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IMF Surveillance: A Case Study on IMF Governance

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Purpose and Scope of the Case Study

Central to the purposes of the IMF (the "Fund") is oversight of the international monetary and financial system. The Fund's Articles of Agreement direct the institution to exercise firm surveillance over the exchange rate policies of its member countries. To carry out this mandate, the Fund typically analyzes the appropriateness of each country's economic and financial policies for achieving orderly economic growth, and assesses the consequences of these policies for other countries and for the global economy.[1]

While the objectives of surveillance remain unchanged, its scope has been broadened in response to changes in the world economy. New tools of economic analysis became necessary after the demise of the Bretton Woods system of fixed exchange rates gave countries greater scope for discretion in national policymaking. The same happened following the

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[1]The modalities of Fund surveillance currently in use are succinctly described in Public Information Notice 04/95 of the Fund's Executive Board, of August 24, 2004: "The IMF fulfils this [surveillance] mandate through bilateral, regional, and multilateral surveillance. In accordance with Article IV of its Articles of Agreement, the main instrument of bilateral surveillance is consultations, normally held every year, with each of the Fund's members.

dramatic growth of international capital flows and the attendant explosion of external debt. Surveillance now takes account of the interrelationships of a growing set of policy objectives and instruments, and has come to encompass microeconomic and institutional aspects of economic reform.

The adaptation of IMF surveillance results from the continual interaction among the governing bodies of the Fund—the Executive Board (the "Board"), Management,[2] and the International Monetary and Financial Committee (the Interim Committee, prior to 1999)—as well as among the Fund and the intergovernmental entities engaged in the governance of international monetary affairs and finance. Assessing how such interactions affect the adaptation and the effectiveness of surveillance is important for making judgments on the effectiveness of the Fund's governance.

This study addresses three general issues: (1) how Fund governance has affected the adaptation of surveillance, (2) the role that the Fund's governing bodies have played in the conduct of surveillance, and (3) the ways in which Fund governance can be improved to make surveillance more effective. The paper considers how global financial governance interacts with Fund governance to influence the Fund's efficacy in fulfilling its surveillance mandate. In particular, it examines the way global governance defines the scope and boundaries of Fund governance in exercising surveillance.

The study covers the period from the mid-1990s onward, which has been a formative one for the policy agenda of the international financial community and its mechanisms of governance. In the economic arena, national actors emerged who have increasingly shared in global governance responsibilities. A growing number of national or regional policies have been seen to produce unintended global consequences that demand coordinated policy

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These consultations are complemented with regular analysis of economic and financial data provided by members and, as needed, informal contacts between the Fund and national authorities. At the regional level, the IMF holds regular discussions with the economic institutions of currency unions and participates in the activities of regional bodies. The pillars of the Fund's multilateral surveillance are the *World Economic Outlook* report and the *Global Financial Stability Report*, which are produced twice a year. The reports are complemented by more frequent, informal reviews of global economic and market developments." Comprehensive information on Fund surveillance is available on the IMF's website at www.imf.org. Extended treatments of surveillance, from institutional and historical perspectives, are offered by Guitián (1992), James (1995), Masson and Mussa (1995), and Boughton (2001). For a short and effective discussion of the legal basis of surveillance, see IEO (2006). For a recent discussion of political economy aspects of Fund surveillance, see Lombardi and Woods (2007).

[2]Fund Management" denotes the Managing Director, the First Deputy Managing Director, and two Deputy Managing Directors.

responses from the international community. More generally, the international community has come to recognize that a world economy dominated by integrated markets, and with countries at different levels of economic and institutional development, requires a system of global though non-binding rules of conduct, internationally promulgated and nationally implemented.

The information sources used for the study include IMF documents (annual reports, internal and external review reports, minutes and summing-up reports of Board discussions), communiqués and public statements of relevant entities, reports and studies of international organizations, and IEO interviews with officials from national governments, international institutions, and the Fund.

The study is organized as follows. The next section describes how international economic surveillance has evolved over time; it analyzes the pressures from world events and the international community and the Fund's responses. The third section evaluates how Fund governance has worked in adapting surveillance policy, and the fourth section proposes measures to enhance the role of the governing bodies of the Fund in adapting surveillance and ensuring its effective implementation.

IMF Surveillance: A History of Continuous Adaptation

Broadening the Scope of Surveillance Since the Collapse of Fixed Exchange Rates

The introduction of surveillance as an explicit component of the Fund's mandate was the product of adapting the Fund's mandate to the post–Bretton Woods order. With the abandonment in the early 1970s of the par value system, and the 1978 amendment of the Articles of Agreement, decisions on a member country's exchange rate moved into the domain of domestic policy. The international system shifted from rules to discretion, and the responsibilities of the Fund changed from those of guardian to those of overseer of members' policies. The introduction of surveillance represented an attempt to ensure that the international community would continue to exert discipline on exchange rates, even in the absence of hard rules. Under the Fund's amended Article IV, surveillance was to involve a continual exchange of information between the Fund and its members, culminating periodically in bilateral consultations. The new surveillance process was intended to provide an instrument of policy dialogue, persuasion, and peer pressure—in lieu of prescription—that would produce domestic economic conditions that would serve members' self-interest and contribute to international stability and prosperity.

The Fund's responsibilities in this new process were more complex than in the Bretton Woods days. In the new discretion-based system, preserving orderly economic and financial conditions required that members' external payments positions be sustainable. This implied that each country should make active use of domestic macroeconomic and structural policies to ensure the viability of the balance of payments over the medium term. As a result, the line between domestic and external policies became blurred and the scope of Fund surveillance broadened. To assess the medium-term external position of the economy called for analyses of market, industrial, and competition policies, as well as macroeconomic diagnostics. Re-drawing the boundaries of Fund surveillance became complicated and open to judgment.

Over the 1980s and early 1990s, the growing complexity of the world economy compounded the difficulties of effective surveillance. First, an impressive increase in international capital flows expanded the opportunities for investment and saving globally, but ultimately led to a severe debt crisis that strained the fabric of the international monetary and financial system. The strategy that was adopted in response eliminated the systemic threat, but left the tasks of restoring and preserving normality to capital flows as critical global concerns. Surveillance by the Fund had to devote increased attention to international capital markets and to reflect a better understanding of their dynamics and policy implications. Subsequently, the integration of the transition economies within the international system stretched the scope of surveillance even further, well into the realm of structural issues such as public enterprise reform, privatization, and administrative, judicial, and civil service reform. Other changes that challenged the Fund in its oversight of the international monetary and financial system were its substantially enlarged membership, a record number of countries accessing Fund resources, and major moves toward regional integration in Europe, America, and Africa.

Since the mid-1990s, the scope of surveillance has expanded further in response to pressure by important stakeholders to look beyond macroeconomic policy and into areas like poverty reduction, social protection, and sustainable development. Other factors include the growing consensus about the importance of supply-side factors for economic stability and growth; the increased risk of financial crises and contagion in a world of integrated capital markets; the vulnerability of financial systems to criminal abuse; and the emergence of global economic imbalances caused by inconsistent national economic policies.

The reason Fund surveillance has come to be concerned with all these factors lies in the Fund's unique features: its near-universal membership, its mechanism of regular and mandatory consultations with all its members, and its organizational efficacy (IMF, 1999). Because of these features, and although the Article IV consultation was originally intended only to cover a narrowly defined set of macroeconomic issues, the international community directed the Fund to adapt surveillance beyond its core mandate.

Overlapping Forums for Surveillance

The fact that surveillance has not been an exclusive prerogative of the Fund has affected the way the Fund has governed and implemented surveillance. As early as the early 1960s, with the creation of the Fund's General Arrangements to Borrow, which they would finance, the Group of Ten (G-10) became a leading forum for discussing international monetary matters. The G-10 felt that conducting multilateral surveillance within a small group, rather than at the Fund Board, would help the relevant policymakers to address the necessary issues. This practice achieved important results, but it also created deep resentment among the Fund's non-G-10 members, and was a factor behind the polarization between the industrial (creditor) countries and the developing (borrowing) countries, which has since become a distinctive feature of the Fund.[3]

Following the breakdown of the par value system, the U.S. pushed to bring the reform debate back into the Fund. The Ad Hoc Committee on Reform of the International Monetary System (Committee of Twenty) comprised of IMF Governors—was created in 1972, with representatives from the same constituencies as the Executive Board and in a position to make decisions on behalf of governments. Among other things, the Committee proposed tasking the Fund with new surveillance responsibilities over exchange rate policies. Among the Committee's legacies was the creation in 1976 of the Interim Committee (IC) of the Governors of the Fund.

Starting in the late 1980s, the new center of action became the finance ministers and central bank governors from the five (later seven) larger industrial countries known as the G-5 (later the G-7). The rationale was, again, that it was easier to resolve things within a small group. The G-5/7 customarily invited the Managing Director of the Fund (the "MD") to attend its meetings in "his personal capacity" rather than as

[3]The creation of the Intergovernmental Group of Twenty-Four (G-24) was a response by developing countries to the perceived exclusion and the loss of voice and influence caused by the establishment of the G-10.

representative of the institution (Boughton, 2001: 190–200).[4] The MD would make a presentation on major economic developments and leave the room as the group began its policy discussions. Later on, as a basis for policy discussions, the Fund was asked to draft confidential surveillance notes for the group, on international economic and market developments and prospects. The G-7 acquired much greater traction on Fund issues than did the IC or its successor the International Monetary and Finance Committee (IMFC). It has involved itself heavily in the oversight of the international monetary and financial system, directing the Fund on adapting its surveillance function The group has identified new Fund initiatives, defined their broad outlines, and mobilized the political and financial support to carry them forward.[5]

The IC developed a prominent role in the governance of the Fund, but it was not effective in surveillance of industrial countries. This failure reflected the determination of G-7 countries to keep these issues to themselves (Van Houtven, 2002). In 1994, the IC attempted to strengthen its leadership of multilateral surveillance through its Madrid Declaration on Cooperation to Strengthen the Global Expansion, which was broadened in 1996 with the Partnership for Sustainable Global Growth.[6]

Mexico Blues: The Cry for Transparency

The Fund entered the 1990s with the clear understanding that the external changes it was confronting demanded significant adaptations of its surveillance function, and showed a strong resolve to take the needed action. In 1993, at the conclusion of the periodic review of surveillance policy, the Fund's Board agreed that surveillance needed strengthening, especially in anticipation of the risks that macroeconomic imbalances and exchange rate misalignments in the industrial countries might pose in the context of growing and increasingly integrated international capital

[4]Some members of the Board criticized this practice, suggesting that the Managing Director should participate as Chairman of the Board, representing the view of Fund membership and reporting back to the Board. See "Future Orientation of the Fund—Making Multilateral Surveillance More Effective, and Observation and Issues Concerning International Policy Coordination" (Minutes of Executive Board Meeting 94/89, 11/ 22/1994).

