COMMITTEE ON

IMF GOVERNANCE REFORM

Final Report

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EXECUTIVE SUMMARY

The global economy has entered a period of unprecedented turmoil, with the prospect of a prolonged economic downturn, heightened financial volatility, and social instability. Weakly coordinated macroeconomic policies among major world economies, deficient financial regulation, and insufficient commitment to financial stability as a public good have each contributed to the current global economic conditions.

The world needs a multilateral institution at the center of the world economy to help anchor global financial stability. Achieving that aim depends on the monitoring of risks, coordinated policy responses, and agreed norms and standards to which all countries subscribe. To be effective, the institution requires a strong and respected voice, human and financial resources appropriate to its mission, and it must be accountable to its members. It must also work closely with other international organizations and standard setters, and provide a focal point for discussions on crisis management and the macroeconomics of financial regulation.

The International Monetary Fund is well placed to be this institution, but it needs a re-energized multilateral mandate to reflect the evolution of the world economy and to increase its legitimacy and effectiveness in addressing today's global challenges. Few of the conditions outlined above are currently being met.

This report puts forth recommendations for governance reforms. A recomposition of the Executive Board to reflect economic realities by allowing greater representation of emerging market economies, more timely and effective decision-making by a ministerial-level body, and a more precise delineation of responsibilities between management and the Executive Board are central objectives.

We recommend a series of governance reform measures that should be agreed as a single package. That package comprises the following:

- An accelerated quota revision process, to be concluded by April 2010, and an amendment to the Articles of Agreement that would eliminate appointed chairs, thereby allowing for the needed consolidation of chairs, including those of EU countries. This is critical to facilitate the rapid reconfiguration of the composition of the Council (see below) and the Executive Board to reflect current economic realities;

- The activation of a Council of ministers and governors to provide a forum for coordination and to take strategic decisions critical to global stability, as provided for in the Articles of Agreement;

- The expansion of the Fund's surveillance mandate beyond exchange rates to provide appropriate coverage of macroeconomic policies, prudential issues and financial spillovers. The capital account would fall within the mandate;

- The adoption of a troika leadership model for the Council, with regular rotation, and agenda-setting by the leadership, with input from the Executive Board and management;

- The giving of most authority for conducting and completing member-specific surveillance to Fund management, together with strengthened accountability;

- The elevation of the Executive Board from day-to-day operational decisions to giving advice on strategic issues to the Council and to delivering a critical supervisory function, including oversight and review of surveillance. The Board would retain responsibility over lending and financial decisions, and with greater accountability;

- The lowering of the voting threshold on critical decisions from 85 percent to 70–75 percent, and consideration given to extending double majorities to a wider range of decisions, thus ensuring that decisions affecting key aspects of the institution command the support of the majority of members; and

- The introduction of an open, transparent and merit-based system for the appointment of the Managing Director and Deputy Managing Directors.

Governance reforms are necessary but not sufficient to enhance the Fund's legitimacy, effectiveness and accountability. Achieving the aim of a multilateral institution that is able to secure global financial stability needs to be supported with complementary measures. These include steps to progress rapidly on adjustments to quota and voice of members, additions to the Fund's available financial resources, and enhancing its expertise, capabilities and role in macroeconomic coordination, financial and capital account issues. These measures are as important as our governance reform recommendations.

I. INTRODUCTION

This section summarizes the Committee's point of departure on Fund governance.

1. ***Global financial stability***. The world needs a strong multilateral institution at the center of the global financial system that with the support of various groupings and standard setters secures a critical public good, namely, global financial stability, with the benefits of smoothly functioning financial markets accruing to the entire global community.[1] This good could be attained through effective action addressing macroeconomic policy and its coordination, financial regulation, and provision of liquidity.

2. ***Fragmented responsibility***. In recent years, the responsibility for securing global financial stability has become fragmented and the Fund's advice has lost traction and influence.

- Some advanced countries have preferred to seek resolution of monetary and financial issues in other, smaller international fora implying a diminished commitment to multilateral solutions to international economic and financial challenges.

- Emerging markets and developing countries have perceived their voice and quota shares at the Fund to be far short of their role in the global economy, and believe they receive unfair treatment (more intensive surveillance and heavy conditionality) and insufficient attention to their needs (loan size and instruments, policy advice).

- Their engagement at the Fund has been further diminished by the failure of the Fund's financial resources to keep pace with private capital flows; many economies are simply too large to benefit greatly from the financial support that is presently available.

- At the same time, the Fund's powers and advice in areas of increasing importance to the sustainability of economic growth such as the capital account have not kept up with members' needs. The lack of an explicit mandate to oversee global financial stability in all its dimensions—financial sector, domestic macroeconomic policies, and currency arrangements—has reduced the effectiveness of Fund surveillance.

The result has been a Fund that is ineffective in critical areas and struggles with a lack of ownership by the main actors in the global economy. This has reduced the Fund's relevance, and resulted in a de facto delegation of core financial sector work to a range of narrower and specialized agencies, networks, and working groups—all of which can claim expertise on selected issues, but no recognized responsibility for the overall stability of the global system. Naturally, all these bodies should play a fundamental role in a new

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[1] The International Task Force on Global Public Goods defines global public goods as "issues that are broadly conceived as important to the international community, that for the most part cannot or will not be adequately addressed by individual countries acting alone and that are defined through a broad international consensus or a legitimate process of decision-making" (p. 13 of the Final Report).

international financial architecture. However, a stronger IMF and greater collaboration with these bodies would be helpful for the discharge of the obligations of both.

3. ***Need for a multilateral solution***. The upheaval in the world economy is a reminder of two stark realities. First, financial and macroeconomic instability is not limited to just emerging market and developing countries, but a risk to all countries, with today's crisis originating in the most advanced part of the world economy and spreading to its various corners. Second, an effective mechanism for discussing risks to global financial and macroeconomic stability irrespective of their sources, and for coordinating policy responses, has been lacking. The need for greater coordination demonstrates the importance of multilateral solutions and assistance – both technical and financial – to countries in an integrated world. A multilateral institution at the center of the global financial system would have responsibility for the overall stability of the system, providing a forum for discussion, analysis and action on macroeconomic policy, financial regulation, and liquidity provision.

