CIGI/CIC Special Report

The Future of the International Monetary Fund: A Canadian Perspective

Edited by Bessma Momani and Eric Santor

CIGI The Centre for International Governance Innovation
Centre pour l'innovation dans la gouvernance internationale
Addressing International Governance Challenges

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Introduction and Overview of Recommendations

There is broad recognition that the International Monetary Fund (IMF) was unable to prevent the global financial crisis, and to some extent, resolve it in a timely manner. But at the same time, when the G20 took control of trying to contain the crisis, nations turned to the Fund to facilitate the global policy response. With its enhanced funding and renewed capacity, the IMF should be an integral part of reinvigorating the international financial system. Throughout the crisis, many changes have already taken place, such as introducing a new quick-disbursing lending instrument, the Flexible Credit Line (FCL), an augmentation of the Fund's resources via the New Arrangements to Borrow (NAB), and a US$250 billion allocation of Special Drawing Rights (SDRs). Despite these initiatives, IMF reform is far from complete and many issues remain unresolved, such as voice and representation, corporate governance, staffing, the use of IMF resources and the Fund's role within the global financial architecture. Failure to address these pressing issues will undermine the IMF's legitimacy and capacity to weather the financial crisis storm, and assist in returning calm to the international financial and monetary system.

IMF reform is well-traveled ground. Nevertheless, the financial crisis provides an unprecedented opportunity to re-examine the Fund's role and to discuss how best to equip it for the post-crisis world. The objective of this project was to bring together Canadian academics and policy experts in order to provide practical perspectives on IMF reform. The project considers a full spectrum of issues, and importantly, makes policy recommendations based on the group's analysis. These recommendations cover three main areas: the IMF's role within the international financial system, internal governance, and its instruments and resources:

1. **IMF and the International Financial System**
   - **IMF-FSB coordination**: IMF-Financial Stability Board (FSB) accountability and coordination needs to be improved to ensure that the Early Warning Exercise (EWE) is effectively delivered.
   - **IMF-WTO**: The IMF and the World Trade Organization (WTO) need better coordination, particularly on exchange rates, financial services, trade and finance policy review, and investment by state enterprises, including sovereign wealth funds.
   - **Decentralization**: In light of the financial crisis, the IMF's responsibilities will increasingly need to be shared with other institutions — most notably, the Bank for International Settlements (BIS) and the Organisation for Economic Co-operation and Development (OECD).
   - **SDRs**: Careful consideration of the role of the SDR by the IMF and its members, in the context of ensuring orderly functioning of the international monetary system and engagement by member countries, is needed.

2. **Governance**

- **Council of Ministers**: To provide direction, build trust and increase legitimacy, a council of ministers should be created to ensure that a political body sets the broad strategic decisions, appoints the managing director and has broad oversight of the international economy.

- **Executive Board**: The Executive Board needs to provide more detached oversight and less day-to-day management. There should be more board committees, a separation of functional responsibilities from management, and the managing director should not be chair of the Board.

- **Quota and Voice:** The IMF membership needs to increase the quota and voice of under-represented members. If members do not have sufficient voice, their commitment to the IMF and its mission will wane. Without the commitment of its members, the IMF's ability to maintain the stability of the international monetary system will be undermined.

3. **IMF Functional Reforms**

- **Technocratic Framework**: The IMF should enhance the autonomy of its staff to provide candid surveillance, advise on conditionality and avoid political interference by the Board. It needs to separate approval of lending from the oversight of the Board and management.

- **Staffing**: To enhance its staff's political-economy skills, the IMF needs to broaden its recruitment and staff training efforts. The IMF can change organizational incentives and, by extension, IMF staff behaviour.

- **Surveillance**: Surveillance should focus on coherent and sustainable macroeconomic and financial policy frameworks that preserve external stability. This includes assessing the direction and speed of real exchange rate (RER) adjustment and on the extent to which policies are permitting the RER to adjust, which are critical for external stability.

- **Lending and Resources**: Lending instruments and resources should reflect the IMF's mandate and focus on crisis prevention and resolution, both at the global and member-country levels; greater use of precautionary facilities, and standstills, should be encouraged.

- **Low-Income Country Lending**: The IMF needs to avoid mission creep into the World Bank and aid agencies' jurisdiction of developing poverty reduction policies. Instead, it should focus on short-term financial assistance, managing volatile capital flows and exchange rate issues.

The recommendations set out above are, to say the least, ambitious, and enormous political consensus is required if meaningful reform is to be achieved. Nevertheless, the IMF has a key role to play in the ongoing efforts to foster international financial and monetary stability. Simply, it is more important than ever that members continue in their efforts to ensure that the IMF has the proper mandate, role, governance, staff and tools to achieve its goals.

Strengthening International Regulatory Coordination: IMF/FSB Relations

Randall Germain

The crisis that has paralyzed much of the world's financial system since 2007 has revealed several significant regulatory problems that need to be addressed. Many issues are associated with regulatory practices in specific countries; however, some pertain to how financial firms undertake transactions and operate in cross-border markets. The response to the financial crisis has been predominantly national in focus; it has taken the form of national authorities (regulators, central banks, finance ministries) supporting financial institutions and markets as they operate within the context of national financial systems. Nevertheless, the international dimension of financial regulation has remained an important part of the policy mix because it is widely recognized that all national regulations require robust international support to be effective. To make the world's financial systems less vulnerable to disruption and more stable in their modes of operation, this international dimension must be strengthened.

The various organs of international financial stability and regulation encompass a plethora of institutions, organizations, committees and associations; these are public, private or are a hybrid of the two in their orientation. Therefore, it is critical to clarify and better organize the division of labour between these groups to maximize the design and actual delivery of effective, accountable financial regulation.

Two of the most important international institutions responsible for financial stability are the IMF and the Financial Stability Board (FSB). They are important for different reasons. The IMF is a formal international institution, universal in scope, with its own financial resources and expertise ready to be committed to countries in the event of a financial crisis. The FSB, however, cannot accurately be described as an "institution"; rather, it is a quasi-formal committee, unique among its peers in that it is the only venue that regularly brings together the key national and international agencies responsible for ensuring systemic stability across all major financial systems. Clarifying and strengthening how these two organs of international financial stability work together should be a priority for the international community.

At the G20 Summit in London in April 2009, the IMF and FSB were asked to work together to develop an early warning exercise to better protect the global financial system from disruption and crisis. This is an important start, even if there are many questions about the accuracy and effectiveness of such a system. Yet if the international community wants the international dimension of financial stability to be strengthened and better integrated with national regulatory initiatives, it must go further. It must, through the G20, identify the lead organization responsible for developing, coordinating and monitoring appropriate financial regulations, and decide which organization should be the main venue to provide the critical interface between national authorities and international agencies. On both counts, the FSB should be unambiguously tasked with providing leadership and the IMF with providing support.

The reasons for identifying the FSB rather than the IMF as the lead organization are both technocratic and political. Most importantly, the FSB possesses the fundamental prerequisite of being able to facilitate the interface between national authorities and international agencies. This ability is crucial because only national authorities can implement and enforce financial regulations; they need to be an organic part of the policy-development process. The IMF is not organized to foster the deep involvement of national authorities in regulatory policy development, and its charter and mandate have often pitted its officials against national counterparts. Ultimately, the IMF is designed to be an international financial institution and to this end, it has developed over its history an identity and ethos separate from any one national government, even if on many occasions it appears to be excessively biased towards the United States (US) and/or G7 countries.

The FSB, on the other hand, was designed from the start to foster precisely the kind of engagement between national and international agencies that a successful and effective international regulatory framework demands. Created as the Financial Stability Forum (FSF) in 1999, it brought together regulators, central bankers and finance ministry officials of the G7 nations for the first time. From April 2009, the FSB, the interface between these authorities, has been maintained and even deepened with the extension of its membership to parallel the G20 (along with additional relevant international agencies). Even though this expanded membership has grown far beyond the 20 or so representatives the early organizers envisioned as optimal, the benefits of having all of the key high-ranking players around one table is enormous. It has taken nearly a century of international financial governance reform to get to this point, which makes this an accomplishment worth noting.

The second reason for making the FSB the lead regulatory institution lies within one of its important political characteristics: the ability to accommodate international political change. Financial regulation, whether at the national or international level, is not simply a technocratic affair. It involves international politics insofar as specific regulations reward some forms of governance over others, and privileges some organizations and global financial concerns over their competitors. Furthermore, the rise and decline of entire economies cannot be divorced from diverse national financial governance practices. It is here where the FSB has proven itself better able to negotiate and accommodate the many differences stemming from the diverse ways national authorities govern their financial systems. This is partly due to the technical nature of the FSB and its origins, but also to the regulators' recognition of how systemic vulnerabilities are able to migrate from one financial system to the next. This is why at the first meeting of the FSF, it was expanded beyond the G7 to include Hong Kong, Singapore, Australia and the Netherlands, and why — after the inaugural meeting of the G20 in Washington in November 2008 — it was so easy to forge an agreement that the FSB should again be expanded.

In contrast, the IMF remains a much more constricted international organ of financial stability, less able to reform itself and less responsive to the changing dynamics of international politics. Part of this is bound up with the history of the institution and with the fact that it has actual resources to dispense — these are always going to provoke tensions among its members. Yet, the IMF is a much less politically adaptive institution. In many areas of endeavour this is not necessarily a problem, but it a burden with consequences in the fast-changing world of financial systems and their governance.

Given that financial regulation is disproportionately about marshalling and applying knowledge, as opposed to distributing resources to save financial institutions and systems — this is more properly crisis management, and falls more clearly within the remit of the IMF at the international level — it is logical that as much expertise as possible be brought to bear on the issues and questions confronting the world's financial systems. Coordinating regulatory practices, developing appropriate standards and codes, compiling and sharing information and most crucially, building trust among national authorities — whose principal remit is to enforce responsible behaviour onto financial institutions — are the most important tasks confronting policy makers who want to build a robust and durable international support structure for financial regulation. Directing the IMF and FSB to collaborate to develop an effective early warning exercise will help advance some of these tasks, but it is only a start.

The G20 should be pushed to identify a lead organization that will become the central organ of financial regulation. The argument has been made that the FSB should be so identified, with the IMF cast in a supporting (but not insignificant) role. This recommendation runs counter to the joint FSF/IMF Declaration of November 13, 2008, but this document is itself ambiguous about the real division of labour between the two organizations. The current global financial crisis has revealed that the division of labour needs clarification.

Finally, the G20 should convene a panel of experts — drawn from industrialized and developing economies, including regulators, private sector and civil society actors and academia — to consider the broader question of the regulatory division of labour at the international level. Its mandate should be to deliver a clear picture of who is responsible for what, and to recommend lines of authority to connect the architects of regulatory frameworks with the officials who implement and enforce them. Such a panel should have the mandate to examine the entire panoply of regulatory organs at the international level, and report back to the G20 within a suitable timeframe. Financial regulation is a complex set of affairs that has evolved piecemeal over many years. The last, partial, rethink was a decade ago; it is time for another holistic examination, while full knowledge of the consequences of letting things continue as before remains fresh in our minds.

Recommendations

1. The G20 should be pushed to identify a leading organization that will become the central organ of financial regulation. The argument has been made that the Financial Stability Board (FSB) should be so identified, with the IMF cast in a supporting (but not insignificant) role.

2. The G20 should convene a panel of experts — drawn from industrialized and developing economies, including regulators, private sector and civil society actors and academia — to consider the broader question of the regulatory division of labour at the international level.

Promoting IMF and WTO Cooperation

Debra Steger

The International Economic System

The original Bretton Woods organizations — the IMF and the International Bank for Reconstruction and Development (the World Bank) — were designed at the end of the Second World War to work together as a system to promote economic growth and prosperity, and to maintain peace. The International Trade Organization (ITO) was stillborn as the US administration did not complete the ratification procedure, and in its place, the General Agreement on Tariffs and Trade (GATT) was negotiated. It was not until 1995 that history was corrected and the World Trade Organization was established.

From the beginning, the IMF and GATT had some overlapping purposes. One of the key IMF functions, for example, is "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." Similarly, the preamble of the 1947 GATT recognized the goal of "raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods."

The respective mandates of the two organizations are different, although there are some overlaps with respect to the impact of trade policies on macroeconomic stability. The IMF was created "to promote monetary cooperation through a permanent institution," by promoting exchange rate stability, establishing a multilateral system of payments, eliminating foreign exchange restrictions and providing temporary relief to members with balance-of-payments difficulties. The GATT contracting parties were to enter into reciprocal, mutually beneficial arrangements "directed to substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce." In 1995, the preamble of the new WTO added the goals of "optimal use of the world's resources in accordance with the objective of sustainable development" and respect for the needs and concerns of members at different levels of development.

At the London Summit in April 2009, G20 leaders emphasized "the only sure foundation for sustainable globalisation and rising prosperity for all is an open world economy based on market principles, effective regulation and strong global institutions." Globalization has demonstrated that international finance, trade and investment are inextricably linked. It is imperative, therefore, that international economic policy be made by strong multilateral institutions acting cooperatively within a coherent system, rather than in separate silos. The world economy has been transformed by the rise of the emerging economies, and the international economic architecture needs to be redesigned to recognize new power relationships as a multi-polar world develops. The recent financial crisis has highlighted the urgent need for major reform of the international financial institutions, the IMF in particular, to give effective voice to all participants in the system. However, if there is to be a strong international economic system, the WTO must not be left out of this reform effort.

