Renewing the International Monetary Fund: A Review of the Issues

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- *Given the rapid and ongoing integration of the global economy, the role of the International Monetary Fund (IMF) as the institution charged with promoting global financial stability has never been more relevant.*
- *If the IMF is to be effective in the twenty-first century, there is a need to renew its role, governance structure, and functions.*
- *The IMF has embraced the reform process through the review of its Medium-Term Strategy championed by Managing Director de Rato.*
- *The Bank of Canada has been an active participant in the reform process, with particular emphasis on surveillance and governance reform.*
- *In support of this participation, research at the Bank of Canada has focused on a new framework for IMF surveillance that clarifies the objectives, scope, and conduct of surveillance.*
- *Researchers have also explored how enhancing the IMF's governance structure could further strengthen the Fund's decision-making process.*
- *The ultimate aim of these reform efforts is to enhance the IMF's ability to promote crisis prevention and support a well-functioning international financial system.*

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Recent decades have witnessed an unprecedented degree of integration among global financial markets. While globalization has brought tremendous benefits, it has also brought many risks. Ongoing global imbalances, concerns over the extent of global liquidity, and the not-so-distant experience of financial crises in Latin America and East Asia highlight the importance of maintaining a well-functioning and stable international financial system. In particular, the global nature of these issues has prompted policy-makers to advocate for a new, reinvigorated role for the International Monetary Fund (IMF) (King 2006; Dodge 2006).

Clearly, the IMF is still *the* institution charged with maintaining global financial stability, and it has evolved over the past decades to fulfill this role. But concerns remain that its governance structure and policy instruments have not kept up with the changing global economic landscape. Simply put, the world for which the IMF was founded, one characterized by fixed exchange rates, capital controls, and limited international trade, no longer exists. Instead, the IMF must operate in a world of greater exchange rate flexibility, trade liberalization, and capital account openness, and one where emerging-market economies (EMEs) have grown in importance. This has necessitated a reconsideration of the role, governance structure, and functions of the IMF.

To this end, in 2005, the IMF Managing Director (MD) issued a report on the IMF's Medium-Term Strategy (de Rato 2005). Aimed at renewing the IMF's mandate, this initiative offers the opportunity to comprehensively review all aspects of the Fund. How best to renew the IMF for the twenty-first century is currently the subject of an active international discussion, and few aspects of the IMF have been left unexplored.

Six main areas of reform are under consideration: (i) quota, voice, and representation; (ii) internal governance; (iii) surveillance; (iv) lending instruments; (v) finances; and (vi) the Fund's role in low-income countries.

Governor David Dodge and Deputy Governor Tiff Macklem have been actively promoting improved surveillance as well as governance reform.

The IMF has an important role to play in the international monetary system. To this end, the Bank is working to facilitate the reform process in many of the areas described above. In particular, Governor David Dodge (2006) and Deputy Governor Tiff Macklem (2006) have been actively promoting improved surveillance as well as governance reform. But it is important to stress that all six elements of the proposed plan for renewal are designed to fit together and reinforce each other. With this is mind, the objective of this article is to examine each of the respective reform issues and explore how they might be resolved. The article also highlights the Bank's research contribution to this process, which offers perspectives rooted in economic analysis, empirical evidence, and experience.[1]

The article is organized as follows: the next section examines governance issues, including quota and how decisions are made. It is followed by a discussion of the reform of the IMF's instruments, namely, surveillance and lending. Issues relating to IMF finances and the role of the Fund in low-income countries are then reviewed, and the article concludes with a brief summary.

Governance

The IMF's governance structure is organized into five broad groups: the Board of Governors, the Board of Executive Directors, the Managing Director (MD) and the staff, the Independent Evaluation Office (IEO), and the International Monetary and Financial Committee (IMFC) (see Chart 1).[2]