4. ***Global role***. Fulfilling the global role we have in mind requires a set of basic criteria:

a) Such an institution must have a global membership and an agreed set of norms and standards to which all countries subscribe.

b) It must have a legitimate and effective voice to establish and defend the norms and standards needed to deliver financial stability.

c) It needs to articulate a clear view of the global situation and play a guardian role, providing a platform for those countries less represented, but deeply affected by problems at the core.

d) It should seek to ensure compliance with norms to prevent financial instability, and have the courage to speak truth to power.

e) It should work in cooperation with other international bodies and standard setters (e.g. the Financial Stability Forum).

f) It must be respected for its expertise and capable of adjusting its skill mix in line with changes in the global financial markets.

g) It should have the financial resources appropriate to its mission of delivering global financial stability over time.

5. ***Role of governance reform***. The Fund has structural strengths that make it well-placed to play this multilateral role. First, its universal membership is the basis of the multilateral framework currently in place and could provide an effective global forum for the resolution of global problems. Second, its professional staff and management are able to provide high quality technical advice. However, until the Fund is viewed as legitimate and appropriate for the discussion and resolution of global macroeconomic issues, it will remain peripheral and unable to achieve the overall stability mandate envisaged by its founders and shareholders.

6. Having an effective voice, articulating a clear view of the global situation and playing a guardian role, monitoring compliance with norms to prevent financial instability, and working with other inter-governmental institutions involves having an appropriate governance framework. With higher-level and more balanced political representation, better strategic guidance and policy direction, clearer executive authority, as well as an expanded mandate to cover issues beyond a narrow conception of external stability, the Fund's strengths could be enhanced to enable the institution to deliver effective multilateral solutions to global financial, monetary and economic problems.

II. Drawbacks in the Fund's Current Governance Framework

The world has changed dramatically since the Fund's founding, yet the key features of the Fund's governance structures have not.

7. ***Legitimacy and Effectiveness***. The governance of the Fund has two dimensions.

- The first is that pertaining to power-sharing ("chairs and shares"). The Resolution on Quota and Voice Reform approved by the Board of Governors on April 28, 2008 reflected some adjustment to the current dispensation, with a commitment to adjust shares further over time as part of an ongoing process. However, the changes in voting power have thus far been marginal compared with the changes that have occurred globally, and the process of periodic adjustments is painfully slow—the next installment is not until 2013!

- This process needs to be accelerated and brought forward. Given the time commitments involved for negotiations, we urge that the current agreement be ratified immediately, and that members build on their pledge of last April to make quota reform an ongoing dynamic process by bringing forward the next quota exercise for completion by the Spring Meetings in 2010.

- The second dimension of governance covers the decision-making process itself; i.e. how members actually exercise their voting power (Box 1 provides an overview of the existing decision-making structure of the Fund).

- While this dimension of governance of the Fund has received less attention than the quota and voice issues, it is equally important. Current decision making structures have not helped build trust, confidence or legitimacy across the membership. Some shareholders, particularly advanced economies, have avoided some of the responsibilities and standards that others have found important. As part of a multilateral system, external evaluation and peer review should not be optional for any member.

- Existing governance bodies and formalistic procedures have impeded timely and effective responses, and have generated the systematic use of more informal processes that undermines good governance.

Box 1: An Overview of the Existing Decision-Making Framework of the IMF

A resident Executive Board, comprising of civil servants appointed or elected by member countries, currently takes many key decisions of the Fund, whether they are of a strategic or operational nature. These decisions are normally taken up by the Executive Board at the initiative of the Managing Director, based on the recommendations of staff and the institution's work program. The IMFC formed of the most senior political authorities in the areas of finance and monetary policy provides broad guidance to the institution through meetings and communiqués issued twice yearly.

As a financial institution, with resources derived from subscriptions, members control decisions regarding the use of resources, in proportion to their subscription. *As a regulatory institution*, the concept of "peer review" has been an important feature of the Fund's assessment of members' observance of their economic policy obligations under the Articles of Agreement.

For the most part, members exercise control over the decision-making process through the Fund's Executive Board. The Executive Board currently consists of 24 Executive Directors, who are either elected or appointed by members, and is in continuous session at Fund headquarters. With some exceptions, it is responsible for taking both strategic and operational decisions of the Fund – and therefore performs both a legislative and executive role.[2]

Strategic decisions cover broad financial issues (e.g., approval of general terms of credit facilities, such as access limits and repayment periods) and regulatory issues (e.g., the 2007 Surveillance decision that guides Fund assessments of member country policies).

Operational decisions cover the day-to-day application of strategic decisions, be it in the financial area (e.g. the approval of a specific credit arrangement for a member) or on the regulatory side (e.g. the Fund's assessment of a particular member's policies under the Article IV Consultation).

As a general matter, the Managing Director exercises the power of initiative. Most decisions taken by the Executive Board are proposed by the Managing Director and supported by the staff's technical analysis. Similar initiative is exercised in terms of individual Fund programs and the technical discussions that provide the basis for Article IV Consultations.

The Managing Director also has the authority to take a limited number of operational decisions. The allocation of authority between the Executive Board and the Managing Director with respect to operational decisions has been fluid in some respects, reflecting the changing needs and priorities of the Fund. In some circumstances, the Executive Board has ceded authority to the Managing Director (since 1991, for example, requests for technical assistance from members no longer require Executive Board approval). In other cases, the Board has placed additional limitations on the authority of the Managing Director (e.g. requiring consultation with the Board while negotiating a financial arrangement with a member that exceed the access limits prescribed by policies on the use of Fund resources).

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[2] The exceptions relate to powers reserved for the Board of Governors, the supreme decision-making organ of the Fund—such as decisions on changes to members' quota subscriptions—and certain operational decisions taken by the Managing Director.

8. ***Political voice***. High-level political representation on a decision-making body that provides strategic and policy direction, and discusses macroeconomic and financial policy coordination, is needed.[3] The absence of such a body not only contributes to the perception of a "democratic deficit" but also limits engagement of senior policymakers on critical and systemic issues. These shortcomings are not entirely corrected for by the current International Monetary and Financial Committee (IMFC), which is an advisory body. In the absence of any institutional imperative to take concrete decisions, the outcome of high-level global deliberations are of too general a nature to come to grips with emerging systemic problems.