While an infusion of funds into the IMF to assist its members with economic difficulties is urgently needed, this in itself will not forestall future crises. There were a number of financial crisis in the 1990s, in Asia, Latin America and Russia. Global imbalances and pressures on the system will only increase if the international economic institutions are not strengthened and made more coherent. The financial crisis provides a unique, historical opportunity to reform the global economic institutions, to enable them to respond effectively to future challenges.

The IMF and WTO: Conflicting or Coherent Roles?

In the real world, monetary policies affect international trade flows and trade policies affect macroeconomic stability. The IMF and WTO have both influenced trade policy, but in different ways and from different perspectives. The IMF has encouraged unilateral liberalization of trade through its practice of conditionality in lending programs. In the WTO, members have negotiated reciprocal reductions of tariffs and non-tariff barriers and have bound their concessions in schedules. From the perspective of the developing countries, the IMF often had more power to influence domestic policies than the WTO because the former can lend money; however, the WTO has binding international rules with enforcement and shaming capabilities in the dispute settlement and trade policy review mechanisms.

In a recent report, the IMF's Independent Evaluation Office (IEO) found that, since 2000, the IMF has significantly reduced its involvement in traditional trade policy issues, especially with respect to conditionality. While this is a positive development, the IEO emphasizes that this "scaling back on trade policy advice came at the cost of constructive roles in trade issues central to financial and systemic stability." In particular, the IEO concludes that the IMF has not been active enough in financial services and preferential trade agreements with significant macroeconomic effects, and has not focused on the global effects of trade policies in systemically important countries, including the emerging economies.

There are areas of overlapping jurisdiction between the IMF and WTO which, if not appropriately coordinated, can lead to conflict. A key example relates to the two organizations' different approaches to trade liberalization. For many years, through its policy of conditionality, the IMF required certain members to significantly reduce their applied tariff rates on goods. In the WTO, as in the GATT, members reciprocally negotiate tariff concessions, binding the Most Favoured Nation (MFN) rates in their schedules. A result of these two policy actions is a great discrepancy in many countries between their bound MFN rates of tariffs in the WTO and the applied rates that they must impose because of IMF conditionality. This incoherence has made WTO negotiations on further reductions of tariffs very difficult, because concerned countries do not get credit or reciprocal concessions from other WTO members for reducing their applied rates.

Another area of overlap relates to balance of payments and foreign exchange measures. The GATT permits members, under specific circumstances, to impose trade restrictions for balance-of-payments reasons. The WTO recognizes that the IMF is the expert in these areas, and the agreements provide for consultation with the IMF on such matters. However, in practice, WTO dispute settlement panels do not always consult the IMF when such issues arise.

Moreover, during China's accession to the WTO, conflicts emerged over members' rights to use foreign exchange restrictions in the future. Similar conflicts have arisen between the prohibition on restrictions of capital transactions in the WTO General Agreement on Trade in Services (GATS) and the rights of members to impose such controls under Article VI of the IMF's Articles of Agreement.

The failure of both organizations to come to grips with the systemic implications of preferential trade agreements and financial services regulation are major omissions crucial to the world economy.

The Need for Greater Coherence

As the financial crisis has highlighted, it is not easy to draw lines of causation between monetary, finance and trade policies, but it is clear they interact and can contribute to, or detract from, economic stability. A need exists for greater formal cooperation and coherence in international economic policy making among the responsible international organizations. In the early days, the WTO and IMF cooperated. In 1996, the two organizations signed an agreement on cooperation. In 1998, the heads of the organizations, together with the World Bank, agreed to a joint statement on coherence. While the IMF has significantly more resources than the WTO, the WTO on several occasions has asked for IMF studies on key matters of mutual interest and relied upon IMF surveillance reports to prepare its Trade Policy Reviews on member countries. In the early 2000s, the IMF had a small office in Geneva and a division in its headquarters dedicated to trade policy. Through this office, the IMF participated as an observer in important WTO meetings and negotiations. However, in 2008, both the Geneva office and the Trade Policy Division were eliminated.

The level of cooperation between the two organizations reached its peak in the first few years of the WTO and has since steadily declined. In key areas, the IMF and the WTO have missed opportunities for collaborative action. Surprisingly, the IMF played a relatively insignificant role in the Integrated Framework and Aid for Trade technical assistance initiatives. IMF surveillance reports are prepared without consultation with the WTO, and the WTO dispute settlement panels have not consulted the IMF on issues within its competence. To make matters worse, both organizations have failed to work together to promote liberalization of trade in financial services and to examine the effects of preferential trade agreements on the stability of the international economic system.

The Consequences of Inaction

As international finance and trade become more complex and interconnected, the need is greater for strong global economic institutions with effective oversight capabilities. Central to their effectiveness and efficiency will be their abilities to cooperate and collaborate to make international economic policies coherent.

The potential for conflict is serious. Take, for example, China's valuation of its currency, which it has pegged to the US dollar. This policy has led interest groups in the United States to complain that China has manipulated its currency contrary to WTO rules. While the IMF clearly has the jurisdiction to deal with exchange rates, the WTO has rules and a binding dispute settlement mechanism. There have been conflicts in the past between WTO and IMF rules. However, if this case were brought forward, it could have very serious consequences for both the international financial and trading systems.

Clearly, there is a need for enhanced cooperation between the IMF and WTO. Areas for more intensive cooperation include: trade in financial services, surveillance of members' trade and finance policies, the impact of preferential trade agreements on the global economic system, aid for trade and technical assistance, and exchange rate policies. To build strong, legitimate international institutions, leaders should make serious commitments to reform the IMF and WTO governance structures to ensure they are accountable, representative, effective and efficient in the future.

Recommendations

1. The WTO must be a part of the reform to the wider international economic system.
2. The IMF needs to be more active in financial services and preferential trade agreements.
3. Increase formal cooperation and coherence in international economic policy making, particularly between international organizations.

Decentralization of the International Financial System: The IMF, BIS and OECD

Tony Porter

The institutions responsible for governing international money and finance have evolved very differently than might have been predicted in the middle of the last century when the IMF was created. At that time, formal intergovernmental organizations were considered the best means for governments to cooperate in addressing international problems. A series of such organizations were created or significantly strengthened. Intergovernmental organizations were created for major issues that require coordinated governance responses. The IMF had a strong, distinctive role in international monetary affairs. Today, however, the most prominent feature of global governance has instead been its increasing reliance upon informal institutions, often with complexly overlapping areas of responsibility. Many governance functions that might otherwise be managed by the IMF have been carried out through informal intergovernmental groupings such as the G7, G8, G20 and the regulatory groupings at the Bank for International Settlements (BIS).

While the idea of restoring the IMF to its earlier, more exclusive, dominant role might seem like a reasonable response to the governance failures that the current financial crisis has revealed, this would be a mistake. IMF reformers should consider carefully how the IMF can complement and share responsibility with other types of institutions that will continue to play a key role in governing international money and finance. As well, the IMF should seek to build some of the complexity and informality evident in the work of other international institutions into its own structure. Two intergovernmental organizations whose work is particularly close to the IMF, the BIS and Organisation for Economic Co-operation and Development (OECD) are especially worth consideration.

There are many reasons to support this trend toward greater reliance on decentralized, informal and complex arrangements with greater involvement of non-state actors, not just in monetary and financial affairs, but in global governance more generally. These decentralized arrangements address the limits of centralized "command and control" in coping with complex, rapidly changing environments; they promote greater effectiveness and legitimacy by drawing on the capacity of actors outside formal government processes to contribute to governance; and, they make good use of how information, communications and transportation technologies have allowed more horizontal, informal and networked governance arrangements to operate globally.

The OECD and BIS deserve particular attention for the lessons they provide to the IMF on how formal intergovernmental organizations can work with decentralizing trends in global governance. They also provide examples of monetary and financial governance capacity outside the IMF, which could be further strengthened. The OECD's well-developed peer review process, which it pioneered in the early 1960s and which considers macroeconomic policy, is similar to the IMF's surveillance function. In addition to its more informal work on emerging financial issues, the OECD has played a key role in investment and financial services through its hard law Code of Liberalisation of Capital Movements and Code of Liberalisation of Current Invisible Operations. Due to its "whole of government" character, the OECD is especially well positioned to address financial issues with a social dimension, such as pensions. The BIS hosts regulatory committees that set standards and involve informal mechanisms of peer accountability on financial regulation issues. In addition to the Financial Stability Board and the Basel Committee on Banking Supervision, the BIS hosts the Committee on the Global Financial System, the International Association of Insurance Supervisors, the Committee on Payment and Settlement Systems, the International Association of Deposit Insurers and the Joint Forum. Historically, the BIS has also facilitated swaps between central banks to help manage imbalances. Both the OECD and the BIS have professional staffs which help produce reports and statistics on the global economy that overlap with the IMF's.

The ways the BIS and OECD have managed decentralizing trends in global governance provide useful lessons to the IMF. Both organizations have displayed greater flexibility than the IMF in sponsoring informal issue-specific structures, including the regulatory committees the BIS hosts and the committees, forums, networks, working groups and roundtables the OECD created. Both organizations also routinely bring senior officials from national governments together with their own staffs to a much greater degree than does the IMF. National officials play a leading role in the work of the BIS-based committees and about 40,000 senior national officials attend OECD committee meetings each year. Work methods at both the BIS and OECD involve identifying best practices by bringing together the practical experiences of officials with research carried out by the organization's secretariat. These work methods help make the resulting research and guidelines more sensitive to variation in problems across countries and issues.

Neither the BIS nor the OECD have the near-universal membership of the IMF, but there are also useful lessons in how both organizations have reached beyond their original membership. The BIS's 55 members now extend well beyond the original Western European base to include an additional 37 countries. Moreover, the BIS has offices in Hong Kong and Mexico. Although the committees it hosts tend to have exclusive memberships, they increasingly involve non-members informally in their work. The Basel Committee on Banking Supervision has established relations with regional bank supervisory groups that together cover most of the world. The OECD has plans to expand its membership beyond 30. In 2007, the OECD started accession talks with Chile, Estonia, Israel, Russia and Slovenia, and it offered enhanced engagement, with a view to possible membership, to Brazil, China, India, Indonesia and South Africa. It has created a wide variety of vehicles to facilitate collaboration with non-members, including selective invitations to participate in the main committees and groups. It has also created forums, networks and roundtables, often working together with regional and other international institutions, in which non-members and non-state actors participate. The OECD has institutionalized participation from business and trade unions and has created mechanisms to involve other non-governmental organizations as well as parliaments (for example, through its Network of Parliamentary Budget Committee Chairs).

Rather than attempting to restore the IMF to the relatively exclusive, autonomous and dominant position in international and monetary affairs that one could have imagined when it was created, the IMF should adopt more of the flexibility and engagement with decentralized governance practices that have been evident in the BIS and OECD. This should include more efforts to involve national officials, collaborate with other international organizations and non-governmental actors, and experiment with new informal organizational arrangements. This is especially important for the IMF's surveillance and technical assistance functions, but such efforts could be applied to the IMF's lending function as well. It should also further strengthen its relations with other institutions that play key roles in monetary and financial governance, including the BIS and OECD.

To prevent the IMF from obstructing change and to allow tasks to be allocated to other institutions when the IMF is underperforming, it is important to maintain and further develop alternative channels for IMF to launch, endorse and implement programs as it is reformed. It is crucial to reform the governance of the IMF to restore its credibility and allow it to play a more effective role in global monetary and financial governance. With its near universal membership and formal structure, it has a distinctive role to play in legitimizing the rules and initiatives it manages. However, past perceptions of its biases, inflexibility and lack of accountability, and its slow pace of reform have highlighted the reasons why it should not become the only governance mechanism in international monetary and financial affairs. The surveillance or peer review capacities and technical assistance programs that exist at the OECD, BIS and other institutions such as the New Partnership for Africa's Development should be strengthened to complement and compete with the IMF's. Further development of alternative financing arrangements should be undertaken, for instance, through central banks at the BIS or the Chiang Mai Initiative. The IMF should work with and encourage these alternatives.

On high-level policy matters, the G20 provides a useful alternative governance mechanism to the IMF. The role the G20 plays in asking other institutions to take on tasks should grow, but the influence of states and regions not adequately represented in the G20 should be strengthened in existing or new formal or informal organizations. These organizations can serve as vehicles to propose policy initiatives or to endorse or criticize initiatives from G20, the IMF or other bodies. The G20 should increasingly consult and collaborate with groups outside of its membership, and governments outside the G20 should work to develop such groups. The incentive that states and international institutions have to allow a group or institution to take the lead where exclusive or centralized control will work to minimize the duplication, fragmentation and confusion that might otherwise accompany decentralized arrangements. The benefits of decentralization, including flexibility; sensitivity to variation across regions and issues; and the wider mobilization of the resulting knowledge, finance and policy inputs outweigh the risks of these problems, and the risks of relying too exclusively on the IMF.

Recommendations

1. The IMF should consider how the IMF can complement other institutions and share responsibilities with them.

2. The IMF should build complexity and informality into its structure.

3. The IMF should be more flexible and engage in decentralized governance practices, involving a wider range of actors, including national official, international organizations and non-governmental actors.

4. Maintain and further develop alternative channels to launch, endorse and implement programs.

The IMF and the SDR: What to Make of China's Proposals?

Eric Helleiner

Special Drawing Rights (SDR) are suddenly an important issue in IMF reform debates. At past moments of US dollar weakness in the late 1960s, and early and late 1970s, the SDR also received a great deal of considerable attention. This time around a new voice – Chinese central bank governor Zhou Xiaochuan – played the lead role in placing the issue on the international policy agenda.

