



“IMF Reform from Another Angle – Towards a
More Responsive and Responsible Fund”

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1 Introduction

This meeting was organized jointly by the Brookings Institution (Wolfensohn Center), the New Rules for Global Finance Coalition, and the Friedrich Ebert Foundation (FES). The purpose of the meeting was to bring together the results of a series of regional caucuses in Africa, Asia, Latin America, and the Middle East on IMF reform and the views of experts from Washington-based think tanks and civil society organizations, government representatives and senior officials of the IMF.

This meeting and the others preceding it build on the premise that the IMF is at a critical crossroads and faces an uncertain future in the absence of fundamental reform. In this light, the discussions were viewed as one of a number of initiatives aimed at advancing the agenda of IMF reform by bringing the views of regional stakeholders in the IMF and the Washington-based policy community to the attention of those involved in the ongoing reform debate within the IMF. While some positive, but limited, reform steps were initiated at the recent Spring Meetings of the IMF, it is widely viewed outside the Fund that much more action on reform is needed.

The discussions were organized around three themes: 1) the current financial crisis and the role of the IMF at the global level; 2) the revisions to the surveillance, lending and advisory functions of the IMF that are needed to allow the Fund to accomplish its goals and objectives in the international system; and 3) the essential aspects of IMF governance reform that need to be addressed building on the recent completion by the IMF Independent Evaluation Office of its study on the IMF's governance structure.

This report provides a summary of the discussion and various proposals presented at the meeting, but it does not purport to serve as a consensus text of those who participated in it.

2 The Current Financial Crisis and the Role of the IMF at the Global Level

In the current financial crisis originating within the US sub-prime mortgage market, the IMF is viewed

as playing a largely unimportant role. At the recent Spring Meetings, the proposals on regulatory reform emanating from the Financial Stability Forum (FSF) were endorsed, but little or no follow-up action on the part of the Fund was determined. This outcome has raised a number of questions and challenges for the Fund: what should be its role vis-à-vis the BIS and FSF which have taken the lead at the global level in financial supervision and regulatory matters, but are dominated by the G7; how can the IMF upgrade its role in crisis prevention and management; and how can the IMF promote the re-engagement of emerging market economies (EMEs) which largely view the recent crisis as an indictment of the US approach to regulatory issues that implicitly had been endorsed by the Fund.

In the discussions, it was recognized that the IMF should strengthen its monitoring of international capital markets, although it was not clear how far the Fund could move in this area. As the leading global financial institution, the Fund should be making efforts to coordinate its activities more closely with those of the BIS and FSF and to build a network of contacts with national regulatory authorities. In this connection, it was suggested that the Fund could take the lead in convening meetings of leading regulatory authorities and policymakers from major countries to examine the causes and impacts of the current financial crisis. In this way, the Fund could be a catalyst for distilling the lessons to be learned from the current crisis and the best practices on regulatory issues that need to be promoted to minimize the risk of adverse spillovers and future crises. In this role, it would be following a well-established practice of the OECD in providing a forum for debate on issues of key interest to its membership.

In upgrading the Fund's role in crisis prevention and management, a number of proposals were advanced. The promotion of global financial stability needs to be set as a key objective in a reformed IMF, and the Fund needs to be equipped with instruments to assist countries facing financial shocks and to mitigate problems of pro-cyclical capital flows. To this end, the IMF should seek to strengthen its multilateral and bilateral surveillan

mechanism with a stronger focus on early warning signals of global financial risks, the linkages between financial markets and the real economy in individual countries, and the monitoring of country initiatives to improve regulatory practices¹.

In order to meet this objective, some participants argued that an upgrading of financial sector skills of Fund staff may be required, as well as a streamlining of internal work practices across departments. In this connection, downsizing may not be so much a priority for the Fund as that of rebalancing the skill-mix of the staff and re-aligning work priorities. At an operational level, emphasis was placed on the development of an emergency financing facility in the Fund to provide liquidity support to member countries facing financial shocks.

Participants in the regional meetings generally reflected an attitude of withdrawal of commitment to the IMF system on the part of many EMEs given their under-representation in the power structure of the Fund and a view that the costs of full commitment to the IMF system outweighed the benefits. In their view, further IMF governance reform was essential in order to increase their role and influence in IMF decision-making. It was also recognized that the IMF has a potentially important role to play in financing for EMEs and other developing countries in "bad times" when private capital flows may be diminished, thus reinforcing the need for an emergency liquidity facility noted earlier.

3 Reshaping Traditional IMF Functions of Surveillance, Lending and Policy Advice

In a world where member countries have many alternative sources of financing, at least during "good financial times", and where significant improvements have been made in their macroeconomic policy management, the challenge for the Fund is to maintain the relevance of its lending

operations and to adapt its surveillance function while enhancing its impact. At the same time, the regional meetings registered a clear call to maintain the Fund's technical assistance operations while adapting them more closely to deal with regional concerns and issues.

On the lending function of the Fund, while the crisis lending that started in the 1990s has been brought to a close with Turkey's intention not to renew its stand-by arrangement with the Fund, it was recognized that the risk of future financial crises has not been eliminated. In this sense, the Fund still has an essential financial role to play in being able to respond to member country needs in "bad financial times". However, some participants argued that the role of conditionality in Fund lending needs to be reviewed and greater emphasis given to the development of a true "lender of last resort facility" that would approximate the classic criterion of "lending freely at penalty rates of interest". It was also suggested that the Fund's exogenous shocks facility be expanded to enhance its flexibility in connection with PRGF lending operations.

Regional representatives also called attention to the interests of various regions in developing their own liquidity support mechanisms (such as the Banco del Sur and the Chiang Mai Initiative) that could supplement or be coordinated with IMF financial support packages. Again, the IMF's lending operations were seen as unique, as experience to date suggests that regional financial support arrangements have not been effective in exercising influence over the policies of members of those groups.

