



**Dialogue** on  
**Globalization**

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**An Agenda for Reform  
of the International  
Monetary Fund (IMF)**

## ***Dialogue on Globalization***

*Dialogue on Globalization* contributes to the international debate on globalization – through conferences, workshops and publications – as part of the international work of the Friedrich-Ebert-Stiftung (FES). *Dialogue on Globalization* is based on the premise that globalization can be shaped into a direction that promotes peace, democracy and social justice. *Dialogue on Globalization* addresses “movers and shakers” both in developing countries and in the industrialized parts of the world, i.e. politicians, trade unionists, government officials, business people, and journalists as well as representatives from NGOs, international organizations, and academia.

*Dialogue on Globalization* is co-ordinated by the head office of the Friedrich-Ebert-Stiftung in Berlin and by the FES offices in New York and Geneva. The programme intensively draws on the international network of the Friedrich-Ebert-Stiftung – a German non-profit institution committed to the principles of social democracy – with offices, programmes and partners in more than 100 countries.

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### **Table of Contents:**

<b>1. Preface</b>	3
<b>2. Introduction</b>	4
<b>3. The Role of the International Monetary Fund (IMF)</b>	6
a. Fund Surveillance	7
b. The Financing Role of the IMF	8
c. The Role of the Fund in Low Income Countries	9
<b>4. The Governance of the Fund</b>	13
a. The Voice and Vote of Member Countries	13
b. The Governance Structure within the Fund	16
c. Governance from Outside the Fund	20
d. Other Important Governance Issues	22
<b>5. Managing the Fund</b>	24
<b>6. The Fund's Income Model</b>	27
<b>7. Conclusion</b>	29

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# 1. Preface

Calls for reform of the International Monetary Fund (IMF) are certainly not the only but perhaps the most striking example of the “winds of change” affecting international organizations. Gone are the days when the relevance of the IMF was largely unquestioned and friends and foes alike treated the institution with utmost respect. Today even the Fund’s most loyal supporters engage in painful soul-searching exercises. Like many other international bodies, the IMF suffers from static governance structures and struggles to cope with the worldwide political, economic and financial changes.

The debate on the subprime mortgage crisis in the United States is a case in point. Despite the severe repercussions the crisis may have for the economic stability of both developed and emerging economies, the voice of the IMF is notably absent from the public debates on the subject. The same “fading effect” applies to the level of legitimacy the IMF enjoys among its membership, which has to do with the current distribution of votes and the representation on the Board of Directors. Last but not least the IMF suffers from an increasingly precarious financial situation. Early repayments of large interest bearing debt tranches by clients from middle-income countries have robbed the Fund of major sources of income and pressured it into a discussion on its very own “fiscal space”.

What are the underlying factors shaking the very foundation of one of the pillars of the international financial architecture? What strategic and managerial reforms would be necessary to allow the IMF to address the most pressing challenges to economic and financial stability? And finally, what can be done within the governance structure of the Fund to make it more representative of all segments of its membership?

This occasional paper addresses those questions in a concise and pointed manner. As the paper was conceptualized as a briefing note for a series of regional conferences on IMF reform organized by the Friedrich-Ebert-Stiftung in Latin America, Africa and Asia, it is rather broad in scope. Written by Jack Boorman, former Counselor and Special Advisor to the Managing Director of the IMF and a long serving senior staff member of the Fund, the analysis benefits from the author’s profound inside experience and institutional knowledge. Other papers due to be published shortly will represent the opinions and views, which emanated from the conversations held in the different regions of the Global South.

With this program of publications and dialogues on IMF reform, the Friedrich-Ebert-Stiftung wishes to engage decision makers both inside and outside of the Fund, representatives of civil society as well as scholars from think tanks and academia in an open and constructive debate on how the IMF can be turned into an institution that lives up to its mandate, serves all segments of its membership and is capable of addressing the economic and financial challenges of today and tomorrow.

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# 2. Introduction

**The International Monetary Fund (IMF) is facing an uncertain future. New lending by the Fund is negligible; its role as policy advisor to member countries seems diminished; and its oversight role in fostering stability in the international monetary system is uncertain.**

The International Monetary Fund (IMF) is facing an uncertain future. Notwithstanding the important contributions it has made in helping the global economy deal with major economic and financial changes and crises over the past 25 years, its role is now questioned. New lending by the Fund is negligible; its role as policy advisor to member countries seems diminished; and its oversight role in fostering stability in the international monetary system is uncertain. Efforts to reform the Fund and to better define its place in the global economic and financial system have been underway for some time. The most recent attempt at reform began in the context of the Medium Term Strategy (MTS) announced by Rodrigo de Rato, the then managing director, and endorsed by the International Monetary and Financial Committee (IMFC) in April 2006. Some successes have come from those efforts. However, a great deal remains to be done, both on issues elaborated in the MTS and on matters well beyond the scope of that strategy. Progress will require the full commitment of the new managing director, Dominique Strauss-Kahn. This paper reviews the major items that are, or that should be, on the agenda for reforming the IMF. In certain areas, specific reform proposals will be suggested; in other areas, formulating concrete proposals and securing the necessary political support will require much more debate and discussion than has taken place to date.

The major elements of reform must include the following:

- **More clearly defining the role of the IMF in the emerging global economic and financial system.**

This will need to be done with agreement among the broadest possible segments of the membership and will require, in particular:

- a. clarifying the monitoring and surveillance role of the Fund – both surveillance over the global system, including financial markets, as well as over the economies of individual member countries;
- b. forging broad agreement on the Fund's financing role, and the facilities and the resources needed to fulfill that role; and
- c. seeking broader consensus on the overall role to be played by the Fund in the low income countries.

- **Modifying and improving critical aspects of the governance of the Fund, including:**

- a. pressing forward with a new energy, and a far more ambitious agenda, the alignment of member country quotas and voting power with the realities of the emerging global economy and the place of each member in that economy; going

beyond quotas and voting power, but within the context of that discussion, to some of the other factors that determine the voice of members in the Fund. This will involve, inter alia, the size and composition of the executive board and the quality of representation of member countries on that board.

- b. reexamining the responsibilities and accountabilities of those charged with over-seeing and running the operations of the Fund. This will require, in particular, more active application of the principles of good governance in the Fund; and
- c. finding a better alignment between the structure of and representation in the various agenda-setting bodies – the G7/8, G20, et al, and the configuration of the governing boards of the international financial institutions, including the IMF. (This is obviously a longer term issue and is well beyond the influence of IMF management alone.)

- **Reviewing the management structure of the Fund, as well as the mechanisms to assess the responsibilities and accountability of management. And,**
- **Radically altering the Fund’s income model to assure sustainable funding regardless of the level of the Fund’s lending operations.**

This is a massive agenda comprising a large number of issues, many of which are deeply intertwined. For example, better definition of the role of the Fund will influence the appropriate size and skill mix of the staff and, thereby, the cost of running the institution and the feasibility of certain income models to cover the associated costs. Agreement on the potential financing role of the Fund is necessary to determine the appropriate size of the financial resources of the Fund and global quotas. Thus, there needs to be a better sequencing of the debate on these issues than has been the case in recent discussions. At the same time, some of the needed reforms are generally independent of the resolution of these other issues, and some are urgent. On the top of that list is reform of management, which should be the highest priority of the new managing director and of the executive board.

# 3. The Role of the International Monetary Fund (IMF)

The Fund has made major contributions to the resolution of problems that have confronted the global economic and financial system over the past several decades. These have included the oil crises of the 1970's; the emerging market debt crises of the 1980's; the integration of the transition economies of Eastern Europe and the former Soviet Union into the global system in the 1990's; the long-smoldering debt crises of the low income countries, culminating in the HIPC Initiative in the 1990's; the Mexican, Asian, Russian, Turkish and Latin American crises of the mid and later 1990's and early years of this decade; and, the establishment, implementation and assessment of standards and codes over the past decade. The Fund's role was central in each of these events.

