The Future of the IMF

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The financial turmoil sparked by the subprime mortgage market has revealed again the vulnerabilities of economies to global financial disturbances. The continuing need for improved bank regulation and financial market oversight world-wide and for coordinated policy and liquidity responses is now clear again. The blasé attitude recently that financial market forces suffice for market clearing and would in any case overwhelm any public policy response is giving way to the notion that international cooperation, coordination and policy intervention still matter. But even as this shift takes place, Asia is less vulnerable than the North Atlantic and is able to stand aside for the moment as Europe and the United States struggle to reassure markets and bring them back into balance.

This environment is a propitious one in which to consider what it is that the world needs from the IMF and how member governments could reshape its role, governance and practices to strengthen its role.

Even with the differential regional impacts of the current turmoil, contemporary financial crises have global reach requiring that policy, regulatory and oversight responses be coordinated world-wide. Financial forces tend to magnify the weakest links in the global financial system. As a consequence, there is a need for a site in the financial system where global financial consultation, coordination and cooperation occur. That site is the IMF.

Challenges to the IMF's *Raison d'Etre*

But the challenges facing the IMF and its member countries are how to reshape it so that it is a magnet for national governments, an indispensable institution for addressing global financial issues, and a place you have to be to protect national economic interests and to be part of the global conversation about global financial stability.

The answer to these challenges, I would like to propose, pivots less around resources than around *ownership*. Whose institution is it? Is the IMF really a global institution? Do all countries believe it is *their* institution and that they *belong* to it in the same way as all others?

The answers to these questions are evident. Most of the non-Western world regards the IMF as a transatlantic institution in which they have a relatively minor role, hence they do not perceive it to be yet a global institution. The IMF is seen by the rest of the world as a transatlantic institution in which the US and Europe dominate and in which they are second class citizens. It is not *their* institution, it is *the West's.* This is the crux of the crisis facing the IMF.

Alternative Perspectives on Power and Process

To resolve this problem a number of extremely valuable specific proposals are on the table which, despite the difficulty of implementing them, deserve serious attention and support and should , if not must, be implemented to transform the IMF from a parochial Western institution into a truly global site. (See Truman, Boorman, and Bradford and Linn PB #163.) But as crucial as these proposals are and as necessary as it is to execute them, they suffer from relying on a *narrow construct of power and influence* which frustrates the realization of their purpose. The current proposals rely on the idea that power follows from formal structural elements –which country holds the position of Managing Director, which countries hold single nation chairs, what percentage of the quota shares does each country and region hold, etc..---and that influence follows from involvement in the specifics of operations, policies and decisions by the Board in its relation with the management and staff.

An alternative view of power and influence would give greater weight to ideas, to leadership, to quality of representation, to capacity for insight and innovation and envisages the policy process as one that is fluid, flexible, open-ended, and porous as well as formal, structured and regularized.

The alternative view would require a number of changes in the way in which countries prepare, organize and execute their engagement with the IMF. Countries that want to achieve a greater influence in the IMF would have to make their involvement in running the IMF a higher priority national interest and to make long-term investments in it. This would involve a number of actions by IMF member-countries.

I. Systemic Strengthening of Representation

First, there is a need to deliberately cultivate a cadre of economists, financial market experts, civil servants, and technocrats who have the education and experience to be able to represent their countries in the staff, management, and boards of the IMF and who would staff the ministries and agencies in their home governments which support the country's engagement in the Fund. There needs to be a system of rotation of these professionals so that a cadre of people is built up which have experience in the home-country ministry of finance and central bank and at the IMF in Washington. For effective representation, there needs to be a solid understanding of global financial issues and how the IMF relates to them (the view from the Fund out to the world) as well as a sound understanding of the national interests of the country in the issues and in the Fund's role in them (the view from the national capital) on the part of both the professionals at the Fund and those in the capital.

The best way to achieve this fusion of perspectives for effective representation is to rotate personnel so that individuals understand *how to manage the reconciliation of the global and national perspectives* in a way that advances the common good and the national interest at the same time. *This is the essence of global policy making—providing a strong national basis for global undertakings so they are <u>sustainable</u> and infusing relevant national perspectives into global actions so they are <u>representative</u> and hence <u>legitimate</u>.* Although this is the essence of the enterprise, insufficient attention is paid to it and what needs to be done by all IMF member-countries to assure it. Rotation of personnel broadens the perspectives of rising officials, giving them a better grasp of complex issues than those who spend their careers in single institutions who can fall victim to a single lens perspective.

