1

Evaluating the Governance of the IMF

RUBEN LAMDANY AND LEONARDO MARTINEZ-DIAZ

Why Evaluate IMF Governance?

The papers contained in this volume draw on background work done in preparation for a study of the governance of the International Monetary Fund (IMF) by the Independent Evaluation Office (IEO) of the IMF, and they seek to contribute to the ongoing dialogue on how best to strengthen the governance of this important global institution.[1] Since the IEO study was released in May 2008, the task of strengthening the IMF's governance, already pressing and long overdue, became a matter of urgent attention. The ongoing financial crisis that has precipitated the deepest global recession since the 1930s has raised questions about the Fund's capacity to perform its key surveillance mandate under its current governance arrangements. There is widespread concern that the Fund (and other international organizations as well) appears to have missed the crisis as it was evolving and thus did not issue timely and effective warnings. This has intensified calls to restructure the international financial architecture. But even as world leaders move in this direction, they seem to agree overwhelmingly that the IMF should remain a central part of that architecture. At the same time, they emphasize that a more legitimate, accountable, and effective IMF must emerge from the crisis.

[1]For details on the IEO evaluation, see *Governance of the IMF: An Evaluation*, Independent Evaluation Office, International Monetary Fund, May 28, 2008. Available via the Internet: www.ieo-imf.org. The papers in this volume represent the authors' views and not necessarily those of the IEO, the IMF, or IMF policy.

What do we mean by "governance" in this volume, and what is the governance reform debate about? At issue is whether governance arrangements—the formal and informal structures and procedures that determine how an organization is steered and controlled—are the most appropriate given the institution's mandate, the expectations of its shareholders and stakeholders, and the political environment in which it operates.

Much has been written in recent years on how to strengthen the governance of public and private sector institutions. In the private sector, high-profile corporate scandals earlier in the decade highlighted the importance of good governance in protecting shareholder value. These failures accelerated the production of at least a dozen codes of good corporate governance in countries around the globe. In the public sector, citizens' demands for better-run state-owned enterprises, more responsive and accountable government agencies, and more transparent central banks also led to greater scrutiny of governance arrangements.

Based on codes developed in member countries, the OECD developed principles of good governance for the private sector and for state-owned enterprises. The OECD Council endorsed the Principles of Corporate Governance, standards and guidelines for good corporate governance practices and their implementation. The Principles have been endorsed by the IMF itself, and observance of the standards by the Fund's member countries is routinely assessed as part of its Reports on the Observance of Standards and Codes (ROSCs). Additionally, the OECD developed Guidelines on Corporate Governance of State-Owned Enterprises (SOEs), which provide governments with benchmarks to help improve the governance of their SOEs and to evaluate their performance. The IMF has developed a Code of Good Practices on Transparency in Monetary and Financial Policies, as well as standards for Central Bank Internal Governance and Audit, which are also reviewed as part of the ROSCs.

Yet, international organizations—often forceful advocates of good governance in developing and transition economies—have lagged behind in terms of examining and strengthening their own governance arrangements. There are three reasons why governance reform has proven so difficult to address in international organizations. First, these organizations face the problem of "multiple principals" to a much larger extent than public and private enterprises. They are controlled by many governments—governments that often do not agree on what the organization should do. In addition, multiple principals make accountability a thorny problem. In contrast to the domestic political context, where citizens usually have channels to hold policymakers ultimately accountable, e.g., through elec-

tions, it is less clear where accountability ultimately lies for the actions of an international organization and how that accountability can be exercised.

Second, unlike private corporations, which focus on the clear, quantifiable goal of profit maximization, international organizations are entrusted with multiple and sometimes conflicting objectives. International organizations are asked, for instance, to promote free trade, eradicate world poverty, safeguard global financial stability, stop the spread of infectious diseases, and promote respect for human rights and democratic norms. In the case of the IMF, the Articles of Agreement list a series of institutional goals, including to promote international monetary cooperation, to facilitate the expansion and balanced growth of international trade, to promote exchange stability, to lend to members to allow them to correct balance of payments imbalances without resorting to measures destructive of national or international prosperity, and to shorten the duration and lessen the degree of disequilibrium of members' balance of payments. Measuring an international organization's contribution toward meeting such a variety of objectives is often difficult, if not impossible. Even more difficult, therefore, is evaluating the extent to which its governance structures facilitate or complicate these endeavors.