In a paper released a few weeks before the London G20 Summit in April 2009, Governor Zhou advocated strengthening the SDR's role in the international monetary system. The paper provoked some strong reactions. Some saw it as an unusually aggressive and blunt challenge to US power and an effort to replace the dollar with a global monetary union. At the other extreme, the paper was dismissed cursorily as an irrelevant attempt to deflect international criticism of Chinese economic policy.

Both of these reactions missed the mark. Zhou's proposals were not designed to revolutionize the world through some kind of world monetary union, but neither were they irrelevant. While Chinese officials no doubt have tactical political reasons for raising the SDR issue, they are offering some very practical policy proposals that deserve serious consideration in debates about the IMF's future. Some are in fact already being implemented and others are endorsed by some of the world's leading economists. Indeed, if anything, the Chinese proposals are more limited than those put forward by many others at the moment.

Determining the SDR's Value

Many of the reactions to Zhou's proposals lacked careful attention to the actual detailed content. His most straightforward and simplest proposal concerns the valuation of the SDR. At the moment, the SDR is valued according to a basket of four currencies: the US dollar (44 percent of the basket), the euro (34 percent), the yen (11 percent) and sterling (11 percent). Zhou proposed that "the basket of currencies forming the basis for SDR valuation should be expanded to include currencies of all major economies, and the GDP may also be included as a weight."

In any event, the SDR's value is due for review in 2010. At the time of the last review in 2005, the role of the four SDR currencies was justified on the basis that their countries had the largest value of exports and they were freely available (while weighting was determined by export value and the amount of other countries' reserves denominated in each currency). But the basket has changed over time; in the 1970s, for example, 16 currencies were involved.

Proposals for a wider and reweighted basket should be discussed in the upcoming review. It is important for the SDR to reflect changes in the relative importance of internationally used currencies. A wider basket might also enable the SDR to serve as a more stable monetary anchor at a time when the relative values of the world's major currencies may well become more variable.

The Allocation of SDRs

Zhou also called for a new SDR allocation and for the approval of the 1997 Fourth Amendment of the IMF Articles of Agreement which allowed for a special one-time allocation of SDR 21.4 billion (in order to bring the cumulative allocation of SDRs of each member in line with its quota share). Both goals are already being realized. In June, the US Congress approved the Fourth Amendment, paving the way for its implementation. The next month, the IMF's executive board approved a new SDR allocation and on a much more ambitious scale than Zhou probably anticipated: approximately SDR 150 billion (US$250 billion).

This new allocation is the largest allocation of SDRs ever (the previous allocations in 1970-1972 and 1979-1981 totaled SDR 21.4 billion) and it will raise the share of SDRs in the world's non-gold official reserves from less than 0.5 percent to about 5 percent. One of Zhou's rationales for a new SDR allocation was similar to those that motivated other G20 leaders: it will help buffer countries from balance-of-payments shocks in the context of the severe global financial crisis.

Zhou also put the case for more SDRs in the broader context of the Triffin dilemma that justified the SDR's creation in 1969; that is, the dilemma that the reserve currency country must provide liquidity to the world while ensuring the stability of its currency. Reiterating this case, Zhou noted that a "super-sovereign reserve currency" like the SDR could be managed "according to a clear set of rules" in order to "ensure orderly supply" without reference to any individual country's distinctive domestic goals or balance-of-payments situation.

A limitation of Zhou's proposal is that he does not follow up this point with any discussion of the content of possible "rules" for SDR allocation. The UN's Stiglitz Commission has been more ambitious, suggesting that SDRs could be allocated either on a regular (for example, annual) and automatic basis, or counter-cyclically with allocations concentrated during crises (or IMF crisis loans could be made in SDRs that would then be removed when the loans were repaid).

Zhou also failed to address the equity issue that SDRs are presently allocated in proportion to countries' IMF quotas. Many developing countries have objected to the very large share of new SDR allocations going to wealthy industrialized countries that need them least. The Stiglitz Commission discusses alternative allocation principles on the basis of GDP or some measure of need, as well as the possibility of investing SDRs in the bonds of multilateral development banks.

An IMF Substitution Account

Zhou's only comment concerning SDR allocation rules is that they could "be shifted from a purely calculation-based system to a system backed by real assets, such as a reserve pool, to further boost market confidence in its value." This recommendation seems to reinforce his broader proposal that the IMF manage a portion of countries' reserves by setting up "an open-ended SDR-denominated fund based on the market practice, allowing subscription and redemption in the existing reserve currencies by various investors as desired."

Proposals for an IMF fund of this kind are not new. Between 1978 and 1980, policy makers discussed in detail the creation of an IMF "substitution account," which would allow national monetary authorities to exchange dollar reserves for SDR-denominated reserves. Because the exchange was off-market, it would have enabled a diversification of reserves without provoking a dollar collapse at the time. This outcome appealed not just to many dollar-reserve-holding countries, but also to many US officials who feared the "dollar overhang" and the risk of a dollar crisis.

Some experts dismiss Zhou's attempt to revive the substitution account idea as simply an effort to get the IMF and/or world community to share the exchange rate risks that China has assumed by accumulating such large dollar reserves. But the important question from the standpoint of other countries should be whether the initiative will also provide benefits to them and the global system as a whole; that is, whether the proposal is positive sum. Prominent economists such as Fred Bergsten make a strong case that the substitution account will indeed benefit other countries and speak to some systemic needs in the current global predicament.

Bergston highlights the risks to the US and the world as a whole if the large, dollar-holding countries choose to dump their dollar reserves unilaterally. Echoing the case made in the late 1970s for a substitution account, Bergsten argues that disorderly selling of dollars by large reserve holders could generate a sudden dollar collapse that is in no one's interest, including the euro zone whose currency would likely rise dramatically in that event. Indeed, from a political economy standpoint, the risks may be even higher today than in the late 1970s when the key official dollar holders were all close US allies.

The political dilemma, however, is how to share the exchange rate risk that a substitution account would assume if the dollar sinks in value. This question ultimately sank the 1978-1980 negotiations, but it is not insurmountable. If the account lost money, Bergsten notes that the difference could be made up by the IMF's gold reserves or even by new SDR allocations. Given the mutual benefits to be reaped, one could also imagine the US, the large-dollar reserve holders, and Europe reaching a deal on sharing the exchange rate risks assumed by the Fund.

More generally, Bergsten argues that creating a substitution account may provide the opportunity for a broader tripartite deal on IMF reform. He suggests that US endorsement of a substitution account could be accompanied by a greater Chinese contribution to the Fund and a European acceptance to give up some of its quota share to China. It would also be useful to try to include in such a deal provisions to strengthen IMF surveillance of major economies (as a way of minimizing the exchange rate risk to the Fund).

Making the SDR a More Attractive Reserve Asset

The IMF's decision in June to issue non-marketable SDR-denominated bonds to the BRIC countries provides them with an alternative tool for diversifying their reserves in an off-market manner. But, of course, these bonds are not a very liquid form of reserves for national monetary authorities. Neither are SDRs more generally, a situation that Zhou, in his final recommendation, suggests should be addressed.

Zhou recommends broadening the "scope" of the SDR's use at both the official and private levels through initiatives such as issuing of SDR-denominated bonds; establishing "settlement system between the SDR and other currencies"; and generally promoting SDR use "in international trade, commodities pricing, investment and corporate book-keeping."

These are perhaps the most ambitious of Zhou's proposals. Past efforts to make the SDR a more liquid reserve asset have achieved few results. There is still no private market for SDRs. Various economists have made proposals similar to Zhou's over the years. Barry Eichengreen has suggested the IMF needs to take on the active role of a market-maker, buying and selling SDR claims at narrow spreads that are competitive with those for dollars. These various ideas are worth discussing, but it is important to recognize that the goal of making the SDR a more attractive reserve asset will not be achieved quickly or easily.

Taking Zhou's Proposals Seriously

Governor Zhou's various proposals deserve serious consideration not just on their merits, but also because they have broader political significance. China's frustrations with the existing international monetary system are resonating with many other countries at the moment, including many key powers in the G20. These frustrations could be channeled in several directions, some of which could result in a much more disorderly and unstable world economy. In this political context, it is desirable that pressure for change is directed towards multilateral solutions involving the IMF and help to restore that institution to a more central role in the governance of the international monetary system.

Zhou's proposals for the SDR are very much in this spirit. His thinking follows a tradition of multilateralists from Keynes to Triffin, and sets out some practical ways to work towards the goal laid out in the Second Amendment of the IMF's Articles of Agreement of making the SDR the "principal reserve asset in the international monetary system." Zhou's paper should thus be welcomed as a signal of China's growing willingness to embrace multilateral solutions to global monetary issues. Foreign dismissals of his ideas risk pushing Chinese policy makers in other directions and diminishing the prospects that the IMF will remain an important forum for discussing these and other international monetary reform issues.

Recommendations:

1. Encourage the IMF to engage Governor Zhou's proposals relating to Special Drawing Rights (SDR) valuation, establishing a substitution account and broadening the scope of the SDR's use.

2. Link debates about an IMF substitution account to broader discussions about IMF quota reform, new funding for the IMF, and strengthening IMF surveillance of major economies.

3. Ensure that the IMF remains an important forum for discussing other proposals for international monetary reform, including those put forward by the Stiglitz Commission and others.

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The Role and Place of the Council of Ministers in the IMF's Future

Thomas A. Bernes

Despite massive changes in the global economy and in the IMF's role since its creation in 1945, the basic governance structure set in place at that time remains largely unchanged. The IMF's original role was important, but much more limited than it is today. At that time, the international monetary system was based on a system of fixed exchange rates; the IMF's role was to approve changes in national exchange rates and, when appropriate, provide financing to countries facing emergency balance-of-payments problems until they could adjust their economies. The power to make decisions, which were largely technical, was delegated to executive directors in Washington, and ministers met annually to review developments. It was a time when easy and instantaneous communications between capitals and Washington did not exist and executive directors were left alone to make decisions.

The world has changed dramatically since then. In the 1970s, the system of fixed exchange rates gave way to a world of floating rates. IMF membership grew from 44 countries to 185. The explosive growth in capital flows led to new interdependencies, as seen in the current global financial crisis. The Fund also took on a new role in the surveillance of its members' macroeconomic policies and in helping to elaborate a set of standards and codes, which governments were encouraged to apply to a whole range of economic activities. Moreover, communication between capitals and IMF headquarters has become instantaneous due to improvements in communications technology. IMF governance structures, however, have remained basically unchanged.

When the fixed exchange rate system collapsed in the 1970s, a series of ad hoc ministerial and senior official meetings were convened to create a new system. This task was not left with the Executive Board. A Council of Ministers to oversee the new global system was envisaged to come into force at a later stage. Unfortunately, the necessary political consensus to bring the Council into existence has remained elusive until today.

The result has been that the G7 were left to respond to financial crises in Mexico, Russia and Asia in the 1990s. In the aftermath of the Asian crisis, emerging economies came to view the IMF as lacking legitimacy and as an agent for the G7 countries. The massive build-up in foreign exchange reserves by Asian and other large emerging countries in recent years was, in part, a means by which to help ensure these countries would not find themselves again in the position of having to implement policies demanded by an unrepresentative body.

As the world responds to the current global economic crisis, political leadership has been similarly assumed by the G20; the IMF has been expected to implement decisions made elsewhere without the full participation of its membership. Current IMF decision-making structures have not built trust, confidence or legitimacy across the membership. This failure has impeded timely, effective responses to major policy challenges and generated the systemic use of informal processes that undermine good governance.

Part of the problem rests with the IMF's system of weighted voting, with country voting rights based on a world that has long since changed and evolved. A major negotiation last year to correct this problem resulted in only marginal changes many observers dismissed as meaningless. To ensure a more balanced representation of all Fund members, the IMF's legitimacy as the centre of decision making regarding the international monetary system must be enhanced; its ability to set its own strategic direction must be strengthened; and it must be held accountable. This cannot be achieved by a group of senior officials sitting as the Executive Board in Washington, lacking the political and moral authority to make commitments for the countries they represent. Rather, as called for both by the IMF's Independent Evaluation Office and *the Report of the Eminent Persons' Group* (chaired by Trevor Manuel of South Africa), this can best be achieved by creating a Ministerial Council. The Council would set the IMF's strategic direction with full buy-in by their respective countries, hold management accountable for implementing these directions effectively and, in turn, the ministers could be held accountable for their decisions.

The Manuel Report proposed seven specific functions for the Council. It would: discuss policy coordination when needed (as in the current crisis); establish new financing facilities; build consensus on the set of norms and standards to which all members subscribe; launch rounds of multilateral consultations, including regional surveillance; identify emerging risks and provide a forum for discussing and coordinating systemic macro and financial policies; review key management and Board decisions, thereby increasing accountability; and, appoint the managing director through an open and transparent process.

Within the IMF's governance structure, the Council would provide political representation at the strategic level and a more direct political voice to articulate the Fund's decisions. The Council would acquire legal powers, unlike the current ministerial body — which is only advisory — to make the strategic decisions that constitute the general legislative framework for the Fund. Its functions would include engaging in policy coordination and reacting to emerging risks. The Funds managing director would be responsible for operational decisions, notably the application of surveillance legislation in country-specific cases. The Executive Board would then: operate with a more focused mandate centred on overseeing the work of the managing director and staff, thus enforcing accountability; advise the Council on strategic decisions and prepare its work; decide on the use of Fund resources; and make decisions on internal matters with major financial implications.