[5]For a comprehensive historical account of the role of the G-7 in international economic and financial cooperation, see Kenen and others (2004).

[6]See Communiqué of the Interim Committee of the Board of Governors of the International Monetary System (henceforth, "IC Communiqué"), October 2, 1994, Madrid, and September 29, 1996, Washington.

markets.[7] The Board endorsed new measures to make surveillance more continuous, timely, and flexible; and it approved the extension of the enhanced surveillance procedures that had been agreed eight years earlier.[8] The Board agreed to expand the scope of its discussions on exchange rates and financial market developments and to ensure their integration into surveillance. The Board also promoted efforts to involve Fund Management more closely in deliberations affecting the functioning of the international monetary system. The IC wanted greater involvement in surveillance, and at its meeting in October 1994, it requested the Board to prepare a report on strengthening Fund surveillance.[9]

Yet both the resolve and the actions taken proved inadequate when surveillance failed to warn of the impending crises in Europe (in 1992) and Mexico (1994–95) or their potential systemic implications (Mussa, 1997; IMF, 1995). The serious financial difficulties that hit Mexico revealed major weaknesses in the way surveillance had been conducted by the Fund, despite the overall progress that had been made in the policy framework.[10] These weaknesses included a reluctance of some authorities to engage the Fund in a meaningful policy dialogue, inadequate integration of outside views into Fund analysis, and an organizational culture that discouraged independent thinking. These issues raise important governance concerns which are discussed in the next section below.

The MD was anxious to draw lessons for the Fund and its members (Van Houtven, 2002). In early 1995, following the conclusion of biennial review of surveillance the Board agreed to new procedures for a more continuous policy dialogue with members, stricter standards of transparency for member countries, closer scrutiny of capital account phenomena and domestic financial sectors (especially for countries that were seen to be at risk, and where financial tensions were likely to spill over to other countries), and more candid surveillance. The Board also amended the 1977 Decision on Surveillance to take account more explicitly of the role of private capital flows.[11]

[7]See "Summing Up by the Acting Chairman—Biennial Review of the Fund's Surveillance Policy" (SUR/93/15, February 3, 1993).

[8]The Fund's enhanced surveillance policy and procedures were elaborated in 1985, in response to the request of some members for intensified monitoring without a Fund arrangement in place. See "The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors" (EBS/850173, July 23, 1985, and Sup. 1, August 13, 1985).

[9]See IC Communiqué, Washington, October 2, 1994.

[10]See "Report of the Executive Board to the Interim Committee on Strengthening Fund Surveillance" (SM/95/70 Revision 3, April 20, 1995).

[11]See Decision No. 10949-95/37, adopted on April 10, 1995.

In its 1995 spring meeting communiqué, the IC endorsed the Board's decisions, reaffirming its intention to reinforce its own role in international policy coordination. It requested the Fund to review progress in implementing policies under the 1994 Madrid Declaration, and called for a six-month review of the policies implemented by members in the context of Fund surveillance. It also requested a report on members' cooperation with data provision requirements. But while the IC regarded the six-month review process as a useful bridge between its surveillance role and the Board's regular work on bilateral surveillance, no mechanisms had been envisaged to enable it to take remedial action if members did not cooperate. Thus the review process had no practical consequences, and the IC's conclusions did not add much substance to those of the Board. Nor did they have any "teeth" for inducing member countries to engage more responsibly in policy coordination.

Providing the IC with better information on bilateral surveillance was the subject of a very interactive Board meeting later in 1995, at which a number of useful procedural issues were agreed on the initiative of the MD.[12] The six-month reviews were broadened to include an assessment of policy performance under Article IV, and an indication of the issues that had surfaced most frequently in country surveillance discussions. But no attempt was made to clarify how the IC could strengthen its handling of international policy coordination.

Following the Mexico crisis, the G-7 acquired a leading role in setting the international financial policy agenda. The preparation for the Halifax Summit, in June 1995, perhaps marked the beginning of a new phase of activism by the group in the governance of global finance. The Halifax Summit communiqué set out a number of elements to deal with the policy challenges at hand, including early warning systems and appropriate policy responses (G-7, 1995). Besides emphasizing that the backbone of effective surveillance is the availability of timely and comprehensive data, the G-7 requested the Fund to enact specific procedures to improve the transparency standards of members. These proposed procedures were more rigorous than those that had been stipulated by the

[12]See "Statement by the Managing Director on Modalities for Review of Implementation of Madrid Declaration and Member Country Policies in the Context of Fund Surveillance" (BUFF/95/126, November 29, 1995); "Concluding Remarks by the Chairman-Managing Director on Modalities for Review of Implementation of Madrid Declaration and Member Country Policies in the Context of Fund Surveillance" (BUFF/96/4, January 19, 1996); and "Modalities for Review of Implementation of Madrid Declaration and Member Country Policies in the Context of Fund Surveillance" (EBM/95/115; December 6, 1995).

Fund Board and endorsed by the IC some time earlier.[13] The G-7 also identified specific areas where Fund surveillance needed strengthening, especially with regard to countries that had a potentially large impact on the world economy. It called for the MD to play a greater role, and for members to engage in a more intense policy dialogue with "problem" countries, and demanded that the Fund be more open and transparent in its assessments and policy advice (IMF, 1996).

The G-7 urged the Fund to consider extending existing current account convertibility obligations to capital account transactions[14] and simultaneously put pressure on the Fund to broaden its surveillance over domestic financial sector and capital flows issues—a move that the MD strongly supported. In late 1995, the Board reviewed the experience of Fund members with capital account liberalization, and discussed the role of the Fund in promoting currency convertibility. The Board agreed that capital account convertibility was desirable but emphasized the need for strong and well-supervised domestic financial sectors as a necessary precondition, and argued for a stronger role of the Fund in promoting and assisting the improvement of prudential regulatory systems in member countries.[15] In early 1996, the Board considered the relationships between banking system soundness and macroeconomic and structural policies, and started discussing ways in which issues in bank soundness could be incorporated into Fund surveillance.

Even before the Mexico crisis, developing countries—through the G-24—had expressed their concern with the unstable exchange rates and risks of highly volatile short-term capital flows that were associated with financial globalization. They emphasized that the Fund could help to reduce these risks by strengthening its surveillance of the policies of industrial countries. Noting the proposals discussed by the Board in the aftermath of the Mexico crisis, they insisted on the need for intensified and symmetrical surveillance of the policies of industrial and developing countries alike. And they repeated their earlier proposal that any evaluation of the functioning of the system should involve the participation of

[13]The G-7 was quite effective in accelerating the establishment of the Special Data Dissemination Standard (SDDS) for members having or seeking access to capital markets and, later on, of the General Data Dissemination System (GDDS) for members that are not in a position to subscribe to the SDDS and need to further develop their statistical systems.

[14]See G-7 (1995).

[15]"Capital Account Convertibility: Review of Experience, and Implications for Fund Policy" (EBM/95/73, July 28, 1995). The staff papers on which the Board discussion was based were subsequently published (see Quirk and Evans, 1995).

the developing countries—along the lines of the Committee of Twenty in the early 1970s—to ensure its effectiveness and legitimacy.[16]

Developing countries reiterated their calls for participation on several occasions, concerned as they were that decisions taken without their participation would neglect their interests. This concern was evident, for instance, during the Fund's discussions to integrate financial sector analysis into surveillance. Similarly, in discussions of capital account liberalization, developing countries cautioned against considering amending the Fund's Articles of Agreement before resolving issues that they considered sensitive, such as the possibility of reintroducing restrictions on capital movements under specific circumstances, or that of introducing safeguards and transitional arrangements.

In concluding the 1997 review of Fund surveillance policy, the Board acknowledged the Fund's role in supporting international efforts to promote the acceptance and implementation of sound banking principles and practices, in close cooperation with other international institutions and bodies. It endorsed the need to raise the attention given to regional surveillance, especially in consideration of the upcoming transition toward European Monetary Union. And, to enhance the Fund's transparency, the Board agreed to release press information notices following the conclusion of Article IV consultations with members.[17]

By the end of 1997, gradual progress was reported on members' data provision to the Fund. The Board urged members to place greater emphasis on the quality and integrity of data, since both had a major bearing on the Fund's ability to conduct effective surveillance.[18]

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[16]See Intergovernmental Group of Twenty-Four on International Monetary Affairs, Communiqué (henceforth, "G-24 Communiqué"), issues of October 1, 1994; April 25, 1995;October 7, 1995; April 21, 1996; September 28, 1996. Available via the Internet: www.g24.org.

[17]See "Summing Up by the Chairman—Biennial Review of the Implementation of the Fund's Surveillance over Members' Exchange Rate Policies and of the 1977 Surveillance Decision" (SUR/97/38, April 3, 1997). On Fund transparency, the Board found itself weighing the merits of two legitimate roles—that of confidential policy advisor to members, on one hand, and that of public monitor on the other—that were both strongly supported in the Board (see "Members' Policies in the Context of Fund Surveillance—Review," EBM/96/84, September 9, 1996).

[18]See "Summing Up by the Acting Chairman—Progress Report on the Provision of Information to the Fund for Surveillance" (Executive Board Meeting 97/117, December 8, 1997).

Lessons from Asia: The Need for Better Standards and Governance

In early 1998, in response to a request from the IC,[19] the Board examined the unfolding Asian crisis to understand its origin and consequences, as well as the Fund's failure to predict them. The staff provided a candid analysis of shortcomings in Fund surveillance and made recommendations for adapting it accordingly.[20] Whereas the Mexican crisis had shown a lack of transparency to be the single most critical factor, the Asian crisis emphasized the need to pursue international standards of sound policies and good economic conduct at the country level.

The analysis also pointed to the importance of developing standards in a variety of areas that could assist in the exercise of surveillance.[21] The international community looked to the Fund to take the lead in promoting and monitoring the implementation of standards, as an outgrowth of its surveillance mandate. Countries would, it was hoped, adopt standards with a view to strengthening their financial systems and promoting good governance, thus enhancing accountability and policy credibility. The adoption of standards would facilitate investors' decisions to allocate resources by providing them with information on countries' actual practices vis-à-vis agreed benchmarks.

While the Fund experimented with the observance of standards in a number of pilot country cases, an internal debate developed about the appropriate role for the Fund in dissemination of standards.[22] The Board agreed that monitoring countries' observance of international standards would encourage members to improve their adherence to the standards and that this should be done through the Article IV consultation process. Bridging a broad range of positions, the Board decided on the appropriate coverage of standards, and defined the modalities of the Fund's involve-

[19]See IC Communiqué, September 21, 1997, Hong Kong SAR.