There was widespread recognition that the Fund's surveillance function needs to be upgraded. While it was noted that other institutions (e.g., investment banks, rating agencies) are providing market participants with macroeconomic analysis and assessments of major economies, the IMF is uniquely placed to provide periodic evaluations of member country macroeconomic positions and policies. However, more emphasis needs to be given to an evaluation of financial sector and other macroeconomic risks of countries, especially during boom

¹ In this connection, particular attention was drawn to the proposals to enhance the Fund's role in crisis prevention that were presented by the Australian chair at the recent Spring Meeting of the IMFC.

times, and of members' equilibrium exchange rate positions in order to identify more clearly situations of exchange rate misalignment. It was also suggested that the Fund should be refining its debt sustainability analyses and extending its analysis of cyclically-adjusted fiscal positions to cover debt and reserve positions of member countries.

Participants from the regional meetings also emphasized the need for the development of more regional expertise within the Fund staff and a focus on issues of regional policy coordination in its surveillance exercises. Such a change would be fostered by less staff turnover in country work, a greater presence of Fund staff "on the ground", and more recruitment of economists with experience in the regions covered by the Fund's area departments. These changes would also be helpful in allowing the Fund to support the interest of certain regions in developing their own country peer review mechanisms.

Various proposals were advanced to make the Fund's bilateral surveillance exercises more effective in influencing policy decisions in member countries. To this end, it was suggested that the Fund could urge more transparency in its Article IV consultation process by limiting a member's right to delete references in the consultation reports to market-sensitive information, e.g. on exchange rate issues, before publication. In addition, the Fund could be more aggressive in publicizing the views of the Executive Board at the conclusion of Article IV consultations. In such efforts, it was recognized that there is a tension between the Fund's role as a trusted policy advisor to member countries, based on the cooperative nature of the Board's activities, and its responsibility for identifying potential risks of a financial or macroeconomic nature in member countries.

On the Fund's role in monitoring members' exchange rate policies, some participants noted that there is a potential role for cooperation between the IMF and the WTO through the latter's dispute resolution mechanism to address issues of currency manipulation (i.e., exchange rate undervaluation) that might give rise to complaints by

one country of unfair trade practices on the part of one of its trading partners. Under the GATT/WTO system, there is a long-standing practice for the Fund to be called on to render opinions on a country's balance of payments and exchange rate arrangements.

In the area of the Fund's policy advisory role more generally, proposals were made that the Fund should be more attentive to the requests of various regions to provide inputs and analysis on issues of regional policy coordination (e.g. in the exchange rate area). In particular, in the case of low-income countries, some concern was raised that the Fund staff has not been effective in providing advice on poverty-related issues and in the development of policy frameworks supportive of growth and stability. It was also suggested that the Fund could play a role in advising countries on foreign reserve management, given the large reserve accumulation undertaken by many EMEs.

4 Governance Issues

The discussion on governance issues focused mainly on the conclusions and recommendations of a recent study by the IMF Independent Evaluation Office (IEO) of the Fund's governance structure. This study evaluated the Fund's governance arrangements against four criteria: effectiveness, efficiency, accountability and voice. Governance of the IMF was judged to be relatively high according to the first criterion and relatively low as measured against the criteria of accountability and voice.

In this light, the IEO study recommended a number of changes in the Fund's governance arrangements, including: (1) the conversion of the IMFC, which is an advisory body of the Fund, into an IMF Council with decision-making powers, as envisaged in the current Articles of Agreement; (2) a shift in the responsibility of the Executive Board to deal with more strategic aspects of IMF activities with less emphasis on its oversight of day-to-day operations; (3) the elimination of the distinction between appointed and elected Executive Directors which would allow all Directors to represent constituencies, thus improving voice and legitimacy within the Board and possibly reducing the

number of Director positions; (4) the establishment of an accountability framework for the Executive Board and the Managing Director of the Fund; and (5) the creation of a transparent and open selection process for the Managing Director and First Deputy Managing Director.

The IEO report was welcomed by participants and was considered to be an important contribution to the on-going debate on IMF reform. Notwithstanding the IEO's recognition of the Fund's efficiency and "rapid response" capability, some participants noted that the failure of the institution to call attention to the warning signals of the sub-prime crisis in the US and the criticisms over its handling of certain aspects of crisis management during the 1990s confirmed the need for a clear accountability framework for Management and Board of the Fund and more attention by the Board to the strategic aspects of Fund operations.

The recommendations on leadership selection in the Fund were seen as particularly timely, but some concern was raised that the IEO report did not address the governance issues of "voice and vote" associated with recent changes in quota determination, with a view to making further revisions to the quota formula and the distribution of quotas. However, others stressed that further action on voice and vote was not required until the next quinquennial review. Some questions were also raised about the potential conflicts created by establishing a new layer of decision-making authority in the Fund with the creation of an IMF Council.

It was also noted in the discussion that normal procedures for IEO reports to ensure effective follow-up on the implementation of its recommendations were not pursued in this case, in part because of the nature of the report and the view that the Executive Board and Management of the Fund would not be solely responsible for giving effect to its recommendations. In this particular case, it is the Fund membership at large which needs to reflect on the recommendations of the IEO and determine the actions to be implemented. However, in the absence of any timetable or precise follow-up mechanism, it was suggested that

the Board and Management of the Fund need to ensure that a timely decision-making process is pursued.

Other aspects of governance reform that were explored included the possible separation of the positions of IMF Managing Director and Chairman of its Executive Board, the selection of a non-European to be the next Chairman of the IMFC, and experimentation in the use of double-majorities (quota shares and countries) in the decisions of the IMF Council once it is established.

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More information is available at
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