the complexity of the sovereign debt markets.

CACs. In short, while the latest CACs are a major improvement, they do not solve the problems in the current system.

Many have argued that only a statutory mechanism, modeled after domestic bankruptcy law, can deal with the complexity of the sovereign debt markets. A proposal for such a mechanism - the Sovereign Debt Restructuring Mechanism, or SDRM, was put forward by the IMF in 2001. That proposal was discussed at length; it was modified several times in light of those discussions; but, in the end, it was not adopted. Given the inherent difficulties noted above with even the latest CACs, it would be appropriate to revisit the SDRM proposal. The G20 should ask the IMF to organize those discussions, including with participation of all individuals and groups with an interest and experience in sovereign debt problems and in international bond markets.

The SDR

The SDR was created by the IMF in 1969 as an international reserve asset to supplement its member countries' official reserves. Its value is currently based on a basket of four key international currencies.[40] SDRs can be exchanged by member countries for freely usable currencies. With the general SDR allocation that took effect on August 28, 2009 to help countries deal with the fallout from the global crisis and a special allocation[41] on September 9, 2009, the amount of SDRs increased from SDR 21.4 billion to around SDR 204 billion (equivalent to about $290 billion).[42]

As the Palais Royal Report says, "there is a question whether, looking forward, the new needs (for international reserves) that arise in a multi-polar world can be adequately addressed by one or more national currencies, or if a non-national currency instrument may have a role to play, e.g., as a complementary reserve asset and/or as an international numeraire not directly affected by the domestic policies of one economy."

The objective in creating the SDR was to make the SDR "the principal reserve asset" in the international monetary system. That objective has obviously not been achieved, but the usefulness of the SDR was well-demonstrated in the recent global crisis. While there is a large body of research and writing on the SDR, There is no well-elaborated plan to increase the role of the SDR, let alone agreement on such a plan. What is needed today is a thoughtful examination and reflection on the implications of developments in the global economy and in the international monetary system for an instrument like the SDR.

Clearly the reliance on a single country's currency in a world where the relative importance of that country in the global economy will decline in the years to 2050 must be subject to question. The world is already in a process of transition towards a multi-currency system, not least because the role played by the US dollar is seen by many as problematic. The buildup of global reserves as a result, inter alia, of the large current account deficits run by the United States in the lead up to the financial crisis and the associated spike in global liquidity that accompanied that buildup in reserves is one dimension of that problem. The pressures put on other countries, especially EMCs, from quantitative easing by the US Federal Reserve are further reflections of these problems.[43] The dollar's increasing strength in recent months is also causing serious problems for EMCs, not least because of the large volume of dollar-denominated debt taken on by the private sector and public corporations in those countries. The instability in the international monetary system since the breakdown of the Bretton Woods system in the early 1970s and episodes such as the global financial crisis and the recent sharp

40. The United States dollar, the EU euro, the United Kingdom pound, and the Japanese yen. The composition of the SDR is now under a routine periodic review. One issue in the current discussions, as was the case in the last review in 2010, is whether the Chinese RMB should be included in the SDR basket. That remains a contentious issue that will turn on, among other things, the extent to which the Yuan is "a freely usable currency".
41. The intent of this allocation was to enable all members of the IMF to participate in the SDR system on an equitable basis and adjust for the fact that countries that joined the Fund after 1981—more than one-fifth of the current IMF membership—had never received an SDR allocation.
42. Converted using the rates on February 19, 2015.

43. This is not a critique of the Federal Reserve's quantitative easing policy. It is, rather, a manifestation of the problems US policy can cause for other countries because of the role played by the dollar in the global system.

The instability in the international monetary system since the breakdown of the Bretton Woods system in the early 1970s and episodes such as the global financial crisis and the recent sharp movements in the dollar and other currencies call for an in-depth assessment of the potential role that could be played by the SDR.

movements in the dollar and other currencies call for an in-depth assessment of the potential role that could be played by the SDR.