**The institution is said to have expanded its activities well beyond its original mandate while, at the same time, coming up short on the job it is supposed to perform under the original Articles of Agreement.**

**The responsibilities on which it is said to fall short include the monitoring of or, more importantly, the force of its policy advice regarding global imbalances, a key threat that has confronted, and continues to confront, the global economy.**

At the same time, however, the way in which the Fund has gone about some of its activities has been questioned. Critics, as well as some supporters of the Fund, have offered a laundry list of ways in which the institution is said to have expanded its activities well beyond its original mandate while, at the same time, coming up short on the job it is supposed to perform under the original Articles of Agreement and the Second Amendment. The list includes a widening, and alleged weakening, of the focus of its surveillance activities; straying into areas in which it had little expertise or an uncertain mandate;<sup>1</sup> the broadening of the focus of its work in the low income countries; the breadth of the structural conditionality included in financial arrangements with member countries; and an unnecessary proliferation of the facilities for providing financing to countries seeking its assistance. There has also been criticism that the institution has not been doing, or not doing sufficiently well, some of the things that it should be doing – perhaps distracted by its activities in the areas peripheral to its core mandate. The responsibilities on which it is said to fall short include the monitoring of or, more importantly, the force of its policy advice regarding global imbalances, a key threat that has confronted, and continues to confront, the global economy;<sup>2</sup> its lack of influence over the policies of the larger industrial countries; an insufficient involvement in global financial sector issues; and the lack of engagement with emerging market economies on some of the policy issues of greatest concern to them, including on the practical aspects of managing their exchange rate regimes and the opening of their capital accounts.<sup>3</sup> These issues go to the heart of the Fund's surveillance responsibilities.

1 These include activities such as the work related to money laundering and combating the financing of terrorism and the coverage of certain social issues in the context of Article IV consultations. The Fund's Legal department alone reportedly devotes 25 staff and contractuels to the former activity.

2 While the imbalances may be declining, the residue of those imbalances in the excessive reserves held by some countries, the explosion of sovereign wealth funds, etc. pose new challenges to the global financial system.

3 This is not the oft-heard critique that the Fund forced countries into premature liberalization of their capital accounts. That fiction was put to rest by the study done by the Fund's Independent Evaluation Office. Rather, the more recent critique is aimed at the lack of capacity among staff to give practical advice to member countries on their exchange rate regimes and on the best policy path for integrating banking and financial systems into the global economy. See: *IEO Evaluation of Exchange Rate Policy Advice – 1999–2005*, May 17, 2007 and the *IEO Report on the Evaluation of the IMF's Approach to Capital Account Liberalization*, April 20, 2005.

## a. Fund Surveillance

Notwithstanding the identification of some of these issues in the Medium Term Strategy, better direction is needed to improve the Fund's contribution to member countries in their policy choices. This will require monitoring and advising on the policies adopted to confront the challenges of globalization. It will also require greater involvement by the Fund in determining the proper responses to events that threaten the stability of the global economic and financial system and the responses of member countries to the major change underway in that system. For example, some question the Fund's effectiveness – both before and since the launching of the multilateral surveillance initiative – in containing the potential threat to the global system from the persistent imbalances of the past decade.<sup>4</sup> In this context, critics have asked where the Fund stands in viewing the enormous build up in reserves that has taken place in recent years in reflection of these imbalances and what it has done to contribute to an understanding of the implication of those reserve levels, and their investment, both for individual countries and for the system. Similarly, the Fund has been faulted for the lack of precision in its advice to countries regarding exchange rate and other policies, including those of the countries contributing most to the global imbalances. Perhaps most importantly, it has also been criticized for its slow adjustment from a mostly macroeconomic focus in its work to a broader view encompassing the dynamics of financial markets.

Despite the creation of new departments and the reorganization of others, there continues to be a 'silo' mentality within the institution. This results in an undue focus of the staff on the problems and issues of their own department and an insufficient synergy of work across departments. This has, at times, prevented the best mobilization and integration of staff in dealing with critical issues. The Fund has an extraordinary base of experience in helping countries confront economic and financial policy challenges. But that experience has not always been brought to bear as well as it might have been in providing advice to member countries or in assessing the implications of emerging tensions for the global system. In particular, and despite recent efforts, there remains a need for a genuine integration of financial sector issues with the world class macro economic analysis that has been the hallmark of the Fund over its entire history.

To be fair, the Fund has been a player in all these debates, and has taken a number of important steps to better align the organization and the skills of its staff to the realities of globalized financial markets. Most observers continue to give the Fund and its staff high marks for its analytic capacity and its increasing familiarity with institutional issues in the financial sector to address such problems. The issue turns, rather, on the timeliness, force and effectiveness of its advice, the positions it has taken as the pre-eminent arbiter of macroeconomic policy issues in the international system, its pace of change in the face of major developments in global financial markets, and its capacity to provide practical policy guidance to its members. Changes in some of these areas could come more quickly, but require a willingness – and support from the membership at large – to be more candid,

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**There remains a need for a genuine integration of financial sector issues with the world class macro economic analysis that has been the hallmark of the Fund over its entire history.**

<sup>4</sup> See IMF, Press Release No 07/72: *IMF's International Monetary and Financial Committee Reviews Multilateral Consultation*, April 14, 2007.

more specific, and more forceful in its recommendations to all member countries, including the largest.<sup>5</sup> In other areas, change will be evolutionary, but should occur in the context of a vision of the role of the Fund more specific, and more widely agreed, than that elaborated thus far.<sup>6</sup>

## b. The Financing Role of the IMF

Overriding these specific questions is a broader debate about the focus of the Fund's work and the allocation – and size – of its staff resources. On one side of this debate are those who see the Fund's primary, or sole, responsibility as surveillance – monitoring and providing advice on both individual country economic and financial developments as well as on developments across regions and the entire global system. Some of those arguing for this narrower mandate premise their views on what they see as the limited need for the IMF to play a financing role in the new world of huge and fluid private capital markets. Others, however, see a continuing need for the Fund to be prepared to provide financing to member countries in the event of a crisis affecting either an individual country or, indeed, a region or the global system.

**It is telling that the emerging market countries continue to argue for a readiness on the part of the Fund to provide contingent or insurance financing, while some of the major industrial countries argue for giving up the Fund's financing role.**

It is telling that the emerging market countries – a growing constituency within the Fund, continue to argue for a readiness on the part of the Fund to provide contingent or insurance financing, while some of the major industrial countries – countries that are unlikely ever to come to the Fund for financing, argue for giving up the Fund's financing role. The major emerging market countries have been in a sweet spot in the global economy in recent years. This has been the result of high commodity prices, robust growth in much of the world, high global savings rates contributing to low financing costs, and the availability of huge amounts of capital from the major surplus countries (China and much of Asia, as well as the major oil exporting countries).<sup>7</sup> These conditions, together with much better policies reflecting, in part, the lessons learned from the Mexican, Asian, Argentine, Brazilian, Russian, and other crises of the second half of the 1990's and the early years of this decade, have changed the situations of these countries dramatically, not least, putting them in much stronger positions to weather any disturbances or crises that may occur.

The reality, of course, is that the factors contributing to this sweet spot are unlikely to last and unforeseen events are likely to create a situation in which the IMF will be called upon again to provide distress financing to some of its members.

<sup>5</sup> Perhaps the multilateral surveillance initiative holds promise: that remains to be seen. A positive aspect of the initiative is, as John Lipsky, the First Deputy Managing Director has said, that it allows the countries most interested in and affected by an issue to be at the table rather than having the G8 or some other predetermined group preside. However, the recent exercise seemed to suffer both from the near co-incident establishment of regular United States/China bilateral discussions of economic issues and from the rejection by the Chinese of the decision revising the 1977 Decision on Fund Surveillance. Surely the latter episode needs review and reconciliation.

<sup>6</sup> Jack Boorman, *Global Imbalances and Capital Flows to Emerging Market Countries*, Emerging Markets Forum, September, 2006.