[20]See "Review of Members' Policies in the Context of Surveillance—Lessons for Surveillance from the Asian Crisis" (EBS/98/44, March 9, 1998).

[21]The Board listed five main needs for effective surveillance: more timely availability of accurate information from members; broader focus of surveillance beyond the core short-term macroeconomic issues; closer attention to international policy interdependence; greater transparency; and willingness of members to take Fund advice. See "Summing Up by the Acting Chairman—Members' Policies in the Context of Surveillance—Review—Lessons from the Asian Crisis" (SUR/98/39, April 1, 1998).

[22]See "Summing Up by the Acting Chairman—International Standards and Fund Surveillance" (SUR/98/95, July 30, 1998); "Summing Up by the Acting Chairman—International Standards and Fund Surveillance—Further Issues" (SUR/99/42, March 31, 1999); and "Summing Up by the Acting Chairman—International Standards and Fund Surveillance—Progress and Issues" (SUR/99/112, September 20, 1999).

ment in reporting on compliance.[23] The Board decided to monitor the new activity through periodic reviews.

Consistent with this standards-based approach to promoting accountability and policy credibility was a new emphasis on good governance. In 1997, the Board endorsed the Fund's involvement in this area noting that the Fund should focus on the economic aspects of governance, mainly in two areas: improving public resource management and supporting a transparent regulatory regime. In addressing governance at the country level, the Fund was to be guided by an assessment of whether the issues in question had any actual or potential impact on macroeconomic performance. Developing and emerging market countries stressed that, in following these principles, the Fund should strictly adhere to its mandate and stand ready to provide assistance to help members meet the requirements of the principles. The staff produced guidelines addressing the Fund's role in governance issues. In adopting the guidelines, the Board stressed the Fund's mandate did not allow it to act as an investigation agency and asked that the legal boundaries of Fund action in this area be clearly defined.[24]

Transparency was a necessary underpinning of the move toward improved standards and good governance. In April 1998, the Board agreed on a draft Code of Good Practice in the Area of Government Budgetary Operations, subsequently endorsed by the IC.[25] The draft discussed modalities through which the Fund could use its surveillance, technical assistance, and program design to help members achieve greater fiscal transparency.[26] In a similar process a year later, the Fund produced the Code of Good Practices on Transparency in Monetary and Financial Policy: Declaration of Principles as a guide to members. In addition, it agreed to the public release of staff reports and country policy documents.

Developing member countries, while supporting the process to increase transparency, emphasized their concern that the release of staff reports

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[23]The areas to be covered by standards were data dissemination, fiscal transparency, monetary and financial transparency, banking supervision, securities regulation, insurance regulation, accounting, auditing, bankruptcy, and corporate governance. Later, the list came to include payments and settlement systems.

[24]See "Concluding Remarks by the Chairman—The Role of the Fund—Governance Issues—Guidance to Staff" (SUR/97/48, May 21, 1997). The guidelines were published as *Good Governance: The IMF's Role*, available at www.imf.org.

[25]See IC Communiqué, April 16, 1998, Washington.

[26]See "Concluding Remarks by the Acting Chairman—Draft Code of Conduct on Fiscal Transparency" (BUFF/98/40, April 3, 1998).

could compromise the quality and candor of the policy dialogue with the Fund, thereby undermining the effectiveness of surveillance. They underlined the need to apply transparency criteria not only to public institutions, but also to the private sector, and emphasized the need to enhance transparency in the working of private financing entities, especially those that are highly leveraged. They argued that countries at different stages of development needed different timeframes for implementing the new standards and that some countries would need technical assistance.[27] Discussing the code for fiscal transparency, Directors from developing country constituencies claimed that the areas covered were too broad and were concerned that the code would become a standard against which fiscal transparency would be formally assessed.

During this period, working groups of the G-7 and selected emerging market countries were established to implement recommendations in the key areas of transparency, strengthening financial systems, and crisis management, with the involvement of the private sector. Following detailed discussions in a variety of forums, the G-7 agreed on a set of specific reforms to increase the transparency and openness of the international financial system, disseminate standards and codes of best practice, and strengthen both the incentives to meet these standards and the official assistance made available to help developing countries reinforce their financial systems.

Developing countries broadly endorsed this international agenda, but were concerned about being sidelined from the global decision-making process. Supporting the need to strengthen international cooperation, the G-24 proposed that a task force comprising industrial and developing countries be set up to reform the international monetary and financial system.[28] The group reiterated this proposal several times, but to no avail.

To take a fresh look at the surveillance process, in 1999, the Board commissioned an independent evaluation by a group of external experts. This evaluation cast doubt on the Fund's capacity to carry out bilateral surveillance of structural issues of a non-financial nature; it also highlighted the very limited attention that bilateral surveillance gave to the international dimension of a country's macroeconomic and financial situation, and the

[27]See "Summing Up by the Acting Chairman—Transparency in Members' Policies and Fund Surveillance" (SUR/98/91, July 27, 1998), and IC Communiqué, Washington, April 26, 1999, and September 26, 1999.

[28]See Caracas Declaration II of the Group of Twenty-Four (G-24), February 7–9, 1998. www.g77.org/doc/Caracas%20Declaration.html.

inadequate cross-fertilization taking place between bilateral and multilateral surveillance. Importantly, the evaluation noted a lack of focus by the Board in Article IV discussions, and the Board's limited ownership of surveillance priorities. The evaluation also found that the Fund faced some internal organizational, management, and staffing challenges that had an impact on surveillance (IMF, 1999). As before, questions were asked about why the Board had failed to see many of these weaknesses, despite its continuous oversight, and why it dismissed criticisms so easily, especially those that concerned its own role.[29]

In 2000, the Board endorsed the conclusions of the biennial review of surveillance. The conclusions were that, since the Asian crisis, the Fund's work had advanced in several important areas, providing deeper analytical coverage of exchange rate policies and a greater emphasis on financial sector analysis and on capital account and cross-country issues. Private market views, where relevant, were increasingly being discussed in staff reports. The Fund had made progress in integrating multilateral and bilateral surveillance; and multilateral surveillance had been significantly broadened, to give more attention to potential spillover and contagion effects. Overall, the Board agreed that the tools for preventing crises had been strengthened.

According to the 2000 biennial review, in light of the growing complexity of the international financial architecture and its reflection on surveillance, an important area that needed to be addressed was how to draw on the expertise and resources of other institutions in order to achieve better coverage of both core and non-core issues. Regarding the focus of surveillance, the Board identified a hierarchy of concerns, to be adapted to country circumstances and over time, that would help Fund staff identify the right focus and priorities for its surveillance activities.[30]

Turning Millennium: The Long March Toward "Soft Law"

The newly-formed IMFC recognized that Fund surveillance was the principal mechanism through which the results of many initiatives to strengthen the international monetary and financial system would

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[29]See "Summing Up by the Chairman—Report of External Evaluators on Fund Surveillance" (SUR/99/108, September 10, 1999).

[30]See "Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision" (SM/00/40, February 18, 2000); and "Summing Up by the Acting Chairman—Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision" (SUR/00/32, March 21, 2000).

come together, including primarily in the areas of standards and governance.[31] Surveillance subsequently evolved along two related paths: developing standards, principles, and guidelines; and preventing crises. The underlying rationale was that standards of sound policy and codes of good economic conduct would foster better economic performance in member countries (especially in systemically relevant economies with still rudimentary economic institutions), help them fend off crises, and thereby contribute to global financial stability. In other words, the international community would move toward a system of "soft law" (although the Fund did not use this terminology, to the author's knowledge), whereby the adoption of standards and codes would be voluntary, yet subject to strong encouragement from the international community through peer pressure, public monitoring and, possibly, market discipline.

During this period much of the Fund's internal debate and deliberation was about how to design soft law in ways that members would accept, and that would induce positive changes in economic conduct. Once designed, rules had to be implemented, and compliance monitored. The importance of systematically collecting information on compliance and of appropriate follow-up recommendations to national authorities was recognized. The Fund invested significant resources in refining its assessment and policy advisory machinery. For this purpose, it developed the Reports on Observance of Standards and Codes (ROSCs). A significant extension of this work, and of the associated assessment activity, took place in 2001 with the introduction of standards for fighting international money laundering and combating the financing of terrorism.[32]

While progress was achieved, the intense negotiations in the Board reflected wariness and distrust among developing and emerging market countries which lamented that their participation in the development of standards and codes had been limited.[33] They were concerned that "soft law" would become "law" *tout court*, implying new obligations that would be enforced asymmetrically and to their detriment. They took the view that standards should not extend beyond the core areas of Fund responsibility and should not be prematurely integrated into the Article IV consultation process, and that the observance of standards should not be

[31]See Communiqué of the International Monetary and Financial Committee of the Board of Governors on the International Monetary System (henceforth, "IMFC Communiqué"), Prague, September 24, 2000.

[32]See IMF (2003: Chapter 2).

[33]See G-24 Communiqué, September 23, 2000.

incorporated in program conditionality.[34] They were concerned that the Fund would surrender its cooperative mission and transform itself into a policing institution with a compliance-based culture. Perhaps because of this concern, Fund members were unable (or unwilling) to agree on adopting an effective monitoring system.[35]

The Fund continued to develop analytical tools for assessing vulnerability to crises, and strengthened its efforts to incorporate the views and developments of international financial markets into surveillance. The establishment in 2001 of the International Capital Markets Department (ICM) and the Capital Markets Consultative Group aimed to respond to these challenges. As the importance of financial sector analysis and the need to integrate it effectively into surveillance came to be more deeply appreciated, Management commissioned ad hoc external reviews of aspects of financial sector surveillance in order to strengthen its effectiveness.

The Board kept up its pressure to improve Fund surveillance through a tight review process.[36] In 2002–03, much attention focused on refining the tools for assessing vulnerability to crises and on improving assessments of standards and codes. Staff reviews brought in new dimensions, such as the importance of analyzing political economy issues, the need to integrate insights from cross-country experience more systematically, and questions of

[34]As regards the risk of asymmetric implementation, in a 2003 progress review of the standards initiatives the Board noted that, while most systemically important countries were participating in the initiatives, industrial countries needed to step up their participation rate to achieve more balanced coverage by the assessments. See "Summing Up by the Acting Chair—International Standards—Strengthening Surveillance, Domestic Institutions, and International Markets" (BUFF/03/43, March 26, 2003).