Finally, international organizations are political institutions embedded in the arena of world politics. As a result, governments regard international organizations not only as mechanisms for producing global public goods, but also as vehicles for advancing their national interests and as forums for securing voice and influence in international affairs. They therefore measure the effectiveness of an organization's governance structure not only by its contribution to its effectiveness, but also by the extent to which it affords them voice and influence. This dimension further complicates the evaluation of the governance of any international organization.

The remainder of this introduction provides background information on the IMF, puts the different papers in this compendium in context, and concludes with a discussion of the three cross-cutting themes that emerge from these studies: the need for greater ministerial-level involvement in the governance of the IMF, the need to redefine the role and activities of the Executive Board, and the need to address the accountability gaps that afflict the organization.

How Do We Evaluate IMF Governance?

Despite the above-mentioned difficulties, a re-evaluation of the governance of the International Monetary Fund is both necessary and urgent,

especially in the context of the global economic crisis. Since its creation in the 1940s, the Fund's membership has quadrupled in size and its mission as guardian of the par value system has long been superseded. The nature of its operations has changed from what was basically a cooperative of broadly similar countries to an organization where some members are always creditors and others are always borrowers. Also, the extent and complexity of its surveillance and technical assistance activities have expanded considerably. Yet, its governance structures and business practices have not evolved in line with these changes, raising the question of whether they have become obsolete.

Much of the debate about IMF governance has focused on whether and how its ownership structure should be adjusted to reflect the increasing weight of emerging market countries in the global economy (referred to as quota reform), and on whether emerging and especially low-income countries should receive voting power beyond their quotas (through the allocation of basic votes). But how the institution is steered and controlled goes beyond quotas and voting mechanisms—it also includes how the governing bodies are structured and what procedures are used for making decisions and holding decision-makers accountable. Those are the aspects of the IMF governance analyzed in this volume.

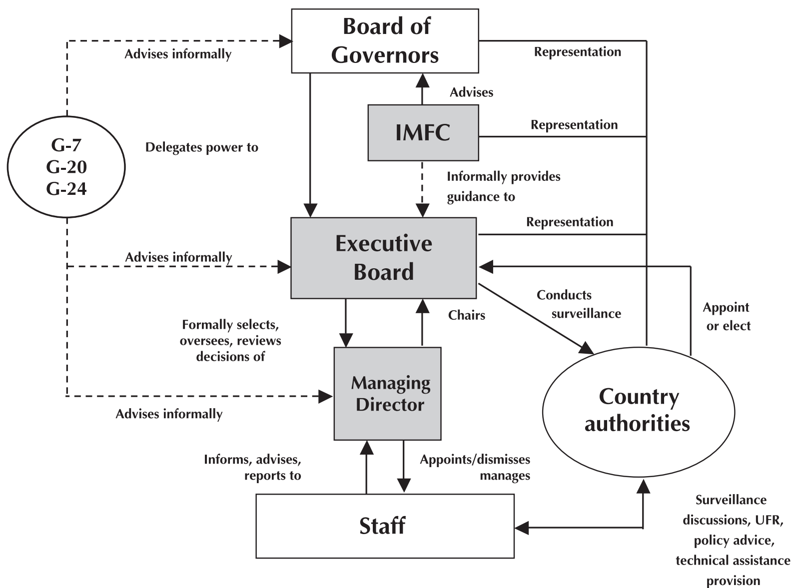
The papers in this compendium focus on the apex of the Fund's institutional structure—the Board of Governors, the Executive Board, Management, and the International Monetary and Financial Committee (IMFC). The Board of Governors is composed of one governor and one alternate from each of the IMF's 185 member countries, usually the finance minister or central bank governor. It meets once a year for a few hours and oversees the Executive Board (the Board), to which it has delegated most of its powers. The Board is composed of 24 Executive Directors (Directors), five of whom are appointed by the IMF members having the largest quotas, and 19 of whom are elected by the other members and organized in constituencies. Voting power on the Board is determined by members' quotas. Management is composed of the Managing Director (MD) and three deputies. The MD is both the non-voting chair of the Board and the "chief of the operating staff of the Fund." The MD is charged with conducting "the ordinary business of the Fund" under the "general control" of the Board.

The IMFC is composed of 24 Governors, reflecting the constituencies in the Board, and it meets twice a year for about one day each time. While formally it is only an advisory body, informally it wields significant power, given its composition. Like the Interim Committee, which it succeeded in 1999, the IMFC was created as a forum to allow for ministerial-political-level involvement in the governance of the Fund, given that the Board of

Governors is impractically large. The Articles of Agreement contemplate the creation of a ministerial-level decision-making body, the Council, with a formal mandate to play this role. However, the membership has so far found it difficult to reach agreement on the specifics of this ministerial body, and therefore it has not been activated.