9. ***Executive Board***. The Executive Board is a body with high technical and professional capacity, but its members have tended to be viewed as international civil servants, rather than political representatives, and are often removed from actual policy-making at the national level. The Board is also not always well-placed to exercise genuine oversight over management. In practice, the Board's mandate conflates too many governance objectives (political voice, day-to-day operational decisions, broad oversight of the institution, and strategic vision), diluting its ability to give strategic direction and undermining the technical value of its operational decisions.[4]

10. ***Overlaps and gaps***. Best practice in corporate governance requires clarity of roles and responsibilities, which the Fund's current governance framework does not accomplish. Components of institutional decision-making—namely, the legislative function, the executive function, and a means of measuring performance and holding the executive accountable—are insufficiently delineated and assigned. The IMFC lacks the mandate to take strategic decisions; the Board is too stretched in day-to-day operational decisions to be able to set broad strategic directions; and there are few explicit systems for measuring management and board performance and holding them accountable.

11. ***Mandate***. Governance reforms to address the above drawbacks need to be complemented with other measures. The ongoing crisis confirms the extent to which financial stability has become a global public good and the need for updating the Fund's mandate. While the Fund is mandated to exercise firm surveillance over exchange rates, addressing this crisis and future ones also implies more attention to financial sector issues and how they intersect with macroeconomic policies (see Box 2). The Fund's relationship

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[3] The need for a decision-making body made up of senior policy makers was recognized when the Fund's Articles were amended in 1978. The amended Articles allow for the activation of a Council made up of governors, ministers, or "persons of comparable rank" that would be appointed on the same basis as Executive Directors are appointed or elected. Since 1978, calls have been made—notably after the Mexican and Asian crisis of the 90s—for the creation of the Council. Most recently, the Independent Evaluation Office of the IMF also recommended activating the Council in its evaluation of corporate governance of the Fund (Independent Evaluation Office, 2008, "Governance of the IMF: An Evaluation," IMF, Washington, DC).

[4] As noted in the IMF's IEO report on corporate governance, "the Board has played only a reactive role in strategy formulation and it has not been effective in monitoring policy implementation. The Board's involvement in day-to-day operations has deflected its attention from these needed oversight functions and constrained its ability to perform them in an independent manner." (IEO, 2008, "Governance of the IMF: An Evaluation," IMF.)

with the Financial Stability Forum (FSF) as central regulatory standard setter will be crucially important, and we welcome the enhanced collaboration already embarked on, especially on early warning.

Box 2. The IMF's Mandate

According to Article IV of the Articles of Agreement, members have a general obligation "to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates". To that end, the Fund is charged with exercising firm surveillance over the exchange rate policies of its members. As a result, domestic and financial sector policies are, in large measure, assessed in as much as they impinge upon the external account.

Domestic policies

The current global financial crisis shows that domestic policies, and in particular financial sector policies, cannot be assessed only in terms of the balance of payments impact. In this crisis, the hit to the financial sector was not transmitted to the rest of the world through a collapse in currencies and forced adjustments of the global imbalances. For example, while the U.S. had been one of the largest deficit countries entering the crisis, the U.S. dollar strengthened in a global flight to safety; and the U.S. deleveraging process prompted a "sudden stop" of capital flows from major money centers to emerging market and developing countries. Thus, a narrow focus on external stability can be highly misleading. An amendment of the Articles that would provide the Fund with a broader mandate for effective surveillance would give equal importance to macroeconomic and prudential policies and financial spillovers.

Capital account

Our Committee considered the issue of oversight of cross-border financial policies and spillovers. A way forward would be to extend the Fund's jurisdiction over the current account to also cover international capital movements by amending the Articles; a recommendation made by the advisory Interim Committee urged the Executive Board to do so in 1997/98. The objective was to ensure that changes to capital account policies were pursued within a multilateral framework in a manner that took into account macroeconomic stability and the regulatory capacity of members. The objective was never to champion the liberalization of capital movements per se, but rather to ensure that countries adequately assess domestic macroeconomic and financial risks ahead of liberalization. If the proposal were taken up now, it would require the Fund to establish the capacity to effectively monitor capital account policies of members and ensure that restrictions imposed (as allowed under Article VI, Section 3) are non-discriminatory.

Article IV reports should in any event take up capital account issues where they are relevant, and address spillovers and linkages across borders. Multilateral surveillance, exercised principally through the WEO and the GFSR, should also take up these issues in greater depth than has been the case so far.

III. TOWARDS A NEW GOVERNANCE FRAMEWORK

12. ***Key recommendation***. We propose a new governance framework to harness the Fund's strengths to work effectively in pursuit of the overall aims of the institution. The central objectives of governance reforms must be to enhance clear leadership, enable effective executive decision making, and increase accountability to the membership.

13. ***Approach***. Each of the main governance bodies needs change with a view to enhancing its effectiveness. A major impact on governance comes from activating the Council and amending the remit of the Executive Board. Freeing the Board from day-to-day and routine decisions would not only be consistent with best practices in the corporate context, but would create the basis for truly effective oversight and the capacity to provide more substantive strategic advice to the Council and Management. A refocusing of the Board would also facilitate greater focus by Management on outputs and create greater efficiencies and accountability in the overall operation of the Fund.

- Political representation at the strategic level—a ministerial-level Council to provide more direct political voice to the Fund's decisions. Representation on the Council would be enhanced by "direct" voting that enables splitting of constituency votes, which is allowed under the Articles of Agreement.

- Since the Council would have legal powers, it should take strategic decisions, which would constitute the general "legislative" decisions; e.g. the adoption of the Surveillance Decision and the establishment of new financial facilities. It should also among other functions engage in policy coordination and react to emerging risks.

- The Managing Director would be responsible for operational decisions, notably the application of the surveillance "legislation" in country-specific cases.

- The Executive Board would have four functions: (i) it would oversee the work of the Managing Director and staff, including surveillance, thus enforcing accountability; (ii) it would advise the Council on strategic decisions and prepare its work; (iii) it would be responsible for decisions on use of Fund resources; and (iv) it would take decisions on internal matters with major financial implications, including setting the medium-term budget and the staff compensation framework.

