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Internal Governance and IMF Performance

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Most recent debates over reform of the International Monetary Fund have centered on what role the IMF should play in international economic affairs and, in particular, whether it should do more or less (Eichengreen 1999, CFR 1999, Kenen 2001). Judgments about the IMF's appropriate role, however, have organizational requirements that have received less attention. Is the current internal governance of the IMF—the configuration of national governments, Executive Board, management, and staff—the best design for accomplishing the goals set by the shareholders of the IMF?

An evaluation of the IMF's organizational design requires agreement on the standards appropriate for judging its performance or that of a reformed alternative. Those standards have themselves been the subject of controversy. Effectiveness (accomplishment of goals) and efficiency (linking output to expenditure of resources) dominate evaluations of the IMF. During the past decade, however, a new criterion—legitimacy—has become more prominent. Minority shareholders (the developing countries) and stakeholders (nongovernmental organizations [NGOs]) have closely linked acceptability of the IMF's goals and operations to accountability and representation.[1]

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1. Kenen et al. (2004, 28) give a somewhat different account of principles for evaluating IMF performance; they suggest effectiveness, legitimacy, accountability, and representativeness

Legitimacy can be defined by process, such as following an agreed set of rules, or by outcome, particularly the support won from a defined set of actors.[2] An organization or individual that is accountable—clear judgments on action can be made and sanctions applied if necessary—is likely to be regarded as more legitimate by those judging its actions. At the same time, an organization that fails the test of accountability may still accumulate legitimacy through effectiveness: It produces "the goods" for relevant actors, but how it does so may be opaque. To complicate matters further, effectiveness may bolster legitimacy, but some means for achieving legitimacy may undermine effectiveness. Calls for wider participation or broader consensus in the interests of democratic legitimacy may reduce decision-making efficiency (Cottarelli 2005).

Drawing on the insights of corporate governance, we can evaluate IMF governance using these criteria. First, the power of blockholders (dominant shareholders) as an important barrier to both effectiveness and legitimacy is analyzed. Then composition and capabilities of management and staff are evaluated. Finally, possible conflicts between enhanced legitimacy and increased effectiveness are outlined.

Limiting the Power of Large Shareholders

How does the IMF's current organization limit its effectiveness? The classic account of corporate governance failure—an inability of dispersed shareholders or their weakly motivated representatives to monitor management—does not seem to apply to the IMF (Becht, Bolton, and Röell 2003, 113). A few critics (Barnett and Finnemore 2004) outside the IMF endorse this model of management and staff autonomy in their criticisms of Fund policies.[3] Despite repeated efforts by shareholders, for example, a streamlining of conditionality has been difficult to achieve. The informational advantages of management and staff are cited in support of shareholder impotence.

This portrait of IMF governance is easily countered by an alternative with more empirical support: a small number of large shareholders that are relatively cohesive, an Executive Board in continuous session that attempts to exercise close oversight of management and staff, a relatively small organization, and an organization whose staff has few informational advantages over its most influential members. Executive directors for the major shareholders enjoy little autonomy, and few would argue that the

as four coequal attributes that should characterize good governance. Here legitimacy is viewed as dependent on accountability and effectiveness. Subsumed by accountability is the question of accountability to whom (representativeness).

2. Compare with Gelpi (2003, 14).

3. Barnett and Finnemore do not deploy a principal-agent approach to governance, however.

IMF management could capture its board in the way that many corporate chief executive officers have done.

Governance at the IMF resembles more closely the model of corporate blockholder power: A few large shareholders dominate the organization, overriding at times the interests of minority shareholders.[4] One advantage of blockholder power lies in the ability of shareholders, at least the largest shareholders, to exercise oversight of management and staff, ensuring that shareholder interests are realized. A key disadvantage, emphasized by critics of the existing model of governance, is that these shareholders (the largest industrialized countries) exert too much day-to-day control over the organization for the wrong reasons; in fact, their tendency to do so appears to have increased since 1990 (Cottarelli 2005, Kahler 2001). The IMF in this respect resembles other multilateral organizations: "The problem is not lack of accountability as much as the fact that the principal lines of accountability run to powerful states, whose policies are at odds with those of their critics, and which may or may not themselves be fully democratic" (Grant and Keohane 2005, 37).