This strategy rests on a pluralistic, multifaceted notion of influence rather than the idea that power derives solely from formal structural elements such as the quota-share formula determining voting shares in the board, as important as that still is. A country that develops a system for organizing its broad involvement in the Fund at different levels and in different dimensions will have a greater "voice" in Fund affairs, because it has many "voices" embedded in the organization itself. This does *not* suggest or support the notion that IMF staff members *should* represent their country's *official* views but rather a more general way of looking at the world from their country's perspective. To think that power and influence derive only from a single country representative and the share of votes held by the country is an excessively narrow interpretation of how any organization works, much less one as complex as the IMF.

II. Diversity of Ideas and Policy Options Strengthen Country Engagement

Second, there needs to be a greater focus at the policy level on ideas, especially strategically important ideas, and the importance of developing the capacity to generate, articulate, debate and gain agreement on innovative thinking. This goes to the heart of the intellectual culture of the IMF and its relationship to the degree to which the Fund is a compelling magnet for debate and decision as opposed to being off-putting. As one astute observer put it recently, if we live in a knowledge economy and if the IFIs are knowledge-based institutions, the question is whether the knowledge is diversified or dogmatic ! This is a telling remark from the point of view of *<u>ownership</u>*. If countries do not see in the IMF an open intellectual culture, one in which a variety of perspectives, policy orientations and views are present into which their own national perspectives can have a place and from which they can draw different conclusions relevant to their particular national experience, then the IMF is a less appealing place to belong to and invest in.

Ownership of an institution derives in substantial measure from the ability of members to see themselves reflected in it. Diversity, variety and intellectual openness enhances the intensity and breadth of involvement and ownership.

It is fair to say that in trying to be fair and even-handed in the treatment of all member countries, there has been rather more effort in the IMF throughout its history to push toward uniform policy recommendations than to generate alternative policy approaches to enhance policy choices open to national governments. There has been more concern about having a recipe than a menu, to put it succinctly. (See Rodrik.) Good examples are the trend in the IMF to see exchange rate regimes as a choice between fixing and floating whereas in fact more countries have intermediate exchange rate regimes than those having fixed and floating regimes put together, if you count managed floating regimes as "intermediate" rather than floating regimes. (See Fischer and Bradford 2005, Table 1.)

The IMF Independent Evaluation Office (IEO) in its recent review of IMF exchange rate policy advice found that "the most prevalent concern of authorities related to bias in [exchange rate] regime selection, with 30-60 percent of the respondents raising this concern, depending on the country group (even 40 percent of the staff respondents identified the concern). The proportion of those expressing concerns is by far the highest [65%] for 'Large EMEs'." (IEO pp. 89-90 and Figure A6.15.) Further, the IEO found that "based on the last two staff reports through 2005 [on article IV consultations], IMF staff were found to have advised countries to adjust their exchange rate regimes..in 63 cases. In 51 of these (63) cases, they (the IMF staff) advised in favor of more exchange rate flexibility." (IEO, p.22 and Table 3.3.)

This pattern of consistent advice toward greater exchange rate flexibility goes diametrically against the grain of the recent experience with exchange rate regime choice, as illustrated below. First, it is clear that in 1999, twice as many countries had intermediate exchange rate regimes as had either fixed or floating rate regimes. Second, in the period between 1999 and 2006 there was a fifty percent reduction in the number of countries with floating rate regimes and with all but one of the countries shifting to intermediate exchange rate regimes. As of 2006, only 13 percent of the world had floating rate regimes, whereas 62 percent had intermediate exchange rate regimes.

EXCHANGE RATE REGIMES

	FIXED	INTERMEDIATE*	FLOAT	*TOTAL*	*%*
1999	45	91	49	*185*	*49*%
2006	47	115	24	*185*	*62%*
Difference	+2	+24	-25	+ 1	

* Intermediate Exchange Rate regime category includes managed float regimes.

And the IMF proclivity to see capital controls as a less than optimal policy, reduces still further the range of policy instruments and policy choices open to governments. (See IMF WEO 2007 and Bradford 2005.) The box on "can capital controls work?" in the 2007 WEO chapter on managing large capital inflows concludes by saying: "In sum, although the macroeconomic impact of capital controls has been temporary at best, evidence suggests they have been associated with substantial microeconomic costs. While capital controls might have a role in certain cases, *they should not be seen as a substitute for sound macroeconomic policies* that include a prudent fiscal stance and a supporting exchange rate and monetary policy framework, as well as appropriate prudential measures." (WEO chapter 3, page 12, emphasis added, and Bradford 2005 Table 2, pp 9-10.) [1]

The issue is really not whether capital controls should be "seen as a substitute for sound macroeconomic policies" but rather given a commitment to sound macroeconomic policies, can the selective use of capital controls enhance the achievement of other economic policy objectives and the range of macropolicy choice open to countries. The evidence provided by the IMF in the AERAR since 1996, when for the first time thirteen categories of capital controls were tracked annually, confirms that in fact most countries do indeed use capital controls and that they are used in a selective rather than across-the-board manner.

