PERSPECTIVE

A Global Shared Societies Agenda

The Role of the International Monetary Fund

JACK BOORMAN

June 2012

- This paper is written in response to a series of conferences organized between April 2011 and April 2012 at the International Monetary Fund by the Friedrich-Ebert-Stiftung, Club de Madrid and Center of Concern aimed at defining an agenda to promote Shared Societies.

- A 'shared society' is a socially cohesive society. It is stable, safe. It is where all those living there feel at home. It respects everyone's dignity and human rights while providing every individual with equal opportunity. It is tolerant. It respects diversity. A shared society is constructed and nurtured through strong political leadership.

- The author's participation in this project has led him to reflect upon which way the causality with regard to shared societies and economic vitality runs. Does the promotion of equitable and shared societies produce sustainable development and growth? Or does sustainable growth promote equity?

- These questions lie at the heart of political debates in many countries, but according to the author, there is increasing evidence supporting the first proposition. It is hoped that this paper will help inspire further research into the questions raised by the prospect of a Global Shared Societies Agenda, and particularly, of the role of the IMF in it.

Dialogue on Globalization

FRIEDRICH EBERT STIFTUNG NEW YORK OFFICE

CLUB DE MADRID

Center of Concern

1. Introduction

A series of conferences has been organized by the Friedrich-Ebert-Stiftung, the Club de Madrid and the Center of Concern aimed at defining an agenda to promote Shared Societies. The organizers of these conferences define a shared society as one »...based on equity, where each and every person ...feels at home, feels that they belong, that they can play a full part in that society and, at the same time, fulfill themselves«. The over-riding objective is the achievement of sustainable development and growth through the promotion of equitable and shared societies. Interestingly, and perhaps uniquely, their concept includes »reform of the international financial and monetary system« as one of the keys to achieving that objective. I believe that broadening the contribution that a reformed international monetary system can make to improving the prospects for more equitable societies and sustainable development is a welcome departure from the usual way of framing initiatives that include these objectives. At the same time, it is critical to define—at least in broad terms—what is meant by an »equitable and shared society«—and, perhaps, which way the causation runs. Does the promotion of equitable and shared societies produce sustainable development and growth? Or does sustainable growth promote equity? These questions lie at the heart of the political debates in many countries, but there is increasing evidence supporting the first proposition.

2. Shared Societies

In thinking about a shared society, there is a natural tendency to think in terms of the nation state as the relevant unit.[1] That is, after all, the locus of most policy making. But this immediately raises many issues. For one thing, a nation state is not always in control of its own destiny, even if it is in control of much of its own policy. That is true of even the largest and most developed countries—although they generally have more options than smaller and poorer countries in this regard. The increasing inter-connectedness of the global community decreases the capacity of any individual nation to control its fate.[2] Like never before, the fate of all of us—and of our nation states—is tightly linked and intertwined. It becomes all the more so with the ascendency of cross-national organizations of all kinds—both public and private.[3]

That recognition of interdependence makes the inclusion by the organizers of this initiative of reform of the international financial and monetary system—and of the institutions that constitute that system—completely appropriate. Decreasing the negative impact of policies or events in one country or region on others requires, more than ever, international cooperation and coordination. And that requires both global and regional organizations of nation states and of private organizations.

But what would a shared society look like and what are the necessary conditions for fostering such a society? And, in that context, is there a role for an international institution such as the International Monetary Fund in fostering the objectives of this initiative?

Let me suggest four characteristics that I believe must underlay a shared and more equitable society—whether at the national or international level:

[1] There are two other aspects of the concept of sharing. One is »intergenerational sharing«. This is a key issue in the management of University endowments, for example. (»Intergenerational equity« is the term generally used.) But it can also be an issue in public policy. As a recent and ongoing example, in paying for the wars in Iraq and Afghanistan by borrowing rather than taxing the United States public, the monetary cost of those wars was shifted to future generations. A second aspect of sharing that warrants mention is the allocation of losses and costs in a society - rather than considering only the sharing of gains. This is taken up below.

[2] Think of spillovers from financial crises. Think of the impact of global climate change on the agricultural prospects of certain regions of the world. Think of air quality in some countries in Asia and even the Western United States from air pollution in China. Think of immigration. Think also of events such as a volcano in Iceland that shut down air traffic in much of Europe or of cholera in Haiti that appears to have come from Nepal. Think of upstream irrigation dams denying water to counties downstream. The connections are intense - and endless.