[35]As acknowledged in the 2005 ROSCs, there are no mechanisms to track systematically either members' implementation of ROSC recommendations or the extent and degree of their observance of the standards in all ROSCs. Also, since ROSCs have only been run once for most countries, they do not yet provide enough information on how observance has evolved over time. See "The Standards and Codes Initiative—Is It Effective? And How Can It Be Improved?" (SM/05/252, July 1, 2005).

[36]"Biennial Review of the Implementation of Surveillance and of the 1977 Surveillance Decisions—Overviews, and Extension of Deadline for Review" (Minutes of Executive Board Meeting 02/38, April 5, 2002); "Summing Up by the Chairman—Biennial Review of the Implementation of Surveillance and of the 1977 Surveillance Decisions—Follow Up" (SUR/02/81, July 23, 2002); "Summing Up by the Acting Chair—Data Provision to the Fund for Surveillance Purposes" (SUR/02/54, May 16, 2002); "Enhancing Effectiveness of Surveillance—Operational Responses, Agenda Ahead, and Next Steps" (EBM/03/30, March 28, 2003); "Strengthening Surveillance—Further Considerations" (Minutes of Executive Board 03/79, August 20, 2003); and "Summing Up by the Acting Chair—International Standards—Strengthening Surveillance, Domestic Institutions, and International Markets" (BUFF/03/43).

how to enhance the impact of Fund advice to systemically relevant countries and how to strengthen surveillance in program countries. As a way to expand the information base and introduce new perspectives, the 2004 biennial review of surveillance built on the views collected from a large set of external stakeholders, including country authorities, financial market participants, think tanks, non-governmental agencies, and the media.[37]

Except for an external evaluation of 1999, the Fund did not assess the strengths and weaknesses of the Board's role in surveillance policy and its implementation until the evaluations of aspects of surveillance recently undertaken by the IEO (2006, 2007). These are discussed in the next section below.

During 2002–06, the IMFC kept the Fund's work on surveillance under scrutiny. The committee's strong leadership lent support to a number of initiatives, including focusing attention on reviewing the Fund's 1977 Decision on Exchange Rate Policy Surveillance and setting up a new framework for surveillance.[38] These issues are discussed next.

New Challenges and Opportunities for Surveillance: Tackling Global Imbalances

In 2006, the MD was insistent that his Medium-Term Strategy (MTS) would include multilateral consultations and a review of the Fund's 1977 Decision on Exchange Rate Policy Surveillance. These both offered the Fund new ways to strengthen surveillance. Frankel (2007) characterized the new task of the Fund as follows:

> . . . the Fund was handed a new mandate in 2006, both by its governing body and by the G7, that could restore it to central importance in the management of the world monetary system. . . . The mandate was to reconsider the 1977 Decision on Surveillance, and thereby look into the issue of global current account imbalances through a multilateral consultation process. In practical terms, this means that the US Treasury in early 2006 passed the Chinese *renminbi* hot potato on to the IMF, giving that institution a rare potential to help midwife or broker a multilateral agreement over the Chinese currency and also the G7 imbalances.

[37]See "Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Modalities of Surveillance" (SM/04/212, Supplement 1, July 2, 2004); "Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision" (Minutes of the Executive Board Meeting 04/72-1, July 23, 2004); and "The Chairman's Summing Up—Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision" (SUR/04/80, August 2, 2004).

[38]See IMFC Communiqué and G-7 Communiqué, 2002-06 issues, and G-20 Communiqué, 2004-06 issues. www.g20.org.

Multilateral Consultations

The Fund launched its first round of multilateral consultations intended to strengthen the Fund's analysis of the potential benefits of collective action. They aim to help Fund members agree on policy actions to address vulnerabilities that affect individual members and the global financial system. The Board has been supportive of the new instrument, underscoring the importance of its own involvement as well as that of the IMFC—so it can exercise its role in the conduct of surveillance, give the process legitimacy, and allow the international community to assess results.[39]

The approach adopted for the consultations assigns specific roles to specific actors according to their comparative advantage. Thus, while Management (and staff) supports policymakers in their dialogue, capitals play the role of policymakers and the Board oversees the exercise ex post for future guidance. The final section discusses the issue of optimal role assignment to the Fund's governing bodies.

While conclusive results cannot be expected in a short period, the first multilateral consultation has proven fruitful. In April 2007, participants presented to the IMFC a joint document in which each affirmed that reducing global imbalances in a manner compatible with sustained growth was a multilateral challenge and a shared responsibility, and set out a policy plan consistent with this objective.[40]

Review of the 1977 Decision on Exchange Rate Policy Surveillance

The other pillar of the MTS is the review of the 1977 Decision on Exchange Rate Policy Surveillance in July 2006. The importance of the exercise is evident in the April 2007 statement of U.S. Treasury Secretary Henry Paulson who concluded that even "[a] more representative IMF . . . will mean little without significant improvements in the institution's surveillance over exchange rate policies."[41] The Board was asked to revise the Decision to unify what was diffused in various forms of guidance, clarify what was not clear, and address shortcomings in the

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[39]See "The Chairman's Summing Up—Implementing the Fund's Medium-Term Strategy" (BUFF/06/66, April 7, 2006); and "IMF Executive Board Discusses Multilateral Consultation on Global Imbalances," IMF Public Information Notice No. 07/97, August 7, 2007.

[40]See "The Multilateral Consultation on Global Imbalances," *IMF Issues Brief*, Issue 07/03, April 2007.

[41]See "Statement by Treasury Secretary Henry M. Paulson, Jr., Following the Meeting of the G-7 Finance Ministers and Central Bank Governors," Washington, April 13, 2007.

practice of surveillance. The review was intended to provide the Fund with a more operational, practical, and transparent approach to meet members' needs.

The Board was deeply divided over the first draft from Management. Among industrial country members, some supported the effort on the grounds that the Fund's surveillance had failed to meet the mandate of "firm surveillance" over the exchange rate policies of members. Board members from developing and emerging market countries feared that the proposal would give the Fund more leverage over their countries, while leaving untouched the real crux of the matter: the Fund's inability to exercise leverage on major economies that have no need for Fund resources or signaling. Directors in this camp worried that the proposal would produce new limits on the independence of member countries' economic policies, and that these constraints would be applied loosely to the larger economies but tightly to smaller ones.[42]

In the face of a seriously divided Board, it took a considerable effort to build consensus. Through difficult negotiations, the Board arrived at a new Decision that, while crystallizing a common vision of the best practice of surveillance, would provide safeguards against asymmetric treatment of members and undue Fund interference in domestic policy matters. The new Decision was adopted on June 15, 2007.[43]

New Surveillance Framework

Another recent controversy has surrounded a proposed new framework for implementing surveillance, and the attendant "remit" issue. The proposal for the IMFC to set a remit, or responsibility, for surveillance, and the Board discussions that ensued, are symptomatic of a confusion of roles and misperception of identities, which the current system of Fund governance does not help to resolve and itself exacerbates.

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[42]"Review of the 1977 Decision on Surveillance Over Exchange Rate Policies—Preliminary Considerations" (Minutes of Executive Board Meeting 06/66-1, July 19, 2006); and "Review of the 1977 Decision on Surveillance Over Exchange Rate Policies—Further Considerations" (Minutes of Executive Board Meeting 07/13-1, February 14, 2007). See also the concerns expressed in the G-24 Communiqué, April 13, 2007.

[43]See "The Chairman's Summing Up—Review of the 1977 Decision—Proposal for a New Decision on Bilateral Surveillance Over Members' Policies" (BUFF/07/85, June 2007); and "IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies," IMF Public Information Notice No. 07/69, June 21, 2007.

In 2006 the IMFC, at the instigation of its Chair,[44] proposed a new framework for implementing surveillance that included two provisions.[45] One required members to restate their commitments under Article IV, and the other required the IMFC to set an annual remit for surveillance, through which the Board, Management, and staff would be accountable. Both provisions were consistently and strongly supported by the G-7.

The Committee's communiqué on this subject raised governance issues of its own. First, in a Board discussion following the IMFC meeting, several Directors noted that the idea of a surveillance remit was not part of the MTS and had been introduced in the communiqué without prior agreement from members and without Board involvement. They lamented the non-transparency of this process. Second, to many Directors it was not clear what exactly "remit" meant. Third, many Directors wondered what role the IMFC would be expected to play on the remit, given that the IMFC is only an advisory body. A seminar on the issue clarified that, if adopted, the remit would need to be set by the Board, consistent with its prerogatives. In the discussion, serious reservations were expressed on the value of such a remit, and it was concluded that the issue needed further consideration before the Board could come to any decision.[46]

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[44]Speaking on behalf of the United Kingdom, Gordon Brown explained his proposal for ". . . a new annual remit for surveillance—set by the IMF's board and endorsed by its members at the IMFC each year—to match independence in the process of surveillance with a clear commitment to it. And so each year the IMFC should set the direction, and emphasize the unique role of the Fund as a universal institution to support all economies individually and collectively. . . . In multilateral surveillance, the IMFC in its annual remit should task the Fund to identify and quantify the key risks to the global economy—and set out the individual or collective policies to manage those risks. . . . For issues which can only be resolved by a number of countries, the Managing Director's proposal for strengthened mechanisms for bringing together the key systemic members of the global economy will assist reaching more effective collective solutions to the challenges this new model of multilateral surveillance could identify. This will strengthen the IMFC as a direct channel of peer pressure and peer support—and promote multilateral policy cooperation by focusing policymakers more clearly on the key actions needed to manage global risks. . . ." (IMFC Statement by Rt. Hon. Gordon Brown, Chancellor of the Exchequer of the U.K. and Chairman of the IMFC).

[45]See IMFC Communiqué, Washington, April 22, 2006.

[46]See "The Acting Chair's Concluding Remarks—Toward a Remit-Independence-Accountability (RIA) Framework—Clarifying Accountability and Methodological Issues in Assessing the Effectiveness of Surveillance" (BUFF/07/41, March 22, 2007). Criticizing the tone of the April 22, 2006 IMFC Communiqué, one executive director said it was imperative to reassert the central role and the leadership of the Board in deciding how to strengthen surveillance.

Adapting Surveillance: How Did Governance Work?

This section considers the system of governance over global finance and its recent evolution, examines how global governance has affected Fund governance, and identifies the weaknesses of Fund governance in adapting surveillance. It draws elements from previous independent evaluations of aspects of surveillance (including IMF, 1999; IEO, 2006, 2007).