According to critics, the influence of large shareholders—the United States and West European governments—is often exerted for political or foreign policy reasons, undermining the central purposes of the IMF. That influence is also deployed outside formal avenues, such as the Executive Board, undermining the Fund's legitimacy. Clients (or, less frequently, adversaries) of these governments may be treated differently from other members of the IMF in the implementation of its lending programs. The evidence for these interventions can be found in journalistic accounts, in reports of the Independent Evaluation Office, and in more systematic scholarly research.[5] Randall W. Stone (2002, 2004) has presented the most comprehensive evidence that IMF credibility and effectiveness have been undermined in both transitional economies and in Africa by differential treatment of large or strategically important clients of the IMF's major shareholders.

Whatever the motivation for intervention by the IMF's large shareholders, the Independent Evaluation Office (IEO) has documented the costs of such involvement for IMF effectiveness and legitimacy in recent episodes of crisis management. In dealing with the Asian financial crisis, the IEO has acknowledged the need for "close involvement of the Board and the major shareholders" but has criticized the way in which intervention by Group of Seven governments "unnecessarily subjected staff to micromanagement and political pressure, contributing to a blurring of technical and political judgments" (IMF-IEO 2003, 5–6). In its evaluation of IMF perfor-

4. On blockholder corporate governance, see Becht, Bolton, and Röell (2003, 78) and Gourevitch and Shinn (2005, 5).

5. Paul Blustein (2001), for example, notes unease at the IMF with the July 1998 Russian program, but Executive Board members viewed approval as a foregone conclusion because "our political masters had already approved the deal."

mance in the Argentine financial crisis, the IEO drew attention to "a larger problem of governance in the IMF, where important decisions are made by major shareholders outside the Executive Board and, as potential borrowers, chairs representing developing countries hardly, if ever, challenge the proposal brought to the Board by management to support a member country" (IMF-IEO 2004, 68). Clear signals on the part of the largest shareholders in favor of particular borrowing governments also deepen staff tendencies toward softening their evaluations of national policies.

Misused blockholder power undermines both the effectiveness and the legitimacy of the IMF. Organizational reform should concentrate on curbing that power, at least as it affects the day-to-day operations of the organization. Constraining great powers is difficult, however: Regulatory remedies that are used to counter blockholder power in a domestic context are not available. One solution is direct dilution of large-shareholder power through an adjustment in "chairs and shares," which is the topic of Edwin M. Truman's chapter 9 and a core proposal for many IMF reformers. Because any reform of representation is unlikely to reduce the collective influence of the largest shareholders substantially, other reforms are required. Ultimately, however, these reforms will rely on the self-restraint of the largest IMF shareholders. That short-term self-restraint must be based in turn on a realization that longer-term interests in an effective and legitimate IMF will otherwise be jeopardized.

Enhance the Status and Independence of Executive Board

The influence exerted by large shareholders at the IMF has prompted two different but linked remedies: increasing the autonomy of the IMF Executive Board and ensuring that the Executive Board is "the prime locus of decision making in the IMF" (IMF-IEO 2004, 76). In their quest for greater IMF autonomy, some IMF reformers have argued for an organizational model that resembles an independent central bank: granting a restructured Executive Board a much wider degree of policy autonomy, accompanied by tougher, clearer ex post accountability (De Gregorio et al. 1999; Kelkar, Chaudhry, and Vanduzer-Snow 2005; Lane 2005; Stone 2002, 2004).

The analogy between an independent central bank and the IMF can be questioned on several grounds. The delegation of autonomy to central banks rests on clear rules or targets that can serve as the basis for accountability as well as broad public consensus on the ultimate aim, typically price stability. Equally clear and politically popular standards for IMF performance may be impossible to devise in a changing financial environment.[6] Complete elimination of foreign policy considerations from

6. De Gregorio et al. (1999, 93) argue that central banks and other independent regulatory agencies may also have a multiplicity of goals, rendering accountability on the basis of performance as difficult as it would be in the case of the IMF.

IMF program decisions might reduce the engagement of the most powerful governments and ultimately the effectiveness of the organization. The threat of disengagement by the most powerful shareholders poses a possible conflict between the goals of increasing Executive Board autonomy and maintaining the central position of the board in IMF decision making. Even if national government meddling could be exorcised, the credibility of its elimination could be doubted: The temptation for short-run intervention could be difficult to resist in every case.

