POINT OF VIEW

How Should the IMF Be Reshaped?

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Three points of view on the IMF of the 21st century

As the IMF marks the 60th anniversary of the Bretton Woods institutions and welcomes a new leader, *F&D* decided to find out what three of the institution's previous leaders thought of three hot issues facing the IMF. Editor-in-Chief Laura Wallace spoke with Jacques de Larosière (Managing Director, 1978–87), Michel Camdessus (1987–2000), and Horst Köhler (2000–04). **De Larosière**, who was called upon in the mid-1980s to troubleshoot the Latin American debt crisis, now serves as Advisor to the Chairman of BNP Paribas. **Camdessus**, who led the IMF during the financial crises of the late 1990s and the virulent globalization debates, now serves as Personal Representative of French President Jacques Chirac for NEPAD (New Partnership for Africa's Development). **Köhler**, who saw his tenure punctuated by a series of emerging market debt crises (notably Argentina), is now Germany's President; he spoke with us before assuming that position.

1 Surveillance

What can be done to strengthen IMF surveillance of the global economy and all countries, including the Group of Seven (G-7) industrial countries? Any thoughts on how to find the right balance between confidential advice and possibly escalating public signals of policy shortcomings and crisis potential?

De Larosière: Surveillance is, indeed, the IMF's basic mission. It is essential for the success of the adjustment process. This surveillance-adjustment role is the raison d'être of the IMF, more than its financial assistance. My impression is that, over the past 10 years, too much emphasis might have been on financing and not enough on adjustment.

The basic challenge is to get member countries involved, on an ongoing basis, in a policy dialogue with the IMF. This dialogue can be—and most often is—underpinned by precautionary programs and early detection mechanisms. The more responsive a country is to advice and preventive cooperation, the easier its access should be. But I would avoid formalizing a process of escalating public signals of policy shortcomings and crisis potential. If a member country ignores IMF advice, Article IV reports (now generally made public), data transparency (now largely systematized), and private market analysis should play their roles. Of course, if the G-7 countries were to listen more carefully to the surveillance recommendations directed at them, things would be much easier.

I also believe the international monetary system is slipping into a sort of semifixed à la carte system where some countries choose their exchange rate peg (often undervalued) to take the best advantage of their export capacities. The question is: what should the IMF do about this situation?

Camdessus: I would favor two initiatives: make the analysis of the systemic interrelations between countries and the attention member countries pay to the impact of their policies on their neighbors a key focus of multilateral surveillance; and reinforce the IMF's advice to the Group of Eight (G-8) countries. This could be done by submitting the staff's preliminary conclusions to a broader debate before transmission to the Executive Board. With due precautions, this consultation could be open to academic observers and regional partners.

I also still can't reconcile myself to a degree of instability—every 10 years or so, we observe swings of up to 50 percent in the exchange rates of the major reserve currencies—that is so costly for the entire system, so disruptive for vulnerable countries, and acceptable only to (if not welcomed by) those whose job it is to provide a profitable cover against these fluctuations. Except for the remarkable start of the euro, no significant progress has taken place in this area over the past 20 years. I hope that, as soon as the euro has acquired the full standing and prerogatives of a major reserve currency, the major players will be cooperating effectively to provide the world with the instruments of monetary stabilization it needs to harmonize macroeconomic policies. The IMF is uniquely placed to foster such cooperation. The IMF must also continue to be attentive to the appropriateness of other countries' exchange regimes, particularly those that can be seen as major actors in international trade. In the very long run, I believe that the world will have fewer currencies. However, the example of the birth of the euro—the culmination of a long journey toward regional monetary union—suggests that this progress toward a truly multipolar system is likely to be measured in decades rather than years.

Köhler: Since the emerging market crises of the mid-1990s, there have been significant reforms of the international financial system, including—and especially—at the IMF. It has strengthened its ability to identify vulnerabilities at an early stage through better debt sustainability analysis and a sharper focus on financial sector weaknesses, often at the source of recent crises. It has also actively participated in the development and promotion of international standards and codes. And the remarkable resilience of the global economy to a series of severe shocks in recent years shows, in my view, that these efforts are beginning to pay off. But there is no room for complacency.