[3] Think of supply chains around the world disrupted by a tsunami in Japan or floods in Thailand. Think of the impact of the banking crisis in Iceland on other European savers. Think of the collapse of Lehman Brothers on banks - and individuals - across so many countries. Think of the modern model of American banking infecting the rest of the world.

- Proper governance and institutional structures;
- Reasonable stability—both political and economic;
- Shared opportunity[4]; and
- Positive and widely available incentive structures.

Among the institutions that are needed to underpin a shared society include those that can help prevent major crises and disruptions in the economic and financial systems and help resolve those crises that will, inevitably, still occur. Building such institutions must be an important element of an agenda to foster shared societies.The specific institutions and policies needed to achieve these objectives cannot and should not come by dictum from above. At the national level, they must evolve from within particular societies, and be consistent with the best features of a country's history and culture. At the international level, they must evolve from processes that provide voice and representation to all nations that share a set of global values. But the effectiveness of institutions and policies needs to be assessed against the results they produce—and be subject to change through some form of consensual democracy. Only governance structures that provide basic rights and opportunities to all people in national and international society can foster a global shared society. Only incentive systems that are open to all and that cannot be perverted by special interests and elites can assure a level playing field for all.[5]

What is the role of an institution like the IMF in fostering these prerequisites of a shared society? There are two dimensions to this question:

- What can the IMF do better in the framework of its traditional mandate? and
- What further can it do to respond to the call from this initiative to »...incorporate social policy elements into the aspects of policy and performance that states are required to meet within the framework of the international monetary and financial system?«

Let me take each in turn.

3. IMF Governance

The most important contribution that the IMF can make to the global system is to effectively foster global growth and economic and financial stability. Growth is a sine qua non of improved living conditions and the creation of opportunities for the population. And, as evident in the recent crises in the United States and Europe, instability in the financial system can cause major interruptions to growth—with both short term and long term costs across society, and especially to the poorer segments of society. The IMF's mandate to help avoid such crises is clear; however, it's performance in the lead up to the crises was wanting. Operationally, it is through its surveillance authority that the IMF is to carry out this mandate. While the rules the IMF establishes to guide the international monetary system and to manage its lending operations are important, the preventive functions of its surveillance activities—both multilateral and bilateral—are key to achieving the principal objectives laid out in its Articles of Agreement[6]. Without growth, and the maintenance of

[4] The opportunities provided to individuals in a society are often hindered by the many forces that divide populations: race, religion, tribal structures, control over natural resources, and many other things. That discussion cannot be captured in this note. It is, however, an aspect of »consensual democracy« mentioned below.

In this context, it is useful to distinguish between the ex ante distribution of opportunities (access to education, health care, decision making, etc.) and the ex poste distribution of outcomes (income, wealth, political involvement, etc.). There are important feedback loops from the outcomes that can influence further improvement in access to opportunities. One implication of this view is that an international organization such as the IMF should be expected to comment not only on macroeconomic and financial risks, but also on the risks emanating from a country's social policies and structures.

[5] By way of example, the incentive system created in the U.S. mortgage origination process - and more generally in the financial system - stacked the deck against those seeking mortgages and destroyed the usual protections of the system. The immediate selling of newly originated mortgages and their packaging into improperly rated securities destroyed the protections traditionally available to both borrowers as well as to the ultimate lenders. Similarly, the abuse of derivatives by large financial institutions - an element of the mortgage crisis - destabilized the global financial system with enormous costs to growth and the well being of nations and individuals.

[6] See Article I and especially paragraph (ii) on the purposes of the IMF: »(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the

reasonable stability to prevent major disruptions to growth, the objectives of a shared society will be impossible to achieve.

However, the Fund is hampered in carrying out its surveillance responsibilities if it does not have the commitment of its entire membership to its role, its operations and to its place in the global system. And that commitment is now challenged by the slow pace of the institution, i.e., its membership, in modernizing its governance structure. To achieve the IMF's principal objectives, each and every member country must have a keen interest in and a deep loyalty to the institution that stems from a belief that its place in the institution is an accurate reflection of its place in the global economic and financial system. For very small and poor countries, that requires a minimum number of votes and respect for their voice. For the emerging market and the more developed countries, it requires a system that can update a country's voice and representation in a timely manner to reflect changes in its economic and financial place in the global economy. But these requirements are demonstrably not being met today. The voice and vote of many of the emerging market countries is not what it should be; and that of many European countries, in particular, is an historical anachronism.