If the central bank model is unrealistic and possibly undesirable, more modest proposals for upgrading the Executive Board could actually increase the weight of major shareholders within the organization by bringing more senior governmental officials to the table (Kenen et al. 2004, 92–93; Van Houtven 2004). Political direction might be more informed by the views of management and staff, but the national capitals of major shareholders would still maintain their ability to intervene in ways that undermined the standing of the IMF. Only when coupled with other changes—a board reduced in size or a board with fixed and longer tenure—would increased autonomy of the IMF Executive Board begin to curb meddling by large shareholders.

Delegation of more authority to the Executive Board by the largest shareholders is a desirable end. As noted, the board's credibility ultimately depends on self-restraint of the most influential members, backed by the linked devices of peer pressure and reputational accountability (Grant and Keohane 2005). More delegation to the Executive Board is likely only if clear standards of accountability are agreed. Boundaries for blockholder intervention require agreement on legitimate norms of conduct, policed by an upgraded Executive Board and ultimately by national governments and publics.

The following measures would enhance the status and independence of the Executive Board:

- In the short run, clearer indicators for IMF performance, similar to those requested for surveillance by the International Monetary and Financial Committee (IMFC), should be developed for IMF lending operations.[7]
- Clearer guidelines should be established for acceptable and unacceptable intervention in Fund programs by national governments acting outside the Executive Board. Discussions that take place between management and staff on the one hand and national authorities on the other, apart from those of a purely informational character, should be reported to the Executive Board.

7. The IMFC called upon the IMF to "develop a methodology for better assessing the effectiveness of surveillance" in October 2004 (IMF 2004b). In its biennial review of surveillance, the Executive Board had accepted that "assessing the overall effectiveness of surveillance is an essential but daunting task" (IMF 2004c, 23).

- In the longer run, major shareholders should lead in the appointment of more senior national representatives to the Executive Board. The size of the Executive Board should be reduced over time as a means of increasing its effectiveness and autonomy.[8]

Ensure Independent Assessment

Evaluations of IMF performance have noted excessive deference by the staff to the Executive Board and the member governments that it represents. A tendency by the staff to play the "sympathetic social worker" (Mussa 2002) is induced in part by concern over the reaction of national authorities (through the Executive Board) as well as their large-shareholder patrons.[9] Delegating more authority for lending operations to the management and staff is unlikely, given the need for large shareholders to contribute their own resources and participate in bail-ins of private investors. In the case of IMF analysis, however, liberating the staff to permit dissent and making the terms of disagreement available to the Board would enhance accountability through "a more fully informed Executive Board" (Mussa 2002, 70).

The IMF view of surveillance has long been divided between two models: an audit and a dialogue. Insulating the surveillance role of the Fund from political pressure and cues would clearly move surveillance in the direction of an independent audit, although the benchmarks for that audit could be arrived at in consultation with national authorities. The easiest and most effective initial steps would guarantee the independence of surveillance reports based on Article IV consultations, as recommended by Edward Balls in 2003.[10] UK Chancellor of the Exchequer Gordon Brown (2005) has also called for IMF surveillance "as credible and independent from political influence in its surveillance of economies as an independent central bank is in the operation of monetary policy." As a first step, Brown called for making debt sustainability analysis "independent of other operational decisions within the Fund." Mechanisms to guarantee indepen-

8. Edwin M. Truman suggests in chapter 9 of this volume that one route toward a reduction of the existing board of 24 seats to the 20-seat board called for in the Articles of Agreement might be through eventual consolidation of European Union representation on the Executive Board. He also makes clear that debate over the desirability of EU consolidation is likely to overshadow any discussion of the advantages of a smaller, more coherent, and, perhaps, more influential Executive Board.

9. See the comments in IMF-IEO (2003, 5) on the failure of the staff to make judgments that were "frank and potentially unpopular" with national authorities.

10. See remarks by Edward Balls, "Preventing Financial Crises: The Case for Independent IMF Surveillance," at the Institute for International Economics, Washington, March 6, 2003, available at the Institute's Web site at www.iie.com.

dence of analysis would also benefit new signaling mechanisms that have been proposed at the IMF, such as the Policy Support Instrument (see Taylor and Radelet, chapters 19 and 20, respectively, of this volume).