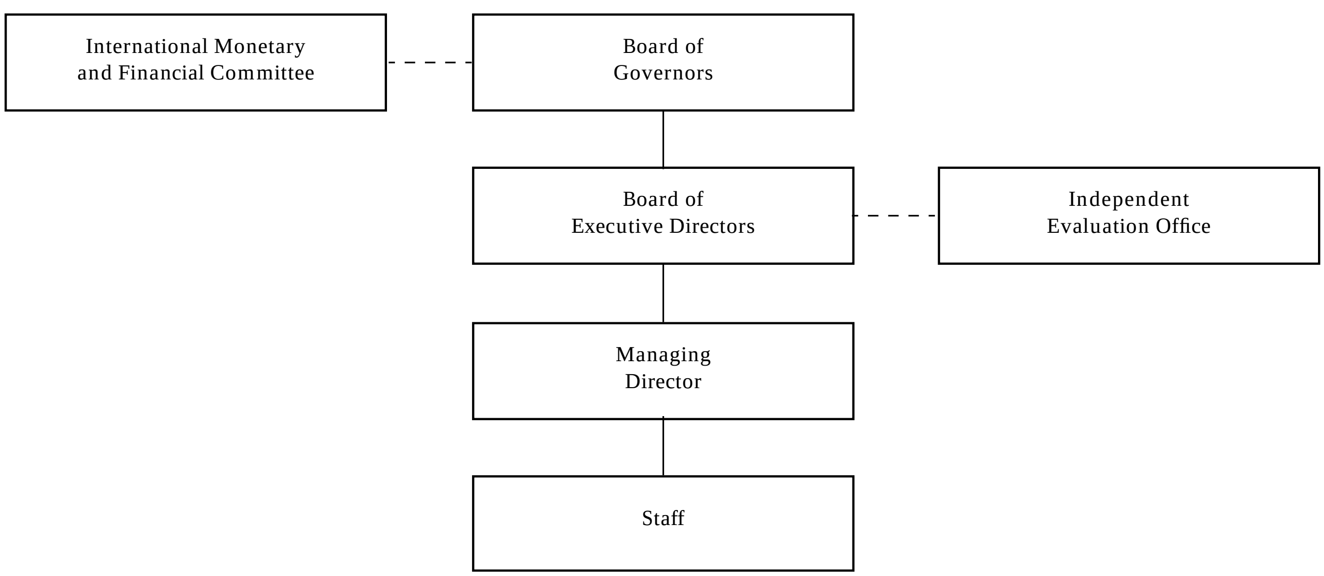
As the highest decision-making body of the IMF, the Board of Governors oversees the Fund's broad policy-formation process and focuses on such issues as quota reviews and accepting new members. Each member of the IMF— there are currently 185 members—has

1. These efforts are not new: the Bank has been involved in IMF reform for many years (Lafrance and Powell 1996; Powell 2001; Haldane and Kruger 2001–2002).

2. See Van Houtven (2002) for detailed information on the IEO and IMFC.

Chart 1

The Governance Structure of the International Monetary Fund



Source: International Monetary Fund

Table 1

Quota Distribution

	Quota share (%)	GDP share (%)*	GDP share (PPP) (%)**
Advanced economies	60.5	79.3	55.1
United States	17.1	29.8	20.5
Major advanced	45.2	64.0	43.0
Developing and transition countries	39.5	20.7	44.9

Source: International Monetary Fund, World Economic Outlook

* Share of world gross domestic product (GDP) based on average GDP, 2002–2004, at market exchange rates

** Share of world GDP based on average GDP, 2002–2004, at purchasing-power parity (PPP) exchange rates

a Governor on the Board. Voting is based on a combination of quota and basic votes.[3] The United States accounts for 17.1 per cent of quota, and major advanced countries for 45.2 per cent (Table 1). Overall, developed countries have a majority of IMF quota.

The enormous size of the Board of Governors naturally implies that most decision making is delegated to the Board of Executive Directors, and the Articles of Agreement allocate to the Executive Board all those powers not explicitly reserved for the Board of Governors. The Executive Board consists of 24 directors and the MD. The United States, Japan, Germany, France, the United Kingdom, China, Russia, and Saudi Arabia each have their own director; the remaining directorships are based on country groupings, with the largest country often holding the directorship.[4] The MD manages the day-to-day operations of the IMF based on recommendations and advice provided by the staff. The MD also plays an important role in guiding the IMF, working closely with the Executive Board, whose meetings he, or his deputies, chairs. There are two distinct aspects to IMF governance: representation and decision making. Each will be considered in turn.