Another important element in the governance structure of the IMF, which this volume covers only indirectly, is composed of several informal country groupings. These meet regularly to coordinate positions and raise issues to the attention of the Board and/or IMFC; the best known and most powerful ones are the G-7, the G-20, and the G-24. These groupings operate outside the formal structure of the IMF, and their memberships are self-selected, which raises questions about its their legitimacy. In addition, there is the staff of the Fund, which comprises some 2,500 people from over 150 countries; they are generally known for their hierarchical, disciplined, and generally cohesive institutional culture. Figure 1 below shows the Fund's main governance structures, as well as their relationships.

Figure 1. Stylized View of IMF Governance



Source: Based on Martinez-Diaz, Chapter 5 in this volume.

The papers in this volume fall into three categories. The first provides background on the evolution of the governance of the Fund, drawing insights from the history of Fund governance and from current practices in the private sector and other international organizations. Alexander Mountford provides a lively description of how the Fund's governance organs evolved and explains their current structure and workings. The author was a protagonist in many of the events described in his paper. Alisa Abrams draws on primary sources to trace the discussions on the creation of a ministerial-level body for the Fund, starting with the Committee of Twenty in the 1960s to the current debate about activating the Council.

Two papers compare Fund governance with that of other organizations. A paper prepared by a team from Dalberg Global Development Advisors looks at practices in the private sector, while a paper by Leonardo Martinez-Diaz looks at other intergovernmental organizations.

Comparisons with other organizations are undertaken with caution. The degree to which the IMF can be compared directly to a business enterprise or to another international organization is limited. There is no other organization that has the same goals and operations as the IMF, and therefore, it would not be appropriate to adopt identical governance arrangements. On the other hand, aspects of the mandate and activities of many organizations are similar to those of the Fund. For example, the World Bank often lends to countries in parallel with the IMF, and provides technical assistance to country authorities. Like the Fund, the OECD and the WHO are engaged in surveillance, even though the former focuses on economic indicators and the latter on health indicators. Like the Fund, committees nested within the BIS formulate financial standards and codes. Moreover, these papers embrace the notion that useful ideas can be derived by examining the mechanisms through which other institutions (public or private) cope with challenges that have parallels at the IMF—facilitating strategic thinking, improving institutional effectiveness, promoting institutional accountability and learning, and increasing the organization's responsiveness to stakeholders and shareholders.

The second category of papers focuses on the internal workings of the Fund. They look at relatively narrow aspects of the functioning and operations of each of the governing bodies. Included in this group are studies by Jeff Chelsky describing the role and operation of the Executive Board's committees and the process for preparing summaries of Board discussions and decisions. The papers by Jeff Chelsky and Scott Clark and by Katrina Campbell describe how the IMF handles certain activities that are commonly considered fiduciary responsibilities of the Board (overseeing and enforcing the institution's framework for preventing and dealing with

misconduct and conflict of interest at the Board and Management levels, as well as with financial auditing). David Peretz describes how the selection process for the Managing Director and his Deputies is supposed to work, how it works in practice, how it works in other intergovernmental organizations, and how it might be reformed. Finally, Alexander Shakow examines the internal workings of the IMFC, including how its meetings are organized and how its communiqués are prepared.

Though these papers deal with technical and at times mundane aspects of the IMF's institutional life, the processes they describe are central to the Fund's effectiveness and legitimacy, as well as to the capacity of member countries to hold the institution and its decision-makers accountable. For example, dysfunctional committees or confusing summaries of Executive Board deliberations would hinder the effectiveness and efficiency of the institution. Also, the Fund's legitimacy would suffer greatly if the institution were not able to safeguard the robustness of its financial management or its ability to prevent misconduct at the levels of Board and Management. Similarly, a transparent leadership selection process is critical to ensure accountability and to confer legitimacy on the Fund's operations.

The third category of papers examines the Fund's governance "in action"—how the governance structures and arrangements work in practice to facilitate the delivery of the Fund's services to its members. There are two papers by Biagio Bossone; the first examines the relationship between Fund governance and the institution's capacity to formulate strategy, while the second studies the relationship between Fund governance and the Fund's surveillance function. Randy Stone's paper is a summary of a larger study[2] on how the Fund's governance conditioned its capacity to serve as fire-fighter in managing several systemic crises over the past fifteen years.[3]

These papers looked at the Fund's governance system as a whole, tracing how the different elements and bodies work together when the institution performs its major functions. Through these papers, we get a clear sense of how the governing bodies of the Fund work together in what is at times a complex, iterative process among Management, the Board, and

[2]The larger study quotes extensively from interviews that were conducted with the understanding that they would not be disclosed.

