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GLOBAL INSIGHTS

Strengthening the Governance of the International Monetary Fund: How a Dual Board Structure Could Raise the Effectiveness and Legitimacy of a Key Global Institution

Christian Thimann, Christian Just, and Raymond Ritter

The ongoing financial crisis and a difficult international adjustment process involve a multitude of actors and forums. They all grapple with the complexities of a globalized economic and financial system and the challenges arising from the financial turmoil and economic downturn. Governments have responded with unilateral, bilateral, or regional actions. Major central banks have cooperated on an ad hoc basis, and the G7 and the G-20 have attempted to provide economic stewardship. But the considerable spillovers and policy interdependence in a globalized economy that were already visible in the run-up to the turmoil have shown that the international monetary and financial system needs an effective steering committee to address such spillovers and facilitate cooperation on global economic matters.

For decades, the International Monetary Fund (IMF) was at the helm of the international monetary system. However, an alleged unequal treatment of its members, an ever expanding mandate diluting its core responsibilities, complacency in its policy advice, and the dominance of its governance by some large countries have more and more sidelined the IMF in the international policy debate. While the actions by the G7 may have been sufficient to address economic shocks in the past, the emergence of new economic players in Latin America, Eastern Europe, and Asia necessitates a fresh look at how to address global economic challenges, which involve a rising number of systemically important players.

The IMF has realized that it risks being sidelined in global economic affairs and is now in its fourth year of a strategic review of its setup and activities, with the declared objective of regaining its position as the "steward of international financial cooperation and stability" and putting itself firmly at the center of the international monetary system. Progress is under way: The IMF is strengthening its surveillance by deepening the analysis of interlinkages, including exchange rates, in its bilateral economic surveillance. It is placing

more focus on macrofinancial linkages. Moreover, it is reviewing its lending instruments to adapt to the requirements of Fund members, and it is also revising its leading role. As far as IMF resources are concerned, there is broad agreement among the membership that the Fund's lending capacity needs to be substantially increased. While discussions continue on the precise amounts and modalities, Japan and the EU have announced that they will provide loans to the Fund in the order of US$100 billion each; a response from the US is still outstanding.

Will these reform steps be sufficient to restore the IMF as the central institution for international monetary cooperation? This is to be doubted. The crucial element that is missing to complete the reforms is an overhaul in the governance of the IMF and, in particular, in the structure and functioning of the executive board to transform this body into an effective and legitimate forum for dealing with global economic issues. The only step undertaken in this context was to update the byzantine way of calculating quotas; that is, countries' shares in the Fund, in spring 2008. This topic had occupied IMF bodies for over two years and resulted in a shift of 2.7 percent of the votes from advanced to emerging and developing economies. The reform is a good illustration of the proverbial elephant giving birth to a mouse, because it abstracted from changes to the structure and functioning of the board that are much more relevant than small adjustments in voting rights of a body that rarely takes formal votes.[1] In principle, the IMF executive board is uniquely placed to provide authoritative guidance to IMF member countries, exert peer pressure, and give economic policy advice. Being in continuous session, it receives up-to-date information on developments in member countries as well as in the global economy. It has an overview of different policy frameworks and economic policy tools and is aware of the constraints of domestic policymaking, all of which can facilitate tailoring its advice to specific countries. However, as we show in this article, the board is unconditionally overwhelmed by its tasks and responsibilities and too large to be an effective forum for true international economic dialogue.

Therefore, if there is no adjustment in the structure and functioning of the executive board, the final objective of IMF reform will be missed. The Fund will become more efficient, but it will not be more effective in providing a high-level forum for international economic cooperation in which peer pressure can be exerted also on systemically relevant economies, including the Fund's largest members whose macroeconomic and financial policies are prone to create important international spillovers. Without a change in its governance, the IMF will continue to lose clout at the expense of informal groupings, such as the G7 and G-20, that are potentially more effective and flexible but that do not have universal status.