14. ***Fundamental leadership reform***. We want to be clear that we are calling for a fundamental reform of the IMF's governance structures, not a mere re-labeling of existing ones. Changing the name of the IMFC to the IMF Council and giving it *de jure* decision making authority is unlikely to accomplish much. As discussed below, changing the composition of the Council, with a membership that reflects global economic realities, is essential for legitimacy. As recognized under the Articles, the members of the Council must be at a sufficiently high level of authority, namely, the finance ministerial level, to discuss core global macroeconomic and financial issues, if there is to be traction. Furthermore, devolving responsibilities (e.g., the surveillance function) to management and staff, must lead to greater agility and accountability, not a weakening of peer review.

15. ***Engagement***. The reform package is far reaching and requires the personal involvement of Ministers and Governors, preserving as much as possible consensus as the predominant pattern of decision making. This will require from all a spirit of multilateralism, leadership, and ownership. The reforms will improve decision-making in the Fund, enhance capacity to engage in critical economic and financial issues of the day, and improve the effectiveness of the institution's advice and financial support to its members.

IV. Enhancing Political Voice in Decision Making

Since the management of globalization demands a strong multilateral framework, one core element of a governance reform package should be a high-level political voice in the Fund's decision making. The Fund's Articles of Agreement already provide for such a voice.

16. ***A Council***. The Articles of Agreement empower the Fund's Board of Governors to establish, by an eighty five percent voting majority, a Council to be composed of ministers, governors, or "persons of comparable rank". This Council would be responsible for strategic issues, namely, to "supervise the management and adaptation of the international monetary system, including the continuing operation of the adjustment process and developments in global liquidity."

17. ***Scope***. The Articles provide for flexibility in determining the scope of the Council's functions, which can be determined by the Board of Governors on an ongoing basis and should be responsive to changing circumstances. It seems critical to us that the Council should embody and practice a reinvigorated spirit of multilateralism, realized by an explicitly forward-looking agenda covering global and regional macroeconomic and financial issues.

18. ***Weight***. A Council would enhance the gravitas of decisions made and the speed of response so addressing two common sets of complaints about Fund decision making.

19. ***Functions***. Given that a high-level Council would take decisions on issues that are strategic in nature, it should be composed of ministers and governors. We propose that the functions include:

a) Discussing when needed policy coordination;

b) Establishing new financing facilities and other decisions of general application (i.e., the legislative function; see Box 2 for an example);

c) Building consensus on the set of norms and standards to which all members subscribe and providing for their adoption;

d) Launching and completing new rounds of multilateral consultations, including regional surveillance;

e) Reviewing developments, identifying emerging risks, and providing a forum for discussing and coordinating systemic macro and financial policies;

f) Reviewing key Management and Board decisions, particularly surveillance of systemically important issues or countries, and increased accountability (Box 3); and

g) Appointing the Managing Director through an open, transparent and merit-based selection process.

20. ***Operations***. The Council needs to operate with a high degree of peer review, mutual accountability, and consensus. This would be facilitated by the following proposals for deciding its leadership and agenda.

- ***Leadership and participation***. The adoption of informal understandings or conventions concerning its leadership would enhance further the legitimacy of the Council, both in terms of securing broader regional representation in its leadership and ensuring systematic turnover. The chairperson, selected every two years, should be assisted by two additional Councillors in a "troika"-type arrangement—i.e., the former chair and the following chair, which has the benefit of enhancing ownership and allowing for sufficient continuity.

- ***Agenda***. The leadership should set the agenda, taking input from Fund management and the Board. The Board in particular should assist in distilling research and policy discussions into actionable format for the Council's deliberations. This would enable the Council to hold meetings focused on a specific set of systemic, strategic or policy issues, on the basis of brief background notes.

- ***Meetings***. The Council should meet at least twice a year, during the Annual and Spring meetings, with ad hoc meetings as needed. Such flexibility would allow the Council to act rapidly and effectively. In addition to receiving input from the Executive Board, management would be expected to make periodic reports to the Council, as is the case with the IMFC.

21. ***Configuration***. Getting right the composition and size of the Council and Board is critical to the governance reform project. The Council must be of the highest possible legitimacy and representation, and aimed at enhancing the role and effectiveness of the Fund. It must, thanks to an appropriate and effective system of constituency, represent all 185 Fund members. Representation in the Council should reflect current economic realities and be adjustable over time.

22. ***Size and composition***. The Council and the Board need to be small enough to be workable but large enough to be representative. The Fund's Board of 24 warrants consolidation. The easiest approach is to move to 20 seats, as envisaged in the Articles of Agreement, to ensure effective representation without loss of efficiency. Since the size and composition of the Council and Board, according to the Articles, need to mirror each other, steps will need to be taken in the near term to allow for greater representation of emerging and developing economies at the Board, so that the Council is established with as much legitimacy as possible right from the beginning.

23. ***Relationship to quotas***. Bringing forward the quota review to realign existing shares with members' global economic weights is fundamental to achieve the optimal composition. The current quota and voice reform will lead to a realignment of existing shares, primarily through redistribution among the group of emerging market and developing economies. Further realignments of shares are expected in the context of future general quota reviews, beginning with the 14^{th} general review currently scheduled for 2013. This process is far too gradual. A more thorough and far-reaching revision to the quota formula will help to improve

the political legitimacy of the Council. As noted earlier, we recognize that quota negotiations are difficult and time consuming, and recommend approving the current reform resolution and bringing forward the next quota review to 2010.

24. ***Appointed chairs***. Additionally, achieving the right composition can be facilitated by eliminating the requirement of appointing five chairs for the largest quota-holders. Instead, all chairs should be elected, which would also help consolidate European Union member countries and so achieve a better balance between advanced and emerging market/developing countries.[5]

25. ***Voting***. Voting in the Council provides for a more direct political voice and representation. According to the Articles, the Councillor appointed by a group of members *may* cast separately the votes allotted to each member in the group, unlike at the Executive Board, where Executive Directors elected by multi-country constituencies must cast the votes of their constituencies as a block. Votes at the Council do not have to be split, and the rules for each constituency could make clear when splitting would occur. This is an important safeguard for countries that by virtue of their constituency rules, size, or interests will not be present on the Council.