Representation

Quotas are a fundamental issue for the IMF, since they affect many aspects of the Fund's governance and activities, and especially members' voice and representation. Quotas determine members' (i) voting power at the Board of Governors and the Executive Board (together with the basic votes), (ii) financial contribution, and (iii) access to resources. Members' quotas are based on a combination of five formulas that are determined by four variables: gross domestic product (GDP) at market prices, reserves, openness, and the variability of current receipts.[5] These variables are a measure of members' ability to contribute to the Fund's finances, as well as their potential demand for Fund resources.

Table 2

Quota Under-Representation

	Actual quota (% of total)	Existing quota formulas (% of total)	Actual quota minus existing quota formulas (% of total)
Singapore	0.40	1.92	–1.52
China	3.72	5.20	–1.48
Korea	1.35	2.51	–1.16
Mexico	1.45	1.93	–0.48
Turkey	0.55	0.74	–0.19

Source: International Monetary Fund

There is currently much dissatisfaction within the IMF's membership with respect to quota and voice. Some countries, especially rapidly growing EMEs, feel that they are under-represented, since their actual quota share is significantly below their "calculated quota," the figure suggested by the five formulas (see column 2, Table 2).[6] The current formulas are also complex and, in some cases, can produce counterintuitive results. A rise in a member's GDP, for example, can sometimes lead to a decrease in its calculated quota, all else being equal. Moreover, members' views on the nature of the variables that should enter the equations differ. For example, a number of developing countries would prefer that GDP be measured at purchasing-power parity (PPP) exchange rates (see Table 1, columns 2 and 3), while many low-income countries oppose the gradual erosion in their voting power that has occurred because of the decrease in the

3. Each member receives 250 basic votes plus one vote for each SDR (Special Drawing Right) 100,000 of quota.

4. For example, the constituency that consists of Antigua and Barbuda, the Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines is represented by the Canadian director.

5. More information on the formulas can be found in IMF (2006b).

6. Under-representation occurs because quotas are most often adjusted during general quota reviews, which are held every five years and are undertaken to assess the adequacy of the Fund's balance sheet. Moreover, the resulting general quota increases tend to have a large "equiproportional" element, which means that new quotas are distributed, for the most part, in proportion to existing quotas, and disparity is only addressed at the margin.

ratio of basic votes to the membership's total voting power.[7] The consequence of quota misalignment is that some countries do not feel adequately represented at the IMF, and this lack of appropriate voice and representation impairs their confidence in the IMF and, ultimately, in the legitimacy and effectiveness of the Fund.

In response to these issues, the first step in a two-year reform of quota and voice at the IMF was taken in September 2006.[8] The objectives of the reform are fourfold: (i) to develop a single quota formula that is simpler and more transparent than the existing ones, (ii) to achieve significant progress in realigning quota shares with countries' relative weight in the global economy, (iii) to make quota and voting shares in the Fund more responsive to future changes in the world economy, and (iv) to enhance the participation and protect the voice of low-income countries.[9]

All members will gain if every one of them is adequately represented, since the IMF's credibility and legitimacy as a truly global institution will be enhanced.

The updating of quota shares means that, for the shares of some members to be increased, other members will have to accept a reduction, since quota shares sum to 100 per cent. Thus, for the reform to be successful, members must co-operate and act in the best interest of the international monetary system. Indeed, all members will gain if every one of them is adequately represented, since the IMF's credibility and legitimacy as a truly global institution will be enhanced. It would also be useful to develop a mechanism to ensure that future quota reviews lead to a regular updating of quota shares, since the relative positions of countries in the global economy will keep evolving. Ideally, the process for updating quotas should be timely, relatively automatic, and transparent. Lastly, quota review should not be considered in isolation: rather, "with a larger voice comes greater responsibility" (Macklem 2006). All members should be prepared to shoulder their fair share of the responsibility for promoting a well-functioning and stable international monetary system.