There is no shortage of historic and analytic work to feed such reflections. The issues that should be addressed immediately include the following:

- Consideration should be given to making regular allocations of SDRs and to formulating guidelines for allocating SDRs in exceptional circumstances, as was done in 2009.
- The attractiveness of the SDR as a numeraire and the potential for its use by the private sector, both as a store of value and in private transactions, should be explored. International statistics, such as balance of payments, holdings of international reserves, and the like could be reported in SDRs.
- The use of the US dollar in the pricing of most commodities, and in international trade more generally, should be reconsidered; the distortions in the currency and other markets caused by the use of the dollar as numeraire needs careful analysis.
- The composition of the SDR should be rules-based and should be changed only infrequently, partly to provide confidence to the private sector. The currencies included in the SDR basket should continue to accurately reflect the importance of the economies issuing those currencies in international trade and in the global financial system, including the free usability of those currencies.[44]

The scope for the use of the SDR in creating incentives to improve the workings of the global adjustment process should be explored. For example, consideration might be given to conditioning allocations of SDRs to countries on their observance of norms (or agreed targets) in a strengthened IMF surveillance system.45 Access to the voluntary SDR market might be conditioned on a country's meeting the full requirements of such a strengthened multilateral surveillance system. This is a medium- to longer-term program. But changes to the SDR could be made in steps, with the knowledge gained from each step that broadened its use helping to determine the nature and pace of additional changes.46 One immediate step would be to work with the private sector to explore ways in which the SDR could be more widely used in private transactions, as was beginning to happen in the early 1980s.

The issues surrounding the role of the dollar and the potential usefulness of the SDR are closely related to the questions surrounding the excessive liquidity creation in the lead up to the recent financial crisis and, more generally, to the absence of effective regulation of global liquidity. On global liquidity management, the Palais-Royal Initiative had basically two suggestions:

1. The IMF and the BIS should work together towards a shared analytical approach for a better measurement and surveillance of global liquidity.
2. The central banks and the authorities in charge of macro-prudential policies of systemically relevant economies should conduct their policies taking into account the need for appropriate

44. The currency composition of the SDR is now under a regular periodic review. A major question in this review, as was the case in the 2010 review, is the qualification of the Chinese RMB for inclusion in the basket of currencies that comprise the SDR. In his statement at the Spring meetings of the IMF in April 2015, the Governor of the IMF for China, the Honorable Zhou Xiaochuan, reviewed the history of China's moves to increase the capital account convertibility of the RMB and outlined China's plan to make the RMB a more freely usable currency. See: Statement to the IMFC, Washington DC, April 18, 2015.

45. Richard Cooper has recently made a new proposal to help determine the amount of SDRs to be created. As he states it:" To focus minds on concrete action, here's a proposal: let each country set a target level for its foreign exchange reserves five years hence. Then subject these proposed national targets to international discussion and review. Each country would be expected to defend its proposed target before peers, especially if it was unusually high or low. Adjustments would be made to the targets as a result of these discussions. Then SDRs would be created over the coming five years to match the total of the adjusted targets. In this fashion, the supply of reserves, without resort to national currencies, would be matched to the desired demand for reserves. SDRs would not be allocated to countries on the basis of their targets; only the totals would match....Countries with targets greater than their allocations would earn the difference by running current account surpluses or by increasing their liabilities to foreigners. Countries with allocations greater than their targets would invest abroad (net) or run current account deficits.

46. One additional change that might invite greater support for regular SDR allocations would be to restore the reconstitution requirement. That would ensure that allocations would be used primarily to bolster a country's reserves and not as an unconditional and permanent source of development financing.