26. ***Broad majority***. We believe nevertheless that it is important for the Council to operate as fully as possible by consensus, as it is with the Board and the present IMFC. In this respect, voting rules have a way of helping participants move towards consensus by maintaining the underlying prospect of moving to a vote. To strengthen the democratic process, we suggest lowering the voting threshold on critical decisions from 85 percent to 70–75 percent. Additionally, consideration could be given to extending double majorities to a wider range of decisions thus ensuring that those decisions affecting key aspects of the institution command the support of the majority of members of the organization. [6]

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[5] Providing for the election of all Executive Directors would require an amendment of the Fund's Articles. Currently, there are 10 European Directors on the Board, 8 of whom are from EU countries. Consolidating European chairs—8 EU chairs going for instance to 2 or 3—would enhance the voice of the region while making more space for emerging market and developing country directors and allowing for a reduction in the total number of chairs.

[6] We recognize that these changes would involve amendments to the Fund's Articles. A double majority is used already at the Fund – Article XXVIII, Section A provides that an amendment of the Articles requires support by three-fifths of the members, having 85 percent of the total voting power.

Box 3. Increased Accountability

An important advantage of our proposed delineation of responsibilities is enhanced accountability of Management and the Executive Board. The Council would be able to identify more clearly successes and failures in the fulfillment of the Fund's mandate and the meeting of strategic priorities. For instance, if important IMF programs fail to deliver results, Councillors may want to ask what role Fund advice and conditionality played—or failed to play—in this outcome.

Management would be held accountable by the Board through ex ante goal setting and ex post performance assessments. The Board in turn would be held accountable by the Council, who may commission reports on the Board's performance as and when desired.

V. Reconfiguring Governance Responsibilities

The clear demarcation of responsibilities between the Board and Management is a central objective of governance reforms. Should the Board continue to take the vast majority of day-to-day operational decisions with Fund management, should Fund management be responsible for operational decisions and the Board have mainly a supervisory and an advisory function, or should there be a blend of responsibilities with some delegation of operational responsibilities to management? We recommend the blended option.

27. ***The Board as an executive body***. With the Council making key strategic decisions, one option is for the Board to be responsible for applying these decisions in individual cases and retaining a far-reaching executive function with respect to key operational matters. While this governance framework would ensure that members maintain close political control over the key operational decisions of the Fund, such as the approval of Fund financing to individual member countries, it would not establish a clear delineation of responsibilities between the Executive Board and the Managing Director that is critical to enhancing accountability. Moreover, once the responsibility for taking strategic decisions is transferred to the Council, it is likely that the Executive Board's involvement in the day-to-day management of the Fund will increase. This form of Board operation would involve high costs, reduce accountability, and generally slow decision making. It would also do little to improve representation of emerging markets and developing countries in the Fund's operational decisions.

28. ***Clear delineation of responsibilities***. An alternative framework is to give the responsibility for all operational decisions to the Managing Director. In this conception, the Board would be responsible for (a) exercising independent oversight over the Managing Director, and (b) making recommendations with respect to the strategic decisions to be made by the Council. This option delineates responsibilities clearly and enables the exercise of oversight in an independent manner, consistent with the best practices in the corporate governance context. The Board would perform ex post oversight as opposed to ex ante checks and balances. The main drawback, however, is that there would be limited member involvement in programs and the use of Fund resources.

29. ***A blend***. Our recommendation is a blended approach, wherein operational decisions involving Fund financing are retained by the Executive Board. It is only natural that members control decisions regarding the use of the Fund's resources. In this vein, the Board would also be responsible for internal decisions with major financial implications, including setting the medium-term budget and general compensation framework. Management would conduct surveillance, continue to have the responsibility to make staff appointments, and would have the discretion—within the framework of strategic priorities, Fund policies and the medium-term budget—to conduct surveillance and allocate resources to achieve the given priorities. Table 1 summarizes our proposed delineation of responsibilities. This greater delineation of responsibilities would permit increased accountability of management and the Board, which in turn would allow members to clearly identify successes as well as failures.

Table 1. Delineation of Responsibilities among the Council, Board, and Management

Council	**Board**	**Management**
Legislative functions in "critical" areas (which are defined responsively over time) - e.g. surveillance mandate, establishment of financing instruments and facilities	*Legislative functions in "non-critical" areas*, such as: - Routine reviews of and non-critical amendments to existing Fund policies and lending instruments - e.g. review of data provision to the Fund	Exercises initiative (status quo)
	Advisory role to Council: - provides input on preliminary policy papers on the critical legislative issues	Exercises initiative (status quo)
Regulatory function—surveillance: - early warnings and policy responses - concludes multilateral consultations	*Regulatory Function – Surveillance* - quarterly review of themes from Articles IVs	*Surveillance:* - concludes all Article IVs - however, the concerned ED/ group of EDs (at least 5) could ask for discussion - WEO/GFSR/early warnings
Financing decisions Legislative function for key financial policies and instruments	*Financing Function #1 Arrangements* - approval of arrangements - completion of reviews - waivers of PCs Advisory role in recommending new policies and instruments to the Council	Exercises initiative (status quo)

Strategic Priorities : - defines medium-term priorities	*Financing function #2: Budget* Sets medium-term budget and general compensation framework	*Operational autonomy on allocating resources to achieve priorities:* - develops and implements annual budget consistent with medium-term priorities and framework - free to appoint, organize, and dismiss staff (status quo)
Selection of MD: Sets out criteria for MD selection and conducts open, transparent, and merit-based selection process. MD remains Chair of the Board.		- MD appoints DMDs on approval of the Board (status quo)
	Supervision over management: - Review of management's performance including ex post assessment (on Article IVs and meeting medium term priorities)	- In matters of oversight over the MD, the dean (or another Board member) chairs the Board (status quo)
Supervision/accountability of Board: - reviews report on Board, prepared by the Council or by a subset of Councillors (as and when desired)		

VI. Delegating Responsibilities to Management

Responsibilities given to management include the authority to ordinarily conclude Article IV consultations with members and develop and implement annual budgets to meet the institution's strategic priorities. An open, transparent, and merit-based system for the selection of the Managing Director is essential.