Global Governance

The second section illustrated the leading role played by the G-7 in steering Fund surveillance of the world economy from the mid-1990s onwards, in particular since the East Asian financial crisis. But for a full understanding of the links among the governance of global finance, Fund governance, and the effectiveness of surveillance, several important trends need to be considered:

- *While powerful, the G-7 has become less effective in tackling global challenges* (Kenen and others, 2004). The advent of new critical issues—most notably, the resolution of international financial problems—and the increasing economic weight of other nations on global financial stability and growth have diminished the capacity of the G-7 to resolve global challenges on its own. In the view of Kenen and his coauthors, the G-7's experiments with broader international groupings are telling signals of the group's diminished capacity.
- *Global governance of finance now requires broader participation in decision making.* The growing systemic importance of emerging economies requires direct involvement in international policy cooperation. Engaging these economies in international decision making motivates their governments to share in global responsibilities. The creation of the G-20 and the Financial Stability Forum is a response to the new state of global economic affairs.
- *The authorities of most countries have become more deeply involved in global governance.* Globalization gives each country greater opportunities to exploit as well as greater risks to manage. Hence, the interests of national policymakers in international policy issues have become pressing, leading them to devote more time and resources to international economic relations. As a result, contacts between capitals and international organizations have dramatically expanded.
- *Governing the global economy has highlighted the need for new rules of conduct.* Concerns have grown about systemic risks, international policy spillovers, and cross-country contagion of economic and financial shocks. Policies at the country or regional level have

been seen to produce unintended global consequences that have demanded appropriate coordinated policy responses from the international community. It is now recognized that a world economy dominated by integrated markets, and with countries at very different levels of economic and institutional development, requires a system of global, yet non-binding, rules of conduct ("soft law") that are internationally promulgated and nationally implemented.

- *The Fund has become the vehicle of international finance "soft law."* A new global financial architecture has evolved, founded on international entities within which groups of countries can meet and address critical cooperative issues. The Fund is at the core of the new architecture, as the most consolidated and structured multilateral organization with near-universal membership. The international community regards the Fund's contribution as instrumental to provide robust technical solutions, mobilize financial support, grant legitimacy to international cooperative decisions, and act as an efficient implementing agency of those decisions. The Fund has become the main instrument to disseminate new standards and codes globally, to promote their adoption, and to monitor their observance by members.

The leading countries have responded to these trends by applying the following practical principles:

- *Select the "minimum winning coalitions"* to address global issues: that is, include in the decision-making process (only) those countries whose support is needed to implement effective collective action (Kenen and others, 2004).
- *Keep governance frameworks informal and flexible*, so as to modulate participation (of countries and institutions) as and when required by the problem at hand.
- *Hold control tightly in the hands of capitals.* The practice of working on problems together, pursuing common objectives—reinforced by the opportunities for continuous contact made possible by technology—has greatly increased the cooperation potential of policymakers in the leading countries, giving them strong incentives and tools to exert tight control over global agendas and policy decisions.[47]

A key implication of all this is that the center of decision making regarding the international monetary and financial system remains

[47]Such a degree of cohesion is particularly strong within the G-7, and has not yet been paralleled by other existing international groupings. This feature helps to keep the G-7 highly effective notwithstanding the progressive waning of its influence. For an insightful illustration of the cooperative work of the G-7, see Sobel and Stedman (2006).

outside the Fund. While the Fund is seen as an essential instrument of the new global financial architecture, the emerging governance organs of the international monetary and financial system promoted by the G-7—the G-20 and the Financial Stability Forum—have not been placed under the aegis of the Fund. This reflects the determination of the leading countries to keep decision making outside of the governance rules and practices enshrined in the Fund's governance structure.[48] These decisions contrast starkly with the choice made by the international community in 1972, at the insistence of the United States, to bring back into the Fund the discussions on reforming the international monetary system.[49]

Another important implication is that the control from capitals over the Board has increased (Cottarelli, 2005). Since the 1990s, interactions between capitals and the Board have intensified.[50] More intense interactions have accompanied a tendency by national authorities (especially in the leading industrial countries, and increasingly in emerging market countries) to exert tighter control over decisions by their executive directors, with effects on the quality of surveillance that will be discussed below.

Fund Governance

The recent evolution of global finance governance has weakened the role of the governing bodies of the Fund, with overall effects that need to be evaluated. Here, each of the Fund's governing bodies is discussed in turn.

[48]Referring to the G-7 countries, Van Houtven (2002) remarks that they ". . . have exhibited a growing tendency in recent years to act as a self-appointed steering group or 'Directoire' of the IMF. Recent reports of the finance ministers to the heads of state and government at the annual summit meetings have sometimes tended to deal with IMF matters in a manner that raises the question of whether they will leave the Executive Directors representing the Group of Seven countries with the necessary margin for discussion and room for give-and-take that is essential for consensus building" (pp. 30–31).

[49]In recent years, the rise of large global macroeconomic imbalances and the decision to address them in the context of strengthened Fund surveillance signal a renewed interest in having the Fund play a greater role in facilitating policy coordination. Whether this is a reflection of a long-term strategic vision or of opportunistic behavior remains to be seen.

[50]The public-good nature of Fund "production," and in particular the potentially large impact it may have on countries' welfare and politics, leads members to seek close control of the Fund's production process, through frequent processes of monitoring, feedback, and error corrections, and through tighter control over the Fund's decision-making processes. The involvement of capitals has intensified with the increased concerns about systemic issues and the perception that the Fund has a relevant role to play in addressing them.

The IC/IMFC

Today, the IMFC confronts a serious identity problem. Its role is weakened by the tendency to keep decision making on the international monetary and financial system outside of the Fund. As the second section illustrated, the Committee's role is overshadowed by other entities. As a result, it is neither the crucible for new policies nor the forum for coordinating or debating international financial policy. Many observers believe that, as a ministerial entity with a relatively small and manageable structure, the IMFC serves the important function of legitimizing on behalf of the membership the strategic directions that the Fund sets out to pursue.

Over the period considered in the present study, the Committee endorsed the various steps of the surveillance adaptation process. *It imparted discipline to the exercise, inducing the Fund to be responsive and to deliver on its work program. Finally, by asking the Fund to report on surveillance periodically, the Committee has exercised an important function of global accountability* vis-à-vis, and on behalf of, the Fund's shareholders and stakeholders.

However, the Committee has not made a distinctive contribution in terms of policy guidance, agenda setting, or strategy making beyond the contribution made by the Board. In this regard, the contribution of the IMFC deputies has been minimal. This mostly reflects the existing arrangement, whereby capitals interact continuously with executive directors, to such an extent that Board deliberations closely reflect the views from capitals. In addition, the established practices are such that the Committee receives policy or strategic directions set elsewhere by policymakers of the leading countries and endorses them as Fund mandates only after the Board and Management have worked out the operational modalities.

What value, then, does the Committee add to the effectiveness of surveillance? Under both its incarnations (the IC and the IMFC), the committee has been organized to play both an oversight role—by discussing international economic and financial issues and policies in a cooperative way—and an advisory role—concerning the adaptation of Fund surveillance policy to changes in the world economy. The role of the Committee chair is relevant and important, but within limits.

Oversight

Under the constraints described, the IMFC's oversight of surveillance does not substantively add to what the Fund's Board ordinarily does. The Committee reviews the world economic outlook and prospects based on the analyses prepared by the Fund, and considers the relevant policy issues of systemically important countries and regions. It monitors the progress made since the previous review, identifies areas of concern requiring action, and formulates recommendations on measures that members should adopt to achieve sustainable growth. But the Committee may not request members to commit to policy actions, nor does its modus operandi encourage it to exert moral suasion strong enough to bring about adequate policy responses from members. Therefore, statements like:

> "The Committee considered at length the challenges facing the world economy. It is its unanimous view that forceful action is required on the part of member countries over a broad range of policies . . ."[51]

followed by detailed lists of policy prescriptions, as commonly appear in its communiqués, are mere exhortations, no matter their underlying sense of urgency. The attempt by the IC in 1993-96, mentioned in the second section, to enhance systematic reporting from the Fund on selected country issues, did not translate into any significant strengthening of surveillance.

Surveillance can ultimately be effective only if members are prepared to consider the views of the international community when formulating and adopting their macroeconomic and structural policies.[52] Mindful of this view, the Committee has often reiterated its call to strengthen the policy dialogue between the Fund and its members. The Committee would add value to surveillance if, as the only financial multilateral ministerial forum with near-universal representation, it were to provide the locus where national policymakers can address each other directly and candidly on policy measures, commitments, and constraints relating to systemic issues, and consider collective action when needed. No group of officials

[51]IC Communiqué, Washington, October 4, 1998.

[52]This view, which staff and Management have several times emphasized in the context of the Fund's periodic reviews of surveillance, is well expressed in the following passage from the concluding section of the 1992 "Biennial Review of the Fund's Surveillance Policy" (SM/92/234, December 30, 1992): ". . . no set of surveillance guidelines and procedures can truly succeed unless all members, recognizing their interdependence within the international monetary system and their mutual self interest in the smooth operation of the system, are willing to implement sound and stable economic policies with appropriate attention to multilateral consideration. This suggests that if the effectiveness of the Fund's surveillance over its members' exchange rate policies is to be strengthened, the basic issue is the willingness of members to be prepared to take full consideration of the views expressed by the international community in formulating their macroeconomic policies" (p. 29).

without direct responsibility for national policy decisions could act on a comparable level. The final section returns to this point.

Advice

In its advisory capacity, the IMFC takes notice of the Fund's periodic reviews of surveillance and ongoing policy work, provides general guidance to the Fund where surveillance needs strengthening, agrees on next steps and deadlines, and monitors further progress. But in conveying to the Fund the views of ministers and governors on gaps that need to be addressed by Fund surveillance, the emphasis should be on the substance of problems rather than on the Fund's responses. This would not be dissimilar to the approach the G-7 has consistently been taking since the 1990s. But the advantage would be that the IMFC's debates and considerations would reflect the views of all Fund members and would benefit from a much broader and deeper knowledge base.

Currently, IMFC members do not elaborate their own analyses of surveillance, and rely instead on Fund reports (which the Board preliminarily discusses in consultation with capitals). In preparing for their meetings, IMFC ministers and governors receive feedback from Directors, and have staff in their capitals draft speaking notes for their interventions and written statements for the record. Often, these materials are prepared by executive directors. At the meetings, ministers and governors deliver their notes, with limited, if any, interaction with one another and hardly any opportunity for meaningful dialogue.[53] The deputies' meetings that precede (and are supposed to carry out preparatory work for) meetings of their principals do not offer substantive contributions.

Role of the Committee Chair

The effectiveness of the IMFC partly depends on the attitude, skills, and repute of its chairperson. Such features are important intangibles, especially for an advisory body. The attempts by the IC in the 1990s, and the IMFC more recently, to take on a more proactive role in surveillance originated from the determined efforts of the Committee's chairmen.