Decision making

Although much attention is paid to quota, the issue of how decisions are made at the IMF is also important. The governance structure of the Fund was founded on the notion that IMF decision making would need to command the broad support of its members (Van Houtven 2002). But some members have expressed the view that the IMF's objectives and decisions may, at times, be determined more by political considerations than by sound economic analysis (Cottarelli 2005; Calomiris 2000). Moreover, the role and responsibilities of the Executive Board and the MD can become blurred. The Executive Board sits in almost "continuous session," working closely with the MD on the day-to-day business of the Fund. This can make it difficult to assign clear accountability for decisions.[10]

Governance issues with respect to both private corporations and public institutions have received considerable attention in recent years. And while governance structures should be tailored to the specific circumstances of each institution, there are nevertheless some principles that have emerged as "best practice." In particular, institutions can benefit, and hence be more effective, from having clearly stated objectives, being transparent in their decision-making process, and possessing the means to hold each level of decision-maker accountable. These principles have also been reflected in recent developments in the governance of central banks. In fact, part of the success of central banks in maintaining low and stable inflation can be attributed to the fact that they too have improved their governance mechanisms along the dimensions described above (Cukierman 1998).

In the same way, the IMF could benefit from considering these best-practice governance mechanisms (Macklem 2006). Simply, the governance of the IMF could be further enhanced by having clearly stated objectives,

7. The absolute level of basic votes has not changed from 250 since the IMF was created; the share of basic votes in total voting power has fallen from over 10 per cent in 1945 to 2 per cent at present.

8. Four significantly under-represented members—China, Korea, Mexico, and Turkey—were granted an increase in their respective quota, totalling 1.8 per cent of total quotas.

9. The current reform process takes as given the current roles of quota, but such an approach may be asking too much from a single quota formula, and consideration could be given to separating access from voice.

10. Santor (2006) provides a discussion of decision making and accountability at the IMF.

greater transparency, and greater accountability. This could be facilitated by a clear separation of the roles of the Executive Board and the MD. As the MD has stressed, the Executive Board should focus more on strategic issues and less on the details of the day-to-day operations of the Fund.[11] For instance, more emphasis could be placed on setting the objectives of the Fund and on the design of the policy instruments that are needed to achieve its goals (i.e., the modalities of surveillance). Then, given a set of clearly defined objectives and instruments, the MD would be responsible for the implementation of policy and would be held accountable by the Board. The clarification of the roles and responsibilities of the Executive Board and the MD would increase the transparency of the Fund's decision-making process, leading to greater accountability and, ultimately, a more effective IMF.

The IMF's Instruments

In order to effectively promote a well-functioning international monetary system, good governance is not enough. The IMF must also have the right set of instruments at its disposal. The Fund relies on the use of three main instruments: surveillance, lending, and technical assistance. This section will discuss surveillance and lending. Issues related to technical assistance will be addressed in the section on the role of the IMF in low-income countries.

IMF surveillance

The IMF, under its Articles of Agreement, is charged with maintaining a well-functioning international financial system. The primary means by which the Fund seeks to achieve this goal is bilateral surveillance. Typically conducted through Article IV consultations, bilateral surveillance is the monitoring of members' economies, combined with the timely provision of policy advice principally aimed at crisis prevention (IMF 2006c). The Fund also conducts multilateral surveillance: the examination of economic linkages between countries and international developments, including the global implications of policies pursued by individual members. The findings of multilateral surveillance are typically reported in the IMF's *World Economic Outlook* (WEO) and *Global Financial Stability Report* (GFSR).

The IMF has responded to the challenges of a rapidly changing global environment with professionalism, taking on new responsibilities and developing new expertise. However, policy-makers, and the IMF, have recognized several concerns. First, the legal basis of surveillance, the 1977 *Decision on Surveillance over Exchange Rate Policies*, is outdated (Lomax 2006). The world for which the 1977 Decision was made no longer exists, since the global economy is increasingly interdependent and market-based, and flexible exchange rates have become more prominent. Moreover, countries have also become more vulnerable to cross-border shocks and policy-spillover effects.

Second, the scope of bilateral surveillance is often very broad, covering issues beyond those directly relevant for countries' external stability (Adams 2005). The IEO (2006) also notes that greater emphasis needs to be placed on the linkages between the financial and real sectors, and that multilateral issues addressed in the WEO and GFSR could be more closely integrated with bilateral surveillance. Lastly, there are also issues regarding the institutional framework that supports Fund surveillance. As the IMF (2005) notes, progress in recent years notwithstanding, some Article IV reviews remain unpublished, and as Dodge (2006) observes, surveillance analysis sometimes lacks candour. Moreover, some members feel that they do not receive equal treatment from the Fund's surveillance process (Akyüz 2005; Lombardi and Woods 2007). With these concerns in mind, policy-makers, and the IMF itself, have begun to tackle the issue of surveillance reform.