The authority and responsibilities of all institutions that make up the global governance structure need to be clear, and the modalities through which they must work with and support each other need to be better understood and accepted by all.

global liquidity conditions. The IMF, the BIS and the FSB should regularly monitor developments in global liquidity with a view toward formulating recommendations regarding the potential impact on global liquidity of systemic country monetary and exchange rate policies as well as financial regulatory and supervisory policies.[47] This remains to be done. Michel Camdessus has proposed a first step: "...to decide that, on the basis of a report established and publicly disclosed by a group of Central Bank Governors (for instance, those whose currencies are part of the SDR basket), the IMF should provide to the G20, every six months, its own assessment of global liquidity and its recommendations to contribute to its best possible evolution in view of the global economic situation."[48,49] If the suggestions made earlier in the chapter regarding the G20 were to be adopted, these reports should be submitted to the IMFC

Much more work needs to be done to examine the role played by the rapid rise in global liquidity in the run up to the global economic and financial crisis. The impact of the rapidly growing shadow banking system in the explosion of global liquidity during that period still needs to be better understood. As important now, is a better understanding of impact on global liquidity of the monetary measures taken to deal with that crisis, especially quantitative easing (QE). While that policy was an appropriate and effective response to the crisis. Its legacy on the global financial system - and its stability - is still to be explored. The likely path of the global economic, financial and monetary systems in the next decades to 2050 will be affected in important ways by our understanding of the events and policies of the past decade.

Concluding Remarks

The world should be grateful for the wisdom of those who saw the need for fundamental change and reform in the global governance structures in the wake of World War II. Institutions such as the UN, the IMF, the World Bank and, later the GATT and the WTO and others - whatever failings they may have had - have stood the test of time. The dramatic increases in living standards around the world would not have occurred without them. But the world has changed dramatically in the past 30 years. The overall governance structure, as well as those institutions, need to do better to keep up with and adapt to those changes.

The suggestions for reform made in this chapter are directed primarily at the G7 and G20, as they are at the pinnacle of global governance, and at the IMF. But a similar exercise is needed to identify needed reforms in the UN and other institutions. The authority and responsibilities of all institutions that make up the global governance structure need to be clear, and the modalities through which they must work with and support each other need to be better understood and accepted by all.

The following suggested reforms of the G20 and the IMF should be given the most immediate consideration.

Reforming the G20 by:

1. Reconsidering the G20 model as regards size, membership and modus operandi;
2. Setting up a process to rotate some of the membership, perhaps only beyond those members that are in the current, or a modified, G7; establishing fixed periods of participation that create staggered terms for non-G7 members so as to provide continuity;
3. Limiting the number of meetings held at the leaders level;

47. The BIS publishes updates on indicators for global liquidity conditions semi-annually, together with the underlying BIS data. This initiative constitutes part of the Bank's support for G20 activities and follows up on earlier work by the BIS and the Committee on the Global Financial System (CGFS). See Annex 2 for a conceptual background from the BIS on global liquidity.

48. Michel Camdessus, "Seventy years after Bretton Woods: The International Monetary System," China Society for Finance and Banking, Hangzhou, May 17-18, 2014.

49. The IMF is addressing the impact of monetary policy on global liquidity. See, inter alia, The Global Financial Stability Report, October, 2014, Chapter 1.

An assessment is urgently needed on the experience of the IMF in negotiating in tandem and at the same table with the European Commission and the European Central Bank (the Troika) when dealing with the crisis countries in Europe.

4. Exploring the possibility of creating a constituency system to give greater voice to all countries, and aligning those constituencies with those in the IMF;
5. Bringing central bank governors formally into the IMFC so as to merge that body and the G20 finance ministers and central bank governors group when discussing and making recommendations on global monetary, financial and economic issues;
6. Continue the active role of the IMF that has been underway with the G20 since the global financial crisis.

Reforming the IMF by:

1. Further improving the analytics, products, and processes of surveillance. This needs to be accompanied by measures to increase the impact of IMF surveillance over member countries' policies, i.e., to put "teeth" into surveillance.
2. Find some means to quickly unblock the lack of action on the part of the United States to increase quotas and to implement the other reforms agreed to in 2010. This should be accompanied by action to permanently reduce the majority of 85% of total voting power required to pass certain decisions—such as quota increases and amendments to the Articles of Agreement. No single member country should, in todays world, have a blocking minority in the IMF. In addition, double majorities should be considered for certain decisions.
3. Reform the quota determination system to better reflect member country positions in the global economic and financial system and raise quotas substantially to give the needed firepower to the IMF to deal with the inevitable future crises.
4. Take whatever action is needed to assure the complementarities and effectiveness of the IMF, the BIS, and the FSB, especially as regards the monitoring and control of global liquidity.
5. Reopen the discussion of amending Article VI of the Articles of Agreement to clarify the role of the IMF as regards member countries' capital controls in today's global financial system.
6. Establish a high-level Advisory Group to explore and propose changes needed to allow the SDR to play the role originally intended for it and to modernize it to play an effective role in the fast evolving global monetary and financial system.
7. There should also be an effort by the IMF, together with the other interested parties, to address the evident need for a mechanism to better deal with sovereign debt crises. The G20 should ask the IMF to take up this issue.
8. While not discussed in this paper, an assessment is urgently needed on the experience of the IMF in negotiating in tandem and at the same table with the European Commission and the European Central Bank (the Troika) when dealing with the crisis countries in Europe. Particularly in the case of Greece, this approach has clearly not provided an appropriately designed program to help resolve Greece's economic and financial crisis. Moreover, it has raised important issues regarding the governance of the IMF. This kind of arrangement risks being emulated elsewhere, with important implications for the independence and credibility of the IMF. The Independent Evaluation Office (IEO) of the Fund has begun a assessment of the IMF's handling of the Greek crisis. An element of that assessment should be an evaluation of the effectiveness of the Troika and the appropriateness of the involvement of the IMF within such a negotiating structure. The executive board of the IMF should also request separate an assessment by a panel of outside experts constituted to do such an assessment and to make recommendations. Both perspectives are necessary to do justice to

More ambitious and fundamental reforms are needed, including those that would move the IMF in the direction of the vision of Keynes— to create a global central bank.

the complex array of issues raised by this unprecedented arrangement.

The original and amended Bretton woods framework that established the IMF has generally served the world well. The IMF has gone a good distance in adjusting to the enormous changes in the powers of individual countries in the global economic and financial systems – even if, at times, too slowly. It has absorbed a vast increase in its membership, from decolonization and the breakup of the former Soviet Union. It has helped member countries deal with the explosive growth of international capital movements; and many other dramatic changes in the world political, economic and financial systems. But there is a need to review the results of these many changes and the IMF response thereto, and to assess the relevance, the authority, and the capacity of the IMF as the world looks forward to the next thirty-plus years to 2050.

Some of the issues that need to be addressed are best left to the relevant bodies within the IMF: the Executive Board, the International Monetary and Finance Committee, and the Board of Governors. Other reforms may be needed in various other institutions such as the BIS and the FSB. The appropriate fora need to be identified to push this part of agenda forward.

In addition to these changes, more ambitious and fundamental reforms are needed, including those that would move the IMF in the direction of the vision of Keynes—to create a global central bank. Reaching this and other objectives, and putting the IMF in a position to better control global liquidity, would be a major task and will require amendments to the Articles of Agreement. One possibility would be to convene a second Bretton Woods Conference to address the major issues confronting the international monetary system, find consensus within the membership, and to propose the necessary modifications to the Articles of Agreement Convening a second Bretton Woods Conference - after the needed reflections to help assure the success of such an undertaking, would be the appropriate vehicle for confronting these challenges. Other forums may need to be convened to address any needed reforms to other international institutions such as the FSB, the BIS and the WTO.

The success of the G20 is achieved with support from international organizations, which provide advice on G20 priorities and help G20 members and guests identify policy gaps where actions will have the most impact.

Annex 1: Global Institutions that may participate in G20 meetings

The success of the G20 is achieved with support from international organizations, which provide advice on G20 priorities and help G20 members and guests identify policy gaps where actions will have the most impact. Representatives of international organizations are invited to relevant G20 meetings, including meetings of Sherpas, Finance Deputies, and working groups.