However, the Committee's failure to become the global forum of surveillance—and, hence, of international monetary and financial policy cooperation—exposes the limits of what a leader's personal prestige and ability

[53]More useful, perhaps, are the informal discussions that IMFC members hold at the luncheon following the plenary session. Unfortunately, no written records or communiqués are available for a systematic evaluation of these discussions.

can achieve, and shows that the Committee's effectiveness ultimately depends on how the leading countries intend to run global financial governance.

Executive Board

Executive directors are Fund officials appointed or elected to the Board by the Fund's member countries. They are commonly characterized as having a "dual" responsibility, although no explicit reference to such duality is made in the Fund's Articles of Agreement (see Box 1 below). This dual role places the Board at the delicate juncture between the Fund's "technical" level (Management and staff) and the "political" level (member governments). This juncture, and the extent to which directors succeed in balancing their dual responsibility, influence the relationship between the Fund and its members and, ultimately, the quality of Fund outputs.

Executive Directors must balance their dual responsibilities if the Board is to act collegially, to guarantee the Fund's neutrality and uniformity of treatment of members, and to exercise independent and informed judgment in the interest of all members. Balancing the two responsibilities requires directors to rely on consensus building as a decision making practice to reconcile the institution's largely asymmetric governing structure with its fundamentally cooperative mission. Directors should do this bearing in mind that as members of a corporate board their primary loyalty is to the institution.

Incentives Facing Executive Directors

The incentive structure facing executive directors, and the way they interpret their role, affect how they balance their responsibilities, determine the strengths and weaknesses of the Board as a governing body, and eventually has an effect on the quality of Fund outputs. While the Board has played a central role in adapting Fund surveillance policy, many surveillance shortcomings identified by the independent reviews can be explained by factors that have weakened the Board in exercising its governance function. Overall, directors face an inappropriate incentive structure, which limits the Board's collegiality and independence as well as its capacity to build and use information.

It was noted above that the control by capitals (especially of the leading industrial countries) over the Fund's decision-making process has intensified recently. Tighter external control over directors is a neglect of basic governance principles, that can only partly be justified by the lack of a clear interpretation of the role of directors as provided for in the Articles

Box 1. The Dual Role of the IMF's Executive Directors

To whom should the Fund's executive directors ultimately be loyal? While the Fund's Articles of Agreement explicitly provide that "(t)he Managing Director and the staff of the Fund . . . shall owe their duty entirely to the Fund and to no other authority" (Article XII, Section 4(c)), they are silent as to whom executive directors should owe their allegiance.

This silence may reflect the drafters' consideration that, as members of a corporate board, executive directors owe their loyalty exclusively to the institution and its members as a whole. Under such an understanding, executive directors may not be representative of any parties or interests other than those provided for under the Articles. The Fund's former General Counsel François Gianviti (1999) supports this view, arguing that, unlike representatives of member states to other international organizations, executive directors are officials of the Fund and legally accountable to the Fund for the discharge of their duties. The fact that they have been selected by member states does not create an obligation for them to defer to members' views or to cast their votes in accordance with members' instructions. Their votes are valid even if they are inconsistent with any instructions they may have received from their constituents. As to their voting power, Gianviti claims that the drafters of the Articles were very careful to dissociate the votes cast by a member from those cast by its executive director. In other words, executive directors cast their votes not on behalf of the members appointing or electing them but as members of the executive board.

On the other hand, the silence of the Articles (especially if juxtaposed with the explicit reference to Management and staff noted above) may reflect the drafters' understanding that executive directors have a composite role, as Fund administrators and as the voice of Fund members. This is recognized by the legal interpretation of the Articles of Agreement of the World Bank (2004). The interpretation clarifies that, in discharging their duties, executive directors fulfill a "dual" function as officials of the Bank and as representatives of the member countries that appoint or elect them: they owe their duty both to the Bank and to their constituencies Their relation with their countries is a two-way relationship, in which they are expected to inform the countries of the issues before the Board, and to take into account the views of their countries in forming their positions on issues. However, as the interpretation clarifies, executive directors are not to act simply as ambassadors of their constituents; they are expected to exercise their individual judgment in the interest of the Bank and its members as a whole.

of Agreement. Responsibility for this neglect lies with the authorities in capital cities and with the executive directors themselves.[54]

In fact, many directors understand their role as to execute their capitals' instructions at the Board. Others, who interpret their role as implying a primary obligation of loyalty to the institution and its membership, face incentives that discourage such an interpretation. Such factors as low seniority, undefined terms of reference, short duration of mandate (for those who are elected) or duration at the pleasure of the authorities (for those who are appointed), and the desire to preserve good relations with home administrations for career purposes, reinforce the subjection of executive directors to their capitals. Communication technologies have virtually eliminated the distance between Washington and other capitals, which previously granted directors broader latitude for autonomy. The development of efficient modes of consultation among capitals has magnified the ability of national policymakers to coordinate decisions internationally and to transmit them (in real time) to their directors. As such, where directors face conflicts between what they deem to be in the interest of the Fund and the view of their capitals, even the most independent-minded of them eventually side with their capitals.[55] Exceptions are rare.

The disregard for the Board's autonomy and the migration of decision making to capitals may explain the weak collegiality of the Board and its suboptimal use of information, as well as its reactive attitude. This is discussed in Chapter 13 in this volume. In addition, by weakening the authority of the Board, the migration of decision making to capitals may deprive the Fund staff of the institutional protection it needs to carry out surveillance evenhandedly and under no temptation of clientism. None of

[54]In the case of the U.S., the provision governing the U.S. Executive Director is clear: "One of the ways in which the US Congress endeavors to influence Fund policy is by passing legislation or mandates that direct the Secretary of the Treasury *to instruct the US Executive Director* to pursue specific policies or vote on certain programs or assistance within the Board of the Fund. . . . The legislation often directs Treasury *to instruct the US Executive Director* to use its "voice" or "vote" at the Executive Board to bring about a policy change at the Fund" (GAO, 2001, p. 4, emphasis added).

[55]Boorman (2007) refers to the Multilateral Debt Relief Initiative (MDRI), led by the G-7/8 and adopted by the Fund and the World Bank in March 2006, as an example of such conflicts. The author of the present study can testify to the relevance of this example, as he was an executive director of the World Bank when the MDRI was discussed and approved by the Board of the IDA. Notwithstanding his strong reservations against the way the initiative had been designed, due to its potential long-term negative consequences for the World Bank's financing to its poorest members, he supported the initiative all along, not least because the leading country of his constituency was a member of the G-7/8 and a subscriber to the initiative.

the above should be taken to imply that directors do not form their own views on the issues discussed at the Board. But the question is to what extent these views are oriented to the interest of the Fund's membership as a whole, rather than reflecting the positions of individual capitals. As also discussed in Chapter 13, the wealth of views expressed at Board meetings often fails to translate into real dialogue, with give-and-take, attempts at mutual persuasion, openness to persuasion, and changes of opinion.

This "hetero-direction" of the Fund from a non-representative group of capitals feeds the widespread perception of a global governance system that does not serve the interests of all its members equally. This may explain why most governments increasingly recognize the need for new "rules of the game" to govern domestic economies in the new global context but strongly resist subjecting themselves to new international obligations ("hard rules").[56] Governments of developing and emerging market country governments have a deep-seated concern that new hard rules would inordinately reflect the interests of the industrial countries, and would unduly restrict their competitive and developmental capacity. At a minimum, these governments fear that the rules would be applied asymmetrically and to their disadvantage. This in turn creates a lack of trust that undermines international cooperation.

Conduct of Board functions

In surveillance, the Board oversees surveillance policy, guides its adaptation to changes in the world economy, and conducts surveillance based on staff analysis and advice on economic developments at the country, regional, and world level. In addition, in their capacity as country officials, Board members assist their authorities in fulfilling their surveillance obligations to the Fund.

Policy oversight. In its policy oversight role, the Board has ensured that the design and operation of the evolving framework of surveillance responds to the needs, interests, and concerns of the range of Fund members, and would therefore receive their broad support. The Board has served as the forum where members could think through proposals for policy adaptation and innovation, and contribute ideas. Through close contacts with the governments of their constituent countries, and by keeping governments abreast of the policy thinking evolving within the Fund, Board members have played a critical role, helping to forge the

[56]This perception emerged vividly in the recent Board discussions on the 1977 Decision on Exchange Rate Policy Surveillance, and in the Board discussions of financial sector standards and codes in the late 1990s/early 2000s.

consensus on changes to surveillance policy. In the global governance context described earlier, the Board has played the delicate role of making the standards and codes advocated by the leading countries "digestible" to Fund members, by matching their design as closely as possible to members' composite set of preferences and concerns.

The Board has been more effective as a diligent agency on behalf of members, ensuring good design and execution of the Fund's mandates, than as a collegial body of administrators working together to shape a vision and perception of problems. For its periodic reviews of surveillance policy, the Board has typically relied mostly, if not exclusively, on staff reports and recommendations. However rigorous and analytically deep, staff reports do not exhaust the observation space that the Board, as the overseer, should explore in order to challenge Management and staff as extensively as possible and to prompt them to push the Fund's "production possibility frontier" further.

Except for the external review of surveillance that the Board requested in 1999 (IMF, 1999), *the Board has not sought opinions from independent sources*—although a major change in this respect has come with the establishment of the IEO. *Nor has the Board made systematic and integrated use of stakeholder feedback collected by executive directors through their contacts with member countries, nor does it avail itself of systematic evaluation of its own performance.* In preparation for surveillance reviews, the Board has not carried out preliminary (committee) work to look at policy surveillance issues from different angles than those considered by staff or to prompt staff and Management to consider other aspects and problems. This reactive attitude has limited the Board's oversight potential and capacity to exercise policy guidance. It may have led the institution into "tunnel vision," and deprived it of the powerful system of checks and balances that a resident Board in continuous session should in principle be able to afford.

In the oversight context, these Board weaknesses, along with the lack of independence and collegiality among directors, may have detracted from the Fund's capacity to prevent many of the surveillance shortcomings that were observed by the independent evaluation studies. The weaknesses may have constrained, for example, the Board's capacity to take issue with the depth and breadth of Fund analysis beyond the issues addressed by the staff; to investigate the quality of the Fund's relationships with country authorities; and to assess Management's practices more thoroughly. As the organ responsible for Fund surveillance, a more independent and collegial Board would have been better placed to use its information more effectively, and deliver stronger oversight of Fund surveillance overall, if necessary even by using more committee-type work and by resorting more often to external expertise and advice.