Decision making in the IMF—never fully located in the executive board or in the International Monetary and Financial Committee (IMFC)—has been further weakened by the creation of the G20 and its elevation to the level of Leaders. Key decisions of the IMF in the last several years have been made in the G20—and brought into the Fund essentially decided, with little opportunity for modification or amendment. Beyond that, to be fully effective, and credible, the staff of the Fund must be—and be seen to be—independent in its analysis and in its views. This has traditionally been the case. However, I believe this has been brought into question by the modus operandi of the Fund's involvement with the Troika[7] in dealing with the ongoing crises in Europe[8]. Only fundamental change in its governance structure—as well as in the global governance structures in which the IMF is imbedded, and of the capacity of the Fund to conduct effective surveillance, will allow it to play the role that it should be playing in the global system.

Progress is being made in improving IMF governance. As part of an agreement on quota and governance reform, the Board of Governors in December 2010 called for a comprehensive review of the quota formula, to be concluded by January 2013. The review is to be followed by discussions of the 15th General Review of Quotas, to be concluded by January 2014. Moreover, there is already agreement to modify the structure of the executive board to provide for all executive directors to be elected and for the Europeans to give up two chairs on the board which will be filled by directors representing emerging market countries. Together, the changes that should be made could significantly increase the voice and vote of the most rapidly growing countries in the IMF and create an executive board whose composition might better reflect the economic and financial place of countries in the global economy.

The issues of IMF governace and the related aspects of global economic governance were addressed in the report of the Palais Royal Initiative provided to the Leaders of the G20 in February 2011.[9] The

promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.« The full text of the articles can be found at http://www.imf.org/external/pubs/ft/aa/index.htm#art1

[7] The »Troika« refers to the three institutions negotiating and financing the programs of Greece, et. al. in the Eurozone: the European Commission, the European Central Bank and the International Monetary Fund.

[8] Even the IMF's funding needs were recently held hostage to the willingness of the Europeans to increase the size of their own »firewall« to deal with the ongoing crisis.

[9] The Palais Royal Initiative was organized by Michel Camdessus, Tommaso Padoa-Schioppa and Alexandre Lamfalussy to evaluate the international monetary system and to propose changes that would be needed to help stabilize the system and reduce the likelihood of future failures. Members of the Group included 18 former finance ministers, central bank governors and senior officials in national or international institutions. The full report of the Group can be found in »Reform on the International Monetary System: The Palais Royal Initiative« edited by

recommendations of the Group on governance reform are reproduced in Annex I. Implementation of these recommendations would bring about major changes in global economic and financial governance.

4. Strengthening IMF Surveillance[10]

Fund surveillance has had many successes. But its weaknesses are also evident and have been discussed at length elsewhere. Among these weaknesses have been a failure to identify some of the worst crises in the global system and in specific regions, and to deal effectively with the global imbalances that still threaten the system.[11]

Surveillance over country policies is conducted by a number of institutions (the OECD and within the BIS, for example), in regional forums (such as the European Commission, ASEAN, and others), and in Global groupings such as the G7/8, the G20 and others. However, none of these forums has the authority or legitimacy through international treaty that the IMF enjoys; nor do they have the capacity to impose on member countries the kind of obligations that members accept when they accept the IMF Articles of Agreement. Fund surveillance should serve as the global system's primary instrument for preventing country-specific, regional and global crises and for fostering the stability necessary for sustainable growth. But its authority is not clear and its role is weakened by the fragmentation of surveillance among the other forums and, especially, by the way in which the G7/8 and the G20 have operated. This is further undermined by the lack of ownership in the institution that results, in part, from the failure of the governance structure of the institution to keep up with the changing power and place of countries in the global system.

Proposals to strengthen IMF surveillance are also contained in the report of the Palais Royal Initiative and are reproduced in Annex 2 to this note.[12] The essence of these proposals is to »put teeth« into the surveillance process so as to give it greater traction in getting countries to adjust their policies when needed. There has been resistance to these kinds of proposals in the past. It remains to be seen whether the experience of the recent crises will persuade the membership—and especially the major countries—to adopt these kinds of changes to strengthen IMF surveillance.

5. Dealing with Inequality

Beyond the needed changes to its governance and to surveillance, what specific things could the IMF do to promote more equitable and shared societies among its member countries?

Recent research suggests that high levels of economic inequality between the rich and poor in individual countries can have a negative impact on growth.[13] Earlier, most economists held the reverse position. Growing inequality has been seen in many countries—developed, developing and emerging market countries—since the early 1980s. Recent research in the IMF and elsewhere raise important questions about these trends. That research suggests that »...income distribution may....belong in the pantheon of critical determinants of growth duration«[14]. It concludes that

Jack T. Boorman and A. Icard, Sage Publications, 2011, pp 7-26.