* * *

A brief look at the current organization and working modalities of the twenty-four-member executive board shows how implausible it is to conjecture that the

board will take on a more central role in the international monetary system. Mandated by the board of governors,[2] the executive board is the IMF's permanent decisionmaking organ and conducts the day-to-day business of the IMF. In principle, it has a central role in policy formulation and oversight of the international monetary system. However, there are several shortcomings with the current setup and structure.

Some executive directors retain a significant degree of freedom in developing positions they represent at the board, while others mainly transmit views from their capital. This limits their maneuvering room in discussions and negotiations. Many directors are midlevel officials from a country's ministry of finance or central bank, which reduces their authority to decide independently or to exert proper peer pressure. Some directors enjoy long tenures of a decade or more. They develop considerable expertise also on the internal IMF issues but, by implication, are at times rather remote from member countries' policymaking. Most IMF member countries are grouped into one of the sixteen constituencies represented on the board, but the eight most important countries in the IMF have their own director, which means that the interests of the large countries can be represented much more effectively.

On top comes the daunting and complex workload that the executive board faces. The board usually convenes three times a week to discuss all the different facets of IMF activities. In 2007, the board held over 200 meetings, received a total of more than 70,000 pages of documents, and produced over 10,000 pages. Typically, the agenda is filled with the review of bilateral surveillance and lending cases. After all, the board has to go through about 180 country surveillance reports each year, noting that countries receiving IMF financial assistance are reviewed up to four times per year. In addition, the board regularly assesses the IMF's own policies and instruments and has to deal with new tasks, such as anti–money laundering initiatives or the impact of climate change on members' economic policies. This plethora of topics invariably leads to a crowding out of the executive board's prime function of multilateral surveillance, on which the board spends only 6 percent of its time.[3]

* * *

Not surprisingly, proposals to strengthen the board abound. Most of these proposals focus on reducing the size of the board, improving the pattern of country representation, upgrading the status of members, and strengthening the independence and accountability of its members. Other contributions suggest enlarging the board to give more voice to, especially, developing countries. Some contributions contain proposals to boost effectiveness through greater delegation to staff or subcommittees. Finally, there are proposals to complement the board through an agenda-setting "supercommittee" like a council.[4]

All these proposals rest on the assumption that a single executive board is sufficient to perform the great number of various tasks in an efficient and legitimate manner. One simply has to find the right size and level of representation, as well as the right mode of operation, and the board will be able to deal effectively with all its tasks. We doubt that this assumption is sound: even after the different elements of the medium-term strategy are put into practice, the board will continue to be confronted with an overwhelming and excessively complex workload. Unless its current one-size-fits-all structure is appropriately reformed, the board will not become the key policy forum for global economic and financial issues.

Our proposal is fundamentally different from those in the literature: we argue that the highly diverse tasks of the IMF, to be implemented effectively, require different governance structures. We believe that the optimal number of governing bodies for the ongoing IMF work is not one but two, duly distinguishing between multilateral matters and country-related matters. Specifically, we propose to split the tasks that are predominantly systemic in nature from those that are primarily country focused and technical, and we believe that this can be done. Two different boards would be dealing with these issues: a systemic issues board and a country issues board.

The systemic issues board would supervise the setup and functioning of the international monetary and financial system and identify related policy implications. The conduct of multilateral surveillance would become its central task. Guided by various inputs provided by Fund staff including the World Economic Outlook, the Global Financial Stability Report, reports on exchange rates, and the multilateral consultation process on systemic and horizontal issues this board would assess global risks stemming from the rising integration of national economies into the global economy. These risks pertain in particular to market and policy spillovers that have a bearing on the stability of the international monetary and financial system. Moreover, this board would be in charge of developing a consensus on policy measures to address the challenges posed by globalization. With its clear focus and mandate, the systemic issues board would become the key forum for global monetary consultation.