- To ensure independent assessment, an autonomous unit within the IMF should be made responsible for bilateral surveillance. Its head, reporting directly to management, should be a senior staff member with fixed tenure.

Mobilize the Power of Consensus for Reform of Leadership Selection

Efforts to constrain the power of large shareholders on the basis of delegated authority, peer pressure, and reputational costs may fail. The record of reform in leadership selection at the IMF is stark testimony to the ability and willingness of the largest shareholders to shrug off prior commitments that would curb their freedom of action.

Following a divisive battle between the United States and Germany over the selection of a successor to Michel Camdessus in 2000, the executive boards of the IMF and the World Bank authorized two working groups that produced a joint report on selection of the World Bank president and the IMF managing director (report reproduced in Kahler 2001 at 111–17). The joint report outlined a process for selection that was far more open and transparent than the existing US-European duopoly. At the same time, the report did not directly address the duopoly or call for its end.

Despite the commitment represented by the joint report, neither the IMF's selection of Rodrigo de Rato in 2004 nor the World Bank's appointment of Paul Wolfowitz in 2005 approached the principles or the procedures that had been discussed by the two executive boards. In the case of the IMF, the selection of de Rato differed from its more contentious antecedent in a few dimensions: The Europeans presented two candidates (Jean Lemierre was the second candidate) to the rest of the world, as they had in 1987; the United States and Japan contested neither the individuals nor the European claim on the position of managing director; UK Chancellor of the Exchequer Gordon Brown managed the process in a way that appeared more open and consultative than the preceding selection process (although no non-European candidate was seriously considered); and de Rato was far more effective than Caio Koch-Weser had been in mobilizing support in the developing world, particularly Latin America.

Members who were not part of the duopoly protested the process once again. A formal statement from the Group of Eleven, Australia, Switzerland, and Russia called for a process that was "open and transparent, with the goal of attracting the best person for the job, regardless of national-

ity."[11] Members of the IMF staff also registered an unprecedented expression of concern. In response to the continuing European claim on the IMF's top position, Executive Director Shakour Shaalan floated three non-European names for the managing directorship—Stanley Fischer, Andrew Crockett, and Mohamed El-Erian—although only the last allowed his name to be placed in nomination before the Executive Board. Since these efforts to open the process failed, the developing world "will have to live under a European macroeconomic emperor, albeit one who rules with United States consent."[12]

In contrast with the IMF, the World Trade Organization (WTO) demonstrated in its 2005 leadership selection that a source of conflict and organizational paralysis could be transformed by reform. Unlike the deadlocked and divisive selection of its director-general in 1998–99, the WTO's selection of Pascal Lamy in 2005 followed closely a script agreed by the organization's General Council in December 2002. In a remarkably open, three-month campaign period, Lamy and three other candidates—all but Lamy from developing countries—competed for the support of WTO members. Adhering to a strict timetable set forth in the 2002 procedures, the WTO membership was able to reach consensus on a new director-general with a minimum of conflict at a critical moment in the Doha Round. The United Nations has also moved to a more open selection process for senior leaders of its funds and programs. The new process has already been used in the selection of new heads for the United Nations Development Program and the United Nations High Commissioner for Refugees (UN 2005). The IMF now clearly lags behind other key global institutions in its procedures for selecting top management.

Members of the IMF who wish to end the convention that assigns the managing directorship to a West European have one instrument of minority shareholder power that they have so far declined to exploit: a strong norm of consensus decision making. Despite the power granted them by weighted voting, the United States and the European capitals are unlikely to force selection of a managing director against the opposition of either the other industrialized countries (particularly Japan) or the developing countries.[13]

Thus, in light of continuing resistance by the United States and the European Union to any revision of their conventional hold on the top posi-

11. See Statement by a Group of IMF Executive Directors on the Selection Process for a New Managing Director, IMF Press Release No. 04/55, March 19, 2004, available at the IMF's Web site (accessed on December 7, 2005).