Conduct of surveillance. The Board completes the conduct of surveillance by discussing the analyses and policy recommendations of staff and by issuing a summary of their views. This is where the Board is perhaps least effective and misdirects its resources most visibly. Although the Board devotes between a quarter and a third of its boardroom time to discussing Article IV reports, it does not contribute much to the staff's economic policy advice. In addition, as the independent evaluations have observed, the authorities of member countries do not attach particular importance to the Board's conclusion of consultations, and skepticism is common about the efficacy of the direct role of the Board and its peer-review effects (IMF, 1999; IEO, 2007). Similarly limited is the Board's contribution to multilateral surveillance, which has also been criticized for its lack of focused recommendations and clear messages (IEO, 2006). Finally, the coverage of issues by surveillance has been found insufficient, and perceptions of inconsistent treatment of members and of clientism remain widespread (IMF, 1999; IEO, 2007).

The Board seems to be doing too much of what it is less good at, and too little of what it can do best. After all, the Board is not mandated to act as an economic policy advisory body, nor does it bring together country officials with policymaking responsibility to defend their countries' policy stances in the context of peer review (see Box 2). Moreover, even if the expectation is that directors' statements on Article IV consultations reflect the viewpoints of the entire membership and thus legitimize the surveillance exercise, the reality is that few capitals have enough resources to invest in reviewing the policies of other members.[57]

Instead, the Board should act as the ultimate guarantor of quality of Fund surveillance, and should ensure that staff and Management handle the policy dialogue with members to the highest standards of competence, integrity, and balance. The way the current multilateral consultation exercise is taking shape can be taken as an example to show that Fund Management and the authorities in member capitals—not the Board—are indeed the natural actors in surveillance, while the Board is better placed to ensure that the Fund provides the best possible support to the exercise.

[57]In most cases, directors form their own judgments by reading staff reports, and consult their capitals for comments prior to finalizing their statements to the Board. This does not contradict the observation on the increasing role of capitals in Fund decision making. The capitals referred to are those of a relatively small group of countries and their attention is focused mostly on Fund policy, sensitive country matters, and crisis cases, and much less on routine Article IV consultations.

Box 2. Peer Review in Other International Organizations

The participation of high-level national officials is a key common principle underlying the peer-review process of country policies in other international organizations. This principle guarantees that member states are represented by national officials who are directly involved in domestic policymaking. It grants relevance and content to the peer-review exercise, ensuring that members speak with adequate voice and that the countries under review provide the best possible answers to their peer reviewers' questions. The principle ultimately strengthens the ownership by member states of the peer-review process.

In the OECD, where peer review offers members the framework to compare experiences and examine best practices, the Economic and Development Review Committee (EDRC) is at the core of the mechanism. This committee is made up of representatives of all 30 OECD members and the European Commission, and is responsible for examining economic trends and policies in individual member countries. The committee carries out the reviews, with participation by member countries' permanent delegates to the OECD, sometimes assisted by experts from their governments. The committee discusses the review report, and a delegation of high-level government officials represents the country under review and answers questions from the other members. The delegation may include civil servants from ministries and agencies. Examiners representing the collective body carrying out the review. The effectiveness of the peer review depends crucially on an adequate commitment to the process by participating countries. High-level participation is especially a major factor in the work of the OECD's Working Party 3, which groups the G-10 countries to focus on multilateral reviews of economic policies.

The Trade Policy Review Mechanism (TPRM) is the WTO's instrument for surveillance of national trade policies. The TPRM examines the impact of a member's trade policies and practices on the multilateral trading system. The reviews, which are essentially peer-group assessments, take place in the Trade Policy Review Body (TPRB), comprising the WTO's full membership. When a country report is circulated to the WTO members, each of them can address questions in writing to the member under review (reviewee), even in advance of the meeting. The reviewee can reply in writing, and the replies can be further discussed. At the meeting, the reviewee is represented by the competent minister or the most senior civil servant. High-level participation in the peer-review exercise is predicated on the understanding that the WTO's deep look at the country's trade policies requires the direct involvement of the national authorities responsible for those policies.

In the European Union (EU), the technical and political levels of economic policy surveillance are carried out, respectively, by the Economic and Financial Committee (EFC), comprising top public officials, and by the Economic and Financial Affairs Council (ECOFIN), whose members are the economics and finance ministers of the EU. The EFC keeps under review the economic and

Box 2 ***(concluded)***

financial situation of EU member states. Each member appoints to the EFC two representatives, one from the national administration (generally the ministry of finance) and the other from the national central bank. The EFC meets with national central banks, when a review of the economic situation, issues of financial stability, or questions concerning the IMF are on the agenda.

Assistance to country authorities. In their capacity as country representatives, executive directors are directly involved in the conduct of surveillance as they assist their country authorities throughout the bilateral consultation process. This aspect of surveillance has never received outside scrutiny, because the related activities of executive directors have been considered as strictly part of the inner relationships between their offices and their constituency members.

To appreciate the importance of this it is worth recalling that, in 1995, in the wake of the Mexican crisis, the Board reported to the IC that the extent to which directors could provide independent and frank assessment to the staff was an important factor in effective surveillance.[58] The report stated that directors had an important role to play in fostering an atmosphere of cooperation and trust by facilitating dialogue between Fund staff and the members of their constituencies. Cognizant of this, the MD at the time proposed to examine how directors could integrate themselves more effectively into the policy dialogue with members.[59]

However, this idea was not followed up, and since then no consistent practice has been developed. There are no records of how this function is actually performed, nor are there guidelines that set good practice principles for it. How to carry out this role is left to individual directors. For example, should they take a neutral stance or should they participate actively in the policy dialogue between staff and capitals?[60] Should they facilitate communications between the two sides? Should they facilitate, or even encourage, the undertaking of surveillance ad hoc or follow-up procedures with their capitals when needed? Should they have a public

[58]See "Report of the Executive Board to the Interim Committee on Strengthening Fund Surveillance" (SM/95/70, Revision 3, April 20, 1995).

[59]See "Statement by the Managing Director to the Executive Board—Department Heads Retreat—Strengthening Country Surveillance" (BUFF/95/67, July 18, 1995).

[60]IEO (2007: 48, footnote 67) refers to cases where directors' involvement in the consultation process was helpful.

relations role and help the Fund communicate its policy recommendations to their countries' public opinion? It is reasonable to assume that different country cases would require different types of conduct from directors. What should be noted is that all these questions are somehow resolved within the directors' routine, based exclusively on their preferences, in the absence of standards of effectiveness and consistent criteria.

Board Accountability

Some of the issues relating to the role of the Board on surveillance policy have been the object of the independent evaluations cited earlier. *But the Board has devoted only passing attention to observations critical of its own role*.[61] The Board has defended its performance generically, without considering where its conduct might require revisiting or corrective action.

The dismissive responses of the Board signal a crucial problem of governance, starting from the basic questions of who is responsible for holding the Board to account for its performance, and how the Board can take responsibility for its acts. The Board's dismissive responses to evaluation findings are also a manifestation of what this paper and Chapter 13 point to as the Board's major weakness: its lack of collegiality. If directors fail to recognize collegiality as an essential value of the Board, they may not perceive an obligation to respond adequately to criticisms.

Management

Fund Management obviously plays a central role in surveillance policy, and enjoys considerable latitude to influence the policy's adaptation and implementation. An example is the role played by the MD in "waking up" the Board to weaknesses in surveillance after the Mexican financial crisis. Management can exercise significant leadership thanks to control over a highly qualified and disciplined staff, direct access to country authorities and leaders, extensive involvement in external relations, and the role of chairing the Board.

Management has an important role in communicating the Fund's views to world public opinion, and in prompting the staff to use communication strategically as a means to raise the institution's profile in the policy debate both within countries and globally. The use of communication as a management tool has helped the Fund to extend its policy dialogue with

[61]These observations have been dismissed rather rapidly in the Chair's Summings Up. See IMF (1999, pp. 4–6); IEO (1996, pp. 46–47); and "The Chairman's Summing Up—IEO Report on the Evaluation of the IMF Exchange Rate Policy Advice, 1999—2005" (BUFF/07/71, May 15, 2007).

members beyond the traditional narrow circles of national policy experts, and to improve its capacity both to deliver its messages to broader and more composite audiences and to receive feedback from them.

Management may influence the effectiveness of surveillance by intervening directly in the Fund's policy dialogue with members, as the story of the 1994 CFA franc devaluation (IEO, 2007) or past episodes of interim consultations indicate. Similarly, Management's participation in the work of international policy groupings helps introduce the multilateral perspective from an authoritative source. The same may hold in the context of the multilateral consultations recently adopted. Skills and personality matter since candor must combine with diplomacy, technical knowledge, and political sensitivity to deliver effective messages to powerful interlocutors, and being heard. Where such talents are present, Management is in a privileged position vis-à-vis the Board to conduct surveillance operations in cooperation with national authorities (quietly and behind the scenes, if necessary), acting as an independent, technically competent, and trustworthy party that represents the interest of the Fund's whole membership. Yet Management's ability to exploit this vantage position is constrained by the latitude that the leading countries are willing to grant to the Fund in the context of national and international policy discussions. Examples like the absence of Fund involvement in such a critical event as the 1992 currency crisis in Europe (IEO, 2007), or the Managing Director's restricted participation in G-7/8 meetings, make these constraints quite evident.

Management is responsible for decisions on human resources. *While these decisions may affect the Fund's outputs, they are not covered under the periodic reviews of surveillance, and the Board has no regular opportunity to oversee this important aspect of operations.*[62] Management typically announces important organizational decisions to the Board, but does not seek or receive much feedback on them from the Board. Important reorganizations and organizational innovations have taken place since the early 2000s in the area of financial sector surveillance, to address weaknesses noted by the ad hoc external reviews. Similarly, the recent IEO evaluations of multilateral and exchange rate policy surveillance have pointed to organizational limitations that need correction. In no case has the Board concluded its discussions by indicating an intent to look into these problems specifically. Nor has the Board raised organizational issues on its

[62]The organizational aspects of the surveillance function were covered in the external ad-hoc reviews of financial sector surveillance that Management commissioned, but these reports were transmitted to the Board for information only. The external evaluation of surveillance (IMF, 1999) covered organizational issues but these did not attract the Board's attention.

own initiative. Yet, as the analysis by Cottarelli (2005) suggests, human resource and organizational issues may strike at the heart of the Fund's capacity to deliver its outputs.

Management has traditionally guarded its decision-making prerogative on organizational matters, with little inclination to be held accountable by the Board. This aspect of the Board-Management relationship raises two separate problems. First, the Board has usually been happy not to engage Management on this front, on the grounds that organizational issues fall within the purview of Management and that the Board should not attempt to micro-manage the institution. *But leaving decisions to Management does not release the Board from holding Management to account for decisions taken, especially when these have a significant impact on Fund outputs.* Nor does it prevent the Board from providing Management with views and recommendations on organizational matters.