[10] IMF surveillance over the policies of its member countries was discussed in some detail at the first meeting of this group in April 2011. See »Reform of the International Monetary System«, Jack Boorman, April 17,2011. Reprinted in New Directions for International Financial and Monetary Policy, Friedrich-Ebert-Stiftung, September 2011, pp. 21-25.

[11] Among others, see »IMF Performance in the Run-UP to the Financial and Economic Crisis: IMF Surveillance in 2004 - 2007, Independent Evaluation Office of the IMF, Washington D.C., 2011

[12] Palais Royal Initiative - Reform of the International Monetary System: A Cooperative Approach for the 21st Century, in Reform of the International Monetary System, edited by Jack T. Boorman and Andre Icard, Sage Publications, 2011, pp. 7 - 26.

[13] Inequality obviously has critical moral and ethical dimensions. This note focuses only on the economic issues.

[14] See »Equality and Efficiency: Is there a trade-off between the two or do they go hand in hand?«. Andrew Berg and Jonathan D. Ostry. Finance and Development, September 2011.

»... income inequality stood out for the strength and robustness of its relationship with the duration of growth spells«. That robustness suggests that, among other things, »...closing ... half the inequality gap between Latin America and emerging Asia would more than double the expected duration of a growth spell in Latin America«.

Other research suggests that economic development and financial development reinforce each other.[15] It has been long been understood that improved financial services, i.e., financial deepening—one that provides access to quality financial services to a broad base of firms and individuals—can increase growth. But this recent research suggests that financial development can not only increase the size of the pie, but also help divide it more evenly.[16]

If this research is correct, it is critical for IMF staff—and for the membership as a whole—to understand better the polices that can foster inclusive financial deepening and reduce the extremes of inequality. The IMF, in its advice to member countries, needs to understand this. Some may argue that this is work for the World Bank and others. Perhaps! But I would argue that wherever the research is conducted, its results need to intimately inform the work of the Fund. Greater openness on the part of the Fund, and closer cooperation with other institutions—including joint research on issues such as this—seems warranted. On the operational level, in providing advice to members on tax systems and tax policy in its assessments of country policies in surveillance, the Fund staff should analyze—and should routinely present to member countries—the impact of taxes and other policies on the distribution of income and wealth.

The Fund has already tried to be aware of the impact of its policy advice and conditionality in the context of its lending operations as well as in its dialogue with member countries. On the former, perhaps the most ambitious effort was in the context of the programs with several countries during the Asian crisis in 1997/'98. In a number of the programs, specific measures—safety nets—were included to try to protect the poor from the initial impact of some of the reforms needed to improve the working of those economies. On the latter, the breadth of consultations and discussions with various segments of the population—as well as the general transparency of the Fund in its dealings with countries—increased substantially. It has become routine to meet with labor unions, parliamentarians, civil society and others whereas consultations earlier on had generally been limited to the fiscal and financial ministries of government and, in some cases, the financial sector.

Fortunately, further change is reported to be under way, stimulated in part by the Arab Spring. There is said to be greater recognition that growth and stability are not by themselves sufficient to foster political stability and sustainable development. Rather, there is reported to be increasing agreement among the membership that the benefits of growth need to be more broadly shared and demonstrably reflected in improvements in living standards across society—and that the Fund has a role to play in fostering these results. Three initiatives, in particular, are reported to be underway:

1. Research to better understand what inclusive growth must involve. This includes greater attention to employment issues and the impact of macroeconomic policies on job creation and income inequality. A staff group on »jobs issues« is reportedly actively examining the operational implications of these issues for the IMF.

2. A full review of how these issues were dealt with in Fund supported programs over the last ten years. This kind of exercise can possibly provide insight into »best practices« in dealing with these issues both in Fund programs and in surveillance.

[15] See »A Bigger Slice of a Growing Pie«, Sarwat Jahan and Brad McDonald. Finance and Development, September 2011.

[16] Not all financial development reduces inequality, at least not in the short run. Jahan and McDonald themselves note, »For example, a study of stock market liberalization in emerging markets shows that the benefits accrue primarily to the rich at the expense of middle-income citizens. Similarly, financial globalization, especially when it comes to foreign direct investment, has been associated with widening income disparities (IMF, 2007). More generally, there is a risk that small groups of elites may capture the process of financial liberalization, directing it in ways that narrow rather than broaden access (Claessens and Perotti, 2007).« It is therefore imperative to advocate the right kind of financial deepening to ensure financial inclusion.