Towards a new framework for surveillance

Improved surveillance is in the interest of all members, since it strengthens the Fund's efforts to maintain international financial stability, promote orderly adjustment, and prevent crises. The impetus for surveillance reform has come from several sources, including the Bank of England (King 2006), the United States Treasury (Adams 2005), and the IMFC (2006). The latter, for example, has emphasized the need for greater focus on multilateral issues and consideration of a Surveillance Remit. The Remit would give the IMF a mandate to carry out surveillance, while establishing a mechanism for holding it accountable (Lomax 2006).

At the same time, the IMF's review of its Medium-Term Strategy identified surveillance as a key area of reform (de Rato 2005). With the support of the Executive Board, the IMF staff is exploring the merits of revising the 1977 Decision and the adoption of a Remit (de Rato 2006). These are clearly important steps forward. And to reinforce these efforts, the Bank of Canada has

11. See de Rato (2005).

been actively promoting the discussion on surveillance reform (Dodge 2006).

Research at the Bank of Canada has focused on developing an integrated framework for IMF surveillance (Lavigne, Maier, and Santor forthcoming). The framework consists of two elements: the Guidelines for Economic Policy Frameworks and a renewed institutional framework, consisting of a Remit, a process for communicating surveillance, and a means for ensuring accountability. The Guidelines for Economic Policy Frameworks revise and update the 1977 Decision: in particular, the Guidelines seek to outline the objective and scope of surveillance, as well as delineating the benchmarks against which members' economic policy frameworks will be assessed. To make surveillance more focused, the IMF should assess the overall coherence of a country's exchange rate, monetary, fiscal, and financial policies with a view to analyzing their effects on external stability. The Guidelines also serve to clarify and modernize the principles under which surveillance will be conducted and to reaffirm members' commitment to the surveillance process under their Article IV obligations.

Research at the Bank of Canada has developed an integrated framework for IMF surveillance which consists of two elements: the Guidelines for Economic Policy Frameworks and a renewed institutional framework, consisting of a Remit, a process for communicating surveillance, and a means for ensuring accountability.

The second element of the proposal develops an institutional framework that supports the conduct of surveillance. The key mechanism is a Surveillance Remit, inspired by the work of the Bank of England (King 2006; Lomax 2006). The Surveillance Remit is much like a performance agreement: it defines the aim of bilateral and multilateral surveillance and the obligations of the Fund to pursue this goal and clarifies the means by which the Fund will be held accountable for doing so. In essence, members charge the Fund to conduct surveillance and, in return, agree to recognize its role and the policy advice it generates. Importantly, with its emphasis on increased accountability, the Remit should heighten the Fund's ability to provide candid and objective surveillance advice.[12]

Taken together, the framework clarifies the roles and responsibilities of the IMF and its member countries in the surveillance process. It also aims to tie together the existing proposals for a revised 1977 Decision, the Remit, and measures for enhancing accountability. These reforms offer a number of benefits for all members. Simply, members can expect to receive focused, high-quality bilateral and multilateral surveillance aimed squarely at crisis prevention. Moreover, surveillance will be applied in an even-handed and symmetric manner, for developed and developing countries alike. In fact, given their dependence on trade and capital flows, effective bilateral and multilateral surveillance would be particularly beneficial for EMEs, since it would help to protect them from being sideswiped by global economic events. It is often the most vulnerable countries that are hardest hit by financial crises, and thus they have the most to gain from a stable international monetary system. Additionally, by focusing clearly on macro policies related to external stability, IMF surveillance will avoid mission creep into structural policies and institutional reform issues. In sum, these surveillance reforms will help to enhance the IMF's ability to promote a well-functioning international financial system.

Lending

Over the years, the IMF has developed various loan facilities to address the individual circumstances of its members (Table 3). These facilities can be grouped into two main categories. The first consists of long-term loans made to low-income countries through the Poverty Reduction and Growth Facility. An evaluation of these loans by the IEO (2004) suggests that they have had limited success. The second category refers to the loans granted to countries experiencing a financial crisis.[13] These are countries that cannot access sufficient financing on affordable terms to meet their international obligations. This type of IMF lending aims at facilitating the adjustment policies and

12. The Remit is supported by a process for communicating surveillance. Under the framework, the IMF is obligated to communicate its surveillance activities in a complete, timely, and transparent manner. To ensure that the Fund fulfills its surveillance obligations, a Framework for Assessing Surveillance is proposed. The MD and the staff will be assessed on whether they have conducted surveillance in an effective and transparent manner.