This mandate requires that the board be comparatively small in size but retain universal status. We suggest twelve executive directors representing the main regions of the global economy. The size corresponds to Keynes's original proposal for the IMF's board and would be half that of today's board, thus allowing much greater interaction and dialogue. Importantly, and in contrast to the G7 or G-20, this board would reflect the Fund's universal membership, as all executive directors would represent multiple-country constituencies comprising regional geographic groupings.[5] It would mean that the constituency system, which has been operating successfully at the Fund for sixty years, would be applied consistently to all executive directors.[6] Moreover, and fundamentally different from the G7 or G-20, the board would form part of a fully legitimate

and universal international organization, rather than an ad hoc grouping, and would be regularly supported by input from IMF staff and management.

Its members should be senior officials from member countries with sufficient political clout and authority to act independently. These officials would be elected for a period of some years by members of each constituency and typically could be second in command at treasuries or central banks. They could be those who are involved in other key international economic and financial forums (e.g., G7, G-20, or G-24 deputies) to guarantee consistency of policy advice and prescriptions; they should also be closely linked to decision-makers in their constituencies. Chaired by one of its members, the systemic issues board would be a nonresident board and would meet on a regular basis, perhaps three or four times per year. The managing director would be invited to its sessions to provide a close nexus with the country issues board.

The systemic issues board would address two main areas of criticism made vis-à-vis the Fund, namely, that it is not effectively providing a central forum for global monetary cooperation and that it has paid insufficient attention to multilateral surveillance such as the systemic implications of macroeconomic policies of large economies.[7] With sufficiently senior representation, there would be less of a desire to outsource policy issues pertaining to global monetary cooperation to other forums. With its focus on the multilateral dimension of surveillance, adequate treatment would be given to economic and financial linkages among countries, and with its higher level of representation, the key tool of the Fund peer pressure would be used more effectively. Effective peer pressure is especially important vis-à-vis the larger economies, since it is they that create important externalities and spillovers. The current financial turmoil, which affects the global economy in its totality, is a clear case in point. The systemic issues board could alleviate such risks and push for early policy correction by convening at one table the critical mass of those countries in the global economy that are potentially affected.

The country issues board would retain the main features of the current executive board. It would conduct the Fund's bilateral surveillance activities and run the organization's day-to-day business. Moreover, it would focus on issues such as capacity building; that is, technical assistance and training as well as structural and crisis lending within access limits. As far as the Fund's day-to-day business is concerned, this board would be responsible for all administrative matters and decide inter alia on the Fund's budget. In sum, it would be in charge of all issues not explicitly relegated to the board of governors or the systemic issues board.

Its working focus implies that the country issues board can be more inclusive. Since it does not focus on horizontal issues but rather discusses one country case at a time, it could even be enlarged, when compared to today's situation, to foster its legitimacy. One could envisage creating additional chairs exclusively for developing countries from Africa, Latin America, and Asia to

increase their effective participation in this body. At the same time, even a partial consolidation of Europe's fragmented representation to reflect growing economic cohesion on this continent would allow reducing the number of chairs by at least a few.[8] This could return the board size to its current situation. In line with current practice, this body would be a resident board and be chaired by the managing director. The workload of the country issues board could be alleviated by a more rigorous recourse to a committee substructure along functional lines such as structural lending, technical assistance, or policy issues.

The larger country issues board would have more resources and time to devote to country matters, including the Fund's role in low-income countries and its overall advice to member countries. Emerging and developing economies would have more chairs at the table and thus have a greater voice in discussions on country issues, especially when it comes to the Fund's role in developing economies. Double-majority voting in this board could further increase further the legitimacy of IMF policy recommendations and foster ownership by member countries.