12. See the *Financial Times*, March 15, 2004, 22.

13. Developing-country opposition played a major role in the selection of Johannes Witteveen over Emile van Lennep in 1973; it also figured in the failure of the Caio Koch-Weser candidacy in 2000 (Kahler 2001).

tions at the IMF and the World Bank, the norm of consensus should be mobilized to force reform.

- In advance of the next selection of an IMF managing director, members who agree on the need for change in the selection process should signal clearly that they will withhold their support from any candidate for managing director who is not selected in a process that is open and transparent, with the goal of attracting the best person for the job, regardless of nationality. Specific selection procedures should parallel the 2001 joint report on IMF–World Bank leadership selection.

Management and Staff: Qualifications and Capacity

The persistent power of large shareholders at the IMF reflects an unwillingness to adapt to changes in the international economy and world politics, particularly the rising economic importance of Asia and the greater engagement of developing countries with the world economy. The qualifications of IMF management and the composition of the IMF staff must also change to reflect shifts in the role of the organization. The job description for future IMF managing directors must reflect not the musical chairs of European politics but familiarity with "the role of speculative capital flows, banking supervision, debt dynamics and exchange rate policy."[14]

The IMF should also discard its bias against insiders as candidates for top management positions. The three names floated by Executive Director Shaalan in 2004 were all individuals with substantial experience at the IMF.

The IMF has spent considerable effort in adapting its human resources so that it can deal with a world in which private capital flows dominate official flows and the soundness of financial systems has become a prime means of reducing economic vulnerability. The creation of the International Capital Markets Department in 2001 was a major step in building expertise and understanding of private financial markets. The recently named Review Group on the Organization of Financial Sector and Capital Markets Work at the IMF will evaluate IMF capabilities and outline remaining shortcomings in this sphere.

IMF capacity for assessing national political economies and their implications for program effectiveness remains inadequate, however. IEO reports on the Asian financial crisis and on IMF technical assistance point to the need for a "good understanding of the political economy context" in particular countries (IMF-IEO 2003). Models of IMF practice based on

14. See Sebastian Edwards, "Europe should give up its hold on the Fund," *Financial Times*, March 17, 2004, 19.

technocratic beachheads are no longer adequate; the IMF must comprehend and engage with wider sectors of government and civil society.[15]

The following recommendations would enhance the qualifications and capacity of IMF management and staff:

- In advance of the next selection of an IMF managing director, the Executive Board should establish precise minimum qualifications and a list of desirable characteristics for the managing director position. These should track the current and prospective organizational agenda.
- Future selections of a managing director should not exclude internal candidates or candidates with substantial experience at the IMF.
- The IMF should build staff capacity in the analysis of political economy and politics, as well as deeper country expertise. Recruitment of staff with experience in national governments could provide one means for building this capacity.

Legitimacy and Effectiveness at the IMF

In certain cases, efforts to increase legitimacy through democratic accountability may undercut effectiveness (Kahler 2004, 154–58; Cottarelli 2005, 4). The appropriate analogues for institutions of global governance are not the core institutions of democratic governance such as legislatures, but institutions of delegated authority such as regulatory agencies, the judiciary, and central banks.[16] Although global institutions can and should be held accountable to their principals (member governments and the electorates to which they are responsible), mechanisms of accountability may differ from those in other democratic contexts. In two areas—transparency and relations with stakeholders—the trade-off between legitimacy and effectiveness requires careful examination.

Enhance Transparency and Effectiveness

Proposals for further increases in IMF transparency center on three domains: decision rules, information provision, and independent review. Arguments (Woods 2000, Kapur and Naim 2005) in favor of clear, recorded votes in the Executive Board, based on democratic legitimacy, are fundamentally misplaced. As Leo Van Houtven (2002, 31) declares, con-

15. The IEO report on technical assistance (IMF-IEO 2005) notes that technical assistance is undermined by "lack of awareness of institutional, organizational, or managerial features of the recipient country."

16. Pollack (2002) has labeled these "nonmajoritarian institutions."

sensus decision making is an "essential condition for safeguarding the rights of minority shareholders in the IMF." Undermining this informal but strong norm in the interests of transparency would further strengthen the position of the dominant shareholders and weaken the Fund's legitimacy. Negative consequences for effectiveness are few because consensus operates in the shadow of formal voting rules that are majoritarian or supermajoritarian.