13. This category is covered by most of the other facilities and has always represented the largest share of IMF outstanding credit. The IMF also provides emergency assistance to countries that have experienced a natural disaster or are emerging from conflict. We do not discuss these loans.

Table 3

The IMF's Lending Facilities

Facility[1]	Purpose
Stand-by Arrangements	To help countries resolve short-term balance-of-payments problems. This is the main lending facility.
Extended Fund Facility	To help countries address longer-term balance-of-payments problems requiring fundamental economic reforms
Compensatory Financing Facility	To help members experiencing either a sudden shortfall in export earnings or an increase in the cost of cereals imports, often caused by fluctuations in world commodity prices.
Supplemental Reserve Facility	Exceptional access lending,[2] introduced in 1997 to address the needs of members who have experienced a loss of market confidence, leading to massive capital outflows
Poverty Reduction and Growth Facility (PRGF)[3]	Concessional lending arrangement to assist low-income countries in the development of a long-term strategy for growth and poverty reduction

Source: International Monetary Fund

1. The IMF also provides emergency assistance to countries that have experienced a natural disaster or are emerging from conflict.
2. Exceptional access is defined as access by a member to the Fund's general resources (all facilities except the Poverty Reduction and Growth Facility and the Exogenous Shocks Facility) in excess of an annual limit of 100 per cent of the member's quota, or a cumulative limit of 300 per cent of the country's quota.
3. Low-income countries also have access to the Exogenous Shocks Facility when facing shocks such as changes in commodity prices, natural disasters, and conflicts and crises in neighbouring countries that disrupt trade.

reforms that these countries must adopt to resolve their balance-of-payments problems. For instance, in response to crises in Latin America, Asia, and elsewhere, the Fund offered large loans through Stand-by Arrangements and the Supplemental Reserve Facility, resulting in high levels of use of its resources (see Chart 2). Despite this high, and often persistent, level of lending activity, research suggests that, while it led to an improvement in borrowing countries' balance-of-payments position, the impact on other macroeconomic variables was limited (see de Resende 2007 for a survey).[14] At the same time, many borrowers felt that the conditions attached to the IMF lending program were often too onerous and were not applied evenly across countries (Goldstein 2000).

Subsequently, many EMEs have, in recent years, accumulated large foreign exchange reserves, possibly to

Chart 2

Total Credit Outstanding in the IMF's General Resources Account

Source: International Monetary Fund

self-insure against capital account crises and to avoid borrowing from the Fund.[15] In this context, it has been suggested that a new precautionary lending instrument is needed at the IMF to support crisis-prevention efforts by EMEs active in capital markets and to reduce the need to accumulate reserves for precautionary purposes.

Reserve Augmentation Line

Work has thus started at the IMF on the development of a high-access financing instrument, called the Reserve Augmentation Line (RAL). This instrument is designed for crisis prevention and would complement the current proposals for surveillance reform. The RAL targets EMEs that have strong macroeconomic policies, sustainable debt, and transparent reporting and are making progress in addressing remaining vulnerabilities.[16] It would provide predictable, imme-

14. Some argue that IMF lending can create moral hazard and potentially distort post-crisis restructuring efforts, leading to poorer macroeconomic outcomes.

15. Some of these countries also accumulated large holdings of reserves via sterilized intervention in order to resist a real appreciation of their currencies and to stimulate the growth of their exporting sector. This may have contributed to the buildup of global imbalances and led to domestic financial vulnerabilities, especially if carried out using non-market methods.