The Council would perform the functions which are performed by the political leadership at the national level and thereby bring this necessary element of political voice and accountability to the international level. Failure to do so will result in the IMF's continued lack of the legitimacy necessary to carry out its functions effectively and could leave leadership in the hands of bodies that are not transparent, accountable or broadly representative.

Recommendations

1. The IMF must enhance its ability to set its own strategic direction and be more accountable.
2. Set strategic direction at the IMF through the creation of a Ministerial Council.

Improving the Accountability and Performance of the Executive Board

C. Scott Clark

The global recession, the financial market meltdown and the G20 have opened the door for the IMF to re-establish itself as the world's preeminent multilateral financial institution. It remains to be seen whether the IMF will take this opportunity.

At its April 2009 meeting in London, the G20 backed a major increase of US$500 billion in the Fund's financing capacity and an issue of US$250 billion of Special Drawing Rights (SDRs), the Fund's quasi-money. The IMF managing director, Dominique Strauss-Kahn, "welcomed the commitments made by the G20 nations… to enhance the Fund's ability to support emerging markets and low income countries, and to boost global liquidity." The IMF website is now full of information on how a changing IMF is responding to the crisis.

But there is an important corollary to this financial support and possible new role for the IMF. In return for its support, the G20 wants a renewed commitment to governance reform from the IMF. Simply put, the G20 knows that without major reforms to the Fund's governance framework, the IMF cannot play a key role in global financial and economic matters. It simply would not have the required legitimacy, effectiveness and institutional capacity.

The IMF has recognized its need for governance reform for some time, but there has been little progress to date. This is not surprising given that there have been three managing directors in nine years. Without consistent, strong leadership, it is difficult to make progress on anything in a multilateral institution. At the spring meetings, most International Monetary and Financial Committee (IMFC) members spoke of the need for governance reforms. The US secretary of the Treasury summed it up by stressing: "the IMF needs a more representative, responsive and accountable governance structure. This is essential to strengthening the IMF's legitimacy, ensuring that it remains at the centre of the international monetary system, and reflects the realities of the 21st century."

There has been no shortage of recommendations on how to reform the governance of the IMF. Most of the recommendations have been focused on quotas and voting power. This is not surprising given the absurd anomalies that currently undermine the legitimacy of the Fund. The G20 agreed at its April meeting to accelerate quota reform to early 2011, a decision which the IMFC endorsed at its spring meeting.

Although quota and voice reforms are perhaps the most important, other governance reforms must also be implemented to improve the IMF's efficiency and effectiveness. The most comprehensive review of these other reforms was prepared by the IMF's Independent Evaluation Office (IEO) and released in the spring of 2008. The IEO did not examine the quota and voice issues, as these were being considered in other fora. In response to the IEO report, the IMF's managing director commissioned a Committee of Eminent Persons on IMF Governance Reform, resulting in the Manuel Report.

Both reports included recommendations for major changes in the structure and operation of the Executive Board. The IEO concluded: "The Board's effectiveness is hindered by excessive focus on executive, rather than supervisory, functions. The Board should reorient its activities towards a supervisory role, playing a more active part in formulating strategy, monitoring policy implementation to ensure timely corrective actions and exercising effective oversight of Management." The authors of the Manuel Report agreed with this conclusion, recommending "[t]he elevation of the Executive Board from day-to-day decisions to giving advice on strategic issues to the Council…."

Changing the long-held operational orientation of the Board will not be easy; old habits die hard. According to the IEO, the IMF Executive Board "has only limited involvement in many of the functions that are commonly associated with a supervisory Board, notably fiduciary oversight (including financial management, risk management, and preventing misconduct and conflict of interest), and oversight of human resources and administrative policies." The IEO concludes: the Board has not played an active role in strategic planning or in assessing the performance of management and holding management accountable; the Board meets too frequently and does not allocate its time among work priorities effectively; attendance by directors at Board meetings is poor; the Board does not make effective use of independent Board committees; the tenure of directors is too short; and directors lack necessary experience and skills.

Without major changes in the composition, structure and operation of the Board, there is simply no way it could play an effective supervisory role. The IEO has made some very useful and practical recommendations. The IMF should act quickly to adopt them.

First, the Board should be reduced in size. This will not be easy to achieve. It would require the consolidation of European country chairs and, not surprisingly, European countries feel the current size of the Board provides just the right balance between effectiveness and representation. The US, on the other hand, has proposed "reducing the size of the Board from 24 to 22 chairs by 2010 and 20 chairs by 2012, while preserving the existing number of emerging market and developing country chairs." The authors of both the IEO report and the Manuel Report recommend that all director positions should be elected, replacing the five appointed directors for the five largest shareholders. Such elections may help reduce the size of constituencies, but it is highly unlikely these countries, particularly the US, would want to form constituencies.

Second, the Board should make greater use of independent Board committees. Currently, management chairs most of the Board committees and the managing director, in consultation with the dean of the Board, chooses the membership of the committees. This would have to change. If the Board is to play an independent and effective supervisory role, it should choose both the chair and membership of committees. The Board would delegate work to the committees and meet less frequently (for example, possibly twice a month). In the IEO survey of current and past directors, almost two-thirds felt that Board committees could be effective if significant changes were made to their structures and operations.

Third, directors should be appointed for longer terms and meet a strengthened set of qualifications. Currently, directors are elected for two-year renewable terms, while the five appointed directors can serve until recalled by their governments. The IEO study found that between 1990 and 2007, the median term in office for all directors was only 23 months. This is hardly long enough to learn how to effectively do a job, let alone make a meaningful contribution to the operation of the IMF. Some observers believe that directors who stay too long are "captured by the staff." This would not likely happen in a truly independent supervisory Board. At a minimum, directors should be elected for three-year renewable terms.

Not surprisingly, most directors surveyed felt they had the knowledge and diplomatic skills required to be a director. Unfortunately, knowledge of financial sector issues was not one of them. The depth and breadth of knowledge, and the level of seniority and experience in policy and decision making, varies widely among directors. There is no assurance that directors are selected on the basis of merit, rather than as a reward for previous service or simply as a means of preparing them for retirement. The IEO recommends a standardized job description that authorities could use in selecting candidates.

Fourth, the Board needs to evaluate itself regularly. If the Board is given a new supervisory role, including the role of assessing management performance and holding management accountable, an independent third party should evaluate the Board on a regular basis. This is essential if the Board is to be held accountable.

Fifth, the Board should exercise its existing responsibility of assessing management performance and holding management responsible. According to the IEO, 80 percent of current and former directors surveyed thought the Board was not sufficiently involved in management performance assessment; 75 percent felt the Board did not have any say in holding management accountable. This is a poor reflection on one of the primary functions of any Board.

Finally, and perhaps most importantly, the managing director should not be the chairman of the Board. Neither the IEO nor the Manuel Report made this recommendation; notwithstanding, it is one of the most basic principles of Board governance. Under this recommendation, the chair of the Board would be appointed by the new Council of Ministers on the basis of merit, and the performance of the chair would be reviewed, along with that of the Board, by an independent third party.

Perhaps the reason this recommendation was not made is that it has little chance of being implemented, since it would truly create a strong, independent Executive Board on a level equal to that of management. The elevation of the Board in independence and influence would go a long way to ensure a high quality of directors. No doubt management would fight strongly against this perceived erosion of its power. The Board would become divided, if it is not already, and this would weaken the chances of successfully implementing any reforms of the Executive Board.

The biggest obstacle to reforming the Executive Board and making it more effective, accountable and independent is the Board itself. It is unrealistic to think the Executive Board, with its operational culture and deeply entrenched political interests, can reach a consensus on any of the above recommendations. Reform will have to be imposed on the Board from "above" by a new Council of Ministers.

There is a final corollary that flows from a failure to reform the Board. Without effective reforms, serious consideration must be given to establishing to a non-resident Board. In effect, this would simply reflect recognition of what is already happening through technology and real-time communication. It would also save the Fund approximately US$60 million a year.

Recommendations

The IMF should adopt the following recommendations by the Independent Evaluation Office (IEO):

1. The Board should be reduced in size.
2. The Board should make greater use of independent Board committees.
3. Directors should be appointed for longer terms.
4. The Board needs to evaluate itself regularly.
5. The Board should exercise its existing responsibility of assessing management performance and holding management responsible.
6. The managing director should not be chairman of the Board.

IMF Quota Reform: Where Do We Stand? Where Do We Go?

James A. Haley*

Not so long ago, the IMF was widely viewed as at risk of sliding into irrelevancy. Fund resources outstanding were shrinking, as members repaid IMF advances ahead of schedule, prompting management to initiate a voluntary downsizing to align operating costs with a declining expected income stream. Staff members that had been attracted to and tempered by the pressures of program work — grizzled veterans of the 1980s debt crisis, transition economy experts and a younger cadre that tackled the Asian financial crisis — looked back wistfully on those times and concluded that a Fund that was not on the frontlines of crisis lending no longer had the same allure.

To some extent, the Fund's diminished stature reflected the convergence of low interest rates, strong global growth and low inflation that followed the Asian financial crisis. Though, in hindsight, we now know this remarkable conjuncture was unsustainable, it allowed many countries to gain access to global capital markets, without the conditionality attached to Fund programs and often at a cost below that of IMF resources. It is not surprising, then, that many members repaid (or "repurchased" in the IMF lexicon) Fund resources early.

It would be a mistake, however, to attribute the Fund's pre-crisis slide to irrelevancy solely to a decline in lending owing to a favourable external financial environment. The Fund also suffered from a credibility gap that undermined its role of "speaking truth to power" in the provision of policy advice. In this respect, while the external environment that followed the Asian crisis allowed members to accumulate sizeable foreign exchange reserves — in effect, take out self-insurance against a possible replay of the Asian financial crisis — many were accumulating reserves because they viewed the Fund as both less effective and less legitimate. Members sought to build up reserves so that they would never again be forced to go to the Fund for assistance.

What a difference a year makes. Since the last annual meeting, Fund lending has expanded rapidly, facilitated by a new Flexible Credit Line (FCL), and the international community has committed to expand the Fund's resources and even to resurrect the Fund's arcane instrument, the Special Drawing Rights (SDR). These timely measures, taken in the worst financial/economic crisis since the Great Depression, demonstrate that the Fund is once again viewed as critical to the promotion of international financial and economic stability and are a testament to a renewed commitment to international cooperation.

This commitment will need to be sustained over the year ahead because, despite encouraging signs of stabilization, significant risks to the global economy remain. In some countries, concerns over deteriorating fiscal positions may generate an incentive to "free ride" on the fiscal expansion of others, while other countries that self-insured by accumulating reserves before the crisis may now be tempted

* This article reflects the purely personal views of the author and not those of the Government of Canada or the Department of Finance.

to target current account surpluses, unwittingly impairing the adjustment process needed to promote sustained global growth. Protectionism remains a threat.

Going forward, the international community must agree on the obligations and responsibilities each member has to the others and to the international system — to develop, in effect, the "rules of the game" for sustainable globalization. A strong, effective and credible IMF can help its members achieve the collective goals of sustainable growth and timely adjustment. Although the global crisis has temporarily masked the Fund's "challenges" with legitimacy, effectiveness and credibility, as members confronted a clear and present danger of an economic collapse, the green shoots that now herald the prospect of economic stabilization, if not recovery, may make it more difficult to sustain cooperation in what will be a more complex period of policy making over the next two years.

In a sense, Fund members must work together to reanimate the remarkable international consensus that prevailed at the Bretton Woods conference 65 years ago. The starting point of these efforts must be the review of IMF quotas — the measure of a member's share in the IMF — that is to be completed by January 2011. This review should recognize the realities of the global economy of the twenty-first century, particularly the importance of global capital flows and the emergence of rapidly growing economies. The emerging market economies, thanks to their integration in the global economy, have moved on to a convergence growth path that has already brought prosperity and offers the promise of continued prosperity. Such a process would create the sense of ownership in the Fund that was eroded due to the Asian crisis.

Quota reform is important to restoring legitimacy to the institution. But for the IMF to play a more effective role in helping promote sustained global growth, it must also be viewed as credible and effective. Quota reform that does not address perceptions of ineffectiveness and strengthen the credibility of the Fund would not be particularly helpful. Moreover, it may be more difficult to achieve quota reform if it is not part of a broader package of reforms. The reason why is clear: quota share realignment is a zero-sum game; to get a deal and sustain the spirit of goodwill and cooperation that currently exists because of the crisis, quota reform must be embedded in a broader positive-sum game. The choice confronting Fund members is stark: preserve the status quo in an institution that is likely to resume its slide into irrelevancy once the crisis is past, or accept a reconfigured share in an institution that is equipped to promote sustained global growth.

As a result, quota reform should be but one part of a broader agenda of reforms that focus on the Fund's desired post-crisis role. Agreement on this mandate would determine the appropriate steady-state size of the institution and its underlying governance arrangements.

There is a well-defined sequencing of issues.

First, members must agree on what the Fund should do to support sustained global growth and promote orderly, timely adjustment. The Fund's original role — to promote international monetary cooperation and financial stability by supporting a judicious balance of financing and adjustment — remains relevant. The challenge is how to ensure that the Fund can promote these objectives in an environment of multiple monetary policy anchors and private capital flows that dwarf official sector flows.