<sup>7</sup> The recent period of very low lending activity by the Fund is by no means unique in the Fund's history, and, like earlier periods, will not last forever.

It is also clear that not all members have found that sweet spot. There are other emerging market economies, in Eastern Europe for example, that are in much less robust economic and financial conditions that could be vulnerable in a less favorable international economy. Moreover, there are new emerging market economies arising that need both helpful dialogue with and policy advice from an institution with the experience of the IMF, as well as possible financing from the Fund in the event of problems. The world would do well to listen to those potentially most in need of IMF financing when deciding the role of the Fund in this important area. It would do well, also, to draw lessons from the recent crisis in the sub-prime mortgage market in the U.S. that surprised many in its impact in other countries and in other markets, such as the inter-bank and the commercial paper markets. This is a renewed reminder that crises can come from unexpected corners and spread rapidly in unforeseen ways. Only dreamers can believe that the days of financial crises, including those that would warrant intervention by the IMF, are over.

A new facility designed to provide insurance to emerging market countries in a global system characterized by these kinds of risks needs to take these realities into account. If a consensus can be found on the financing role of the Fund, new facilities, such as a revised contingent credit line or insurance mechanism, will likely be required for it to properly fulfill that role. Creating such a facility will be no easy task. There remains no firm agreement among the membership regarding the conditions under which the Fund should be prepared to lend large resources (“exceptional access” relative to quotas) to a member country. Similarly, the problems that bedeviled, and ultimately sank, the Contingent Credit Lines (CCL) remain unresolved. These include, besides access levels, the trade off between automaticity in drawings and the conditionality to be associated with such drawings. They also include the difficult issues surrounding the likely market reactions to either the approval or the denial of access to such a facility for a member country. The other financial facilities of the Fund are, of course, available to emerging market (and other) countries. However, a true insurance-like facility may better meet the needs of these countries in the new global system of extraordinarily fluid debt and capital markets.

These are critical questions confronting the membership, and the divisions among members about the Fund’s size, about exceptional access in the context of capital account crises, and on related issues need to be reconciled. Agreement should be sought on these issues before further deliberations on the appropriate volume of financial resources for the Fund and the needed increase in quotas to provide those resources.

### c. The Role of the Fund in Low Income Countries

Beyond crisis financing for emerging market economies (and, possibly, though much less likely, for some of the more developed economies), there is a major issue regarding the role of the Fund in the low income countries. Financing has been an important aspect of that role since the 1970’s. There are some who argue that since the Fund is not a development institution, it should not be lending to developing countries or, more narrowly, that it should not be lending for develop-

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ment purposes. The former argument, in particular, seems specious, and one that is unfair to the developing country members of the Fund, who have a right to expect financial support in appropriate circumstances. Many of these countries continue having problems building and managing reserves. Many, even those with large aid inflows, may temporarily run balance of payments deficits of the kind that the Fund was conceived, or has evolved, to help ameliorate. This is not to say that if the G8 countries and other donors were to come forward with the volume of aid flows promised at Gleneagles at the G8 summit in 2005,<sup>8</sup> and if commodity exports of many of even the poorest developing countries continue to be as buoyant as they have been in recent years, there would not be less need for Fund financing for these countries. But that in no way suggests that it would be wise to close down the Fund's capacity to lend, on appropriate terms, to these countries or to shift the capacity for such lending that now exists in the Fund to another institution such as the World Bank.<sup>9</sup> Fortunately, there is generally broad agreement that the macroeconomic stability, and associated growth, seen in many of the poorer countries over the last decade owes something to the advice provided by the Fund to these countries, most often in the context of Fund financing arrangements. This capacity should not prematurely be taken away.

**The conditionality debate has gone on for years, but there is broader agreement now – even among many of the Fund's critics, that conditionality, especially macroeconomic conditionality, is both legitimate and can be helpful to a country – as well as protective of the Fund's financial resources.**

But two other issues must be confronted in this debate over the role of the Fund in the low income countries. The first is the conditionality sought by the Fund when lending to these countries. The second concerns the scope of the Fund's analysis and involvement in the economic, financial, and social issues confronting these countries. The conditionality debate has gone on for years, but there is broader agreement now – even among many of the Fund's critics, that conditionality, especially macroeconomic conditionality, is both legitimate and can be helpful to a country – as well as protective of the Fund's financial resources. The conditions for assuring the effectiveness of conditionality – not least ownership of policies by the government and affected segments of society, are now better understood. There is also broad agreement that the Fund should both limit the structural conditions it attaches to its financing and concentrate them in the core areas of its expertise, e.g., fiscal and budgetary systems, financial markets, etc. and leave to others, especially the World Bank, areas such as civil service reform, privatization and the like.<sup>10</sup> Debates about how to make limited and focused structural conditionality more effective and less intrusive should, and will, continue. While care needs to be taken to assure uniformity of treatment across the membership, it is clear that such conditionality needs to be well tailored to the circumstances of each member: its track record in policy-making; its record under financing arrangements with the Fund; and the extent and depth of ownership of the adjustment and reform measures being implemented with Fund support. Beyond these issues, broader agreement needs also to be found regarding the appropriateness of using crisis situations to bring about changes in the institutional and structural characteristics of the economy that may have contributed to the emergence of a crisis – something for which the Fund was widely, but wrongly, criticized for during the Asian crisis.

<sup>8</sup> See the communiqué from the G8 Summit at Gleneagles, Scotland, 2005.

<sup>9</sup> One approach to this issue is contained in The Report by the External Review Committee on IMF – World Bank Collaboration (the Malan Report), February 23, 2007, which suggests that the Fund provide only short-term credit to these countries leaving all longer-term lending to the World Bank.

<sup>10</sup> See, for example, the *Report on Structural Conditionality in IMF-Supported Programs*, Independent Evaluation Office, International Monetary Fund, forthcoming.

The second issue regarding the Fund's work in low income countries concerns the breadth of the Fund's analytic focus and collaboration with other agencies. Much greater clarity and better guidance to staff are needed from both the executive board and from management on these issues. What information, and in what detail, is needed to do macroeconomic analysis properly and comprehensively in developing countries? What should be the time horizon of the Fund's analysis and projections? Has the Fund a role to play in mobilizing or coordinating aid and assessing its overall impact on the economy? What is the proper role for the Fund in assessing a country's progress toward achieving the Millennium Development Goals?

Enormous efforts have been made, and continue to be made, both within and outside the Fund to bring closure to these issues. Some argue that the Fund should have a narrow and relatively short term macroeconomic view of the country's prospects and policies. Others believe that the Fund should help provide the overall macroeconomic context over a somewhat longer time period within which the country's development plans will be formulated and implemented. This was the concept underlying the development of the Poverty Reduction Strategy Paper (PRSP) and its call for close cooperation between the IMF, the World Bank, and other active partners of the country, including aid agencies, in determining the role each is to play in assisting the country. For the Fund, this latter view implies a need for full information about the size and likely sectoral allocation of aid flows, an analysis of the capacity of the country to absorb and effectively utilize aid, and the impact of financial flows, policies and other factors on the prospects for the country to achieve the MDGs.<sup>11</sup> All this needs to be set out in the context of a medium term macroeconomic and financial development framework.

These contrasting views of the Fund's role in the low income countries imply quite different levels of involvement with the country, different degrees of cooperation and active engagement with the country's other partners, different information systems, and different staffing levels, among other things. Unfortunately, neither the executive board nor management have provided sufficiently clear guidance to the staff about where on the spectrum between these two models of Fund involvement they should define their role. This has led to confusion among staff, as well as confusion among the countries' other partners about what to expect from the Fund. There is an urgent need for greater clarity on the Fund's responsibilities in this work.

The low income countries would be well-served by an IMF that takes a broad view of its role in these countries. The IMF is the only organization that can effectively help countries put together all the elements of macroeconomic and financial analysis that are needed to have a comprehensive view of the development prospects – and requirements – of the country. In doing so, of course, it needs to rely on the expertise and information available in other organizations, including aid agencies and the development banks. The narrow view espoused by some simply does not recognize the requirements for formulating a comprehensive view of macroeconomic policy in these countries.