I would mention two areas where more progress is needed. First, the IMF needs to continue to work closely with emerging market economies, where debt levels and crisis vulnerability remain high. I am not convinced that escalating public signals are the answer. Rather, I see a need for promoting ownership of countries' policies by strengthening the cooperative relationship between the IMF and its members. Second, the IMF must actively strive for evenhandedness in its surveillance. We know that financial crises can have their origin in mature as well as emerging markets. Therefore, the IMF's surveillance over the policies of advanced economies must be of the highest quality. But for the IMF to be effective requires not only that its advice be timely and of high quality but also that its members heed the advice when it is on target. Here, I believe, there remains room for improvement, particularly in the IMF's largest members.

2 International capital markets

Should the IMF emphasize traditional crisis lending and crisis management, or preventive facilities, or even direct intervention in debt markets?

De Larosière: We live in an integrated financial market. Emerging market countries are, in particular, very dependent on private capital flows. The IMF cannot, and should not, provide *all* the financing for balance of payments problems; it has to count on private flows to do the bulk of the financing (heavy lending by the IMF to a few countries has become a serious issue for the institution and the system). Moreover, the IMF must develop a close relationship with the private sector and not turn a blind eye to it.

If one agrees on those two principles, one should be open to a number of ideas: the international financial institutions and the private sector should develop relations based on mutual trust on an ongoing basis; the private sector can be called upon (especially if that climate of trust has flourished) to participate voluntarily in preventive actions to lessen the probability of a crisis (take, for example, the case of Brazil a few years ago, when commercial banks agreed on a voluntary standstill); and when a crisis erupts, it is critical that the IMF and the debtor country cooperate with private creditors. This was the rule of the game in the 1980s. It still should be.

The fact that dispersed bondholders have replaced commercial banks as the main creditors doesn't mean that unilateral exchanges should be imposed on them. Bondholders have shown that they can work together. The IMF should use its influence to encourage debtor countries to negotiate in good faith with creditor committees because that is its stated policy. The IMF should also share with private creditors the intellectual underpinnings of its programs so that they can better assess debt sustainability constraints. This indispensable relationship between the IMF and the private sector can be much improved. The move toward generalized collective action clauses in international bonds is a step in the right direction. The efforts of the private sector to put together a market-based code of good conduct are promising and, I believe, better than a formalized regulatory mechanism.

Camdessus: Even if consensus is still elusive, a great deal of experience has been gained in debt resolution, and there are several promising avenues: all possible refinements and effective use of early warning instruments; collective action clauses; a sovereign debt restructuring mechanism (SDRM), which was suggested by the IMF; and a code of good conduct, which would both complement the SDRM and provide for an orderly transition until the SDRM is ratified (right now, a distant possibility).

As for what would occur if a truly systemic crisis hit, keep in mind that in the late 1990s, when several systemically important countries simultaneously needed a lot of support, the IMF's resources were stretched to the limit. In a more widespread conflagration, the IMF's resources could be completely inadequate. Wouldn't it be justified in such a situation for the IMF to be able to create additional liquidity on a temporary basis? I don't see any better way than by making an innovative use of the SDR (Special Drawing Right), the IMF's reserve currency. It isn't unreasonable to expect that, in a crisis, the leading countries would collaborate to inject a suitable amount of international liquidity through a very simple mechanism that could decisively underpin confidence in the international system. To this end, the IMF might be authorized to inject international liquidity through the creation and selective allocation of SDRs—and to withdraw the liquidity when the need passes—in a manner analogous to that of a national central bank.

Köhler: Much has been done in recent years to strengthen the IMF's focus on international capital markets, with the dual objectives of helping to prevent further devastating capital account crises where possible, and of contributing to their resolution where necessary. The IMF is not a lender of last resort in the traditional sense; it isn't capable of providing an unlimited amount of financing. Once a crisis hits, the IMF needs to be able to act quickly, and its involvement must be predictable to ensure that the private sector can play its part. During my tenure, I felt that this predictability wasn't always assured, owing to the occasional, overactive involvement of the IMF's largest shareholders in individual country cases.