Next, members should define the facilities, instruments and measures the Fund needs to fulfill its mandate effectively. The international financial crises of the past 15 years have demonstrated the need to deal effectively with capital account problems in a way that does not impose an unsustainable adjustment burden on members on the one hand, or undermines the efficient allocation of capital on the other hand. Sixty-five years ago member countries agreed to endow the Fund with jurisdiction over the current account to ensure that individual members could not undo with payment restrictions the multilateral commitment they made to open trade and investment flows. The capital account was largely ignored because the widespread use of capital controls was expected to continue. The system was designed with open current accounts and closed capital accounts. That asymmetry began to break down almost immediately as markets found ways to evade controls and members sought the benefits of capital account liberalization. Today it is a historical artefact. The escalating series of international financial crises over the past 15 years suggests, however, that ad hoc responses to past crises may be insufficient. The fact that the Fund was designed for a world with only limited financial integration can no longer be ignored.

Members then need to ensure the Fund has adequate resources and that there is an appropriate distribution of resource burden consistent with the realities of the global economy of the twenty-first century and the Fund's proposed role. This will undoubtedly be a difficult process, but the challenges associated with it may well be intractable if not embedded in a broader context.

Finally, the underlying governance arrangements for the institution must support the Fund's role, facilities and the resource arrangements. A key issue here is the extent to which the Fund can or should operate in a rules-based system or in an environment of delegated discretion. The Fund was created as a rules-based institution to enforce the Bretton Woods system of fixed exchange rates and near-universal adoption of capital controls. Since the mid-1970s, however, the Fund has, by necessity, operated with more discretion. This may have contributed to the erosion of Fund legitimacy for some members, since underlying governance arrangements designed for the mid-twentieth century do not reflect this evolution in the exercise of this discretion.

The tension that results from static governance and a dynamic environment partly explains why the Fund is viewed suspiciously by many members. As sovereign states, each member jealously guards its rights and prerogatives; none will agree to give the Fund more say over domestic policies in a framework of unconstrained discretion. If members want to enhance the effectiveness of the Fund's surveillance and lending, this basic problem must be addressed. One way to do so would be to establish a transparent framework to guide the Fund's activities (and that establishes restrictions on its discretion). This underscores the need for a clear consensus on the Fund's role in the global economy going forward.

IMF quota reform is intended to restore member "buy in" and thus address the loss of legitimacy from which the Fund suffers. But quota reform should be about much more than relative quota shares. The goal should be to restore the Fund's effectiveness and credibility and lay the foundations for the sustained, balanced global growth that would allow all members of the international community to address the challenges of the twenty-first century.

Recommendations

1. Quota reform should be but one part of a broader agenda of reforms that focus on the Fund's desired post-crisis role.
2. Members must agree on what the Fund should do to support sustained global growth and promote orderly, timely adjustment. They should also define the facilities, instruments and measures the Fund needs to fulfill its mandate effectively.
3. Members need to ensure the Fund has adequate resources and an appropriate distribution of resource burden.
4. The underlying governance arrangements for the institution must support the Fund's role, facilities and the resource arrangements.
5. Enhance the effectiveness of Fund surveillance and lending by establishing a transparent framework to guide the Fund's activities.

Discretion versus Rules in the Operation of the International Monetary Fund

Dane Rowlands

The IMF has had more than its share of near-death experiences. As recently as 2008, observers noted the shortage of borrowing customers, the impotence of exchange rate and current account surveillance, and the lack of institutional legitimacy. The predictions once again proved premature, however, as the financial crisis inflated the roster of borrowers, while reminding governments of the importance of effective global macroeconomic oversight. With a reinvigorated sense of purpose, the IMF has set about defining its niche in the structure of international economic governance. Critics and supporters alike ponder how to reform the institution to address past deficiencies and deal with future challenges. One component of this debate is how to strike a balance between technocratic rules and political discretion in the Fund's operations.

Far from being just a theoretical debate, balancing rules and discretion is critical to restructuring the governance of the IMF and in terms of its day-to-day operations. The extent to which member states can agree upon the Fund's purpose and operations determines the extent to which it can operate according to defined rules and procedures in relative isolation from transient political forces. Technocratic rules of operation are not apolitical; ideally, they embody a consensus that has been reached among members, though in practice they can also reflect the forces of states pursuing narrower interests. To the extent they reflect a true consensus, technocratic rules — coupled with transparency — can arguably provide greater operational predictability and global institutional legitimacy. By contrast, discretion improves operational flexibility and can help ensure an institution remains relevant to the more powerful countries upon which it relies for support. The rules-discretion conundrum is visibly manifested in the Fund's new precautionary lending instrument: the Flexible Credit Line (FCL). The balance between discretion and rules needs to be addressed generally and also regarding the operation of the IMF's lending instruments.

Throughout the 1950s and 1960s the international monetary system conformed reasonably closely to the Bretton Woods plan. There were some exceptional cases where flexible exchange rate systems were tolerated, but it was not until the beginning of the 1970s that economic and political reality rendered impractical the rules established for a world with modest levels of stable capital flows. The inconsistency between formal rules and reality created a vacuum in the international system that was filled by the ad hoc evolution of more discretionary procedures, thereby recreating some semblance of an international monetary framework.

The collapse of the Bretton Woods system, however, was accompanied by a bifurcated membership. Discretion was exercised largely by the wealthy countries that provided the resources and dominated the Executive Board. The poorer and emerging market countries, essentially the Fund's only or potential borrowers, had only limited capacity for influencing the system or exercising discretion. Consequently the subordination of rules arguably reduced both the legitimacy and effectiveness of the IMF, thereby compromising the integrity of the international economic system.

One key area of operation where discretion has allegedly affected IMF legitimacy and financial credibility is the approval and review of lending agreements by the Executive Board. Influential Board members can effectively block agreements, or promote them unduly, without obvious reference to economic circumstances. There have been several high-profile anecdotes and some large-sample statistical evidence of politically motivated lending behaviour, which undermines claims of economic objectivity. There have been cases of substantial interference by some countries in the functioning of specific programs. Some of these cases damaged the IMF's reputation.

To give this argument a more concrete form, consider the case of the IMF's new lending program, the Flexible Credit Line (FCL). It neatly encapsulates the problem the IMF has balancing rules and discretion in its core operations. Ever since the mid-1990s, the IMF has been seeking a procedure for the rapid release of substantial funding to deal with the sudden onset of international financial crises. The speed (and frequency) with which financial crises occur has made it operationally necessary to avoid the drawn-out negotiations that often accompany more traditional Fund programs such as stand-by agreements. An automatic program on the shelf is seen as helpful because it would be fast acting in the event of a crisis and because its presence may sufficiently reassure financial markets that potential crises can be avoided altogether.

Recent attempts to deal with this problem have resulted in lending facilities that pre-identify countries that qualify for automatic financing. Similar to its immediate, and unsuccessful, predecessors — the Contingent Credit Line and the Short-Term Liquidity Facility — the FCL has recently been established as a precautionary agreement prior to any immediate need to draw on it and has more lenient conditions than standard loan facilities. Its purpose is to make enlarged levels of funding available in a rapid and more automatic fashion to countries pre-identified as meeting established eligibility requirements. In a sense, it functions theoretically in much the same way as a personal credit line at the bank; once negotiated, the credit can be drawn upon without impediment.

The FCL does not avoid the potential for political interference at the time of initial approval and probably not even subsequently, should a country draw on the credit line. The experience with precautionary stand-by agreements seems to be that, even with an agreed program in place, a country still requires approval from the Board at the moment of withdrawal. Presumably, most requests will be approved, but in dynamic economic and political circumstances, the FCL stops short of providing assured and automatic access.

Yet, any attempt to grant FCL agreements based on clear technocratic rules is doomed to fail. The current eligibility criteria are imprecise, perhaps necessarily so. A degree of flexibility and adjustment is necessary to manage fast-moving crises, especially where theory, evidence and technocratic ability have been unable to establish reliable predictive models. If traditional non-borrowers such as Iceland can require IMF assistance, any surprise scenario is possible. Anticipating the unexpected seems to be the key to successful crisis prevention and management, and flexible lending instruments are crucial supporting tools in this task.

The opacity of IMF operations compromises its effectiveness and the signaling value of programs such as the FCL is diminished. Does the presence of an FCL indicate a country's economy is well-managed and stable, that its government is politically acceptable to key Fund shareholders or that it may require IMF assistance due to unobservable structural weaknesses? Does the absence of an FCL indicate a failure to meet the criteria of economic sustainability, political isolation, or a complete lack of interest in securing IMF credit due to economic confidence? The scope for manipulating and misinterpreting these signals is arguably too excessive to facilitate sound international economic oversight.

To improve the FCL specifically, and all IMF operations in general, the first step is to expand the scope for technocratic influence by making program eligibility guidelines more precise. Though difficult, a crucial function of international institutions is to build up understanding of a problem, identify the best practices to deal with it and construct a supportive international political consensus for implementation. The second step is to clarify program signaling by integrating IMF Article IV consultations with program eligibility in a more comprehensive manner, so economic assessments are more routinely publicized and linked to potential IMF support. The third step is to move towards greater transparency of Executive Board deliberations — to shrink the scope for political considerations to override economic assessments. Such openness will also make clear the extent to which a consensus has emerged for overriding technocratic guidelines that prove inadequate or irrelevant to emerging economic problems. By shrinking the grey zone in which the presence or absence of programs provide unclear signals, and by providing more confidence that political discretion is being exercised in a manner consistent with its mandate, the IMF can hopefully emerge from this crisis with an improved capacity to deal with international economic imbalances and the increased political legitimacy to do so.

Recommendations

1. To improve the Flexible Credit Line (FCL) specifically, and all IMF operations in general, the first step is to expand the scope for technocratic influence by making program eligibility guidelines more precise.
2. Clarify program signaling by integrating IMF Article IV consultations with program eligibility in a more comprehensive manner, so economic assessments are more routinely publicized and linked to potential IMF support.
3. Move towards greater transparency for Executive Board deliberations — to shrink the scope for political considerations to override economic assessments.

Developing the Political-Economy Skills of the IMF Staff

Bessma Momani

The IMF was originally designed to prevent its technical work from succumbing to political influence, both from the Executive Board and members, in order to enhance the neutrality of loan agreements, conditionality and technical advice. The staff is largely responsible for carrying out the Fund's mission and daily functions, including surveillance, loan negotiations, program monitoring, designing conditionality and communicating Fund policies. Over time, however, the intellectual transformation of the Fund caused the staff to expand its mission objectives beyond the original intent of its shareholders.

Presently, legitimacy problems continue to plague the Fund. The organization's member states routinely criticize the IMF for going beyond the scope of its intended functions; imposing intrusive loan conditionality; stepping on policy ground reserved for other international organizations; and failing to predict, warn and comprehend the build-up and spread of financial crises. As these criticisms are often aimed at the work done by Fund staff, a focal point in addressing issues of IMF legitimacy should be the Fund's organizational culture, which is crucial to understanding how the staff functions, how staff members' opinions are shaped and how problematic policy outcomes are produced.

The Fund's existing organizational culture is hierarchical, technocratic, officious and conformist. As a result, the organization suffers from a poor reward structure and rigid idea formation. Policy prescriptions are also typically difficult to implement and are made worse by unnecessary self-censorship through various staff departments and a tendency to reject new ideas. To remedy these problems, two crucial reforms are needed: a change in the Fund's recruitment practices and a loosening of its organizational structure.

The reforms offered here may be difficult to implement and seemingly less urgent than other typical recommendations for governance reform. Yet, if the problems inherent in the Fund's organizational culture are not addressed, it will continue to face strained relations with members and fail to successfully implement policy. Of course, addressing the problems suggested here would be half-hearted without governance and functional reforms, including new quota weights, a newly devised Executive Board and a respected non-European managing director. Simply, failing to bring about change in the IMF's organizational culture could undermine the significant policy changes needed to rehabilitate the Fund in its members' eyes and make it a more effective international organization.

Recruitment

The Fund recruits predominantly young, Anglo-American, PhD-educated men with little to no policy-making experience. Policy design is potentially limited by the practice of hiring like-minded recruits used to working within a hierarchical and conformist organizational structure. In the view of many borrowing countries, one problem that has resulted from this type of recruitment has been the proliferation of technical policy advice that tends to ignore important political considerations. Hiring less staff through the Economist Program (EP) — which takes recruits straight from academic institutions — and hiring more from mid-career positions and temporary placements from national secondment would address this problem.

In addition to reducing the number of EP positions, the Fund should consider seeking EP candidates who have more policy-related work experience. First, the Fund should hire more mid-career recruits from finance ministries and reduce in relative terms recruitment from central banks. The former tend to engage in hands-on analysis, while the latter tend to be insulated and concentrate on technical analysis. The Fund should therefore pay more attention to retaining these mid-career recruits who, unlike their EP counterparts, are far more likely to give up their positions at the Fund due to the organization's conformist cultural environment and difficult living arrangements in Washington. While filling more positions with mid-career recruits may not be a problematic proposal in itself, IMF studies have noted that finding excellent mid-career candidates is difficult, because those who excel at their jobs are more likely to advance within their current organizations than move to a new institution.

Second, EP recruits should also: have policy science training; pass equivalency exams, perhaps similar to those used by recruiters from the diplomatic service; take seminars and conferences examining issues in political economy; or, be required to pass an interview process that demands a certain level of policy science comprehension. Hiring staff with degrees in public policy, in addition to economists, would also help infuse the Fund with alternative economic ideas. Area departments also need to be able to track the success of their staff in non-technical field skills like communication and negotiation. Ideas on how to implement Fund policies should become a performance requirement. At present, it is difficult to promote or reprimand staff on these grounds, due to the Fund's highly legalized and complex dismissal and grievance procedures.