30. ***Devolve some decision making***. A more modern structure of the Fund, with a more accountable Managing Director to oversee the work of a professional staff, is sorely needed. Our sense is that the Board is too involved in the day-to-day running of the institution. Accordingly, we propose a devolution of decision-making authority to management from the Board in the areas of surveillance and resource allocation:

31. ***Surveillance***. As reported in the recent Triennial Surveillance Review of the IMF, most country authorities note that IMF surveillance adds significant value, as an integrated macroeconomic assessment from a global perspective, as a test against the authorities' own judgments, as a transparent source of standardized information, and as a source of specific

policy advice. However, this added value tends to come at the conclusion of the Article IV consultation missions during briefings of senior officials.

32. ***Candor***. A greater measure of devolution, moreover, would help to alleviate political constraints imposed on staff's technical analysis. Where surveillance includes advice on multilateral issues, the candor and value of staff's assessments and early warnings could be significantly enhanced.

33. ***Functions***. Management should continue to exercise the power of initiative in the legislative and financing areas. It should also continue to have autonomy in the appointment, organization, and dismissal of staff. In addition, management should conduct surveillance under Article IV. The Board should have the option of requesting a discussion if asked for by the relevant ED or a group of EDs (at least five). Management should have the flexibility to allocate resources—within the overarching policy framework and strategic decisions—to best achieve the surveillance mandate. Accordingly, management should be given the authority to develop and implement annual budgets, within the medium-term budgetary and general compensation framework set by the Board.

34. ***Selection of the MD***. If the Fund is to provide leadership in the global financial system, then the Managing Director must be a world figure or symbol representing global financial stability and a credible and effective spokesman for these values. As such, the selection of the MD should occur through a transparent, open, and merit-based system.[7] The participation of the Council in the MD's selection process is essential. According to the Articles, the Board selects the MD, who serves as its chair. We propose that the MD be appointed by the Council and continue to serve as the chair of the Executive Board. The Articles would need to be amended accordingly.

35. ***Selection of the DMDs***. Although the three Deputy Managing Directors (DMDs) are members of the staff and chosen by the MD, there is a clear perception—confirmed by practice—of reserving the position of first DMD to the U.S. The selection of the DMDs should occur through a transparent, open, and merit-based system.

36. ***Accountability***. As the scope of responsibilities of management increases, so too does the need for effective accountability. A key function of the Board will be to review management's performance and hold it responsible for the conduct of surveillance and fulfillment of strategic priorities and for the effectiveness of the Fund's technical assistance to countries. All members of the management team should be subject to an assessment of their performance by the Board according to clear benchmarks, including taking into consideration the opinion of the staff.[8]

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[7] A selection process for the Managing Director was adopted by the Executive Board in July 2007; see Press Release No. 07/159 (http://www.imf.org/external/np/sec/pr/2007/pr07159.htm).

[8] A Working Group of Executive Directors on the Framework of the Managing Director's Performance Evaluation, chaired by the Dean of the Executive Board, was established in January 2008 to establish an accountability framework for the Managing Director.

VII. STRENGTHENING THE EXECUTIVE BOARD

The role of the Board needs to adjust to the institution's evolving needs. It is too "in the weeds" of day-to-day operations and pro-forma commentary to provide meaningful oversight of the Fund.[9] *It should be strengthened to serve as advisor to the Council, given its intimate knowledge of the institution; becoming more supervisory—as Fund management takes on more operational duties—but also retaining fiduciary/financing responsibilities. The Board should be made more representative of the membership.*[10]

37. ***Functions***. A new role for the Board is essential to the success of the Fund. With an intimate knowledge of the institution, the Board can assist the Council on strategy by providing perspective and advice and in taking policy decisions in areas of a lesser systemic importance. It should continue to decide on the use of Fund resources, with streamlined work practices, and it should perform a more supervisory role over Management.

- *Advising the Council*: the Board should advise the Council on emerging issues and decisions, and provide input in the preparatory stages of new Fund policies in critical areas. It should also provide quarterly or semi-annual reports to the Council on cross-cutting themes that emerge during Article IV consultations.

- *Legislative*: the Board should legislate in ordinary areas of Fund policy review and formulation, such as reviews of access policies.

- *Financial*: the Board should continue to decide on the financing arrangements. It should formulate the medium-term budget and compensation framework.

- *Oversight*: clearly delineating the responsibilities of the Board and management in the area of surveillance allows the Board to supervise management's performance, without a conflict of interest. This oversight function is critical to ensure that the Council's strategic priorities and the surveillance mandate are being fulfilled. The Board could conduct select ex post reviews of surveillance reports, and construct and implement a framework for management accountability, providing an overall assessment every 12 months.

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[9] The Board currently reviews over 80,000 pages of paper annually. Board offices are about 10 percent of total Fund personnel, taking up 8 percent of the budget—over $57 million for the Board offices, and nearly $12 million for the Secretary's Department to service the Board.

[10] In its evaluation of IMF governance reform, the IEO recommended that the Board take on more supervisory responsibilities, with improved representation to ensure a more equal voice of members in strategy formulation. It also recommended delegating authority to management on "certain non-systemic" country issues such as program reviews and some Article IV consultations. The IEO considered the merits of a non-resident Board, though it concluded that the IMF Board should remain resident. See "Governance of the IMF: An Evaluation"; Martinez-Diaz, Leonardo, "Executive Boards in International Organizations: Lessons for Strengthening IMF Governance," IEO, BP/08/08; and Chelsky, Jeff, "The Role and Evolution of Executive Board Standing Committees in IMF Corporate Governance," BP/08/04.

38. ***Structure and staffing***. The functional reform of the Board implies changes to its structure, meetings, and staffing. A lower day-to-day workload from a reduced surveillance function could help to lower overhead costs as offices are made smaller. Lower costs would also derive from less frequent meetings implied by a more supervisory and advisory role.

39. ***Resident or non-resident Board?*** The current practice of meeting thrice a week increases the tendency to micromanage, blunting the Board's efficiency and effectiveness. While a non-resident Board could be considered, it may be preferable to maintain a resident Board, but with fewer meetings and a lighter presence.