I believe that more reliance on a rules-based system would be beneficial for the international financial system. The SDRM proposed by the IMF represented a decisive step in this direction, and I regret that its time wasn't yet ripe. But I am confident that the IMF's work on the SDRM won't have been in vain and that it will serve, eventually, as a valuable basis for establishing an effective way of dealing with cases of sovereign bankruptcy.

3 Governance

What can be done to improve the equity and effectiveness of the way the IMF is governed—giving the emerging markets and developing countries a bigger voice at the Executive Board and reducing the G-7's influence? Should the Managing Director (MD) say no to the G-7? Should representation of the European Union (EU), now spread over some 10 chairs, be reduced to 1 chair?

Köhler: It's critical for the IMF to maintain a spirit of consensus and ensure that all members, large and small, feel that they are heard and can say, "Yes, this is also my Fund." That's why listening and consensus building are more important than numerical representation. That said, I do see scope for some adjustment in voting shares, for example, by increasing so-called basic voting rights, which would favor small, low-income members, and by raising the share of fast-growing emerging market countries, whose quotas no longer reflect their true weight in the world economy. I also think that Europe, in a bold political gesture, could rethink its own representation. Whether this would mean only one chair for the EU is an issue for the Europeans to decide. The draft European constitution does go in that direction. Personally, I support a vision of an ever closer political union in Europe, and consolidating EU chairs on the IMF's Executive Board would be consistent with that vision.

Camdessus: Our objective isn't so much to reduce G-7 influence but to increase developing countries' voice. That said, we should remember that we aren't living in a black and white universe, with the nice IMF and the virtuous developing countries on one side, and the perverse G-7 on the other. Of course, there are instances when the Managing Director must say no to the G-7. Believe me, there are precedents for it, including spectacular ones; those attending the Interim Committee meeting in Madrid in 1994 might remember one related to the role of an SDR allocation. But there are also occasions when the MD must resist pressure from developing countries. The MD's role isn't so much to frequently adopt an antagonistic position but to help create consensus within the membership, even if consensus appears suboptimal from the technical perspective of management and staff. Building consensus is another way of building confidence, one of the IMF's key missions.

To show that the IMF has the legitimate public support of its shareholders, I still favor the idea of transforming the IMF's advisory ministerial committee (the International Monetary and Financial Committee) into a supreme decision-making body. This would also be the best response to the often-raised concern that the IMF is too tightly controlled by the largest shareholders. A similar suggestion would consist in prolonging the G-7/G-8 summit every two years by a meeting of the heads of state or government of the countries—approximately 30 at any one time—that have Executive Directors on the Boards of either the IMF or the World Bank. Provided such meetings were prepared with the active participation of all the countries of all constituencies, this would be thoroughly representative of the entire membership of 184 countries.

Finally, the shrinking of EU representation to one chair seems to me a perfectly desirable objective, even if it can't be implemented immediately. Several intermediate steps could be considered right away, including stronger coordination among the 10 interested chairs.

De Larosière: In defining policies and carrying out their execution, the IMF must act as a consensus builder. During my years as Managing Director, I don't remember that we ever counted votes (except, of course, and rightly so, for quota increases). The G-7 shouldn't be an element in the IMF's decision making. It is for the Executive Board, under management's leadership, to make decisions (even if groups of members are free to get together to help formulate their own positions). Of course, and you can believe me, a Managing Director should be able to say no to the G-7, or to any other strong shareholder or grouping for that matter, if he or she is convinced that a particular decision goes against the policies of the IMF or the interests of the membership at large. This is a matter of authority and credibility for the international institutions. If the main shareholders persist in their positions, the matter should be sorted out by the Executive Board and the consequences of the divergence worked out. In some exceptional cases, crises of that nature may be helpful.

Should there be a radical shrinking of the Executive Board to one European chair? I think you should pause before reaching any quick conclusion. I have always been impressed by the quality of the exchange of ideas and the consensus building that characterizes multination chairs (comprising countries at very different stages of economic development). It seems to me that the achievements over the years of Belgian, Dutch, Swiss, and other directors who have chaired these groups have been outstanding. We shouldn't underestimate the importance of this cross-fertilization in reaching a common position. ■