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<sup>11</sup> In the current situation in which a number of African countries are enjoying increased production and exports of oil and other commodities, absorptive capacity assessments become even more critical.

**The role of the Fund in surveillance, in financing, and in its work with the low income countries are critical to the future direction of the Fund.**

These issues regarding the role of the Fund in surveillance, in financing, and in its work with the low income countries are critical to the future direction of the Fund. While each has been subject to debate over the past several years, there has been insufficient progress in bringing closure to these issues and the work and reputation of the institution has suffered as a result. If the Fund is to re-gather its strength among the membership and be seen as having a well-defined role under which it can effectively partner with other institutions and agencies, and advise its members, greater clarity on all these issues is essential.

# 4. The Governance of the Fund

A clear mandate, strongly endorsed across the membership, is needed for the Fund to play its role in the global economic and financial system. To secure that endorsement and the support of the entire membership in carrying out its responsibilities, the Fund needs to reverse the slide towards indifference that has been taking place among large segments of the membership. This trend has been the result of a number of factors, but probably none more important than those involving the governance of the institution. This, in turn, depends on the voice and vote of members – individual countries, as well as the constituencies represented in the various regional and issue-associated groups of members; the effectiveness of a country's representation in the institution, beyond the basic matter of voting power; and the congruence between the governing bodies of the Fund and the various agenda-setting bodies in the global community that are often the focal point of countries' engagement in the multilateral system.

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## a. The Voice and Vote of Member Countries

Clearer principles are needed to help guide thinking on global and institutional governance issues.<sup>12</sup> One of those principles on which virtually all agree is legitimacy. Unless an organization has a legitimate basis, and is seen as legitimate by all those involved with it, it will not have the authority and credibility to carry out its mission. The search for legitimacy for an institution like the Fund starts by asking what governance features make it acceptable for sovereign countries, and their populations, to work with the organization and to give up some of their sovereign powers in doing so. Without a willingness on the part of all members to cede some authority to the institution, it cannot be effective. In the case of the IMF, it is clear that the current distribution of quotas and the relative voice of members within the Fund, among other things, are causing its shareholders in various regions of the world, as well as other stakeholders, to question its legitimacy.<sup>13</sup>

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Legitimacy, in the first instance, stems from the governance structure of an institution. But it also depends on the way in which that structure operates. Thus, governance of the Fund has many dimensions. The first dimension centers on the issue of power-sharing. This is mainly a matter of what is termed “voice and vote.” That issue is under active discussion in the context of the current review of members' quotas in the Fund. Some progress was made on this issue at the Fund's annual meetings in Singapore in 2006 with the ad hoc quota increases granted to China, Korea, Mexico and Turkey. Importantly, the resolution of the Board of

<sup>12</sup> See “IMF Reform: Congruence with Global Governance Reform”, Jack Boorman in *Global Governance Reform*, edited by Colin Bradford and Johannes Linn, the Brookings Institution, January 2007.

<sup>13</sup> The anomalies in the voice and vote of members in the Fund are well known and need not be restated here.

Governors adopted at that time recognized these ad hoc increases as only a first step. The resolution called on the executive board to reach agreement by the time of the 2007 annual meetings on a new quota formula "...to guide the assessment of the adequacy of members' quotas in the Fund" and "... to provide a basis for a further rebalancing of quotas to be recommended to the Board of Governors... no later than by the annual meetings in 2008." The executive board was also called upon to propose an amendment of the Articles of Agreement to provide for at least a doubling of the basic votes of each member and to safeguard the proportion of basic votes in total voting power. It was also envisaged that "...the Board of Governors will consider distributing any increase in quotas with a view to achieving better alignment of members' quota share with their relative position in the world economy, while assuring that the IMF has adequate liquidity to achieve its purposes."<sup>14</sup>

**It is, unfortunately, unlikely that the action called for by the Board of Governors will address the real and substantive issues of voice and vote in the Fund.**

It is, unfortunately, unlikely that the action called for by the Board of Governors will address the real and substantive issues of voice and vote in the Fund. First, on basic votes. In its report to the Board of Governors in August, 2006, the executive board said that "An increase in basic votes, which reflect the principle of equality of states, is the appropriate mechanism to give the smallest members of the Fund... a greater voice in the Fund's deliberations."<sup>15</sup> This was an excellent starting point. When the Fund was established in 1944, basic votes (under the same principle of "equality of states") were set at 250 votes for each member. At that time, these votes represented 11.3 percent of total voting power. Basic votes have not been changed since then and, with the increase in quotas that has occurred over the years, now represent only 2.1 percent of total voting power. While the resolution of the Board of Governors called for "at least a doubling" of basic votes, language that was repeated in the IMFC communiqué of October, 2007, it appears that agreement is emerging around not more than a doubling. This would leave basic votes at only about four percent of current voting power – an insignificant adjustment.

In a similar vein, the modifications to members' quotas themselves, driven by the adoption of new quota formulas, looks to be less than ambitious. Perhaps most noteworthy is the likelihood that inter-country trade between members of the European Union, including members of the euro zone, will continue to be counted as a measure of the "openness" of these economies. This is likely to leave the EU-25 with cumulative quotas of around 32 percent of the total – almost enough for the EU together with the United States to take majority decisions in the Fund. There are legitimate legal and other issues here, not least the fact that the EU is not a country – the entity that defines membership in the Fund. However, continuing to count this inter-country trade within the Union when calculating quotas is becoming increasingly akin to counting trade between California and New York and between all the other individual states of the United States in determining the quota of the US. If this issue cannot be dealt with through the elimination of inter-country trade when applying the quota formulas to EU countries, some other means, including a voluntary reduction in quotas by EU countries that would achieve the same results, should be considered.

<sup>14</sup> IMF Press Release No 06/205: *IMF Board of Governors Approves Quota and Related Governance Reforms*, September 18, 2006.

<sup>15</sup> *Report of the Executive Board to the Board of Governors, Quota and Voice Reform in the International Monetary Fund*, August 31, 2006, p.4.

Similarly, an overall increase in quotas – the distribution of which was seen as a means of “...achieving better alignment of members’ quota share with their relative positions within the world economy” – seems unlikely to produce much change. The executive board appears to be considering an increase in the total quotas of only about 10 percent – a figure endorsed by the IMFC in its October, 2007 communiqué. The entire debate on the quota issue is further undermined by the fact that it takes place in an environment in which the future financing role to be played by the Fund is uncertain and the differences of view among the membership that arose during the crises of the 1990’s about “exceptional access” to Fund resources in the context of capital account crises remain essentially unresolved.<sup>16</sup> These issues should be resolved before any increase in quotas is recommended by the executive board to the board of governors.

Clearly a different approach and a different process is needed if any review of quotas is to produce the kind of change needed to increase the perceived legitimacy – and usefulness, of the IMF among large segments of the membership. At minimum, this would require:

- commitment at the highest political levels to support genuine reform and change;
- resolution of the key issues regarding the appropriate financing role for the Fund in the case of financial market crises.
- agreement to a significant increase in basic votes; something on the order of a quadrupling would be needed just to restore the relative power of basic votes to their position when the IMF was established; and
- acceptance that inter-country trade within the EU is not to be included in calculating quotas – or some other agreement is found to bring about a similar adjustment to the aggregate EU quota.

Beyond quotas, another aspect of the voice and vote issue is receiving insufficient attention. This involves the size and compositions of the executive board – something that certain segments of the membership are loathe to put on the agenda. Two questions in particular need urgent consideration. First, is an executive board of 24 members the optimal size for an institution like the IMF and for a board that has the operational responsibilities of the Fund board? Much of the literature on the subject suggests smaller boards can be more effective. Second, what needs to be done to reduce the indefensible position of the European countries in the executive board that now occupy eight of the 24 chairs and are represented in one other constituency? This is an historical anachronism that needs to be corrected. The enormous contribution of the Europeans to the IMF, including their generosity in supporting the concessional windows for Fund lending to low income countries, as well as other initiatives, needs to be recognized. Nonetheless, the Europeans need to recognize that they hold the key to genuine reform on the voice and vote issues. They should accept a reduction in quotas and they should agree to reduce their representation in the executive board to no more than three chairs.