- A restructured workload for the Board has implications for the frequency of meetings and the need to delve into minutiae. A non-resident Board would create even greater scope for the Board to provide Management and the Council with the strategic advice that we believe is an important function for the Board.[11]

- A resident Board, however, allows members' concerns to be heard at an early stage, and allows for members to build specific human capital on the institution's complexity and advise Councillors. It enables it to take decisions in a timely manner that relate to the use of the Fund's resources. For these reasons, we recommend maintaining a resident Board, albeit with significantly smaller offices.

- Consideration could also be given to another configuration based on the appointment of a high-level, non-resident Executive Director, such as a minister's deputy or sherpa, who attends meetings in the Fund's headquarters for a week every two months and participates via video/teleconference as necessary. This would have the effect of upgrading the Board. A resident alternate Executive Director would then take decisions in the Executive Director's absence and would handle only urgent or unexpected business. Key to the success of this configuration would be the determination of the highest national authority to preserve the seniority of the appointed Directors, avoiding the practice of delegating downward.

40. ***Composition***. The composition of the Board should be improved to reflect the current economic realities. [12] This is a fundamental issue to enhance Fund legitimacy. Emerging market economies are clearly underrepresented at the Board. Furthermore, we

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[11] Both Bank of England Governor Mervyn King and US Treasury Secretary Henry Paulson recommended consideration of a non-resident board. Governor King said, "serious consideration should be given to a non-resident Board, meeting some six to eight times a year with directors comprising senior finance ministry or central bank officials" (speech on the "Reform of the International Monetary Fund," Indian Council for Research on International Economic Relations, New Delhi, India, February 20, 2006). Secretary Paulson remarked, "a non-resident board could free-up resources and enable management to focus on issues of more strategic importance" (http://www.treas.gov/press/releases/hp1285.htm).

[12] The Articles provide that the minimum number of Executive Directors must be 20 (5 appointed plus 15 elected). The Board of Governors may, by an 85 percent majority, increase the number of elected Executive Directors (and has done so over the years) or decrease the number.

recommend moving towards electing all chairs, which would allow for consolidation. Constituencies at the Board could make their own rules, within reasonable bounds.

VIII. IMPLEMENTING THE REFORM PACKAGE

41. ***Package***. Restoring the Fund to the center of the international financial system is a daunting yet urgent task involving issues that have been left to the side for too long. Fortunately, there is a considerable amount of work underway, both within the Fund and in the G-20. We believe that immediate changes to the mandate of the Fund and its governance present the approach most likely to result in significant benefits for the effectiveness of the Fund. The required amendments to the Articles of Agreement and a new timetable for quota reform need to be set in motion in the very near future to facilitate the establishment of the Council and associated governance reforms as soon as possible. We believe that an explicit package should be composed of the following actions:

a) That a revised timetable be set out as soon as possible for further quota and voice reform, with the intention of completing a new round of revisions no later than the 2010 Spring Meetings.

b) That the composition of the Executive Board be adjusted to reflect economic realities and allow for greater representation of emerging market economies.

c) That the Council be activated through a vote of the Board of Governors and its composition adjusted in line with quota revisions proposed above.

d) That the Articles of Agreement be amended to remove the requirement that the five countries with the largest quotas are required to appoint their own Executive Directors, and that constituency reforms be made to achieve the needed consolidation of chairs, including of European countries, and for whatever other adjustment which could be seen as appropriate.

e) That the Articles be amended to expand the Fund's surveillance mandate beyond exchange rates to provide equal coverage of macroeconomic policies, prudential issues and financial spillovers. The capital account would also fall within the mandate.

f) That decision-making authority on surveillance and resource allocation be devolved as suggested to Fund management shortly after the creation of the Council, while the Board take on advisory responsibility to the Council and oversight responsibilities over management.

g) That the Articles be amended to lower the voting threshold on critical decisions from 85 percent to 70–75 percent, and consideration given to extending double majorities to a wider range of decisions, thus ensuring that decisions affecting key aspects of the institution command the support of the majority of members.

h) That the Articles be amended to provide for the appointment of the MD by the Council, and that the criteria for selecting the Managing Director and the Deputy Managing Directors be modified to allow for an open, transparent and merit based selection process.

42. ***Preferred timing***. Deferring this package of reforms at a critical time for the global economy has major drawbacks. The best way forward would be to implement the package as a whole in 2010, requiring speedy implementation of all measures. The Board of Governors would need to approve resolutions to amend the Articles by fall 2009.[13] The next round of quota revisions would need to be concluded by Spring 2010, and all necessary amendments to the Articles (for example, eliminating appointed chairs) ratified. The Council would be activated by mid 2010 by a resolution of the Board of Governors.[14]

43. ***Logistical support for Council***. The Council would require a support mechanism. The Fund's Secretary would be well placed to provide this support, to help ensure consistency and coherence among the different organs of the Fund.

IX. Conclusions

44. ***Defining moment***. We are at a defining moment for the global financial system and, by implication, for the relationships among countries. The institutional and policy-making landscape is changing in a rapid and unpredictable manner, driven not by a coherent global approach, but instead by separate reactions to the global financial crisis. As a result, the inadequacy of today's multilateral coordination is evident, multiplying the market accidents and policy mistakes.

45. ***Need for urgent and bold modernization***. Crises provide the opportunity and momentum for reform and radical change. We need to grasp this moment to put in place arrangements that forestall their recurrence. There is no decision-making body with the requisite political heft, national policy-making authority, flexibility, and widely acknowledged legitimacy to provide an effective mechanism for collaboration and response to early warnings and global financial problems.

46. ***Fundamental reforms***. To sustainably deliver the much needed public good of global financial stability, a broad package of IMF reforms is needed to its governance framework. This needs to be supported by adjustment to the Fund's mandate. Strategic direction and oversight of the global financial and monetary system needs to be imparted by a high-level political body that reflects global economic realities. A process for the

[13] Including but not necessarily limited to: eliminating appointed chairs; expanding the surveillance mandate including over domestic macroeconomic policies, financial spillovers and the capital account; lowering the voting threshold and possibly extending double majorities; and the appointing of the MD.