Third, the Fund needs to open staff reports to external assessments, especially by contracted third-party political economy specialists, before these reports are brought to the attention of the Executive Board. This would have the effect of dampening excessive self-censorship. For example, the Fund could consider contracting out political assessments to country experts, similar to the European Bank for Reconstruction and Development (EBRD) model of political counsellors, in order to determine the feasibility of, and give comments on, staff reports. Moreover, Fund staff should incorporate external country-specific studies as part of their staff reports, which will help bring in new ideas about policy implementation and ensure the Fund can better integrate country-specific knowledge into its policies. However, this proposal will encounter opposition from the Executive Board, particularly those Board members from non-democratic polities, who jealously guard their roles as evaluators of staff reports.

Fourth, the Fund needs to address its skewed staff promotion system — a product of its hierarchical culture and litigious conflict-resolution system — which can lead to a misallocation of staff resources and expertise. The Fund also needs better communication and negotiations skills with members, which should be reflected in its hiring practices and staff performance evaluations. These skill requirements should be integrated into the Fund's annual review reports and used as criteria for staff promotion. Likewise, policy implementation expertise should be integrated into the internal promotion system.

Fifth, member states' local knowledge should be better incorporated into staff reports. This will help bring in intellectually diverse ideas more tailored to the members' domestic context. Such integration can be achieved by hiring more economists from the developing world and expanding the number of Fund staff in local resident representative offices. Some senior Fund officials have dismissed hiring more staff from developing countries on the grounds that they lack technical knowledge comparable to American and European economists. However, the local knowledge offered by developing world economists can be more useful than technical knowledge in assessing and improving policy implementation.

Sixth, to break down an excessively rigid intellectual structure in its departments, the Fund needs to encourage cross-departmental hiring and exchanges, particularly between the research department and the policy development and review department with area departments. This will ensure that the intellectual and hands-on departments communicate with each other, and most importantly, discover policy shortcomings, stimulate internal debate and break down intellectual rigidity.

Organizational Culture

In an effort to remould the Fund's organizational structure — to improve both Fund policies and its relations with members — the following reforms are needed. First, to foster internal debate and invite new ideas into Fund work, the pre-eminence of the Strategy, Policy and Review (SPR) Department needs to be significantly loosened. One way to achieve this is to remove the overly segmented division of labour in the SPR, where a single individual is assigned an issue/division and bears responsibility for examining all staff reports. Instead, the department should develop a team approach to checking the soundness of staff reports by allowing area department staff to present their input.

Second, to harness local knowledge and integrate new ideas into the Fund's policy framework, IMF staff should cease rotating from country to country, waiting to exhaust the Fund's loan packages. Instead, the IMF should opt for maintaining the same group of staff members in each country where missions are carried out. This will help officials better connect with the IMF staff on site and, in turn, help staff gain valuable field experience and political acuity. Local knowledge can be better stimulated if staff rotation is minimized; however, there is the inherent danger that a constant staff presence can lead to unsavoury political relationships with host governments. To address this risk, private market actors can help curb such conflicts of interest by scrutinizing timely publications of staff reports. To guard against political favouritism, all staff reports should be released to the public in a timely manner and not be subject to the preferences of IMF member states.

Third, to overcome the deeply entrenched lending bias of the Fund's organizational culture, departments should be evaluated on their ability to implement policy. As it stands, IMF area departments are rewarded for the number and amount of loan agreements, but are not implicitly penalized for waivers of loan conditionality and non-compliance. As a result, Fund staff tend to focus their energies on the process of signing a loan agreement and face little recourse if suggested policies are not actually implemented. Therefore, the staff needs reward incentives for devising those loan programs that are implemented. This will push staff to prescribe conditions that are politically feasible, rather than just theoretically impressive.

A downside to this proposal is that political feasibility could start to be privileged at the expense of sound economic advice. Likewise, one could argue that a system which highly privileges implementation could encourage staff to devise overly lenient loan programs, if only to attain higher status and promotions. These are valid concerns; however, it is more likely the Fund would see less conditionality and more potent and effective policy prescriptions. Fund staff, moreover, are mindful of professional integrity and tend to seek tacit approval from the economics profession for devising effective policies. In other words, this professional moral hazard is less likely to occur than might be thought.

Reforming the IMF from the top-down would be half-hearted without looking at the IMF's staff — a missing link in IMF reform proposals.

Recommendations

Recruitment

1. The Fund should hire and focus on retaining more policy-experienced mid-career recruits from finance ministries and reduce, in relative terms, recruitment from central banks.
2. Staff reports should incorporate external country-specific studies and be open to third-party assessment prior to being presented to the Executive Board.
3. Policy implementation expertise and communication and negotiation skills must be integrated into the Fund's employee promotion system and annual review reports.

Organizational Culture

1. IMF staff should cease rotating country to country. Instead, the IMF should opt to maintain the same group of staff members in each country where missions are carried out.
2. Departments should be evaluated on their ability to implement rather than merely create policy.

Improving IMF Surveillance

Robert Lavigne*

Over the past several years, the IMF has set into motion a number of reforms to ensure its continued relevance and legitimacy. Core areas of reform include quota and voice, corporate governance, lending policies and surveillance. While progress has been registered on most fronts, the most significant changes have occurred in the field of surveillance.[1] Certainly, the surveillance reforms are timely, with the recent global crisis underscoring how dramatically international linkages and vulnerabilities have increased. But have the reforms been effective? With the benefit of more than a year of hindsight, now may be the appropriate moment to evaluate the reforms, assess their implementation and consider options for enhancing their effectiveness.

The Roots of Reform

As the Fund entered the new millennium, there was a growing consensus that its country-level surveillance was not living up to its potential. For instance, bilateral surveillance had drifted into a range of areas unrelated to external stability (for example, labour markets), while avoiding its core responsibility of exchange rate analysis and failing to adequately incorporate cross-border spillover effects. It has been argued that political interference sometimes compromises the perceived objectivity of Fund surveillance, obstructing the even-handed treatment of countries and dampening the candour of assessments. Moreover, the roles of members, the Board and the Fund in surveillance are unclear, blurring accountability.

These shortcomings were partly attributable to the policy document guiding Fund staff, referred to as the "1977 Surveillance Decision," which was very much out of date.[2] Members signaled their commitment to reform by adopting the "2007 Decision on Bilateral Surveillance Over Members' Policies," which aims to upgrade surveillance guidelines to current best practices. As well, in 2008 members endorsed the first "Statement of Surveillance Priorities" (SSP), which sets the key priorities for surveillance over the 2008-2011 period and establishes an accountability mechanism to ensure their implementation.

How Do the Reforms Measure Up?

The only independent (that is, non-IMF) assessment of the reforms was carried out by Robert Lavigne and Larry Schembri. Using the "vision" of a reformed surveillance system developed by the Bank of Canada as a baseline to evaluate the reforms, they conclude that, if implemented fully, the 2007 Decision and the SSP have the essential ingredients to create an accountability framework supportive of impartial surveillance.

* The views expressed are those of the author and not those of the Bank of Canada or its staff.

1 Surveillance can be defined as all aspects of the Fund's analysis of, scrutiny over and advice concerning member countries' economic situations, policies and prospects.

2 The old Decision was designed for the period following the collapse of the Bretton Woods system, characterized by still largely fixed exchange rates and limited capital mobility. It was never updated, and with time a large gap developed between the Decision and the actual conduct of IMF surveillance.

The new Decision gets the essentials right in its clarification of the principles of surveillance. It sets the objective of surveillance (external stability), defines its scope (exchange rate, monetary, fiscal and financial sector policies), and stresses the importance of properly integrating multilateral surveillance. The Decision also establishes standards for the conduct of surveillance, which include even-handedness and candour, and underscores that surveillance is a relationship built on cooperation and not on policing obligations.[3]

Yet the document contains some controversial elements. Notably, in an attempt to refocus the Fund's analysis on exchange rates, the new Decision emphasizes the evaluation of the extent of over/undervaluation of exchange rate levels and mandates labeling currencies as "fundamentally misaligned" when appropriate. This label poses some difficulties. On the technical side, evaluating exchange rate levels necessarily involves estimating equilibrium rates, which have large margins of error. From a conceptual viewpoint, the considerable political stigma associated with these labels may ultimately be incompatible with the cooperative and persuasive nature of surveillance required under the institution's current governance structure.

The SSP meets the requirements of the Bank of Canada vision, if not quite as satisfactorily as the 2007 Decision. In the Bank framework, the purpose of the SSP is to help implement the principles of the Decision. It has three objectives: (1) set medium-term priorities; (2) clarify responsibilities; and (3) promote accountability. The actual SSP approved in 2008 focuses primarily on the priorities, but contains sufficient elements of the latter two aspects to play an important role as an accountability mechanism for surveillance. Indeed, the SSP specifies that the Board is responsible for setting and evaluating surveillance priorities; in turn, management and staff are tasked with providing analysis and advice that promote the priorities.

A shortcoming of the SSP is that it does not require the Fund to report specifically on the implementation of the 2007 Decision. However, it indicates that the Decision plays a role in establishing the framework within which the SSP is to operate. This role, combined with a renewed focus on assessing the Decision in the Triennial Surveillance Review (TSR)[4] and regular annual updates on the priorities by the managing director, may be enough to solidify the link between the two documents. A more serious weakness is the SSP's failure to mention the surveillance responsibilities of member countries. Clearly, a formal commitment of members would increase the SSP's potential to galvanize political support for surveillance. For the moment, ad hoc means must be used to reaffirm member commitments, such as the International Monetary and Financial Committee (IMFC) communiqué that endorsed the SSP after the 2008 TSR.

Are the Reforms Being Implemented?

From the onset, developing countries expressed concerns that the new Decision would be used to unduly focus on their economic policies. However, according to an independent evaluation of the first year of the

3 Members' obligations are slightly modified; now it is clarified that countries should refrain from engaging in policies that cause external instability.

4 The TSR is a periodic self-assessment process during which the IMF staff evaluates their surveillance performance. The TSR was last carried out in the fall of 2008 and was used as a basis to generate the operational priorities in the first SSP.

Decision's implementation, so far these concerns do not seem to be substantiated thus far. The Decision was found to have significantly increased the overall quality of Article IV reports, with improvements noted in emerging market, advanced and developing countries.[5] Implementation has been broadly similar across country income groups, although differences persist for specific aspects of the Decision. There remains significant room for improvement in some technical areas, but these are not controversial.[6] In fact, most of the suggested improvements are included as operational priorities in the SSP, so members can expect progress in these areas over the next three years.

There is one area of implementation, however, that remains problematic. Indeed, the contentious "fundamental misalignment" label has not been accepted by the Executive Board in any Article IV report, and the "fear of labeling" has delayed several reviews, notably that of China, whose currency many experts believe is significantly undervalued. In response to this impasse, the IMF removed the requirement to attribute the "fundamental misalignment" label, such that the Chinese Article IV that was ultimately released only indicated concerns that the renminbi was undervalued. This incident indicates that however well designed and implemented the surveillance reforms, they do not yet provide staff with the ability to take stances that are strongly opposed by large members.

Necessary Reforms, but not Sufficient

Overall, the recent reforms are definite steps forward in the ongoing effort to improve the effectiveness of IMF surveillance. They provide staff with a clear mandate and objectives, as well as an accountability structure to motivate their surveillance. However, the Chinese Article IV has made it evident that the reforms have not yet changed the strategic role of surveillance. It would appear that the reforms are necessary, but not sufficient, conditions for fundamentally more influential surveillance. Yet further progress can and should be made.

Gradual reforms are within reach. One way forward would be for surveillance to shift away from exchange rate levels and focus instead on the *direction* and *speed* of real exchange rate (RER) adjustments. This approach would put the focus on the analysis (not the label), allowing for more nuance in RER evaluations and making possible a wider spectrum of verdicts than the present binomial choice (misalignment or not). It also recognizes the difficulty of calculating equilibrium exchange rate levels, leaving that determination to market forces.[7] This change could be implemented through a modification of the Fund's Surveillance Guidance Notes, which are currently being revised.

Improvements to the SSP are also achievable. Because it must be renewed regularly, there is opportunity to refine the document as experience is gained with the new surveillance framework. Drawbacks of the document, such

5 In particular, the report finds that that bilateral surveillance is more focused on external stability and core macroeconomic policies. Exchange rate analysis has also improved significantly.

6 For instance, the authors point out: 1) integration with multilateral surveillance remains relatively weak; 2) cross-country spillovers still do not receive sufficient attention; 3) the link between domestic stability and external stability is not adequately analyzed; and 4) more work also needs to be done in terms of relating structural reforms to external stability and in analyzing real-financial linkages.

7 Moreover, this approach would be more in line with the objective of surveillance because it is RER adjustments that are critical to maintaining external stability.

as the lack of a clear link with the Decision and the need for a formal means of reinforcing member commitments to surveillance, can be corrected in evolutionary changes.

However, to provide staff with true operational independence in its surveillance, significant governance reforms are necessary. These are well-understood and are presently being debated.[8] In general, reforms are needed that would: 1) clarify the roles and responsibilities of management, the Board and the IMFC;[9] 2) develop a framework for holding the managing director accountable; 3) shift the Board towards a more supervisory role; and 4) raise ministerial-level involvement in setting broad strategic goals and overseeing performance. Of particular importance for surveillance is the reduction of daily Board intervention in the surveillance process, which blurs the responsibilities of the staff and the Board and obfuscates lines of accountability. Delegating surveillance responsibilities entirely to staff would be a major step forward.