In 1996, before the Asia crisis over 100 countries had capital controls in seven of the thirteen categories. By 2002 over 90 countries had capital controls in eleven of the thirteen categories. Between 2002 and 2006, the use of capital controls increased in six of the thirteen categories, declined in three and remained unchanged in four. The shift in only one of these elements is in the same direction as the eclectic use of capital controls in the 1996 to 2002 period which itself also manifested selective rather than whole-sale use of capital controls. See Table II at the end of this paper.

[1] The IEO in an evaluation of capital account liberalization (a different topic) acknowledged that the IMF staff was "in principle opposed" to capital controls but also pointed out a high degree of pragmatism on the issue. "It is possible here to make a broad characterization that the IMF staff was in principle opposed to the use of such instruments, either on inflows or outflows. Its view was that they were not very effective, especially in the long run, and could not be a substitute for the required adjustments in macroeconomic and exchange rate policies. Even so, from the earliest days, the IMF staff displayed a remarkable degree of sympathy with some countries in the use of capital controls. In a few cases, both before and after the crises of 1997-98, it even suggested that market-based controls could be introduced as a prudential measure. As a general rule, the IMF staff, in line with the evolution of the institution's view, became much more accommodating of the use of capital controls over time, albeit as a temporary, second-best instrument." Executive Summary, IEO, IMF, Evaluation of the IMF's Approach to Capital Account Liberalization, released May 25, 2005. I am grateful to Ted Truman for steering me toward this source.

Member governments should encourage the IMF to abandon this trend toward hands off economic policy, reversing its bias toward exchange rate flexibility and against the use of capital controls. (See Bradford 2005 and Frankel.) Given recent country experience, there is every reason to have IMF research efforts evaluate the pros and cons of intermediate exchange rate regime performance and of the use of capital controls to elucidate where they have worked and why, as well as the critical aspects. *Greater efforts by the IMF to search for options and alternatives that can fit different circumstances and conditions and in which distinctive country experiences are mined for their contribution to differences in results would create a more attractive climate for diverse country engagement.* This greater openness to a more diverse set of policy options would be in the interest of all member countries because of its positive impact on country *ownership and engagement* in the IMF.

For millennia, great civilizations have been "encountering" each other and have engaged in a process of *selective borrowing*, known as syncretism, as a way of energizing their intrinsic cultural development in a context of openness and awareness of "the other". Selective borrowing has been the means by which cultures have grown increasingly distinctive and dynamic by being open to differences in cultural manifestations of other cultures. This process in the arts could be a model for behaviors in a global forum facilitating countries in their forging of distinctive national approaches to economic policy and to systemic choices in which today differing economic cultures are engaging each other and interacting on both national and global issues. The initial fear that globalization of culture would lead to homogenization is giving way to a better understanding of how cultures develop increasing distinctiveness by interacting with other cultures and borrowing selectively from them rather than imitating or emulating others. Different cultures—with their distinctive perspectives on nature and the environment, community and individualism, and cooperation and competition---can have sharply different views on policy issues and such basic questions as the role of the state. This experience can be a foundation for an open dialogue on global economic issues which continues to be based on global best practice but is also more open to innovative ideas and perspectives from different national experiences. (Bradford 2000.)

A. Diverse Models of Capitalism

This perspective extends further to encompass the question of *economic systems* and the discourse surrounding it. There is an enormous difference between representing the market economy as single idea of liberalized competitive markets that generate optimal outcomes than it is to present the notion of the market economy as a diverse manifestation of different combinations of market forces, regulatory frameworks, policy actions and roles of government and that all economies now are arrayed along a spectrum of mixes and combinations of these elements. This idea of a spectrum of market economic systems which share fundamental common elements but which diverge in their combination of them is a quite different prism through which to examine different national experiences than the dichotomous choices of previous decades. (See Albert and Bruno.) A greater openness to eclectic combinations of state and market in specific sectoral and country circumstances would reduce the sensitivity of the issue of whether the IMF has a dogmatic approach to policy advice.