[14] In addition, the IMFC would need to be abolished through a vote of the Board of Governors. The By-Laws, Rules, and Regulations would need to be amended.

adjustment of quotas to facilitate better representation of emerging and developing economies should be set out, the composition of the Executive Board modified accordingly, and the decision-making Council of ministers and governors provided for in the Articles of Agreement activated. The Council must be small enough to be effective and representative, in addition to being highly representative of the world as we know it. All other governance tasks should be delegated to the Executive Board and Management, with greater delineation of responsibilities to further enhance the efficiency and effectiveness of decision making at the Fund. And while these reforms form a coherent package, it is necessary to bear in mind that implementation of some reforms will necessarily take longer than others. We urge members of the Fund to accept them as a package of reforms at this time, and to move speedily to implementation.

47. ***Fund resources***. The question of the adequacy of Fund resources remains a central concern of the Committee, although not strictly within its mandate. We appreciate the readiness of Japan to provide the IMF with an important bilateral loan, providing fresh and much needed resources at a critical time. This contribution and others that may be forthcoming may not suffice in the current global crisis, and so we conclude this report with an appeal for a substantial SDR allocation to be considered urgently.

APPENDIX I. COMMITTEE MEMBERS

- Trevor Manuel (Chairman), Minister of Finance, Republic of South Africa
- Michel Camdessus, Former Managing Director of the IMF and Honorary Governor, Banque de France
- Kenneth Dam, Professor of Law, University of Chicago
- Mohamed El-Erian, CEO, Pacific Investment Management Company
- Sri Mulyani Indrawati, Minister of Finance and Coordinating Minister of the Economy, Republic of Indonesia
- Guillermo Ortiz, Governor, Banco de Mexico
- Robert Rubin, Council on Foreign Relations
- Amartya Sen, Lamont University Professor, Harvard University
- Zhou Xiaochuan, Governor, People’s Bank of China

APPENDIX II. TERMS OF REFERENCE

1. Over the past few months, significant progress has been made in the reform of the Fund's governance framework. The Fund's Board of Governors has initiated a process designed to realign members' voting power within the Fund in a manner that will enhance the Fund's effectiveness and legitimacy. Notwithstanding the importance of this initiative, a question remains as to whether the institutional framework of the Fund—through which members' voting power is actually exercised—also requires reform, taking into account the significant changes that have taken place since the Fund's establishment.

2. As a means of addressing this important question, the Managing Director is establishing a Committee that will assess the adequacy of the Fund's existing institutional framework and advise the Managing Director as to what, if any, modifications to this framework may be necessary to enable the Fund to fulfill its mandate more effectively. The Committee will be chaired by Trevor Manuel and will also consist of Michel Camdessus, Kenneth Dam, Mohamed El-Erian, Sri Mulyani Indrawati, Guillermo Ortiz, Robert Rubin, Amartya Sen, and Xiaochuan Zhou.

3. In conducting its work, the Committee is expected to consult broadly among the Fund's various shareholders and others, taking into account the need to obtain broad support from the Fund's membership for possible changes to the Fund's existing institutional framework. In that context, the Committee shall take into account the valuable report of the Fund's Independent Evaluation Office entitled "Aspects of IMF Governance—Including the Role of the Executive Board" and the views of the Fund's Executive Directors with respect to this report.

4. The Committee is expected to present its report to the Managing Director by the 2009 Spring Meetings. The Committee's work will be supported by a small secretariat selected from Fund staff.

APPENDIX III. PRESS RELEASE NO. 08/200: MANAGING DIRECTOR STRAUSS-KAHN APPOINTS COMMITTEE ON IMF GOVERNANCE REFORM

September 4, 2008

Managing Director Dominique Strauss-Kahn of the International Monetary Fund (IMF) today announced the appointment of a committee of eminent persons to assess the adequacy of the Fund's current framework for decision making and advise on any modifications that might enable the institution to fulfill its global mandate more effectively.

The committee, chaired by Trevor Manuel, Minister of Finance of South Africa, includes: Michel Camdessus, former Managing Director of the IMF; Kenneth Dam, Max Pam Professor at the University of Chicago; Mohamed El-Erian, co-CEO and co-CIO of Pacific Investment Management Co.; Sri Mulyani Indrawati, Minister of Finance of Indonesia; Guillermo Ortíz, Governor of the Bank of Mexico; Robert Rubin, Senior Counselor at Citigroup; and Amartya Sen, Lamont University Professor at Harvard University.

"Important progress has been made in the reform of the Fund's governance, including the initiation of a process to realign members' voting power within the Fund. However, the task of enhancing the Fund's legitimacy and effectiveness must also come to grips with the question of whether the significant changes since the establishment of the Fund require reform of the institutional framework through which members' voting power is actually exercised. Among other things, this requires careful consideration of the respective roles and responsibilities of the Board of Governors, the International Monetary and Financial Committee (IMFC), the Executive Board, and Fund Management," Mr. Strauss-Kahn stated.

"The committee's perspective, which I hope to have by next April, will provide yet another important input to our reform efforts, which have benefited recently from important work by many groups and individuals, including the Fund's Independent Evaluation Office; the Fund's Executive Directors, who have formed a working group to focus on these issues; numerous academics and analysts; and civil society groups. I want to thank these eminent persons for agreeing to bring their experience, expertise, and wisdom to bear on the on-going reform of IMF governance. It is my hope that concrete proposals can be distilled from this large body of work by September 2009," Mr. Strauss-Kahn added.

Background

The IMF is governed by, and is accountable to, its member countries through its Board of Governors. There is one Governor from each member country, typically the finance minister or central bank governor. The Governors usually meet once a year, in September or October, at the Annual Meetings of the IMF and the World Bank.

Key policy issues related to the international monetary system are considered twice a year by a committee of Governors called the International Monetary and Financial Committee, or the IMFC. A joint committee of the Boards of Governors of the IMF and the World Bank—the Development Committee—advises and reports to the Governors on development policy and other matters of concern to developing countries.

The day-to-day work of the IMF is carried out by the Executive Board, which receives its powers from the Board of Governors, and the IMF's internationally recruited staff. The Executive Board makes key decisions as well as selects the IMF's Managing Director, who is appointed for a renewable five-year term. The Managing Director reports to the Board, serves as its chair and is the chief of the IMF's staff, is responsible for ordinary business subject to the direction of the Board, and is assisted by a First Deputy Managing Director and two other Deputy Managing Directors.