16. See IMF 2006a and 2007b. A member would pre-qualify for the RAL based on a number of criteria. Then, according to the IMF staff's proposal, the member would have immediate access to 300 per cent of its quota, should a capital account crisis occur. Financing would be limited to a short period (12 months, perhaps up to two years), although the possibility of holding several RALs could exist. It is noteworthy that the views of Executive Directors may differ from those expressed in this proposal. For instance, some Directors consider that access should be between 300 and 500 per cent of quota. Some favour a program of longer duration (two or three years, for example). See IMF 2006d and 2007c for further details. There will be further work and discussion on the proposed new lending instrument.

diate, and large-scale access to Fund resources at the onset of trouble, which would help to maintain market confidence and reduce the likelihood of large and sudden capital outflows that often trigger a full-blown crisis. Moreover, if the RAL is perceived as a close proxy for reserves, it would reduce countries' need to actually accumulate reserves themselves. The instrument could serve as a signalling device to financial markets to help them make appropriate decisions regarding the creditworthiness of a member country if the qualifying criteria adequately measure countries' economic and financial soundness. There are nevertheless some challenges with respect to its design. For example, the appropriate balance between access and Fund risk exposure would need to be achieved.

A need to review the framework for crisis resolution

There is also a need to consider how the RAL fits in with the Fund's lending instruments. More generally, as the joint research by the Bank of Canada and the Bank of England (Haldane and Kruger 2001–2002) has stressed, the IMF's framework for crisis resolution would benefit from clear access rules and limits on IMF lending. This would ensure that no country relies on IMF lending as a means of delaying the policy adjustment required to relieve capital account pressures, or balance-of-payments problems more generally. Ideally, IMF lending should help to maintain stability by providing temporary and limited liquidity to solvent countries in extreme cases. As well, clear constraints on IMF lending would ensure that the private sector plays a crucial part in crisis resolution. Constraints would also align debtors' and creditors' incentives to deal with a crisis and seek co-operative solutions.

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Other Reform Issues

Principal among the many other aspects of Fund reform that were identified in the IMF's review of its Medium-Term Strategy is the pressing need to examine the Fund's financing model and its role in low-income countries.

Rethinking the IMF's financing model

A sharp decrease in market borrowing costs and improved fundamentals in many EMEs has led to a relatively rapid reduction in the demand for IMF loans to the lowest level in decades (recall Chart 2). Although this is a very positive development, the low demand for IMF resources has put the Fund's finances under pressure and has raised questions about the viability of its financial model. The Fund derives most of its income from a single source—its lending activities. It borrows from its members and lends these resources on a cost-plus basis. The margin it charges over its cost of funds is the primary source of the income used to cover administrative expenses. As a result, the Fund's current financing model implicitly generates incentives towards lending. As well, when demand for Fund resources is low, the margin required to cover costs can rise to quite high levels, which could lead to a further reduction in the demand for Fund resources if it induces current IMF borrowers to repay the Fund early and to borrow instead on private markets.[17]

Some measures to generate additional revenues and to reduce expenditures have already been put in place to deal with expected operating losses over the next few years.[18] However, the IMF's budget difficulties may not be temporary. Although the current favourable global environment may reflect factors of a cyclical nature, such as ample liquidity, widespread improvement in the macroeconomic policy frameworks of many EMEs may have rendered them less likely to access the IMF's resources. As a result, even though Fund lending could increase in the future, it may not do so to an extent that would make the Fund's current financing model sustainable. Hence, a fundamental review of the Fund's financial model has been required.

Financing reform

Efforts to date have focused on the revenue side of the IMF's administrative budget. In May 2006, the

17. Since January 2005, Russia, Brazil, Argentina, Indonesia, Uruguay, and the Philippines have repaid early their outstanding financial obligations to the Fund. Turkey is currently the largest remaining IMF borrower, accounting for just over 50 per cent of total outstanding Fund credit.

18. For example, an account to invest the Fund's accumulated reserves in a portfolio of fixed-income securities was created last year to generate additional revenues. On the expenditure side, the objective is to achieve no growth in real terms (an increase of 3.5 per cent on a nominal basis) for 2007 and a 1 per cent real reduction (a rise of 2.5 per cent in nominal terms) in 2008 and 2009.

Committee of Eminent Persons was appointed to provide an independent view of the options available to broaden the Fund's revenue base and to generate sustainable long-term financing for its running costs. Chaired by Sir Andrew Crockett, President of JP Morgan Chase International and former General Manager of the Bank for International Settlements, the committee released its report at the end of January (IMF 2007a). It proposed a fundamental change to the Fund's revenue model, basically recommending that the sources and uses of Fund resources be linked. Thus, the Fund's revenues from lending would cover intermediation costs (and the buildup of reserves). Because of their nature as a public good, surveillance activities would be financed by means derived proportionately from resources provided by all members. The committee recommends paying for the costs of these activities through expanded investment operations.[19] Charges would cover the costs of capacity-building activities.