3. What the Fund needs to do to work more closely and better collaborate with the ILO, with trade union organizations, and with other institutions involved in these issues. There has been increasing activity in these areas over the years, but a more focused effort is reported to be underway.[17]

6. What other things might the Fund do—or do better?

The Fund has an impressive record of increasing its focus in ways that have contributed to better performance of its members. In the 1990s, for example, under the leadership of Michel Camdessus, the Fund pushed forward a number of important initiatives. Its own transparency increased substantially, and it pressed member countries to increase their transparency—as regards the publication of data, information about policies, the composition of government spending—even including something as sensitive as countries' military spending. None of this was easy—and some of the initiatives were strongly resisted by many in the membership for some time. But substantial progress was made! Better data provision to markets and the public has helped to better inform markets and, in some cases, the operation of markets.[18] But lax data provision—think Greece, trading in credit default swaps, the operation of special investment vehicles in the largest banks, and many other examples—remains a threat to stability—and, thereby, to growth.

The wasteful and counter-productive levels of military spending also demand greater attention. The Fund obviously cannot—and should not—set itself up as an arbiter of military spending. However, the sheer force of better information—including comparisons between the amount of military spending and social spending in a country and across the globe—can help keep the issue in the public mind and help those willing to press for change.[19]

The issue of distributing the costs in a crisis situation is also an area in which the IMF could play a more active role. Debt crises—both sovereign and private—require difficult decisions about who will bear the burden of providing needed debt relief. In the recent crises in Europe, this has been a continuing problem—both politically and financially. By way of example, the crisis in Ireland was primarily a banking crisis, with massive write-downs in the banking system stemming from the property bubble. When that bubble burst and the banks were facing major losses, the Irish government decided to guarantee most of the senior liabilities of the banks. In a single stroke, major creditors of those banks—mostly other banks in Europe that had financed the explosion of credit in Ireland through the Irish banks, had their claims protected. What originated as a private banking crisis was turned into a sovereign debt crisis—with the cost of the bail out of the bank creditors falling on the Irish public. Was this the proper way the share those losses? There are many reasons that this rescue was designed this way. But was it the best way—economically, morally, ethically? Now that it

[17] A reflection of the Fund's view on some of these issues is contained in a speech by the Managing Director in December 2011: »It is now much clearer that more equal societies are associated with greater economic stability and more sustained growth. While each country in the region must find its own path to change, the over-arching economic goals of the Arab Spring remain clear—higher growth, growth that creates more jobs, and growth that is shared equitably among all strands of society.« *The Arab Spring, One Year On.*

[18] In particular, the more timely release and greater detail in the presentation of countries data on international reserves has reduced the likelihood of markets being surprised when reserves take a negative turn, Similarly, the data dissemination standards developed in the wake of the Mexican and Asian cries in the 1990's have greatly improved the timeliness and reliability of country financial and economic statistics. But there remain obvious problems. These were evident in the run up to the European crisis in which Greek fiscal accounts were shown to have been misleading. They were evident also in the market's inability to assess the implications of growing sovereign and bank debt in Europe before that debt became unsustainable in a number of countries.

[19] See »The Darwin Economy« by Robert H. Frank (Princeton University Press, 2011) on the counterproductive and wasteful nature of continued increases in expenditure on arms. As he notes, »...there's all but universal agreement that military arms races between closely matched rivals are wasteful, and that all parties can gain from collective agreements to limit spending on armaments«. Given the spending on arms -across the world and in specific regions, this understanding and agreement has obviously not been made a reality.

has been done, the resulting debt burden of Ireland raises the possibility that debt relief may be needed for the sovereign—as was the case in Greece, and possibly will be the case in some of the other peripheral countries. But as in earlier sovereign debt crises, it remains the case that there is no formal mechanism for dealing with a sovereign bankruptcy. The IMF made proposals for such a system a decade ago. But the proposals were rejected. I believe it is time to raise that issue again—not least as a means of reducing the losses in such cases and achieving a better sharing of those losses that cannot be avoided.[20]

Once again, continued progress on all of these issues requires close cooperation with other institutions and agencies: with the BIS and regulatory agencies on financial market issues; with statistical agencies on data provision and transparency; with the global legal and financial community on a sovereign debt restructuring mechanism; and with the World Bank on any issues that touch on the prerogatives of member countries. This is never easy, but is necessary if the global system is to work for the benefit of all.