**A different approach and a different process is needed if any review of quotas is to produce the kind of change needed to increase the perceived legitimacy – and usefulness, of the IMF among large segments of the membership.**

**Beyond quotas, another aspect of the voice and vote issue is receiving insufficient attention. This involves the size and compositions of the executive board.**

<sup>16</sup> It is interesting that some of the same countries most vociferous in their objection to large access to Fund financing in the context of the capital account crises of the late 1990’s and early 2000’s are members of the Euro Zone whose central bank, the ECB, has famously, and probably appropriately, flooded the money markets in the face of the disturbance related to the sub-prime mortgage crisis of recent months.

**Europe may come out of such change with a stronger and more effective voice. This would allow it more effectively to counter the power of the United States.**

Among other things, a reduction in the number of European chairs would provide room for additional representation by African countries, 43 of which are now represented by only two executive directors. Without a willingness on the part of the Europeans to give ground on these issues, it is virtually impossible to see how genuine reform can be brought about in the Fund.

Will any of these, or other, changes make a difference to the real and perceived legitimacy and operations of the Fund? Europe may come out of such change with a stronger and more effective voice. This would allow it more effectively to counter the power of the United States. A genuine power shift – in accord with the economic and financial realities of the global economy – would provide the emerging market countries with a greater sense of ownership in the institution. Substantially enlarging basic votes could do the same for the low income countries, as would an additional chair for the African countries. All of this could also affect the power blocks and alignments that form to determine the orientation and evolution of the Fund as globalization continues to change the relative positions of members in the international economic and financial system.

Other reforms also deserve consideration. For example, proposals have been made to expand the use of double majority voting in the Fund. At present, a double majority – 85 percent of voting power and a sixty percent majority of members – is required to amend the Articles of Agreement. Double majority voting (quotas and chairs) could also be considered for the selection of the managing director and the chair of the IMFC, as well as for key policy decisions and, perhaps, even to approve large-access lending operations.<sup>17</sup> These changes could help strengthen the weakening consensus tradition in the Fund by requiring a majority of members to support those decisions that determine the direction of the Fund. It could also help mute the undue power of some of the major shareholders in the Fund. These and other changes in the way business is conducted in the IMF would help correct the legitimacy deficit in the Fund and help regenerate a sense of ownership of the institution among the full membership.

## b. The Governance Structure within the Fund

**The second dimension of the governance issues confronting the Fund involves the structure of the institution and the workings of the various bodies charged with responsibility for overseeing and for managing the institution.**

The second dimension of the governance issues confronting the Fund involves the structure of the institution and the workings of the various bodies charged with responsibility for overseeing and for managing the institution. Here, the major issues concern the specific responsibilities and, critically, the accountabilities of these different bodies. While this dimension of governance of the Fund has received less attention than the voice and vote issues, there does seem to be an increasing willingness to take it on.

<sup>17</sup> Mr. Strauss-Kahn, the new managing director, said in his statement to the executive board on September 20, 2007: "I have given the example of a double majority voting system (quotas and chairs) as a way to better insure that key decisions command the appropriate level of consensus. While I don't think any institutional change is mandatory, I can nevertheless make a commitment to consider that any decision not likely to obtain the support of a qualified majority of chairs should be delayed by the MD."

The organizational structure of the Fund has some unique implications for the governance of the institution. That structure is clearly defined in the Articles of Agreement. Its main elements include the board of governors; the executive board; management; and staff. The Interim Committee and its successor, the IMFC, were added later. The Articles are also reasonably clear about the powers of the various components of the structure:

- The board of governors makes the major decisions – on quotas, SDR allocations, gold sales and the like, and bears overall responsibility for the operation of the institution;
- the IMFC was established as an advisory body, but, in reality, it is a power unto itself;
- the executive board is charged in the Articles with “...conducting the business of the Fund...” and takes most of the operational decisions;
- management runs the Fund on a day to day basis under what the Articles call “...the direction...” of the executive board. Even on matters involving the organization, appointment, and dismissal of staff, management is subject to “...the general control of the executive board...;” and
- the staff operates under the direction of management.

Beyond these general responsibilities, there is some lack of clarity about the specific roles of these various bodies. Some of that is dealt with in the By-Laws, but gaps remain. More importantly, too few well-defined mechanisms and processes have been established to assure that all these players, especially the executive board and the managing director, carry out their responsibilities in accord with the best practices of organizational governance. By way of example:

- The executive board, according to the Articles of agreement, “selects the managing director” and can dismiss a managing director. But, to date, and in substance, that has not been the case.
- Similarly, while the Articles specify that the managing director operates under the general control of the executive board, in fact, no one really assesses the extent to which the board gives effective direction, or how the managing director or management more generally, performs under that direction.<sup>18</sup>

Some of these governance problems stem from unresolved issues that originate in the unique nature of the Fund and the way in which governance best practices should be applied in such an institution. For example, the Board of Governors is the closest analogy to a corporate body representing the owners. But it has some crucial characteristics that distinguish it from the traditional corporate board. For one, while its composition changes – governors come and go, the ownership they represent changes only as new members join the Fund through what is essentially a political process. There is no market for shares in the Fund. And perhaps

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<sup>18</sup> As just one operational example, there is too often a lack of clarity in the direction given to management and staff on policy matters in the summings-up which conclude board discussions. This is often the result of a failure to find consensus in the executive board. But it makes assessing the performance of management in carrying out that direction and holding management accountable nearly impossible. This is one of the causes of the lack of clarity regarding the Fund’s role in the low income countries where a failure to find consensus in the executive board is reflected in a lack of clear direction in the summings-up of executive board discussions.

most importantly, no one from the outside can capture a share of the ownership, appoint like-minded people to the board of governors or the executive board, and force change and reform on the institution as happens in the corporate world. There can be no takeover or buyout by a Warren Buffet or other outside investors or stakeholders! This is as it should be in an inter-governmental institution like the Fund. But it means that change has to come from within what is essentially a static membership and ownership, and it raises questions about how stakeholders other than governments can help bring about change and reform.

**The role and nature of the executive board also challenges some of the traditional concepts of governance.**

Similarly, the role and nature of the executive board also challenges some of the traditional concepts of governance. Boards in the private corporate sector and the non-profit sector, and sometimes in the official sector, have rather circumscribed decision-making authority. Boards typically select the CEO, decide compensation at the most senior levels, determine major strategic issues, and the like. But running the organization is left to the managers – subject to general oversight by the board. This tradition leaves the decisions of such boards at a rather high level; they are not of an ongoing operational nature. A corporate board’s role in operations is typically very limited.

The responsibilities of the executive board of the IMF are very different and far more extensive. The board has many of the high level and strategic decision-making powers of a corporate board. However, aside from the specific organizational and personnel decisions that are left mostly to the managing director, the executive board takes virtually all of the key decisions within the Fund. On surveillance, the board completes the exercise with a decision expressing the Fund’s views about a country’s policies;<sup>19</sup> on lending, the board approves every program and the financing offered by the Fund in support of that program and reviews the country’s performance under the arrangement with the Fund almost continuously; it decides what financial instruments the Fund has at its disposal, its surveillance powers, and it recommends key decisions on quotas, SDR allocations, gold sales, etc. to the board of governors. Even in areas where the executive board does not take specific operational decisions – for example, in the allocation of technical assistance, it periodically reviews and assesses the decisions taken by management.