[3]The governance of the Fund's non-crisis lending has been covered in several IEO evaluations, including *The IMF and Aid to Sub-Saharan Africa,* IEO, 2007, and *Structural Conditionality in IMF-Supported Programs*, IEO, 2007. The governance arrangements for the delivery of technical assistance are discussed in *IMF Technical Assistance*, IEO, 2005, and in M. Cortés, 2008, *The Governance of IMF Technical Assistance*, IEO, Background Paper (BP/08/13).

member country authorities. A key insight to emerge from these papers is how informal governance bodies and processes work alongside the Fund's formal governance arrangements as the Fund delivers its main outputs.

What We Have Learned: Main Messages

In the remainder of this introduction, we outline the three main conclusions that follow from the studies in this volume. First, to strengthen its legitimacy and effectiveness, the Fund needs greater, higher-level, and more transparent involvement of member country authorities in its governance. Second, the Board needs to play a stronger role in strategy development and oversight, which requires a shift away from the day-to-day business of the organization. Finally, there are significant accountability gaps that need to be addressed if the IMF is to remain effective and regain legitimacy.

Ministerial Guidance

Several studies in this volume deal explicitly with the role that country authorities at the ministerial level play in guiding the IMF, both through formal and informal structures and processes. The Fund has always needed ministerial-level guidance to legitimize its surveillance work, to approve and mobilize emergency financing that extends well beyond its own resources, and to ensure buy-in of Fund policies among the membership. Bossone shows how this need arises and how it is handled when designing strategies or performing surveillance, while Stone highlights the informal channels used by country authorities during regional and global crises. Yet, as illustrated in Abrams, Mountford, and Shakow, the Fund's members have been struggling for decades to find the right mechanism for this type of high-level political engagement.

The current arrangement for ministerial-level involvement at the Fund rests on two governance structures, the IMFC and the informal country groupings (the G's), neither of which is provided for in the Articles of Agreement. The IMFC evolved in the 1990s from the Interim Committee, an *ad hoc*, temporary, and advisory body created in the 1970s when the membership recognized that the Board of Governors had become too large to steer the organization. As the Bossone and Shakow papers show, the IMFC today is a useful event-forcing mechanism, one that compels ministers and/or governors to engage regularly with IMF issues, but it is also one with many shortcomings in terms of the quality of engagement, the legitimacy of its communiqués, the degree of voice and representation

it affords the membership, and most important the fact that it is only an advisory body without the formal authority to make decisions on behalf of the IMF or to hold Management or the institution accountable.

The second structure is the network of *ad hoc*, inter-governmental networks known as the "G's." These networks first emerged in the 1970s, and the most prominent of these, the G-7, eventually became the informal steering committee for the global economy and the key source of ministerial-level guidance for the Fund. Since its creation in 1999, the G-20 has become increasingly important. The emergence of the G's can be interpreted as evidence of the limitations of the IMFC, and of the Fund's formal structures as vehicles for ministerial-level guidance. The Board of Governors is too large and unwieldy, and the IMFC is perhaps also too large, and its composition not adequately reflective of the power structure of the global economy.

The trade-offs inherent in the existing structure are revealed clearly by the papers on leadership selection, surveillance, and crisis management. While the G's, working alongside the IMFC, have provided flexibility and rapid decision-making, they also dilute accountability and create a legitimacy deficit. They exacerbate the opacity of key decision-making processes, such as leadership selection. The weaknesses in current practice that are exposed by these papers lend support to the IEO recommendation to activate a formal, decision-making ministerial Council, as provided for in the IMF Articles of Agreement.