7. A More Provocative Suggestion

I believe that there is a major question that should be addressed.

- If, as concluded from recent research, high levels of inequality can be harmful to growth and reduce the size of the pie to be shared;
- If certain political systems generate—and tolerate—extreme levels of inequality in the distribution of income and wealth;
- If certain political systems have proved inimical to growth—and to the provision of social services such as education and health care that are essential to full participation of individuals in an economy; and
- If some form of consensual governance is a necessary condition for sustainable growth and development;

What can be done by the international institutions to take account of these realities in the advice they provide to countries?

This is very tricky territory! The IMF has sometimes been described as being apolitical. I believe that is a fair statement about the work of the staff—and the reason that the independence of staff is so important. But there have clearly been instances when decisions of the executive board have clearly been driven by politics.[21]

Should an institution like the Fund try to take greater account of the impact of a member country's political system on its prospects for fostering sustainable growth and widely sharing the benefits of such growth? This would require the institution—with the help of others—to better identify political and social systems that clearly hold back economic growth and the creation of shared societies. Such an approach may well take the institution into areas that could be seen as interfering with a member country's political prerogatives. Nevertheless, I believe that this possibility deserves serious consideration. Such a move would clearly demand closer cooperation between the IMF and the United Nations.

[20] There have been several conferences held over the past six months on various aspects of the sovereign debt issue. One of those was organized by the Centre for International Governance Initiatives (CIGI) in Waterloo, Canada in February. A summary of the issues and the discussion at the conference is available, »Sovereign Debtors in Distress: Are Our Institutions up to the Challenge?« by Susan Schadler, Senior Visiting Fellow, Centre for International Governance Innovation.

[21] As examples, Zaire was supported for years by lending from the Fund despite an abysmal record on policy implementation, a thoroughly failed governance structure, and an economy that had few opportunities or benefits for most of the population. There are other such cases as well. The continued support provided to these countries was predicated on political considerations. On the other side, Vietnam was denied support for many years after the war because the political issues involved with the missing-in-action (MIAs) remained unresolved.

8. Conclusion

The global economy and financial system remain very fragile:

- Recoveries from financial crises are inevitably more protracted than from more traditional business downturns;
- The European crisis continues, with potentially severe impacts on the global economy;
- Hopes for regulatory strengthening from Dodd/Frank in the U.S. and initiatives through the G20 and in Europe and at Basel are not advancing as they should (not least because of the pushback from banks and others).

At the same time, governance reforms of the global system—and of the IMF, in particular—are progressing slowly, but slowly.

These remain the key challenges facing global policy-makers—and failure to deal with them will thwart any hope of creating shared societies. Therefore, the immediate focus of the IMF and other financial institutions needs to remain on these issues. The fact is that institutions are not always terribly effective at multi-tasking.[22]

Nevertheless, efforts to better define the elements of shared societies and the roles that could be played by institutions like the IMF in fostering conditions favorable to shared societies should continue and should be accelerated. Some of the actions suggested above could help.

---

[22] It also seems to be the case that the IMF remains under considerable strain as a result of the significant downsizing of staff that took place just before the financial crises that have engulfed much of the world since 2008.

Annex 1: Suggestions from the Palais Royal Initiative for Improving IMF Governance[23]

Three essential issues have surfaced over recent years in the governance of the international monetary system, hindering its proper functioning:

- The need for a decision-making structure combining legitimacy and effectiveness by giving a formal framework to the relationship between the pertinent group of Heads of State or Government, the group of Ministers and Governors, and the key International Financial Institutions;
- The tendency for the present peer review processes to operate as peer protection, suggesting the need for a mechanism to break the de facto »pact of non-aggression« among countries that leaves the global interest without an effective advocate;
- The legitimacy deficit of the IMF, partly addressed by the Seoul G20 meeting of November 2010.

Additional meaningful measures should be undertaken to address current fundamental governance problems, especially to respond to the increased responsibilities we envisage for the IMF, and allow the membership to work in a framework even more conducive to mutual trust and partnership.

Suggestion 1

To ensure both effectiveness and legitimacy, we favor considering a governance of the international monetary system based on a single three-level architecture, ensuring universal representation through a system of constituencies, which has served well the IMF and the World Bank. This would ensure both a universal representation which would enhance the legitimacy of the G20, while preserving a limited number of key participants in the decision making bodies, to contribute to the effectiveness of the overall governance structure.