The committee's report provides an important step forward. It will also be worthwhile to undertake a review of the scope and size of the Fund's expenditures. Indeed, the IMF has a responsibility to its membership to ensure that it is managed in the most efficient way possible. Moreover, the review of the Fund's finances cannot be isolated from the other aspects of IMF reform. Ideally, the funding model should be integrated with the activities and comparative advantage of the IMF relative to other international institutions.

The role of the IMF in low-income countries

The IMF provides two key public goods for low-income countries. First, technical assistance helps them to develop the human and institutional capacity to put in place sound macroeconomic policies and structural reforms that can reduce their vulnerability to crises and raise the standard of living of their citizens. Second, data standards facilitate best practices in data collection and dissemination. To some extent, the IMF's responsibilities in these areas are complementary to those of the World Bank. Both institutions collaborate regularly and are involved in several joint initiatives.[20]

Still, with two institutions working on similar initiatives, there is a need to ensure that overlap is minimized, while, at the same time, gaps are avoided and responsibilities are clear. Recognizing that efforts could be unnecessarily duplicated, the IMF's MD, Rodrigo de Rato, and the President of the World Bank Group, Paul Wolfowitz, appointed the External Review Committee on IMF-World Bank Collaboration in March 2006. Chaired by Pedro Malan, Chairman of the Board of Unibanco and a former Minister of Finance of Brazil, the committee has a mandate to examine the areas of collaboration between the two institutions and to propose improvements to ensure that the division of labour is efficient and effective. The committee released its report at the end of February (Malan et al. 2007). It recommended that the collaboration between the two institutions be strengthened to better reflect their comparative expertise. For example, the committee advised that the IMF refocus its activities in low-income countries towards macroeconomic assessments and policy advice and that it gradually withdraw from subsidized long-term financing.

The Report makes a broad set of recommendations that will need to be carefully considered relative to its central insight that each institution could benefit from focusing on its comparative advantage. Thus, the IMF would focus on short-term initiatives to promote the stability of the international financial system, technical assistance in its area of expertise, and its data collection and dissemination efforts, and the World Bank on longer-term initiatives to foster economic development and reduce poverty. This would help to better organize, and thus make more efficient and effective, the activities of both organizations.

Conclusion

The IMF remains the key institution for promoting a well-functioning market-based international monetary system. While it has evolved to meet many of the challenges of an increasingly integrated global economy, further reform is needed. The Fund itself has embraced the reform process, as witnessed by MD de Rato's commitment to the review of its Medium-Term Strategy. The Bank of Canada is involved in facilitating the dialogue on IMF reform and is actively engaged in many of the issues, particularly, governance, surveillance, and lending facilities.

While the task of reforming a multilateral institution may seem daunting, the ongoing efforts of the IMF and its members to seek solutions are encouraging. The implementation of an ad hoc quota increase for the Fund's most under-represented members is a positive step towards a more comprehensive and lasting quota reform. Likewise, the move to revise the

19. Of note, the committee proposes to create an endowment from the sale of a portion of the IMF's gold holdings, which would then be invested.

20. The IMF also collaborates with other regional development banks, such as the African Development Bank, the Asian Development Bank, and the Inter-American Development Bank.

1977 Decision, in conjunction with the proposal of the Surveillance Remit, is a significant step forward in refocusing IMF surveillance. Finally, a rationalization of the Fund's lending instruments and finances and a clarification of its role in low-income countries would greatly facilitate a more focused, and more effective, IMF. Taken together, the reforms to the Fund's governance, instruments, and policies will be mutually reinforcing. It is important not only to improve how the Fund is governed, but also to ensure that it has the right tools to do its job well.

The ultimate aim of these reform efforts is to create an institution that is credible and legitimate in the eyes of its members and effective in supporting global financial stability. By ensuring that the Fund has clear objectives and the right instruments and governance structure to support its goals, the IMF can continue to fulfill its crucial role at the centre of the international monetary system, to the benefit of all its members.

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