**The Fund executive board is not simply an oversight body as are most corporate boards; it is the main player in most of the specific decisions taken in the IMF.**

Thus, the Fund executive board is not simply an oversight body as are most corporate boards; it is the main player in most of the specific decisions taken in the Fund. From a governance perspective, this reality makes the Fund board’s oversight role more complex as it is a direct actor in what it is supposed to oversee. At minimum, this complicates the assigning of responsibility and accountability in the Fund – two key elements in any system of governance. Compounding this problem is the fact that there has been no formal process for assessing the performance of the executive board. Some attempts are made at self-assessment, through periodic reviews of board procedures, board retreats, and other means. However, it is clear that these are not sufficient. At minimum, there should be a formal process of self-assessment by the executive board – a process seen else-

<sup>19</sup> Interestingly, while the executive board concludes the consultation process with individual members in the context of surveillance, it is the staff that presents its views on the global situation in the *World Economic Outlook* and the *Global Financial Stability Report*.

where as a developmental tool for improving the performance of corporate and other boards. Consideration should also be given to mandating an independent assessment of the board's performance, with the outcome reported to the IMFC or to the board of governors.

Another long-standing reality in the Fund is the ill-defined role and responsibility of individual executive directors. Executive directors are often described as wearing two hats: one as the representative of a member country or group of countries that appoint or elect him/her; and one as an official of the Fund. There can be conflicts in these two roles. But while these dual roles have never been well elaborated, they can affect any effort to judge responsibility and accountability.<sup>20</sup> Given the lack of clarity on this issue, it may be preferable to cease referring to executive directors as "officials of the Fund" and recognize that, substantively, and appropriately, they act as representatives of the countries that appoint or elect them. Similarly, the calls for executive directors to be "independent" including through longer than the current two year terms and other changes seem inconsistent with the nature of the IMF as an inter-governmental body. It would be preferable to recognize these realities and consider changes that would result in more senior and more experienced individuals serving as executive directors. A non-permanent board that meets at the Fund's headquarters in Washington, DC only periodically to take major decisions (say one week each month) might help bring about some of these, and other, welcome changes.<sup>21</sup> These issues warrant much more discussion and debate.

**Another long-standing reality in the Fund is the ill-defined role and responsibility of individual executive directors.**

There is another complexity here separate from the one embodied in the issue of the two hats worn by an executive director. While judging the responsibility and accountability of an executive director representing a single country may confront the issue raised above, that judgment is even more difficult in the case of a director elected by a multi-country constituency. To whom, exactly, is he/she accountable? Other than at the time of the next election, can anyone remove an executive director representing a multitude of countries? This, too, has never been clarified.<sup>22</sup>

20 What happens, for example when political considerations formulated in capitals trump the judgment of an executive director? For example, what if an executive director comes to the conclusion that a policy program put forward by a member country – and recommended for approval and financing by management, is inadequate to restore the country's economic and financial viability? A director's fiduciary responsibility to the Fund would suggest a vote against approval of such a program and the financing to support it so as to protect the Fund's resources. But he or she may be instructed by his or her authorities for political or other reasons to vote in favor of that loan. How does that affect judgments about responsibility and accountability, especially if the executive director's concerns turn out to have been correct?

21 Among other changes that would occur as a result of moving to a non-permanent board would be closer contact of executive directors with their capitals and fewer board meetings. The latter would permit the managing director to chair a higher percentage of all meetings. As one of the motivations for creating two additional deputy positions in 1996 was to have additional people on the management team who could chair the board, this management structure could also be re-considered (see below).

22 In thinking about governance issues of the executive board, there is an additional matter that clouds the rules of governance within the Fund. That is the role of the managing director as chair of the executive board. He, too, has several hats that can sometimes sit uneasily with each other – as chair of the board; as CEO; as head of the staff; as the public face of the Fund; etc. Is his position as chair of the executive board fully consistent with best practices of good governance? Do the rather unique responsibilities of the executive board itself validate the arrangement? Does the obvious need for a single individual to have responsibility for running the institution, especially when the executive board is a times tempted to take on that role, recommend continuance of the managing director's chairmanship of the board? These issues, too, require further discussion.

### c. Governance from Outside the Fund

The third dimension of Fund governance is what, for the want of a better name, can be called governance from the outside, i.e., the way in which entities beyond the Fund's own traditional governing bodies influence the Fund and its policies and decisions. This includes the roles played by the various agenda-setting bodies in the global community, perhaps most importantly the G7/8, as well as the roles to be played by civil society organizations, the private financial community, and other stakeholders.

**There are important evolutionary forces that affect the influence that outside bodies have on the policies and operations of the Fund.**

There are important evolutionary forces that affect the influence that outside bodies have on the policies and operations of the Fund. On the official side, there has been the emergence, and ever-increasing visibility, of the various global bodies such as the G7/8, the G20, the G24 and others. Witness the trend in the last fifteen years or so of a system in which the G7 deputies are in almost permanent contact with each other, and often with Fund management and staff, on policy and operational issues active in the Fund. More recently, there has been the institution of preparatory meetings of the deputies to the twenty-four ministerial members before IMFC meetings. Prior to that, Interim Committee meetings were prepared by the executive board. It may be argued that there are positive and productive aspects of these evolutionary changes in terms of better engaging senior officials in capitals on Fund issues, resolving differences of view without involving the ministers, and the like. However, one can also argue that this practice, along with a number of other developments, has eroded the authority of the executive board and the role of executive directors. A clear assessment needs to be made about the impact of these changes on the governance of the Fund. The practice of having the executive board responsible for the preparatory work for IMFC meetings would seem to be warranted. Intervention from capitals on critical issues can be managed through the executive directors, as should be the case with most of the other business of the Fund. Increasing the seniority of executive directors, and possibly making the board a non-permanent body with executive directors spending most of their time in their capitals, could facilitate resolution of this issue.

The emergence of the various agenda-setting groups has also affected the work of the staff and management of the Fund and raise questions about how staff interact with these groups and with the executive board. Staff contact with these groups probably began most intensively with the G-10 in the 1970's. There was a tradition that staff returning from meetings of the G-10 in which they had participated would brief the executive board on those discussions. This practice seems to have fallen by the wayside even as the number, and perhaps the importance, of these groups has increased and staff and management contact with representatives of such groups at various levels – deputies, deputy deputies, etc., has intensified.

The existence of these groups has also called into question the extent to which the principles of good governance are adhered to in the official international community. In the Brookings paper referenced earlier, one of the principles of global governance discussed was “subsidiarity”. This principle says that functions that subordinate organizations can perform effectively belong more properly to them

than to a dominant central organization or group. This is in some ways an issue of “voice” in that it suggests that specific policies and decisions be left to those most affected by them, but within a broad framework established by the 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 limit the agenda of the more global organization or authority, hopefully providing greater efficiency.

The subsidiarity principle is important in the context of the IMF because pulling issues unnecessarily out of the executive board of the Fund and up to the various agenda-setting bodies such as the G7/8 has been, at times, both counterproductive and potentially harmful to good governance practices. Recent examples include dealing with the various debt relief initiatives, especially the Multilateral Debt Reduction Initiative (MDRI), and the formulation of various Fund financing facilities such as the Contingent Credit Lines and, earlier, the Compensatory and Contingency Financing Facility – neither of which proved operational as formulated.<sup>23</sup> If the agenda-setting body, the G8 in the case of MDRI and many other initiatives, had restricted itself to setting out some general principles and desirable objectives and left it to the institutions to figure out how it should be done – that is, if the subsidiarity principle had been respected, better policies would likely have been formulated and a greater sense of ownership of these policies among the rest of the membership would have resulted.

Different issues arise regarding the relationship between the Fund and the private sector financial community and civil society.<sup>24</sup> This is an issue needing greater attention as the role of such bodies under law, as well as in the context of accepted concepts and practices of human rights, keeps evolving. Perhaps most important in the current context is to further increase the transparency of the Fund so that individuals and groups in these communities, and others, can participate as informed partners of their governments in the issues being discussed and debated within the Fund.<sup>25</sup> One aspect of this concerns the transparency of the deliberations of the executive board. The High Level Panel on IMF Board Accountability convened by the New Rules for Global Finance Coalition made a number of specific suggestions in this area. Greater transparency of the executive board would help increase public understanding of Fund decisions and also provide a means to increase the accountability of individual executive directors.