Three levels

The system of governance would be based on a three-level integrated architecture, comprised of:

- The Heads of Government or State, meeting sparingly (e.g., once a year) except in times of crisis;
- The Finance Ministers and Central Bank Governors, taking strategic decisions related to the functioning of the international monetary system in the framework of a »Council« as envisaged in the Fund's Articles of Agreement. This Council could be activated to take over and merge the functions of the IMFC and the G20 ministers and governors, as far as the latter's role in the global economic, monetary and financial domains is concerned. This would require an amendment to ensure a representation of Central Banks in the Council, as it is the case in the current G20 structure; and
- Executive Directors overseeing the work of the IMF, and its managing director.

These organizational changes would require an adjustment of the existing constituencies and of the number of chairs at the three levels.

Voting

We favor lowering of the voting threshold on most important decisions from 85 percent to 70-75 percent as well as the extension of the double majorities to a few other decisions, thus ensuring that decisions affecting key aspects of the institution command the support of the majority of members.

Global institutional coordination

To facilitate the institutional coordination, we suggest that the BIS, the FSB, the WTO, the World Bank and possibly other organizations be invited to meetings of the Council.

[23] Annex 1 and Annex 2 are both excerpts from the Palais-Royal Initiative's »Reform of the International Monetary System: A cooperative approach for the twenty first century«, in which Jack Boorman participated. The report can be downloaded at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0CF0QFjAB&url=http%3A%2F%2Fwww.elysee.fr%2Fpresident%2Froot%2Fbank_objects%2FCamdessus-english.pdf&ei=htHQT9TYCKPI6gGX54R8&usg=AFQjCNGDMUyocNK93avO4ca3C1n2h56FWw&sig2=BnE4YOfHEJHAAHEVePt-IA

Suggestion 2

In order to give a stronger voice to the global interest of the system, consideration should be given to establishing a Global Advisory Committee (GAC) made up of eminent independent personalities.

- Such a body could provide independent advice to the key organs of the IMF (e.g., the IMF Council, Executive Board, Managing Director) in the fields of surveillance, management of international liquidity and reserves, whether at its own initiative or at their request. While that advice would not be binding, it would in principle be made public. Consideration would need to be given to protecting confidentiality in a limited number of cases.
- Its membership, limited in size, should allow a diversity of perspectives and be selected on the basis of highly recognized technical competence, operational experience and independence. Fully transparent nomination rules would have to ensure that these conditions are met, along with some regional balance. Terms of membership would not be renewable.
- This reform could be introduced by the IMFC without requiring an amendment of the IMF Articles of Agreement.

Suggestion 3

Regional organizations. Recognizing that in some parts of the world regional organizations have increasing authority over economic, monetary and financial policies, as well as provision of financing, it would be worth undertaking a study about the modalities of their representation and relations with the IMF.

Annex 2: Suggestions from the Palais Royal Initiative for Stregthening IMF

Strengthened IMF surveillance over its member's policies is therefore required. Effective surveillance needs to address the fiscal, monetary and financial policies of national governments, with particular attention to exchange rates, and must give due attention to global liquidity developments, as elaborated below in Sections III and IV. Stronger surveillance also requires a review of the governance of key international institutions and their relations with all countries, as proposed in Section VI. It should contain, in particular, the following key elements: (a) stronger multilateral obligations, backed by clear, objective norms or quantitative benchmarks on economic and financial policies and performance to function as alarm signals with appropriate thresholds; (b) assessment procedures that permit judgment about the causes and implications of any deviation from those policy norms; and (c) consequences, including the possibility of both incentives and sanctions. While all countries should be subject to the same obligations and assessment procedures, particular attention should be directed to countries whose policies have a larger potential impact on the stability of the international monetary system. This new surveillance process should also aim at eliciting a supportive response from financial markets, helping to orient market sentiment towards stability objectives that have been agreed at a multilateral level.

Suggestion 1

IMF member countries should undertake to ensure that their policies are conducive to the stability of the global economic, monetary and financial system. We suggest that Article IV of the IMF Articles of Agreement be amended to reflect this strengthened commitment and to ensure that firm surveillance applies not only to exchange rate policies but to all economic and financial policies relevant for both domestic and global macro-financial stability. In the same spirit, Article VI should be amended to provide the IMF with the mandate and responsibilities it needs to effectively monitor and assess capital movements and restrictions on such movements imposed by member countries (see suggestion 11.). Its role in this area should be similar to the prerogatives it has regarding current account restrictions.