B. Diversity Stimulates Debate and Debate Stimulates Diversity

For the IMF to be a compelling institution not only does the intellectual culture need to be explicitly open and inviting, but countries and their representatives need to be prepared to present alternative views, substantiate them and argue for them persuasively so that in fact the diversity in the world manifests itself in the internal debate, discussion and work of the institution itself. This has not always been the case. When the dominant culture has appeared to be more aligned to a uniform view of market-oriented economic systems, many countries have chosen to go-along-to-get-along rather than to assert the differences that actually exist and the need for them to be taken into account.

Therefore, a greater focus on the intellectual frameworks, paradigms, mind sets, and models that professionals use to analyze policy issues would open up the policy dialogue in the Fund and create more space for countries to contribute the uniqueness of their own experiences and to generate innovations that might be derived from them. Surely, China thainks that it has something more to offer to the global conversation than yet another manifestation of the virtues of the Washington Consensus. None of the problems facing the international community or the IMF in particular are easily solved with already known solutions. The notion of the IMF as a place in which countries pool their experience, learn from their experience and that of others, and derive innovative policy ideas because the IMF becomes the primary site for the confluence of global experiences in finance and macroeconomic policy would place it once again at the center of the global economy where it indeed should be.

C. Refocus the Board on Strategic Issues

A greater focus in the mission of the Board of Executive Directors of the IMF on strategic perspectives and issues defining the role of the Fund in the global economy and vis a vis its diverse membership would make sense in the current climate. The current practice of the Board involving itself in reviewing, commenting on and approving most important documents produced by the Fund staff runs the danger of losing the forest for the trees. A reorientation of the Board's focus toward big picture issues instead of meddling in the microcosmic details of every country paper and policy document would make sure the Fund is headed in the right direction rather than second-guessing the technocrats on the details. (See a more extensive, thoughtful treatment in Martinez-Diaz.)

III. Some Conclusions

The purpose of these reflections is to highlight two major points. First, that power in the Fund should be viewed as a broad inclusive set of elements and sources of influence which require of countries seeking to have increasing weight in its governance to look to systemic ways of strengthening their presence and power. Second that the processes of deliberation, debate and decision in the IMF need to be opened up to be more inclusive of more diverse ways of thinking and analyzing economic and financial issues in order to more fully engage countries in the Fund , its operations and its governance. These two points which go beyond the formal structural elements of influence imply **a vision of the Fund** which entails it becoming a more central, intense and strategic forum for working out national, international and global approaches to financial issues and policies.

The implications of these points for countries, perhaps particularly emerging market economies with desires and claims for greater influence, is to push hard for increases in quota shares and chairs and other reforms in the formal structures of power in the Fund, but look beyond them to actions countries can take themselves that will unquestionably increase their reach and grasp of issues under discussion and of the decisions made on them. There is also a message here, perhaps especially relevant for the non-Western emerging powers, derived from the substantive core of the functions of the IMF. It is that for the Fund to better reflect the diversity of the world in terms of economic thought, experience and systems, there needs to be a willingness on the part of non-Western countries to represent that diversity analytically, vocally and persuasively so that the policies and approaches of the Fund can reflect that diversity more effectively. Fund deliberations need to be more open to diverse thinking, but country officials also have to be willing to represent that diversity in strong and credible terms and be staffed up and backed up to be able to do so. If the world is in fact intrinsically diverse, then shifting the conventional wisdom so that it more fully incorporates that diversity is a high priority undertaking.

I am aware that the emphasis here on the importance of open debate as important in defining the essential role for the future of the IMF in global finance is itself a Western idea, or rather one that fits perhaps more comfortably in a Western context. It is based on the premise that the competition of ideas actually increases the value of the ideas generated through criticism, debate and discussion whereas competition in goods markets cheapens the price of products. It is also based on the notion mentioned above that none of the problems facing the international community or the IMF in particular are easy. The only way to adequately address global challenges in a variety of issues will be to pool experience, knowledge and ideas in a spirit of seeking innovative approaches that combine elements from a variety of perspectives rather than deriving them from single disciplines, domains or vantage points.

The main purpose of this paper is to make these arguments because of their implications for the future of the IMF itself, to facilitate its transformation into becoming again *the* focal point of the global financial system. Having said that it has to be also said that the salience of power derived from multifaceted representation across different dimensions of the IMF and from "soft power" strength in representing economic ideas is amply manifested in the presence in the Fund of both Europe and the United States. The reason that the charge that the IMF is a transatlantic institution is vexing is because the U.S. and Europe do have both hard and soft power capabilities, formal and informal sources of influence, seats and shares as well as robust representation in the staff and management and strong intellectual influence in the research and the representation of ideas in the Fund. This confirmation of the importance of both sets of elements of influence illustrates pathways to power for aspiring countries, amplifying the avenues for changes which countries themselves can make to increase their role, responsibility and leverage in the IMF. If countries make long-term investments in a systemic approach to enlarging their influence in the IMF, there is every reason to think that it will pay off, not only because the Fund itself and most industrial countries want to make room for new powers to enhance *ownership*, but also because it has been proven that this investment does indeed pay off, given the experience of the U.S. and Europe in doing so.