In short, governance of the Fund needs to be set in the context of these global governance issues and the global governance structures that have emerged over recent decades. One cannot pretend that the agenda-setting bodies, and the deci-

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**Greater transparency of the executive board would help increase public understanding of Fund decisions and also provide a means to increase the accountability of individual executive directors.**

<sup>23</sup> The story of the MDRI is a sorry one. The proposals adopted by the Finance ministers of the G8 in June 2005 and endorsed by the Leaders at the Gleneagles Summit were formulated not in the executive board of the Fund or the other affected institutions, but by the G8 deputies, reportedly amidst serious differences of view about what should be done. What came out of their discussions and compromises was, in the view of many, unfair to many low income countries and was, in other ways, seriously flawed. In fact, what was proposed for the Fund was inconsistent with the Articles of Agreement and an unhappy construct had to be put together by the staff and accepted by the executive board to make it workable, even if still not optimal.

<sup>24</sup> See, for example, *High Level Panel on IMF Board Accountability: Key Findings and Recommendations, New Rules for Global Finance Coalition* (www.new-rules.org), April 10, 2007.

<sup>25</sup> There appears to have been a lapse in practice recently as the staff papers prepared for executive board discussions on the revision of the 1977 Decisions on Surveillance and on quota issues have not been available outside the Fund, except when leaked.

sions taken in those bodies, do not impact in a fundamental way the manner in which the Fund does its work and the extent to which those in the Fund – executive directors, management and staff, can be held responsible and accountable for the actions of the Fund. One cannot also pretend that changing the voice and vote of member countries within the Fund will, by itself, resolve the issues of representation unless the issues surrounding these global agenda-setting bodies are also addressed. These are complex issues and they are obviously well beyond the capacity or authority of Fund management or the Fund executive board to resolve. Nevertheless, the Fund is impacted in fundamental ways by the organization and work of the agenda-setting bodies. A major international effort should be launched to review the way in which these bodies are organized and how they relate to the governing bodies of the major international organizations.<sup>26</sup>

#### d. Other Important Governance Issues

In addition to these fundamental challenges to governance of the Fund that stem from the specific nature and structure of the institution, from the global institutional setting within which it operates, and from its management model (see below), there have been very specific events and actions that have aggravated the governance problems in the Fund. These persistent problems have reduced the legitimacy and effectiveness of the Fund, and have frustrated those who have been looking for better governance and greater accountability in the institution. The specifics include:

**The Europeans and the United States seem intent on holding onto the anachronistic practice of determining by themselves who becomes the managing director of the IMF and who becomes the President of the World Bank.**

- the selection process for the managing director where, by all appearances, the Europeans and the United States seem intent on holding onto the anachronistic practice of determining by themselves who becomes the managing director of the IMF and who becomes the President of the World Bank. The events of recent months seem to suggest unwillingness on the part of the Europeans and the US to reform this process – notwithstanding efforts by the executive board itself in July, 2007 to open the selection process to candidates from the entire membership.<sup>27</sup> Now that a European has been selected by the executive board, it is time to review again the selection process and to evaluate the guidelines established by the board in July, 2007 against that experience. Clearly, changes are needed to create a genuinely open and competitive process in which it is less likely that a small group of countries with significant voting power can preempt the process as was done on this occasion. The prospect of having to face a double-majority vote to select the managing director might help in this regard.

<sup>26</sup> There is, of course, the major issue of the composition of the various groups and their legitimacy in talking among themselves and issuing guidance to the international community on a broad range of issues – issues critical to countries not included in the groups. The most notorious recent example is, of course, the discussions in the G7/8 about the Chinese exchange rate.

<sup>27</sup> The executive boards of the World Bank and IMF established in 2000 working groups to review the selection processes for the Bank President and the Managing Director of the IMF. The working groups submitted their reports to the executive boards in April 2001. The reports were “endorsed” by executive directors on the two boards and were provided to the IMFC which “took note” of them. The boards at that time were asked to consider further steps to reform the process. In this light, it is difficult to understand why the IMF board seemed caught by surprise in 2007 and had to re-open the issue as if little or nothing had been done before.

- Similarly, the process through which the chair of the IMFC is selected needs reform. During much of the time that the Europeans have monopolized the position of managing director, they have also held the chair of the IMFC and its predecessor the IC. Even in the current round, a European was nominated and ultimately selected as IMFC chair at the same time that the Europeans were insisting on retaining their prerogative to name the managing director.
- Finally, just as the selection process for managing director demands reform, the tradition of appointment of the first deputy managing director by the United States needs to be ended. In that position as well, a process open to candidates from all member countries needs to be instituted. If a multi-deputy management structure is maintained, care needs to be taken to assure a reasonable geographic dispersion of nationalities in these positions over time. But, at the same time, the selection process needs to operate in a way that helps assure that it delivers individuals with whom the managing director can work effectively. The managing director should have a say in that selection.

**Just as the selection process for managing director demands reform, the tradition of appointment of the first deputy managing director by the United States needs to be ended.**

# 5. Managing the Fund

**Experience suggests the need for a robust process of review by the executive board of the way in which a managing director is carrying out the responsibilities of the office.**

In recent years, there have been questions raised about the way in which the IMF has been managed. Many of the issues were widely known and discussed both within and outside the Fund, including in commentaries in the press. There have been important issues regarding the leadership provided by management in seeking consensus on key policy issues in the executive board and in clarifying for staff the operational implications of decisions on which consensus has not been found. Other issues have included the proper balance to be sought between travel by the management team and time spent at headquarters and in chairing the executive board. There have also been questions regarding the way in which staff was managed and supervised, and questions about the conditions that had given rise to evident problems affecting morale within the institution.<sup>28</sup> These are the kind of issues that should be discussed in the context of deciding the priorities for a managing director and the deputy managing directors of the Fund – priorities that should be set by the executive board. Discussions on the six-monthly work program have not been sufficient to deal with these issues. Experience suggests the need for a robust process of review by the executive board of the way in which a managing director is carrying out the responsibilities of the office.

As in any large organization and, to some extent, independent of the formal structure of management, the perceptions of individual managers of their responsibilities and priorities, as well as the relations between managers, will affect the way in which the organization is managed. This is inevitable. At the same time, it is the responsibility of the executive board under the Articles to oversee the management of the Fund and to give “...general direction...” to the managing director. Had there been regular assessments of management by the executive board, a number of issues that have arisen and that have affected both the substance of the Fund’s work and the efficiency of its operations may have been uncovered and possibly dealt with as they became evident.

But there may well be a structural problem here as well. For many years, the Fund was managed by a managing director and a single deputy managing director. This model became clearly untenable as the work, responsibilities, and array of activities asked of the Fund by the membership expanded significantly in the 1980’s. The major change made to address this reality was the creation in 1994 of two additional deputy positions – providing for a total of three deputies, with one designated as “First Deputy Managing Director” and intended to be clearly senior to the other two. All three deputy managing directors have the authority to act as chair of the executive board in place of the managing director. This structure seemed to suffice for some years. However, it may be argued that it was the confluence of highly complimentary skills and personalities among the members of the management team in those years that accounted for the success of this

<sup>28</sup> These problems were well-documented in the Staff survey conducted in 2003.

model. It remained an open question as to whether the new structure was optimal for the institution under different circumstances. The experience of the last several years, a period of less activity than during the crises years of the late 1990's and early 2000's, raises important questions about the sufficiency of that management structure.