Suggestion 2

In support of surveillance over each country's or group of countries' compliance with the obligations under the Articles, the IMF should adopt norms for members' policies. The development of such norms should draw on the advice and experience of all IMF members and other available expertise. The norms might cover, for example: current account deficit or surplus; real effective exchange rates; measures to deal with capital inflows and outflows; changes in relative size and composition of reserve assets; inflation rates; fiscal deficits; and government debt ratios. Norms might also be established with respect to financial sector soundness and the effectiveness of banking supervision. Norms should be established in such a way that they function as alarm signals, with appropriate thresholds defined for each of them whenever possible.

Suggestion 3

Persistent breach of a norm would trigger a consultation procedure and, if needed, remedial action. The purpose of the consultation would be to ascertain the underlying causes and potential consequences of the deviation from the norm, both for the country itself and for the good functioning of the international monetary system. The assessment would have to look at all relevant factors, including economic policies in the country concerned and in other countries. The country's specific structural features and its present economic circumstances would also be taken into account. If the assessment concludes that a persistent deviation from the »norm« is not justified by any relevant specific circumstances and is a source of serious disturbance for the good functioning of the international monetary system, it should be followed by policy recommendations.

Suggestion 4

For systemically relevant countries whose policies do not appear to meet the norms, compliance with obligations should be explicitly ruled upon by the relevant organ of the IMF. All countries would be subject to the same obligations; and compliance with these obligations would generally be assessed in the context of IMF bilateral surveillance. However, a more stringent process would apply to countries whose policies are seen by the IMF as having a potential impact on the stability of the international monetary system . In doing so, no double standard should be applied. Oversight of compliance with IMF obligations should be more transparent than is currently IMF practice in order to increase the accountability of those engaged in the surveillance process. For example, relevant documents, other than those dealing with highly sensitive issues, and records of IMF Board discussions should promptly be released to the public and in full.

Suggestion 5

The IMF should develop positive incentives for countries to remain in full compliance with the requirements of the strengthened surveillance system. Such incentives could include automatic qualification for liquidity facilities (such as the flexible credit line -FCL- and precautionary credit line -PCL-) and access to the voluntary SDR market (allowing a member to sell SDRs against freely usable currencies without having to demonstrate a BOP need and without recourse to the mandatory procedure called designation).

Suggestion 6

Strong consideration should be given to including in the surveillance framework the possibility for the IMF to impose appropriate graduated remedial actions if a country has persistently violated one or more obligations. The process might entail more in depth analysis of what the breach of the norm might imply, initial informal meetings with the country concerned, possibly a special consultation, a review by the ministerial body overseeing the IMF, and, ultimately, if no action is taken by the concerned country, moving to the next phase of consequences. The latter might include, e.g., intensive follow-up reviews and public reports on the country's policies and its global spillovers; financial penalties; freezing part or all of the country's voting rights; restrictions on capital flows to countries in current account deficit or with an unsound financial sector. The activation of WTO procedures and trade sanctions, based upon IMF's assessment, should also be considered. The process for adopting such consequences would be the same as for assessing compliance, with the exception that special majorities would be appropriate for some measures.

About the Author

Jack Boorman was the Director of the Policy Development and Review Department of the International Monetary Fund from 1990 to 2002. Subsequently, he served as Counsellor and Special Advisor to the Managing Director until 2006. Earlier in his career, Mr. Boorman held positions in the Asian and European Departments of the Fund, taught at the Universities of Southern California and Maryland, and was in the Research Department of the Federal Deposit Insurance Corporation.

Mr. Boorman is the author of a number of books and many papers on diverse topics including macroeconomics and monetary theory, development, structural adjustment, and developing country debt; emerging market country issues; international insolvency; international governance; and IMF policies and country operations.

Mr. Boorman currently serves as Advisor to the Independent Evaluation Office of the IMF, on the Advisory Board of the Emerging Markets Forum, as the Chairman of the Investment Committee of the Board of Trustees of LeMoyne College, and continues to write and speak on numerous topics. Most recently, he served as a member of the Palais Royal Group, a group of eminent persons from around the world that has produced a report recommending reform to the international monetary system. In 2011, he edited a book on the background material produced for that initiative.

Imprint

Friedrich-Ebert-Stiftung | Global Policy and Development
Hiroshimastr.28 | 10785 Berlin | Germany

Friedrich-Ebert-Stiftung | New York Office
747 Third Avenue | Suite 22B | New York, NY 10017 | USA

Responsible:
Dr. Werner Puschra, Executive Director, FES New York

Phone: ++1-212-687-0208 | Fax: ++1-212-687-0261
www.fes-globalization.org/new_york/index.htm

To order publications:
jlandt@fesny.org