The second problem is more general. Executive directors, especially from borrowing countries, are reluctant to challenge Management decisions or antagonize Management, except in extreme circumstances. The MD—who is chief executive officer and chair of the Board—enjoys a superior status than the executive directors, is in practice not selected by them and has direct access to the highest-level authorities in the countries they represent (which they themselves may not have).[63]

In some cases the Board has given Management strong signals on the need to intervene on organizational matters relating to surveillance. In the wake of major crises—in 1995 and 2002, for instance—the Board found that aspects of the Fund's organizational framework might have detracted from the effectiveness of surveillance. A number of Board members pointed to the need to encourage independent analysis, thought, and evaluation within the Fund; and they considered the related organizational issues. The MTS includes organization as one of the main areas where the Fund needs to undertake important changes.

Conclusions and Recommendations

Surveillance is a fundamental responsibility of the Fund. The principles and practices of Fund governance play a key role in the evolution of surveillance policy, enabling its adaptation to a changing world

[63]In interviews, some executive directors critically noted that the MD has the habit of going directly to the IMFC and Fund governors, bypassing the Board. In some cases, directors who had challenged Management were rebuked by their capitals.

economy and affecting its quality. In fact, those principles and practices are themselves the results of the institutional and political dynamics that underpin the governance mechanisms of global finance. A good understanding of Fund governance, therefore, requires taking governance of global finance into consideration.

Since the demise of the par value system, surveillance has evolved more by way of changes in procedures than through the adoption of new obligations. However, in the aftermath of the Mexican financial crisis, the G-7 and broader country groupings that engaged in global governance have pushed the international community to accept common standards of best practice and codes of conduct ("soft law") to handle the challenges of globalization. Fund surveillance was the instrument to disseminate the new sets of rules across the Fund's near universal membership, and to facilitate their implementation by member countries. But the resolution of the leading countries to keep the center of gravity of global decision making outside of the Fund discouraged the cooperation needed to make the new rules effective. So did the concern of developing countries that a Fund controlled by the leading industrial countries would become the "enforcer" of the new rules. Thus, they were only willing to accept new rules as long as adherence to them would be voluntary.

While the current model of IMF governance has helped to build consensus on adapting surveillance policy to changes in the world economy, overall it has weakened the role of the IMF in delivering effective surveillance, and has failed to generate the right incentives for member countries to engage effectively. The failure of the IMFC to become the global fulcrum of surveillance, and, therefore, of international monetary and financial policy cooperation, underlines that the effectiveness of surveillance is ultimately a function of the political decisions of the leading countries about how to run global governance.

The analysis in this case study calls for revisiting the scope and responsibility of each of the Fund's governing bodies with a view to maximizing their contribution to effective surveillance. A number of recommendations follow which revolve around the principles of *specialization, diversification, and complementarities*: each governing body should do less of what it is least able to do, and more of what it is best positioned to perform. In addition, the scope and responsibilities of each body should be redefined to avoid duplication and enhance complementarities.

Based on these principles, a configuration would emerge whereby the IMFC would focus on the "outcome" of surveillance, ensuring that member countries implement good policies and coordinate their actions on systemic issues as necessary. The Board would oversee the "production process" to ensure good quality "output," making sure that surveillance policy is adapted and implemented to the highest standard of quality. In other words, the IMFC would be the forum of Fund members, the Board would be a body of Fund administrators, and Management would be the operational brain of the institution. Management would manage the resources that go into the production process, ensuring that staff generates sound policy advice and delivers it to member countries.

International Monetary and Financial Committee

The comparative advantage of the IMFC lies in it being the only multilateral financial body of a manageable size that represents nearly all countries and brings together top national officials with monetary and financial policy responsibilities. Viewed in this light, the Committee provides the most appropriate forum for Fund members to discuss international policy and take decisions on collective action (Portugal, 2005). It could be the vehicle to channel the conclusions of multilateral surveillance into concrete policy action by members in their respective countries.[64]

The defining features of this system are that countries would commit to taking certain actions within a specified timeframe and vis-à-vis the international financial community, and that the Fund would monitor their fulfillment of these commitments. Another unique feature is that the IMFC would invest its political capital in ensuring international cooperation—a task that the Board could not discharge with the same authority. In the event of problems involving selected groups of countries, dialogues and negotiations could take place within smaller settings than the whole IMFC (as was recently the case for multilateral consultations on global imbalances). However, this would still take place under the aegis of the IMFC.

Bringing international policy cooperation under Fund auspices in this way would facilitate the Fund's role in supporting member cooperation on the adoption and implementation of soft law. As the highest policy forum for member governments, the IMFC could monitor cooperation based on

[64]A recommended country action program would be discussed by the IMFC deputies, and would be modified as appropriate based on indications from the country about its disposition to commit to the actions. The recommended program would then be submitted to the IMFC, with final decisions to be taken by consensus and only with the explicit agreement of the country directly involved in the action program. An implementation timeframe would be agreed, and implementation would be monitored in the course of each IMFC meeting, based on Fund assessments.

Fund assessments, and intervene where necessary to strengthen cooperation through direct peer pressure at the ministerial level.

To carry forward the above tasks, the IMFC would need to reorganize its working procedures. It should become much less formal and more "hands on" than is currently the case, and would require the very active support of its group of deputies. The willingness of countries (especially the leading industrial ones) to bring international policy cooperation under the Fund's auspices through the IMFC would be an indication of their commitment to making Fund surveillance effective.

Finally, as the forum for member countries, the IMFC would identify areas where the Fund should improve its policies and services and to demand that the Board take appropriate action in response. The IMFC would hold the Board to account for the Fund's response to its demands. For this purpose, the IMFC should rely on its own work processes and sources to identify members' needs and concerns to be addressed by the Fund—much as the G-7 does. There would be plenty of room for an active role of the IMFC deputies in preparing for the IMFC meetings.

Executive Board

The comparative advantage of the Board lies in its continuous engagement on Fund issues, its resident status, and its two-level interaction with the institution—from within and with the authorities in member countries' capitals. These factors give the Board a unique capacity to oversee the Fund's production process, and to ensure the highest quality of its outputs—most notably surveillance.

One conclusion of this study and the companion MTS study (see Chapter 13 in this volume) is that the Board is discouraged from exploiting this vantage point by the inappropriate incentive structure facing its members, which limits the Board's collegiality and independence as well as its capacity to build and use information. This incentive structure needs correction. First, the role and responsibility of directors should be clarified, making explicit that as Fund administrators they owe their primary loyalty to the institution and its membership as a whole, rather than to individual member countries. Governors should endorse this clarification.

Granting greater independence to directors would not imply disconnecting them from members or making them unaccountable to their country authorities. It would mean releasing them from the expectation (or obligation) of acting under members' instructions. In forming their own judgments on Fund matters, independent directors would still have to consider the views of the members who appoint/elect them. But they would also consider the views, interests, and objectives of other members and stakeholders (however diverse), and apply their own wisdom in coming to decisions. Independent directors should always be in a position to explain openly why they have taken certain decisions, and in whose interest they have done so. But they should not have to justify their decisions in terms of following "instructions" from capitals.[65]

In the event that it would be possible to reduce the current size of the Board, an alternative option to strengthen its independence would be to include in the Board a number of independent non-executive directors who would be selected exclusively on merit. While these directors would not have voting power, their credibility, competence, and independence would significantly contribute to balancing the dual responsibility of the Board.

Changes to strengthen the independence of the Board would need to be accompanied by measures to improve its accountability, perhaps involving a greater role for the IMFC (see Chapter 13 in this volume). Valid proposals have been put forward recently and should be considered carefully.[66]

A more independent and accountable Board would best use its administrative, oversight, and advisory capacity to ensure that the Fund would conduct quality surveillance As guarantor of the quality of surveillance, the Board would need to make sure that staff and Management handled the policy dialogue with members with the highest standards of competence, integrity, and balance. In this regard, Board members should agree on guidelines to govern their own direct involvement in Article IV consultations, and use these occasions to draw judgments on surveillance.

As a way to improve the usefulness of Board discussions of Article IV reports, the Fund members under discussion should be represented at the Board by a delegation of top national officials, who would defend the country's position.[67] This would ensure that members speak with adequate voice and that they provide the best possible answers to the Board's questions. By involving national authorities at the highest level, this would strengthen their ownership of the Fund's bilateral surveillance process.

This proposal is consistent with the approach recently adopted for the Fund's multilateral consultations. It envisages that Management (and staff) would play an active role in facilitating policy cooperation among the national

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[65]To strengthen the independence and effectiveness of the Board, the job incentive structure of directors should be adapted as recommended in the companion paper on the MTS.

[66]See De Gregorio and others (1999), Portugal (2005), and High-Level Panel on IMF Board Accountability (2007).

[67]Under the current Articles of Agreement, such practice could already be adopted for members that are not entitled to appoint an executive director (Gianviti, 1999: 45).

authorities of the countries that are party to a global problem, and that the process would engage the highest-level national policymakers but would not require the Board's direct involvement. The Board would be kept informed of progress, and be expected to discuss a final report on the consultation.

To monitor the quality of surveillance more closely and continuously, the Board should reconsider the IEO's recommendation to set up a standing committee on surveillance (IEO, 2006). Such a committee could organize its work in separate subcommittees or working groups covering a combination of policy areas, such as monetary, exchange rate and international trade policies, fiscal policy and structural reforms, and financial sector policy.[68] Part of the committee's responsibility should be to make sure that the Fund's internal organizational structure is adequate to deliver effective surveillance.

Though the findings of this study support the idea of more regular IEO involvement in assessing the performance of Management and staff, as well as of the Board, they do not argue for a non-resident Board, for two reasons. First, the nature of the Fund's output is such that national capitals want to have tight control of its process. Under such circumstances, making the Board non-resident would diminish the Board's capacity to build broad consensus in decision making, further augmenting the power of the larger members to control outcomes. Making the Board non-resident would also reduce the chances for the Board to function as a collegial body of independent administrators accountable to the whole membership. Second, if the non-resident Board proved unable to exercise effective oversight, the Fund would then be in the hands of a very small and independent management (more so than today); the "dual" responsibility that the resident Board was intended to carry—precisely in order to balance independence of judgment and accountability to members—would be lost.

Management

From assigning clearer roles and responsibilities to the Fund's governing bodies follows that well-organized and transparent mechanisms of management accountability should be introduced. In this regard, the Board should be advised to set up a process of periodic evaluation of Management's performance.[69]

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[68]This author recommends establishing a financial sector policy committee to strengthen the Board's oversight role.

[69]The High-Level Panel on IMF Board Accountability (2007) submits valid recommendations to this effect.

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