Under the current structure, each DMD has oversight responsibility for some country work, certain policy issues, and various administrative areas. The country work is demanding, partly because of the travel and representation responsibilities involved, partly because of the internal processes that demand review and sign-off of virtually all country documents by a member of the management team, and because of the time that must be dedicated to chairing the executive board. The policy and administrative responsibilities are similarly daunting. The organization of administrative functions – the budget, personnel/human resources, and the like – may be particularly problematic as they are spread across the DMDs.<sup>29</sup> Beyond these issues, it can be argued that this multi-deputy structure, in addition to other forces, has also had the effect of diminishing the role and stature of department directors. This results from management sometimes keeping issues and decisions within the team to the exclusion of others that should be involved; holding review and sign-off authority on both country and policy papers – the modus operandi of the Fund – to itself; and dominating the Fund's representation in many fora in the international system. This plethora of time-consuming and travel-demanding responsibilities has also robbed management of the time to be sufficiently visible within the institution and to provide clear guidance to staff on the issues confronting the work of the Fund.

Various changes have been made to help deal with some of these problems. Offices have been established to help organize some of the administrative responsibilities of management; the deputy directors have each been provided a special assistant to help manage their offices, and, more recently, some sign-off authority has reportedly been delegated to department directors. However, some of these changes have themselves had unintended consequences, including a possible further reduction in the stature and authority of department directors.

Unfortunately, evident weaknesses continue to exist and no comprehensive review of the management structure has been conducted, nor has serious consideration been given to alternative structures. Suggestions that outside experts be brought in to review the management structure are usually dismissed on the grounds that the Fund is a unique institution and that expertise from outside will not be attuned to its special needs. There may be some truth to that. But it is also likely that outside management expertise would be a useful resource to tap to solicit an assessment of the current system and to begin to develop a set of alternatives that could be subjected to debate and discussion internally. That should be a priority for the new managing director. If management does not take the lead, the executive board, under its oversight responsibilities, should itself commission a review of the Fund's management structure.

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<sup>29</sup> Problems in this area were also highlighted in staff responses to the survey conducted in 2003.

Management's leadership of staff also needs to be an element of the executive board's review of management's performance. There are some long-standing issues, noted earlier in this paper, that should be addressed:

- has the mix of staff been properly adjusted to the realities of the modern, complex global financial system?
- has the organization of staff been sufficiently re-oriented to most effectively bring together the extensive experience that exists within the institution when analyzing and assessing the policies and developments in individual countries and providing advice to members – especially at times of crises?
- are staff sufficiently trained in the practical aspects of economic and financial policy formulation and implementation?
- has the “silo” nature of the departmental structure cited in so many reviews of various aspects of the Fund's operations been dealt with sufficiently in the recent reorganizations?
- have the concerns voiced by staff about management – most forcefully in the extensive staff survey conducted in 2003 – been taken seriously, followed up, and effectively addressed?

Work is reportedly underway on a number of these issues, but by all appearances much remains to be done.

# 6 The Fund's Income Model

The mechanism through which the Fund generates income to cover its administrative expenses – currently nearly \$1 billion annually – is ill-suited to the nature of the Fund and the cyclical character of its lending operations. The Fund generates most of its revenue essentially by setting a margin between the rate charged to borrowing members for the use of the Fund's financial resources and the cost (or rate of remuneration) paid to secure those resources from creditor member countries.<sup>30</sup> Operating on a spread makes sense for a financial institution that runs, on an ongoing basis, a balance sheet comprised of income-earning assets and cost-incurring liabilities such as deposits and debt issues. The IMF is not such an institution. In the best of all times, when global or regional crises are absent and few members are availing themselves of its financial resources, the balance sheet shrinks and the institution has few income-earning assets and few liabilities. That's fine for the balance sheet, but it wreaks havoc on the Fund's income stream. Thus, if the Fund serves the community well through its surveillance, technical assistance and other non-lending operations, thereby contributing to stability and growth in the global system and in individual countries, it is also, under the current income model, denying itself the resources to cover the cost of those activities. This is a contradiction overdue for correction.

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In 2006, a group of eminent persons was asked to consider alternatives to the current model. The group submitted its report and made specific recommendations in January 2007.<sup>31</sup> The recommendations included:

- broadening the Fund's investment mandate, i.e., allowing a broader range of investments for its reserves to produce additional income on these accounts;
- investing part of the quota resources subscribed by members under a similarly broadened (and higher yielding) investment authority;
- selling a limited amount of the Fund's large gold holdings (currently 3,217 metric tons) and investing the profits from such sales in suitable instruments. The group advised that such sales be limited and strictly ring-fenced to exclude further sales, and that such sales be conducted in such a way as to limit the impact on the gold market;
- possibly charging member countries for services provided by the Fund, including technical assistance.

The group estimated that the proposals to increase the Fund's investment capacity would generate, in total, about \$540 million annually.<sup>32</sup> The IMFC, in welcom-

<sup>30</sup> In, practice, there are many complications in the system, including the impact of members' reserve positions in the Fund, burden-sharing mechanisms associated with the arrears of a few members to the Fund, earnings on the reserves held by the Fund, and others. But, in essence, the Fund operates from the revenue generated by the spread on its lending operations with member countries.

<sup>31</sup> Report by the Committee to Study Sustainable Long Term Financing of the IMF, (the Crockett Report), January 31, 2007.

<sup>32</sup> The Fund's current administrative budget is just over \$900 million.

ing the group's report as a basis for discussion in the executive board, emphasized that dealing with the budgetary issues confronting the Fund also required action on expenditures.

**The budgetary constraint the Fund faces should not be allowed to dictate the role and direction of the institution.**

This is an extremely important issue. But care is needed to assure the proper outcome. The budgetary constraint the Fund faces should not be allowed to dictate the role and direction of the institution. It may well be that budgetary savings, perhaps substantial, can be found. But these issues should be treated in the correct sequence. The international community should first decide what it wants from the Fund; then the staffing and organizational requirements – and budgetary needs – to deliver on those responsibilities should be determined. Only then should the means be found, including possibly those suggested by the eminent persons group, to secure the resources needed to operate the institution.<sup>33</sup>

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<sup>33</sup> Unfortunately, this does not appear to be the process underway. Reportedly, efforts are being made within the G7 to strike a grand bargain whereby management of the Fund would accept a specific (and significant) cut in staff positions in return for support on some of its reform proposals. Perhaps this would force resolution of some of the questions about the appropriate role for the Fund and the associated staffing needs, but it seems a distinctly second-best way in which to deal with these important issues.

# 7 Conclusion

There is a need for a comprehensive vision of the role to be played by the IMF in the emerging global economic and financial system. The elements of needed reform are so tightly inter-linked that a piecemeal approach that deals with each element separately will not produce a coherent strategy. For example, the quota discussion needs to be better informed by agreement on the potential financing role of the Fund and the resources and instruments the Fund will need to fulfill that role. The governance issues confronting the Fund need to deal not only with the voting power of members, determined essentially by basic votes and quotas, but also with all the other factors that determine the effective representation of member countries in the institution. These include the size and composition of the executive board, the quality and seniority of executive directors appointed or elected to represent member countries, the way in which the various global agenda setting bodies, especially the G-8, deal with the broader representation in the Fund, and the way in which decisions are taken in the institution (e.g., the issues of special majorities or double majorities). These and other issues including the processes for selecting the managing director and deputy managing directors, as well as the important governance practices to hold management and the board accountable for the way in which the institution performs, will all affect the extent to which the Fund is accepted as legitimate by the membership and by other stakeholders. Obviously, issues of appropriate staffing levels and the organization of staff will have to be informed by decisions taken regarding the role the Fund is expected to play in surveillance, in financing, in assisting the low income countries, and in its role as a center of macroeconomic and financial policy experience and expertise, including as a provider of technical assistance. These considerations, in turn, will determine the staffing and budgetary requirements of the institution and will serve as input to any discussion of the Fund's income model.

This will be a complex task to pull all these elements together into a coherent vision for the institution. It will be even more difficult to secure broad agreement among the membership on such a vision. Right now, such broad agreement does not exist and the absence of agreement is weakening the institution and hindering its effectiveness. The world needs an effective IMF and that effectiveness will be secured only with a major effort to bring about the kind of reforms outlined in this paper.



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