The governance setup we propose here is unique because there are no precursors, either nationally or internationally. Operating the IMF with a dual board structure will clearly entail challenges. The delineation of responsibilities between the two boards would need to be respected to avoid gaps and overlaps. The multilateral issues would be brought to the systemic issues board, and all country-related matters, as well as others (IMF policies, budget, and the like), would be assigned to the country issues board. The two boards would be informed of each other's proceedings. To ensure that this delineation of responsibilities is in line with the goal of achieving consistent and compatible policy recommendations, the agendas of the two boards would be coordinated, including a clustering of treatment of countries in a region or of systemic economies. This would neatly feed into the deliberations of the systemic issues board and its task of identifying multilateral challenges.

* * *

There is a clear need to put the Fund firmly back at the center of the international monetary system. The proposed institutional change would strengthen the legitimacy and effectiveness of the executive board as a forum for multilateral policy debate and, as a consequence, reinforce the central position of the IMF in the governance of the international monetary system. Such an outcome would be highly advantageous given that the stability of the system crucially hinges on having in place and at its center a legitimate and effective IMF. 🌐

Notes

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1. Moreover, it should be noted that the first part of the voting adjustment, in the Singapore 2006 resolution, gave four emerging economies a greater weight (China, Korea, Mexico, and Turkey) at the expense of not only the G7 economies but also African economies.

2. The board of governors, which currently comprises 185 members, who are ministers of finance or central bank governors, meets once a year and is the Fund's supreme organ.

3. See IMF Independent Evaluation Office, *Governance of the IMF: An Evaluation,* April 2008.

4. Contributions focusing on a more effective and/or smaller executive board include L. van Houtven, "Rethinking IMF Governance," *Finance and Development* (September 2004): 18–20; M. Kahler, "Internal Governance and IMF Performance," in E. Truman, ed., *Reforming the IMF for the 21st Century* (Washington, DC: Institute for International Economics, 2006), pp. 257–270; P. Kenen, J. Shafer, N. Wicks, and C. Wyplosz, *International Economic and Financial Cooperation: New Issues, New Actors, New Responses,* Geneva Reports on the Global Economy 6 (Geneva: International Centre for Monetary and Banking Studies, 2004); E. Truman, *A Strategy for IMF Reform* (Washington, DC: Institute for International Economics, 2006); L. Bini Smaghi, "IMF Governance and the Political Economy of a Consolidated European Seat," in Truman, *Reforming the IMF for the 21st Century.* Kenen proposes to replace the executive board with a managing board, which would consist of sixteen individuals representing the Fund's universal membership (P. Kenen, "IMF Reform: Comments on the Address of the Managing Director of the IMF," at the book release meeting for *Reforming the IMF for the 21st Century,* Institute for International Economics, Washington, DC, 2006). For some authors, a greater voice of developing economies is so important that they advocate adding further representatives; see, for example, P. Evans and M. Finnemore, *Organizational Reform and the Expansion of the South's Voice at the Fund* (Washington, DC: International Monetary Fund, 2001). There are also procedural proposals that aim at increasing the efficiency of the executive board; see, for example, M. King, "Through the Looking Glass: Reform of the International Institutions," speech delivered at the Melbourne Centre for Financial Studies, Australia, December 2006; and D. Dodge, "The Evolving International Monetary Order and the Need for an Evolving IMF," speech delivered at Princeton University, March 2006.

5. A possible geographical breakdown of the twelve representatives could be as follows: three executive directors representing Asian countries; three representing European and CIS countries; three representing Western Hemisphere countries; two representing sub-Saharan Africa; and one representing the Middle East and North Africa (MENA) region.

6. Today eight directors represent individual countries and sixteen represent multicountry constituencies.

7. See IMF, *External Evaluation of IMF Surveillance: Report by a Group of Independent Experts,* EBAP/99/86 (Washington, DC: International Monetary Fund, 1999).

8. See L. Bini Smaghi, "Powerless Europe. Why Is the Euro Area Still a Political Dwarf?" *International Finance* 9, no. 3 (August 2006): 1–19.