These organizations include:

- The Financial Stability Board (FSB). The FSB, which was established by G20 leaders following the onset of the global financial crisis, coordinates the work of national financial authorities and international standard-setting bodies to develop and promote effective regulatory, supervisory, and other financial sector policies.
- The International Labor Organization (ILO). The ILO promotes rights at the workplace, encourages decent employment opportunities, enhances social protection, and strengthens dialogue on work-related issues.
- The International Monetary Fund (IMF). The IMF works to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.
- The Organization for Economic Co-operation and Development (OECD). The OECD promotes policies that improve the economic and social well-being of people around the world. It works with governments to understand what drives economic, social, and environmental change, with a focus on analyzing and comparing data to predict future trends.
- The United Nations (UN). The UN is committed to maintaining international peace and security, developing friendly relations among nations, and promoting social progress, better living standards and human rights.
- The World Bank. The World Bank is a vital source of financial and technical assistance to developing countries around the world. It is not a bank in the ordinary sense but a unique partnership to reduce poverty and support development.
- The World Trade Organization (WTO). The WTO provides a forum for negotiating, implementing, and monitoring agreements aimed at reducing obstacles to international trade and ensuring a level playing field, contributing to economic growth and development.

Source: G20 website “About G20”

Global private sector credit reflects the outcome of financial intermediation activity in global markets. Changes in these stocks are closely associated with the build-up of vulnerabilities, with potential implications for financial stability.

Annex 2: Global liquidity—conceptual background

The term global liquidity is used here to mean the ease of financing in global financial markets. Defined this way, global liquidity depends primarily on the actions of private investors and financial institutions.

Financial institutions provide market liquidity to securities markets through their trading activities, and provide funding liquidity to borrowers through their lending activities. The terms on which these intermediaries can fund themselves, in turn, depend on the willingness of other market participants to interact with them and on macroeconomic and prudential policies, including the terms and conditions on which central banks provide funding.

The interaction between these private and official factors determines the economy's overall ease of financing. This, in turn, influences the build-up of financial system vulnerabilities in the form of asset price inflation, leverage, or maturity or funding mismatches. Indicators will tend to measure these "footprints" of liquidity rather than global liquidity itself.

On this basis, and seen from a financial stability perspective, global credit is among the key indicators of global liquidity. The stock of credit outstanding shows how far ease of financing has led to the build-up of exposures. In other words, global private sector credit reflects the outcome of financial intermediation activity in global markets. Changes in these stocks are closely associated with the build-up of vulnerabilities, with potential implications for financial stability. These flows comprise both a domestic and an international element.

Of particular interest for the assessment of global liquidity is the international component of credit (cross-border lending to non-residents or lending in foreign currency). It is this cross-border element that regularly provides the marginal source of financing in the run-up to crises. Although often small relative to the total stock of credit, swings in these international components can amplify domestic trends and are highly correlated with booms and busts in global financial conditions.

Any assessment of global liquidity conditions requires that measures of global credit are put into perspective. Much of this credit, although not all, is provided by banks, so that the indicators focus on this component. A range of supplementary price and quantity indicators can be used to capture additional specific aspects of global liquidity that are relevant for financial stability. These include measures of financing conditions in key financial markets and incentives for position-taking across market segments. Key indicators in this regard are proxies for risk appetite, which is a major driver of leverage and the willingness of private investors to provide funding.

Together with measures of global credit, these indicators can help identify unsustainable lending booms or undue risk-taking in specific markets or globally. The information content of these indicators changes over time, implying that a flexible approach is needed when assessing global liquidity conditions.

Source: Bank for International Settlements, Global Liquidity Indicators, October 2014

The Emerging Markets Forum was created by the Centennial Group as a not-for-profit initiative to bring together high-level government and corporate leaders from around the world to engage in dialogue on the key economic, financial and social issues facing emerging market countries.

The Forum is focused on some 70 market economies in East and South Asia, Eurasia, Latin America and Africa that share prospects of superior economic performance, already have or seek to create a conducive business environment and are of near-term interest to private investors, both domestic and international. Our current list of EMCs is shown on the back cover. We expect this list to eveolve over time, as countries' policies and prospects change.

Further details on the Forum and its meetings may be seen on our website at http://www.emergingmarketsforum.org

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