The issue of ministerial-level guidance for the Fund has taken on new meaning in light of the ongoing dialogue about the reform of "global governance." Key to this debate is whether the G-20 should replace the G-7/8 as the "world's steering committee," as seems to be occurring at least in the economic and financial arenas. In this context, the idea of the Council, suitably modified, could provide a more legitimate, more representative solution not only to the challenge of guiding the IMF, but also to the governance of the global economy.[4]

The Role of the Board

Most studies in this volume deal in one way or another with the role of the Executive Board. The Dalberg paper highlights the challenges faced in designing a board that can perform the multiple roles with which it is entrusted while remaining accountable and effective. Clark

[4]See *Global Governance Reform* by Colin Bradford and Johannes Linn, editors, Brookings Institution, 2007, and the Final Report of the Committee on IMF Governance Reform (also known as the Eminent Persons Committee), March 24, 2009.

and Chelsky and Campbell examine the tensions between the Board's executive role and its responsibility in fiduciary oversight. Martinez-Diaz discusses the four main roles that the IMF's Board is charged with: political counterweight (safeguarding the national interests of members), democratic forum (providing the whole membership with a voice), performance police (overseeing institutional performance), and strategic thinker (adapting the Fund to changing conditions). His paper points out that because of the trade-offs inherent in the current institutional design, the Board cannot be effective in all four roles and it concludes that currently the Board is relatively strong in its first two roles (i.e., political counterweight and democratic forum) but weak in the latter two (i.e., performance police and strategic thinker).

To strengthen its effectiveness in these two latter roles, the Board must rebalance its activities: it needs to delegate some of its executive responsibilities and play instead a stronger oversight role and focus on strategic decisions. The IEO governance evaluation ultimately recommended that this be done by delegation to committees of the Board and to Management.[5] But these changes would not be easy to implement. Chelsky explains that a significant strengthening of the Board committees would be needed. Also, and perhaps more important, a clear framework for Management accountability would need to be put in place, as discussed below.

Martinez-Diaz and Chelsky's paper on summarizing the views of the Board show that the IMF Board performs well in its role as a democratic forum, at least by the standards of other international organizations. Yet, the quality of shareholder representation could be enhanced further. Currently, eight chairs (a third of the total) represent only one country each, leaving the other sixteen to each represent an average of more than ten countries. As a result, the Fund's Board (along with that of the World Bank) has the largest, most crowded, median constituency size of all the international organizations examined in the papers. This reduces the quality of participation by most of the Fund's members, especially by some of the poorest countries that have very intensive policy relationships with the Fund. Based on this finding, the IEO evaluation recommended abolishing the appointed chairs on the Board, opening the door to the eventual reconfiguration of the constituencies.

[5]See *Global Governance Reform* by Colin Bradford and Johannes Linn, editors, Brookings Institution, 2007, and the Final Report of the Committee on IMF Governance Reform (also known as the Eminent Persons Committee), March 24, 2009.

Accountability Framework

The third thread that runs through most papers relates to a problem common to all international organizations: identifying who should be held accountable by whom, for what, and through what means. The most important accountability gap is present at the level of Management. The opacity of the leadership selection process (discussed in this volume by David Peretz), the absence of performance standards for the Managing Director, and the overlap between the Board's and Management's lines of authority make holding Management accountable very difficult. While a decision-making committee of ministers would be well positioned to pass judgment on Management's performance, the IMFC's advisory status makes this difficult.

There are also accountability gaps at the Board level. Campbell argues that crafting and enforcing an adequate code of ethics for Executive Directors is a significant challenge because Executive Directors are sometimes conflicted in their "dual role" of representing their governments and at the same time acting as "officers of the Fund" in the best interest of the institution and its shareholders as a collective. In his piece, Stone documents how the tensions between their national and institutional interests due to their dual role affect Directors during systemic crises. Clearly, these tensions affect those directors appointed by a single country differently than those elected by a multi-country constituency. The absence of Board self-evaluation procedures as practiced in many private and public organizations, and of standardized job descriptions for members of the Executive Board, compound these accountability problems. Finally, as Chelsky and Clark show in their paper, the system in place for ensuring that there is accountability for the institution's financial management—a system for which the Board is ultimately responsible—has significant weaknesses.

Building on these findings, the IEO governance evaluation provided recommendations for creating a more solid accountability framework. It called for a reform of the leadership selection process; for the development of job descriptions for Board members; for the activation of the Council, which could assess some aspects of Managerial performance; for the introduction of Board self-evaluation procedures; and for the adoption of a formal evaluation process for the Managing Director.

Together, the papers in this volume constitute the most extensive study in the public domain on how IMF governance works in theory and practice. As the debate on global governance and IMF reform continues in the corridors of power and in the halls of academia, we hope that the papers

in this volume will help stimulate and advance the discussion. We also hope this volume will motivate scholars and policymakers to continue to study the Fund's governance arrangements and to propose new ways for strengthening this important global institution.