Progress on these corporate governance reforms would significantly bolster the credibility of surveillance. Indeed, if the Board stayed at arm's length from staff as it supervised surveillance, and if there were a regular ministerial-level renewal of member commitments to the surveillance process,[10] the IMF would truly have a mandate to operate independently that could shield it from political pressures that may have compromised the impartiality of its surveillance in the past. This is ultimately the kind of governance framework needed to ensure that the recent reforms allow IMF surveillance to reach the level of credibility and influence required to face today's global challenges.

Recommendations

1. One way forward would be for surveillance to shift away from exchange rate levels and focus instead on the direction and speed of real exchange rate (RER) adjustments. This change could be implemented through a modification of the Fund's Surveillance Guidance Notes, which are currently being revised.

2. Improvements to the Statement of Surveillance Priorities (SSP) are also achievable. Because it is renewed regularly, there is opportunity to refine the SSP document as experience is gained with the new surveillance framework.

3. Progress should be made on corporate governance reforms. This would significantly bolster the credibility of surveillance. If the board stayed at arm's length from staff as it supervised surveillance, and if there was a regular ministerial-level renewal of member commitments to the surveillance process, the IMF would truly have a mandate to operate independently that could shield it from political pressures that may have compromised the impartiality of its surveillance in the past.

8 The Fund is currently considering governance reforms recommended in reports by the Independent Evaluation Office, the managing director-mandated Committee on IMF Governance Reform (also referred to as the Manuel Report) and the Board's own committee on sequencing reforms (the Moser Report).

9 The IMFC is an advisory committee to the Board of Governors (the IMF's supreme governance body) made up of finance ministers and central bankers from the major member nations.

10 It would also be advantageous if the IMFC were transformed into a candid forum for policy makers to discuss surveillance findings.

IMF Lending and Resources

Eric Santor*

Introduction

The financial crisis has led to a dramatic increase in IMF lending commitments, to more than 20 countries totaling more than SDR100 billion, and the introduction of a new lending instrument, the Flexible Credit Line (FCL), a precautionary facility designed to address liquidity needs for countries with otherwise solid policy records. The G20 committed to augmenting the Fund's resources, immediately vis-à-vis bilateral loans, and ultimately, by expanding the New Arrangements to Borrow (NAB) to US$500 billion. While the IMF's lending facilities and resources have been augmented, these reforms are nevertheless ad hoc, as fundamental questions with respect to IMF lending remain to be addressed:

1. What are the objectives of IMF lending (that is, what kinds of problems should the Fund try to remedy)?
2. What lending instruments are needed to achieve its goal, and how should they be designed to ensure they create the correct incentives?
3. Given the possible set of lending facilities that could be considered, what resources are needed, and how should they be funded?

* The views expressed are those of the author and not those of the Bank of Canada or its staff. This paper benefited from comments and suggestions from Timothy Lane.

The first section below describes some of the issues related to IMF lending and resources in the past. The second section sets out one vision for IMF lending and resources; this includes some general principles, the objective of IMF lending, the relevant instruments, and the required resources. It also discusses related issues of risk management and governance. The discussion will focus on lending in the General Resources Account (GRA), as lending to low-income countries involves a distinct set of issues.

IMF Lending

The traditional view of IMF financing envisages a country facing a current account disequilibrium. Temporary financing is provided on the basis of an adjustment program — a combination of policies expected to result in a current account path that can be financed and repaid. The financing enables the country to carry out the needed adjustment more gradually than would otherwise be possible. IMF conditionality policies are designed to ensure financing continues to be provided only if the country continues to adhere to the policy program. But in many emerging market crises, the situation has been very different: a country is faced with a sudden stop or even a reversal in capital inflows. In such cases, the IMF's financing together with the associated policy program have often been intended to restore confidence and halt the reversal of capital flows (the *catalytic* effect) and thus reduce the need for external adjustment. More recently, the IMF has moved to providing high-access precautionary financing based on pre-qualification (and hence limited program conditionality), in the form of the FCL; such financing aims, if possible, to prevent the reversal of capital flows or to alleviate their macroeconomic effects.

Many researchers have examined the experience with IMF lending, including: 1) which countries accessed financing and in what context; 2) the determinants of conditionality and the degree of compliance; and 3) the effect of IMF lending on economic outcomes. From this literature, several broad observations can be made. First, there has been a major change in the use of IMF financing: it is increasingly used in response to (actual or potential) capital account crises, and rarely for the original purpose of meeting temporary current account imbalances. In such crises, IMF financing has often aimed for a "catalytic" effect on capital flows, but in most cases the intended effect has not materialized. There were also concerns about IMF financing being used to support unsustainable policies and debt paths. Despite efforts to resolve these issues in the wake of the series of emerging market crises during 1994-2002, important questions about the IMF's role in crisis resolution remain unresolved. Second, conditionality is widely viewed as too intrusive — but also ineffective — as only a fraction of program conditions are typically implemented. While the 2002 Conditionality Guidelines were intended to move toward greater parsimony, limiting conditions to those that are critical to a program's macroeconomic objectives, many of the same concerns persist. Third, the benefits of IMF lending are elusive: while there have been some notable successes, many countries' macroeconomic situations deteriorated in the context of programs, and it is difficult to attribute either the successes or failures to the IMF. Empirical evidence of the impact on macroeconomic outcomes is at best mixed. Taken together, the literature suggests the need to clarify the intent and strengthen the effectiveness of IMF lending.

A Vision for IMF Lending and Resources

Some basic principles

In considering the appropriate direction for reform, it is useful to state some basic principles:

1. Lending instruments and resources should be grounded in a clear mandate of the IMF with respect to crisis prevention and resolution, both at the global and member-country levels.

2. It is essential to consider IMF financing in relation to the policies pursued by the member country receiving that financing — as in most cases both are needed to achieve the intended results. In particular, lending instruments should be compatible with incentives to implement sound policies in both crisis and non-crisis times.

3. IMF financing also needs to be considered in the context of a country's relations with its private creditors (for instance, it should avoid perpetuating an unsustainable path for sovereign debt).

4. The Fund's resources, and the means by which they are funded, should stem from a clear assessment of the benefits of IMF financing in relation to its costs.

5. Resources should be protected by appropriate risk management practices and governance mechanisms.

Mandate

The objective of Fund lending should be to ensure a stable and well-functioning international monetary system. IMF financing should thus be limited to addressing the balance-of-payments implications of a crisis; thus, funding will not be calibrated to providing a targeted amount of fiscal stimulus or a banking system bailout.

Lending instruments

As at present, we envisage two main types of lending instruments: an FCL and a Stand-By Arrangement (SBA). The FCL is aimed at preventing and/or mitigating liquidity crises, typically associated with contagion. Access will be high (perhaps 1000 percent of quota), front-loaded, based on pre-qualification, and with little or no program conditionality. Importantly, the metrics for qualification would be clear, transparent and public, in order to limit the Fund's discretion. An important aspect of this type of facility is that it will provide incentives for countries to pursue good policies: and only those countries pursuing policies consistent with external stability (as assessed in their Article IV consultation) and that have conducted a Financial Sector Assessment Program (FSAP) (and implemented the recommendations) would be eligible for the FCL.

For countries facing problems that require further policy action, an SBA-type facility should also continue to be available. Much like current SBAs, access would be limited to 600 percent of quota: exceptional access would be available, although subject to strict criteria. Conditionality would be applied to policy actions needed to achieve an appropriate resolution of the external problems, and would be applied very sparingly (to make-or-break conditions the implementation of which cannot be taken for granted).

Moreover, IMF financing through both facilities should be provided only when liquidity provision is the appropriate instrument to address a crisis. The IMF should be prepared to support countries that impose standstills or sovereign default, where these are needed. Standstills can be a useful alternative to lending in cases of liquidity crises, as it can provide needed time to restore confidence in otherwise sound markets. In cases of insolvency, standstills can help to provide incentives to encourage private creditors to undertake negotiations aimed at restoring financial stability and/or debt sustainability. The IMF should refrain from lending in situations where the effect is to delay such difficult decisions.[1] Access limits are also an important discipline for the crisis-resolution process.

Lending through both facilities should provide proper incentives for countries to follow good policies. The FCL rewards good policies with high access on a pre-qualification basis (and thus sends good signals). The SBA allows for conditionality where policy action is needed to resolve a crisis, but for countries with better policies, such conditionality should be more limited.

Resources

In order for the Fund's lending instruments to be effective, they must be funded credibly. But at the same time, too large a resource pool could lead to moral hazard on the part of countries and/or their creditors. The Fund's overall resources should be based on a careful assessment of the financing that would need to be provided to member countries in the event of adverse circumstances. Here, a key question is what fraction of this total should be provided through quotas and what fraction through borrowing (especially through the NAB). Arguably, a transitory need for resources, associated with a sys-

1 It should be noted that the use of standstills is not without difficulty, as the Fund must navigate difficult operational issues (for example, when and how to introduce it to avoid unintended consequences).

temic global crisis of a kind that occurs very infrequently, should be provided for through borrowing rather than a quota expansion. Other considerations are the implications for risk management (as quota resources are analogous to equity financing) and for governance (as, for instance, heavy reliance on borrowing may give greater influence to those providing the loans). Funding by members for the NAB would be flexible: members could contribute via bilateral loans, or through the purchase of IMF bills or bonds (with terms and conditions designed to make them equally attractive to the lending countries).

Risk Management

The global financial crisis has drawn attention to the importance of appropriate risk management, and the Fund may also have room for improvement. In the past, risk management for program lending consisted mainly of the assessment of program policies and access levels through the IMF's internal review process and ultimately, Executive Board approval. It is important to assess whether these mechanisms remain adequate and appropriate for the Fund's current activities, particularly in the case of exceptional access and FCL-type lending, risk-management policies should be designed to safeguard the Fund's resources and to ensure that its liquidity position is adequate in the face of funding demands.

Governance and Incentives

For lending to be effective, proper governance structures and incentives must be in place. That is, access to Fund financing should be based on sound judgement related to economic criteria, as opposed to political considerations. To this end, governance principles are recommended (see box).

Sound governance is critical for ensuring the effectiveness of lending, as the process by which members apply for and receive funds should be based on economic and transparent criteria. In this way, markets can be assured that the Fund's lending facilities are targeted appropriately.

Conclusion

This note has outlined a vision for reforming IMF lending, and identified a number of issues that remain unresolved. At the heart of these issues is the broader question of the Fund's mandate. Simply, to what end should the Fund's resources be employed? At a very basic level, the Fund's lending instruments and resources, in combination with active surveillance, should seek to create incentives that encourage countries to adopt sound macroeconomic and financial sector policies that prevent crises.

Recommendations

1. Clear delineation of roles and responsibilities of each level of decision maker to ensure that accountability is enforced.
2. Clear guidelines and limits on Fund lending; when limits or rules are abrogated, transparent political endorsement is necessary.
3. Adoption of appropriate risk management practices, with clear accountability for risks taken.
4. Recognition of member countries' responsibility for their own policies, both before and during a crisis.

The Future Role of the IMF in Low-Income Countries, Including Debt Relief and Sustainability

Roy Culpeper*

Summary

There is potentially a useful role for the IMF in low-income countries (LICs), in providing an Anti-Shocks Financing Facility — to provide rapid-disbursing, low-conditionality funding to developing countries facing a collapse in export earnings (as at present) or similar external shocks. Observers have long noted the absence of such a facility in the global financial architecture. But the IMF needs to be thoroughly reformed if it is to play this role. The framework of its policy conditionality needs to be overhauled dramatically; the resources it makes available should be on fundamentally different terms; in this manner, and in other ways, it should help LICs avoid the accumulation of unsustainable debt. The voice of LICs should also be enhanced in the governance of the IMF.

How We Got Here

After the demise in 1973 of the Bretton Woods system of fixed exchange rates, a large part of the rationale for the IMF disappeared. In theory, flexible exchange rates would automatically resolve international payments imbalances, eliminating the need for both the Fund's short-term financing and contentious adjustment policy prescriptions. However, financial and economic shocks continued to result in destabilizing short-term balance-of-payments deficits, so the need for the Fund did not disappear. But in addition, the IMF embarked on an era of mission creep, taking it into the realm of long-term financing for development.

During the 1980s and 1990s, financing to low-income countries (for example, through the Structural Adjustment Facility and subsequent arrangements) was provided as soft loans with low interest rates and relatively long repayment periods. But even such soft loans created debt liabilities that accumulated in the 1980s and 1990s and eventually constituted an important part of the debt distress of the poorest countries.

By initiating longer-term financing facilities for developing countries, the Fund began to overlap with the World Bank (and other development agencies). However, the issue of overlap or duplication was particularly acute in the Bank's case, provoking demands for greater coordination. The IMF nevertheless continued, and indeed deepened, its activities in low-income countries until the end of the 1990s with the launch of the Poverty Reduction and Growth Facility.

The issue, moreover, was not simply one of duplication, but of overall *consistency* or *coherence*. Typically the Fund's policy conditionality in low-income country programs was more appropriate to short-term balance-of-payments problems driven by internal fiscal deficits or inflationary domestic policies rather than by external shocks. The Fund's adjustment policies, consisting of fiscal and mon-

* The author is grateful for comments by my colleagues Bill Morton and Aniket Bhushan on an earlier draft.

etary compression, may have reduced external payments deficits, but often did so at the expense of long-term development objectives and growth. In other words, the Fund's policy conditionality was fundamentally at odds with the objectives of the Bank, other development agencies and the low-income countries themselves.