Although the old culture of secrecy at the IMF has been substantially dismantled, the IMF, responding to the wishes of national governments, has moved more slowly to reveal information that could influence governments through public and political channels. Although the quantity of information made public could be offset by a decline in its quality, a strong case can be made for automatic publication of bilateral surveillance reports following steps to insulate the process from member influence. Automatic public disclosure would ultimately increase IMF effectiveness; countermeasures can reduce any tendency on the part of governments to withhold or delay information.

Independent review of Fund operations has produced valuable documentation of IMF practices and evaluations of IMF performance. The IEO has rendered Fund management and staff more accountable, but its writ is too narrow.[17] Excluding the role of the major shareholders and their interaction with management and staff from formal evaluation allows blame shifting, which undermines IMF legitimacy in the longer run. An expanded IEO mandate—a super-IEO for particular parts of the work program—would serve to impose modest reputational constraints on the major shareholders and strengthen guidelines on their intervention in Fund operations.

The following measures would enhance both the transparency and effectiveness of the IMF:

- The norm of consensus decision making should be maintained at the IMF, at least until a reallocation of chairs and shares. Consensus would not be undermined, however, by implementing other steps to increase transparency (speedier publication of Executive Board minutes, for example).
- The IMF should publish all staff reports on Article IV consultations following discussion by the Executive Board. Currently four out of five members agree to have their reports made public.
- IEO evaluations of IMF performance should extend to the governments of the major shareholders. If the IEO is rejected for this role, independent commissions should be deployed to ensure the transparency of major shareholder actions.

17. The IEO admits as much in its report on the Fund's role in Argentina (IMF-IEO 2004, 72).

Expand Engagement with Stakeholders

The IMF's relations with two groups of stakeholders—NGOs and private financial firms—have been particularly sensitive during the past 15 years. The question of what role the IMF should play in resolving emerging-market debt crises is beyond the scope of this paper, but issues of transparency and legitimacy loom large in such Fund interventions. The IMF has opened dialogues with many critics among the NGOs that could be deepened into a more formal frame for collaboration, subject to tests of legitimacy for its NGO interlocutors and shareholder consent.[18] Certainly engagement with civil society actors in program countries, already undertaken by the IMF, can enhance the effectiveness of Fund action by reducing political barriers to collaboration.

In both creditor and borrowing countries, however, one set of governmental actors deserves particular attention: legislatures. IMF discussions with legislatures avoid the issues of political representation that shadow NGOs and build valuable support for the IMF among both major shareholders and developing countries. A greater legislative understanding of the IMF and a larger role in such exercises as national poverty reduction strategies reinforce such IMF goals as fiscal accountability and transparency (Stapenhurst and Pelizzo 2002). Legislative engagement can produce strong positive effects on program implementation, offsetting possible costs to negotiating efficiency.[19] The IMF Executive Board has proposed a number of steps that could be taken to strengthen the Fund's engagement with legislatures: expansion of outreach, particularly at the national level; encouragement of meetings between mission chiefs and resident representatives and legislators; and exploration of training by the IMF for parliamentarians (IMF 2004a).

- In order to expand the IMF's engagement with a key stakeholder, the IMF should establish rules of engagement with national governments that would permit frequent and substantive briefings and exchanges of views with legislators. The IMF should also become a formal partner in the Parliamentary Network on the World Bank or consider support for its own international network of interested parliamentarians.[20]

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18. See the suggestion by Van Houtven (2002, 58).

19. Lisa Martin (2000) documents the positive role that legislatures can have on the successful implementation of policies agreed in international negotiations.

20. The Parliamentary Network on the World Bank (PNoWB) began with a conference in May 2000; it has since become an independent nonprofit association with its secretariat in Paris. Comprising more than 200 legislators from both developed and developing countries, the PNoWB defines itself as a "non-partisan, member-driven network, open to parliamentarians engaged in the issues surrounding international development." See www.pnowb.org and Stapenhurst and Pelizzo (2002).

Each of these recommendations would enhance both the effectiveness and legitimacy of the IMF. Costs in terms of IMF efficiency may be more substantial. The process of building legitimacy is often time-consuming; transparency empowers more actors than had been engaged in the traditional, technocratic model of IMF operations. Such costs seem well worth bearing, however, given the contentious political environment that the IMF confronts.

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