IV. Implications for the Future Role of the United States and Europe in the IMF

This analysis yields implications for the United States and Europe. Given the demonstrable success of the accrual of influence from their own investment in the staffing up for their representation in the IMF and their contributions to the intellectual work in the Fund and in the issues it deals with, it is clear that the U.S. and Europe need to rely less on formal sources of power, such as their vetoes in both the Fund and the Bank and their prerogative to appoint the heads of the Bank and the Fund, respectively, to maintain their influence in the IFIs. These formal sources of power are now relatively less important than they used to be. Also, retaining these prerogatives has now become a source of erosion of the representativeness, legitimacy and effectiveness of the Bretton Woods institutions. Ceding some formal power in the Fund and the Bank would actually redown to the benefit of both the EU and the US because it would enhance the prowess of the IFIs and empower these institutions in which the U.S. and Europe already have well-established influence. Therefore, it seems that the foregoing analysis leads inexorably to the recommendation that the United States and Europe voluntarily give up their veto powers in both IFIs and that they agree between them to open leadership selection in both institutions to an open, competitive merit-based selection process. (See "the grand bargain" idea proposed in Bradford and Linn (eds.), p 126.) To be sure, the veto is a better instrument for blocking actions than promoting them, but their political significance now rests on their symbolic meaning and the degree to which they are anachronistic rather than on their function.

This act, if initiated by Europe and the U.S., would demonstrate more clearly than any other action that these two dominant powers in the IFIs are eager to see them transformed into truly multilateral institutions at the center of the global economy. This action would indicate that the U.S. and Europe want the Bretton Woods institutions to leave their origins behind and reconstitute themselves as truly global institutions where the major issues get worked out. They would show a new commitment to governance processes in which all member countries are engaged in give-and-take process and compromise that are necessary for decisions to be made which embody international support. They would demonstrate that they are willing to be part of truly multilateral decision-making processes in which no single country or set of similar countries has pre-emptive rights to veto the will of the membership.

If this action by the United States and Europe were to be complemented by actions by emerging market economies and other non-Western countries to take a systemic approach to enhancing their representation and influence in the IFIs, the IMF and World Bank would indeed be transformed into global institutions for the 21st century. This transformation in which soft and hard power both have determining roles, would leave behind the Bretton Woods origins of the IFIs of sixty years ago in which hard power was embedded in formal arrangements which defined them as international institutions reflecting the power alignments of the post-world war II era and not as global institutions based on the global realities and challenges of today and the future. As important as the other specific IMF reforms are to its future, this step by the United States and Europe would usher in a new era for the IMF and a new era of international cooperation based on true multilateralism in the world at large, while enhancing the effectiveness of the other reforms by reinforcing them.

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Table II:

Changes in the Use of Capital Controls: 1996-2002*

Calendar Year

Capital Transactions

Controls on:	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
Capital market securities	128	127	133	125	128	131	128
Money market instruments	112	111	115	110	111	110	107
Collective investment securities	107	102	103	103	102	101	99
Derivatives and other instruments	78	82	87	83	84	83	83
Commercial credits	103	110	105	108	109	107	104
Financial credits	76	114	112	113	114	113	112
Guarantees, securities, etc.	82	88	88	93	97	96	92
Direct investment	144	143	149	147	146	147	149
Liquidation of direct investment	54	54	52	54	57	59	57
Real estate transactions	119	128	134	136	138	135	137
Personal capital movements	N/A	64	82	90	93	91	97
Provisions specific to:							
Commercial banks and other credit institutions	131	152	155	158	157	157	160
Institutional investors	60	68	82	83	84	86	91

*Source: International Monetary Fund, *Annual Report on Exchange Arrangements and Exchange Restrictions* (AREAER), annual issues, 1997 through 2003. These annual reports are for the IMF financial year which ends on April 30th of the year of the report. This is important in the case of the AREAER for 1997 in which countries reported *before* the Asia financial crisis hit in mid-year. Individual countries report at different points in the year, but basically the report reflects conditions in the previous calendar year.