Controversy over the IMF's role in low- and middle-income developing countries grew with the structural adjustment programs of the 1980s and 1990s, and attained its apogee with the Asian financial crisis of 1997-1998. The Fund's conditionality expanded to include demands for trade liberalization, privatization and even labour market reforms, which was seen as politically intrusive and unrelated to the IMF's remit. Subsequently, many developing-country borrowers sought to exit from further reliance on the Fund. Some emerging markets opted to rapidly build up their reserves to insure themselves against future financial shocks, rather than having to rely on the Fund, while other borrowers prepaid their loans, drastically reducing the IMF's outstanding credit from US$100 billion in 2003 to US$30 billion in 2006. The defection of borrowers led to a steep fall in the Fund's income and its own financial viability, and growing questions about its future.

The global financial crisis of 2008-2009 has evidently rescued the IMF from oblivion, with calls by the G20 and a UN expert panel for the Fund to play a more active role in crisis prevention and management. The crisis also provides an opportunity to revisit its role in low-income countries and to address the unresolved issues of its overlap with the World Bank and other development agencies.

A Reform Agenda

With respect to conditionality, policies required in Fund programs should support, rather than constrain, growth. Particularly when an external shock is the cause of the current account deficit, as is currently the case for many low-income countries, the Fund's programs should support counter-cyclical macroeconomic policies rather than fiscal and/or monetary compression.

In other words, there should be scope in the short term for fiscal deficits and credit easing to help offset, for example, the drop in export earnings. As growth resumes, fiscal and monetary tightening would be required. In this manner, the Fund's policy conditionality would become more consistent with the objective of maintaining long-term growth and with the policies of the World Bank and other development agencies.

Moreover, the "conditionality creep" during the 1980s and 1990s — including policy conditions relating to trade and capital account liberalization, privatization and other "structural" issues — would have no place in a reformed IMF. No matter what the source of short-term current account deficits, the Fund should desist from imposing "structural" conditionality of this nature, and stick to issues related to macroeconomic policy and exchange-rate management.

The current crisis also suggests that excessive reliance on export expansion and foreign direct investment, and chronic dependence on foreign aid, increase vulnerability to external shocks. The IMF should enhance its current support to LIC members in their efforts to mobilize domestic resources for development, and thereby increase their resilience to such shocks. Such efforts should aim to further widen the tax base, improve the efficiency and effectiveness of tax collection and assist in financial-sector deepening and intermediation of domestic savings and remittances.

As to the resources provided by the IMF, most of its financing had come on non-concessional or mildly concessional terms, accentuating the emphasis on fiscal and monetary constraint, and thereby heightening the problems associated with its conditionality. Moreover, many LICs had become serial borrowers from the IMF, as successive programs failed to achieve their targets and went off-track. This led to an accumulation of debt to the Fund and contributed significantly to the debt distress of LICs, leading eventually to the need for multilateral debt relief in the present decade. A reformed IMF should provide its financing on highly concessional, and preferably grant, terms.

The requisite funding cannot come from the IMF's ordinary facilities, which by design can only support short-term, non-concessional financing. One possible source is through the proceeds from selling some of the IMF's gold holdings, as recommended by the G20 meeting in London in April 2009. In the longer term, grant or concessional resources should come from bilateral aid donors, regularized through periodic replenishments as with the World Bank's International Development Association (IDA) facility.

The other possible mechanism for providing additional resources is through the Fund's issue of Special Drawing Rights (SDRs). The decision by the G20 in April (ratified in July by the IMF's Board) to allocate US$250 billion worth of SDRs to inject liquidity into the global economic system represents by far the largest expansion in the stock of SDRs since their inception 40 years ago. Moreover, SDRs are allocated unconditionally, avoiding the pitfalls of pro-cyclical adjustment programs typically required by the Fund. However, since the allocation takes place according to IMF quotas, the countries with the largest quotas and the least need (the industrial countries) will receive the lion's share, leaving only $100 billion to developing and emerging market countries, and only US$18 billion to the LICs (although this represents a 20 percent increase in their reserves).

Some high-income members are considering donating a portion of their SDR allocation to more needy members; others should be invited to do so. In the longer term, allocations should be made more on the basis of need — thus benefiting primarily the LICs — than on the basis of IMF quotas.

With regard to the problem of indebtedness, greater recourse by LICs to grant concessional financing and SDR allocations would also obviate the accumulation of LICs' debt to the IMF. This is an important objective in itself. As a creditor in its own right, the Fund was in a conflict of interest position in dealing with member countries seeking debt relief. In future, the IMF should assist indebted low-income countries on the same basis as it does in other circumstances — with counter-cyclical, growth-friendly financing and advice, and without financial claims on countries it is supporting. It should also support a debt resolution mechanism spearheaded by the LICs themselves.

Finally, if the IMF continues to have a role in the LICs, they should have enhanced voice and representation in the governance of the Fund.

The under-representation of LICs in both the Bretton Woods institutions undermines their legitimacy and effectiveness. Moreover, current initiatives to increase the voice and representation of emerging market and middle-income countries in the Fund and Bank must not at the same time dilute the LICs' position. As long-term partners of these multilateral organizations it is essential that the LICs can play an effective role in their governance and decision making.

Conclusion

If the IMF is unable or unwilling to reform to become a more cooperative and benign player in the low-income countries, the alternative is an exit strategy. The Fund would provide short-term balance-of-payments support to other more developed members on a non-concessional basis. Low-income countries would look primarily to the multilateral development banks and the bilateral donors, as well as to mobilizing their own resources more effectively. There would still be a need for an anti-shocks facility and a debt-resolution mechanism, which the World Bank could organize (or these could be designed through regional organizations).

Recommendations

1. Particularly when an external shock is the cause of the current account deficit, as is currently the case for many low-income countries, the Fund's programs should support counter-cyclical macroeconomic policies rather than fiscal and/or monetary compression.
2. No matter what the source of short-term current account deficits, the Fund should desist from imposing "structural" conditionality of this nature, and stick to issues related to macroeconomic policy and exchange-rate management.
3. The IMF should enhance its current support to Low-Income Countries (LIC) members in their efforts to mobilize domestic resources for development, and thereby increase their resilience to shocks. Such efforts should aim to further widen the tax base, improve the efficiency and effectiveness of tax collection and assist in financial-sector deepening and intermediation of domestic savings and remittances.
4. A reformed IMF should provide its financing on highly concessional, and preferably grant, terms.
5. Some high-income members are considering donating a portion of their SDR allocation to more needy members; others should be invited to do so. In the longer term, allocations should be made more on the basis of need — thus benefiting primarily the LICs — than on the basis of IMF quotas.
6. In future, the IMF should assist indebted low-income countries on the same basis as it does in other circumstances — with counter-cyclical, growth-friendly financing and advice, and without financial claims on countries it is supporting. It should also support a debt resolution mechanism spearheaded by the LICs themselves.
7. Enhance LICs voice and representation in the governance of the Fund.

Annex I: CIGI Projects Spotlight

CIGI'09: Towards a Global New Deal

Each autumn, The Centre for International Governance Innovation (CIGI) hosts its premier annual event, the Conference on International Governance Innovation, gathering approximately 200 leading experts and policy makers from Canada and around the world to discuss and debate issues of global importance.

This year's conference, titled CIGI'09: Towards a Global New Deal, addresses the systemic impacts of the current global economic crisis and the long-term prospects for international governance. CIGI'09 will bring together CIGI's research team and other global experts to address and debate the following broad themes: (1) the impact of the current global economic crisis on the evolution of various governance systems and (2) the future role of financial regulators, the shifting role of the state in economic governance, and views on whether globalization should be furthered or better harnessed in light of the crisis. For more information on CIGI'09, including its agenda, participants and conference report, please visit: www.cigi09.org.

IMF Reform

The debate about IMF reform has been shaped largely by conversations within and among OECD countries and orthodox or mainstream economists. The IMF Reform Project proposed to remedy this imbalance within the debate.

Durring 2007-2008, CIGI, the Washington, DC-based New Rules of Global Finance, and Oxford University's Global Economic Governance Programme sponsored a series of regional conferences that enabled developing countries to articulate their needs and priorities for future services from the IMF.

Former and current finance ministers, central bank governors, academics and stakeholders from each region gathered to discuss in small and intimate settings the kinds of monetary cooperation that would benefit their region most, and what role the IMF would or would not play in achieving these ends.

A series of regional conferences, in Asia, Central Asia, Africa, the Middle East and Latin America, enabled developing countries to articulate their needs for future services from the IMF. The IMF was evaluated based on technical assistance, conditionality and governance reforms criteria.

IMF Reform Project Meetings.		
Region	**Location**	**Date**
Asia	China	September 2007
Central Asia	Kyrgyzstan	May 2008
Africa	Mozambique	May 2008
Middle East	Jordan	March 2008
Latin America	United States	April 2008
North America	Canada	July 2008

At the sixth meeting, held at CIGI in July 2008, Dr. Bessma Momani, Dr. Jo Marie Griesgraber and Professor Ngaire Woods presented their findings from the five previous meetings. To learn more about this project, please visit: http://www.cigionline.org/project/imf-reform.

STUDY GROUP ON GLOBAL ECONOMIC GOVERNANCE

The global economic crisis has helped to expose significant gaps in the international financial system. While present efforts have focused on the regulation of systemically important institutions, markets and products, major challenges such as institutional reform, currencies and macro-level imbalances loom unaddressed over international debates. In November 2008, CIGI partnered with Chatham House and Istituto Affari Internationali for a two-year examination of the long-term implications of the crisis for the structure and operation of global economic governance.

The Study Group has assembled international scholars and experts to analyze the G20 process, to track national and international policy responses, and to provide recommendations for reform of the global financial and monetary architecture. As an extension of the Economic Diplomacy stream of CIGI's BRICSAM research project, the Study Group focuses on the role of the major emerging powers and to the reform of international financial institutions to reflect the shifting economic order. Through this analysis, the Study Group examines post-crisis scenarios and proposes adaptive structures for responsive economic governance.

A special issue of International Affairs, entitled "Global Economic Governance in a World of Crisis" (May 2010) has been commissioned alongside a set of joint CIGI/Chatham House briefing papers on key issues for G8/G20 deliberations.

GLOBAL TRADE ALERT

The global economic downturn has seen the collapse of banks and industry sectors, and rising unemployment. Governments en masse have introduced massive stimulus packages, bailouts and subsidies to kick start their own economies and by extension the world's economy.

Many of these packages include protectionist measures that, according to the World Trade Organization's General Council, are increasing tensions between nations. Global Trade Alert is a new online resource that monitors policies affecting world trade, coordinated by the Centre for Economic Policy Research (CEPR) and a consortium of international research institutes, including International Development Research Centre (IDRC), the World Bank and CIGI. An independent initiative, Global Trade Alert provides real-time information about measures taken by governments during the global economic downturn and their likely effects on foreign commerce. Member research institutes identify and assess how these new state measures will impact trading partners.

The up-to-date information and informed commentary provided by Global Trade Alert will help ensure that the G20 pledge not to "repeat the historic mistakes of protectionism of previous eras" is met, by maintaining confidence in the world trading system, deterring beggarthy- neighbour acts, and preserving the contribution that exports could play in the future recovery of the world economy. For more information, or to review the Global Trade Alert's analysis, please visit: www.globaltradealert.org.

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Thomas A. Bernes just completed his post as director of the Independent Evaluation Office at the International Monetary Fund (IMF). Before assuming this position in June 2005, he held several positions, including executive secretary of the joint IMF-World Bank Development Committee and deputy corporate secretary of the World Bank, IMF executive director for Canada, Ireland and the Caribbean, assistant deputy minister of Finance and G-7 finance deputy in Canada. In the mid-1980s, Mr. Bernes served as head of the OECD's General Trade Policy Division.

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Robert Lavigne is principal researcher of the Global Issues Division, International Department, at the Bank of Canada. He works on IMF reform issues, notably surveillance reform, and advises the Canadian office at the Fund on policy issues discussed by the Executive Board. His other areas of interest include the economics of fiscal adjustment, global imbalances and the international monetary system.

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About CIGI

The Centre for International Governance Innovation is an independent, nonpartisan think tank that addresses international governance challenges. Led by a group of experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate, builds capacity and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI's work is organized into six broad issue areas: shifting global order; environment and resources; health and social governance; international economic governance; international law, institutions and diplomacy; and global and human security. Research is spearheaded by CIGI's distinguished fellows who are leading economists and political scientists with rich international experience and policy expertise.

CIGI was founded in 2002 by Jim Balsillie, co-CEO of RIM (Research In Motion), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario. CIGI gratefully acknowledges the contribution of the Government of Canada to its endowment Fund.

Le CIGI a été fondé en 2002 par Jim Balsillie, co-chef de la direction de RIM (Research In Motion). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario. Le CIGI exprime sa reconnaissance envers le gouvern-ment du Canada pour sa contribution à son Fonds de dotation.

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About CIC

The Canadian International Council (CIC) is a non-partisan, nationwide council established to strengthen Canada's role in international affairs. With local branches nationwide, the CIC seeks to advance research, discussion and debate on international issues by supporting a Canadian foreign policy network that crosses academic disciplines, policy areas and economic sectors.

The CIC features a privately funded fellowship program and a network of issue-specific Working Groups. The CIC Working Groups identify major issues and challenges in their respective areas of study and suggest and outline the best possible solutions to Canada's strategic foreign policy position on those issues. The CIC aims to generate rigorous foreign policy research and advice.

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